ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
November 06, 2014

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: SEPTEMBER 30, 2014

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	22-3479661
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
1211 AVENUE OF THE AMERICAS, SUITE 2902	
NEW YORK, NEW YORK	10036
(Address of principal executive offices)	(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 o

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 o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o 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 October 31, 2014
Common Stock, $.01 par value	947,602,114

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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)

	September 30, 2014 (Unaudited)	December 31, 2013(1)
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $1,011,566 and $371,790, respectively)	$1,178,621	$552,436
Reverse repurchase agreements	-	100,000
Securities borrowed	-	2,582,893
Investments, at fair value:		
U.S. Treasury securities (including pledged assets of $0 and $1,113,027, respectively)	-	1,117,915
Agency mortgage-backed securities (including pledged assets of $71,955,127 and $63,897,873, respectively)	81,462,387	70,388,949
Agency debentures (including pledged assets of $1,334,181 and $2,931,261, respectively)	1,334,181	2,969,885
Investment in affiliates	136,748	139,447
Commercial real estate debt and preferred equity(2)	1,554,958	1,583,969
Investments in commercial real estate	73,827	60,132
Corporate debt, held for investment	144,451	117,687
Receivable for investments sold	855,161	1,193,730
Accrued interest and dividends receivable	287,231	273,079
Receivable for investment advisory income (including from affiliates of $8,369 and $6,839, respectively)	8,369	6,839
Goodwill	94,781	94,781
Interest rate swaps, at fair value	198,066	559,044
Other derivatives, at fair value	19,407	146,725
Other assets	39,798	34,949
Total assets	$87,387,986	$81,922,460
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
U.S. Treasury securities sold, not yet purchased, at fair value	$-	$1,918,394
Repurchase agreements	69,610,722	61,781,001
Securities loaned	7	2,527,668
Payable for investments purchased	2,153,789	764,131
Convertible Senior Notes	836,625	825,262
Securitized debt of consolidated VIE	260,700	-
Mortgages payable	42,635	19,332

Participation sold	13,768	14,065
Accrued interest payable	180,345	160,921
Dividends payable	284,278	284,230
Interest rate swaps, at fair value	857,658	1,141,828
Other derivatives, at fair value	-	55,518
Accounts payable and other liabilities	36,511	25,055
Total liabilities	74,277,038	69,517,405
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
7.625% Series C Cumulative Redeemable Preferred Stock: 12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
Common stock, par value $0.01 per share, 1,956,937,500 authorized, 947,591,766 and 947,432,862 issued and outstanding, respectively	9,476	9,474
Additional paid-in capital	14,781,308	14,765,761
Accumulated other comprehensive income (loss)	(967,820)	(2,748,933)
Accumulated deficit	(1,625,075)	(534,306)
Total stockholders' equity	13,110,948	12,405,055
Total liabilities and stockholders' equity	$87,387,986	$81,922,460

(1) Derived from the audited consolidated financial statements at December 31, 2013.

(2) Includes senior securitized mortgages of consolidated VIE with a carrying value of $398.4 million at September 30, 2014.

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)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net interest income:				
Interest income	$644,640	$697,160	$1,984,503	$2,147,313
Interest expense	127,069	145,476	378,147	487,321
Net interest income	517,571	551,684	1,606,356	1,659,992
Other income (loss):				
Realized gains (losses) on interest rate swaps(1)	(169,083)	(227,909)	(650,452)	(666,112)
Realized gains (losses) on termination of interest rate swaps	-	(36,658)	(779,333)	(88,685)
Unrealized gains (losses) on interest rate swaps	98,593	6,343	(75,287)	1,441,099
Subtotal	(70,490)	(258,224)	(1,505,072)	686,302
Investment advisory income	8,253	9,558	20,485	35,153
Net gains (losses) on disposal of investments	4,693	43,602	90,296	374,443
Dividend income from affiliates	4,048	4,048	21,141	14,527
Net gains (losses) on trading assets	4,676	(96,022)	(188,041)	(40,427)
Net unrealized gains (losses) on interest-only Agency mortgage-backed securities	(37,944)	(7,099)	(56,652)	184,549
Impairment of goodwill	-	-	-	(23,987)
Loss on previously held equity interest in CreXus	-	-	-	(18,896)
Other income (loss)	(22,249)	4,212	(16,102)	11,536
Subtotal	(38,523)	(41,701)	(128,873)	536,898
Total other income (loss)	(109,013)	(299,925)	(1,633,945)	1,223,200
General and administrative expenses:				
Compensation and management fee	39,028	41,774	116,826	123,981
Other general and administrative expenses	12,289	16,970	34,058	51,806
Total general and administrative expenses	51,317	58,744	150,884	175,787
Income (loss) before income taxes	357,241	193,015	(178,473)	2,707,405
Income taxes	2,385	557	5,534	6,456
Net income (loss)	354,856	192,458	(184,007)	2,700,949
Dividends on preferred stock	17,992	17,992	53,976	53,976
	$336,864	$174,466	$(237,983)	$2,646,973

Net income (loss) available (related) to common stockholders				
Net income (loss) per share available (related) to common stockholders:				
Basic	$0.36	$0.18	$(0.25)	$2.79
Diluted	$0.35	$0.18	$(0.25)	$2.69
Weighted average number of common shares outstanding:				
Basic	947,565,432	947,303,205	947,513,514	947,321,691
Diluted	987,315,527	955,690,471	947,513,514	995,319,670
Dividends declared per share of common stock	$0.30	$0.35	$0.90	$1.20
Net income (loss)	$354,856	$192,458	$(184,007)	$2,700,949
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	(390,871)	(121,942)	1,872,427	(4,133,589)
Reclassification adjustment for net (gains) losses included in net income (loss)	(4,693)	(43,602)	(91,314)	(374,443)
Other comprehensive income (loss)	(395,564)	(165,544)	1,781,113	(4,508,032)
Comprehensive income (loss)	$(40,708)	$26,914	$1,597,106	$(1,807,083)

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized gains (losses) 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
(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	Common Stock Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
BALANCE, December 31, 2012	$177,088	$290,514	$445,457	$9,472	$14,740,774	$3,053,242	$(2,792,103)	$15,924,444
Net income (loss)	-	-	-	-	-	-	2,700,949	2,700,949
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	(4,133,589)	-	(4,133,589)
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(374,443)	-	(374,443)
Exercise of stock options	-	-	-	2	2,202	-	-	2,204
Stock compensation expense	-	-	-	(3)	1,765	-	-	1,762
Net proceeds from direct purchase and dividend reinvestment	-	-	-	2	2,164	-	-	2,166
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	12,833	-	-	12,833
Preferred Series A dividends, declared $1.477 per share	-	-	-	-	-	-	(10,945)	(10,945)

Preferred Series C dividends, declared $1.430 per share	-	-	-	-	-	-	(17,156)	(17,156)
Preferred Series D dividends, declared $1.406 per share	-	-	-	-	-	-	(25,875)	(25,875)
Common dividends declared, $1.20 per share	-	-	-	-	-	-	(1,136,626)	(1,136,626)
BALANCE, September 30, 2013	$177,088	$290,514	$445,457	$9,473	$14,759,738	$(1,454,790)	$(1,281,756)	$12,945,724
BALANCE, December 31, 2013	$177,088	$290,514	$445,457	$9,474	$14,765,761	$(2,748,933)	$(534,306)	$12,405,055
Net income (loss)	-	-	-	-	-	-	(184,007)	(184,007)
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	1,872,427	-	1,872,427
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(91,314)	-	(91,314)
Stock compensation expense	-	-	-	-	998	-	-	998
Net proceeds from direct purchase and dividend reinvestment	-	-	-	2	1,784	-	-	1,786
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	12,765	-	-	12,765
Preferred Series A dividends, declared $1.477 per share	-	-	-	-	-	-	(10,944)	(10,944)
Preferred Series C dividends, declared $1.430 per share	-	-	-	-	-	-	(17,157)	(17,157)
	-	-	-	-	-	-	(25,875)	(25,875)

Preferred Series D dividends, declared $1.406 per share								
Common dividends declared, $0.90 per share	-	-	-	-	-	-	(852,786)	(852,786)
BALANCE, September 30, 2014	$177,088	$290,514	$445,457	$9,476	$14,781,308	$(967,820)	$(1,625,075)	$13,110,948

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 CASH FLOWS
(dollars in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	$(184,007)	$2,700,949
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Investment Securities premiums and discounts, net	466,338	943,094
Amortization of commercial real estate investment premiums and discounts, net	607	326
Amortization of intangibles	445	2,614
Amortization of deferred financing costs	8,023	6,114
Amortization of net origination fees and costs, net	(3,337)	-
Amortization of contingent beneficial conversion feature and equity component of Convertible Senior Notes	24,128	11,804
Depreciation expense	1,264	-
Net gain on sale of commercial real estate	(2,748)	-
Net (gains) losses on sales of Agency mortgage-backed securities and debentures	(91,314)	(374,443)
Stock compensation expense	998	1,762
Impairment of goodwill	-	23,987
Loss on previously held equity interest in CreXus	-	18,896
Unrealized (gains) losses on interest rate swaps	75,287	(1,441,099)
Net unrealized (gains) losses on interest-only Agency mortgage-backed securities	56,652	(184,549)
Net (gains) losses on trading assets	188,041	40,427
Proceeds from repurchase agreements of RCap	747,790,774	1,026,645,402
Payments on repurchase agreements of RCap	(742,842,907)	(1,037,381,608)
Proceeds from reverse repurchase agreements	60,698,578	318,678,534
Payments on reverse repurchase agreements	(60,598,578)	(316,898,513)
Proceeds from securities borrowed	23,888,955	208,108,715
Payments on securities borrowed	(21,306,062)	(209,387,727)
Proceeds from securities loaned	41,939,298	372,155,568
Payments on securities loaned	(44,466,959)	(370,664,793)
Proceeds from U.S. Treasury securities	3,159,253	109,762,391
Payments on U.S. Treasury securities	(3,920,425)	(109,750,041)
Net payments on derivatives	(98,704)	(26,020)
Net change in:		
Due to / from brokers	8,596	683
Other assets	(2,011)	(11,298)
Accrued interest and dividends receivable	(27,362)	119,211
Receivable for investment advisory income	(1,530)	7,675
Accrued interest payable	34,733	(24,141)
Accounts payable and other liabilities	2,958	23,838

Net cash provided by (used in) operating activities	4,798,984	(6,892,242)
Cash flows from investing activities:		
Payments on purchases of Agency mortgage-backed securities and debentures	(27,898,595)	(31,529,258)
Proceeds from sales of Agency mortgage-backed securities and debentures	15,529,556	42,719,851
Principal payments on Agency mortgage-backed securities	5,945,647	19,550,338
Proceeds from Agency debentures called	-	2,147,205
Payments on purchases of corporate debt	(114,183)	(39,717)
Proceeds from corporate debt called	-	24,252
Principal payments on corporate debt	88,078	3,586
Acquisition of CreXus	-	(724,889)
Origination of commercial real estate investments, net	(206,849)	(563,982)
Proceeds from sales of commercial real estate held for sale	26,019	20,192
Principal payments on commercial real estate investments	237,796	50,424
Purchase of investments in real estate	(36,743)	-
Proceeds from derivatives	-	7,465
Net cash provided by (used in) investing activities	(6,429,274)	31,665,467
Cash flows from financing activities:		
Proceeds from repurchase agreements	147,564,412	322,086,276
Principal payments on repurchase agreements	(144,682,558)	(344,924,458)
Proceeds from issuance of securitized debt	260,700	-
Payment of deferred financing cost	(4,288)	-
Proceeds from exercise of stock options	-	2,204
Net proceeds from direct purchases and dividend reinvestments	1,785	2,166
Proceeds from mortgages payable	23,375	-
Principal payments on participation sold	(207)	(132)
Principal payments on mortgages payable	(30)	-
Net payment on share repurchase	-	(141,149)
Dividends paid	(906,714)	(1,291,199)
Net cash provided by (used in) financing activities	2,256,475	(24,266,292)
Net (decrease) increase in cash and cash equivalents	626,185	506,933
Cash and cash equivalents, beginning of period	552,436	615,789
Cash and cash equivalents, end of period	$1,178,621	$1,122,722
	-	-
Supplemental disclosure of cash flow information:		
Interest received	$2,454,211	$3,209,456
Dividends received	$21,141	$17,576
Investment advisory income received	$18,955	$63,070
Interest paid (excluding interest paid on interest rate swaps)	$370,784	$517,134
Net interest paid on interest rate swaps	$640,316	$648,638
Taxes paid	$6,925	$6,763
Noncash investing activities:		
Receivable for investments sold	$855,161	$934,964
Payable for investments purchased	$2,153,789	$2,546,467
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$1,781,113	$(4,508,032)

Noncash financing activities:		
Dividends declared, not yet paid	$284,278	$331,557
Contingent beneficial conversion feature on 4% Convertible Senior Notes	$12,765	$12,833

See notes to consolidated financial statements.

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 owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, agency callable debentures, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate assets and corporate loans. The Company’s principal business objective is to generate net income for distribution to its stockholders from its investments. The Company is externally managed by Annaly Management Company LLC (the “Manager”).

The Company’s business operations are primarily comprised of the following:

- Annaly, the parent company, which invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
- Annaly Commercial Real Estate Group, Inc. (“ACREG,” formerly known as CreXus Investment Corp. (“CreXus”)), a wholly-owned subsidiary that was acquired during the second quarter of 2013 which specializes in acquiring, financing and managing commercial real estate loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
- RCap Securities, Inc. (“RCap”), a wholly-owned subsidiary which operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (“FINRA”).
- Fixed Income Discount Advisory Company (“FIDAC”), a wholly-owned subsidiary which manages an affiliated real estate investment trust (“REIT”) for which it earns fee income.
- Annaly Middle Market Lending LLC (formerly known as Charlesfort Capital Management LLC), a wholly-owned subsidiary which engages in corporate

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("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, 2013 has been derived from audited consolidated financial statements not included herein.

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 wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in Variable Interest Entities ("VIEs"). 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. A VIE is required to be consolidated by its primary

middle market lending transactions.
- Shannon Funding LLC ("Shannon"), a wholly-owned subsidiary which acquires residential mortgage loans and provides warehouse financing to residential mortgage originators in the United States.

The Company has elected to be taxed as a REIT as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the "Code").

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 of the VIE that could potentially be significant to the VIE 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 parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a 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 considers all of its economic interests, including debt and equity investments and other arrangements deemed to be variable interests in the VIE. This assessment requires that the Company applies 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; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by the Company.

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 regarding the VIE to change.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand and cash held in money market funds on an overnight basis. 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 are carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest

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

Agency Mortgage-Backed Securities and Agency Debentures – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of 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.

Agency mortgage-backed securities and Agency debentures are referred to herein as "Investment Securities." Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Investment Securities are classified as available-for-sale and are reported at fair values estimated by management that are compared to independent sources for reasonableness, with unrealized gains and losses reported as a component of other comprehensive income (loss). Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Realized gains and losses on sales of Investment Securities are determined using the average cost method.

The Company elected the fair value option for Agency interest-only mortgage-backed securities. Interest-only securities and inverse interest-only securities are collectively referred to as "interest-only securities." These Agency interest-only mortgage-backed securities represent the Company's right to receive a specified

rate swaps and other derivatives. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to its interest rate swaps and other derivatives totaled approximately $1.0 billion and $371.8 million at September 30, 2014 and December 31, 2013, 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.

proportion of the contractual interest flows of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on interest-only Agency mortgage-backed securities 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.

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. The Company uses a third-party supplied model to project prepayment speeds. The Company's prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan to value, etc.) and market data, including interest rate and home price index forecasts. Adjustments are made for actual prepayment activity.

Corporate Debt – The Company's investments in corporate debt are designated as held for investment, and are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. No allowance for loan losses was deemed necessary as of September 30, 2014 and December 31, 2013.

Equity Securities – The Company may invest in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with unrealized gains and losses reported as a component of other comprehensive income (loss). Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets. Dividends are recorded in earnings based on the declaration date.

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 with the intent to net settle ("TBA derivatives"), options on TBA securities ("MBS options") and U.S. Treasury and Eurodollar futures contracts. The Company may also Some derivative agreements contain provisions that allow for netting or setting off by counterparty; however, beginning on September 30, 2013, the Company elected to present related assets and liabilities on a gross basis in the Consolidated Statements of Financial Condition. Prior to September 30, 2013, the Company presented in the Consolidated Statements of Financial Condition the fair value of interest rate swap contracts net, by counterparty, if the derivative agreements included netting provisions.

Interest rate swap agreements - Interest rate swaps are the primary instrument used to mitigate interest rate risk. In particular, the Company uses interest rate swaps to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Swap agreements may be over-the-counter ("OTC") agreements which are negotiated directly with a counterparty, or centrally cleared through a registered commodities exchange. OTC swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared swaps are fair valued using internal pricing models and compared to the exchange market values.

Interest rate swaptions - Interest rate swaptions are purchased/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/received for interest rate swaptions is reported as an asset/liability in the Consolidated Statement of Financial Position. The difference between the premium and the fair value of the swaption is reported in Net gain (loss) on trading assets in the Consolidated Statements of Comprehensive Income (Loss). If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium received/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

invest in other types of mortgage derivatives such as interest-only securities and synthetic total return swaps, such as the Markit IOS Synthetic Total Return Swap Index. 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). None of the Company's derivative transactions have been designated as hedging instruments for accounting purposes.

paid.

The fair value of interest rate 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 similar methods used to value Agency mortgage-backed securities with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

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 fair valued using internal pricing models and compared to the counterparty market value at the valuation date with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Futures Contracts - Futures contracts are derivatives that track the prices of specific assets. Short sales of futures contracts help 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 with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Other-Than-Temporary Impairment – Management evaluates available-for-sale 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

Loan Loss Reserves – 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 to verify they meet the covenants of the loan documents. If based on the financial review it is deemed probable that the Company will be unable to collect contractual principal and interest amounts (e.g. financial performance and delinquencies), a loan loss provision would be recorded. No allowance for loan losses was deemed necessary as of September 30, 2014 and December 31, 2013.

Repurchase Agreements – The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company examines each of the specified criteria in ASC 860, Transfers and Servicing, at the inception of each transaction and has determined that each of the financings meet the specified criteria in this guidance. None of the Company's repurchase agreements are accounted for as components of linked transactions. As a result, the Company separately accounts for the financial assets and related repurchase financings in the accompanying consolidated financial statements.

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 permit netting. The Company reports cash flows on repurchase agreements as financing activities in the Consolidated Statements of Cash Flows. The Company reports cash flows on reverse repurchase and repurchase agreements entered into by RCap and Shannon as operating activities in the Consolidated Statements of Cash Flows.

Goodwill and Intangible Assets – The Company's acquisitions of FIDAC, Merganser Capital Management, Inc. ("Merganser") and CreXus were accounted for using the acquisition method. In October 2013, the Company sold the operations of Merganser. 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

income (loss). There was no other-than-temporary impairment recognized for the quarters and nine months ended September 30, 2014 and 2013.

prices of FIDAC, Merganser and CreXus were 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 was recognized as goodwill.

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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.

Intangible assets with an estimated useful life are amortized over their expected useful lives.

Convertible Senior Notes – The Company records the 4% Convertible Senior Notes and 5% Convertible Senior Notes (collectively, the "Convertible Senior Notes") at their contractual amounts, adjusted by the effects of a beneficial conversion feature and a contingent beneficial conversion feature (collectively, the "Conversion Features"). The Conversion Features' intrinsic value is included in "Additional paid-in capital" on the Company's Consolidated Statements of Financial Condition and reduces the recorded liability amount associated with the Convertible Senior Notes. A Conversion Feature may be recognized as a result of adjustments to the conversion price for dividends declared to common stockholders.

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

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 from those estimates.

Commercial Real Estate Investments

Commercial Real Estate Loans – The Company's commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. Commercial real estate loans 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. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the loan.

Preferred Equity Interests Held for Investment – 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. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the investment.

Allowance for Losses – The Company evaluates the need for a loss reserve on its commercial real estate loans and preferred equity interests held for investment (collectively referred to as "CRE Debt and Preferred Equity Investments"). A provision for losses related to CRE Debt and Preferred Equity Investments, 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 collectable. Management

asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including FIDAC, RCap and certain subsidiaries of ACREG, 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 as of September 30, 2014 and December 31, 2013.

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. Because this determination is 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 the nature of the assets underlying the 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. Management reviews loan-to-value metrics upon either the origination or the acquisition of a new investment but generally does not update the loan-to-value metrics in the course of quarterly surveillance. 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. Management also reviews economic trends, both macro as well as those directly affecting the property, and the supply and demand of competing projects in the sub-market in which each subject property is located.

In connection with the quarterly surveillance review process, loans are assigned an internal rating of "Performing", "Watch List", "Defaulted-Recovery" or "Impaired". Loans that are deemed to be Performing meet all present contractual obligations and do not qualify for Watch List designation. Watch List loans are defined as Performing loans that are significantly lagging expectations and default is considered imminent. Defaulted–Recovery loans are currently in default; however full recovery of contractual principal and interest is expected. Impaired loans may or may not be in default, impairment is anticipated, and a loan loss provision has been recognized to reflect expected losses.

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	27-40 years
Site improvements	2-10 years

The Company follows the acquisition method of accounting for acquisitions of operating real estate held for investment, where the purchase price of operating real estate is allocated to tangible assets such as land, building, site improvements and other identified intangibles such as above/below market and in-place leases.

The Company evaluates whether real estate acquired in connection with a foreclosure ("REO") or UCC/deed in lieu of foreclosure (herein collectively referred to as a foreclosure) 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, which 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. In addition, if considered material to the overall consolidated financial statements, the results of operations are reclassified to income (loss) from discontinued operations in the Consolidated Statements of Comprehensive Income (Loss).

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

Investments in Commercial Real Estate – Investments in commercial real estate are carried at historical cost less accumulated depreciation. 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.

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.

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

Broker Dealer Activities

In January 2014, RCap ceased its trading activity in U.S. Treasury securities, derivatives and certain securities borrowed and loaned transactions.

Reverse Repurchase Agreements – RCap enters into reverse repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on trade date at the contract 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.

Securities Borrowed and Loaned Transactions – RCap records securities borrowed and loaned transactions as collateralized financings. Securities borrowed transactions require RCap to provide the counterparty with collateral in the form of cash, or other securities.

U.S. Treasury Securities – RCap traded in U.S. Treasury securities for its proprietary portfolio, which consisted of long and short positions on U.S Treasury notes and bonds. U.S. Treasury securities were classified as trading investments and were recorded on the trade date at cost. Changes in fair value were reflected in Net gains (losses) on trading assets in the Company's Consolidated Statement of Comprehensive Income (Loss). Interest income or expense on U.S. Treasury notes and bonds was accrued based on the outstanding principal amount of those investments and their stated terms.

Derivatives - RCap entered primarily into U.S. Treasury, Eurodollar, federal funds, German government and U.S. equity index and currency futures and options contracts. RCap maintained a margin account which was settled daily with FCMs. Changes in the unrealized gains or losses on the futures and options contracts as well as any foreign exchange gains and losses were reflected in Net gains (losses) on trading assets in the Company's Consolidated Statements of Comprehensive Income (Loss). Unrealized gains (losses) were excluded from net income (loss) in arriving at cash flows from operating activities in the Consolidated Statements of Cash Flows.

A Summary of Recent Accounting Pronouncements Follows:

Presentation

Presentation of Financial Statements – Going Concern (Subtopic 205-40)

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-04) Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This ASU requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the

RCap receives collateral in the form of cash or other securities for securities loaned transactions. RCap monitors the fair value of the securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Securities borrowed and securities loaned transactions are recorded at contract value. For these transactions, the rebates accrued by RCap are recorded as interest income or expense.

date the financial statements are issued. If conditions or events indicate it is probable that an entity will be unable to meet its obligations as they become due within one year after the financial statements are issued, the update requires additional disclosures. The update is effective for periods beginning after December 15, 2016 with early adoption permitted. ASU 2014-15 is not expected to have an impact on the consolidated financial statements.

Presentation of Financial Statements (ASC 205)/Property, Plant and Equipment (ASC 360)

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which raises the threshold for a disposal to be treated as discontinued operations. Under this update, the Company is required to report disposals that represent a strategic shift that has (or will have) a major effect on the Company's operations and financial results if the component of the Company or group of components meets the criteria to be accounted for as held for sale or the component of the Company or group of components is disposed of by sale. The ASU removes requirements that operations and cash flows have been (or will be) eliminated from the ongoing operations and that the Company will not have any significant continuing involvement with the component in order to be reported as discontinued operations. Additionally, ASU 2014-08 also eliminates a number of scope exceptions and requires additional disclosures for transactions that meet the discontinued operations definition and significant items that are disposed of or held for sale that do not meet the discontinued operations criteria. The ASU is effective for reporting periods beginning after December 15, 2014 with early adoption permitted. Adoption is not expected to have a significant impact on the consolidated financial statements.

Balance Sheet (ASC 210)

In December 2011, the FASB released ASU 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities. Under this update, the Company is required to disclose both gross and net information about both instruments and transactions eligible for offset in the Company's Consolidated Statements of Financial Condition and transactions subject to an agreement similar to a master netting arrangement. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements and

Comprehensive Income (ASC 220)

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income: Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05, which defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. This was done to allow the FASB time to re-deliberate the presentation on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. No other requirements under ASU 2011-05 are affected by ASU 2011-12. The FASB tentatively decided not to require presentation of reclassification adjustments out of accumulated other comprehensive income on the face of the financial statements and to propose new disclosures instead.

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This update addresses the disclosure issue left open at the deferral under ASU 2011-12. This update requires the provision of information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, it requires presentation, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, a cross-reference must be provided to other disclosures required under GAAP that provide additional detail about those amounts. This update was effective for reporting periods beginning after December 15, 2012. Adoption of ASU 2013-02 did not have a

securities borrowing and securities lending arrangements. This disclosure is intended to enable financial statement users to understand the effect of such arrangements on the Company's financial position. In January 2013, the FASB released ASU 2013-01 Balance Sheet: Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, which served solely to clarify the scope of financial instruments included in ASU 2011-11 as there was concern about diversity in practice. The objective of these updates is to support further convergence of GAAP and IFRS requirements. The updates were effective for annual reporting periods beginning on or after January 1, 2013 and did not have a significant impact on the consolidated financial statements.

significant impact on the consolidated financial statements.

Assets

Receivables – Troubled Debt Restructurings by Creditors (ASC 310-40)

In January 2014, the FASB issued ASU 2014-04, Receivables–Troubled Debt Restructurings by Creditors, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, which clarifies that an in substance repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, when the creditor obtains legal title to the property upon completion of a foreclosure or the borrower conveys all interest in the property to the creditor through a deed in lieu of foreclosure or similar arrangement. ASU 2014-04 also requires disclosure of the amount of foreclosed residential real estate held by the creditor and the recorded investment in mortgage loans collateralized by residential real estate property in the process of foreclosure. The update is effective for reporting periods beginning after December 15, 2014. Adoption is not expected to have a significant impact on the consolidated financial statements.

Revenues

Revenue from Contracts with Customers (ASC 606)

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. This guidance applies to contracts with customers to transfer goods or services and contracts to transfer nonfinancial assets unless those contracts are within the scope of other standards (for example, lease transactions). The update supersedes the revenue recognition requirements in Topic 605, Revenue Recognition and most industry-specific guidance. The core principle of the guidance is that revenue is recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The guidance in this update will be effective for the Company beginning January 1, 2017. The Company does not expect the update to have a material impact on the consolidated financial statements.

Transfers and Servicing (ASC 860)

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. This update makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements. The ASU requires entities to account for repurchase-to-maturity transactions as secured borrowings, rather than as sales with forward repurchase agreements. The ASU defines a repurchase-to-maturity transaction as a repo that (1) settles at the maturity of the transferred financial asset and (2) does not require the transferor to reacquire the transferred financial asset. In addition, the ASU eliminates accounting guidance on linked repurchase financing transactions. The ASU also expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers accounted for as secured borrowings. The guidance in this update will be effective for the Company beginning January 1, 2015, except for the disclosure requirements for transactions accounted for as secured borrowings, which are required to be presented for interim periods beginning after March 15, 2015. As of September 30, 2014, the Company does not have any repurchase-to-maturity transactions or any linked repurchase financing transactions, therefore, the Company expects that this standard will impact disclosures only and will not have a significant impact on the consolidated financial statements.

Industry

Financial Services – Investment Companies (ASC 946)

In June 2013, the FASB finalized ASU 2013-08 amending the scope, measurement and disclosure requirements under Topic 946 – Financial Services-Investment Companies. In January 2014, the FASB has officially removed the Investment Companies: Real Estate Property Investments and the Investment Properties projects from its agenda. As

Broad Transactions

Consolidation (ASC 810)

In August 2014, the FASB issued ASU No. 2014-13, Consolidation (Topic 810) Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity. ASU 2014-13 provides a practical expedient to measure the fair value of the financial assets and financial liabilities of a consolidated collateralized financing entity, which the reporting entity has elected to or is required to measure on a fair value basis. When a reporting entity elects the measurement alternative provided in this update, both the financial assets and the financial liabilities are measured based upon the more observable fair value. The update is effective for periods beginning after December 15, 2015 with early adoption permitted. ASU 2014-13 is not expected to have an impact on the consolidated financial statements as the Company has not elected to nor is it required to measure the financial assets and financial liabilities of its consolidated collateralized financing entities at fair value.

stated in ASC 946-10-15-3, the guidance in Topic 946 does not apply to REITs, and thus has no effect on the consolidated financial statements.

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4. AGENCY MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Agency mortgage-backed securities portfolio as of September 30, 2014 and December 31, 2013, which were carried at their fair value:

September 30, 2014	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	$27,571,992	$49,170,673	$101,600	$76,844,265
Unamortized premium	1,933,435	3,556,906	21,388	5,511,729
Unamortized discount	(11,358)	(10,869)	(369)	(22,596)
Amortized cost	29,494,069	52,716,710	122,619	82,333,398
Gross unrealized gains	213,771	504,236	8,001	726,008
Gross unrealized losses	(676,308)	(917,139)	(3,572)	(1,597,019)
Estimated fair value	$29,031,532	$52,303,807	$127,048	$81,462,387

	Fixed Rate	Adjustable Rate	Total
	(dollars in thousands)		
Amortized cost	$ 79,564,428	$ 2,768,970	$ 82,333,398
Gross unrealized gains	592,974	133,034	726,008
Gross unrealized losses	(1,582,120)	(14,899)	(1,597,019)
Estimated fair value	$ 78,575,282	$ 2,887,105	$ 81,462,387

December 31, 2013	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	$24,458,925	$43,564,657	$120,739	$68,144,321
Unamortized premium	1,627,966	2,970,813	27,085	4,625,864
Unamortized discount	(9,533)	(11,568)	(383)	(21,484)
Amortized cost	26,077,358	46,523,902	147,441	72,748,701
Gross unrealized gains	227,423	456,057	9,845	693,325
Gross unrealized losses	(1,267,106)	(1,781,683)	(4,288)	(3,053,077)
Estimated fair value	$25,037,675	$45,198,276	$152,998	$70,388,949

	Fixed Rate	Adjustable Rate	Total
	(dollars in thousands)		
Amortized cost	$ 68,784,424	$ 3,964,277	$ 72,748,701
Gross unrealized gains	538,556	154,769	693,325
Gross unrealized losses	(3,040,153)	(12,924)	(3,053,077)
Estimated fair value	$ 66,282,827	$ 4,106,122	$ 70,388,949

Actual maturities of Agency mortgage-backed securities are generally shorter than stated contractual maturities because actual maturities of Agency mortgage-backed

The following table summarizes the Company's Agency mortgage-backed securities as of September 30, 2014 and December 31, 2013, according to their estimated

securities are affected by periodic payments and prepayments of principal on the underlying mortgages.

weighted average life classifications:

Weighted Average Life	September 30, 2014 Estimated Fair Value	September 30, 2014 Amortized Cost	December 31, 2013 Estimated Fair Value	December 31, 2013 Amortized Cost
Less than one year	$ 52,872	$ 52,323	$ 65,584	$ 64,561
Greater than one year through five years	13,835,710	13,529,952	50,046,013	51,710,059
Greater than five years through ten years	66,997,257	68,148,447	14,915,716	15,292,973
Greater than ten years	576,548	602,676	5,361,636	5,681,108
Total	$ 81,462,387	$ 82,333,398	$ 70,388,949	$ 72,748,701

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The weighted average lives of the Agency mortgage-backed securities at September 30, 2014 and December 31, 2013 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than projected.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities by length of time that such securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013.

	September 30, 2014			December 31, 2013		
	Estimated Fair Value	Gross Unrealized Losses	Number of Securities	Estimated Fair Value	Gross Unrealized Losses	Number of Securities
	(dollars in thousands)					
Less than 12 Months	$ 10,279,297	$ (55,136)	202	$ 47,677,197	$ (2,569,474)	583
12 Months or More	39,326,443	(1,541,883)	363	6,102,283	(483,603)	55
Total	$ 49,605,740	$ (1,597,019)	565	$ 53,779,480	$ (3,053,077)	638

The decline in value of these securities is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, the Company is guaranteed payment of the principal amount of the securities by the respective issuing government agency.

During the quarter and nine months ended September 30, 2014, the Company disposed of $4.1 billion and $13.3 billion of Agency mortgage-backed securities, respectively, resulting in a net realized gain of $5.5 million and $176.5 million, respectively. During the quarter and nine months ended September 30, 2013, the Company disposed of $12.8 billion and $42.6 billion of Agency mortgage-backed securities, respectively, resulting in a net realized gain of $43.6 million and $374.4 million, respectively. Average cost is used as the basis on which the realized gain or loss on sale is

5. ACQUISITION OF CREXUS

On April 17, 2013, the Company, through its wholly-owned subsidiary CXS Acquisition Corporation, obtained control of CreXus pursuant to the merger agreement dated January 30, 2013. CreXus owned a portfolio of commercial real estate assets which are now owned by the Company. Following the acquisition, CXS Acquisition Corporation was renamed Annaly Commercial Real Estate Group, Inc.

The business combination was accounted for under the acquisition method of accounting in accordance with ASC 805, Business Combinations, ("ASC 805"). Accordingly, goodwill was measured as the excess of the aggregate of the acquisition-date fair value of the consideration transferred and the acquisition-date fair value of the Company's previously held equity interest in CreXus over the fair value, at acquisition date, of the identifiable assets acquired net of assumed liabilities. The following table summarizes the aggregate consideration and fair value of the assets acquired and liabilities assumed at the acquisition date:

determined.

Agency interest-only mortgage-backed securities represent the right to receive a specified portion of the contractual interest flows of the underlying outstanding principal balance of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities in the Company's portfolio as of September 30, 2014 and December 31, 2013 had net unrealized gains of $21.5 million and $78.1 million and an amortized cost of $1.2 billion and $1.0 billion, respectively.

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	April 17, 2013 (dollars in thousands)
Cash consideration transferred	$ 876,267
Fair value of equity interest in CreXus held before the business combination	106,521
	$ 982,788
Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	$ 151,843
Commercial real estate investments	796,950
Accrued interest receivable	3,485
Other assets	5,617
Mortgages payable	(19,376)
Participation sold	(14,352)
Accounts payable and accrued expenses	(12,729)
Total identifiable net assets	911,438
Goodwill	71,350
	$ 982,788

The Company recorded $71.4 million of goodwill during the second quarter of 2013 associated with the acquisition of CreXus in the Consolidated Statements of Financial Condition. The Company recognized additional goodwill of $0.4 million during the second half of 2013. In management's opinion, the goodwill represents the synergies that resulted from integrating CreXus' commercial real estate platform into the Company, which the Company believes is complementary to its existing business and return profile.

The acquisition-date fair value of the previously held equity interest in CreXus excluded the estimated fair value of the control premium that resulted from the merger transaction. The Company recognized a loss of $18.9 million during the second quarter of 2013 as a result of remeasuring the fair value of its equity interest in CreXus held before the business combination.

Under ASC 805, merger-related transaction costs (such as advisory, legal, valuation and other professional fees) are not included as components of consideration transferred but are expensed in the periods in which the costs are incurred. Transaction costs of $7.3 million were incurred during 2013 and were included in other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss).

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6. COMMERCIAL REAL ESTATE INVESTMENTS

At September 30, 2014 and December 31, 2013, commercial real estate investments were composed of the following:

CRE Debt and Preferred Equity Investments

	September 30, 2014			December 31, 2013		
	Outstanding Principal	Carrying Value(1)	Percentage of Loan Portfolio(2)	Outstanding Principal	Carrying Value(1)	Percentage of Loan Portfolio(2)
	(dollars in thousands)					
Senior mortgages	$ 372,210	$ 371,285	23.9 %	$ 669,512	$ 667,299	42.2 %
Senior securitized mortgages(3)	399,541	398,409	25.6 %	-	-	0.0 %
Subordinate notes	-	-	0.0 %	41,059	41,408	2.6 %
Mezzanine loans	537,578	537,654	34.5 %	626,883	628,102	39.5 %
Preferred equity	249,769	247,610	16.0 %	249,769	247,160	15.7 %
Total	$ 1,559,098	$ 1,554,958	100.0 %	$ 1,587,223	$ 1,583,969	100.0 %

(1) Carrying value includes unamortized origination fees of $4.4 million and $5.4 million as of September 30, 2014 and December 31, 2013, respectively.
(2) Based on outstanding principal.
(3) Assets of consolidated VIE.

	September 30, 2014					
	Senior Mortgages	Senior Securitized Mortgages(1)	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)					
Beginning balance	$ 667,299	$ -	$ 41,408	$ 628,102	$ 247,160	$ 1,583,969
Originations & advances (principal)	114,946	-	-	94,748	-	209,694
Principal payments	(12,685)	-	(41,059)	(184,052)	-	(237,796)
Sales (principal)		-	-	-	-	-
Amortization & accretion of (premium) discounts	(102)	-	(349)	(1,031)	82	(1,400)
Net (increase) decrease in origination fees	(2,267)	(116)	-	(463)	-	(2,846)
Amortization of net origination fees	2,072	547	-	350	368	3,337
Transfers	(397,978)	397,978	-	-	-	-

Allowance for loan losses	-	-	-	-	-	-
Net carrying value	$ 371,285	$ 398,409	$ -	$ 537,654	$ 247,610	$ 1,554,958

(1) Assets of consolidated VIE.

	December 31, 2013				
	Senior Mortgages	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	$ 429,229	$ 41,571	$ 568,759	$ 187,623	$ 1,227,182
Originations & advances (principal)	240,150	-	136,040	60,000	436,190
Principal payments	(388)	(90)	(64,035)	-	(64,513)
Sales (principal)	(13,750)	-	-	-	(13,750)
Amortization & accretion of (premium) discounts	(37)	(73)	(192)	31	(271)
Net (increase) decrease in origination fees	(1,106)	-	14	(601)	(1,693)
Amortization of net origination fees	701	-	16	107	824
Transfers	12,500	-	(12,500)	-	-
Allowance for loan losses	-	-	-	-	-
Net carrying value	$ 667,299	$ 41,408	$ 628,102	$ 247,160	$ 1,583,969

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Internal CRE Debt and Preferred Equity Investment Ratings

	September 30, 2014					
			Internal Ratings			
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	Performing	Watch List	Defaulted-Recovery	Workout
			(dollars in thousands)			
Senior mortgages	$ 372,210	23.9 %	$ 359,237	$ -	$ 12,973 (2)	$ -
Senior securitized mortgages(1)	399,541	25.6 %	399,541	-	-	-
Subordinate notes	-	0.0 %	-	-	-	-
Mezzanine loans	537,578	34.5 %	522,095	-	15,483	-
Preferred equity	249,769	16.0 %	249,769	-	-	-
	$ 1,559,098	100.0 %	$ 1,530,642	$ -	$ 28,456	$ -

(1) Assets of consolidated VIE.
(2) Relates to one loan on nonaccrual status.

	December 31, 2013					
			Internal Ratings			
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	Performing	Watch List	Defaulted-Recovery	Workout
			(dollars in thousands)			
Senior mortgages	$ 669,512	42.2 %	$ 644,039	$ -	$ 25,473 (1)	$ -
Subordinate notes	41,059	2.6 %	41,059	-	-	-
Mezzanine loans	626,883	39.5 %	620,883	-	6,000	-
	249,769	15.7 %	249,769	-	-	-

Preferred equity	$ 1,587,223	100.0 %	$ 1,555,750	$ -	$ 31,473	$ -

(1) Relates to one loan on nonaccrual status.

Real Estate Acquisitions

The following table summarizes acquisitions of real estate held for investment during the nine months ended September 30, 2014:

Date of Acquisition	Type	Location	Purchase Price	Remaining Lease Term (1)
		(dollars in thousands)		
April 2014	Single-tenant retail	Tennessee	$ 19,000	2022
June 2014	Multi-tenant retail	Virginia	$ 17,743	2021

(1) Does not include extension options.

The aforementioned acquisitions were accounted for using the acquisition method of accounting. The Company incurred approximately $1.0 million of transaction costs in connection with the acquisitions, which were expensed during the period ended September 30, 2014 and are reflected in other general and administrative expenses in the accompanying Consolidated Statements of Comprehensive Income (Loss).

The following table presents the aggregate allocation of the purchase price:

	September 30, 2014 (dollars in thousands)
Purchase Price Allocation:	
Land	$ 9,711
Buildings	25,972
Site improvements	2,548
Real estate held for investment	38,231
Intangible assets (liabilities):	
Leasehold intangible assets	7,698
Below market lease value	(9,186)
Total purchase price	$ 36,743

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Total Commercial Real Estate Investment

	September 30, 2014	December 31, 2013
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	$ 16,350	$ 6,639
Buildings and improvements	59,619	31,100
Subtotal	75,969	37,739
Less: accumulated depreciation	(2,142)	(877)
Total real estate held for investment at amortized cost, net	73,827	36,862
Real estate held for sale at fair value	-	23,270
Total investment in commercial real estate, net	73,827	60,132
Net carrying value of CRE Debt and Preferred Equity Investments	1,554,958	1,583,969
Total commercial real estate investments	$ 1,628,785	$ 1,644,101

Securitizations and VIEs

In January 2014, the Company closed NLY Commercial Mortgage Trust 2014-FL1 (the "Trust"), a $399.5 million securitization financing transaction which provides permanent, non-recourse financing collateralized by floating-rate first mortgage debt investments originated or co-originated by the Company and is not subject to margin calls. A total of $260.7 million of investment grade bonds were issued by the Trust, representing an advance rate of 65.3% at a weighted average coupon of LIBOR plus 1.74% at closing. The Company is using the proceeds to originate commercial real estate investments. The Company retained bonds rated below investment grade and the only interest-only bond issued by the Trust, which are referred to as the subordinate bonds.

The Company incurred approximately $4.3 million of costs in connection with the securitization that have been capitalized and are being amortized to interest expense. Deferred financing costs are included in Other assets in the accompanying Consolidated Statements of Financial Condition.

The Trust is structured as a pass-through entity that receives principal and interest on the underlying collateral and distributes those payments to the

As of September 30, 2014 the carrying value of the Trust's assets was $398.4 million, net of $1.1 million of unamortized origination fees, which are included in Commercial real estate debt and preferred equity in the accompanying Consolidated Statements of Financial Condition. As of September 30, 2014, the carrying value of the Trust's liabilities was $260.7 million, classified as Securitized debt in the accompanying Consolidated Statements of Financial Condition.

7. FAIR VALUE MEASUREMENTS

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

GAAP requires classification of financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy,

certificate holders. The Trust is a VIE and the Company is the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership interest in the subordinate bonds. The Company's exposure to the obligations of the VIE is generally limited to the Company's investment in the Trust. Assets of the Trust may only be used to settle obligations of the Trust. Creditors of the Trust have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the Trust. No gain or loss was recognized upon initial consolidation of the Trust.

the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

Level 1– inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to overall fair value.

The Company designates its financial instruments as available for sale or trading depending upon the type of instrument and the Company's intent and ability to hold such instrument to maturity. Instruments classified as available for sale and trading are reported at fair value on a recurring basis.

The following is a description of the valuation methodologies used for instruments carried at fair value. These methodologies are applied to assets and liabilities across the three level fair value hierarchy, with the observability of inputs determining the appropriate level.

U.S. Treasury securities and investment in affiliates are valued using quoted prices for identical instruments in active markets. Agency mortgage-backed securities, Agency debentures, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of the security in its estimates of fair value. Management reviews the fair values generated by the internal models to determine whether prices are reflective of the current market. Management indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. Certain liquid asset classes, such as Agency fixed-rate pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

The Agency mortgage-backed securities, interest rate swap and swaption markets are considered to be active markets such that participants transact with sufficient frequency and volume to provide transparent pricing information on an ongoing basis. The liquidity of the Agency mortgage-backed securities, interest rate swaps and swaptions markets and the similarity of the Company's securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair value measurements. Consequently, the Company has classified Agency mortgage-backed securities, interest rate swaps, swaptions, TBA derivatives and MBS options as Level 2 inputs in the fair value hierarchy.

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The following table presents the estimated fair values of financial instruments measured at fair value on a recurring basis.

September 30, 2014	Level 1	Level 2	Level 3	Total
		(dollars in thousands)		
Assets:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
Agency mortgage-backed securities	-	81,462,387	-	81,462,387
Agency debentures	-	1,334,181	-	1,334,181
Investment in affiliates	136,748	-	-	136,748
Interest rate swaps	-	198,066	-	198,066
Other derivatives	6,680	12,727	-	19,407
Total Assets	$ 143,428	$ 83,007,361	$ -	$ 83,150,789
Liabilities:				
U.S. Treasury securities sold, not yet purchased	$ -	$ -	$ -	$ -
Interest rate swaps	-	857,658	-	857,658
Other derivatives	-	-	-	-
Total Liabilities	$ -	$ 857,658	$ -	$ 857,658

At December 31, 2013	Level 1	Level 2	Level 3	Total
		(dollars in thousands)		
Assets:				
U.S. Treasury securities	$ 1,117,915	$ -	$ -	$ 1,117,915
Agency mortgage-backed securities	-	70,388,949	-	70,388,949
Agency debentures	-	2,969,885	-	2,969,885
Investment in affiliates	139,447	-	-	139,447
Interest rate swaps	-	559,044	-	559,044
Other derivatives	3,487	143,238	-	146,725
Total Assets	$ 1,260,849	$ 74,061,116	$ -	$ 75,321,965
Liabilities:				
U.S. Treasury securities sold, not yet purchased	$ 1,918,394	-	-	$ 1,918,394
Interest rate swaps	-	1,141,828	-	1,141,828
Other derivatives	439	55,079	-	55,518
Total Liabilities	$ 1,918,833	$ 1,196,907	$ -	$ 3,115,740

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the financial statements, for which it is practical to estimate the value. In cases where quoted market prices are not available, fair values are based upon discounted cash flows using market yields or other valuation

Estimates of fair value of corporate debt require the use of judgments and inputs including, but not limited to, the enterprise value of the borrower (i.e., an estimate of the total fair value of the borrower's debt and equity), the nature and realizable value of any collateral, the borrower’s ability to make payments when due and its

methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair values. Accordingly, fair values are not necessarily indicative of the amount the Company would realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

The carrying value of short term instruments, including cash and cash equivalents, reverse repurchase agreements and repurchase agreements whose term is less than twelve months, and securities borrowed and securities loaned, generally approximates fair value due to the short term nature of the instruments.

The estimated fair value of commercial real estate debt and preferred equity investments takes into consideration changes in credit spreads and interest rates from the date of origination or purchase to the reporting date. The fair value also reflects consideration of asset-specific maturity dates and other items that could have an impact on the fair value as of the reporting date.

earnings history. Management also considers factors that affect the macro and local economic markets in which the borrower operates.

The fair value of repurchase agreements with remaining maturities greater than one year or with embedded optionality are valued as structured notes, with term to maturity, LIBOR rates and the Treasury curve being primary determinants of estimated fair value.

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The fair value of mortgages payable is calculated using the estimated yield of a new par loan to value the remaining terms in place. A par loan is created using the identical terms of the existing loan; however, the coupon is derived by using the original spread against the interpolated Treasury. The fair value of mortgages payable also reflects consideration of the value of the underlying collateral and changes in credit risk from the time the debt was originated.

The carrying value of participation sold is based on the loan's amortized cost. The fair value of participation sold is based on the fair value of the underlying related commercial loan.

The fair value of convertible senior notes is determined using end of day quoted prices in active markets.

The fair value of securitized debt of consolidated VIE is determined using the average of external vendor pricing services.

The following table summarizes the estimated fair value for financial assets and liabilities as of September 30, 2014 and December 31, 2013.

		September 30, 2014		December 31, 2013	
	Level in Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:			(dollars in thousands)		
Cash and cash equivalents	1	$ 1,178,621	$ 1,178,621	$ 552,436	$ 552,436
Reverse repurchase agreements	1	-	-	100,000	100,000
Securities borrowed	1	-	-	2,582,893	2,582,893
U.S. Treasury securities	1	-	-	1,117,915	1,117,915
Agency mortgage-backed securities	2	81,462,387	81,462,387	70,388,949	70,388,949
Agency debentures	2	1,334,181	1,334,181	2,969,885	2,969,885
Investment in affiliates	1	136,748	136,748	139,447	139,447
Commercial real estate debt and preferred equity	3	1,554,958	1,566,232	1,583,969	1,581,836
Corporate debt	2	144,451	145,008	117,687	118,362
Interest rate swaps	2	198,066	198,066	559,044	559,044
Other derivatives	1,2	19,407	19,407	146,725	146,725
Financial liabilities:					
U.S. Treasury securities sold, not yet purchased	1	$ -	$ -	$ 1,918,394	$ 1,918,394
Repurchase agreements	1,2	69,610,722	69,847,704	61,781,001	62,134,133
Securities loaned	1	7	7	2,527,668	2,527,668
Convertible Senior Notes	1	836,625	873,937	825,262	870,199
Securitized debt of consolidated VIE	2	260,700	262,421	-	-
Mortgages payable	2	42,635	42,595	19,332	19,240

Participation sold	3	13,768	13,756	14,065	14,050
Interest rate swaps	2	857,658	857,658	1,141,828	1,141,828
Other derivatives	1,2	-	-	55,518	55,518

8. SECURED FINANCING

The Company had outstanding $69.6 billion and $61.8 billion of repurchase agreements with weighted average borrowing rates of 1.61% and 2.33%, after giving effect to the Company's interest rate swaps, and weighted average remaining maturities of 159 days and 204 days as of September 30, 2014 and December 31, 2013, respectively.

At September 30, 2014 and December 31, 2013, the repurchase agreements had the following remaining maturities and weighted average rates:

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	September 30, 2014		December 31, 2013	
	Repurchase Agreements	Weighted Average Rate	Repurchase Agreements	Weighted Average Rate
	(dollars in thousands)			
1 day	$ 2,609,132	0.15 %	$ -	0.00 %
2 to 29 days	18,032,715	0.30 %	21,171,574	0.36 %
30 to 59 days	14,241,967	0.37 %	13,373,921	0.43 %
60 to 89 days	2,871,206	0.38 %	3,592,266	0.44 %
90 to 119 days	10,548,578	0.37 %	4,010,334	0.52 %
Over 120 days(1)	21,307,124	1.14 %	19,632,906	1.29 %
Total	$ 69,610,722	0.58 %	$ 61,781,001	0.68 %

(1) Approximately 12% and 16% of the total repurchase agreements had a remaining maturity over 1 year as of September 30, 2014 and December 31, 2013, respectively.

Repurchase agreements and reverse 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 permit netting. The following table summarizes the gross amounts of reverse repurchase agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition as of September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
	(dollars in thousands)			
Gross Amounts	$ 250,000	$ 69,860,722	$ 2,524,980	$ 64,205,981
Amounts Offset	(250,000)	(250,000)	(2,424,980)	(2,424,980)
Netted Amounts	$ -	$ 69,610,722	$ 100,000	$ 61,781,001

Investment Securities pledged as collateral under these secured financings and interest rate swaps had an estimated fair value and accrued interest of $73.3 billion and $230.1 million, respectively, at September 30, 2014 and $67.9 billion and $222.1 million, respectively, at December 31, 2013.

9. DERIVATIVE INSTRUMENTS

In connection with the Company's investment/market rate risk management strategy, the Company economically hedges a portion of its interest rate risk by distribution to stockholders. These derivatives are subject to changes in market values resulting from changes in interest rates, volatility, Agency mortgage-backed security spreads to U.S. Treasuries and market liquidity. The use of derivatives also creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the stated contract. Additionally, the Company may have to pledge cash or assets as collateral for the derivative transactions, the amount of which may vary based on the market value, notional amount and remaining term of

entering into derivative financial instrument contracts, which include interest rate swaps, swaptions and U.S. Treasury futures contracts. The Company also enters into TBA derivatives and MBS options to economically hedge its exposure to market risks. The purpose of using derivatives is to manage overall portfolio risk with the potential to generate additional income for the derivative contract. In the event of a default by the counterparty, the Company could have difficulty obtaining its Investment Securities pledged as collateral as well as receiving payments in accordance with the terms of the derivative contracts.

The table below summarizes fair value information about our derivative assets and liabilities as of September 30, 2014 and December 31, 2013:

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

Derivatives Instruments	Balance Sheet Location	September 30, 2014	December 31, 2013
Assets:		(dollars in thousands)	
Interest rate swaps	Interest rate swaps, at fair value	$ 198,066	$ 559,044
Interest rate swaptions	Other derivative contracts, at fair value	12,268	110,361
TBA derivatives	Other derivative contracts, at fair value	459	20,693
MBS options	Other derivative contracts, at fair value	-	12,184
Futures contracts	Other derivative contracts, at fair value	6,680	3,487
		$ 217,473	$ 705,769
Liabilities:			
Interest rate swaps	Interest rate swaps, at fair value	857,658	1,141,828
Interest rate swaptions	Other derivative contracts, at fair value	-	24,662
TBA derivatives	Other derivative contracts, at fair value	-	13,779
MBS options	Other derivative contracts, at fair value	-	16,638
Futures contracts	Other derivative contracts, at fair value	-	439
		$ 857,658	$ 1,197,346

The following table summarizes certain characteristics of the Company’s interest rate swaps at September 30, 2014 and December 31, 2013:

September 30, 2014				
Maturity	Current Notional (1)	Weighted Average Pay Rate (2) (3)	Weighted Average Receive Rate (2)	Weighted Average Years to Maturity (2)
	(dollars in thousands)			
0 - 3 years	$ 2,202,522	1.47 %	0.16 %	2.84
3 - 6 years	11,013,000	2.06 %	0.22 %	5.34
6 - 10 years	13,204,000	2.65 %	0.22 %	8.71
Greater than 10 years	5,051,800	3.58 %	0.19 %	19.78
Total / Weighted Average	$ 31,471,322	2.48 %	0.21 %	8.61

(1) Notional amount includes $800.0 million in forward starting pay fixed swaps.
(2) Excludes forward starting swaps.
(3) Weighted average fixed rate on forward starting pay fixed swaps was 3.24%.

December 31, 2013				
Maturity	Current Notional	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Years to Maturity
	(dollars in thousands)			
0 - 3 years	$ 24,286,000	1.83 %	0.18 %	1.98
3 - 6 years	8,865,410	2.02 %	0.19 %	4.19
6 - 10 years	15,785,500	2.37 %	0.23 %	7.66
Greater than 10 years	3,490,000	3.62 %	0.20 %	19.93
Total / Weighted Average	$ 52,426,910	2.14 %	0.20 %	5.26

The following table summarizes certain characteristics of the Company's interest rate swaptions at September 30, 2014 and December 31, 2013:

September 30, 2014	Current Underlying Notional