ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
May 03, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2018

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _______________ TO _________________

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	22-3479661 (IRS Employer Identification No.)
1211 AVENUE OF THE AMERICAS NEW YORK, NY 10036 (Address of principal executive offices)	10036 (Zip Code)

(212) 696-0100
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes þ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No þ

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date:

Class	Outstanding at April 30, 2018
Common Stock, $.01 par value	1,159,697,587

ANNALY CAPITAL MANAGEMENT, INC.
FORM 10-Q
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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except per share data)

	March 31, 2018 (Unaudited)	December 31, 2017 [1]
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $884,667 and $579,213, respectively) [2]	$984,275	$706,589
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of $83,893,493 and $83,628,132, respectively)	88,579,097	90,551,763
Credit risk transfer securities (including pledged assets of $411,780 and $363,944, respectively)	628,942	651,764
Non-Agency mortgage-backed securities (including pledged assets of $499,271 and $516,078, respectively) [3]	1,066,343	1,097,294
Residential mortgage loans (including pledged assets of $1,376,883 and $1,169,496, respectively) [4]	1,535,685	1,438,322
Mortgage servicing rights (including pledged assets of $5,153 and $5,224, respectively)	596,378	580,860
Commercial real estate debt investments (including pledged assets of $2,900,098 and $3,070,993, respectively) [5]	2,960,323	3,089,108
Commercial real estate debt and preferred equity, held for investment (including pledged assets of $529,324 and $520,329, respectively)	1,081,295	1,029,327
Investments in commercial real estate	480,063	485,953
Corporate debt (including pledged assets of $666,682 and $600,049, respectively)	1,152,745	1,011,275
Interest rate swaps, at fair value	69,109	30,272
Other derivatives, at fair value	161,193	283,613
Reverse repurchase agreements	200,459	—
Receivable for investments sold	45,126	1,232
Accrued interest and dividends receivable	326,989	323,526
Other assets	421,448	384,117
Goodwill	71,815	71,815
Intangible assets, net	20,948	23,220
Total assets	$100,382,233	$101,760,050
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$78,015,431	$77,696,343
Other secured financing	3,830,075	3,837,528
Securitized debt of consolidated VIEs [6]	2,904,873	2,971,771
Mortgages payable	309,794	309,686
Interest rate swaps, at fair value	427,838	569,129
Other derivatives, at fair value	153,103	38,725
Dividends payable	347,897	347,876

Payable for investments purchased	91,327	656,581
Accrued interest payable	284,696	253,068
Accounts payable and other liabilities	74,264	207,770
Total liabilities	86,439,298	86,888,477
Stockholders' Equity:		
7.625% Series C Cumulative Redeemable Preferred Stock: 12,000,000 authorized, 7,000,000 and 12,000,0000 issued and outstanding, respectively	169,466	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock: 11,500,000 authorized, 0 and 11,500,000 issued and outstanding, respectively	—	287,500
6.95% Series F Cumulative Redeemable Preferred Stock: 28,800,000 authorized, issued and outstanding	696,910	696,910
6.50% Series G Cumulative Redeemable Preferred Stock: 19,550,000 and 0 authorized, 17,000,000 and 0 issued, and outstanding, respectively	411,335	—
Common stock, par value $0.01 per share, 1,909,750,000 and 1,929,300,000 authorized, 1,159,657,350 and 1,159,585,078 issued and outstanding, respectively	11,597	11,596
Additional paid-in capital	17,218,191	17,221,265
Accumulated other comprehensive income (loss)	(3,000,080)	(1,126,020)
Accumulated deficit	(2,015,612)	(2,961,749)
Total stockholders' equity	13,937,264	14,865,473
Noncontrolling interest	5,671	6,100
Total equity	13,942,935	14,871,573
Total liabilities and equity	$100,382,233	$101,760,050

(1) Derived from the audited consolidated financial statements at December 31, 2017.

(2) Includes cash of consolidated Variable Interest Entities ("VIEs") of $43.2 million and $42.3 million at March 31, 2018 and December 31, 2017, respectively.

(3) Includes $61.3 million and $66.3 million at March 31, 2018 and December 31, 2017, respectively, of non-Agency mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

(4) Includes securitized residential mortgage loans transferred or pledged to a consolidated VIE carried at fair value of $560.2 million and $478.8 million at March 31, 2018 and December 31, 2017, respectively.

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(5) Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $2.7 billion and $2.8 billion at March 31, 2018 and December 31, 2017, respectively.
(6) Includes securitized debt of consolidated VIEs carried at fair value of $2.9 billion and $3.0 billion at March 31, 2018 and December 31, 2017, respectively.

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended March 31, 2018	2017
Net interest income:		
Interest income	$879,487	$ 587,727
Interest expense	367,421	198,425
Net interest income	512,066	389,302
Realized and unrealized gains (losses):		
Realized gains (losses) on interest rate swaps [1]	(48,160)	(104,156)
Realized gains (losses) on termination or maturity of interest rate swaps	834	—
Unrealized gains (losses) on interest rate swaps	977,285	149,184
Subtotal	929,959	45,028
Net gains (losses) on disposal of investments	13,468	5,235
Net gains (losses) on trading assets	(47,145)	319
Net unrealized gains (losses) on investments measured at fair value through earnings	(51,593)	23,683
Subtotal	(85,270)	29,237
Total realized and unrealized gains (losses)	844,689	74,265
Other income (loss):		
Other income (loss)	34,023	31,646
Total other income (loss)	34,023	31,646
General and administrative expenses:		
Compensation and management fee	44,529	39,262
Other general and administrative expenses	17,981	14,566
Total general and administrative expenses	62,510	53,828
Income (loss) before income taxes	1,328,268	441,385
Income taxes	564	977
Net income (loss)	1,327,704	440,408
Net income (loss) attributable to noncontrolling interest	(96)	(103)
Net income (loss) attributable to Annaly	1,327,800	440,511
Dividends on preferred stock	33,766	23,473
Net income (loss) available (related) to common stockholders	$1,294,034	$ 417,038
Net income (loss) per share available (related) to common stockholders:		
Basic	$1.12	$ 0.41
Diluted	$1.12	$ 0.41
Weighted average number of common shares outstanding:		
Basic	1,159,617,848	1,018,942,746
Diluted	1,160,103,185	1,019,307,379
Dividends declared per share of common stock	$0.30	$ 0.30
Net income (loss)	$1,327,704	$ 440,408
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities	(1,879,479)	(59,615)
Reclassification adjustment for net (gains) losses included in net income (loss)	5,419	19,417
Other comprehensive income (loss)	(1,874,060)	(40,198)

Comprehensive income (loss)	(546,356)	400,210
Comprehensive income (loss) attributable to noncontrolling interest	(96)	(103)
Comprehensive income (loss) attributable to Annaly	(546,260)	400,313
Dividends on preferred stock	33,766	23,473
Comprehensive income (loss) attributable to common stockholders	$(580,026)	$ 376,840

(1) Consists of interest expense on interest rate swaps.

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2018 and 2017
(dollars in thousands, except per share data)
(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	7.625% Series E Cumulative Redeemable Preferred Stock	6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulate deficit
BALANCE, December 31, 2016	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,189	$15,579,342	$(1,085,893)	$(3,136,01
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	440,511
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	(59,615)	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	19,417	—
Stock compensation expense	—	—	—	—	—	—	—	101	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	595	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
	—	—	—	—	—	—	—	—	—	(3,648

Preferred Series A dividends, declared $0.492 per share										
Preferred Series C dividends, declared $0.477 per share	—	—	—	—	—	—	—	—	—	(5,719
Preferred Series D dividends, declared $0.469 per share	—	—	—	—	—	—	—	—	—	(8,625
Preferred Series E dividends, declared $0.477 per share	—	—	—	—	—	—	—	—	—	(5,481
Common dividends declared, $0.30 per share	—	—	—	—	—	—	—	—	—	(305,691
BALANCE, March 31, 2017	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,190	$15,580,038	$(1,126,091)	$(3,024,67
BALANCE, December 31, 2017	$—	$290,514	$445,457	$287,500	$696,910	$—	$11,596	$17,221,265	$(1,126,020)	$(2,961,74
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	1,327,800
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	(1,879,479)	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	5,419	—
Stock compensation expense	—	—	—	—	—	—	—	133	—	—
Redemption of Preferred Stock	—	(121,048)	—	(287,500)	—	—	—	(3,952)	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	745	—	—

Net proceeds from issuance of preferred stock	—	—	—	—	—	411,335	—	—	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Preferred Series C dividends, declared $0.477 per share (1)	—	—	—	—	—	—	—	—	—	(4,316
Preferred Series D dividends, declared $0.469 per share	—	—	—	—	—	—	—	—	—	(8,625
Preferred Series E dividends, declared $0.196 per share	—	—	—	—	—	—	—	—	—	(2,253
Preferred Series F dividends, declared $0.434 per share	—	—	—	—	—	—	—	—	—	(12,510
Preferred Series G dividends, declared $0.357 per share	—	—	—	—	—	—	—	—	—	(6,062
Common dividends declared, $0.30 per share	—	—	—	—	—	—	—	—	—	(347,897
BALANCE, March 31, 2018	$—	$169,466	$445,457	$—	$696,910	$411,335	$11,597	$17,218,191	$(3,000,080)	$(2,015,61

(1) Represents dividends declared per share for shares outstanding at March 31, 2018.

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$1,327,704	$440,408
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of premiums and discounts of investments, net	92,976	201,590
Amortization of securitized debt premiums and discounts and deferred financing costs	408	340
Depreciation, amortization and other noncash expenses	5,822	7,006
Net (gains) losses on disposals of investments	(13,468)	(5,235)
Net (gains) losses on investments and derivatives	(878,547)	(173,186)
Income from unconsolidated joint ventures	618	1,031
Payments on purchases of loans held for sale	(37,190)	(54,234)
Proceeds of sales and repayments of loans held for sale	30,178	144,890
Net payments on derivatives	951,021	(738,872)
Net change in:		
Other assets	(42,361)	(52,903)
Accrued interest and dividends receivable	(2,963)	3,294
Accrued interest payable	31,628	19,465
Accounts payable and other liabilities	(132,910)	(15,995)
Net cash provided by (used in) operating activities	$1,332,916	$(222,401)
Cash flows from investing activities:		
Payments on purchases of Residential Investment Securities	$(3,718,947)	$(2,043,364)
Proceeds from sales of Residential Investment Securities	463,214	1,787,574
Principal payments on Residential Investment Securities	2,696,245	2,952,739
Purchase of MSRs	(249)	(7,210)
Payments on purchases of corporate debt	(230,103)	(91,749)
Principal payments on corporate debt	92,820	44,418
Originations and purchases of commercial real estate related assets	(91,647)	(142,738)
Proceeds from sales on commercial real estate related assets	9,556	11,960
Principal repayments on commercial real estate related assets	130,555	370,689
Proceeds from reverse repurchase agreements	20,050,112	21,015,000
Payments on reverse repurchase agreements	(20,250,571)	(21,015,000)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	2,813	2,042
Payments on purchases of residential mortgage loans held for investment	(167,124)	(375,367)
Proceeds from repayments from residential mortgage loans held for investment	67,384	28,308
Payments on purchases of equity securities	—	(2,104)
Net cash provided by (used in) investing activities	$(945,942)	$2,535,198
Cash flows from financing activities:		
Proceeds from repurchase agreements and other secured financing	$1,299,589,620	$783,704,227
Principal payments on repurchase agreements and other secured financing	(1,299,277,944)	(786,209,502)

Proceeds from issuance of securitized debt	279,203	—
Principal repayments on securitized debt	(317,773)	(197,749)
Payment of deferred financing cost	—	(1,079)
Net proceeds from stock offerings, direct purchases and dividend reinvestments	412,081	596
Redemption of preferred stock	(412,500)	—
Principal payments on participation sold	—	(84)
Principal payments on mortgages payable	—	(18)
Net contributions/(distributions) from/(to) noncontrolling interests	(333)	(366)
Dividends paid	(381,642)	(329,147)
Net cash provided by (used in) financing activities	$(109,288)	$(3,033,122)
Net (decrease) increase in cash and cash equivalents	$277,686	$(720,325)
Cash and cash equivalents including cash pledged as collateral, beginning of period	706,589	1,539,746
Cash and cash equivalents including cash pledged as collateral, end of period	$984,275	$819,421
Supplemental disclosure of cash flow information:		
Interest received	$1,017,534	$787,971
Interest paid (excluding interest paid on interest rate swaps)	$320,988	$223,109
Net interest paid on interest rate swaps	$39,206	$77,192
Taxes paid	$2	$—
Noncash investing activities:		
Receivable for investments sold	$45,126	$354,126
Payable for investments purchased	$91,327	$340,383
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$(1,874,060)	$(40,198)
Noncash financing activities:		
Dividends declared, not yet paid	$347,897	$305,691

See notes to consolidated financial statements.

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the “Company” or “Annaly”) is a Maryland corporation that commenced operations on February 18, 1997. The Company is a leading diversified capital manager that invests in and finances residential and commercial assets. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, credit risk transfer (“CRT”) securities, other securities representing interests in or obligations backed by pools of mortgage loans, residential mortgage loans, mortgage servicing rights (“MSRs”), commercial real estate assets and corporate debt. The Company’s principal business objective is to generate net income for distribution to its stockholders and to preserve capital through prudent selection of investments and continuous management of its portfolio. The Company is externally managed by Annaly Management Company LLC (the “Manager”).

The Company’s investment groups are primarily comprised of the following:

- The Annaly Agency Group invests in Agency mortgage-backed securities collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
- The Annaly Residential Credit Group invests in non-Agency residential mortgage assets within securitized product and residential mortgage loan markets.
- The Annaly Commercial Real Estate Group (“ACREG”) originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
- The Annaly Middle Market Lending Group (“AMML”) provides financing to private equity-backed middle market businesses across the capital structure.

The Company has elected to be taxed as a Real Estate Investment Trust (“REIT”) as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”).

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”).

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent annual report on Form 10-K. The consolidated financial information as of December 31,

2017 has been derived from audited consolidated financial statements included in the Company’s annual report on Form 10-K for the fiscal year ended December 31, 2017.

In the opinion of management, all normal, recurring adjustments have been included for a fair presentation of this interim financial information. Interim period operating results may not be indicative of the operating results for a full year.

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The Company reclassified previously presented financial information to conform to the current presentation.

Variable Interest Entities – A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A variable interest is an investment or other interest that will absorb portions of a VIE’s expected losses or receive portions of the entity’s expected residual returns. The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in VIEs. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that (i) has the power to control the activities that most significantly impact the VIE’s economic performance and (ii) has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance, the Company considers all facts and circumstances, including the Company’s role in establishing the VIE and the Company’s ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE’s economic performance; and second, identifying which party, if any, has power over those activities. In general, the party that makes the most significant decisions affecting the VIE or has the right to unilaterally remove those decision makers is deemed to have the power to direct the activities of the VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Company applies significant judgment and considers all of its economic interests, including debt and equity investments and other arrangements deemed to be variable interests, both explicit and implicit, in the VIE. This assessment requires that the Company apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; and relative share of interests held across various classes within the VIE's capital structure.

The Company performs ongoing reassessments of whether changes in the facts and circumstances regarding the Company's involvement with a VIE causes the Company's consolidation conclusion to change.

Use of Estimates – The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. In accordance with a clearing organization's rulebook, the Company presents the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. At March 31, 2018, $873.4 million of variation margin was reported as a reduction to interest rate swaps, at fair value. RCap Securities, Inc., the Company's wholly-owned broker-dealer ("RCap") is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled $884.7 million and $579.2 million at March 31, 2018 and December 31, 2017, respectively.

Fair Value Measurements – The Company reports various financial instruments at fair value. A complete discussion of the methodology utilized by the Company to estimate the fair value of certain financial instruments is included in these Notes to Consolidated Financial Statements.

Revenue Recognition – The revenue recognition policy by asset class is discussed below.

Agency Mortgage-Backed Securities, Agency Debentures, Non-Agency Mortgage-Backed Securities and Credit Risk

Transfer Securities – The Company invests in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of residential or multifamily mortgage loans and certificates guaranteed by the Government National Mortgage Association ("Ginnie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Federal National Mortgage Association ("Fannie Mae") (collectively, "Agency mortgage-backed securities"). These Agency mortgage-backed securities may include forward contracts for Agency mortgage-backed securities purchases or sales of a generic pool, on a to-be-announced basis ("TBA securities"). The Company also invests in Agency debentures issued by the Federal Home Loan Banks, Freddie Mac and Fannie Mae, as well as CRT securities. CRT securities are risk sharing instruments issued by Fannie Mae and Freddie Mac, and similarly structured transactions arranged by third party market participants. CRT securities are designed to synthetically transfer mortgage credit risk from Fannie Mae and Freddie Mac to private investors. The Company also invests in non-Agency mortgage-backed securities such as those issued in non-performing loan ("NPL") and re-performing loan ("RPL") securitizations.

Agency mortgage-backed securities, Agency debentures, non-Agency mortgage-backed securities and CRT securities are referred to herein as "Residential Investment Securities." Although the Company generally intends to hold most of its Residential Investment Securities until maturity, it may, from time to time, sell any of its Residential Investment Securities as part of the overall management of its portfolio. Residential Investment Securities classified as available-for-sale are reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss) unless the Company has elected the fair value option, where the unrealized gains and losses on these financial instruments are recorded through earnings. The fair value of Residential Investment Securities classified as available-for-sale are estimated by management and are compared to independent sources for reasonableness. Residential Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Gains and losses on sales of Residential Investment Securities are recorded on trade date based on the specific identification method.

The Company elected the fair value option for interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities as this election simplifies the accounting. Interest-only securities and inverse interest-only securities are collectively referred to as "interest-only securities." These interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific mortgage-backed securities. Interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on investments measured at fair value through earnings in the Company's Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.

The Company recognizes coupon income, which is a component of interest income, based upon the outstanding principal amounts of the Residential Investment Securities and their contractual terms. In addition, the Company amortizes or accretes premiums or discounts into interest income for its Agency mortgage-backed securities (other than multifamily securities), taking into account estimates of future principal prepayments in the calculation of the effective yield. The Company recalculates the effective yield as differences between anticipated and actual prepayments occur. Using third-party model and market information to project future cash flows and expected remaining lives of securities, the effective interest rate determined for each security is applied as if it had been in place from the date of the security's acquisition. The amortized cost of the security is then adjusted to the amount that would have existed had the new effective yield been applied since the acquisition date, which results in a cumulative premium amortization adjustment in each period. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

Premiums or discounts associated with the purchase of Agency interest-only securities, reverse mortgages and residential credit securities are amortized or accreted into interest income based upon current expected future cash flows with any adjustment to yield made on a prospective basis.

The following table summarizes the interest income recognition methodology for Residential Investment Securities:

	Interest Income Methodology
Agency	
Fixed-rate pass-through (1)	Effective yield (3)
Adjustable-rate pass-through (1)	Effective yield (3)
Multifamily (1)	Contractual Cash Flows
Collateralized Mortgage Obligation ("CMO") (1)	Effective yield (3)
Reverse mortgages (2)	Prospective
Interest-only (2)	Prospective
Residential Credit	
CRT (2)	Prospective
Alt-A (2)	Prospective
Prime (2)	Prospective
Subprime (2)	Prospective
NPL/RPL (2)	Prospective
Prime Jumbo (2)	Prospective
Prime Jumbo interest-only (2)	Prospective

(1) Changes in fair value are recognized in Other comprehensive income (loss) on the accompanying Consolidated Statements of Comprehensive Income (Loss).
(2) Changes in fair value are recognized in Net unrealized gains (losses) on investments measured at fair value through earnings on the accompanying Consolidated Statements of Comprehensive Income (Loss).
(3) Effective yield is recalculated for differences between estimated and actual prepayments and the amortized cost is adjusted as if the new effective yield had been applied since inception.

Residential Mortgage Loans – The Company's residential mortgage loans are primarily comprised of performing adjustable-rate and fixed-rate whole loans. Additionally, the Company consolidates a collateralized financing entity that securitized prime adjustable-rate jumbo residential mortgage loans. The Company also consolidates a securitization trust in which it had purchased subordinated securities because it also has certain powers and rights to direct the activities of such trust. Please refer to the "Variable Interest Entities" Note for further information related to the Company's consolidated Residential Mortgage Loan Trusts. The Company made elections to account for the investments in residential mortgage loans held in its portfolio and in the securitization trusts at fair value as these elections simplify the accounting. Residential mortgage loans are recognized at fair value on the accompanying Consolidated Statements of Financial Condition. Changes in the estimated fair value are presented in Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

Premiums and discounts associated with the purchase of residential mortgage loans and with those held in the securitization trusts are primarily amortized or accreted into interest income over their estimated remaining lives using the effective interest rates inherent in the estimated cash flows from the mortgage loans. Amortization of premiums and accretion of discounts are presented in Interest income in the Consolidated Statements of Comprehensive Income (Loss).

There was no real estate acquired in settlement of residential mortgage loans at March 31, 2018 or December 31, 2017 other than real estate held by securitization trusts that the Company was required to consolidate. The Company would be considered to have received physical possession of residential real estate property collateralizing a residential mortgage loan, so that the loan is derecognized and the real estate property would be recognized, if either (i) the Company obtains legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveys all interest in the residential real estate property to the Company to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

MSRs – MSRs represent the rights associated with servicing pools of residential mortgage loans, which the Company intends to hold as investments. The Company and its subsidiaries do not originate or directly service mortgage loans. Rather, these activities are carried out by duly licensed subservicers who perform substantially all servicing functions for the loans underlying the MSRs. The Company elected to account for all of its investments in MSRs at fair value. As such, they are recognized at fair value on the accompanying Consolidated Statements of Financial Condition with changes in the estimated fair value presented as a component of Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss). Servicing income, net of servicing expenses, is reported in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

Equity Securities – The Company may invest in equity securities that are not accounted for under the equity method or do not result in consolidation. These equity securities are required to be reported at fair value with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets, unless the securities do not have readily determinable fair values. For such equity securities without readily determinable fair values, the Company has elected to apply the measurement alternative and carry the securities at cost less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. For equity securities carried at fair value through earnings, dividends are recorded in earnings on the declaration date. Dividends from equity securities without readily determinable fair values are recognized as income when received to the extent they are distributed from net accumulated earnings.

Derivative Instruments – The Company may use a variety of derivative instruments to economically hedge some of its exposure to market risks, including interest rate and prepayment risk. These instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps (“swaptions”), TBA securities without intent to accept delivery (“TBA derivatives”), options on TBA securities (“MBS options”), U.S. Treasury and Eurodollar futures contracts and certain forward purchase commitments. The Company may also enter into other types of mortgage derivatives such as interest-only securities, credit derivatives referencing the commercial mortgage-backed securities index and synthetic total return swaps. Derivatives are accounted for in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). The changes in the estimated fair value are presented within Net gains (losses) on trading assets with the exception of interest rate swaps which are separately presented. None of the Company’s derivative transactions have been designated as hedging instruments for accounting purposes.

Some derivative agreements contain provisions that allow for netting or setting off by counterparty; however, the Company elected to present related assets and liabilities on a gross basis in the Consolidated Statements of Financial Condition.

Interest Rate Swap Agreements – Interest rate swap agreements are the primary instruments used to mitigate interest rate risk. In particular, the Company uses interest rate swap agreements to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Interest rate swap agreements may or may not be cleared through a derivatives clearing organization (“DCO”). Uncleared interest rate swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared interest rate swaps are fair valued using internal pricing models and compared to the DCO’s market values. We may use market agreed coupon (“MAC”) interest rate swaps in which we may receive or make a payment at the time of entering into the swap to compensate for the out of the market nature of such interest rate swap. MAC interest rate swaps are also centrally cleared and fair valued using internal pricing models and compared to the DCO’s market value.

Swaptions – Swaptions are purchased or sold to mitigate the potential impact of increases or decreases in interest rates. Interest rate swaptions provide the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. They are not centrally cleared. The premium paid or received for swaptions is reported as an asset or liability in the Consolidated Statements of Financial Condition. If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium received or paid. If the Company sells or exercises a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash received or the fair value of the underlying interest rate swap received and the premium paid.

The fair value of swaptions is estimated using internal pricing models and compared to the counterparty market value.

TBA Dollar Rolls – TBA dollar roll transactions are accounted for as a series of derivative transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities.

MBS Options – MBS options are generally options on TBA contracts, which help manage mortgage market risks and volatility while providing the potential to enhance returns. MBS options are over-the-counter traded instruments and those written on current-coupon mortgage-backed securities are typically the most liquid. MBS options are measured at fair value using internal pricing models and compared to the counterparty market value at the valuation date.

Futures Contracts – Futures contracts are derivatives that track the prices of specific assets or benchmark rates. Short sales of futures contracts help to mitigate the potential impact of changes in interest rates on the portfolio performance. The Company maintains margin accounts which are settled daily with Futures Commission Merchants (“FCMs”). The margin requirement varies based on the market value of the open positions and the equity retained in the account. Futures contracts are fair valued based on exchange pricing.

Forward Purchase Commitments – The Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing residential mortgage loans at a particular price, provided the residential mortgage loans close with the counterparties. The counterparties are required to deliver the committed loans on a “best efforts” basis.

Goodwill and Intangible Assets – The Company’s acquisitions are accounted for using the acquisition method. Under the acquisition method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The purchase prices are allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired is recognized as goodwill. Conversely, any excess of the fair value of the net assets acquired over the purchase price is recognized as a bargain purchase gain.

The Company tests goodwill for impairment on an annual basis and at interim periods when events or circumstances may make it more likely than not that an impairment has occurred. If a qualitative analysis indicates that there may be an impairment, a quantitative analysis is performed. The quantitative impairment test for goodwill utilizes a two-step approach, whereby the Company compares the carrying value of each identified reporting unit to its fair value. If the carrying value of the reporting unit is greater than its fair value, the second step is performed, where the implied fair value of goodwill is compared to its carrying value. The Company recognizes an impairment charge for the amount by which the carrying amount of goodwill exceeds its fair value.

Finite life intangible assets are amortized over their expected useful lives.

Reverse Repurchase and Repurchase Agreements – The Company finances the acquisition of a significant portion of its assets with repurchase agreements. At the inception of each transaction, the Company assesses each of the specified criteria in ASC 860, Transfers and Servicing, and has determined that each of the financing agreements meet the specified criteria in this guidance.

Reverse repurchase agreements and repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements meet the criteria to permit netting. The Company reports cash flows on repurchase agreements as financing activities and cash flows on reverse repurchase agreements as investing activities in the Consolidated Statements of Cash Flows.

Stock Based Compensation – The Company is required to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The Company recognizes compensation expense on a straight-line basis over the requisite service period for the entire award.

Income Taxes – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not be subject to federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including RCap and certain subsidiaries of ACREG and Hatteras Financial Corp., have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries (“TRSs”). As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.

The provisions of ASC 740, Income Taxes ("ASC 740"), clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary at March 31, 2018 and December 31, 2017.

Commercial Real Estate Investments

Commercial Real Estate Debt Investments – The Company's commercial real estate debt investments are comprised of commercial mortgage-backed securities and loans held by consolidated collateralized financing entities. Commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss), except for conduit commercial mortgage-backed securities for which the Company has elected to fair value through earnings to simplify the accounting. Management evaluates commercial mortgage-backed securities, excluding conduit commercial mortgage-backed securities, for other-than-temporary impairment at least quarterly. See the "Commercial Real Estate

Investments” Note for additional information regarding the consolidated collateralized financing entities.

Commercial Real Estate Loans and Preferred Equity Interests (collectively referred to as “CRE Debt and Preferred Equity Investments”) – The Company’s commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. The Company designates loans as held for investment if it has the intent and ability to hold the loans until maturity or payoff. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Commercial real estate loans that are designated as held for investment and are originated or purchased by the Company are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less an allowance for losses if necessary. Origination fees and costs, premiums or discounts are amortized into interest income over the life of the loan.

If the Company intends to sell or securitize the loans and the securitization vehicle is not expected to be consolidated, they are classified as held for sale. Commercial real estate loans that are designated as held for sale are carried at the lower of amortized cost or fair value and recorded as Commercial loans held for sale, net in the accompanying Consolidated Statements of Financial Condition. Any origination fees and costs or purchase premiums or discounts are deferred and recognized upon sale. The Company determines the fair value of commercial real estate loans held for sale on an individual loan basis.

Preferred equity interests are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. See the “Commercial Real Estate Investments” Note for additional information.

Investments in Commercial Real Estate – Investments in commercial real estate are carried at historical cost less accumulated depreciation. Historical cost includes all costs necessary to bring the asset to the condition and location necessary for its intended use, including financing during the construction period. Costs directly related to acquisitions deemed to be business combinations are expensed. Ordinary repairs and maintenance which are not reimbursed by tenants are expensed as incurred. Major replacements and improvements that extend the useful life of the asset are capitalized and depreciated over their useful life.

Investments in commercial real estate are depreciated using the straight-line method over the estimated useful lives of the

assets, summarized as follows:

Category	Term
Building	30 - 40 years
Site improvements	1 - 28 years

The Company applies the equity method of accounting for its investments in joint ventures where it is not considered to have a controlling financial interest. Under the equity method of accounting, the Company will recognize its share of earnings or losses of the investee in the period in which they are reported by the investee. The Company also considers whether there are any indicators of other-than-temporary impairment of joint ventures accounted for under the equity method.

The Company evaluates whether real estate acquired in connection with a foreclosure or deed in lieu of foreclosure, herein collectively referred to as a foreclosure, (“REO”) constitutes a business and whether business combination accounting is applicable. Upon foreclosure of a property, the excess of the carrying value of a loan, if any, over the estimated fair value of the property, less estimated costs to sell, is charged to provision for loan losses.

Investments in commercial real estate, including REO, that do not meet the criteria to be classified as held for sale are separately presented in the Consolidated Statements of Financial Condition as held for investment. Real estate held for sale is reported at the lower of its carrying value or its estimated fair value less estimated costs to sell. Once a property is determined to be held for sale, depreciation is no longer recorded.

The Company's real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property's value is considered impaired if the Company's estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.

Revenue Recognition – Commercial Real Estate Investments – Interest income is accrued based on the outstanding principal amount of CRE Debt and Preferred Equity Investments and their contractual terms. Origination fees and costs, premiums or discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the lives of the CRE Debt and Preferred Equity Investments using the effective interest method.

Corporate Debt

Corporate Loans – The Company's investments in corporate loans are designated as held for investment when the

Company has the intent and ability to hold the investment until maturity or payoff. These investments are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the effective interest method. These investments typically take the form of senior secured loans primarily in first or second lien positions. The Company's senior secured loans generally have stated maturities of three to eight years. In connection with these senior secured loans the Company receives a security interest in certain of the assets of the borrower and such assets support repayment of such loans. Senior secured loans are generally exposed to less amount of credit risk than more junior loans given their seniority to scheduled principal and interest and priority of security in the assets of the borrower. To date, the significant majority of the Company's investments in corporate debt have been funded term loans versus bonds.

Corporate Debt Securities – The Company's investments in corporate debt that are debt securities are designated as held-to-maturity when the Company has the intent and ability to hold the investment until maturity. These investments are carried at their principal balance outstanding plus any premiums or discounts less other-than-temporary impairment. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the interest method.

Impairment of Securities and Loans

Other-Than-Temporary Impairment – Management evaluates available-for-sale securities and held-to-maturity debt securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market conditions warrant such evaluation.

When the fair value of an available-for-sale security is less than its amortized cost, the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of Other comprehensive income (loss). If the fair value is less than the cost of a held-to-maturity security, the Company performs an analysis to determine whether it expects to recover the entire cost basis of the security. There was no other-than-temporary impairment recognized for the three months ended March 31, 2018 and 2017.

Allowance for Losses – The Company evaluates the need for a loss reserve on its CRE Debt and Preferred Equity Investments and its corporate loans. A provision for losses related to CRE Debt and Preferred Equity Investments and corporate loans, including those accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, may be established when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectible. Management assesses the credit quality of the portfolio and adequacy of loan loss reserves on a quarterly basis, or more frequently as necessary. Significant judgment is required in this analysis. Depending on the expected recovery of its investment, the Company considers the estimated net recoverable value of the CRE Debt and Preferred Equity Investments as well as other factors, including but not limited to the fair value of any collateral, the amount and the status of any senior debt, the prospects for the borrower and the competitive landscape where the borrower conducts business. To determine if loan loss allowances are required on investments in corporate debt, the Company reviews the monthly and/or quarterly financial statements of the borrowers, verifies loan compliance packages, if applicable, and analyzes current results relative to budgets and sensitivities performed at inception of the investment. Because these determinations are based upon projections of future economic events, which are inherently subjective, the amounts ultimately realized may differ materially from the carrying value as of the reporting date.

The Company may be exposed to various levels of credit risk depending on the nature of its investments and credit enhancements, if any, supporting its assets. The Company's core investment process includes procedures related to the initial approval and periodic monitoring of credit risk and other risks associated with each investment. The Company's investment underwriting procedures include evaluation of the underlying borrowers' ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics at origination or acquisition of a new investment and if events occur that trigger re-evaluation by management.

Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to, net operating income ("NOI"), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company's CRE Debt and Preferred Equity Investments, and may consider other factors management deems important. Management also reviews market pricing to determine each borrower's ability to refinance their respective assets at the maturity of each loan, economic trends (both macro and those affecting the property specifically), and the supply and demand of competing projects in the sub-market in which each subject property is located. Management monitors the financial condition and operating results of its corporate borrowers and continually assesses the future outlook of the borrower's financial performance in light of industry developments, management changes and company-specific considerations.

The Company evaluates the need for a loss reserve on at least a quarterly basis through its surveillance review process. In connection with the surveillance review process, the Company's CRE Debt and Preferred Equity Investments are assigned an internal risk rating. The loan risk ratings conform to guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The initial internal risk ratings ("Initial Ratings") are based on net operating income, debt service coverage ratios,
property debt yields, loan per unit, rent rolls and other factors management deems important. A provision for loan losses may occur when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectible of the Company's CRE Debt and Preferred Equity Investments and based upon leverage and cash flow coverages of the borrowers' debt and operating obligations. The final internal risk ratings are influenced by other quantitative and qualitative factors that can result in an adjustment to the Initial Ratings, subject to review and approval by the respective committee. The internal risk rating categories include "Performing", "Performing - Closely Monitored", "Performing - Special Mention", "Substandard", "Doubtful" or "Loss". Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans exhibit potential weakness that deserves management's close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible.

Nonaccrual Status – If collection of a loan's principal or interest is in doubt or the loan is 90 days or more past due, interest income is not accrued. For nonaccrual status loans carried at fair value or held for sale, interest is not accrued, but is recognized on a cash basis. For nonaccrual status loans carried at amortized cost, if collection of principal is not in doubt, but collection of interest is in doubt, interest income is recognized on a cash basis. If collection of principal is in doubt, any interest received is applied against principal until collectability of the remaining balance is no longer in doubt; at that point, any interest income is recognized on a cash basis.

Generally, a loan is returned to accrual status when the borrower has resumed paying the full amount of the scheduled contractual obligation, if all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period of time and there is a sustained period of repayment performance by the borrower. The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing at March 31, 2018 and December 31, 2017. There were no allowances for loan losses at March 31, 2018 and December 31, 2017.

Broker Dealer Activities

Reverse Repurchase and Repurchase Agreements – RCap enters into reverse repurchase agreements and repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on settlement date at the contractual amount and are collateralized by mortgage-backed or other securities. Margin calls are made by RCap as necessary based on the daily valuation of the underlying collateral as compared to the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. RCap's policy is to obtain possession of collateral with a market value in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and RCap will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements that give RCap the right, in the event of default, to liquidate collateral held and in some instances, to offset receivables and payables with the same counterparty. Substantially all of RCap's reverse repurchase activity is with affiliated entities.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Financial Statements

Recent Accounting Pronouncements

The Company considers the applicability and impact of all Accounting Standards Updates ("ASUs"). ASUs not listed

below were not applicable, not expected to have a significant impact on the Company's consolidated financial statements when adopted, or did not have a significant impact on the Company's consolidated financial statements upon adoption.

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
ASU 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	This ASU updates the existing incurred loss model to a current expected credit loss ("CECL") model for financial assets and net investments in leases that are not accounted for at fair value through earnings. The amendments affect loans, held-to-maturity debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures and any other financial assets not excluded from the scope. There are also limited amendments to the impairment model for available-for-sale debt securities.	January 1, 2020 (early adoption permitted)	The Company currently plans to adopt the new standard on its effective date. While the Company is continuing to assess the impact the ASU will have on the consolidated financial statements, the measurement of expected credit losses under the CECL model will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts of the financial assets in scope of the model. The Company needs to complete the development of an appropriate allowance methodology, assess the impact on the consolidated financial statements and determine appropriate internal controls and financial statement disclosures. Further, based on the amended guidance for available-for-sale debt securities, the Company: • will be required to use an allowance approach to recognize credit impairment, with the allowance to be limited to the amount by which the security's fair value is less than its amortized cost basis; • may not consider the length of time fair value has been below amortized cost, and • may not consider recoveries of fair value after the balance sheet date when assessing whether a credit loss exists.

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Standards that were adopted			
ASU 2017-01 Business Combinations	This update provides a screen to determine and a framework to evaluate when a set of assets and	January 1, 2018	The amendments are expected to result in fewer transactions being accounted for as business combinations.

(Topic 805): Clarifying the Definition of a Business	activities is a business.		
ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments	This update provides specific guidance on certain cash flow classification issues, including classification of cash receipts and payments that have aspects of more than one class of cash flows. If cash flows cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the predominant source or use of cash flows.	January 1, 2018	As a result of adopting this standard, the Company reclassified its cash flows on reverse repurchase and repurchase agreements entered into by RCap from operating activities to investing and financing activities, respectively, in the Consolidated Statements of Cash Flows. The Company applied the retrospective transition method, which resulted in reclassification of comparative periods.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
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4. FINANCIAL INSTRUMENTS

The following table presents characteristics for certain of the Company's financial instruments at March 31, 2018 and December 31, 2017.