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AGNC Investment Corp.  
Form 10-Q  
August 06, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

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

Commission file number 001-34057

AGNC INVESTMENT CORP.

(Exact name of registrant as specified in its charter)

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Delaware 26-1701984  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)  
2 Bethesda Metro Center, 12th Floor  
Bethesda, Maryland 20814  
(Address of principal executive offices)  
(301) 968-9315  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports 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 ☒ No ☐  
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller Reporting Company ☐

Emerging growth company ☐

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

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

The number of shares of the issuer's common stock, \$0.01 par value, outstanding as of August 3, 2018 was 477,831,997.



AGNC INVESTMENT CORP.  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## AGNC INVESTMENT CORP.

## CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

|   | June 30,<br>2018<br>(Unaudited) | December 31,<br>2017 |
|---|---------------------------------|----------------------|
| Assets:   |                                 |                      |
| Agency securities, at fair value (including pledged securities of \$51,356 and \$53,055, respectively)                                    | \$ 55,524                       | \$ 55,506            |
| Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities)                              | 587                             | 662                  |
| Credit risk transfer securities, at fair value  | 936                             | 876                  |
| Non-Agency securities, at fair value  | 60                              | 36                   |
| REIT equity securities, at fair value   | 46                              | 29                   |
| Cash and cash equivalents   | 863                             | 1,046                |
| Restricted cash   | 447                             | 317                  |
| Derivative assets, at fair value  | 458                             | 205                  |
| Receivable for investment securities sold (pledged securities)  | 31                              | —                    |
| Receivable under reverse repurchase agreements  | 13,306                          | 10,961               |
| Goodwill and other intangible assets, net   | 550                             | 551                  |
| Other assets  | 330                             | 187                  |
| Total assets  | \$ 73,138                       | \$ 70,376            |
| Liabilities:  |                                 |                      |
| Repurchase agreements   | \$ 48,839                       | \$ 50,296            |
| Debt of consolidated variable interest entities, at fair value  | 313                             | 357                  |
| Payable for investment securities purchased   | 1,503                           | 95                   |
| Derivative liabilities, at fair value   | 6                               | 28                   |
| Dividends payable   | 87                              | 80                   |
| Obligation to return securities borrowed under reverse repurchase agreements, at fair value   | 12,898                          | 10,467               |
| Accounts payable and other liabilities  | 450                             | 299                  |
| Total liabilities   | 64,096                          | 61,622               |
| Stockholders' equity:   |                                 |                      |
| 7.750% Series B Cumulative Redeemable Preferred Stock (aggregate liquidation preference of \$175)   | 169                             | 169                  |
| 7.000% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock (aggregate liquidation preference of \$325)                  | 315                             | 315                  |
| Common stock - \$0.01 par value; 900 and 600 shares authorized, respectively; 434.1 and 391.3 shares issued and outstanding, respectively | 4                               | 4                    |
| Additional paid-in capital  | 11,964                          | 11,173               |
| Retained deficit  | (2,299)                         | (2,562)              |
| Accumulated other comprehensive loss  | (1,111)                         | (345)                |
| Total stockholders' equity  | 9,042                           | 8,754                |
| Total liabilities and stockholders' equity  | \$ 73,138                       | \$ 70,376            |
| See accompanying notes to consolidated financial statements.  |                                 |                      |



AGNC INVESTMENT CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)  
(in millions, except per share data)

|  | Three Months<br>Ended June<br>30,<br>2018 |        | Six Months<br>Ended June<br>30,<br>2017 |        |
|--|---|--------|---|--------|
| Interest income:   |   |        |   |        |
| Interest income  | \$414                                     | \$293  | \$845                                   | \$589  |
| Interest expense   | 237                                       | 112    | 443                                     | 210    |
| Net interest income  | 177                                       | 181    | 402                                     | 379    |
| Other gain (loss), net:  |   |        |   |        |
| Gain (loss) on sale of investment securities, net  | (74 )                                     | 15     | (76 )                                   | (69 )  |
| Unrealized gain (loss) on investment securities measured at fair value through net income, net | (94 )                                     | 9      | (617 )                                  | 25     |
| Gain (loss) on derivative instruments and other securities, net                                | 298                                       | (169 ) | 1,036                                   | (209 ) |
| Management fee income  | 4   | 4      | 8                                       | 8      |
| Total other gain (loss), net:  | 134                                       | (141 ) | 351                                     | (245 ) |
| Expenses:  |   |        |   |        |
| Compensation and benefits  | 10  | 10     | 20                                      | 20     |
| Other operating expense  | 8   | 6      | 16                                      | 14     |
| Total operating expense  | 18  | 16     | 36                                      | 34     |
| Net income   | 293                                       | 24     | 717                                     | 100    |
| Dividend on preferred stock  | 9   | 7      | 18                                      | 14     |
| Net income available to common stockholders  | \$284                                     | \$17   | \$699                                   | \$86   |
| Net income   | \$293                                     | \$24   | \$717                                   | \$100  |
| Other comprehensive income (loss):   |   |        |   |        |
| Unrealized gain (loss) on available-for-sale securities, net                                   | (145 )                                    | 121    | (766 )                                  | 167    |
| Comprehensive income (loss)  | 148                                       | 145    | (49 )                                   | 267    |
| Dividend on preferred stock  | 9   | 7      | 18                                      | 14     |
| Comprehensive income (loss) available (attributable) to common stockholders                    | \$139                                     | \$138  | \$(67 )                                 | \$253  |
| Weighted average number of common shares outstanding - basic                                   | 404.9                                     | 346.4  | 398.2                                   | 338.8  |
| Weighted average number of common shares outstanding - diluted                                 | 405.2                                     | 346.5  | 398.4                                   | 338.9  |
| Net income per common share - basic  | \$0.70                                    | \$0.05 | \$1.76                                  | \$0.25 |
| Net income per common share - diluted  | \$0.70                                    | \$0.05 | \$1.75                                  | \$0.25 |
| Dividends declared per common share  | \$0.54                                    | \$0.54 | \$1.08                                  | \$1.08 |
| See accompanying notes to consolidated financial statements.                                   |   |        |   |        |

AGNC INVESTMENT CORP.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
(in millions)

|  | 8.000%<br>Series A<br>Cumulative<br>Redeemable<br>Preferred<br>Stock | 7.750%<br>Series B<br>Cumulative<br>Redeemable<br>Preferred<br>Stock | 7.000%<br>Series C<br>Fixed-to-Floating<br>Rate<br>Cumulative<br>Redeemable<br>Preferred<br>Stock | Common<br>Stock<br>Shares | Amount | Additional<br>Paid-in<br>Capital | Retained<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total    |
|--|--|--|---|---------------------------|--------|----------------------------------|---------------------|---|----------|
| Balance, December 31, 2016                               | \$ 167   | \$ 169   | \$ —  | 331.0                     | \$ 3   | \$ 9,932                         | \$(2,518)           | \$(397)   | \$ 7,356 |
| Net income   | —  | —  | —   | —                         | —      | —                                | 100                 | —   | 100      |
| Other comprehensive income:                              |  |  |   |                           |        |                                  |                     |   |          |
| Unrealized gain on<br>available-for-sale securities, net | —  | —  | —   | —                         | —      | —                                | —                   | 167   | 167      |
| Stock-based compensation                                 | —  | —  | —   | —                         | —      | 1                                | —                   | —   | 1        |
| Issuance of common stock                                 | —  | —  | —   | 24.5                      | 1      | 502                              | —                   | —   | 503      |
| Preferred dividends declared                             | —  | —  | —   | —                         | —      | —                                | (14)                | —   | (14)     |
| Common dividends declared                                | —  | —  | —   | —                         | —      | —                                | (368)               | —   | (368)    |
| Balance, June 30, 2017                                   | \$ 167   | \$ 169   | \$ —  | 355.6                     | \$ 4   | \$ 10,435                        | \$(2,800)           | \$(230)   | \$ 7,745 |
| Balance, December 31, 2017                               | \$ —   | \$ 169   | \$ 315  | 391.3                     | \$ 4   | \$ 11,173                        | \$(2,562)           | \$(345)   | \$ 8,754 |
| Net income   | —  | —  | —   | —                         | —      | —                                | 717                 | —   | 717      |
| Other comprehensive loss:                                |  |  |   |                           |        |                                  |                     |   |          |
| Unrealized loss on<br>available-for-sale securities, net | —  | —  | —   | —                         | —      | —                                | —                   | (766)   | (766)    |
| Stock-based compensation                                 | —  | —  | —   | —                         | —      | 3                                | —                   | —   | 3        |
| Issuance of common stock                                 | —  | —  | —   | 42.8                      | —      | 788                              | —                   | —   | 788      |
| Preferred dividends declared                             | —  | —  | —   | —                         | —      | —                                | (18)                | —   | (18)     |
| Common dividends declared                                | —  | —  | —   | —                         | —      | —                                | (436)               | —   | (436)    |
| Balance, June 30, 2018                                   | \$ —   | \$ 169   | \$ 315  | 434.1                     | \$ 4   | \$ 11,964                        | \$(2,299)           | \$(1,111)   | \$ 9,042 |

Amounts may not total due to rounding.

See accompanying notes to consolidated financial statements.

AGNC INVESTMENT CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(in millions)

|  | Six Months<br>Ended June 30, |            |
|--|------------------------------|------------|
|  | 2018                         | 2017       |
| Operating activities:  |                              |            |
| Net income   | \$717                        | \$ 100     |
| Adjustments to reconcile net income to net cash provided by operating activities:              |                              |            |
| Amortization of premiums and discounts on mortgage-backed securities, net                      | 143                          | 185        |
| Amortization of intangible assets  | 1                            | 2          |
| Stock-based compensation   | 3                            | 1          |
| Loss on sale of investment securities, net   | 76                           | 69         |
| Unrealized (gain) loss on investment securities measured at fair value through net income, net | 617                          | (25 )      |
| (Gain) loss on derivative instruments and other securities, net                                | (1,036 )                     | 209        |
| (Increase) decrease in other assets  | (139 )                       | 121        |
| Increase in accounts payable and other accrued liabilities                                     | 28                           | 17         |
| Net cash provided by operating activities  | 410                          | 679        |
| Investing activities:  |                              |            |
| Purchases of Agency mortgage-backed securities   | (7,946 )                     | (9,065 )   |
| Purchases of credit risk transfer and non-Agency securities                                    | (437 )                       | (611 )     |
| Proceeds from sale of Agency mortgage-backed securities  | 4,326                        | 7,636      |
| Proceeds from sale of credit risk transfer and non-Agency securities                           | 380                          | 318        |
| Principal collections on Agency mortgage-backed securities                                     | 3,421                        | 3,262      |
| Principal collections on credit risk transfer and non-Agency securities                        | 4                            | 4          |
| Payments on U.S. Treasury securities   | (4,734 )                     | (7,320 )   |
| Proceeds from U.S. Treasury securities   | 7,318                        | 6,873      |
| Net proceeds from (payments on) reverse repurchase agreements                                  | (2,251 )                     | 227        |
| Net proceeds from (payments on) derivative instruments   | 630                          | (132 )     |
| Purchases of REIT equity securities  | (16 )                        | (4 )       |
| Net cash provided by investing activities  | 695                          | 1,188      |
| Financing activities:  |                              |            |
| Proceeds from repurchase arrangements  | 702,295                      | 164,896    |
| Payments on repurchase agreements  | (703,752 )                   | (163,696 ) |
| Payments on Federal Home Loan Bank advances  | —                            | (3,037 )   |
| Payments on debt of consolidated variable interest entities                                    | (42 )                        | (55 )      |
| Net proceeds from common stock issuances   | 788                          | —          |
| Cash dividends paid  | (447 )                       | (377 )     |
| Net cash used in financing activities  | (1,158 )                     | (2,269 )   |
| Net change in cash, cash equivalents and restricted cash                                       | (53 )                        | (402 )     |
| Cash, cash equivalents and restricted cash at beginning of period                              | 1,363                        | 1,282      |
| Cash, cash equivalents and restricted cash at end of period                                    | \$1,310                      | \$ 880     |
| See accompanying notes to consolidated financial statements.                                   |                              |            |



AGNC INVESTMENT CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The unaudited interim consolidated financial statements of AGNC Investment Corp. (referred throughout this report as the "Company," "we," "us" and "our") are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The preparation of 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 income and expenses during the reporting period. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of financial statements for the interim period have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year.

Our unaudited interim consolidated financial statements include the accounts of all of our wholly-owned subsidiaries and variable interest entities for which we are the primary beneficiary. Significant intercompany accounts and transactions have been eliminated.

Adoption of Accounting Standard Updates

As of January 1, 2018, we adopted Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), and ASU 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash. The adoption of ASU 2014-09 resulted in reclassification of expense reimbursements from MTGE Investment Corp. ("MTGE") from an other operating expense offset to management fee income on the consolidated statements of comprehensive income. Net income was not impacted. The adoption of ASU 2016-18 resulted in the presentation of restricted cash with cash and cash equivalents on the consolidated statements of cash flows when reconciling the total beginning and ending amounts. Our prior period results have been revised to conform to the current presentation.

Note 2. Organization

We were organized in Delaware on January 7, 2008 and commenced operations on May 20, 2008 following the completion of our initial public offering. Our common stock is traded on The Nasdaq Global Select Market under the symbol "AGNC."

We operate to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). As a REIT, we are required to distribute annually 90% of our taxable income. So long as we continue to qualify as a REIT, we will generally not be subject to U.S. Federal or state corporate taxes on our taxable income to the extent that we distribute our annual taxable income to our stockholders on a timely basis. It is our intention to distribute 100% of our taxable income, after application of available tax attributes, within the limits prescribed by the Internal Revenue Code, which may extend into the subsequent tax year. We earn income primarily from investing in Agency residential mortgage-backed securities ("Agency RMBS") for which the principal and interest payments are guaranteed by a U.S. Government-sponsored enterprise ("GSE") or a U.S. Government agency. We may also invest in other types of mortgage and mortgage-related securities, such as credit risk transfer ("CRT") securities and non-Agency residential and commercial mortgage-backed securities ("non-Agency RMBS" and "CMBS," respectively), where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency. We fund our investments primarily through borrowings structured as repurchase agreements.

Our principal objective is to provide our stockholders with attractive risk-adjusted returns through a combination of monthly dividends and tangible net book value accretion. We generate income from the interest earned on our investments, net of associated borrowing and hedging costs, and net realized gains and losses on our investment and hedging activities.

Note 3. Summary of Significant Accounting Policies

Investment Securities

Agency RMBS consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") guaranteed by the Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac," and together with Fannie Mae, the "GSEs") or the Government National Mortgage Association ("Ginnie Mae").

CRT securities are risk sharing instruments issued by the GSEs, and similarly structured transactions issued by third-party market participants, that transfer a portion of the risk associated with credit losses within pools of conventional residential mortgage loans from the GSEs and/or third parties to private investors. Unlike Agency RMBS, full repayment of the original principal balance of CRT securities is not guaranteed by a GSE or U.S. Government agency; rather, "credit risk transfer" is achieved by writing down the outstanding principal balance of the CRT securities if credit losses on a related pool of loans exceed certain thresholds. By reducing the amount that they are obligated to repay to holders of CRT securities, the GSEs and/or other third parties offset credit losses on the related loans.

Non-Agency RMBS and CMBS (together, "Non-Agency MBS") are backed by residential and commercial mortgage loans, respectively, packaged and securitized by a private institution, such as a commercial bank. Non-Agency MBS typically benefit from credit enhancements derived from structural elements, such as subordination, overcollateralization or insurance, but nonetheless carry a higher level of credit exposure than Agency RMBS. Mortgage-related securities may also include investments in the common stock of other publicly traded mortgage REITs, including MTGE, that primarily invest in Agency securities, non-Agency securities, other mortgage related instruments and/or real estate on a leveraged basis. As of June 30, 2018, our investments in REIT equity securities consisted solely of MTGE common stock.

Accounting Standards Codification ("ASC") Topic 320, Investments—Debt and Equity Securities, requires that at the time of purchase, we designate a security as held-to-maturity, available-for-sale or trading, depending on our ability and intent to hold such security to maturity. Alternatively, we may elect the fair value option of accounting for such securities pursuant to ASC Topic 825, Financial Instruments. All of our securities are reported at fair value as they have either been designated as available-for-sale or trading or we have elected the fair value option of accounting.

Unrealized gains and losses on securities classified as available-for-sale are reported in accumulated other comprehensive income ("OCI"). Unrealized gains and losses on securities classified as trading or for which we elected the fair value option are reported in net income through other gain (loss) during the period in which they occur. Upon the sale of a security designated as available-for-sale, we determine the cost of the security and the amount of unrealized gains or losses to reclassify out of accumulated OCI into earnings based on the specific identification method.

Prior to fiscal year 2017, we primarily designated our investment securities as available-for-sale. On January 1, 2017, we began electing the fair value option of accounting for all investment securities acquired after fiscal year 2016. In our view, this election simplifies the accounting for investment securities and more appropriately reflects the results of our operations for a particular reporting period, as the fair value changes for these assets are presented in a manner consistent with the presentation and timing of the fair value changes of our hedging instruments. We are not permitted to change the designation of securities acquired prior to January 1, 2017; accordingly, such securities will continue to be classified as available-for-sale securities until we receive full repayment of principal or we dispose of the security. We estimate the fair value of our investment securities based on prices provided by multiple third-party pricing services and non-binding dealer quotes (collectively "pricing sources"). These pricing sources use various valuation approaches, including market and income approaches, using "Level 2" inputs. The pricing sources primarily utilize a matrix pricing technique that interpolates the estimated fair value of our Agency RMBS based on observed quoted prices for forward contracts in the Agency RMBS "to-be-announced" market ("TBA securities") of the same coupon, maturity and issuer, adjusted to reflect the specific characteristics of the pool of mortgages underlying the Agency security, which may include maximum loan balance, loan vintage, loan-to-value ratio, geography and other characteristics as may be appropriate. The pricing sources may also utilize discounted cash flow model-derived pricing techniques to estimate the fair value of investment securities. Such models incorporate market-based discount rate assumptions based on observable inputs such as recent trading activity, credit data, volatility statistics, benchmark interest rate curves and other market data that are current as of the measurement date and may include certain unobservable inputs, such as assumptions of future levels of prepayment, defaults and loss severities. We review the pricing estimates obtained from the pricing sources and perform procedures to validate their reasonableness. Refer to Note 8 for further discussion of fair value measurements.

We evaluate our investments designated as available-for-sale for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired may involve judgments and assumptions based on subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if any one of the following three conditions exists as of the financial reporting date: (i) we intend to sell the security (that is, a decision has been made to sell the security), (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis or (iii) we do not expect to recover the security's amortized cost basis, even if we do not intend to sell the security and it is not more likely than not that we will be required to sell the security. A general allowance for unidentified impairments in a portfolio of securities is not permitted.

## Interest Income

Interest income is accrued based on the outstanding principal amount of the investment securities and their contractual terms. Premiums or discounts associated with the purchase of Agency RMBS and non-Agency MBS of high credit quality are amortized or accreted into interest income, respectively, over the projected lives of the securities, including contractual payments and estimated prepayments using the effective interest method in accordance with ASC Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs.

We estimate long-term prepayment speeds of our mortgage securities using a third-party service and market data. The third-party service provider estimates prepayment speeds using models that incorporate the forward yield curve, current mortgage rates, mortgage rates of the outstanding loans, age and size of the outstanding loans, loan-to-value ratios, interest rate volatility and other factors. We review the prepayment speeds estimated by the third-party service and compare the results to market consensus prepayment speeds, if available. We also consider historical prepayment speeds and current market conditions to validate the reasonableness of the third-party estimates. We review our actual and anticipated prepayment experience on at least a quarterly basis and effective yields are recalculated when differences arise between (i) our previously estimated future prepayments and (ii) actual prepayments to date and our current estimated future prepayments. If the actual and estimated future prepayment experience differs from our prior estimate of prepayments, we are required to record an adjustment in the current period to the amortization or accretion of premiums and discounts for the cumulative difference in the effective yield through the reporting date.

At the time we purchase CRT securities and non-Agency MBS that are not of high credit quality, we determine an effective yield based on our estimate of the timing and amount of future cash flows and our cost basis. Our initial cash flow estimates for these investments are based on our observations of current information and events and include assumptions related to interest rates, prepayment rates and the impact of default and severity rates on the timing and amount of credit losses. On at least a quarterly basis, we review the estimated cash flows and make appropriate adjustments based on inputs and analysis received from external sources, internal models, and our judgment regarding such inputs and other factors. Any resulting changes in effective yield are recognized prospectively based on the current amortized cost of the investment adjusted for credit impairments, if any.

## Repurchase Agreements

We finance the acquisition of securities for our investment portfolio primarily through repurchase transactions under master repurchase agreements. Pursuant to ASC Topic 860, Transfers and Servicing, we account for repurchase transactions as collateralized financing transactions, which are carried at their contractual amounts (cost), plus accrued interest. Our repurchase agreements typically have maturities of less than one year, but may extend up to five years or more. Interest rates on our repurchase agreements generally correspond to one or three-month LIBOR plus or minus a fixed spread. The fair value of our repurchase agreements is assumed to equal cost as the interest rates are considered to be at market.

## Reverse Repurchase Agreements and Obligation to Return Securities Borrowed under Reverse Repurchase Agreements

We borrow securities to cover short sales of U.S. Treasury securities through reverse repurchase transactions under our master repurchase agreements (see Derivative Instruments below). We account for these as securities borrowing transactions and recognize an obligation to return the borrowed securities at fair value on the balance sheet based on the value of the underlying borrowed securities as of the reporting date. Our reverse repurchase agreements typically have maturities of 30 days or less. The fair value of our reverse repurchase agreements is assumed to equal cost as the interest rates are considered to be at market.

## Derivative Instruments

We use a variety of derivative instruments to hedge a portion of our exposure to market risks, including interest rate, prepayment, extension and liquidity risks. The objective of our risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates. The primary instruments that we use are interest rate swaps, options to enter into interest rate swaps ("swaptions"), U.S. Treasury securities and U.S. Treasury futures contracts. We also use forward contracts in the Agency RMBS "to-be-announced" market, or TBA securities, to invest in and finance Agency securities as well as to periodically reduce our exposure to Agency RMBS.

We account for derivative instruments in accordance with ASC Topic 815, Derivatives and Hedging ("ASC 815"). ASC 815 requires an entity to recognize all derivatives as either assets or liabilities in our accompanying consolidated balance sheets and to measure those instruments at fair value.

Our derivative agreements generally contain provisions that allow for netting or setting off derivative assets and liabilities with the counterparty; however, we report related assets and liabilities on a gross basis in our consolidated balance sheets. Derivative instruments in a gain position are reported as derivative assets at fair value and derivative instruments in a loss position are reported

as derivative liabilities at fair value in our consolidated balance sheets. Changes in fair value of derivative instruments and periodic settlements related to our derivative instruments are recorded in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Cash receipts and payments related to derivative instruments are classified in our consolidated statements of cash flows according to the underlying nature or purpose of the derivative transaction, generally in the investing section.

The use of derivative instruments 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 contracts. Our derivative agreements require that we post or receive collateral to mitigate such risk. We also attempt to minimize our risk of loss by limiting our counterparties to major financial institutions with acceptable credit ratings, monitoring positions with individual counterparties and adjusting posted collateral as required.

#### Interest rate swap agreements

We use interest rate swaps to hedge the variable cash flows associated with our borrowings made under repurchase agreements. Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on one or three-month LIBOR ("payer swaps") with terms up to 20 years. The majority of our interest rate swaps are centrally cleared through a registered commodities exchange. We value centrally cleared interest rate swaps using the daily settlement price, or fair value, determined by the clearing exchange based on a pricing model that references observable market inputs, including LIBOR, swap rates and the forward yield curve. Our centrally cleared swaps require that we post an "initial margin" amount determined by the clearing exchange, which is generally intended to be set at a level sufficient to protect the exchange from the interest rate swap's maximum estimated single-day price movement. We also exchange daily settlements of "variation margin" based upon changes in fair value, as measured by the exchange. Pursuant to rules governing central clearing activities, we recognize variation margin settlements as a direct reduction of the carrying value of the interest rate swap asset or liability.

We value non-centrally cleared swaps using a combination of third-party valuations obtained from pricing services and the swap counterparty. The third-party valuations are model-driven using observable inputs, including LIBOR, swap rates and the forward yield curve. We also consider both our own and our counterparties' nonperformance risk in estimating the fair value of our interest rate swaps. In considering the effect of nonperformance risk, we assess the impact of netting and credit enhancements, such as collateral postings and guarantees, and have concluded that our own and our counterparty risk is not significant to the overall valuation of these agreements.

#### Interest rate swaptions

We purchase interest rate swaptions to help mitigate the potential impact of larger, more rapid changes in interest rates on the performance of our investment portfolio. Interest rate swaptions provide us 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. Our interest rate swaption agreements are not subject to central clearing. The premium paid for interest rate swaptions is reported as an asset in our consolidated balance sheets. We estimate the fair value of interest rate swaptions using a combination of inputs from counterparty and third-party pricing models based on the fair value of the future interest rate swap that we have the option to enter into as well as the remaining length of time that we have to exercise the option, adjusted for non-performance risk, if any. The difference between the premium paid and the fair value of the swaption is reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. If a swaption expires unexercised, the realized loss on the swaption would be equal to the premium paid. If we sell or exercise a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash or the fair value of the underlying interest rate swap and the premium paid.

#### TBA securities

A TBA security is a forward contract for the purchase or sale of Agency RMBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific Agency RMBS to be delivered into the contract are not known until shortly before the settlement date. We may choose, prior to settlement, to move the settlement of these securities out to a later date by entering into an offsetting TBA position, net settling the offsetting positions for cash, and simultaneously purchasing or selling a similar TBA contract for a later settlement date (together referred to as a "dollar roll transaction"). The Agency securities purchased or sold for a forward settlement date are typically priced at a discount to equivalent securities settling in the current month. This difference, or "price

drop," is the economic equivalent of interest income on the underlying Agency securities, less an implied funding cost, over the forward settlement period (referred to as "dollar roll income"). Consequently, forward purchases of Agency securities and dollar roll transactions represent a form of off-balance sheet financing.

We account for TBA contracts as derivative instruments since either the TBA contracts do not settle in the shortest period of time possible or we cannot assert that it is probable at inception and throughout the term of the TBA contract that we will physically settle the contract on the settlement date. We account for TBA dollar roll transactions as a series of derivative transactions.



Gains, losses and dollar roll income associated with our TBA contracts are recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. We estimate the fair value of TBA securities based on similar methods used to value our Agency RMBS securities.

#### U.S. Treasury securities

We use U.S. Treasury securities and U.S. Treasury futures contracts to mitigate the potential impact of changes in interest rates on the performance of our portfolio. We borrow U.S. Treasury securities under reverse repurchase agreements to cover short sales of U.S. Treasury securities. We account for these as securities borrowing transactions and recognize an obligation to return the borrowed securities at fair value on our accompanying consolidated balance sheets based on the value of the underlying U.S. Treasury security as of the reporting date. Gains and losses associated with U.S. Treasury securities and U.S. Treasury futures contracts are recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

#### MTGE Management Agreement

On May 2, 2018, MTGE announced its proposed acquisition by Annaly Capital Management, Inc. Coincident with the announcement, we entered into an amendment to our management agreement with MTGE. Pursuant to the amendment, we will continue to manage MTGE through the closing of the proposed merger and for a short transitional period following the merger. In addition to regular monthly management fees payable for ongoing service through the transition period, under the amendment we will be paid a termination fee of \$41.7 million. The transaction is expected to close in 2018, subject to closing conditions.

#### Loss Contingencies

We evaluate the existence of any pending or threatened litigation or other potential claims against the Company in accordance with ASC Topic 450, Contingencies, which requires that we assess the likelihood and range of potential outcomes of any such matters. We are the defendant in three stockholder derivative lawsuits alleging that certain of our current and former directors and officers breached fiduciary duties and wasted corporate assets relating to past renewals of the management agreement with our former external manager and the internalization of our management, which occurred on July 1, 2016. Although the outcomes of these cases cannot be predicted with certainty, we do not believe that these cases have merit or will result in a material liability, and, as of June 30, 2018, we did not accrue a loss contingency related to these matters.

#### Recent Accounting Pronouncements

We consider the applicability and impact of all Accounting Standards Updates ("ASUs") issued by the Financial Accounting Standards Board. ASUs not listed below were determined to be either not applicable, are not expected to have a significant impact on our consolidated financial statements when adopted or did not have a significant impact on our consolidated financial statements upon adoption.

ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): ASU 2016-13 changes the impairment model for most financial assets and certain other instruments. Allowances for credit losses on available-for-sale debt securities will be recognized, rather than direct reductions in the amortized cost of the investments. The new model also requires the estimation of lifetime expected credit losses and corresponding recognition of allowance for losses on trade and other receivables, held-to-maturity debt securities, loans, and other instruments held at amortized cost. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2019, with early adoption permitted for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2018. ASU 2016-13 is not expected to have a significant impact on our consolidated financial statements.

#### Note 4. Investment Securities

As of June 30, 2018 and December 31, 2017, our investment portfolio consisted of \$57.1 billion and \$57.1 billion of investment securities, at fair value, respectively, and \$20.0 billion and \$15.7 billion of TBA securities, at fair value, respectively. Our TBA position is reported at its net carrying value of \$105 million and \$3 million as of June 30, 2018 and December 31, 2017, respectively, in derivative assets / (liabilities) on our accompanying consolidated balance sheets. The net carrying value of our TBA position represents the difference between the fair value of the underlying Agency security in the TBA contract and the cost basis or the forward price to be paid or received for the underlying

Agency security.

As of June 30, 2018 and December 31, 2017, our investment securities had a net unamortized premium balance of \$2.6 billion and \$2.7 billion, respectively, including interest and principal-only securities.

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The following tables summarize our investment securities as of June 30, 2018 and December 31, 2017, excluding TBA securities, (dollars in millions). Details of our TBA securities as of each of the respective dates are included in Note 6.

| Investment Securities                   | June 30, 2018  |            | December 31, 2017 |            |
|---|----------------|------------|-------------------|------------|
|   | Amortized Cost | Fair Value | Amortized Cost    | Fair Value |
| Agency RMBS:                            |                |            |                   |            |
| Fixed rate                              | \$56,918       | \$55,119   | \$55,477          | \$55,026   |
| Adjustable rate                         | 247            | 249        | 278               | 283        |
| CMO                                     | 559            | 551        | 629               | 631        |
| Interest-only and principal-only strips | 191            | 192        | 213               | 228        |
| Total Agency RMBS                       | 57,915         | 56,111     | 56,597            | 56,168     |
| Non-Agency RMBS                         | 34             | 35         | 7                 | 7          |
| CMBS                                    | 25             | 25         | 28                | 29         |
| CRT securities                          | 901            | 936        | 834               | 876        |
| Total investment securities             | \$58,875       | \$57,107   | \$57,466          | \$57,080   |

| Investment Securities                                      | June 30, 2018             |             |            | Non-Agency |       |       | Total    |
|--|---------------------------|-------------|------------|------------|-------|-------|----------|
|  | Agency RMBS<br>Fannie Mae | Freddie Mac | Ginnie Mae | RMBS       | CMBS  | CRT   |          |
| Available-for-sale securities:                             |                           |             |            |            |       |       |          |
| Par value  | \$20,785                  | \$6,890     | \$30       | \$7        | \$—   | \$—   | \$27,712 |
| Unamortized discount                                       | (24 )                     | (2 )        | —          | —          | —     | —     | (26 )    |
| Unamortized premium  | 1,016                     | 397         | —          | —          | —     | —     | 1,413    |
| Amortized cost   | 21,777                    | 7,285       | 30         | 7          | —     | —     | 29,099   |
| Gross unrealized gains                                     | 4                         | 3           | 1          | —          | —     | —     | 8        |
| Gross unrealized losses                                    | (813 )                    | (306 )      | —          | —          | —     | —     | (1,119 ) |
| Total available-for-sale securities, at fair value         | 20,968                    | 6,982       | 31         | 7          | —     | —     | 27,988   |
| Securities remeasured at fair value through earnings:      |                           |             |            |            |       |       |          |
| Par value  | 16,598                    | 11,097      | —          | 30         | 25    | 858   | 28,608   |
| Unamortized discount                                       | (32 )                     | (2 )        | —          | (2 )       | (1 )  | (1 )  | (38 )    |
| Unamortized premium  | 734                       | 428         | —          | —          | —     | 44    | 1,206    |
| Amortized cost   | 17,300                    | 11,523      | —          | 28         | 24    | 901   | 29,776   |
| Gross unrealized gains                                     | 15                        | 4           | —          | —          | 1     | 36    | 56       |
| Gross unrealized losses                                    | (438 )                    | (274 )      | —          | —          | —     | (1 )  | (713 )   |
| Total securities remeasured at fair value through earnings | 16,877                    | 11,253      | —          | 28         | 25    | 936   | 29,119   |
| Total securities, at fair value                            | \$37,845                  | \$18,235    | \$31       | \$35       | \$25  | \$936 | \$57,107 |
| Weighted average coupon as of June 30, 2018                | 3.69                      | % 3.72      | % 2.94%    | 3.70%      | 6.55% | 5.81  | % 3.74 % |
| Weighted average yield as of June 30, 2018 <sup>1</sup>    | 2.96                      | % 3.03      | % 2.03%    | 4.46%      | 7.34% | 5.53  | % 3.03 % |

<sup>1</sup> Incorporates a weighted average future constant prepayment rate assumption of 7.1% based on forward rates as of June 30, 2018.

| Investment Securities                                       | December 31, 2017         |             |            | Non-Agency |        |        | Total    |
|---|---------------------------|-------------|------------|------------|--------|--------|----------|
|   | Agency RMBS<br>Fannie Mae | Freddie Mac | Ginnie Mae | RMBS       | CMBS   | CRT    |          |
| Available-for-sale securities:                              |                           |             |            |            |        |        |          |
| Par value   | \$24,200                  | \$8,219     | \$ 34      | \$7        | \$—    | \$—    | \$32,460 |
| Unamortized discount  | (25 )                     | (3 )        | —          | —          | —      | —      | (28 )    |
| Unamortized premium   | 1,119                     | 447         | —          | —          | —      | —      | 1,566    |
| Amortized cost  | 25,294                    | 8,663       | 34         | 7          | —      | —      | 33,998   |
| Gross unrealized gains                                      | 98                        | 22          | 1          | —          | —      | —      | 121      |
| Gross unrealized losses                                     | (325 )                    | (141 )      | —          | —          | —      | —      | (466 )   |
| Total available-for-sale securities, at fair value          | 25,067                    | 8,544       | 35         | 7          | —      | —      | 33,653   |
| Securities remeasured at fair value through earnings:       |                           |             |            |            |        |        |          |
| Par value   | 13,558                    | 7,956       | —          | —          | 29     | 801    | 22,344   |
| Unamortized discount  | (34 )                     | —           | —          | —          | (1 )   | —      | (35 )    |
| Unamortized premium   | 711                       | 415         | —          | —          | —      | 33     | 1,159    |
| Amortized cost  | 14,235                    | 8,371       | —          | —          | 28     | 834    | 23,468   |
| Gross unrealized gains                                      | 26                        | 2           | —          | —          | 1      | 42     | 71       |
| Gross unrealized losses                                     | (70 )                     | (42 )       | —          | —          | —      | —      | (112 )   |
| Total securities remeasured at fair value through earnings  | 14,191                    | 8,331       | —          | —          | 29     | 876    | 23,427   |
| Total securities, at fair value                             | \$39,258                  | \$16,875    | \$ 35      | \$7        | \$29   | \$876  | \$57,080 |
| Weighted average coupon as of December 31, 2017             | 3.67 %                    | 3.73 %      | 2.84 %     | 2.50 %     | 6.55 % | 5.26 % | 3.71 %   |
| Weighted average yield as of December 31, 2017 <sup>1</sup> | 2.84 %                    | 2.87 %      | 2.02 %     | 3.08 %     | 7.30 % | 5.19 % | 2.89 %   |

<sup>1</sup> Incorporates a weighted average future constant prepayment rate assumption of 8.4% based on forward rates as of December 31, 2017.

As of June 30, 2018 and December 31, 2017, our investments in CRT and non-Agency securities had the following credit ratings:

| CRT and Non-Agency Security Credit Ratings <sup>1</sup> | June 30, 2018 |       |       | December 31, 2017 |      |       |
|---|---------------|-------|-------|-------------------|------|-------|
|   | CRT           | RMBS  | CMBS  | CRT               | RMBS | CMBS  |
| AAA   | \$—           | \$ 7  | \$ —  | \$—               | \$ 7 | \$ —  |
| BBB   | 56            | 18    | 25    | 20                | —    | 29    |
| BB  | 499           | 2     | —     | 136               | —    | —     |
| B   | 345           | —     | —     | 691               | —    | —     |
| Not Rated   | 36            | 8     | —     | 29                | —    | —     |
| Total   | \$936         | \$ 35 | \$ 25 | \$876             | \$ 7 | \$ 29 |

<sup>1</sup> Represents the lowest of Standard and Poor's ("S&P"), Moody's and Fitch credit ratings, stated in terms of the S&P equivalent rating as of each date.

Our CRT securities reference the performance of loans underlying Agency RMBS issued by Fannie Mae or Freddie Mac, which were subject to their underwriting standards. As of June 30, 2018, our CRT securities had floating and fixed rate coupons ranging from 3.7% to 9.0%, referenced to loans originated between 2011 and 2018 with weighted average coupons ranging from 3.6% to 4.4%. As of December 31, 2017, our CRT securities had floating rate coupons ranging from 3.9% to 8.5%, referenced to loans originated between 2012 and 2017 with weighted average coupons ranging from 3.6% to 4.4%.

The actual maturities of our investment securities are generally shorter than their stated contractual maturities. Actual maturities are affected by the contractual lives of the underlying mortgages, periodic contractual principal payments

and principal prepayments. As of June 30, 2018 and December 31, 2017, the weighted average expected constant prepayment rate ("CPR") over the remaining life of our aggregate investment portfolio was 7.1% and 8.4%, respectively. Our estimates can differ materially for different securities and thus our individual holdings have a wide range of projected CPRs. The following table summarizes our investments as of June 30, 2018 and December 31, 2017 according to their estimated weighted average life classification (dollars in millions):

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|  | June 30, 2018 |                |                         |                        | December 31, 2017 |                |                         |                        |
|--|---------------|----------------|-------------------------|------------------------|-------------------|----------------|-------------------------|------------------------|
| Estimated Weighted Average Life of Investment Securities | Fair Value    | Amortized Cost | Weighted Average Coupon | Weighted Average Yield | Fair Value        | Amortized Cost | Weighted Average Coupon | Weighted Average Yield |
| ≥ 1 year and ≤ 3 years                                   | \$2,075       | \$ 2,099       | 4.24%                   | 2.61%                  | \$2,712           | \$ 2,693       | 3.90%                   | 2.67%                  |
| > 3 years and ≤ 5 years                                  | 4,986         | 5,104          | 3.13%                   | 2.37%                  | 7,499             | 7,518          | 3.31%                   | 2.39%                  |
| > 5 years and ≤ 10 years                                 | 41,174        | 42,591         | 3.79%                   | 3.05%                  | 45,977            | 46,398         | 3.75%                   | 2.95%                  |
| > 10 years   | 8,872         | 9,081          | 3.72%                   | 3.40%                  | 892               | 857            | 4.87%                   | 4.74%                  |
| Total  | \$57,107      | \$ 58,875      | 3.74%                   | 3.03%                  | \$57,080          | \$ 57,466      | 3.71%                   | 2.89%                  |

The following table presents the gross unrealized loss and fair values of securities classified as available-for-sale by length of time that such securities have been in a continuous unrealized loss position as of June 30, 2018 and December 31, 2017 (in millions):

|   | Unrealized Loss Position For |                 |                   |                 |            |                 |
|---|------------------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Less than 12 Months          |                 | 12 Months or More |                 | Total      |                 |
| Securities Classified as Available-for-Sale | Fair Value                   | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| June 30, 2018                               | \$9,159                      | \$ (176 )       | \$17,885          | \$ (943 )       | \$27,044   | \$ (1,119 )     |
| December 31, 2017                           | \$3,582                      | \$ (15 )        | \$20,577          | \$ (451 )       | \$24,159   | \$ (466 )       |

We did not recognize OTTI charges on our investment securities during any of the periods presented herein. As of the end of each respective reporting period, a decision had not been made to sell securities in an unrealized loss position and we did not believe it was more likely than not that we would be required to sell such securities before recovery of their amortized cost basis. The unrealized losses on our securities were not due to credit losses given the GSE or U.S. Government agency guarantees, but rather were due to changes in interest rates and prepayment expectations. However, as we continue to actively manage our portfolio, we may recognize additional realized losses on our investment securities upon selecting specific securities to sell.

#### Gains and Losses on Sale of Investment Securities

The following table is a summary of our net gain (loss) from the sale of investment securities for the three and six months ended June 30, 2018 and 2017 by investment classification of accounting (in millions):

|   | Three Months Ended June 30, 2018           |                   |           | Three Months Ended June 30, 2017           |                   |           |
|---|--|-------------------|-----------|--|-------------------|-----------|
| Investment Securities                                 | Available-for-Sale Securities <sup>2</sup> | Option Securities | Total     | Available-for-Sale Securities <sup>2</sup> | Option Securities | Total     |
| Investment securities sold, at cost                   | \$(1,449)                                  | \$(1,975 )        | \$(3,424) | \$(586)                                    | \$(2,401 )        | \$(2,987) |
| Proceeds from investment securities sold <sup>1</sup> | 1,429                                      | 1,921             | 3,350     | 582  | 2,420             | 3,002     |
| Net gain (loss) on sale of investment securities      | \$(20 )                                    | \$(54 )           | \$(74 )   | \$(4 )                                     | \$19              | \$15      |
| Gross gain on sale of investment securities           | \$2  | \$3               | \$5       | \$2  | \$20              | \$22      |
| Gross loss on sale of investment securities           | (22 )                                      | (57 )             | (79 )     | (6 )                                       | (1 )              | (7 )      |
| Net gain (loss) on sale of investment securities      | \$(20 )                                    | \$(54 )           | \$(74 )   | \$(4 )                                     | \$19              | \$15      |

|   | Six Months Ended June 30, |                    |           | 2017         |                    |           |
|---|---------------------------|--------------------|-----------|--------------|--------------------|-----------|
|   | 2018                      | Available-for-Sale |           | 2017         | Available-for-Sale |           |
| Investment Securities                                 | Securities                | Option             | Total     | Securities   | Option             | Total     |
|   | <sup>2</sup>              | Securities         |           | <sup>2</sup> | Securities         |           |
| Investment securities sold, at cost                   | \$(1,836)                 | \$(2,978)          | \$(4,814) | \$(5,735)    | \$(2,620)          | \$(8,355) |
| Proceeds from investment securities sold <sup>1</sup> | 1,817                     | 2,921              | 4,738     | 5,647        | 2,639              | 8,286     |
| Net gain (loss) on sale of investment securities      | \$(19)                    | \$(57)             | \$(76)    | \$(88)       | \$19               | \$(69)    |
| Gross gain on sale of investment securities           | \$5                       | \$10               | \$15      | \$6          | \$20               | \$26      |
| Gross loss on sale of investment securities           | (24)                      | (67)               | (91)      | (94)         | (1)                | (95)      |
| Net gain (loss) on sale of investment securities      | \$(19)                    | \$(57)             | \$(76)    | \$(88)       | \$19               | \$(69)    |

<sup>1</sup> Proceeds include cash received during the period, plus receivable for investment securities sold during the period as of period end.

<sup>2</sup> See Note 10 for a summary of changes in accumulated OCI.

#### Securitizations and Variable Interest Entities

As of June 30, 2018 and December 31, 2017, we held investments in CMO trusts, which are VIEs. We have consolidated certain of these CMO trusts in our consolidated financial statements where we have determined we are the primary beneficiary of the trusts. Our CMO securities are backed by fixed or adjustable-rate Agency RMBS. Fannie Mae or Freddie Mac guarantees the payment of interest and principal and acts as the trustee and administrator of their respective securitization trusts. Accordingly, we are not required to provide the beneficial interest holders of the CMO securities any financial or other support. Our maximum exposure to loss related to our involvement with CMO trusts is the fair value of the CMO securities and interest and principal-only securities held by us, less principal amounts guaranteed by Fannie Mae and Freddie Mac.

In connection with our consolidated CMO trusts, we recognized Agency securities with a total fair value and approximate unpaid principal balance of \$0.6 billion and \$0.7 billion as of June 30, 2018 and December 31, 2017, respectively, and debt with a total fair value and approximate unpaid principal balance of \$0.3 billion and \$0.4 billion, respectively, in our accompanying consolidated balance sheets. We re-measure our consolidated debt at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Our involvement with the consolidated trusts is limited to the Agency securities transferred by us upon the formation of the trusts and the CMO securities subsequently held by us. There are no arrangements that could require us to provide financial support to the trusts.

As of June 30, 2018 and December 31, 2017, the fair value of our CMO securities and interest and principal-only securities was \$0.7 billion and \$0.9 billion, respectively, excluding the consolidated CMO trusts discussed above, or \$1.0 billion and \$1.2 billion, respectively, including the net asset value of our consolidated CMO trusts. Our maximum exposure to loss related to our CMO securities and interest and principal-only securities, including our consolidated CMO trusts, was \$74 million and \$124 million as of June 30, 2018 and December 31, 2017, respectively.

#### Note 5. Repurchase Agreements and Other Secured Borrowings

We pledge our securities as collateral under our borrowing agreements with financial institutions. Interest rates on our borrowings are generally based on LIBOR plus or minus a margin and amounts available to be borrowed are dependent upon the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, type of security and liquidity conditions within the banking, mortgage finance and real estate industries. If the fair value of our pledged securities declines, lenders will typically require us to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of our pledged securities increases, lenders may release collateral back to us. As of June 30, 2018, we had met all margin call requirements. For additional information regarding our pledged assets, please refer to Note 7.

#### Repurchase Agreements

As of June 30, 2018 and December 31, 2017, we had \$48.8 billion and \$50.3 billion, respectively, of repurchase agreements outstanding. The terms and conditions of our repurchase agreements are typically negotiated on a transaction-by-transaction basis. Our repurchase agreements with original maturities greater than one year have floating interest rates based on an index plus or minus a fixed spread. The following table summarizes our borrowings under repurchase agreements by their remaining maturities as of June 30, 2018 and December 31, 2017 (dollars in millions):



| Remaining Maturity  | June 30, 2018           |   |   |  | December 31, 2017       |   |   |  |
|---------------------|-------------------------|---|---|--|-------------------------|---|---|--|
|                     | Repurchase<br>Agreement | Weighted<br>Average<br>Interest<br>Rate | Weighted<br>Average Days<br>to Maturity |  | Repurchase<br>Agreement | Weighted<br>Average<br>Interest<br>Rate | Weighted<br>Average Days<br>to Maturity |  |
| Agency repo:        |                         |   |   |  |                         |   |   |  |
| ≤ 1 month           | \$25,920                | 2.16 %                                  | 10                                      |  | \$19,771                | 1.59 %                                  | 11                                      |  |
| > 1 to ≤ 3 months   | 10,072                  | 2.03 %                                  | 61                                      |  | 16,150                  | 1.50 %                                  | 50                                      |  |
| > 3 to ≤ 6 months   | 743                     | 2.22 %                                  | 113                                     |  | 7,287                   | 1.50 %                                  | 130                                     |  |
| > 6 to ≤ 9 months   | 7,979                   | 2.13 %                                  | 197                                     |  | 2,361                   | 1.66 %                                  | 225                                     |  |
| > 9 to ≤ 12 months  | 900                     | 2.53 %                                  | 305                                     |  | 202                     | 1.64 %                                  | 297                                     |  |
| > 12 to ≤ 24 months | 2,300                   | 2.79 %                                  | 562                                     |  | 1,700                   | 1.84 %                                  | 468                                     |  |
| > 24 to ≤ 36 months | 925                     | 2.80 %                                  | 921                                     |  | 2,200                   | 1.80 %                                  | 803                                     |  |
| > 36 to ≤ 48 months | —                       | — %                                     | —                                       |  | 625                     | 1.90 %                                  | 1,141                                   |  |
| Total Agency repo   | \$48,839                | 2.18 %                                  | 101                                     |  | \$50,296                | 1.57 %                                  | 116                                     |  |

As of June 30, 2018 and December 31, 2017, \$9.2 billion and \$5.3 billion, respectively, of our Agency repurchase agreements matured overnight and none of our repurchase agreements were due on demand. As of June 30, 2018 and December 31, 2017, 43% and 33%, respectively, of our repurchase agreement funding was sourced through our wholly-owned captive broker-dealer subsidiary, Bethesda Securities, LLC ("BES"). Amounts sourced through BES include repo funding from the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation ("FICC"), which totaled 40% and 30% of our repurchase agreement funding outstanding as of June 30, 2018 and December 31, 2017, respectively, and is presented gross of \$3.1 billion and \$2.7 billion, respectively, of reverse repurchase agreements to the FICC on our consolidated balance sheet.

#### Note 6. Derivative and Other Hedging Instruments

We hedge a portion of our interest rate risk by entering into interest rate swaps, interest rate swaptions and U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales. We may also utilize TBA securities, options and other types of derivative instruments to hedge a portion of our risk. For additional information regarding our derivative instruments and our overall risk management strategy, please refer to the discussion of derivative and other hedging instruments in Note 3.

#### Derivative and Other Hedging Instrument Assets (Liabilities), at Fair Value

The table below summarizes fair value information about our derivative and other hedging instrument assets/(liabilities) as of June 30, 2018 and December 31, 2017 (in millions):

| Derivative and Other Hedging Instruments    | Balance Sheet Location                  | June 30, 2018 | December 31, 2017 |
|---|---|---------------|-------------------|
| Interest rate swaps                         | Derivative assets, at fair value        | \$223         | \$ 81             |
| Swaptions                                   | Derivative assets, at fair value        | 127           | 75                |
| TBA securities                              | Derivative assets, at fair value        | 108           | 30                |
| U.S. Treasury futures - short               | Derivative assets, at fair value        | —             | 19                |
| Total derivative assets, at fair value      |   | \$458         | \$ 205            |
| Interest rate swaps                         | Derivative liabilities, at fair value   | \$—           | \$ (1 )           |
| TBA securities                              | Derivative liabilities, at fair value   | (3 )          | (27 )             |
| U.S. Treasury futures - short               | Derivative liabilities, at fair value   | (3 )          | —                 |
| Total derivative liabilities, at fair value |   | \$(6 )        | \$(28 )           |
| U.S. Treasury securities - long             | U.S. Treasury securities, at fair value | \$—           | \$ —              |

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|   |   |            |              |
|---|---|------------|--------------|
| U.S. Treasury securities - short                  | Obligation to return securities borrowed under reverse repurchase agreements, at fair value | (12,898 )  | (10,467 )    |
| Total U.S. Treasury securities, net at fair value |   | \$(12,898) | \$ (10,467 ) |

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The following tables summarize certain characteristics of our derivative and other hedging instruments outstanding as of June 30, 2018 and December 31, 2017 (dollars in millions):

|                     | June 30, 2018                |                                     |                      |                          | December 31, 2017            |                                     |                      |                          |
|---------------------|------------------------------|-------------------------------------|----------------------|--------------------------|------------------------------|-------------------------------------|----------------------|--------------------------|
|                     | Notional Amount <sup>1</sup> | Average Fixed Pay Rate <sup>2</sup> | Average Receive Rate | Average Maturity (Years) | Notional Amount <sup>1</sup> | Average Fixed Pay Rate <sup>2</sup> | Average Receive Rate | Average Maturity (Years) |
| Interest Rate Swaps |                              |                                     |                      |                          |                              |                                     |                      |                          |
| ≤ 3 years           | \$20,600                     | 1.56%                               | 2.34%                | 1.4                      | \$21,025                     | 1.40%                               | 1.46%                | 1.5                      |
| > 3 to ≤ 5 years    | 8,975                        | 1.91%                               | 2.34%                | 4.0                      | 6,825                        | 1.82%                               | 1.43%                | 4.1                      |
| > 5 to ≤ 7 years    | 4,775                        | 2.39%                               | 2.34%                | 6.0                      | 5,775                        | 2.02%                               | 1.44%                | 5.9                      |
| > 7 to ≤ 10 years   | 10,450                       | 2.34%                               | 2.34%                | 8.6                      | 6,650                        | 2.10%                               | 1.42%                | 9.1                      |
| > 10 years          | 3,075                        | 2.35%                               | 2.34%                | 12.7                     | 3,425                        | 2.49%                               | 1.45%                | 12.9                     |
| Total               | \$47,875                     | 1.93%                               | 2.34%                | 4.6                      | \$43,700                     | 1.74%                               | 1.44%                | 4.5                      |

<sup>1</sup> As of June 30, 2018 and December 31, 2017, notional amount includes forward starting swaps of \$4.4 billion and \$4.6 billion, respectively, with an average forward start date of 0.4 and 0.3 years, respectively.

<sup>2</sup> Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.83% and 1.68% as of June 30, 2018 and December 31, 2017, respectively.

| Swaptions          | Option                         |            |            | Underlying Payer Swap   |                 |                        |                              |                      |
|--------------------|--------------------------------|------------|------------|---|-----------------|------------------------|------------------------------|----------------------|
|                    | Current Option Expiration Date | Cost Basis | Fair Value | Average Months to Current Option Expiration Date <sup>1</sup> | Notional Amount | Average Fixed Pay Rate | Average Receive Rate (LIBOR) | Average Term (Years) |
| June 30, 2018      |                                |            |            |   |                 |                        |                              |                      |
| ≤ 1 year           |                                | \$96       | \$98       | 6   | \$4,700         | 2.82%                  | 3M                           | 7.7                  |
| > 1 year ≤ 2 years |                                | 26         | 29         | 20  | 900             | 2.87%                  | 3M                           | 8.6                  |
| Total              |                                | \$122      | \$127      | 8   | \$5,600         | 2.83%                  | 3M                           | 7.8                  |
| December 31, 2017  |                                |            |            |   |                 |                        |                              |                      |
| ≤ 1 year           |                                | \$118      | \$46       | 7   | \$5,100         | 2.71%                  | 3M                           | 8.8                  |
| > 1 year ≤ 2 years |                                | 23         | 16         | 18  | 1,050           | 2.71%                  | 3M                           | 8.7                  |
| > 2 year ≤ 3 years |                                | 18         | 13         | 30  | 500             | 2.78%                  | 3M                           | 10.0                 |
| Total              |                                | \$159      | \$75       | 10  | \$6,650         | 2.72%                  | 3M                           | 8.9                  |

As of June 30, 2018 and December 31, 2017, ≤ 1 year notional amount includes \$700 million of Bermudan swaptions where the options may be exercised on predetermined dates up to their final exercise date, which is six months prior to the underlying swaps' maturity date.

| U.S. Treasury Securities       | June 30, 2018       |            |            | December 31, 2017   |            |            |
|--------------------------------|---------------------|------------|------------|---------------------|------------|------------|
|                                | Face Amount (Short) | Cost Basis | Fair Value | Face Amount (Short) | Cost Basis | Fair Value |
| 5 years                        | \$(330 )            | \$(328 )   | \$(330 )   | \$(288 )            | \$(286 )   | \$(283 )   |
| 7 years                        | (8,092 )            | (8,058 )   | (7,853 )   | (6,131 )            | (6,106 )   | (6,029 )   |
| 10 years                       | (4,972 )            | (4,914 )   | (4,715 )   | (4,280 )            | (4,230 )   | (4,155 )   |
| Total U.S. Treasury securities | \$(13,394)          | \$(13,300) | \$(12,898) | \$(10,699)          | \$(10,622) | \$(10,467) |

| U.S. Treasury Futures | June 30, 2018                  |            |            |                                 | December 31, 2017              |            |            |                                 |
|-----------------------|--------------------------------|------------|------------|---------------------------------|--------------------------------|------------|------------|---------------------------------|
|                       | Notional Amount - Long (Short) | Cost Basis | Fair Value | Net Carrying Value <sup>1</sup> | Notional Amount - Long (Short) | Cost Basis | Fair Value | Net Carrying Value <sup>1</sup> |
| 5 years               | \$—                            | \$—        | \$—        | \$ —                            | \$(730 )                       | \$(852 )   | \$(848 )   | \$ 4                            |

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|                             |           |           |           |         |           |           |           |       |
|-----------------------------|-----------|-----------|-----------|---------|-----------|-----------|-----------|-------|
| 10 years                    | (1,650 )  | (1,980 )  | (1,983 )  | (3 )    | (2,180 )  | (2,718 )  | (2,703 )  | 15    |
| Total U.S. Treasury futures | \$(1,650) | \$(1,980) | \$(1,983) | \$ (3 ) | \$(2,910) | \$(3,570) | \$(3,551) | \$ 19 |

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Net carrying value represents the difference between the fair market value and the cost basis (or the forward price to be paid/(received) for the underlying U.S. Treasury security) of the U.S. Treasury futures contract as of period-end and is reported in derivative assets/(liabilities), at fair value in our consolidated balance sheets.

| TBA Securities by Coupon          | June 30, 2018                           |               |               |                                       | December 31, 2017                       |               |               |                                       |
|-----------------------------------|---|---------------|---------------|---------------------------------------|---|---------------|---------------|---------------------------------------|
|                                   | Notional<br>Amount<br>- Long<br>(Short) | Cost<br>Basis | Fair<br>Value | Net<br>Carrying<br>Value <sup>1</sup> | Notional<br>Amount<br>- Long<br>(Short) | Cost<br>Basis | Fair<br>Value | Net<br>Carrying<br>Value <sup>1</sup> |
| 15-Year TBA securities:           |   |               |               |                                       |   |               |               |                                       |
| 2.5%                              | \$295                                   | \$285         | \$286         | \$ 1                                  | \$1,373                                 | \$1,372       | \$1,370       | \$ (2 )                               |
| 3.0%                              | 1,853                                   | 1,827         | 1,840         | 13                                    | 3,161                                   | 3,225         | 3,217         | (8 )                                  |
| 3.5%                              | 2,282                                   | 2,301         | 2,308         | 7                                     | 414                                     | 428           | 428           | —                                     |
| 4.0%                              | 225                                     | 230           | 230           | —                                     | —                                       | —             | —             | —                                     |
| Total 15-Year TBA securities      | 4,655                                   | 4,643         | 4,664         | 21                                    | 4,948                                   | 5,025         | 5,015         | (10 )                                 |
| 30-Year TBA securities:           |   |               |               |                                       |   |               |               |                                       |
| 3.0%                              | 2,962                                   | 2,843         | 2,867         | 24                                    | 4,317                                   | 4,303         | 4,312         | 9                                     |
| 3.5%                              | 1,839                                   | 1,821         | 1,829         | 8                                     | 3,932                                   | 4,027         | 4,034         | 7                                     |
| 4.0%                              | 5,594                                   | 5,662         | 5,697         | 35                                    | 2,338                                   | 2,449         | 2,446         | (3 )                                  |
| 4.5%                              | 4,755                                   | 4,929         | 4,946         | 17                                    | (61 )                                   | (65 )         | (65 )         | —                                     |
| Total 30-Year TBA securities, net | 15,150                                  | 15,255        | 15,339        | 84                                    | 10,526                                  | 10,714        | 10,727        | 13                                    |
| Total TBA securities, net         | \$19,805                                | \$19,898      | \$20,003      | \$ 105                                | \$15,474                                | \$15,739      | \$15,742      | \$ 3                                  |

Net carrying value represents the difference between the fair market value and the cost basis (or the forward price to be paid/(received) for the underlying Agency security) of the TBA contract as of period-end and is reported in derivative assets/(liabilities), at fair value in our consolidated balance sheets.

## Gain (Loss) From Derivative Instruments and Other Securities, Net

The following table summarizes changes in our derivative and other hedge portfolio and their effect on our consolidated statements of comprehensive income for the three and six months ended June 30, 2018 and 2017 (in millions):

| Derivative and Other Hedging Instruments         | Beginning<br>Notional<br>Amount | Additions | Settlement,<br>Termination,<br>Expiration or<br>Exercise | Ending<br>Notional<br>Amount | Gain/(Loss)<br>on<br>Derivative<br>Instruments<br>and Other<br>Securities,<br>Net <sup>1</sup> |
|--|---------------------------------|-----------|--|------------------------------|--|
| Three months ended June 30, 2018:                |                                 |           |  |                              |  |
| TBA securities, net                              | \$ 13,636                       | 64,406    | (58,237 )  | \$ 19,805                    | \$ (14 )   |
| Interest rate swaps                              | \$45,250                        | 4,500     | (1,875 )   | \$47,875                     | 216  |
| Payer swaptions                                  | \$6,750                         | —         | (1,150 )   | \$5,600                      | 34   |
| U.S. Treasury securities - short position        | \$(10,798 )                     | (5,629 )  | 3,033  | \$(13,394 )                  | 35   |
| U.S. Treasury securities - long position         | \$225                           | 90        | (315 )   | \$—                          | —  |
| U.S. Treasury futures contracts - short position | \$(2,380 )                      | (1,650 )  | 2,380  | \$(1,650 )                   | 21   |
|  |                                 |           |  |                              | \$ 292   |
| Three months ended June 30, 2017:                |                                 |           |  |                              |  |
| TBA securities, net                              | \$ 14,170                       | 56,306    | (53,609 )  | \$ 16,867                    | \$ 163   |
| Interest rate swaps                              | \$35,775                        | 5,725     | (1,500 )   | \$40,000                     | (194 )   |
| Payer swaptions                                  | \$2,200                         | 2,750     | —  | \$4,950                      | (13 )  |
| U.S. Treasury securities - short position        | \$(9,169 )                      | (3,932 )  | 5,743  | \$(7,358 )                   | (110 )   |
| U.S. Treasury securities - long position         | \$—                             | —         | —  | \$—                          | —  |
| U.S. Treasury futures contracts - short position | \$(1,810 )                      | (3,710 )  | 2,610  | \$(2,910 )                   | (16 )  |
|  |                                 |           |  |                              | \$ (170 )  |
| Six months ended June 30, 2018:                  |                                 |           |  |                              |  |
| TBA securities, net                              | \$ 15,474                       | 108,075   | (103,744 )   | \$ 19,805                    | \$ (306 )  |
| Interest rate swaps                              | \$43,700                        | 7,650     | (3,475 )   | \$47,875                     | 879  |
| Payer swaptions                                  | \$6,650                         | 1,100     | (2,150 )   | \$5,600                      | 125  |
| U.S. Treasury securities - short position        | \$(10,699 )                     | (6,291 )  | 3,596  | \$(13,394 )                  | 247  |
| U.S. Treasury securities - long position         | \$—                             | 1,049     | (1,049 )   | \$—                          | —  |
| U.S. Treasury futures contracts - short position | \$(2,910 )                      | (4,559 )  | 5,819  | \$(1,650 )                   | 83   |
|  |                                 |           |  |                              | \$ 1,028   |
| Six months ended June 30, 2017:                  |                                 |           |  |                              |  |
| TBA securities, net                              | \$ 10,916                       | 92,402    | (86,451 )  | \$ 16,867                    | \$ 202   |
| Interest rate swaps                              | \$37,175                        | 7,025     | (4,200 )   | \$40,000                     | (172 )   |
| Payer swaptions                                  | \$ 1,200                        | 3,750     | —  | \$4,950                      | (24 )  |
| U.S. Treasury securities - short position        | \$(8,061 )                      | (6,490 )  | 7,193  | \$(7,358 )                   | (188 )   |
| U.S. Treasury securities - long position         | \$ 189                          | 303       | (492 )   | \$—                          | 1  |
| U.S. Treasury futures contracts - short position | \$(1,810 )                      | (5,520 )  | 4,420  | \$(2,910 )                   | (28 )  |
|  |                                 |           |  |                              | \$ (209 )  |

1. Amounts above exclude other miscellaneous gains and losses recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

Note 7. Pledged Assets

Our funding agreements require us to fully collateralize our obligations under the agreements based upon our counterparties' collateral requirements and their determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. Our derivative contracts similarly require us to fully collateralize our obligations under such agreements, which will vary over time based on similar factors as well as our counterparties' determination of the value of the derivative contract. We are typically required to post initial margin upon execution of derivative transactions, such as under our interest rate swap agreements

and TBA contracts, and subsequently post or receive variation margin based on daily fluctuations in fair value. Our prime brokerage agreements, pursuant to which we receive custody and settlement services, and the clearing organizations utilized by our wholly-owned captive broker-dealer subsidiary, Bethesda Securities, LLC, also require that we post minimum daily clearing deposits. If we breach our collateral requirements, we will be required to fully settle our obligations under the agreements, which could include a forced liquidation of our pledged collateral. Our counterparties also apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value and limits the amount we can borrow against our securities. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value. Our agreements do not specify the haircut; rather haircuts are determined on an individual transaction basis. Consequently, our funding agreements and derivative contracts expose us to credit risk relating to potential losses that could be recognized if our counterparties fail to perform their obligations under such agreements. We minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings or to registered clearinghouses and U.S. government agencies, and we monitor our positions with individual counterparties. In the event of a default by a counterparty, we may have difficulty obtaining our assets pledged as collateral to such counterparty and may not receive payments provided for under the terms of our derivative agreements. In the case of centrally cleared instruments, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the clearing exchanges' initial and daily mark to market margin requirements, clearinghouse guarantee funds and other resources that are available in the event of a clearing member default.

Our International Swaps and Derivatives Association ("ISDA") Master Agreements contain a cross default provision under which a default under the terms of certain of our other indebtedness in excess of certain thresholds causes an event of default under the ISDA Master Agreement. Threshold amounts vary by lender. Following an event of default, we could be required to settle our obligations under the agreements. Additionally, under certain of our ISDA Master Agreements, we could be required to settle our obligations under the agreements if we fail to maintain certain minimum stockholders' equity thresholds or our REIT status or if we fail to comply with limits on our leverage up to certain specified levels. As of June 30, 2018, the fair value of additional collateral that could be required to be posted as a result of the credit-risk-related contingent features being triggered was not material to our financial statements. As of June 30, 2018, our maximum amount at risk with any counterparty related to our repurchase agreements, excluding the FICC, was less than 5% of our tangible stockholders' equity. As of June 30, 2018, 6% of our tangible stockholder's equity was at risk with the FICC. The following table summarizes repurchase agreements outstanding with the FICC as of June 30, 2018 (dollars in millions):

June 30, 2018

| Amount Outstanding | Net Counterparty Exposure <sup>1</sup> | Percent of Tangible Stockholders' Equity | Weighted Average Months to Maturity |
|--------------------|--|--|-------------------------------------|
| FICC \$19,400      | \$ 539                                 | 6.3 %                                    | 3                                   |

Represents the net carrying value of securities pledged under repurchase agreements, including accrued interest plus 1. any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest.



## Assets Pledged to Counterparties

The following tables summarize our assets pledged as collateral under our funding, derivative and prime broker agreements by type, including securities pledged related to securities sold but not yet settled, as of June 30, 2018 and December 31, 2017 (in millions):

| Assets Pledged to Counterparties                   | June 30, 2018                      |                           | Derivative Agreements | Prime Broker Agreements | Total    |
|--|------------------------------------|---------------------------|-----------------------|-------------------------|----------|
|  | Repurchase Agreements <sup>1</sup> | Debt of Consolidated VIEs |                       |                         |          |
| Agency RMBS - fair value                           | \$50,912                           | \$ 587                    | \$ 193                | \$ 450                  | \$52,142 |
| U.S. Treasury securities - fair value <sup>3</sup> | 172                                | —                         | 57                    | —                       | 229      |
| Accrued interest on pledged securities             | 153                                | 2                         | 1                     | 1                       | 157      |
| Restricted cash and cash equivalents               | 65                                 | —                         | 375                   | 7                       | 447      |
| Total  | \$51,302                           | \$ 589                    | \$ 626                | \$ 458                  | \$52,975 |
| Assets Pledged to Counterparties                   | December 31, 2017                  |                           | Derivative Agreements | Prime Broker Agreements | Total    |
|  | Repurchase Agreements <sup>1</sup> | Debt of Consolidated VIEs |                       |                         |          |
| Agency RMBS - fair value                           | \$52,497                           | \$ 662                    | \$ 221                | \$ 519                  | \$53,899 |
| U.S. Treasury securities - fair value <sup>3</sup> | 113                                | —                         | 72                    | —                       | 185      |
| Accrued interest on pledged securities             | 153                                | 2                         | 1                     | 2                       | 158      |
| Restricted cash and cash equivalents               | 35                                 | —                         | 281                   | 1                       | 317      |
| Total  | \$52,798                           | \$ 664                    | \$ 575                | \$ 522                  | \$54,559 |

1. Includes \$168 million and \$182 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements as of June 30, 2018 and December 31, 2017, respectively.

2. Includes margin for TBAs cleared through prime brokers and other clearing deposits.

3. Includes repledged securities received as collateral from counterparties.

Securities transferred to our consolidated VIEs can only be used to settle the obligations of each respective VIE. However, we may pledge our retained interests in our consolidated VIEs as collateral under our repurchase agreements and derivative contracts. Please refer to Note 4 for additional information regarding our consolidated VIEs.

The following table summarizes our securities pledged as collateral under our repurchase agreements by the remaining maturity of our borrowings, including securities pledged related to sold but not yet settled securities, as of June 30, 2018 and December 31, 2017 (in millions). For the corresponding borrowings associated with the following amounts and the interest rates thereon, refer to Note 5.

| Securities Pledged by Remaining Maturity of Repurchase Agreements | June 30, 2018                    |                                      |  | December 31, 2017                |                                      |  |
|---|----------------------------------|--------------------------------------|--|----------------------------------|--------------------------------------|--|
|   | Fair Value of Pledged Securities | Amortized Cost of Pledged Securities | Accrued Interest on Pledged Securities | Fair Value of Pledged Securities | Amortized Cost of Pledged Securities | Accrued Interest on Pledged Securities |
| RMBS: <sup>1,2</sup>  |                                  |                                      |  |                                  |                                      |  |
| ≤ 30 days   | \$26,699                         | \$27,565                             | \$ 80                                  | \$20,162                         | \$20,313                             | \$ 59                                  |
| > 30 and ≤ 60 days  | 5,164                            | 5,341                                | 16                                     | 12,950                           | 13,061                               | 38                                     |
| > 60 and ≤ 90 days  | 5,349                            | 5,505                                | 16                                     | 4,000                            | 4,013                                | 11                                     |
| > 90 days   | 13,700                           | 14,192                               | 41                                     | 15,385                           | 15,512                               | 45                                     |
| Total RMBS  | \$50,912                         | \$52,603                             | \$ 153                                 | \$52,497                         | \$52,899                             | \$ 153                                 |

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1. Includes \$168 million and \$182 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements as of June 30, 2018 and December 31, 2017, respectively.
  2. June 30, 2018 amounts exclude \$172 million of repledged U.S. Treasury securities received as collateral from counterparties.

Assets Pledged from Counterparties

As of June 30, 2018 and December 31, 2017, we had assets pledged to us from counterparties as collateral under our reverse repurchase and derivative agreements summarized in the tables below (in millions).

| Assets Pledged to AGNC                | June 30, 2018                 |                       |          | December 31, 2017             |                       |          |
|---------------------------------------|-------------------------------|-----------------------|----------|-------------------------------|-----------------------|----------|
|                                       | Reverse Repurchase Agreements | Derivative Agreements | Total    | Reverse Repurchase Agreements | Derivative Agreements | Total    |
| U.S. Treasury securities - fair value | \$13,247                      | \$ 64                 | \$13,311 | \$10,853                      | \$ —                  | \$10,853 |
| Cash                                  | —                             | 226                   | 226      | —                             | 82                    | 82       |
| Total                                 | \$13,247                      | \$ 290                | \$13,537 | \$10,853                      | \$ 82                 | \$10,935 |

U.S. Treasury securities received as collateral under our reverse repurchase agreements for which we use to cover short sales of U.S. Treasury securities are accounted for as securities borrowing transactions. We recognize a corresponding obligation to return the borrowed securities at fair value on the accompanying consolidated balance sheets based on the value of the underlying borrowed securities as of the reporting date.

Cash collateral received is recognized in cash and cash equivalents with a corresponding amount recognized in accounts payable and other accrued liabilities on the accompanying consolidated balance sheets.

#### Offsetting Assets and Liabilities

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of setoff under master netting arrangements (or similar agreements), including in the event of default or in the event of bankruptcy of either party to the transactions. We present our assets and liabilities subject to such arrangements on a gross basis in our consolidated balance sheets. The following tables present information about our assets and liabilities that are subject to master netting arrangements and can potentially be offset on our consolidated balance sheets as of June 30, 2018 and December 31, 2017 (in millions):

#### Offsetting of Financial and Derivative Assets

|  | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Assets Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets | Net Amount        |
|--|------------------------------------|---|--|---|-------------------|
| June 30, 2018  |                                    |   |  |   |                   |
| Interest rate swap and swaption agreements, at fair value <sup>1</sup> | \$350                              | \$ —  | \$ 350   | \$—   | \$(277 ) \$ 73    |
| TBA securities, at fair value  | 108                                | —   | 108  | (3 )  | — 105             |
| Receivable under reverse repurchase agreements                         | 13,306                             | —   | 13,306   | (8,949 )  | (4,357 ) —        |
| Total  | \$13,764                           | \$ —  | \$ 13,764  | \$(8,952)   | \$(4,634 ) \$ 178 |
| December 31, 2017  |                                    |   |  |   |                   |
| Interest rate swap and swaption agreements, at fair value <sup>1</sup> | \$156                              | \$ —  | \$ 156   | \$(1 )  | \$(82 ) \$ 73     |
| TBA securities, at fair value  | 30                                 | —   | 30   | (22 )   | — 8               |
| Receivable under reverse repurchase agreements                         | 10,961                             | —   | 10,961   | (9,682 )  | (1,279 ) —        |
| Total  | \$11,147                           | \$ —  | \$ 11,147  | \$(9,705)   | \$(1,361 ) \$ 81  |

| Offsetting of Financial and Derivative Liabilities        |   |   |   |   |   |            |
|---|---|---|---|---|---|------------|
|   | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Liabilities Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets | Financial Collateral Pledged <sup>2</sup> | Net Amount |
| June 30, 2018   |   |   |   |   |   |            |
| Interest rate swap agreements, at fair value <sup>1</sup> | \$—                                     | \$  | —\$ —   | \$—   | \$—                                       | \$ —       |
| TBA securities, at fair value                             | 3                                       | —   | 3   | (3 )  | —   | —          |
| Repurchase agreements                                     | 48,839                                  | —   | 48,839  | (8,949 )  | (39,890 )                                 | —          |
| Total   | \$48,842                                | \$  | —\$ 48,842  | \$(8,952)   | \$(39,890)                                | \$ —       |
| December 31, 2017   |   |   |   |   |   |            |
| Interest rate swap agreements, at fair value <sup>1</sup> | \$1                                     | \$  | —\$ 1   | \$(1 )  | \$—                                       | \$ —       |
| TBA securities, at fair value                             | 27                                      | —   | 27  | (22 )   | (5 )                                      | —          |
| Repurchase agreements and FHLB advances                   | 50,296                                  | —   | 50,296  | (9,682 )  | (40,614 )                                 | —          |
| Total   | \$50,324                                | \$  | —\$ 50,324  | \$(9,705)   | \$(40,619)                                | \$ —       |

<sup>1</sup> Reported under derivative assets / liabilities, at fair value in the accompanying consolidated balance sheets. Refer to Note 6 for a reconciliation of derivative assets / liabilities, at fair value to their sub-components.

<sup>2</sup> Includes cash and securities pledged / received as collateral, at fair value. Amounts presented are limited to collateral pledged sufficient to reduce the net amount to zero for individual counterparties, as applicable.

#### Note 8. Fair Value Measurements

We determine the fair value of our financial instruments based on our estimate of the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. We typically obtain price estimates from multiple third-party pricing services and dealers or, if applicable, the clearing exchange (see Note 3 for further details.) We utilize a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of valuation hierarchy are defined as follows:

Level 1 Inputs —Quoted prices (unadjusted) for identical unrestricted assets and liabilities in active markets that are accessible at the measurement date.

Level 2 Inputs —Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs —Instruments with primarily unobservable market data that cannot be corroborated.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. Third-party pricing sources may also use certain unobservable inputs, such as assumptions of future levels of prepayment, defaults and loss severities, especially when estimating fair values for securities with lower levels of recent trading activity.

We make inquiries of third-party pricing sources to understand the significant inputs and assumptions they used to determine their prices. We also review third-party price estimates and perform procedures to validate their reasonableness, including an analysis of the range of estimates for each position, comparison to recent trade activity for similar securities, and for consistency with market conditions observed as of the measurement date. While we do

not adjust prices we obtain from pricing sources, we will exclude prices for securities from our estimation of fair value if we determine (based on our validation procedures and our market knowledge and expertise) that the price is significantly different from what observable market data would indicate and we cannot obtain an understanding from the third-party source as to the significant inputs used to determine the price.

The validation procedures described above also influence our determination of the appropriate fair value measurement categorization. The following table provides a summary of our assets and liabilities that are measured at fair value on a recurring

basis as of June 30, 2018 and December 31, 2017 based on their categorization within the valuation hierarchy (in millions). There were no transfers between valuation hierarchy levels during the periods presented.

|  | June 30, 2018 |          |         | December 31, 2017 |          |         |
|--|---------------|----------|---------|-------------------|----------|---------|
|  | Level 1       | Level 2  | Level 3 | Level 1           | Level 2  | Level 3 |
| Assets:  |               |          |         |                   |          |         |
| Agency securities  | \$—           | \$55,524 | \$—     | \$—               | \$55,506 | \$—     |
| Agency securities transferred to consolidated VIEs   | —             | 587      | —       | —                 | 662      | —       |
| Credit risk transfer securities  | —             | 936      | —       | —                 | 876      | —       |
| Non-Agency securities  | —             | 60       | —       | —                 | 36       | —       |
| U.S. Treasury securities   | —             | —        | —       | —                 | —        | —       |
| REIT equity securities   | 46            | —        | —       | 29                | —        | —       |
| Interest rate swaps  | —             | 223      | —       | —                 | 81       | —       |
| Swaptions  | —             | 127      | —       | —                 | 75       | —       |
| TBA securities   | —             | 108      | —       | —                 | 30       | —       |
| U.S. Treasury futures  | —             | —        | —       | 19                | —        | —       |
| Total  | \$46          | \$57,565 | \$—     | \$48              | \$57,266 | \$—     |
| Liabilities:   |               |          |         |                   |          |         |
| Debt of consolidated VIEs  | \$—           | \$313    | \$—     | \$—               | \$357    | \$—     |
| Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements | 12,898        | —        | —       | 10,467            | —        | —       |
| Interest rate swaps  | —             | —        | —       | —                 | 1        | —       |
| TBA securities   | —             | 3        | —       | —                 | 27       | —       |
| U.S. Treasury futures  | 3             | —        | —       | —                 | —        | —       |
| Total  | \$12,898      | \$316    | \$—     | \$10,467          | \$385    | \$—     |

Excluded from the table above are financial instruments, including cash and cash equivalents, restricted cash and cash equivalents, receivables, payables and borrowings under repurchase agreements, which are presented in our consolidated financial statements at cost. The cost basis of these instruments is determined to approximate fair value due to their short duration or, in the case of longer-term repo, due to floating rates of interest based on an index plus or minus a fixed spread which is consistent with fixed spreads demanded in the market. We estimate the fair value of these instruments using "Level 1" or "Level 2" inputs.

#### Note 9. Net Income Per Common Share

Basic net income per common share includes no dilution and is computed by dividing net income applicable to common stock by the weighted-average number of common shares outstanding for the respective period. Diluted earnings per common share includes the impact of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares outstanding include unvested restricted stock units and performance share units granted under our long-term incentive program to employees and non-employee Board of Directors. The following table presents the computations of basic and diluted net income per common share for the periods indicated (shares and dollars in millions):

|  | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|--|-----------------------------|-------|---------------------------|-------|
|  | 2018                        | 2017  | 2018                      | 2017  |
| Weighted average number of common shares outstanding - basic   | 404.9                       | 346.4 | 398.2                     | 338.8 |
| Unvested restricted stock units and performance share units    | 0.3                         | 0.1   | 0.2                       | 0.1   |
| Weighted average number of common shares outstanding - diluted | 405.2                       | 346.5 | 398.4                     | 338.9 |

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|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Net income available to common stockholders | \$284  | \$17   | \$699  | \$86   |
| Net income per common share - basic         | \$0.70 | \$0.05 | \$1.76 | \$0.25 |
| Net income per common share - diluted       | \$0.70 | \$0.05 | \$1.75 | \$0.25 |

## Note 10. Stockholders' Equity

### Preferred Stock

Pursuant to our amended and restated certificate of incorporation, we are authorized to designate and issue up to 10.0 million shares of preferred stock in one or more classes or series. As of December 31, 2017 and June 30, 2018, 8,050 shares were designated as 7.750% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock") and 13,800 shares were designated as 7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock ("Series C Preferred Stock"). Shares of Series B and Series C Preferred Stock are represented by depositary shares equal to 1/1000 interest in each share of Series B and Series C Preferred Stock, respectively. As of December 31, 2017 and June 30, 2018, we had 7,000 shares of Series B Preferred Stock and 13,000 shares of Series C Preferred Stock outstanding (represented by 7.0 million Series B depositary shares and 13.0 million Series C depositary shares outstanding, respectively) and 9,980,000 of authorized but unissued shares of preferred stock.

Holders of depositary shares underlying our Series B Preferred Stock are entitled to receive cumulative cash dividends at a rate of 7.750% per annum of their \$25.00 per depositary share liquidation preference. Holders of depositary shares underlying our Series C Preferred Stock are entitled to receive cumulative cash dividends at a rate of 7.00% per annum up to, and including, October 14, 2022 and thereafter at a floating rate equal to three-month LIBOR plus a spread of 5.111% per annum of their \$25.00 per depositary share liquidation preference. Dividends are payable quarterly in arrears on the 15th day of each January, April, July and October. As of June 30, 2018, we had declared all required quarterly dividends on our preferred stock.

Our preferred stock ranks senior to our common stock with respect to the payment of dividends and the distribution of assets upon a voluntary or involuntary liquidation, dissolution or winding up of the Company. Our preferred stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and ranks on parity with each other.

Under certain circumstances upon a change of control, our preferred stock is convertible to shares of our common stock. Holders of our preferred stock and depositary shares underlying our preferred stock have no voting rights, except under limited conditions. Beginning on May 8, 2019 and October 15, 2022, depositary shares underlying our Series B and Series C Preferred Stock, respectively, will be redeemable at \$25.00 per depositary share, plus accumulated and unpaid dividends (whether or not declared) exclusively at our option. We may redeem shares of our preferred stock prior to our optional redemption date under certain circumstances intended to preserve our qualification as a REIT for Federal income tax purposes.

### Common Stock Offerings

In May 2018, we completed a public offering in which 34.5 million shares of our common stock were sold to the underwriters for proceeds of \$633 million, or \$18.35 per common share, net of offering costs. In May 2017, we completed a public offering in which 24.5 million shares of our common stock were sold to the underwriters for proceeds of \$503 million, or \$20.51 per common share, net of offering costs.

### At-the-Market Offering Program

We have entered into agreements with sales agents to publicly offer and sell shares of our common stock in privately negotiated and/or at-the-market transactions from time-to-time up to a maximum aggregate offering price of our common stock. On June 14, 2018, our existing sales agreement terminated and we entered into new sales agreements for shares of our common stock having an aggregate offering price of up to \$1 billion. During the three and six months ended June 30, 2018, we sold 8.3 million shares of our common stock under sales agreements for proceeds of \$155 million, or \$18.73 per common share, net of offering costs. During the three and six months ended June 30, 2017, we did not sell shares of our common stock under the sales agreements. As of June 30, 2018, shares of our common stock with an aggregate offering price of \$881 million remained available for issuance under this program.



# Accumulated Other Comprehensive Income (Loss)

The following table summarizes changes to accumulated OCI for the three and six months ended June 30, 2018 and 2017 (in millions):

|  | Three Months   |         | Six Months     |         |
|--|----------------|---------|----------------|---------|
|  | Ended June 30, |         | Ended June 30, |         |
|  | 2018           | 2017    | 2018           | 2017    |
| Accumulated Other Comprehensive Income (Loss)  |                |         |                |         |
| Beginning Balance  | \$(966 )       | \$(351) | \$(345 )       | \$(397) |
| OCI before reclassifications   | (165 )         | 117     | (785 )         | 79      |
| (Gain) loss amounts for available-for-sale securities                                      |                |         |                |         |
| reclassified from accumulated OCI to realized gain (loss) on sale of investment securities | 20             | 4       | 19             | 88      |
| Ending Balance   | \$(1,111)      | \$(230) | \$(1,111)      | \$(230) |

## Note 11. Subsequent Events

On July 12, 2018, our Board of Directors declared a monthly dividend of \$0.18 per common share, payable on August 8, 2018 to common stockholders of record as of July 31, 2018.

On August 3, 2018, we completed a follow-on public offering of 43.7 million shares of our common stock for proceeds of \$817 million, or \$18.68 per common share, net of estimated offering costs.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of AGNC Investment Corp.'s consolidated financial statements with a narrative from the perspective of management, and should be read in conjunction with the consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q for quarterly period ended June 30, 2018. Our MD&A is presented in six sections:

Executive Overview

Financial Condition

Results of Operations

Liquidity and Capital Resources

Off-Balance Sheet Arrangements

Forward-Looking Statements

### EXECUTIVE OVERVIEW

We are an internally managed Real Estate Investment Trust ("REIT"). We commenced operations on May 20, 2008 following the completion of our initial public offering. Our common stock is traded on The Nasdaq Global Select Market under the symbol "AGNC."

As a REIT, we are required to distribute annually 90% of our taxable income. So long as we continue to qualify as a REIT, we will generally not be subject to U.S. Federal or state corporate taxes on our taxable income to the extent that we distribute all our annual taxable income to our stockholders on a timely basis. It is our intention to distribute 100% of our taxable income within the time limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

We earn income primarily from investing in Agency residential mortgage-backed securities ("Agency RMBS") on a leveraged basis. These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations for which the principal and interest payments are guaranteed by a U.S. Government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac," and together with Fannie Mae, the "GSEs"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae"). We may also invest in other types of mortgage and mortgage-related residential and commercial mortgage-backed securities where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency.

Our principal objective is to provide our stockholders with attractive risk-adjusted returns through a combination of monthly dividends and tangible net book value accretion. We generate income from the interest earned on our investments, net of associated borrowing and hedging costs, and net realized gains and losses on our investment and hedging activities. We fund our investments primarily through borrowings structured as repurchase agreements. The size and composition of our investment portfolio depends on the investment strategies we implement, availability of attractively priced investments, suitable financing to appropriately leverage our investment portfolio and overall market conditions. Market conditions are influenced by a variety of factors, including interest rates, prepayment expectations, liquidity, housing prices, unemployment rates, general economic conditions, government participation in the mortgage market, regulations and relative returns on other assets.

### Trends and Recent Market Impacts

In the first quarter, the 10-year U.S. Treasury rate increased 33 basis points, while shorter maturity Treasury and swap rates increased 40 to 50 basis points. Consistent with the increase in rates and wider credit spreads more broadly, spreads on Agency RMBS relative to swap and Treasury benchmarks widened close to 10 basis points and drove our negative economic return of -2.6% for the first quarter, comprised of a (\$1.06) per common share decline in tangible net book value and \$0.54 per common share of dividends declared for the quarter.

After a somewhat turbulent first quarter, financial market volatility returned to more normal levels in the second quarter of 2018. During the second quarter, the 10-year U.S. Treasury rate increased 11 basis points to 2.85% as of June 30, 2018, and the yield curve continued its flattening trend. Agency RMBS and credit spreads were largely unchanged for the quarter. We earned a positive economic return for the second quarter of 1.7%, consisting of a

(\$0.22) per common share decline in tangible net book value and \$0.54 per common share of dividends declared. Given our expectation that interest rates would likely move higher, we chose to operate with greater interest rate risk protection during the first half of 2018. Our interest rate hedge position totaled 103% of our funding liabilities as of March 31, 2018 and 99% as of June 30, 2018. Our hedge portfolio also included a larger relative portion of interest rate swaptions, which provided

us with greater protection against large interest rate increases and higher interest rate volatility. Consistent with the size and composition of our hedge portfolio, and despite the increase in interest rates, our estimated net "duration gap," which is a measure of risk from mismatches between the interest rate sensitivity of our assets and liabilities, remained well contained at 0.5 years as of March 31, 2018 and 0.8 years as of June 30, 2018. Our hedge portfolio limited the impact of the increase in interest rates in the first half of the year on our tangible net book value and, we believe, will continue to mitigate, but not fully offset, our exposure to further rate increases. (For further information regarding our interest rate and spread sensitivity refer to Item 3. Quantitative and Qualitative Disclosures about Market Risk of this Form 10-Q.)

Consistent with the Federal Reserve's 50 basis points increase of the federal funds rate through the first two quarters of 2018, our average repo funding cost increased 56 basis points to 1.99% for the second quarter of 2018 from 1.43% for the fourth quarter of 2017. Our average total cost of funds, which includes the cost of our repurchase agreements, the implied funding costs of our TBA securities and interest rate swap hedges, increased 15 basis points to 1.67% for the second quarter of 2018 from 1.52% for the fourth quarter of 2017. Our funding cost during the first half of 2018 benefited from the favorable spread differential between the rate that we paid on our repo funding and the three-month LIBOR rate that we received on our pay fixed interest rate swaps. This positive funding dynamic moderated somewhat during the second quarter but remained favorable relative to historical levels.

Our average asset yield, including the implied yield on our TBA assets and excluding "catch-up" premium amortization associated with changes in our CPR forecast, increased 14 basis points to 3.02% for the second quarter of 2018 from 2.88% for the fourth quarter of 2017. Our net interest spread, which represents the differential between our asset yield and our cost of funds, was 1.35% for the second quarter of 2018, compared to 1.36% for the fourth quarter of 2017. Our investment portfolio increased to \$77.1 billion, inclusive of TBA securities, as of June 30, 2018 from \$72.8 billion as of December 31, 2017, consistent with the deployment of \$788 million of new equity capital raised during the second quarter. As of June 30, 2018, our "at risk" leverage ratio was 8.3x our tangible equity, marginally up from 8.1x as of December 31, 2017. Our holdings of 30-year fixed rate Agency RMBS increased to 81% of our investment portfolio as of June 30, 2018 from 77% as of December 31, 2017.

Looking ahead, we continue to believe levered investments in Agency RMBS provide attractive risk adjusted returns, particularly relative to other credit sensitive products.

## Market Information

The following table summarizes interest rates and prices of generic fixed rate Agency RMBS as of each date presented below:

| Interest Rate/Security Price <sup>1</sup> | June 30,<br>2017 | Sept. 30,<br>2017 | Dec. 31,<br>2017 | Mar. 31,<br>2018 | June 30,<br>2018 | June 30,<br>2018<br>vs<br>Mar. 31,<br>2018 | June 30,<br>2018<br>vs<br>Dec. 31,<br>2017 |
|---|------------------|-------------------|------------------|------------------|------------------|--|--|
| <b>LIBOR:</b>                             |                  |                   |                  |                  |                  |  |  |
| 1-Month                                   | 1.22%            | 1.23%             | 1.56%            | 1.88%            | 2.09%            | +0.21 bps                                  | +0.53 bps                                  |
| 3-Month                                   | 1.30%            | 1.33%             | 1.69%            | 2.31%            | 2.34%            | +0.03 bps                                  | +0.65 bps                                  |
| 6-Month                                   | 1.45%            | 1.51%             | 1.84%            | 2.45%            | 2.50%            | +0.05 bps                                  | +0.66 bps                                  |
| <b>U.S. Treasury Security Rate:</b>       |                  |                   |                  |                  |                  |  |  |
| 2-Year U.S. Treasury                      | 1.38%            | 1.48%             | 1.89%            | 2.27%            | 2.53%            | +0.26 bps                                  | +0.64 bps                                  |
| 3-Year U.S. Treasury                      | 1.55%            | 1.61%             | 1.98%            | 2.39%            | 2.62%            | +0.23 bps                                  | +0.64 bps                                  |
| 5-Year U.S. Treasury                      | 1.89%            | 1.93%             | 2.21%            | 2.57%            | 2.73%            | +0.16 bps                                  | +0.52 bps                                  |
| 10-Year U.S. Treasury                     | 2.30%            | 2.33%             | 2.41%            | 2.74%            | 2.85%            | +0.11 bps                                  | +0.44 bps                                  |
| 30-Year U.S. Treasury                     | 2.84%            | 2.86%             | 2.74%            | 2.97%            | 2.98%            | +0.01 bps                                  | +0.24 bps                                  |
| <b>Interest Rate Swap Rate:</b>           |                  |                   |                  |                  |                  |  |  |
| 2-Year Swap                               | 1.61%            | 1.73%             | 2.08%            | 2.58%            | 2.79%            | +0.21 bps                                  | +0.71 bps                                  |
| 3-Year Swap                               | 1.74%            | 1.84%             | 2.17%            | 2.65%            | 2.85%            | +0.20 bps                                  | +0.68 bps                                  |
| 5-Year Swap                               | 1.95%            | 2.00%             | 2.24%            | 2.71%            | 2.88%            | +0.17 bps                                  | +0.64 bps                                  |
| 10-Year Swap                              | 2.27%            | 2.28%             | 2.40%            | 2.78%            | 2.93%            | +0.15 bps                                  | +0.53 bps                                  |
| 30-Year Swap                              | 2.53%            | 2.52%             | 2.53%            | 2.82%            | 2.93%            | +0.11 bps                                  | +0.40 bps                                  |
| <b>30-Year Fixed Rate Agency Price:</b>   |                  |                   |                  |                  |                  |  |  |
| 3.0%                                      | \$99.88          | \$100.33          | \$100.02         | \$97.52          | \$96.86          | -\$0.66                                    | -\$3.16                                    |
| 3.5%                                      | \$102.70         | \$103.09          | \$102.70         | \$100.20         | \$99.52          | -\$0.68                                    | -\$3.18                                    |
| 4.0%                                      | \$105.12         | \$105.27          | \$104.59         | \$102.61         | \$101.96         | -\$0.65                                    | -\$2.63                                    |
| 4.5%                                      | \$107.27         | \$107.33          | \$106.40         | \$104.70         | \$104.13         | -\$0.57                                    | -\$2.27                                    |
| <b>15-Year Fixed Rate Agency Price:</b>   |                  |                   |                  |                  |                  |  |  |
| 2.5%                                      | \$100.53         | \$100.69          | \$99.88          | \$97.98          | \$97.22          | -\$0.76                                    | -\$2.66                                    |
| 3.0%                                      | \$102.64         | \$102.75          | \$101.88         | \$99.88          | \$99.41          | -\$0.47                                    | -\$2.47                                    |
| 3.5%                                      | \$104.06         | \$104.14          | \$103.23         | \$101.94         | \$101.16         | -\$0.78                                    | -\$2.07                                    |
| 4.0%                                      | \$103.44         | \$103.13          | \$102.72         | \$102.63         | \$102.58         | -\$0.05                                    | -\$0.14                                    |

Price information is for generic instruments only and is not reflective of our specific portfolio holdings. Price information is as of 3:00 p.m. (EST) on such date and can vary by source. Prices and interest rates in the table above were obtained from Barclays. LIBOR rates were obtained from Bloomberg.

## FINANCIAL CONDITION

As of June 30, 2018 and December 31, 2017, our investment portfolio consisted of \$57.1 billion and \$57.1 billion of investment securities, at fair value, respectively, and \$20.0 billion and \$15.7 billion of TBA securities, at fair value, respectively. The following table is a summary of our investment portfolio as of June 30, 2018 and December 31, 2017 (dollars in millions):

| Investment Portfolio (Includes TBAs) <sup>1</sup> | June 30, 2018  |            |                |       | December 31, 2017 |            |                |       |
|---|----------------|------------|----------------|-------|-------------------|------------|----------------|-------|
|   | Amortized Cost | Fair Value | Average Coupon | %     | Amortized Cost    | Fair Value | Average Coupon | %     |
| Fixed rate Agency RMBS and TBA securities:        |                |            |                |       |                   |            |                |       |
| ≤ 15-year:  |                |            |                |       |                   |            |                |       |
| ≤ 15-year RMBS                                    | \$7,466        | \$7,324    | 3.27 %         | 9 %   | \$8,951           | \$8,933    | 3.31 %         | 12 %  |
| 15-year TBA securities                            | 4,642          | 4,664      | 3.26 %         | 6 %   | 5,025             | 5,015      | 2.90 %         | 7 %   |
| Total ≤ 15-year                                   | 12,108         | 11,988     | 3.27 %         | 15 %  | 13,976            | 13,948     | 3.16 %         | 19 %  |
| 20-year RMBS                                      | 793            | 787        | 3.62 %         | 1 %   | 673               | 687        | 3.48 %         | 1 %   |
| 30-year:  |                |            |                |       |                   |            |                |       |
| 30-year RMBS                                      | 48,659         | 47,008     | 3.73 %         | 61 %  | 45,853            | 45,406     | 3.72 %         | 62 %  |
| 30-year TBA securities                            | 15,255         | 15,339     | 3.90 %         | 20 %  | 10,714            | 10,727     | 3.40 %         | 15 %  |
| Total 30-year                                     | 63,914         | 62,347     | 3.77 %         | 81 %  | 56,567            | 56,133     | 3.65 %         | 77 %  |
| Total fixed rate Agency RMBS and TBA securities   | 76,815         | 75,122     | 3.69 %         | 97 %  | 71,216            | 70,768     | 3.55 %         | 97 %  |
| Adjustable rate Agency RMBS                       | 247            | 249        | 2.97 %         | 1 %   | 278               | 283        | 2.90 %         | 1 %   |
| CMO Agency RMBS:                                  |                |            |                |       |                   |            |                |       |
| CMO   | 559            | 551        | 3.43 %         | 1 %   | 629               | 631        | 3.43 %         | 1 %   |
| Interest-only strips                              | 89             | 90         | 3.94 %         | — %   | 101               | 112        | 4.39 %         | — %   |
| Principal-only strips                             | 103            | 102        | — %            | — %   | 112               | 116        | — %            | — %   |
| Total CMO Agency RMBS                             | 751            | 743        | 3.36 %         | 1 %   | 842               | 859        | 3.58 %         | 1 %   |
| Total Agency RMBS and TBA securities              | 77,813         | 76,114     | 3.68 %         | 99 %  | 72,336            | 71,910     | 3.55 %         | 99 %  |
| Non-Agency RMBS                                   | 34             | 35         | 3.70 %         | — %   | 7                 | 7          | 2.50 %         | — %   |
| CMBS  | 25             | 25         | 6.55 %         | — %   | 28                | 29         | 6.55 %         | — %   |
| CRT   | 901            | 936        | 5.81 %         | 1 %   | 834               | 876        | 5.26 %         | — %   |
| Total investment portfolio                        | \$78,773       | \$77,110   | 3.71 %         | 100 % | \$73,205          | \$72,822   | 3.57 %         | 100 % |

<sup>1</sup> TBA securities are presented net of long and short positions. For further details of our TBA securities refer to Note 6 of the accompanying consolidated financial statements.

TBA securities are recorded as derivative instruments in our accompanying consolidated financial statements and our TBA dollar roll transactions represent a form of off-balance sheet financing. As of June 30, 2018 and December 31, 2017, our TBA positions had a net carrying value of \$105 million and \$3 million, respectively, reported in derivative assets/(liabilities) on our accompanying consolidated balance sheets. The net carrying value represents the difference between the fair value of the underlying Agency security in the TBA contract and the contract price to be paid or received for the underlying Agency security.

As of June 30, 2018 and December 31, 2017, the weighted average yield on our investment securities (excluding TBA securities) was 3.03% and 2.89%, respectively.

The following tables summarize certain characteristics of our fixed rate Agency RMBS portfolio, inclusive of TBAs, as of June 30, 2018 and December 31, 2017 (dollars in millions):

| Fixed Rate Agency<br>RMBS and TBA<br>Securities | June 30, 2018<br>Includes Net TBA Position |                   |               |  | Excludes Net TBA Position |                                      |                    |                 | Projected<br>Life<br>CPR <sup>4</sup> |
|---|--|-------------------|---------------|--|---------------------------|--------------------------------------|--------------------|-----------------|---------------------------------------|
|   | Par<br>Value                               | Amortized<br>Cost | Fair<br>Value | % Lower Loan<br>Balance &<br>HARP <sup>1,2</sup> | Amortized<br>Cost Basis   | Weighted Average<br>WAC <sup>3</sup> | Yield <sup>4</sup> | Age<br>(Months) |                                       |
| Fixed rate                                      |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 15-year                                       |  |                   |               |  |                           |                                      |                    |                 |                                       |
| 2.5%  | \$1,583                                    | \$1,589           | \$1,551       | 56%  | 101.2%                    | 2.98%                                | 2.11%              | 68              | 9%                                    |
| 3.0%  | 4,569                                      | 4,593             | 4,551         | 47%  | 101.9%                    | 3.50%                                | 2.43%              | 51              | 9%                                    |
| 3.5%  | 3,789                                      | 3,857             | 3,836         | 36%  | 103.3%                    | 4.01%                                | 2.57%              | 45              | 9%                                    |
| 4.0%  | 1,807                                      | 1,872             | 1,855         | 77%  | 103.9%                    | 4.40%                                | 2.65%              | 89              | 11%                                   |
| 4.5%  | 186  | 194               | 192           | 98%  | 104.2%                    | 4.87%                                | 3.01%              | 93              | 11%                                   |
| ≥ 5.0%  | 3  | 3                 | 3             | 24%  | 102.6%                    | 6.59%                                | 4.62%              | 129             | 13%                                   |
| Total ≤ 15-year                                 | 11,937                                     | 12,108            | 11,988        | 50%  | 102.5%                    | 3.75%                                | 2.47%              | 62              | 9%                                    |
| 20-year   |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 3.0%  | 182  | 181               | 180           | 31%  | 99.4%                     | 3.55%                                | 3.10%              | 61              | 8%                                    |
| 3.5%  | 338  | 345               | 341           | 74%  | 102.1%                    | 4.05%                                | 3.00%              | 64              | 10%                                   |
| 4.0%  | 149  | 154               | 153           | 83%  | 103.7%                    | 4.44%                                | 3.22%              | 26              | 10%                                   |
| 4.5%  | 105  | 111               | 111           | 100%   | 105.9%                    | 4.97%                                | 3.19%              | 44              | 11%                                   |
| ≥ 5.0%  | 2  | 2                 | 2             | —%   | 106.0%                    | 5.96%                                | 3.33%              | 123             | 16%                                   |
| Total 20-year:                                  | 776  | 793               | 787           | 69%  | 102.3%                    | 4.15%                                | 3.09%              | 53              | 10%                                   |
| 30-year:  |  |                   |               |  |                           |                                      |                    |                 |                                       |
| 3.0%  | 6,069                                      | 5,956             | 5,894         | 2%   | 100.2%                    | 3.58%                                | 2.96%              | 48              | 6%                                    |
| 3.5%  | 23,165                                     | 24,060            | 23,166        | 60%  | 104.3%                    | 4.04%                                | 2.92%              | 39              | 6%                                    |
| 4.0%  | 25,238                                     | 26,472            | 25,868        | 59%  | 105.9%                    | 4.46%                                | 3.16%              | 32              | 7%                                    |
| 4.5%  | 6,927                                      | 7,238             | 7,233         | 22%  | 106.3%                    | 4.96%                                | 3.54%              | 39              | 8%                                    |
| 5.0%  | 88   | 94                | 95            | 64%  | 107.1%                    | 5.45%                                | 3.71%              | 122             | 8%                                    |
| ≥ 5.5%  | 85   | 94                | 91            | 36%  | 110.5%                    | 6.17%                                | 3.38%              | 140             | 12%                                   |
| Total 30-year                                   | 61,572                                     | 63,914            | 62,347        | 50%  | 104.8%                    | 4.24%                                | 3.06%              | 37              | 7%                                    |
| Total fixed rate                                | \$74,285                                   | \$76,815          | \$75,122      | 50%  | 104.5%                    | 4.18%                                | 2.98%              | 40              | 7%                                    |

Lower loan balance securities represent pools backed by an original loan balance of ≤ \$150,000. Our lower loan balance securities had a weighted average original loan balance of \$100,000 and \$109,000 for 15-year and 30-year securities, respectively, as of June 30, 2018.

HARP securities are defined as pools backed by 100% refinance loans with LTV ≥ 80%. Our HARP securities had a weighted average LTV of 115% and 136% for 15-year and 30-year securities, respectively, as of June 30, 2018.

WAC represents the weighted average coupon of the underlying collateral.

Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of June 30, 2018.

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| Fixed Rate Agency<br>RMBS and TBA<br>Securities | December 31, 2017<br>Includes Net TBA Position |                   |               |  | Excludes Net TBA Position |                                      |                    |                 |                                       |
|---|--|-------------------|---------------|--|---------------------------|--------------------------------------|--------------------|-----------------|---------------------------------------|
|   | Par<br>Value                                   | Amortized<br>Cost | Fair<br>Value | % Lower Loan<br>Balance &<br>HARP <sup>1,2</sup> | Amortized<br>Cost Basis   | Weighted Average<br>WAC <sup>3</sup> | Yield <sup>4</sup> | Age<br>(Months) | Projected<br>Life<br>CPR <sup>4</sup> |
| Fixed rate                                      |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 15-year                                       |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 2.5%  | \$3,041  | \$ 3,061          | \$3,046       | 32%  | 101.2%                    | 2.98%                                | 2.13%              | 63              | 9%                                    |
| 3.0%  | 5,616  | 5,749             | 5,724         | 33%  | 102.8%                    | 3.49%                                | 2.18%              | 62              | 10%                                   |
| 3.5%  | 2,710  | 2,804             | 2,804         | 75%  | 103.5%                    | 3.96%                                | 2.42%              | 69              | 11%                                   |
| 4.0%  | 2,054  | 2,134             | 2,145         | 89%  | 103.9%                    | 4.40%                                | 2.68%              | 84              | 11%                                   |
| 4.5%  | 215  | 224               | 225           | 98%  | 104.3%                    | 4.87%                                | 3.01%              | 88              | 12%                                   |
| ≥ 5.0%  | 4  | 4                 | 4             | 17%  | 102.8%                    | 6.56%                                | 4.47%              | 125             | 44%                                   |
| Total ≤ 15-year                                 | 13,640   | 13,976            | 13,948        | 51%  | 103.0%                    | 3.77%                                | 2.38%              | 70              | 10%                                   |
| 20-year   |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 3.0%  | 195  | 193               | 198           | 31%  | 99.4%                     | 3.55%                                | 3.10%              | 55              | 9%                                    |
| 3.5%  | 365  | 373               | 380           | 75%  | 102.1%                    | 4.05%                                | 3.00%              | 58              | 11%                                   |
| 4.0%  | 45   | 47                | 48            | 51%  | 104.2%                    | 4.54%                                | 2.96%              | 76              | 11%                                   |
| 4.5%  | 55   | 58                | 59            | 99%  | 106.5%                    | 4.90%                                | 2.95%              | 85              | 11%                                   |
| ≥ 5.0%  | 2  | 2                 | 2             | —%   | 106.0%                    | 5.95%                                | 3.32%              | 116             | 17%                                   |
| Total 20-year:                                  | 662  | 673               | 687           | 62%  | 101.8%                    | 4.02%                                | 3.02%              | 61              | 10%                                   |
| 30-year:  |  |                   |               |  |                           |                                      |                    |                 |                                       |
| ≤ 3.0%  | 7,583  | 7,576             | 7,592         | 1%   | 100.2%                    | 3.58%                                | 2.96%              | 43              | 6%                                    |
| 3.5%  | 24,045   | 25,072            | 24,800        | 56%  | 104.6%                    | 4.04%                                | 2.84%              | 35              | 7%                                    |
| 4.0%  | 21,015   | 22,348            | 22,166        | 64%  | 106.5%                    | 4.47%                                | 2.99%              | 29              | 9%                                    |
| 4.5%  | 1,271  | 1,366             | 1,369         | 71%  | 107.4%                    | 4.98%                                | 3.18%              | 62              | 10%                                   |
| 5.0%  | 97   | 103               | 104           | 65%  | 106.6%                    | 5.45%                                | 3.69%              | 116             | 10%                                   |
| ≥ 5.5%  | 92   | 102               | 102           | 36%  | 110.0%                    | 6.18%                                | 3.34%              | 135             | 14%                                   |
| Total 30-year                                   | 54,103   | 56,567            | 56,133        | 52%  | 105.2%                    | 4.23%                                | 2.93%              | 34              | 8%                                    |
| Total fixed rate                                | \$68,405                                       | \$ 71,216         | \$70,768      | 52%  | 104.8%                    | 4.15%                                | 2.84%              | 40              | 8%                                    |

Lower loan balance securities represent pools backed by an original loan balance of ≤ \$150,000. Our lower loan balance securities had a weighted average original loan balance of \$97,000 and \$109,000 for 15-year and 30-year securities, respectively, as of December 31, 2017.

HARP securities are defined as pools backed by 100% refinance loans with LTVs ≥ 80%. Our HARP securities had a weighted average LTV of 114% and 136% for 15-year and 30-year securities, respectively, as of December 31, 2017.

3. WAC represents the weighted average coupon of the underlying collateral.

4. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2017.

As of June 30, 2018 and December 31, 2017, our investments in CRT and non-Agency securities had the following credit ratings:

| CRT and Non-Agency Security Credit Ratings <sup>1</sup> | June 30, 2018 |      |      | December 31, 2017 |      |      |
|---|---------------|------|------|-------------------|------|------|
|   | CRT           | RMBS | CMBS | CRT               | RMBS | CMBS |
| AAA   | \$ —          | \$ 7 | \$ — | \$ —              | \$ 7 | \$ — |
| BBB   | 56            | 18   | 25   | 20                | —    | 29   |
| BB  | 499           | 2    | —    | 136               | —    | —    |
| B   | 345           | —    | —    | 691               | —    | —    |
| Not Rated   | 36            | 8    | —    | 29                | —    | —    |



|       |       |       |       |       |      |       |
|-------|-------|-------|-------|-------|------|-------|
| Total | \$936 | \$ 35 | \$ 25 | \$876 | \$ 7 | \$ 29 |
|-------|-------|-------|-------|-------|------|-------|

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1. Represents the lowest of Standard and Poor's ("S&P"), Moody's and Fitch credit ratings, stated in terms of the S&P equivalent rating as of each date.

Our CRT securities reference the performance of loans underlying Agency RMBS issued by Fannie Mae or Freddie Mac, which were subject to their underwriting standards. As of June 30, 2018, our CRT securities had floating and fixed rate coupons ranging from 3.7% to 9.0%, referenced to loans originated between 2011 and 2018 with weighted average coupons ranging from 3.6% to 4.4%. As of December 31, 2017, our CRT securities had floating rate coupons ranging from 3.9% to 8.5%, referenced to loans originated between 2012 and 2017 with weighted average coupons ranging from 3.6% to 4.4%.

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## RESULTS OF OPERATIONS

### Non-GAAP Financial Measures

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including "economic interest income," "economic interest expense," "net spread and dollar roll income," "net spread and dollar roll income, excluding 'catch-up' premium amortization," "estimated taxable income" and the related per common share measures and certain financial metrics derived from such non-GAAP information, such as "cost of funds" and "net interest spread."

"Economic interest income" is measured as interest income (GAAP measure), adjusted (i) to exclude "catch-up" premium amortization associated with changes in CPR estimates and (ii) to include TBA dollar roll implied interest income. "Economic interest expense" is measured as interest expense (GAAP measure) adjusted to include TBA dollar roll implied interest expense and interest rate swap periodic income/(cost). "Net spread and dollar roll income, excluding "catch-up" premium amortization" includes (i) the components of economic interest income and economic interest expense and dividends on REIT equity securities (referred to as "adjusted net interest and dollar roll income"), less (ii) total operating expenses (GAAP measure), net of management fee income (GAAP measure).

By providing such measures, in addition to the related GAAP measures, we believe we give greater transparency into the information used by our management in its financial and operational decision-making. We also believe it is important for users of our financial information to consider information related to our current financial performance without the effects of certain measures that are not necessarily indicative of our current investment portfolio performance and operations.

Specifically, in the case of "adjusted net interest and dollar roll income," we believe the inclusion of TBA dollar roll income is meaningful as TBAs, which are accounted for under GAAP as derivative instruments with gains and losses recognized in other gain (loss) in our consolidated statement of comprehensive income, are economically equivalent to holding and financing generic Agency RMBS using short-term repurchase agreements. Similarly, we believe that the inclusion of periodic interest rate swap settlements in "economic interest expense" is meaningful as interest rate swaps are the primary instrument we use to economically hedge against fluctuations in our borrowing costs and it is more indicative of our total cost of funds than interest expense alone. In the case of "economic interest income" and "net spread and dollar roll income, excluding 'catch-up' premium amortization," we believe the exclusion of "catch-up" adjustments to premium amortization cost or benefit is meaningful as it excludes the cumulative effect from prior reporting periods due to current changes in future prepayment expectations and, therefore, exclusion of such cost or benefit is more indicative of the current earnings potential of our investment portfolio. In the case of estimated taxable income, we believe it is meaningful information because it directly relates to the amount of dividends we are required to distribute to maintain our REIT qualification status.

However, because such measures are incomplete measures of our financial performance and involve differences from results computed in accordance with GAAP, they should be considered as supplementary to, and not as a substitute for, results computed in accordance with GAAP. In addition, because not all companies use identical calculations, our presentation of such non-GAAP measures may not be comparable to other similarly-titled measures of other companies. Furthermore, estimated taxable income can include certain information that is subject to potential adjustments up to the time of filing our income tax returns, which occurs after the end of our fiscal year.

### Selected Financial Data

The following selected financial data is derived from our interim consolidated financial statements and the notes thereto. The tables below present our condensed consolidated balance sheets as of June 30, 2018 and December 31, 2017 and our condensed consolidated statements of comprehensive income and key statistics for the three and six months ended June 30, 2018 and 2017 (in millions, except per share amounts):

(\$ in Millions, Except Per Share Amounts)

|   |                   |           |              |                |
|---|-------------------|-----------|--------------|----------------|
| Balance Sheet Data  | June 30, December |           |              |                |
|   | 2018              | 31, 2017  |              |                |
| Investment securities, at fair value  | \$57,107          | \$ 57,080 |              |                |
| Total assets  | \$73,138          | \$ 70,376 |              |                |
| Repurchase agreements and other debt  | \$49,152          | \$ 50,653 |              |                |
| Total liabilities   | \$64,096          | \$ 61,622 |              |                |
| Total stockholders' equity  | \$9,042           | \$ 8,754  |              |                |
| Net book value per common share <sup>1</sup>                                | \$19.68           | \$ 21.09  |              |                |
| Tangible net book value per common share <sup>2</sup>                       | \$18.41           | \$ 19.69  |              |                |
|   |                   |           | Three Months | Six Months     |
|   |                   |           | Ended June   | Ended June 30, |
|   |                   |           | 30,          |                |
| Statement of Comprehensive Income Data                                      | 2018              | 2017      | 2018         | 2017           |
| Interest income   | \$414             | \$293     | \$845        | \$589          |
| Interest expense  | 237               | 112       | 443          | 210            |
| Net interest income   | 177               | 181       | 402          | 379            |
| Other gain (loss), net  | 134               | (141 )    | 351          | (245 )         |
| Operating expenses  | 18                | 16        | 36           | 34             |
| Net income  | 293               | 24        | 717          | 100            |
| Dividend on preferred stock   | 9                 | 7         | 18           | 14             |
| Net income available to common stockholders                                 | \$284             | \$17      | \$699        | \$86           |
|   |                   |           |              |                |
| Net income  | \$293             | \$24      | \$717        | \$100          |
| Other comprehensive income (loss)   | (145 )            | 121       | (766 )       | 167            |
| Comprehensive income (loss)   | 148               | 145       | (49 )        | 267            |
| Dividend on preferred stock   | 9                 | 7         | 18           | 14             |
| Comprehensive income (loss) available (attributable) to common stockholders | \$139             | \$138     | \$(67 )      | \$253          |
|   |                   |           |              |                |
| Weighted average number of common shares outstanding - basic                | 404.9             | 346.4     | 398.2        | 338.8          |
| Weighted average number of common shares outstanding - diluted              | 405.2             | 346.5     | 398.4        | 338.9          |
| Net income per common share - basic   | \$0.70            | \$0.05    | \$1.76       | \$0.25         |
| Net income per common share - diluted                                       | \$0.70            | \$0.05    | \$1.75       | \$0.25         |
| Comprehensive income (loss) per common share - basic and diluted            | \$0.34            | \$0.40    | \$(0.17)     | \$0.75         |
| Dividends declared per common share   | \$0.54            | \$0.54    | \$1.08       | \$1.08         |

|  | Three Months   |          | Six Months     |          |
|--|----------------|----------|----------------|----------|
|  | Ended June 30, |          | Ended June 30, |          |
|  | 2018           | 2017     | 2018           | 2017     |
| Other Data (Unaudited) *   |                |          |                |          |
| Average investment securities - at par                                       | \$52,856       | \$41,986 | \$53,421       | \$42,102 |
| Average investment securities - at cost                                      | \$55,329       | \$43,992 | \$55,927       | \$44,083 |
| Average net TBA portfolio - at cost  | \$16,912       | \$16,931 | \$16,252       | \$15,205 |
| Average total assets - at fair value   | \$68,830       | \$54,241 | \$68,785       | \$54,441 |
| Average Agency repurchase agreements and other debt outstanding <sup>3</sup> | \$47,823       | \$38,945 | \$48,690       | \$39,073 |
| Average stockholders' equity <sup>4</sup>                                    | \$8,652        | \$7,552  | \$8,630        | \$7,451  |
| Average tangible net book value "at risk" leverage <sup>5</sup>              | 8.0:1          | 8.0:1    | 8.1:1          | 7.9:1    |
| Tangible net book value "at risk" leverage (as of period end) <sup>6</sup>   | 8.3:1          | 8.1:1    | 8.3:1          | 8.1:1    |
| Economic return on tangible common equity, unannualized <sup>7</sup>         | 1.7 %          | 2.5 %    | (1.0) %        | 4.3 %    |
| Expenses % of average total assets, annualized                               | 0.10 %         | 0.12 %   | 0.10 %         | 0.12 %   |
| Expenses % of average assets, including average net TBA position, annualized | 0.08 %         | 0.09 %   | 0.08 %         | 0.09 %   |
| Expenses % of average stockholders' equity, annualized                       | 0.83 %         | 0.85 %   | 0.83 %         | 0.89 %   |

\* Except as noted below, average numbers for each period are weighted based on days on our books and records.

1. Net book value per common share is calculated as total stockholders' equity, less preferred stock liquidation preference, divided by number of common shares outstanding as of period end.

2. Tangible net book value per common share excludes goodwill and other intangible assets, net.

3. Other debt includes debt of consolidated VIEs. Amount excludes U.S. Treasury repo agreements and TBA contracts.

4. Average stockholders' equity calculated as average month-ended stockholders' equity during the period.

5. Average tangible net book value "at risk" leverage is calculated by dividing the sum of daily weighted average mortgage borrowings outstanding (Agency repo, other debt and TBA securities (at cost)) for the period by the sum of average stockholders' equity less average investment in REIT equity securities, goodwill and other intangible assets, net for the period. Leverage excludes U.S. Treasury repurchase agreements.

6. "At risk" leverage as of period end is calculated by dividing the sum of mortgage borrowings outstanding and receivable/payable for unsettled investment securities as of period end (at cost) by the sum of total stockholders' equity less the fair value of investments in REIT equity securities, goodwill and other intangible assets, net at period end. Leverage excludes U.S. Treasury repurchase agreements.

7. Economic return on tangible common equity represents the sum of the change in tangible net book value per common share and dividends declared on common stock during the period over beginning tangible net book value per common share.

#### Economic Interest Income and Asset Yields

The following table summarizes our economic interest income (a non-GAAP measure) for the three and six months ended June 30, 2018 and 2017, which includes the combination of interest income (a GAAP measure) on our holdings reported as investment securities on our consolidated balance sheets, adjusted to exclude estimated "catch-up" amortization adjustments due to changes in our CPR forecast, and implied interest income on our TBA securities (dollars in millions):

|  | Three Months Ended June 30, |         |        | Six Months Ended June 30, |        |         |
|--|-----------------------------|---------|--------|---------------------------|--------|---------|
|  | 2018                        |         | 2017   | 2018                      |        | 2017    |
|  | Amount                      | Yield   | Amount | Yield                     | Amount | Yield   |
| Interest income:   |                             |         |        |                           |        |         |
| Cash/coupon interest income  | \$488                       | 3.69 %  | \$389  | 3.70 %                    | \$988  | 3.70 %  |
| Net premium amortization   | (74 )                       | (0.70)% | (96 )  | (1.04)%                   | (143 ) | (0.68)% |
| Interest income (GAAP measure)   | 414                         | 2.99 %  | 293    | 2.66 %                    | 845    | 3.02 %  |
| Estimated "catch-up" premium amortization (benefit) cost due to change in CPR forecast | (12 )                       | (0.08)% | 13     | 0.12 %                    | (33 )  | (0.12)% |
|  |                             |         |        |                           | 22     | 0.10 %  |

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|  |        |        |        |        |         |        |        |        |
|--|--------|--------|--------|--------|---------|--------|--------|--------|
| Interest income, excluding "catch-up" premium amortization   | 402    | 2.91 % | 306    | 2.78 % | 812     | 2.90 % | 611    | 2.77 % |
| TBA dollar roll income - implied interest income <sup>1,2</sup>                                      | 144    | 3.41 % | 130    | 3.08 % | 264     | 3.25 % | 220    | 2.91 % |
| Economic interest income, excluding "catch-up" amortization (non-GAAP measure) <sup>3</sup>          | \$546  | 3.02 % | \$436  | 2.86 % | \$1,076 | 2.98 % | \$831  | 2.81 % |
| Weighted average actual portfolio CPR for investment securities held during the period               | 9.7 %  |        | 10.9 % |        | 9.1 %   |        | 10.8 % |        |
| Weighted average projected CPR for the remaining life of investment securities held as of period end | 7.1 %  |        | 8.6 %  |        | 7.1 %   |        | 8.6 %  |        |
| Average 30-year fixed rate mortgage rate as of period end <sup>4</sup>                               | 4.55 % |        | 3.88 % |        | 4.55 %  |        | 3.88 % |        |
| 10-year U.S. Treasury rate as of period end  | 2.85 % |        | 2.30 % |        | 2.85 %  |        | 2.30 % |        |

<sup>1.</sup> Reported in gain (loss) on derivatives instruments and other securities, net in the accompanying consolidated statements of operations.

Implied interest income from TBA dollar roll transactions is computed as the sum of (i) TBA dollar roll income and (ii) estimated TBA implied funding cost (see Economic Interest Expense and Aggregate Cost of Funds below). TBA dollar roll income represents the price differential, or "price drop," between the TBA price for current month settlement versus the TBA price for forward month settlement and is the economic equivalent to interest income on the underlying Agency securities, less an implied funding cost, over the forward settlement period. Amount is net of TBAs used for hedging purposes. Amount excludes TBA mark-to-market adjustments.

The combined asset yield is calculated on a weighted average basis based on our average investment and TBA balances outstanding during the period and their respective yields.

4. Source: Freddie Mac Primary Fixed Mortgage Rate Mortgage Market Survey

The principal elements impacting our economic interest income are the size of our average investment portfolio and the yield (actual and implied) on our securities. The following is a summary of the estimated impact of each of these elements on our economic interest income for the three and six months ended June 30, 2018 compared to the prior year period (in millions):

Impact of Changes in the Principal Elements Impacting Economic Interest Income  
Periods ended June 30, 2018 vs. June 30, 2017

|  | Total<br>Increase /<br>(Decrease) | Due to<br>Change in<br>Average<br>Portfolio<br>Size | Asset<br>Yield |
|--|-----------------------------------|---|----------------|
| Three months ended:  |                                   |   |                |
| Interest Income (GAAP measure)   | \$ 121                            | \$76  | \$45           |
| Estimated "catch-up" premium amortization due to change in CPR forecast        | (25 )                             | —   | (25 )          |
| Interest income, excluding "catch-up" premium amortization                     | 96                                | 76  | 20             |
| TBA dollar roll income - implied interest income                               | 14                                | (1 )  | 15             |
| Economic interest income, excluding "catch-up" amortization (non-GAAP measure) | \$ 110                            | \$75  | \$35           |

Six months ended:

|  |        |       |       |
|--|--------|-------|-------|
| Interest Income (GAAP measure)   | \$ 256 | \$158 | \$98  |
| Estimated "catch-up" premium amortization due to change in CPR forecast        | (55 )  | —     | (55 ) |
| Interest income, excluding "catch-up" premium amortization                     | 201    | 158   | 43    |
| TBA dollar roll income - implied interest income                               | 44     | 15    | 29    |
| Economic interest income, excluding "catch-up" amortization (non-GAAP measure) | \$ 245 | \$173 | \$72  |

Our average investment portfolio increased 19% and 22% (at cost) for the three and six months ended June 30, 2018, respectively, from the prior year period, mainly due to the deployment of new equity capital. The increase in our average asset yield over the prior year periods was largely due to changes in asset composition and lower forecasted prepayment rates, as we increased our holdings of 30-year fixed rate securities and higher interest rates reduced our prepayment forecasts.

Leverage

Our primary measure of leverage is our tangible net book value "at risk" leverage ratio. Tangible net book value "at risk" leverage is measured as the sum of our Agency repurchase agreements, other debt used to fund our investment securities and net TBA position (at cost) (together referred to as "mortgage borrowings") and our net receivable/payable for unsettled investment securities, divided by our total stockholders' equity adjusted to exclude goodwill and other intangible assets.

We include our net TBA position in our measure of leverage because a forward contract to acquire Agency RMBS in the TBA market carries similar risks to Agency RMBS purchased in the cash market and funded with on-balance sheet liabilities. Similarly, a TBA contract for the forward sale of Agency securities has substantially the same effect as selling the underlying Agency RMBS and reducing our on-balance sheet funding commitments. (Refer to Liquidity

and Capital Resources for further discussion of TBA securities and dollar roll transactions). Repurchase agreements used to fund short-term investments in U.S. Treasury securities ("U.S. Treasury repo") are excluded from our measure of leverage due to the temporary and highly liquid nature of these investments.

Our tangible net book value "at risk" leverage was 8.3x and 8.1x as of June 30, 2018 and December 31, 2017, respectively. The table below presents a summary of our leverage ratios for the periods listed (dollars in millions):

| Quarter Ended      | Agency Repurchase<br>Agreements and Other Debt<br><sup>1</sup> |                            |                  | Net TBA<br>Position<br>Long/(Short) <sup>2</sup> |                  | Average<br>Tangible Net<br>Book Value<br>"At Risk"<br>Leverage<br>during the<br>Period <sup>3</sup> | Average<br>"At Risk"<br>Leverage<br>during the<br>Period <sup>4</sup> | Tangible Net<br>Book Value<br>"At Risk"<br>Leverage<br>as of<br>Period End <sup>3</sup> | "At Risk"<br>Leverage<br>as of<br>Period<br>End <sup>5</sup> |
|--------------------|--|----------------------------|------------------|--|------------------|---|---|---|--|
|                    | Average<br>Daily<br>Amount                                     | Maximum<br>Daily<br>Amount | Ending<br>Amount | Average<br>Daily<br>Amount                       | Ending<br>Amount |   |   |   |  |
| June 30, 2018      | \$47,823   | \$49,892                   | \$49,152         | \$16,912   | \$19,898         | 8.0:1   | 7.5:1   | 8.3:1   | 7.8:1  |
| March 31, 2018     | \$49,567   | \$50,645                   | \$49,292         | \$15,585   | \$13,529         | 8.2:1   | 7.7:1   | 8.2:1   | 7.6:1  |
| December 31, 2017  | \$48,122   | \$51,322                   | \$50,653         | \$18,355   | \$15,739         | 8.1:1   | 7.6:1   | 8.1:1   | 7.6:1  |
| September 30, 2017 | \$41,406   | \$47,442                   | \$45,885         | \$18,616   | \$19,433         | 7.9:1   | 7.4:1   | 8.0:1   | 7.6:1  |
| June 30, 2017      | \$38,945   | \$40,112                   | \$39,463         | \$16,931   | \$17,283         | 8.0:1   | 7.4:1   | 8.1:1   | 7.5:1  |
| March 31, 2017     | \$39,203   | \$41,221                   | \$39,809         | \$13,460   | \$14,377         | 7.8:1   | 7.2:1   | 8.0:1   | 7.4:1  |

1. Other debt includes debt of consolidated VIEs. Amounts exclude U.S. Treasury repo agreements.

2. Daily average and ending net TBA position outstanding measured at cost.

3. Tangible net book value "at risk" leverage includes the components of "at risk" leverage with stockholders' equity adjusted to exclude goodwill and other intangible assets, net.

Average "at risk" leverage during the period was calculated by dividing the sum of our daily weighted average mortgage borrowings outstanding during the period by the sum of our average month-ended stockholders' equity less our average investment in REIT equity securities for the period.

"At risk" leverage as of period end is calculated by dividing the sum of our mortgage borrowings outstanding and our receivable/payable for unsettled investment securities as of period end (at cost) by the sum of our total stockholders' equity less the fair value of investments in REIT equity securities at period end. Leverage excludes U.S. Treasury repo agreements.

#### Economic Interest Expense and Aggregate Cost of Funds

The following table summarizes our economic interest expense and aggregate cost of funds (non-GAAP measures) for the three and six months ended June 30, 2018 and 2017 (dollars in millions), which includes the combination of interest expense on Agency repurchase agreements and other debt (GAAP measure), implied interest expense on our TBA securities and periodic interest rate swap (income) cost:

|   | Three Months Ended June 30, 2018 |               |        | Six Months Ended June 30, 2017 |               |        |
|---|----------------------------------|---------------|--------|--------------------------------|---------------|--------|
|   | Amount                           | Cost of Funds | Amount | Amount                         | Cost of Funds | Amount |
| Economic Interest Expense and Aggregate Cost of Funds <sup>1</sup>  |                                  |               |        |                                |               |        |
| Repurchase agreement and other debt - interest expense (GAAP measure)   | \$237                            | 1.99 %        | \$112  | \$443                          | 1.83 %        | \$210  |
| TBA dollar roll income - implied interest expense <sup>2,3</sup>  | 74                               | 1.75 %        | 37     | 132                            | 1.63 %        | 56     |
| Economic interest expense - before interest rate swap costs <sup>4</sup>  | 311                              | 1.92 %        | 149    | 575                            | 1.79 %        | 266    |
| Periodic interest costs of interest rate swaps reported in gain (loss) on derivative instruments and other securities, net <sup>5</sup> | (41 )                            | (0.25) %      | 35     | (32 )                          | (0.10) %      | 80     |



Total economic interest expense (non-GAAP measure)    \$270   1.67   %   \$184   1.31   %   \$543   1.69   %   \$346   1.29   %

1. Amounts exclude interest rate swap termination fees and variation margin settlements paid or received, forward starting swaps or the impact of other supplemental hedges, such as swaptions and U.S. Treasury positions.

2. Reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

3. The implied funding cost of TBA dollar roll transactions is determined using the price differential, or "price drop," between the TBA price for current month settlement versus the TBA price for forward month settlement and market based assumptions regarding the "cheapest-to-deliver" collateral that can be delivered to satisfy the TBA contract, such as the anticipated collateral's weighted average coupon, weighted average maturity and projected 1-month CPR. The average implied funding cost for all TBA transactions is weighted based on our daily average TBA balance outstanding for the period.

4. The combined cost of funds for total mortgage borrowings outstanding, before interest rate swap costs, is calculated on a weighted average basis based on average repo, other debt and TBA balances outstanding during the period and their respective cost of funds.

5. Interest rate swap cost of funds measured as a percent of average mortgage borrowings outstanding for the period.

The principal elements impacting our economic interest expense are (i) the size of our average mortgage borrowings and interest rate swap portfolio outstanding during the period, (ii) the average interest rate (actual and implied) on our mortgage borrowings and (iii) the average net interest rate paid/received on our interest rate swaps. The following is a summary of the estimated impact of these elements on our economic interest expense for the three and six months ended June 30, 2018, compared to the prior year period (in millions):

Impact of Changes in the Principal Elements of Economic Interest Expense  
Periods ended June 30, 2018 vs. June 30, 2017

|   | Total<br>Increase /<br>(Decrease) | Due to Change<br>in Average<br>Borrowing<br>/ Swap<br>Rate<br>Balance |
|---|-----------------------------------|---|
| Three months ended:                                   |                                   |   |
| Repurchase agreements and other debt interest expense | \$ 125                            | \$25 \$ 100   |
| TBA dollar roll income - implied interest expense     | 37                                | — 37  |
| Periodic interest rate swap costs                     | (76 )                             | 6 (82 )   |
| Total change in economic interest expense             | \$ 86                             | \$31 \$ 55  |

|   |        |             |
|---|--------|-------------|
| Six months ended:                                     |        |             |
| Repurchase agreements and other debt interest expense | \$ 233 | \$52 \$ 181 |
| TBA dollar roll income - implied interest expense     | 76     | 4 72        |
| Periodic interest rate swap costs                     | (112 ) | 13 (125 )   |
| Total change in economic interest expense             | \$ 197 | \$69 \$ 128 |

The increase in our average borrowing cost over prior year periods was a function of a higher federal funds rate, which was partly offset by a larger portion of our Agency repo funded through our captive broker-dealer subsidiary, Bethesda Securities, LLC ("BES"). On average, repo sourced through BES carries a lower cost of funds than comparable traditional bi-lateral repo. The decrease in our periodic swap costs was primarily due to an increase in three-month LIBOR received on our pay-fixed receive-floating interest rate swaps.

The table below presents a summary of the ratio of our average interest rates swaps outstanding, excluding forward starting swaps, to our average mortgage borrowings for the three and six months ended June 30, 2018 and 2017 (dollars in millions):

|  | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |          |
|--|--------------------------------|----------|------------------------------|----------|
| Average Ratio of Interest Rate Swaps (Excluding Forward Starting Swaps) to Mortgage Borrowings Outstanding | 2018                           | 2017     | 2018                         | 2017     |
| Average Agency repo and other debt outstanding   | \$47,823                       | \$38,945 | \$48,690                     | \$39,073 |
| Average net TBA portfolio outstanding - at cost  | \$16,912                       | \$16,931 | \$16,252                     | \$15,205 |
| Average mortgage borrowings outstanding  | \$64,735                       | \$55,876 | \$64,942                     | \$54,278 |
| Average notional amount of interest rate swaps outstanding (excluding forward starting swaps)              | \$42,804                       | \$36,549 | \$41,918                     | \$36,161 |
| Ratio of average interest rate swaps to mortgage borrowings outstanding                                    | 66                             | % 65     | % 65                         | % 67     |
| Average interest rate swap pay-fixed rate (excluding forward starting swaps)                               | 1.79                           | % 1.52   | % 1.76                       | % 1.50   |
| Average interest rate swap receive-floating rate   | (2.17 )%                       | (1.14 )% | (1.91 )%                     | (1.05 )% |
| Average interest rate swap net pay/(receive) rate  | (0.38 )%                       | 0.38 %   | (0.15 )%                     | 0.45 %   |

For the three and six months ended June 30, 2018, we had an average forward starting swap balance of \$3.9 billion and \$3.6 billion, respectively. For the three and six months ended June 30, 2017 we had an average forward starting swap balance of \$2.5 billion and \$1.5 billion, respectively. Forward starting interest rate swaps do not impact our economic interest expense and aggregate cost of funds until they commence accruing net interest settlements on their forward start dates. Including forward starting swaps, our average ratio of interest rate swaps outstanding to our average mortgage borrowings for the three and six months ended June 30, 2018 was 72% and 70%, respectively,

compared to 70% and 69%, respectively, for the prior year period.

#### Net Interest Spread

The following table presents a summary of our net interest spread (including the impact of TBA dollar roll income, interest rate swaps and excluding "catch-up" premium amortization) for the three and six months ended June 30, 2018 and 2017:

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|  | Three Months<br>Ended June 30, |         | Six Months<br>Ended June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2018                           | 2017    | 2018                         | 2017    |
| Investment and TBA Securities - Net Interest Spread                    |                                |         |                              |         |
| Average asset yield, excluding "catch-up" premium amortization         | 3.02 %                         | 2.86 %  | 2.98 %                       | 2.81 %  |
| Average aggregate cost of funds  | (1.67)%                        | (1.31)% | (1.69)%                      | (1.29)% |
| Average net interest spread, excluding "catch-up" premium amortization | 1.35 %                         | 1.55 %  | 1.29 %                       | 1.52 %  |

# Net Spread and Dollar Roll Income

The following table presents a summary of our net spread and dollar roll income, excluding estimated "catch-up" premium amortization, per diluted common share (a non-GAAP financial measure) and a reconciliation to our net interest income (the most comparable GAAP financial measure) for the three and six months ended June 30, 2018 and 2017 (dollars in millions):

|   | Three Months<br>Ended June<br>30, |        | Six Months<br>Ended June<br>30, |        |
|---|-----------------------------------|--------|---------------------------------|--------|
|   | 2018                              | 2017   | 2018                            | 2017   |
| Net interest income (GAAP measure)  | \$177                             | \$181  | \$402                           | \$379  |
| TBA dollar roll income, net <sup>1</sup>  | 70                                | 93     | 132                             | 164    |
| Periodic interest income (cost) of interest rate swaps, net <sup>1</sup>  | 41                                | (35 )  | 32                              | (80 )  |
| Dividend income from REIT equity securities <sup>1</sup>  | 1                                 | —      | 2                               | —      |
| Adjusted net interest and dollar roll income  | 289                               | 239    | 568                             | 463    |
| Other operating income (expense):   |                                   |        |                                 |        |
| Management fee income   | 4                                 | 4      | 8                               | 8      |
| Operating expenses  | (18 )                             | (16 )  | (36 )                           | (34 )  |
| Adjusted operating income (expense), net  | (14 )                             | (12 )  | (28 )                           | (26 )  |
| Net spread and dollar roll income   | 275                               | 227    | 540                             | 437    |
| Dividend on preferred stock   | 9                                 | 7      | 18                              | 14     |
| Net spread and dollar roll income available to common stockholders (non-GAAP measure)   | 266                               | 220    | 522                             | 423    |
| Estimated "catch-up" premium amortization (benefit) cost due to change in CPR forecast  | (12 )                             | 13     | (33 )                           | 22     |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, available to common stockholders (non-GAAP measure) | \$254                             | \$233  | \$489                           | \$445  |
| Weighted average number of common shares outstanding - basic  | 404.9                             | 346.4  | 398.2                           | 338.8  |
| Weighted average number of common shares outstanding - diluted  | 405.2                             | 346.5  | 398.4                           | 338.9  |
| Net spread and dollar roll income per common share - basic  | \$0.66                            | \$0.64 | \$1.31                          | \$1.25 |
| Net spread and dollar roll income per common share - diluted  | \$0.66                            | \$0.63 | \$1.31                          | \$1.25 |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common share - basic                            | \$0.63                            | \$0.67 | \$1.23                          | \$1.31 |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common share - diluted                          | \$0.63                            | \$0.67 | \$1.23                          | \$1.31 |

<sup>1</sup> Reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income

# Gain (Loss) on Investment Securities, Net

The following table is a summary of our net gain (loss) on investment securities for the three and six months ended June 30, 2018 and 2017 (in millions):

| Three<br>Months | Six Months<br>Ended June 30, |
|-----------------|------------------------------|
|-----------------|------------------------------|

|  | Ended June |       |           |         |
|--|------------|-------|-----------|---------|
|  | 30,        |       |           |         |
|  | 2018       | 2017  | 2018      | 2017    |
| Gain (Loss) on Investment Securities, Net <sup>1</sup>   |            |       |           |         |
| Gain (loss) on sale of investment securities, net  | \$(74 )    | \$15  | \$(76 )   | \$(69 ) |
| Unrealized gain (loss) on investment securities measured at fair value through net income, net <sup>2</sup>    | (94 )      | 9     | (617 )    | 25      |
| Unrealized gain (loss) on investment securities measured at fair value through other comprehensive income, net | (145 )     | 121   | (766 )    | 167     |
| Total gain (loss) on investment securities, net  | \$(313)    | \$145 | \$(1,459) | \$123   |

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1. Amounts exclude gain (loss) on TBA securities, which are reported in gain (loss) on derivative instruments and other securities, net in our Consolidated Statements of Comprehensive Income.

2. Investment securities acquired after fiscal year 2016 are measured at fair value through net income (see Note 3 of our Consolidated Financial Statements in this Form 10-Q).

#### Gain (Loss) on Derivative Instruments and Other Securities, Net

The following table is a summary of our gain (loss) on derivative instruments and other securities, net for the three and six months ended June 30, 2018 and 2017 (in millions):

|  | Three Months<br>Ended June<br>30, |          | Six Months<br>Ended June 30, |          |
|--|-----------------------------------|----------|------------------------------|----------|
|  | 2018                              | 2017     | 2018                         | 2017     |
| Periodic interest costs of interest rate swaps, net                              | \$41                              | \$(35 )  | \$32                         | \$(80 )  |
| Realized gain (loss) on derivative instruments and other securities, net:        |                                   |          |                              |          |
| TBA securities - dollar roll income, net   | 70                                | 93       | 132                          | 164      |
| TBA securities - mark-to-market net gain (loss)                                  | (108 )                            | 152      | (540 )                       | (98 )    |
| Payer swaptions  | 30                                | —        | 36                           | —        |
| U.S. Treasury securities - long position   | —                                 | —        | —                            | 1        |
| U.S. Treasury securities - short position  | (4 )                              | (22 )    | (1 )                         | (16 )    |
| U.S. Treasury futures - short position   | (6 )                              | (29 )    | 104                          | (27 )    |
| Interest rate swaps - termination fees and variation margin settlements, net     | 134                               | (160 )   | 716                          | 107      |
| REIT equity securities   | 1                                 | —        | 2                            | —        |
| Other  | —                                 | 1        | —                            | 2        |
| Total realized gain (loss) on derivative instruments and other securities, net   | 117                               | 35       | 449                          | 133      |
| Unrealized gain (loss) on derivative instruments and other securities, net:      |                                   |          |                              |          |
| TBA securities - mark-to-market net gain (loss)                                  | 24                                | (82 )    | 102                          | 136      |
| Interest rate swaps  | 41                                | 1        | 131                          | (199 )   |
| Payer swaptions  | 4                                 | (13 )    | 89                           | (24 )    |
| U.S. Treasury securities - short position  | 39                                | (88 )    | 248                          | (172 )   |
| U.S. Treasury futures - short position   | 27                                | 13       | (21 )                        | (1 )     |
| REIT equity securities   | 4                                 | —        | 4                            | —        |
| Other  | 1                                 | —        | 2                            | (2 )     |
| Total unrealized gain (loss) on derivative instruments and other securities, net | 140                               | (169 )   | 555                          | (262 )   |
| Total gain (loss) on derivative instruments and other securities, net            | \$298                             | \$(169 ) | \$1,036                      | \$(209 ) |

For further details regarding our use of derivative instruments and related activity refer to Notes 3 and 6 of our Consolidated Financial Statements in this Form 10-Q.

#### Estimated Taxable Income

For the three months ended June 30, 2018 and 2017, we had estimated taxable income available to common stockholders of \$104 million and \$46 million (or \$0.26 and \$0.13 per diluted common share), respectively. For the six months ended June 30, 2018 and 2017, we had estimated taxable income available to common stockholders of \$183 million and \$76 million (or \$0.46 and \$0.22 per diluted common share), respectively. Income as determined under GAAP differs from income as determined under tax rules because of both temporary and permanent differences in income and expense recognition. The primary differences are (i) unrealized gains and losses on derivative instruments and other securities marked-to-market in current income for GAAP purposes, but excluded from taxable income until realized or settled, (ii) timing differences, both temporary and potentially permanent, in the recognition of certain realized gains and losses and (iii) temporary differences related to the amortization of premiums and discounts on investments. Furthermore, our estimated taxable income is subject to potential adjustments up to the time of filing our appropriate tax returns, which occurs after the end of our fiscal year. The following is a reconciliation of our GAAP net income to our estimated taxable income for the three and six months ended June 30, 2018 and 2017 (dollars in millions, except per share amounts):



|   | Three Months<br>Ended June<br>30, |        | Six Months<br>Ended June<br>30, |        |
|---|-----------------------------------|--------|---------------------------------|--------|
|   | 2018                              | 2017   | 2018                            | 2017   |
| Net income  | \$293                             | \$24   | \$717                           | \$100  |
| Estimated book to tax differences:  |                                   |        |                                 |        |
| Premium amortization, net   | (22 )                             | 4      | (45 )                           | 1      |
| Realized gain/loss, net   | (221 )                            | 99     | (873 )                          | (280 ) |
| Net capital loss/(utilization of net capital loss carryforward)           | 109                               | (232 ) | 354                             | 44     |
| Unrealized gain/loss, net   | (46 )                             | 160    | 62                              | 237    |
| Other   | —                                 | (2 )   | (14 )                           | (12 )  |
| Total book to tax differences   | (180 )                            | 29     | (516 )                          | (10 )  |
| Estimated REIT taxable income   | 113                               | 53     | 201                             | 90     |
| Dividend on preferred stock   | 9                                 | 7      | 18                              | 14     |
| Estimated REIT taxable income available to common stockholders            | \$104                             | \$46   | \$183                           | \$76   |
| Weighted average number of common shares outstanding - basic              | 404.9                             | 346.4  | 398.2                           | 338.8  |
| Weighted average number of common shares outstanding - diluted            | 405.2                             | 346.5  | 398.4                           | 338.9  |
| Estimated REIT taxable income per common share - basic and diluted        | \$0.26                            | \$0.13 | \$0.46                          | \$0.22 |
| Beginning cumulative non-deductible net capital loss                      | \$602                             | \$728  | \$357                           | \$452  |
| Net capital loss / (utilization of net capital loss carryforward)         | 109                               | (232 ) | 354                             | 44     |
| Ending cumulative non-deductible net capital loss <sup>1</sup>            | \$711                             | \$496  | \$711                           | \$496  |
| Ending cumulative non-deductible net capital loss per ending common share | \$1.64                            | \$1.39 | \$1.64                          | \$1.39 |

Capital losses in excess of capital gains are not deductible from ordinary taxable income, but may be carried 1. forward for up to five years and applied against future net capital gains. As of March 31, 2018, \$0.6 B and \$0.1 B of net capital losses were available through 2018 and 2023, respectively.

The following table summarizes dividends declared during the six months ended June 30, 2018 and 2017:

| Quarter Ended  | Dividends Declared per Share |   |   |              |
|----------------|------------------------------|---|---|--------------|
|                | Series A Preferred Stock     | Series B Preferred Stock (Per Depositary Share) | Series C Preferred Stock (Per Depositary Share) | Common Stock |
| March 31, 2018 | \$—                          | \$0.484375                                      | \$0.43750                                       | \$ 0.54      |
| June 30, 2018  | —                            | 0.484375  | 0.43750   | 0.54         |
| Total          | \$—                          | \$0.968750                                      | \$0.87500                                       | \$ 1.08      |
| March 31, 2017 | \$0.50000                    | \$0.484375                                      | \$—   | \$ 0.54      |
| June 30, 2017  | 0.50000                      | 0.484375  | —   | 0.54         |
| Total          | \$1.00000                    | \$0.968750                                      | \$—   | \$ 1.08      |

#### LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funds are borrowings under master repurchase agreements, asset sales, receipts of monthly principal and interest payments on our investment portfolio and equity offerings. We may also enter into TBA contracts to acquire or dispose of Agency RMBS and TBA dollar roll transactions to finance Agency RMBS purchases. Because the level of our borrowings can be adjusted daily, the level of cash and cash equivalents carried on our balance sheet is significantly less important than the potential liquidity available under our borrowing arrangements. Our leverage will vary periodically depending on market conditions and our assessment of risks and returns. We generally would expect our leverage to be within six to twelve times the amount of our tangible



stockholders' equity. However, under certain market conditions, we may operate at leverage levels outside of this range for extended periods of time.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, maintenance of any margin requirements and the payment of cash dividends as required for our continued qualification as a REIT. We currently expect to distribute 100% of our taxable income so that we are not subject to U.S. Federal and state corporate income taxes. Our REIT distribution requirement of at least 90% of our taxable income limits our ability to retain earnings and thereby replenish or increase capital from operations.

## Debt Capital

As of June 30, 2018 and December 31, 2017, our mortgage borrowings consisted of the following (dollars in millions):

|  | June 30, 2018 |       | December 31, 2017 |       |
|--|---------------|-------|-------------------|-------|
| Mortgage Borrowings  | Amount        | %     | Amount            | %     |
| Repurchase agreements used to fund Agency RMBS                 | \$48,839      | 71 %  | \$50,296          | 75 %  |
| Debt of consolidated variable interest entities, at fair value | 313           | — %   | 357               | 1 %   |
| Total debt   | 49,152        | 71 %  | 50,653            | 76 %  |
| Net TBA position, at cost                                      | 19,898        | 29 %  | 15,739            | 24 %  |
| Total mortgage borrowings                                      | \$69,050      | 100 % | \$66,392          | 100 % |

Our tangible net book value "at risk" leverage was 8.3x and 8.1x as of June 30, 2018 and December 31, 2017, respectively, measured as the sum of our total mortgage borrowings and net payable / (receivable) for unsettled investment securities, divided by the sum of our total stockholders' equity adjusted to exclude goodwill and other intangible assets and investments in REIT securities.

## Repurchase Agreements

As part of our investment strategy, we borrow against our investment portfolio pursuant to master repurchase agreements. We expect that the majority of our borrowings under repurchase agreements will have maturities ranging up to one year, but may have terms ranging up to five years or longer. Borrowings with maturities greater than one year typically have floating rates of interest based on LIBOR plus or minus a fixed spread.

As of June 30, 2018, we had \$48.8 billion of repurchase agreements outstanding used to fund acquisitions of investment securities with a weighted average interest rate of 2.18% and a weighted average remaining days-to-maturity of 101 days, compared \$50.3 billion, 1.57% and 116 days, respectively, as of December 31, 2017. To limit our counterparty exposure, we diversify our funding across multiple counterparties and by counterparty region. As of June 30, 2018, we had master repurchase agreements with 46 financial institutions located throughout North America, Europe and Asia, including counterparties accessed through our wholly-owned captive broker-dealer subsidiary, BES. BES has direct access to bilateral and triparty funding, including the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation, or "FICC," which provides us greater depth and diversity of funding at favorable terms relative to traditional bilateral repurchase agreement funding. As of June 30, 2018, \$21.2 billion of our repurchase agreement funding was sourced through BES.

The table below includes a summary of our Agency RMBS repurchase agreement funding by number of repo counterparties and counterparty region as of June 30, 2018. For further details regarding our borrowings under repurchase agreements as of June 30, 2018, please refer to Notes 5 and 7 to our Consolidated Financial Statements in this Form 10-Q.

|                      | June 30, 2018             |   |
|----------------------|---------------------------|---|
| Counter-Party Region | Number of Counter-Parties | Percent of Agency RMBS Repurchase Agreement Funding |
| North America:       |                           |   |
| FICC                 | 1                         | 40%   |
| Other                | 26                        | 41%   |
| Total North America  | 27                        | 81%   |
| Europe               | 14                        | 12%   |
| Asia                 | 5                         | 7%  |
| Total                | 46                        | 100%  |

Amounts available to be borrowed under our repurchase agreements are dependent upon lender collateral requirements and the lender's determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In addition, our counterparties apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value, but



conversely subjects us to counterparty credit risk and limits the amount we can borrow against our investment securities. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the six months ended June 30, 2018, haircuts on our pledged collateral remained stable and, as of June 30, 2018, our weighted average haircut was approximately 4.3% of the value of our collateral, inclusive of collateral funded through BES. As of June 30, 2018, our maximum amount at risk (or the amount of our repurchase liabilities in excess of the value of collateral pledged) with any counterparty related to our repurchase agreements, excluding the FICC, was less than 5% of our tangible stockholders' equity, with our top five repo counterparties, excluding the FICC, representing less than 10% of our tangible stockholders' equity. As of June 30, 2018, 6% of our tangible stockholder's equity was at risk with the FICC. We could be exposed to credit risk if the FICC or an FICC netting member defaults on its obligations. However, we believe that the risk is minimal due to the FICC's initial and daily mark to market margin requirements, guarantee funds and other resources that are available in the event of a default.

We may be required to pledge additional assets to our counterparties in the event the estimated fair value of the existing collateral pledged under our agreements declines and our counterparties demand additional collateral (a "margin call"), which may take the form of additional securities or cash. Specifically, margin calls would result from a decline in the fair value of our investment securities securing our repurchase agreements as well as due to prepayments on the mortgages securing such securities. Similarly, if the estimated fair value of our investment securities increases due to changes in interest rates or other factors, counterparties may release collateral back to us. Our repurchase agreements generally provide that the valuations of securities securing our repurchase agreements are to be obtained from a generally recognized source agreed to by the parties. In certain circumstances, however, our lenders have the sole discretion to determine the value of pledged collateral. In such instances, our lenders are required to act in good faith in making determinations of value. Our repurchase agreements generally provide that in the event of a margin call, we must provide additional securities or cash on the same business day that a margin call is made if the lender provides us notice prior to the margin notice deadline on such day.

As of June 30, 2018, we had met all of our margin requirements and we had unrestricted cash and cash equivalents of \$0.9 billion and unpledged securities of approximately \$3.9 billion, including securities pledged to us and unpledged interests in our consolidated VIEs, available to meet margin calls on our repurchase agreements and other funding liabilities, derivative instruments and for other corporate purposes.

Although we believe we will have adequate sources of liquidity available to us through repurchase agreement financing to execute our business strategy, there can be no assurances that repurchase agreement financing will be available to us upon the maturity of our current repurchase agreements to allow us to renew or replace our repurchase agreement financing on favorable terms or at all. If our repurchase agreement lenders default on their obligations to resell the underlying collateral back to us at the end of the term, we could incur a loss equal to the difference between the value of the collateral and the cash we originally received.

To help manage the adverse impact of interest rate changes on the value of our investment portfolio as well as our cash flows, we utilize an interest rate risk management strategy under which we use derivative financial instruments. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings of our long-term fixed rate assets during a period of rising interest rates. The primary derivative instruments that we use are interest rate swaps, interest rate swaptions, U.S. Treasury securities and U.S. Treasury futures contracts. Please refer to Notes 3 and 6 to our Consolidated Financial Statements in this Form 10-Q for further details regarding our use of derivative instruments.

As with repurchase agreements, our derivative agreements typically require that we pledge/receive collateral to/from our counterparties. Our counterparties, or the central clearing agency, typically have the sole discretion to determine the value of the derivative instruments and the value of the collateral securing such instruments. In the event of a margin call, we must provide additional collateral generally on the same or next business day. We minimize counterparty credit risk associated with our derivative instruments by limiting our counterparties to central clearing exchanges and major financial institutions with acceptable credit ratings and by monitoring positions with individual counterparties. Excluding centrally cleared derivative instruments, as of June 30, 2018, our amount at risk with any counterparty related to our interest rate swap and swaption agreements was less than 1% of our stockholders' equity.

In the case of centrally cleared derivative instruments, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its obligation to perform under the contract. However, we believe that the risk is minimal due to the exchanges' initial and daily mark to market margin requirements and clearinghouse guarantee funds and other resources that are available in the event of a default.

#### TBA Dollar Roll Transactions

TBA dollar roll transactions represent a form of off-balance sheet financing accounted for as derivative instruments. We may also use TBAs to leverage (or deleverage) our investment portfolio using long (or short) TBA contracts (see Notes 3 and 6 to our Consolidated Financial Statements in this Form 10-Q additional details on of our TBA transactions).

Under certain market conditions, it may be uneconomical for us to roll our TBA contracts into future months and we may need to take or make physical delivery of the underlying securities. If we were required to take physical delivery to settle a long TBA contract, we would have to fund our total purchase commitment with cash or other financing sources and our liquidity position could be negatively impacted. As of June 30, 2018, we had a net long TBA position with a total market value of \$20.0 billion and a net carrying value of \$105 million recognized in derivative assets/(liabilities), at fair value, on our Consolidated Balance Sheets in this Form 10-Q.

Our TBA dollar roll contracts are also subject to margin requirements governed by the Mortgage-Backed Securities Division ("MBSD") of the FICC and by our prime brokerage agreements, which may establish margin levels in excess of the MBSD. Such provisions require that we establish an initial margin based on the notional value of the TBA contract, which is subject to increase if the estimated fair value of our TBA contract or the estimated fair value of our pledged collateral declines. The MBSD has the sole discretion to determine the value of our TBA contracts and of the pledged collateral securing such contracts. In the event of a margin call, we must generally provide additional collateral on the same business day.

Settlement of our TBA obligations by taking delivery of the underlying securities as well as satisfying margin requirements could negatively impact our liquidity position. However, since we do not use TBA dollar roll transactions as our primary source of financing, we believe that we will have adequate sources of liquidity to meet such obligations.

#### Bethesda Securities Regulatory Capital Requirements

BES is subject to regulations of the securities business that include but are not limited to trade practices, capital structure, recordkeeping and conduct of directors, officers and employees. As a self-clearing registered broker-dealer, BES is required to maintain minimum net regulatory capital as defined by SEC Rule 15c3-1 (the "Rule"). As of June 30, 2018, the minimum net capital required was \$0.3 million and BES had excess net capital of \$321.1 million. Regulatory capital in excess of the minimum required by the Rule is held to meet levels required by clearing organizations, the clearing bank and other repo counterparties.

#### Asset Sales and TBA Eligible Securities

We maintain a portfolio of highly liquid mortgage-backed securities. We may sell our Agency securities through the TBA market by delivering them into TBA contracts, subject to "good delivery" provisions promulgated by the Securities Industry and Financial Markets Association ("SIFMA"). We may alternatively sell Agency securities that have more unique attributes on a specified basis when such securities trade at a premium over generic TBA securities or if the securities are not otherwise eligible for TBA delivery. Since the TBA market is the second most liquid market (after the U.S. Treasury market), maintaining a significant level of Agency securities eligible for TBA delivery enhances our liquidity profile and provides price support for our TBA eligible securities at or above generic TBA prices. As of June 30, 2018, approximately 90% of our fixed rate Agency RMBS portfolio was eligible for TBA delivery.

#### Equity Capital

To the extent we raise additional equity capital we may use cash proceeds from such transactions to purchase additional investment securities, to make scheduled payments of principal and interest on our funding liabilities and/or for other general corporate purposes. There can be no assurance, however, that we will be able to raise additional equity capital at any particular time or on any particular terms. Furthermore, when the trading price of our common stock is significantly less than our estimate of our current tangible net book value per common share, among other conditions, we may repurchase shares of our common stock, subject to the provisions of a stock repurchase program in effect at such time.

#### OFF-BALANCE SHEET ARRANGEMENTS

As of June 30, 2018, we did not maintain relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Additionally, as of June 30, 2018, we had not guaranteed obligations of unconsolidated entities or entered into a commitment or intent to provide

funding to such entities.

#### FORWARD-LOOKING STATEMENTS

This document contains forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward looking statements are based on estimates, projections, beliefs and assumptions of our management as of the date of this Quarterly Report on Form 10-Q and involve risks and uncertainties in predicting future results and conditions. Our actual performance could differ materially from those projected or anticipated in any forward looking statements due to a variety of factors, including, without limitation, changes in interest rates, the yield curve or prepayment rates; the availability and terms of financing; changes in the market value of our assets; the effectiveness of our risk mitigation strategies; conditions in the

market for Agency and other mortgage securities; or legislative or regulatory changes that affect our status as a REIT or our exemption from the Investment Company Act of 1940 or that affect the GSE's or secondary mortgage market in which we participate. A discussion of risks and uncertainties that could cause actual results to differ from any of our forward looking statements is included in our most recent Annual Report on Form 10-K and this document under Item 1A. Risk Factors. We caution readers not to place undue reliance on our forward looking statements.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate, prepayment, spread, liquidity, extension and credit risk.

#### Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and related financing obligations. Subject to maintaining our qualification as a REIT, we engage in a variety of interest rate management techniques to mitigate the influence of interest rate changes on our net interest income and fluctuations of our net asset value.

We seek to hedge interest rate risk with respect to both the fixed income nature of our assets and short-term, variable rate nature of our financing. In hedging interest rates with respect to our fixed income assets, we attempt to reduce the risk of losses on the value of our investments that may result from changes in interest rates in the broader markets. In utilizing interest rate hedges with respect to our financing, we attempt to improve risk-adjusted returns and, where possible, to obtain a favorable spread between the yield on our assets and the cost of our financing. The principal instruments that we use to hedge our interest rate risk are interest rate swaps, swaptions, U.S. Treasury securities and U.S. Treasury futures contracts.

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate assets will largely remain static. This can result in a decline in our net interest spread. The severity of any such decline would depend on our asset, liability and hedge composition at the time, as well as the magnitude and duration of the interest rate increase.

Changes in the level of interest rates can also affect the rate of mortgage prepayments and the value of our assets. Our hedging techniques are highly complex and are partly based on assumed levels of prepayments of our assets. If prepayments are slower or faster than assumed, the maturity of our investments will also differ from our expectations, which could reduce the effectiveness of our hedging strategies and may cause losses on such transactions and adversely affect our cash flow.

Primary measures of an instrument's price sensitivity to interest rate fluctuations are its duration and convexity.

Duration measures the estimated percentage change in market value of our assets or our hedge portfolio that would be caused by a parallel change in short and long-term interest rates. The duration of our assets changes with interest rates and tends to increase when interest rates rise and decrease when interest rates fall. This "negative convexity" generally increases the interest rate exposure of our investment portfolio in excess of what is measured by duration alone.

We estimate the duration and convexity of our assets using both a third-party risk management system and market data. We review the duration estimates from the third-party model and may make adjustments based on our judgment to better reflect any unique characteristics and market trading conventions associated with certain types of securities. The table below quantifies the estimated changes in (i) net interest income (including periodic interest costs on our interest rate swaps); (ii) the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes); and (iii) our tangible net book value per common share as of June 30, 2018 and December 31, 2017 should interest rates go up or down by 50 and 100 basis points, assuming instantaneous parallel shifts in the yield curve and including the impact of both duration and convexity. All changes in income and value in the table below are measured as percentage changes from the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of June 30, 2018 and December 31, 2017.



To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high volatility, actual results could differ materially from our projections. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate changes on a static

portfolio, we actively manage our portfolio and we continuously adjust the size and composition of our asset and hedge portfolio.

#### Interest Rate Sensitivity <sup>1</sup>

| Change in Interest Rate | Percentage Change in Projected   |                                       |  |
|-------------------------|----------------------------------|---------------------------------------|--|
|                         | Net Interest Income <sup>2</sup> | Portfolio Market Value <sup>3,4</sup> | Tangible Net Book Value <sup>3,5</sup> |
| As of June 30, 2018     |                                  |                                       |  |
| -100 Basis Points       | -7.2%                            | —%                                    | -0.1%                                  |
| -50 Basis Points        | -2.6%                            | +0.2%                                 | +2.0%                                  |
| +50 Basis Points        | +2.0%                            | -0.5%                                 | -4.9%                                  |
| +100 Basis Points       | +3.7%                            | -1.2%                                 | -11.8%                                 |
| As of December 31, 2017 |                                  |                                       |  |
| -100 Basis Points       | -10.4%                           | -1.0%                                 | -9.1%                                  |
| -50 Basis Points        | -3.9%                            | -0.2%                                 | -1.9%                                  |
| +50 Basis Points        | +0.4%                            | -0.2%                                 | -2.0%                                  |
| +100 Basis Points       | +0.2%                            | -0.7%                                 | -6.6%                                  |

Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties, assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.

Represents the estimated dollar change in net interest income expressed as a percent of net interest income based on asset yields and cost of funds as of such date. It includes the effect of periodic interest costs on our interest rate swaps, but excludes costs associated with our forward starting swaps and other supplemental hedges, such as swaptions and U.S. Treasury securities. Amounts also exclude costs associated with our TBA position and TBA dollar roll income/loss, which are accounted for as derivative instruments in accordance with GAAP. Base case scenario assumes interest rates and forecasted CPR of 7.1% and 8.4% as of June 30, 2018 and December 31, 2017, respectively. As of June 30, 2018, rate shock scenarios assume a forecasted CPR of 9%, 8%, 6% and 6% for the -100, -50, +50 and +100 basis points scenarios, respectively. As of December 31, 2017, rate shock scenarios assume a forecasted CPR of 13%, 10%, 7% and 7% for such scenarios, respectively. Estimated dollar change in net interest income does not include the impact of retroactive "catch-up" premium amortization adjustments due to changes in our forecasted CPR.

3. Includes the effect of derivatives and other securities used for hedging purposes.

4. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.

5. Estimated dollar change in portfolio value expressed as a percent of tangible stockholders' equity, net of the aggregate preferred stock liquidation preference, as of such date.

#### Prepayment Risk

Prepayment risk is the risk that our assets will be repaid at a faster rate than anticipated. Interest rates and numerous other factors affect the rate of prepayments, including housing prices, general economic conditions, loan age, size and loan-to-value ratios, and the pace of GSE buyouts of delinquent loans underlying our securities among other factors. Generally, prepayments increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case.

If our assets prepay at a faster rate than anticipated, we may be unable to reinvest the repayments at acceptable yields. If the proceeds are reinvested at lower yields than our existing assets, our net interest income would be negatively impacted. We also amortize or accrete premiums and discounts we pay or receive at purchase relative to the stated principal of our assets into interest income over their projected lives using the effective interest method. If the actual and estimated future prepayment experience differs from our prior estimates, we are required to record an adjustment

to interest income for the impact of the cumulative difference in the effective yield.

**Extension Risk**

Extension risk is the risk that our assets will be repaid at a slower rate than anticipated and generally increases when interest rates rise. In which case, we may have to finance our investments at potentially higher costs without the ability to reinvest principal into higher yielding securities because borrowers prepay their mortgages at a slower pace than originally expected, adversely impacting our net interest spread, and thus our net interest income.

**Spread Risk**

Spread risk is the risk that the market spread between the yield on our assets and the yield on benchmark interest rates linked to our interest rate hedges, such as U.S. Treasury rates and interest rate swap rates, may vary. The inherent spread risk

associated with our investment securities and the resulting fluctuations in fair value of these securities can occur independent of interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by U.S. and foreign central banks, liquidity, or changes in required rates of return on different assets. Our strategies are generally not specifically designed to protect against spread risk, thus while we use interest rate swaps and other hedges to attempt to protect against moves in interest rates, our hedges will typically not protect our net book value against spread risk and our tangible net book value could decline if spreads widen.

The table below quantifies the estimated changes in the fair value of our assets, net of hedges, and our tangible net book value per common share as of June 30, 2018 and December 31, 2017 should spreads widen or tighten by 10 and 25 basis points. The estimated impact of changes in spreads is in addition to our interest rate shock sensitivity included in the interest rate shock table above. The table below assumes a spread duration of 5.8 and 5.3 years as of June 30, 2018 and December 31, 2017, respectively, based on interest rates and prices as of such dates. However, our portfolio's sensitivity of mortgage spread changes will vary with changes in interest rates and in the size and composition of our portfolio. Therefore, actual results could differ materially from our estimates.

#### Spread Sensitivity <sup>1</sup>

| Change in MBS Spread    | Percentage Change in                            |   |
|-------------------------|---|---|
|                         | Projected Portfolio Market Value <sup>2,3</sup> | Tangible Net Asset Value <sup>2,4</sup> |
| As of June 30, 2018     |   |   |
| -25 Basis Points        | +1.5%   | +14.0%                                  |
| -10 Basis Points        | +0.6%   | +5.6%                                   |
| +10 Basis Points        | -0.6%   | -5.6%                                   |
| +25 Basis Points        | -1.5%   | -14.0%                                  |
| As of December 31, 2017 |   |   |
| -25 Basis Points        | +1.3%   | +12.6%                                  |
| -10 Basis Points        | +0.5%   | +5.0%                                   |
| +10 Basis Points        | -0.5%   | -5.0%                                   |
| +25 Basis Points        | -1.3%   | -12.6%                                  |

Spread sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties, 1. assumes there are no changes in interest rates and assumes a static portfolio. Actual results could differ materially from these estimates.

2. Includes the effect of derivatives and other securities used for hedging purposes.

3. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.

4. Estimated dollar change in portfolio value expressed as a percent of tangible stockholders' equity, net of the aggregate preferred stock liquidation preference, as of such date.

#### Liquidity Risk

Our liquidity risk principally arises from financing long-term fixed rate assets with shorter-term variable rate borrowings. As of June 30, 2018, we had unrestricted cash and cash equivalents of \$0.9 billion and unpledged securities of approximately \$3.9 billion available to meet margin calls on our funding liabilities and derivative contracts and for other corporate purposes. However, should the value of our collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our funding liabilities and derivative agreements could increase, causing an adverse change in our liquidity position. Furthermore, there is no assurance that we will always be able to renew (or roll) our short-term funding liabilities. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge against our funding liabilities, thereby reducing the

amount that can be borrowed against an asset even if they agree to renew or roll our funding liabilities. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

In addition, we often utilize TBA dollar roll transactions to invest in and finance Agency RMBS. Under certain conditions it may be uneconomical to roll our TBA dollar roll transactions beyond the next settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash, which could negatively impact our liquidity position, result in defaults or force us to sell assets under adverse conditions.

### Credit Risk

We may not receive full repayment of principal, interest or other remuneration related to credit sensitive instruments, such as investments in CRT and non-Agency securities. We are also exposed to credit risk in the event our derivative counterparties do not perform under the terms of our derivative agreements or in the event our repurchase agreement counterparties default on their obligations to resell the underlying collateral back to us at the end of the repo term.

We accept credit exposure related to our credit sensitive assets at levels we deem to be prudent within the context of our overall investment strategy. We attempt to manage this risk through prudent asset selection, pre-acquisition due diligence, post-acquisition performance monitoring, and sale of assets where we identify negative credit trends. We may also manage credit risk with credit default swaps or other financial derivatives that we believe are appropriate. Additionally, we may vary the mix of our interest rate and credit sensitive assets or our duration gap to adjust our credit exposure and/or improve the return profile of our assets, such as when we believe credit performance is inversely correlated with changes in interest rates. Our credit risk related to derivative and repurchase agreement transactions is largely mitigated by limiting our counterparties to major financial institutions with acceptable credit ratings and monitoring concentration levels with any one counterparty. We also monitor and adjust the amount of collateral pledged based on changes in market value.

There is no guarantee that our efforts to manage credit risk will be successful and we could suffer losses if credit performance is worse than our expectations or our counterparties default on their obligations. Excluding amounts cleared through a central clearing exchange, as of June 30, 2018, our maximum amount at risk with any counterparty related to our repurchase agreements was less than 5% of our tangible stockholders' equity and less than 1% of tangible stockholders' equity related to our interest rate swap and swaption agreements.

### Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934, as amended (the "Exchange Act") reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" as promulgated under the Exchange Act and the rules and regulations thereunder. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2018. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

### Changes in Internal Control over Financial Reporting

There have been no changes in our "internal control over financial reporting" (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

AGNC is named as a nominal defendant in certain stockholder derivative lawsuits filed against the Company and certain of our current and former directors and officers as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017. On July 3, 2018, in the matter called In re American Capital Agency Stockholder Derivative Litigation, pending in the U.S. District Court for the District of Maryland, the Court granted in part and denied in part our and other defendants' motions to dismiss. The Court dismissed the claims that the Company's proxy statements in 2014, 2015 and 2016 contained material omissions and that the current and former directors and officers named as defendants in the case breached fiduciary duties to the Company in connection with the internalization of our management through the acquisition of AGNC Mortgage Management, LLC, the parent company of our former external Manager, which was completed on July 1, 2016. The Court also dismissed the aiding and abetting claim against American Capital Asset Management, LLC. However, the Court did not dismiss the claims against certain of our current officers and directors related to decisions not to terminate our management agreement with our former external Manager, AGNC Management, LLC, prior to the internalization of our management. On July 18, 2018, the plaintiffs in this action moved to amend their complaint in an effort to cure the deficiencies identified by the Court in its ruling on the motion to dismiss. Defendants' response to that motion is due August 15, 2018. We believe the claims in these lawsuits lack merit, and we expect that the defendants will vigorously defend them. See also "Loss Contingencies" in Note 3 to our Consolidated Financial Statements included in this Form 10-Q.

### Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

### Item 3. Defaults upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

Item 6. Exhibits and Financial Statement Schedules

(a) Exhibit Index

Exhibit No. Description

\*3.1 AGNC Investment Corp. Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended March 31, 2018 (File No. 001-34057), filed May 7, 2018.

\*3.2 AGNC Investment Corp. Third Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-Q for the quarter ended September 30, 2016 (File No. 001-34057), filed November 7, 2016.

\*3.3 Certificate of Designations of 7.750% Series B Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.4 of Form 8-A (File No. 001-34057), filed May 7, 2014.

\*3.4 Certificate of Designations of 7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.5 of Form 8-A (File No. 001-34057), filed August 18, 2017.

\*3.5 Certificate of Elimination of 8.000% Series A Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.1 of Form 8-K (File No 001-34057), filed October 26, 2017.

\*4.1 Instruments defining the rights of holders of securities: See Article IV of our Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended September 30, 2016 (File No. 001-34057) filed November 7, 2016.

\*4.2 Instruments defining the rights of holders of securities: See Article VI of our Third Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-Q for the quarter ended September 30, 2016 (File No. 001-34057) filed November 7, 2016.

\*4.3 Form of Certificate for Common Stock, incorporated herein by reference to Exhibit 4.3 of Form 10-Q for the quarter ended September 30, 2016 (File No. 001-34057), filed November 7, 2016.

\*4.4 Specimen 7.750% Series B Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-A (File No. 001-34057), filed May 7, 2014.

\*4.5 Specimen 7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-A (File No. 001-34057), filed August 18, 2017.

\*4.6 Deposit Agreement relating to 7.750% Series B Cumulative Redeemable Preferred Stock, dated May 8, 2014, among American Capital Agency Corp., Computershare Inc. and Computershare Trust Company, N.A., jointly as depositary, incorporated herein by reference to Exhibit 4.2 of Form 8-K (File No. 001-34057), filed May 8, 2014.

\*4.7 Form of Depositary Receipt representing 1/1,000th of a share of 7.750% Series B Cumulative Redeemable Preferred Stock (included as part of Exhibit 4.6), incorporated herein by reference to Exhibit A of Exhibit 4.2 of Form 8-K (File No. 001-34057), filed May 8, 2014.

\*4.8 Deposit Agreement relating to 7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, dated August 22, 2017, among AGNC Investment Corp., Computershare Inc. and Computershare Trust Company, N.A., jointly as depositary, incorporated herein by reference to Exhibit 4.2 of Form 8-K (File No. 001-34057) filed August 22, 2017.

\*4.9 Form of Depositary Receipt representing 1/1,000th of a share of 7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock (included as part of Exhibit 4.8), incorporated herein by reference to Exhibit A of Exhibit 4.2 of Form 8-K (File No. 001-34057) filed August 22, 2017.

14 AGNC Investment Corp. Code of Ethics and Conduct, adopted July 19, 2018, filed herewith.

31.1 Certification of CEO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

31.2 Certification of CFO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.



32 Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS\*\*XBRL Instance Document

101.SCH\*\*XBRL Taxonomy Extension Schema Document

101.CAL\*\*XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB\*\*XBRL Taxonomy Extension Labels Linkbase Document

101.PRE\*\*XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF\*\*XBRL Taxonomy Extension Definition Linkbase Document

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\* Previously filed

\*\* This exhibit is being furnished rather than filed, and shall not be deemed incorporated by reference into any filing, in accordance with Item 601 of Regulation S-K

(b) Exhibits

See the exhibits filed herewith.

(c) Additional financial statement schedules

None.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AGNC INVESTMENT CORP.

By: /s/ GARY D. KAIN

Gary D. Kain

Chief Executive Officer and

Chief Investment Officer (Principal Executive Officer)

Date: August 6, 2018

/s/ BERNICE E. BELL

Bernice E. Bell

Senior Vice President and Chief Financial Officer

(Principal Financial Officer)

Date: August 6, 2018