

ANNALY CAPITAL MANAGEMENT INC  
Form 10-Q  
November 04, 2016  
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: SEPTEMBER 30, 2016

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 1-13447

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

MARYLAND  
(State or other jurisdiction of  
incorporation or organization) 22-3479661  
(IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS 10036  
NEW YORK, NY 10036 (Zip Code)  
(Address of principal executive offices)

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

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

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



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes      No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at October 31, 2016
Common Stock, \$.01 par value	1,018,869,843

ANNALY CAPITAL MANAGEMENT, INC.  
FORM 10-Q  
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

<u>Item 1. Financial Statements</u>	Page
<u>Consolidated Statements of Financial Condition at September 30, 2016 (Unaudited) and December 31, 2015 (Derived from the audited consolidated financial statements at December 31, 2015)</u>	1
<u>Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the quarters and nine months ended September 30, 2016 and 2015</u>	2
<u>Consolidated Statements of Stockholders' Equity (Unaudited) for the nine months ended September 30, 2016 and 2015</u>	3
<u>Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2016 and 2015</u>	4
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	
<u>Note 1. Description of Business</u>	5
<u>Note 2. Basis of Presentation</u>	5
<u>Note 3. Significant Accounting Policies</u>	5
<u>Note 4. Acquisition of Hatteras</u>	14
<u>Note 5. Residential Investment Securities</u>	17
<u>Note 6. Residential Mortgage Loans</u>	19
<u>Note 7. Mortgage Servicing Rights</u>	20
<u>Note 8. Commercial Real Estate Investments</u>	20
<u>Note 9. Corporate Debt</u>	25
<u>Note 10. Variable Interest Entities</u>	25
<u>Note 11. Fair Value Measurements</u>	29
<u>Note 12. Secured Financing</u>	34
<u>Note 13. Derivative Instruments</u>	35
<u>Note 14. Convertible Senior Notes</u>	39
<u>Note 15. Common Stock and Preferred Stock</u>	39
<u>Note 16. Interest Income and Interest Expense</u>	41
<u>Note 17. Goodwill</u>	41
<u>Note 18. Net Income (Loss) per Common Share</u>	41
<u>Note 19. Long-Term Stock Incentive Plan</u>	42
<u>Note 20. Income Taxes</u>	42
<u>Note 21. Lease Commitments and Contingencies</u>	43
<u>Note 22. Risk Management</u>	43
<u>Note 23. RCap Regulatory Requirements</u>	44
<u>Note 24. Related Party Transactions</u>	44
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Special Note Regarding Forward-Looking Statements</u>	46
<u>Overview</u>	48
<u>Acquisition of Hatteras</u>	48
<u>Business Environment</u>	48
<u>Results of Operations</u>	50
<u>Financial Condition</u>	59
<u>Capital Management</u>	63
<u>Risk Management</u>	65

<u>Critical Accounting Policies and Estimates</u>	74
<u>Glossary of Terms</u>	76
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	84
<u>Item 4. Controls and Procedures</u>	84
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	85
<u>Item 1A. Risk Factors</u>	85
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	86
<u>Item 6. Exhibits</u>	87
<u>SIGNATURES</u>	88

---

## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2016 (Unaudited)	December 31, 2015 <sup>(1)</sup>
<b>ASSETS</b>		
Cash and cash equivalents (including cash pledged as collateral of \$2,271,856 and \$1,584,686, respectively) <sup>(2)</sup>	\$2,382,188	\$1,769,258
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of \$67,902,771 and \$60,678,548, respectively)	73,476,105	65,718,224
Agency debentures	-	152,038
Credit risk transfer securities (including pledged assets of \$446,529 and \$184,160, respectively)	669,295	456,510
Non-Agency mortgage-backed securities (including pledged assets of \$1,293,530 and \$744,783, respectively) <sup>(3)</sup>	1,460,261	906,722
Residential mortgage loans (including pledged assets of \$179,626 and \$0, respectively) <sup>(4)</sup>	310,148	-
Mortgage servicing rights	492,169	-
Commercial real estate debt investments (including pledged assets of \$4,319,077 and \$2,911,828, respectively) <sup>(5)</sup>	4,319,077	2,911,828
Commercial real estate debt and preferred equity, held for investment (including pledged assets of \$583,131 and \$578,820, respectively) <sup>(6)</sup>	1,070,197	1,348,817
Commercial loans held for sale, net	144,275	278,600
Investments in commercial real estate	500,027	535,946
Corporate debt (including pledged assets of \$475,453 and \$0, respectively)	716,831	488,508
Interest rate swaps, at fair value	113,253	19,642
Other derivatives, at fair value	87,921	22,066
Receivable for investments sold	493,839	121,625
Accrued interest and dividends receivable	260,583	231,336
Other assets	301,419	119,422
Goodwill	71,815	71,815
Intangible assets, net	39,903	38,536
Total assets	\$86,909,306	\$75,190,893
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Repurchase agreements	\$61,784,121	\$56,230,860
Other secured financing	3,804,742	1,845,048

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Securitized debt of consolidated VIEs <sup>(7)</sup>	3,712,821	2,540,711
Participation sold	12,976	13,286
Mortgages payable	327,632	334,707
Interest rate swaps, at fair value	2,919,492	1,677,571
Other derivatives, at fair value	73,445	49,963
Dividends payable	269,111	280,779
Payable for investments purchased	454,237	107,115
Accrued interest payable	173,320	151,843
Accounts payable and other liabilities	115,606	53,088
Total liabilities	73,647,503	63,284,971
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
7.625% Series C Cumulative Redeemable Preferred Stock: 12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock: 11,500,000 authorized, issued and outstanding	287,500	-
Common stock, par value \$0.01 per share, 1,945,437,500 and 1,956,937,500 authorized, 1,018,857,866 and 935,929,561 issued and outstanding, respectively	10,189	9,359
Additional paid-in capital	15,578,677	14,675,768
Accumulated other comprehensive income (loss)	1,119,677	(377,596 )
Accumulated deficit	(4,655,440 )	(3,324,616 )
Total stockholders' equity	13,253,662	11,895,974
Noncontrolling interest	8,141	9,948
Total equity	13,261,803	11,905,922
Total liabilities and equity	\$86,909,306	\$75,190,893

(1) Derived from the audited consolidated financial statements at December 31, 2015.

(2) Includes cash of consolidated VIEs of \$31.3 million and \$48.5 million at September 30, 2016 and December 31, 2015, respectively.

(3) Includes \$96.0 million and \$0 at September 30, 2016 and December 31, 2015, respectively, of non-Agency mortgage-backed securities pledged as collateral in a consolidated VIE and eliminated from the Company's Consolidated Statements of Financial Condition.

(4) Includes securitized mortgage loans of a consolidated VIE carried at fair value of \$176.7 million and \$0 at September 30, 2016 and December 31, 2015, respectively.

(5) Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of \$4.0 billion and \$2.6 billion at September 30, 2016 and December 31, 2015, respectively.

(6) Includes senior securitized commercial mortgage loans of a consolidated VIE with a carrying value of \$128.9 million and \$262.7 million carried at amortized cost, net of an allowance for losses of \$0, at September 30, 2016 and December 31, 2015, respectively.

(7) Includes securitized debt of consolidated VIEs carried at fair value of \$3.7 billion and \$2.4 billion at September 30, 2016 and December 31, 2015, respectively.

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands, except per share data)

(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net interest income:				
Interest income	\$558,668	\$450,726	\$1,403,929	\$1,594,117
Interest expense	174,154	110,297	474,356	352,789
Net interest income	384,514	340,429	929,573	1,241,328
Realized and unrealized gains (losses):				
Realized gains (losses) on interest rate swaps <sup>(1)</sup>	(124,572 )	(162,304 )	(402,809 )	(465,008 )
Realized gains (losses) on termination of interest rate swaps	1,337	-	(58,727 )	(226,462 )
Unrealized gains (losses) on interest rate swaps	256,462	(822,585 )	(1,148,478 )	(587,995 )
Subtotal	133,227	(984,889 )	(1,610,014 )	(1,279,465 )
Net gains (losses) on disposal of investments	14,447	(7,943 )	25,307	58,246
Net gains (losses) on trading assets	162,981	108,175	370,050	(12,961 )
Net unrealized gains (losses) on investments measured at fair value through earnings	29,675	(24,501 )	(24,351 )	(40,466 )
Bargain purchase gain	72,576	-	72,576	-
Impairment of goodwill	-	-	-	(22,966 )
Subtotal	279,679	75,731	443,582	(18,147 )
Total realized and unrealized gains (losses)	412,906	(909,158 )	(1,166,432 )	(1,297,612 )
Other income (loss):				
Investment advisory income	-	3,780	-	24,848
Dividend income from affiliate	-	-	-	8,636
Other income (loss)	29,271	(13,455 )	13,226	(36,754 )
Total other income (loss)	29,271	(9,675 )	13,226	(3,270 )
General and administrative expenses:				
Compensation and management fee	38,709	37,450	111,754	113,093
Other general and administrative expenses	59,028	12,007	83,149	39,311
Total general and administrative expenses	97,737	49,457	194,903	152,404
Income (loss) before income taxes	728,954	(627,861 )	(418,536 )	(211,958 )
Income taxes	(1,926 )	(370 )	(2,839 )	(8,039 )
Net income (loss)	730,880	(627,491 )	(415,697 )	(203,919 )
Net income (loss) attributable to noncontrolling interest	(336 )	(197 )	(883 )	(436 )
Net income (loss) attributable to Annaly	731,216	(627,294 )	(414,814 )	(203,483 )
Dividends on preferred stock	22,803	17,992	58,787	53,976



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net income (loss) available (related) to common stockholders	\$708,413	\$(645,286 )	\$(473,601 )	\$(257,459 )
Net income (loss) per share available (related) to common stockholders:				
Basic	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )
Diluted	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )
Weighted average number of common shares outstanding:				
Basic	1,007,607,893	947,795,500	953,301,855	947,732,735
Diluted	1,007,963,406	947,795,500	953,301,855	947,732,735
Dividends declared per share of common stock	\$0.30	\$0.30	\$0.90	\$0.90
Net income (loss)	\$730,880	\$(627,491 )	\$(415,697 )	\$(203,919 )
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	18,237	609,725	1,519,874	116,154
Reclassification adjustment for net (gains) losses included in net income (loss)	(15,606 )	8,095	(22,601 )	(58,182 )
Other comprehensive income (loss)	2,631	617,820	1,497,273	57,972
Comprehensive income (loss)	\$733,511	\$(9,671 )	\$1,081,576	\$(145,947 )
Comprehensive income (loss) attributable to noncontrolling interest	(336 )	(197 )	(883 )	(436 )
Comprehensive income (loss) attributable to Annaly	733,847	(9,474 )	1,082,459	(145,511 )
Dividends on preferred stock	22,803	17,992	58,787	53,976
Comprehensive income (loss) attributable to common stockholders	\$711,044	\$(27,466 )	\$1,023,672	\$(199,487 )

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

See notes to consolidated financial statements.

2

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(dollars in thousands, except per share data)

(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	7.625% Series E Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholder equity
BALANCE, December 31, 2014	\$177,088	\$290,514	\$445,457	\$-	\$9,476	\$14,786,509	\$204,883	\$(2,585,436)	\$13,328
Net income (loss) attributable to Annaly	-	-	-	-	-	-	-	(203,483 )	(203,483 )
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	-	116,154	-	116,154
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	-	(58,182 )	-	(58,182 )
Stock compensation expense	-	-	-	-	-	1,089	-	-	1,089
Net proceeds from direct purchase and dividend reinvestment	-	-	-	-	2	1,722	-	-	1,724
Equity contributions from (distributions to) noncontrolling interest	-	-	-	-	-	-	-	-	-
Preferred Series A dividends, declared \$1.477 per share	-	-	-	-	-	-	-	(10,944 )	(10,944 )
Preferred Series C dividends,	-	-	-	-	-	-	-	(17,157 )	(17,157 )

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

declared \$1.430 per share Preferred Series D dividends, declared \$1.406 per share Common dividends declared, \$0.90 per share	-	-	-	-	-	-	-	(25,875 )	(25,875 )
BALANCE, September 30, 2015	\$177,088	\$290,514	\$445,457	\$-	\$9,478	\$14,789,320	\$262,855	\$(3,695,884)	\$12,278
BALANCE, December 31, 2015	\$177,088	\$290,514	\$445,457	\$-	\$9,359	\$14,675,768	\$(377,596 )	\$(3,324,616)	\$11,895
Net income (loss) attributable to Annaly	-	-	-	-	-	-	-	(414,814 )	(414,814 )
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	-	1,519,874	-	1,519,874
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	-	(22,601 )	-	(22,601 )
Stock compensation expense	-	-	-	-	-	6,949	-	-	6,949
Net proceeds from direct purchase and dividend reinvestment	-	-	-	-	2	1,793	-	-	1,795
Buyback of common stock	-	-	-	-	(111 )	(102,601 )	-	-	(102,712 )
Acquisition of subsidiary	-	-	-	287,500	939	996,768	-	-	1,285,207
Equity contributions from (distributions to) noncontrolling interest	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	(10,944 )	(10,944 )

Preferred Series A dividends, declared \$1.477 per share										
Preferred Series C dividends, declared \$1.430 per share	-	-	-	-	-	-	-	-	(17,157 )	(17,157 )
Preferred Series D dividends, declared \$1.406 per share	-	-	-	-	-	-	-	-	(25,875 )	(25,875 )
Preferred Series E dividends, declared \$0.477 per share	-	-	-	-	-	-	-	-	(4,811 )	(4,811 )
Common dividends declared, \$0.90 per share	-	-	-	-	-	-	-	-	(857,223 )	(857,223 )
BALANCE, September 30, 2016	\$177,088	\$290,514	\$445,457	\$287,500	\$10,189	\$15,578,677	\$1,119,677	\$(4,655,440)	\$13,253	

See notes to consolidated financial statements

3

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

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$ (415,697	) \$ (203,919 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Residential Investment Securities premiums and discounts, net	834,257	633,937
Amortization of commercial real estate investment premiums and discounts, net	(2,393	) (1,080 )
Amortization of intangibles	10,446	5,095
Amortization of deferred financing costs	1,315	5,192
Amortization of net origination fees and costs, net	(3,925	) (3,350 )
Amortization of contingent beneficial conversion feature and equity component of Convertible Senior Notes	-	12,246
Depreciation expense	16,511	8,773
Bargain purchase gain	(72,576	) -
Net gain on sale of commercial real estate	(821	) -
Net gain on sale of commercial loans held for sale	72	100
Net (gains) losses on sales of Residential Investment Securities	(24,941	) (70,796 )
Net (gains) losses on sale of residential mortgage loans	383	-
Net (gain) loss on sale of investment in affiliate	-	12,450
Stock compensation expense	6,949	1,089
Impairment of goodwill	-	22,966
Unrealized (gains) losses on interest rate swaps	1,148,478	587,995
Net unrealized (gains) losses on investments measured at fair value through earnings	24,351	40,466
Equity in net income from unconsolidated joint ventures	5,344	414
Net (gains) losses on trading assets	(370,050	) 12,961
Originations of commercial loans held for sale, net	-	(476,400 )
Proceeds from sale of commercial loans held for sale	134,253	-
Payments on purchase of residential mortgage loans	(73,370	) -
Proceeds from repayments from residential mortgage loans	107,648	-
Proceeds from repurchase agreements of RCap	1,661,650,000	1,447,650,000
Payments on repurchase agreements of RCap	(1,662,100,000)	(1,452,000,000)
Proceeds from reverse repurchase agreements of RCap	48,390,000	39,875,000
Payments on reverse repurchase agreements of RCap	(48,390,000	) (39,775,000 )
Net payments on derivatives	23,168	7,288
Net change in:		
Other assets	(72,800	) (29,324 )

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Accrued interest and dividends receivable	13,970	52,057
Receivable for investment advisory income	-	6,410
Accrued interest payable	15,729	(34,947 )
Accounts payable and other liabilities	(23,162 )	17,417
Net cash provided by (used in) operating activities	\$ 833,139	\$ (3,642,960 )
Cash flows from investing activities:		
Payments on purchases of Residential Investment Securities	(13,628,516 )	(13,172,943 )
Proceeds from sales of Residential Investment Securities	8,729,912	22,081,011
Principal payments on Agency mortgage-backed securities	8,580,353	7,811,368
Purchase of MSRs	(127,489 )	-
Proceeds from sale of investment in affiliate	-	126,402
Payments on purchases of corporate debt	(324,863 )	(301,739 )
Principal payments on corporate debt	98,542	43,846
Purchases of commercial real estate debt investments	(76,862 )	(368,511 )
Sales of commercial real estate debt investments	-	41,016
Purchase of securitized loans at fair value	(1,489,268 )	(2,574,353 )
Origination of commercial real estate investments, net	(204,184 )	(350,477 )
Proceeds from sale of commercial real estate investments	12,750	227,450
Principal payments on commercial real estate debt investments	71,116	10,170
Principal payments on securitized loans at fair value	106,786	-
Principal payments on commercial real estate investments	486,435	327,936
Purchase of investments in real estate	(2,043 )	(29,900 )
Investment in unconsolidated joint venture	(3,109 )	(70,602 )
Distributions in excess of cumulative earnings from unconsolidated joint ventures	4,155	-
Payments on purchase of residential mortgage loans held for investment	(8,022 )	-
Proceeds from repayments from residential mortgage loans held for investment	11,771	-
Purchase of equity securities	(88,062 )	(27,519 )
Proceeds from sales of equity securities	16,112	13,119
Cash acquired in business combination	41,697	-
Net cash provided by (used in) investing activities	\$ 2,207,211	\$ 13,786,274
Cash flows from financing activities:		
Proceeds from repurchase agreements	128,601,867	156,196,644
Principal payments on repurchase agreements	(133,021,365 )	(166,759,206 )
Payments on maturity of convertible senior notes	-	(857,541 )
Proceeds from other secured financing	2,358,314	687,935
Payments on other secured financing	(434,458 )	(327,965 )
Proceeds from issuance of securitized debt	1,381,640	2,382,810
Principal repayments on securitized debt	(273,091 )	(84,560 )
Principal repayments on securitized loans	-	201
Payment of deferred financing cost	(3,076 )	(886 )
Net proceeds from direct purchases and dividend reinvestments	1,795	1,724
Proceeds from mortgages payable	-	20,450
Principal payments on participation sold	(230 )	(220 )
Principal payments on mortgages payable	(7,500 )	(262 )
Contributions from noncontrolling interests	-	1,107
Distributions to noncontrolling interests	(926 )	(456 )
Net payment on share repurchase	(102,712 )	-
Dividends paid	(927,678 )	(906,910 )

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net cash provided by (used in) financing activities	\$ (2,427,420	) \$ (9,647,135	)
Net (decrease) increase in cash and cash equivalents	\$ 612,930	\$ 496,179	
Cash and cash equivalents, beginning of period	1,769,258	1,741,244	
Cash and cash equivalents, end of period	\$ 2,382,188	\$ 2,237,423	
Supplemental disclosure of cash flow information:			
Interest received	\$ 2,197,880	\$ 2,241,301	
Dividends received	\$ 1,253	\$ 12,684	
Fees received	\$ 4,266	\$ -	
Investment advisory income received	\$ -	\$ 31,258	
Interest paid (excluding interest paid on interest rate swaps)	\$ 441,121	\$ 314,568	
Net interest paid on interest rate swaps	\$ 415,223	\$ 450,750	
Taxes paid	\$ 858	\$ 1,926	
Noncash investing activities:			
Receivable for investments sold	\$ 493,839	\$ 127,571	
Payable for investments purchased	\$ 454,237	\$ 744,378	
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	\$ 1,497,273	\$ 57,972	
Noncash financing activities:			
Dividends declared, not yet paid	\$ 269,111	\$ 284,348	
Decrease in securitized debt	\$ 16,663	\$ -	

See notes to consolidated financial statements.

4

---

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

1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the “Company” or “Annaly”) is a Maryland corporation that commenced operations on February 18, 1997. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, Agency debentures, credit risk transfer (“CRT”) securities, other securities representing interests in or obligations backed by pools of mortgage loans, residential mortgage loans, mortgage servicing rights, commercial real estate assets and corporate debt. The Company’s principal business objectives are to generate net income for distribution to its stockholders from its investments and capital preservation. The Company is externally managed by Annaly Management Company LLC (the “Manager”). The Company’s business operations are primarily comprised of the following:

Annaly, the parent company, which invests primarily in Agency mortgage-backed securities and related derivatives to hedge these investments. Its portfolio also includes residential credit investments such as CRT and non-Agency mortgage-backed securities.

Annaly Commercial Real Estate Group, Inc. (“ACREG,” formerly known as CreXus Investment Corp.), a wholly-owned subsidiary that was acquired during the second quarter of 2013 which specializes in acquiring, financing and managing commercial real estate loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.

Annaly Middle Market Lending LLC (“MML,” formerly known as Charlesfort Capital Management LLC), a wholly-owned subsidiary which engages in corporate middle market lending transactions.

Hatteras Financial Corp. (“Hatteras”), a wholly-owned subsidiary that was acquired during the third quarter of 2016 which, through its wholly-owned subsidiaries, primarily engages in acquiring, investing in, securitizing and managing residential whole mortgage loans and investing in and managing mortgage servicing rights.

RCap Securities, Inc. (“RCap”), a wholly-owned subsidiary, which operates as a broker-dealer and is a member of the Financial Industry Regulatory Authority (“FINRA”).

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

2. BASIS OF PRESENTATION

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

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2015 has been derived from audited consolidated financial statements not included herein.

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

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and consolidated variable interest entities. All intercompany balances and transactions have been eliminated in consolidation. The Company reclassified previously presented financial information so that amounts previously presented conform to the current period presentation.



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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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

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

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

**Cash and Cash Equivalents** – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. RCap is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled approximately \$2.3 billion and \$1.6 billion at September 30, 2016 and December 31, 2015, respectively.

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

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

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

Agency mortgage-backed securities, Agency debentures, non-Agency mortgage-backed securities and CRT securities are referred to herein as “Residential Investment Securities.” Although the Company generally intends to hold most of its Residential Investment Securities until maturity, it may, from time to time, sell any of its Residential Investment Securities as part of the overall management of its portfolio. Residential Investment Securities classified as available-for-sale are reported at fair value with unrealized gains and losses reported in other comprehensive income (loss) unless

6

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

the Company has elected the fair value option, where the unrealized gains and losses on these financial instruments are recorded through earnings (e.g., interest-only securities). The fair value of Residential Investment Securities classified as available-for-sale is estimated by management and is compared to independent sources for reasonableness. Residential Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Gains and losses on sales of Residential Investment Securities are recorded on trade date based on the specific identification method. The Company elected the fair value option for interest-only mortgage-backed securities, non-Agency mortgage-backed securities and CRT securities as this election simplifies the accounting. Interest-only securities and inverse interest-only securities are collectively referred to as “interest-only securities.” These interest-only mortgage-backed securities represent the Company’s right to receive a specified proportion of the contractual interest flows of specific mortgage-backed securities. Interest-only mortgage-backed securities, non-Agency mortgage-backed securities and CRT securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on investments measured at fair value through earnings in the Company’s Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.

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

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

Interest income for Agency debentures is recognized by applying the interest method using contractual cash flows without estimating prepayments.

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

	Interest Income Methodology
Agency	
Fixed-rate pass-through <sup>(1)</sup>	Effective yield <sup>(3)</sup>
Adjustable-rate pass-through <sup>(1)</sup>	Effective yield <sup>(3)</sup>
Collateralized Mortgage Obligation (“CMO” <sup>(1)</sup> )	Effective yield <sup>(3)</sup>
Debentures <sup>(1)</sup>	Contractual Cash Flows
Interest-only <sup>(2)</sup>	Prospective
Residential Credit	
CRT <sup>(2)</sup>	Prospective
Legacy <sup>(2)</sup>	Prospective

NPL/RPL <sup>(2)</sup>	Prospective
New issue <sup>(2)</sup>	Prospective
New issue interest-only <sup>(2)</sup>	Prospective

<sup>(1)</sup> Changes in fair value are recognized in Other comprehensive income (loss) on the accompanying Consolidated Statements of Comprehensive Income (Loss).

<sup>(2)</sup> Changes in fair value are recognized in Net unrealized gains (losses) on investments measured at fair value through earnings on the accompanying Consolidated Statements of Comprehensive Income (Loss).

<sup>(3)</sup> Effective yield is recalculated for differences between estimated and actual prepayments and the amortized cost is adjusted as if the new effective yield had been applied since inception.

Residential Mortgage Loans – The Company’s residential mortgage loans are primarily comprised of prime jumbo adjustable-rate whole mortgage loans acquired in connection with the Company’s acquisition of Hatteras (“Hatteras Acquisition”) and subsequent purchases. Additionally, pursuant to the Hatteras Acquisition, the Company consolidates a collateralized financing entity that securitized prime adjustable-rate jumbo whole mortgage loans. The Company made elections to account for the investments in residential mortgage loans held in its portfolio and in the securitization trust at fair value as these elections simplify the accounting. Residential mortgage loans are recognized at fair value on the

7

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

accompanying Consolidated Statements of Financial Condition. Changes in the estimated fair value are presented in Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

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

There was no real estate acquired in settlement of residential mortgage loans as of September 30, 2016 or December 31, 2015. The Company would be considered to have received physical possession of residential real estate property collateralizing a residential mortgage loan, so that the loan is derecognized and the real estate property would be recognized, if either (i) the Company obtains legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveys all interest in the residential real estate property to the Company to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

Mortgage Servicing Rights (“MSRs”) – MSRs represent the rights associated with servicing contracts obtained in connection with the Hatteras Acquisition or through the subsequent purchase of such rights from third parties with the intention of holding them as investments. The Company and its subsidiaries do not originate or directly service mortgage loans. Rather, the Company utilizes duly licensed subservicers to perform substantially all servicing functions for the loans underlying the MSRs. The Company elected to account for all of its investments in MSRs at fair value; as such, they are recognized at fair value on the accompanying Consolidated Statements of Financial Condition with changes in the estimated fair value presented as a component of Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss). Servicing income, net of servicing expenses, is reported in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

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

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

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

Interest rate swap agreements - Interest rate swaps are the primary instrument used to mitigate interest rate risk. In particular, the Company uses interest rate swaps to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Swap agreements may or may not be cleared through a derivatives clearing organization (“DCO”). Uncleared swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared swaps are fair valued using the DCO’s market values.

Interest rate swaptions - Interest rate swaptions are purchased/sold to mitigate the potential impact of increases or decreases in interest rates. Interest rate swaptions provide the option to enter into an interest rate swap agreement for a predetermined notional amount,



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

stated term and pay and receive interest rates in the future. They are not centrally cleared. The premium paid/received for interest rate swaptions is reported as an asset/liability in the Consolidated Statements of Financial Condition. The difference between the premium and the fair value of the swaption is reported in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss). If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium received/paid. If the Company sells or exercises a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash received or the fair value of the underlying interest rate swap received and the premium paid.

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

TBA Dollar Rolls - TBA dollar roll transactions are accounted for as a series of derivative transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

MBS Options – MBS options are generally options on TBA contracts, which help manage mortgage market risks and volatility while providing the potential to enhance returns. MBS options are over-the-counter traded instruments and those written on current-coupon mortgage-backed securities are typically the most liquid. MBS options are measured at fair value using internal pricing models and compared to the counterparty market value at the valuation date with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Futures Contracts - Futures contracts are derivatives that track the prices of specific assets. Short sales of futures contracts help mitigate the potential impact of changes in interest rates on the portfolio performance. The Company maintains margin accounts that are settled daily with Futures Commission Merchants (“FCMs”). The margin requirement varies based on the market value of the open positions and the equity retained in the account. Futures contracts are fair valued based on exchange pricing with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Forward purchase commitments – The Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing mortgage loans at a particular price, provided the mortgage loans close with the counterparties. Gains and losses are recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Repurchase Agreements – The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company examines each of the specified criteria in ASC 860, Transfers and Servicing, at the inception of each transaction and has determined that each of the financings meet the specified criteria in this guidance.

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

Goodwill and Intangible Assets – The Company’s acquisitions are accounted for using the acquisition method. Under the acquisition method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The purchase prices are allocated to the assets acquired, including

identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired is recognized as goodwill. Conversely, any excess of the fair value of the net assets acquired over the purchase price is recognized as a bargain purchase gain. The Company tests goodwill for impairment on an annual basis and at interim periods when events or circumstances may make it more likely than not that an impairment has occurred. If a qualitative analysis indicates that there may be an impairment, a quantitative analysis is performed. The quantitative impairment test for goodwill utilizes a two-step approach, whereby the Company compares the carrying value of each identified reporting unit to its fair value. If the carrying value of the reporting unit is greater than its fair value, the second step is performed, where the implied fair value of goodwill is compared to its carrying value. The Company recognizes an impairment charge for the amount by which the carrying amount of goodwill exceeds its fair value. An impairment of the goodwill associated with the Company's acquisition of Fixed Income Discount Advisory Company ("FIDAC") was recorded during the year ended December 31, 2015.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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

Convertible Senior Notes – The Company recorded the 4% Convertible Senior Notes and 5% Convertible Senior Notes (collectively, the “Convertible Senior Notes”) at their contractual amounts, adjusted by the effects of a beneficial conversion feature and a contingent beneficial conversion feature (collectively, the “Conversion Features”). The Conversion Features’ intrinsic value is included in “Additional paid-in capital” on the Company’s Consolidated Statements of Financial Condition and reduces the recorded liability amount associated with the Convertible Senior Notes. A Conversion Feature may be recognized as a result of adjustments to the conversion price for dividends declared to common stockholders. The 4% and 5% Convertible Senior Notes matured in February 2015 and May 2015, respectively.

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

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

The provisions of ASC 740, Income Taxes, (“ASC 740”) clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of September 30, 2016 and December 31, 2015.

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

#### Commercial Real Estate Investments

Commercial Real Estate Debt Investments - The Company’s commercial real estate debt investments are comprised of commercial mortgage-backed securities and loans held by consolidated collateralized financing entities. Commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of other comprehensive income (loss). Management evaluates commercial mortgage-backed securities for other-than-temporary impairment at least quarterly. See the “Commercial Real Estate Investments” Note for additional information regarding the consolidated collateralized financing entities.

Commercial Real Estate Loans – The Company's commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. The Company designates loans as held for investment if it has the intent and ability to hold the loans until maturity or payoff. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Commercial real estate loans that are designated as held for investment and are originated or purchased by the Company are carried at their outstanding principal balance, net of unamortized

origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. If the Company intends to sell or securitize the loans and the financing vehicle is not expected to be consolidated, they are classified as held for sale. Commercial real estate loans that are designated as held for sale are carried at the lower of amortized cost or fair value and recorded as Commercial Loans held for sale in the accompanying Consolidated Statements of Financial Condition. Any origination fees and costs or purchase premiums or discounts are deferred and recognized upon sale. The Company determines the fair value of commercial real estate loans held for sale on an individual loan basis. The Company has elected the fair value option for multi-family mortgage loans held in securitization trusts that it was required to consolidate. Preferred equity interests are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. See “Commercial Real Estate Investments” Note for additional information.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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

Investments in commercial real estate are depreciated using the straight-line method over the estimated useful lives of the assets, summarized as follows:

<u>Category</u>	<u>Term</u>
Building	30 - 40 years
Site improvements	1 - 28 years

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

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

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

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

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

Revenue Recognition – Commercial Real Estate Investments - Interest income is accrued based on the outstanding principal amount of the commercial real estate loans and preferred equity interests held for investment (collectively referred to as “CRE Debt and Preferred Equity Investments”) and their contractual terms. Premiums and discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest

income over the projected lives of the CRE Debt and Preferred Equity Investments using the interest method.

#### Corporate Debt

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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

**Impairment of Securities and Loans**

**Other-Than-Temporary Impairment** – Management evaluates available-for-sale securities and held-to-maturity debt securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market conditions warrant such evaluation. When the fair value of an available-for-sale security is less than its amortized cost, the security is considered impaired. For available-for-sale securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of other comprehensive income (loss). If the fair value is less than the cost of a held-to-maturity security, the Company performs an analysis to determine whether it expects to recover the entire cost basis of the security. There was no other-than-temporary impairment recognized for the quarters ended September 30, 2016 and 2015.

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

The Company may be exposed to various levels of credit risk depending on the nature of its investments and credit enhancements, if any, supporting its assets. The Company’s core investment process includes procedures related to the initial approval and periodic monitoring of credit risk and other risks associated with each investment. The Company’s investment underwriting procedures include evaluation of the underlying borrowers’ ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics upon either the origination or the acquisition of a new investment but generally does not update the loan-to-value metrics in the course of quarterly surveillance. Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to, net operating income (“NOI”), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company’s CRE Debt and Preferred Equity Investments, and may consider other factors management deems important. Management also reviews market pricing to determine each borrower’s ability to refinance its respective assets at the maturity of each loan. Management also reviews economic trends, both macro and those affecting the property specifically, and the supply and demand of competing projects in the sub-market in which each subject property is located. Management monitors the financial condition and operating results of its corporate borrowers and continually assesses the future outlook of the borrower’s financial performance in light of industry developments,

management changes and company-specific considerations.

12

---



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

In connection with the quarterly surveillance review process, CRE Debt and Preferred Equity Investments are assigned an internal risk rating. Effective December 31, 2015, the loan risk ratings were enhanced to reflect guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The initial internal risk ratings (“Initial Ratings”) are based on loan-to-values and the NOI debt yields of the underlying collateral of the Company’s CRE Debt and Preferred Equity Investments and based upon leverage and cash flow coverages of the borrowers’ debt and operating obligations. The final internal risk ratings are influenced by other quantitative and qualitative factors that can result in an adjustment to the Initial Ratings, subject to review and approval by the respective committee. The internal risk rating categories include “Performing”, “Performing - Closely Monitored”, “Performing - Special Mention”, “Substandard”, “Doubtful” or “Loss”. Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans meet all present contractual obligations, but exhibit potential weakness that deserve management’s close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible. The presentation of prior period internal risk ratings have been revised to conform to the current period presentation.

Nonaccrual Status – If collection of a loan’s principal or interest is in doubt or the loan is 90 days or more past due, interest income is not accrued. For nonaccrual status loans carried at fair value or held for sale, interest is not accrued, but is recognized on a cash basis. For nonaccrual status loans carried at amortized cost, if collection of principal is not in doubt, but collection of interest is in doubt, interest income is recognized on a cash basis. If collection of principal is in doubt, any interest received is applied against principal until collectability of the remaining balance is no longer in doubt; at that point, any interest income is recognized on a cash basis. Generally, a loan is returned to accrual status when the borrower has resumed paying the full amount of the scheduled contractual obligation, if all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period of time and there is a sustained period of repayment performance by the borrower. The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing as of September 30, 2016 and December 31, 2015. Accordingly, no allowance for loan losses was deemed necessary as of September 30, 2016 and December 31, 2015.

Broker Dealer Activities

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

Recent Accounting Pronouncements

The Company considers the applicability and impact of all Accounting Standards Updates (“ASUs”). 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.

13

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Standards that are not yet adopted	This ASU updates the existing incurred loss model to a current expected credit loss model for financial assets and net investments in leases that are not accounted for at fair value through earnings. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures and any other financial assets not excluded from the scope. There are also changes to the accounting for available for sale debt securities.	January 1, 2020 (early adoption permitted)	The Company is assessing the impact to the consolidated financial statements.
ASU 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments			
Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Standards that were adopted			
ASU 2014-13, Consolidation (Topic 810) Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity	This update provides a practical expedient to measure the fair value of the financial assets and financial liabilities of a consolidated collateralized financing entity, which the reporting entity has elected to or is required to measure on a fair value basis.	January 1, 2016 (early adoption permitted)	The Company early adopted this ASU in the first quarter of 2015 and applied the guidance to commercial mortgage backed securitization transactions. See "Variable Interest Entity" footnote for further disclosure.

## 4. ACQUISITION OF HATTERAS

As previously disclosed in the Company's filings with the SEC, on July 12, 2016 the Company completed its acquisition of Hatteras, an externally managed mortgage REIT that invested primarily in single-family residential mortgage real estate assets, for aggregate consideration to Hatteras common shareholders of \$1.5 billion, consisting of \$1.0 billion in equity consideration and \$521.1 million in cash consideration. The Company issued 93.9 million shares of common shares as part of the consideration for the Hatteras Acquisition, which includes replacement share-based payment awards.

In addition, as part of the Hatteras Acquisition, each share of Hatteras 7.625% Series A Cumulative Redeemable Preferred Stock, par value \$0.001 per share ("Hatteras Preferred Share"), that was outstanding as of immediately prior to the completion of the Hatteras Acquisition was converted into one share of a newly-designated series of the Company's preferred stock, par value \$0.01 per share, which the Company classified and designated as 7.625%

Series E Cumulative Redeemable Preferred Stock, and which has rights, preferences, privileges and voting powers substantially the same as a Hatteras Preferred Share.

Hatteras' portfolio of adjustable rate mortgage-backed securities is believed to be complementary to the Company's existing portfolio. The combined capital base is believed to support continued growth of the Company's businesses and the acquisition is believed to create efficiency and growth opportunities.

The following table summarizes the aggregate consideration and preliminary fair value of the assets acquired and liabilities assumed recognized at the acquisition date, which is subject to change if new information becomes available:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## Purchase Price Allocation (dollars in thousands)

## Consideration transferred:

Cash	\$521,082
Common Equity	997,707

## Preferred Shares:

Exchange of Hatteras preferred stock for Annaly preferred stock	278,252
Preferred stock fair value adjustment	9,248
Preferred Shares	287,500

Total Consideration	\$1,806,289
---------------------	-------------

## Net Assets:

Cash	\$562,780
Agency mortgage-backed securities, at fair value	10,863,070
Credit risk transfer securities, at fair value	116,770
Residential mortgage loans	360,447
Mortgage servicing rights	355,820
Other derivatives, at fair value	8,677
Principal receivable	438,005
Accrued interest and dividend receivable	83,814
Other assets	57,250
Total Assets Acquired	\$12,846,633

Repurchase agreements	\$10,422,757
Other secured financing	35,769
Securitized debt of consolidated VIEs	54,135
Other derivatives, at fair value	349,922
Dividends payable	670
Payable for investments purchased	2,643
Accrued interest payable	4,833
Accounts payable and other liabilities	97,039
Total Liabilities Assumed	10,967,768
Net Assets Acquired	\$1,878,865

Bargain Purchase Gain	\$72,576
-----------------------	----------

For time-based restricted stock awards granted by Hatteras that fully vested as of the Hatteras Acquisition closing date, the fair value of the Company's common stock issued in the satisfaction of these awards was included in equity consideration transferred as no post acquisition service was required. For time-based restricted stock awards granted by Hatteras that did not fully vest as of the acquisition date and require post-acquisition service, the fair value of the Company's common stock issued as replacement awards has been allocated between the pre- and post-acquisition service period, with the amount allocated to the pre-acquisition period included in the equity consideration transferred. The amount allocated to the post-acquisition service period for the time-based restricted stock awards was \$5.8 million and expensed during the third quarter of 2016 in Other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss). Also, in connection with the Hatteras Acquisition, the Company entered into consulting agreements with certain former employees of Hatteras. During the third quarter of 2016, the Company recognized the full amount of the fees related to the consulting agreements totaling \$19.9 million

in Other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss).

Under the acquisition method of accounting, merger-related transaction costs (such as advisory, legal, valuation, consulting and other professional fees) are not included as components of consideration transferred but are expensed in the periods in which the costs are incurred. Transaction costs of \$48.9 million were incurred during the nine months ended September 30, 2016 and were included in Other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss).

The fair value and unpaid principal balance of residential mortgage loans acquired in connection with the Hatteras acquisition were \$360.4 million and \$350.5 million, respectively.

The bargain purchase gain is the result of the mortgage REIT sector facing significant headwinds for a variety of reasons, including uncertainty regarding the outlook for interest rates and the financial markets generally. Consequently, in recent years, the price per share of Hatteras common stock has traded at a substantial discount to Hatteras' book value per share, which made raising equity capital to fund new investments dilutive to stockholders. Because of these circumstances, Hatteras was unable to raise equity capital on acceptable terms and significantly increase its size and scale through capital market transactions. The bargain purchase is recognized in Realized and unrealized gains (losses) in the Consolidated Statements of Comprehensive Income (Loss).

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2016 includes Net interest income and Net income (loss) of \$35.5 million and \$86.7 million, respectively, attributable to the Hatteras Acquisition. The following unaudited pro forma summary presents consolidated information of the Company, assuming the Hatteras Acquisition had occurred as of January 1, 2015 for purposes of the 2016 and 2015 pro forma disclosures presented. They include certain adjustments for the periods presented to exclude deferred swap net losses of Hatteras from net interest expense to conform to the Company's presentation, recalculate the management fee based upon pro forma stockholders' equity and the Company's management fee rate, eliminate Hatteras common stock outstanding and record the issuance of the Company's common stock to Hatteras stockholders and reflect direct costs incurred by the Company and the bargain purchase gain as if the Hatteras Acquisition occurred as of January 1, 2015. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the Hatteras Acquisition occurred on January 1, 2015 and may not be indicative of future operating results:

	For the Quarters		For the Nine Months	
	Ended		Ended	
	September	September	September	September
	30, 2016	30, 2015	30, 2015	30, 2015
	(dollars in thousands, except per share data)			
Net interest income	\$395,396	\$397,602	\$1,027,202	\$1,434,947
Net income (loss)	\$708,191	\$(710,720)	\$(520,830)	\$(272,007)
Basic earnings per common share	\$0.67	\$(0.70)	\$(0.58)	\$(0.33)
Diluted earnings per common share	\$0.67	\$(0.70)	\$(0.58)	\$(0.33)

For additional details regarding the terms and conditions of the Hatteras Acquisition and related matters, please refer to the Company's other filings with the SEC that were made in connection with the Hatteras Acquisition, including the Prospectus/Offer to Exchange filed with the SEC pursuant to Rule 424(b)(3) on July 8, 2016 and the Current Report on Form 8-K filed with the SEC on July 12, 2016.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 5. RESIDENTIAL INVESTMENT SECURITIES

The following tables present the Company's Residential Investment Securities portfolio carried at fair value as of September 30, 2016 and December 31, 2015:

Agency	September 30, 2016						
	Principal / Notional (dollars in thousands)	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains <sup>(1)</sup>	Unrealized Losses <sup>(1)</sup>	Estimated Fair Value
Fixed-rate pass-through	\$55,713,247	\$3,174,800	\$(1,828 )	\$58,886,219	\$1,102,609	\$(46,259 )	\$59,942,569
Adjustable-rate pass-through	11,760,633	409,677	(4,399 )	12,165,911	77,056	(14,340 )	12,228,627
Interest-only	8,562,837	1,498,193	-	1,498,193	13,145	(206,429 )	1,304,909
Total Agency investments	\$76,036,717	\$5,082,670	\$(6,227 )	\$72,550,323	\$1,192,810	\$(267,028 )	\$73,476,105
Residential Credit CRT	\$641,531	\$7,333	\$(11,742 )	\$637,122	\$32,188	\$(15 )	\$669,295
Legacy <sup>(2)</sup>	1,075,956	1,634	(169,677 )	907,913	26,767	(513 )	934,167
NPL/RPL	347,105	434	(877 )	346,662	2,037	(264 )	348,435
New issue	161,275	946	(359 )	161,862	4,484	(16 )	166,330
New issue interest-only	935,395	16,615	-	16,615	-	(5,286 )	11,329
Total residential credit investments	\$3,161,262	\$26,962	\$(182,655 )	\$2,070,174	\$65,476	\$(6,094 )	\$2,129,556
Total Residential Investment Securities	\$79,197,979	\$5,109,632	\$(188,882 )	\$74,620,497	\$1,258,286	\$(273,122 )	\$75,605,661
Agency	December 31, 2015						
	Principal / Notional (dollars in thousands)	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains <sup>(1)</sup>	Unrealized Losses <sup>(1)</sup>	Estimated Fair Value
Fixed-rate pass-through	\$57,339,705	\$3,270,521	\$(2,832 )	\$60,607,394	\$400,350	\$(824,862 )	\$60,182,882
Adjustable-rate pass-through	2,894,192	61,781	(6,427 )	2,949,546	70,849	(10,317 )	3,010,078
CMO	964,095	27,269	(477 )	990,887	9,137	(12,945 )	987,079
Debentures	158,802	-	(648 )	158,154	-	(6,116 )	152,038
Interest-only	9,499,332	1,634,312	-	1,634,312	18,699	(114,826 )	1,538,185
Total Agency investments	\$70,856,126	\$4,993,883	\$(10,384 )	\$66,340,293	\$499,035	\$(969,066 )	\$65,870,262
Residential Credit CRT	\$476,084	\$2,225	\$(12,840 )	\$465,469	\$250	\$(9,209 )	\$456,510
Legacy <sup>(2)</sup>	378,527	773	(37,150 )	342,150	698	(1,140 )	341,708



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

NPL/RPL	354,945	19	(1,270 )	353,694	19	(1,172 )	352,541
New issue	197,695	566	-	198,261	-	(1,060 )	197,201
New issue							
interest-only	811,245	15,430	-	15,430	-	(158 )	15,272
Total residential							
credit securities	\$2,218,496	\$19,013	\$(51,260 )	\$1,375,004	\$967	\$(12,739 )	\$1,363,232

Total Residential

Investment Securities	\$73,074,622	\$5,012,896	\$(61,644 )	\$67,715,297	\$500,002	\$(981,805 )	\$67,233,494
-----------------------	--------------	-------------	-------------	--------------	-----------	--------------	--------------

(1) Unrealized gains and losses on Agency securities (other than interest-only securities), are reported as a component of other comprehensive income (loss). Unrealized gains and losses on residential credit investments and Agency interest-only investments are generally reported in Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

(2) Legacy residential credit refers to securities whose underlying collateral was securitized prior to 2009.

The following tables present the Company's Agency mortgage-backed securities portfolio by issuing Agency concentration as of September 30, 2016 and December 31, 2015:

Investment Type	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Fannie Mae	\$48,151,223	\$42,647,075
Freddie Mac	25,246,425	22,960,595
Ginnie Mae	78,457	110,554
Total	\$73,476,105	\$65,718,224

Actual maturities of the Company's Residential Investment Securities portfolio are generally shorter than stated contractual maturities because actual maturities of the portfolio are affected by periodic payments and prepayments of principal on underlying mortgages. The following table summarizes the Company's available-for-sale Residential Investment Securities as of September 30, 2016 and December 31, 2015, according to their estimated weighted average life classifications:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

Weighted Average Life	September 30, 2016		December 31, 2015	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	\$654,108	\$663,561	\$37,862	\$37,850
Greater than one year through five years	55,394,787	54,543,574	20,278,111	20,066,435
Greater than five years through ten years	19,480,416	19,337,485	46,473,701	47,174,319
Greater than ten years	76,350	75,877	443,820	436,693
Total	\$75,605,661	\$74,620,497	\$67,233,494	\$67,715,297

The weighted average lives of the Agency mortgage-backed securities at September 30, 2016 and December 31, 2015 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be materially longer or shorter than projected.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities by length of time that such securities have been in a continuous unrealized loss position at September 30, 2016 and December 31, 2015.

	September 30, 2016			December 31, 2015		
	Estimated Fair Value <sup>(1)</sup>	Gross Unrealized Losses <sup>(1)</sup>	Number of Securities <sup>(1)</sup>	Estimated Fair Value <sup>(1)</sup>	Gross Unrealized Losses <sup>(1)</sup>	Number of Securities <sup>(1)</sup>
	(dollars in thousands)					
Less than 12 Months	\$8,204,957	\$ (28,676 )	445	\$20,072,072	\$ (164,259 )	463
12 Months or More	6,867,701	(31,923 )	54	21,705,764	(689,981 )	189
Total	\$15,072,658	\$ (60,599 )	499	\$41,777,836	\$ (854,240 )	652

(1) Excludes interest-only mortgage-backed securities.

The decline in value of these securities is solely due to market conditions and not the quality of the assets.

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

During the quarter and nine months ended September 30, 2016, the Company disposed of \$3.8 billion and \$9.1 billion of Residential Investment Securities, respectively, resulting in a net realized gain of \$14.7 million and \$24.9 million, respectively.

During the quarter and nine months ended September 30, 2015, the Company disposed of \$3.7 billion and \$21.1 billion of Residential Investment Securities, respectively, resulting in a net realized gain of \$4.5 million and \$70.8 million, respectively.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 6. RESIDENTIAL MORTGAGE LOANS

The table below presents the fair value and the unpaid principal balance for these loans as of September 30, 2016:

	(dollars in thousands)
Fair value	\$ 310,148
Unpaid principal balance	\$ 301,957

The following table provides information regarding the line items and amounts recognized in the Consolidated Statements of Comprehensive Income (Loss) for the quarter and nine months ended September 30, 2016 for these investments:

	(dollars in thousands)
Net gains (losses) on disposal of investments	\$ (383 )
Net unrealized gains (losses) on investments measured at fair value through earnings	(493 )
Net interest income	1,203
Total included in net income (loss)	\$ 327

None of the change in the fair value of the residential mortgage loans was attributable to changes in credit risk based on current delinquencies.

The following table provides the geographic concentrations based on the unpaid principal balances as of September 30, 2016 for the residential mortgage loans, including loans held in a securitization trust:

Geographic Concentrations of Residential Mortgage Loans	
Property Location	% of Balance
California	48.5%
Texas	11.0%
Illinois	5.5%
Florida	5.3%
All other (none individually greater than 5%)	29.7%
Total	100.0%

The table below provides additional data on the Company's residential mortgage loans, including loans held in a securitization trust, at September 30, 2016:

	September 30, 2016	
	Portfolio Range	Portfolio Weighted Average
	(dollars in thousands)	
Unpaid principal balance	\$ 164 - \$1,903	\$ 716
Interest rate	2.50% - 4.13 %	3.45 %
	3/5/2044 -	
Maturity	7/21/2046	6/10/2045
FICO score at loan origination	700 - 815	765
Loan-to-value ratio at loan origination	23.73% - 80.27 %	70.56 %



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 7. MORTGAGE SERVICING RIGHTS

In connection with the Hatteras Acquisition, the Company obtained an MSR portfolio and began investing in MSRs through Hatteras' wholly-owned subsidiary during the third quarter of 2016. The Company elected to carry all investments in MSRs at fair value.

The following table presents activity related to MSRs for the quarter and nine months ended September 30, 2016:

	September 30, 2016 (dollars in thousands)
Fair value, beginning of period	\$ -
Obtained through Hatteras Acquisition	355,820
Purchases	131,729
Change in fair value due to:	
Changes in valuation inputs or assumptions <sup>(1)</sup>	26,254
Other changes, including realization of expected cash flows	(21,634 )
Fair value, end of period	\$ 492,169

(1) Principally represent changes in discount rates and prepayment speed inputs used in valuation model, primarily due to changes in interest rates.

For the three and nine months ended September 30, 2016, the Company recognized \$26.2 million of net servicing income from MSRs in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

## 8. COMMERCIAL REAL ESTATE INVESTMENTS

On December 11, 2015, the Company originated a \$335.0 million recapitalization financing with respect to eight class A/B office properties in Orange County, California.

As of December 31, 2015, such financing was comprised of a \$280.0 million senior mortgage loan (\$278.6 million, net of origination fees), and mezzanine debt with an initial principal balance of \$55.0 million (\$52.7 million, net of origination fees) and a future funding component of \$30.0 million. The senior loan was held for sale as of December 31, 2015. In April and

August 2016, the Company sold \$115.0 million (\$114.3 million, net of origination fees) and \$20.0 million (\$19.9 million, net of origination fees) of the senior loan to unrelated third parties at carrying value, accordingly, no gain or loss was recorded in connection with these sales. The balance of the senior loan of \$145.0 million (\$144.3 million, net of origination fees) remains held for sale as of September 30, 2016.

The following tables present commercial real estate investments held for investment at September 30, 2016 and December 31, 2015.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## CRE Debt and Preferred Equity Investments

	September 30, 2016			December 31, 2015				
	Outstanding Principal	Carrying Value <sup>(1)</sup>	Percentage of Loan Portfolio <sup>(2)</sup>	Outstanding Principal	Carrying Value <sup>(1)</sup>	Percentage of Loan Portfolio <sup>(2)</sup>		
	(dollars in thousands)							
Senior mortgages	\$468,258	\$466,169	43.6	%	\$387,314	\$385,838	28.6	%
Senior securitized mortgages <sup>(3)</sup>	128,896	128,896	12.0	%	263,072	262,703	19.4	%
Mezzanine loans	468,864	466,170	43.6	%	582,592	578,503	43.0	%
Preferred equity	9,000	8,962	0.8	%	122,444	121,773	9.0	%
Total <sup>(4)</sup>	\$1,075,018	\$1,070,197	100.0	%	\$1,355,422	\$1,348,817	100.0	%

(1) Carrying value includes unamortized origination fees of \$4.9 million and \$6.9 million as of September 30, 2016 and December 31, 2015, respectively.

(2) Based on outstanding principal.

(3) Assets of consolidated VIEs.

(4) Excludes Loans held for sale, net.

	September 30, 2016				
	Senior Mortgages	Senior Securitized Mortgages <sup>(1)</sup>	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	\$385,838	\$ 262,703	\$578,503	\$121,773	\$1,348,817
Originations & advances (principal)	159,173	-	46,858	-	206,031
Principal payments	(78,229 )	(134,176 )	(160,585 )	(113,444 )	(486,434 )
Amortization & accretion of (premium) discounts	(102 )	-	(192 )	-	(294 )
Net (increase) decrease in origination fees	(1,566 )	-	(282 )	-	(1,848 )
Amortization of net origination fees	1,055	369	1,868	633	3,925
Net carrying value <sup>(2)</sup>	\$466,169	\$ 128,896	\$466,170	\$8,962	\$1,070,197

(1) Assets of consolidated VIE.

(2) Excludes Loans held for sale, net.

	December 31, 2015				
	Senior Mortgages	Senior Securitized Mortgages <sup>(1)</sup>	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	\$383,895	\$ 398,634	\$522,731	\$212,905	\$1,518,165
Originations & advances (principal)	293,925	-	195,312	-	489,237
Principal payments	(243,270)	(136,469 )	(153,693 )	(92,210 )	(625,642 )
Sales (principal)	(46,945 )	-	-	-	(46,945 )
Amortization & accretion of (premium) discounts	(142 )	-	(232 )	517	143
Net (increase) decrease in origination fees	(3,702 )	(279 )	(4,806 )	-	(8,787 )



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Amortization of net origination fees	2,077	817	691	561	4,146
Transfers	-	-	18,500	-	18,500
Net carrying value <sup>(2)</sup>	\$385,838	\$ 262,703	\$578,503	\$121,773	\$1,348,817

(1) Assets of consolidated VIE.

(2) Excludes Loans held for sale, net.

21

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## Internal CRE Debt and Preferred Equity Investment Ratings

The Company's internal loan risk ratings are based on the guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The Company's internal risk rating categories include "Performing", "Performing - Closely Monitored", "Performing - Special Mention", "Substandard", "Doubtful" or "Loss". Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans meet all present contractual obligations, but exhibit potential weakness that deserve management's close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible. The presentation of prior period internal risk ratings have been revised to conform to the current period presentation. The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing as of September 30, 2016 and December 31, 2015. Accordingly, no allowance for loan losses was deemed necessary as of September 30, 2016 and December 31, 2015.

Investment Type	September 30, 2016									
	Outstanding Principal (1)	Percentage of CRE Debt and Preferred Equity Portfolio		Internal Ratings					Total	
	(dollars in thousands)			Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard	Doubtful		Loss
Senior mortgages	\$468,258	43.6	%	\$92,290	\$243,528	\$132,440	\$ -	\$ -	\$ -	\$468,258
Senior securitized mortgages <sup>(2)</sup>	128,896	12.0	%	-	17,500	111,396	-	-	-	128,896
Mezzanine loans	468,864	43.6	%	268,190	164,357	36,317	-	-	-	468,864
Preferred equity	9,000	0.8	%	-	-	9,000	-	-	-	9,000
	\$1,075,018	100.0	%	\$360,480	\$425,385	\$289,153	\$ -	\$ -	\$ -	\$1,075,018

(1) Excludes Loans held for sale, net.

(2) Assets of consolidated VIE.

Investment Type	December 31, 2015								
	Outstanding Principal (1)	Debt and Preferred Equity Portfolio	Percentage of CRE	Internal Ratings			Substandard	Doubtful	Loss
			Performing	- Closely Monitored	- Special Mention				
Senior mortgages	\$387,314	28.6	% \$71,000	\$283,148	\$33,166	\$ -	\$ -	\$ -	\$387,314
Senior securitized mortgages <sup>(2)</sup>	263,072	19.4	% 106,770	15,500	140,802	-	-	-	263,072
Mezzanine loans	582,592	43.0	% 342,493	219,969	20,130	-	-	-	582,592
Preferred equity	122,444	9.0	% -	81,944	40,500	-	-	-	122,444
	\$1,355,422	100.0	% \$520,263	\$600,561	\$234,598	\$ -	\$ -	\$ -	\$1,355,422

(1) Excludes Loans held for sale, net.

(2) Assets of consolidated VIE.

## Investments in Commercial Real Estate

There were no acquisitions of new real estate holdings during the quarter and nine months ended September 30, 2016. The following table summarizes real estate held for investment acquired in 2015:

Date of Acquisition	Type	Location	Original Purchase Price	Remaining Lease Term (Years) <sup>(1)</sup>
July 2015	Single Tenant Retail	Ohio	\$11,000	4.1
August 2015	Multi Tenant Retail	Florida	\$18,900	4.8
October 2015	Multifamily Property	Washington, DC	\$75,000	1.0
October 2015	Multi Tenant Retail	California	\$37,750	3.8
November 2015	Multi Tenant Retail	Texas	\$131,950	4.4

(1) Does not include extension options.

22

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

In the second quarter of 2016, the Company finalized the purchase price allocation of the eleven multi-tenant retail properties portfolio (“Texas Portfolio”) acquired in November 2015 for a total purchase price of \$132.0 million and recognized \$4.2 million of additional depreciation and amortization as a result. The following presents the aggregate final purchase price allocation of the Texas Portfolio:

	Texas (dollars in thousands)
Purchase Price Allocation:	
Land	\$ 32,452
Buildings	82,552
Site improvements	5,446
Tenant Improvements	6,835
Real estate held for investment	127,285
Intangible assets (liabilities):	
Leasehold intangible assets	14,598
Above market lease	274
Below market lease	(10,207 )
Total purchase price	\$ 131,950

The weighted average amortization period for intangible assets and liabilities as of September 30, 2016 is 4.7 years. Above market leases and leasehold intangible assets are included in Intangible assets, net and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	\$ 117,023	\$ 113,494
Buildings and improvements	355,899	373,603
Subtotal	472,922	487,097
Less: accumulated depreciation	(32,239 )	(16,886 )
Total real estate held for investment, at amortized cost, net	440,683	470,211
Equity in unconsolidated joint ventures	59,344	65,735
Investments in commercial real estate, net	\$ 500,027	\$ 535,946

Depreciation expense was \$5.0 million and \$15.7 million for the quarter and nine months ended September 30, 2016, respectively. Depreciation expense was \$3.1 million and \$8.8 million for the quarter and nine months ended

September 30, 2015, respectively. Depreciation expense is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

#### Rental Income

The minimum rental amounts due under leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the tenants reimburse us for certain operating costs. Approximate future minimum rents payments under non-cancelable operating leases in effect at September 30, 2016 for consolidated investments in real estate are as follows:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	September 30, 2016 (dollars in thousands)
2016 (remaining)	\$ 8,189
2017	31,102
2018	27,504
2019	23,448
2020	18,877
Later years	56,266
	\$ 165,386

Mortgage loans payable as of September 30, 2016 and December 31, 2015, were as follows:

## September 30, 2016

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	\$285,899	\$289,125	4.03% - 4.61	%Fixed	2024 and 2025	First liens
Tennessee	12,253	12,350	4.01	%Fixed	9/6/2019	First liens
Virginia	11,014	11,025	3.58	%Fixed	6/6/2019	First liens
Arizona	16,080	16,063	3.50	%Fixed	1/1/2017	First liens
Nevada	2,386	2,383	L+200	Floating <sup>(1)</sup>	3/29/2017	First liens
	\$327,632	\$330,946				

(1) Includes a mortgage with a fixed rate via an interest rate swap (pay fixed 3.45%, receive floating rate of L+200).

## December 31, 2015

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	\$292,658	\$296,325	2.30% to 4.61%	Fixed	2016, 2024 and 2025	First liens
Tennessee	12,228	12,350	4.01	%Fixed	9/6/2019	First liens
Virginia	11,012	11,025	3.58	%Fixed	6/6/2019	First liens
Arizona	16,365	16,308	3.50	%Fixed	1/1/2017	First liens
Nevada	2,444	2,436	L+200	Floating <sup>(1)</sup>	3/29/2017	First liens
	\$334,707	\$338,444				

(1) Includes a mortgage with a fixed rate via an interest rate swap (pay fixed 3.45%, receive floating rate of L+200).

The following table details future mortgage loan principal payments as of September 30, 2016:

	Mortgage Loan Principal Payments (dollars in thousands)
2016 (remaining)	\$ 101
2017	18,345
2018	-
2019	23,375
2020	-
Later years	289,125
	\$ 330,946

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 9. CORPORATE DEBT

The Company invests in corporate loans and corporate debt securities through the MML subsidiary. The industry and interest rate characteristics of the portfolio as of September 30, 2016 are as follows:

	Industry Dispersion		Total
	Fixed Rate	Floating Rate	
	(dollars in thousands)		
Airports, Flying Fields and Airport Terminal	\$-	\$47,184	\$47,184
Commercial Fishing	-	40,590	40,590
Computer Programming & Data Processing	-	63,253	63,253
Drugs	-	34,247	34,247
Home Health Care Services	-	39,339	39,339
Insurance Agents, Brokers & Services	4,380	44,344	48,724
Management & Public Relations Services	-	39,116	39,116
Medical & Dental Laboratories	-	17,324	17,324
Miscellaneous Business Services	84,448	63,677	148,125
Miscellaneous Health & Allied Services	-	38,886	38,886
Miscellaneous Nonmetallic Minerals	-	24,682	24,682
Miscellaneous Plastic Products	-	27,075	27,075
Motor Vehicles, Parts & Supplies	-	12,347	12,347
Offices & Clinics of Doctors of Medicine	-	83,582	83,582
Research, Development & Testing Services	-	17,739	17,739
Schools & Educational Services	-	21,042	21,042
Surgical, Medical & Dental Instruments	-	13,576	13,576
Total	\$88,828	\$628,003	\$716,831

The table below reflects the Company's aggregate positions by their respective place in the capital structure of the borrowers as of September 30, 2016.

	September 30, 2016 (dollars in thousands)
First lien loans	\$ 466,099
Second lien loans	161,904
Second lien notes	84,448
Subordinated notes	4,380
Total	\$ 716,831

## 10. VARIABLE INTEREST ENTITIES



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

The Company incurred approximately \$4.3 million of costs in connection with the securitization that have been capitalized and are being amortized to interest expense. Deferred financing costs are included in Securitized debt of consolidated VIEs in the accompanying Consolidated Statements of Financial Condition. As of September 30, 2016, the underlying securitized debt was fully paid off, and accordingly, the respective origination fees were fully amortized.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

The Company is considered to be the primary beneficiary of NLY Commercial Mortgage Trust as a result of its ability to remove the special servicer without cause and through its ownership of subordinated certificates. The Company did not elect the fair value option for the loans in this VIE in order to consistently account for loans it originated that are held for investment.

In February 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KLSF (“FREMF 2015-KLSF”) for \$102.1 million. The underlying portfolio is a pool of 11 floating rate multifamily mortgage loans with a cut-off principal balance of \$1.4 billion. The Company is required to consolidate the FREMF 2015-KLSF Trust’s assets and liabilities of \$1.4 billion and \$1.3 billion, respectively, at September 30, 2016.

In April 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KF07 (“FREMF 2015-KF07”) for \$89.4 million. The underlying portfolio is a pool of 40 floating rate multifamily mortgage loans with a cut-off principal balance of \$1.2 billion. The Company is required to consolidate the FREMF 2015-KF07 Trust’s assets and liabilities of \$1.1 billion and \$1.0 billion, respectively, at September 30, 2016.

In February 2016, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREM Mortgage Trust 2016-KLH1 (“FREM 2016-KLH1”) for \$107.6 million, net of a \$4.4 million discount to face value of \$112.0 million. The underlying portfolio is a pool of 28 floating rate multifamily mortgage loans with a cut-off principal balance of \$1.5 billion. The Company is required to consolidate the FREM 2016-KLH1 Trust’s assets and liabilities of \$1.5 billion and \$1.4 billion, respectively, at September 30, 2016. FREMF 2015-KLSF, FREMF 2015-KF07 and FREM 2016-KLH1 are collectively referred to herein as the FREMF Trusts.

The FREMF Trusts are structured as pass-through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The FREMF Trusts are VIEs and the Company is considered to be the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership of the Class C Certificates and its current designation as the directing certificate holder. The Company’s exposure to the obligations of the VIEs is generally limited to the Company’s investment in the FREMF Trusts of \$291.3 million at September 30, 2016. Assets of the FREMF Trusts may only be used to settle obligations of the FREMF Trusts. Creditors of the FREMF Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the FREMF Trusts. No gain or loss was recognized upon initial consolidation of the FREMF Trusts, but \$0.2 million and \$0.8 million of related costs were expensed upon consolidation and are reflected in the Consolidated Statements of Comprehensive Income (Loss). The FREMF Trusts’ assets are included in Commercial real estate debt investments and the FREMF Trusts’ liabilities are included in Securitized debt of consolidated VIEs in the accompanying Consolidated Statements of Financial Condition.

Upon consolidation, the Company elected the fair value option for the financial assets and liabilities of the FREMF Trusts in order to avoid an accounting mismatch, and to more accurately represent the economics of its interest in the entities. The fair value option requires that changes in fair value be reflected in the Company’s Consolidated Statements of Comprehensive Income (Loss). The Company has adopted ASU 2014-13 and applied the practical expedient fair value measurement whereby the Company determines whether the fair value of the financial assets or financial liabilities is more observable as a basis for measuring the less observable financial instruments. The Company has determined that the fair value of the financial liabilities of the FREMF Trusts is more observable, since the prices for these liabilities are available from third-party pricing services utilized for multifamily mortgage-backed securities, while the fair value of the individual assets of the trusts are inherently less capable of precise measurement given their illiquid nature and the limitations on available information related to these assets. Given that the

Company's methodology for valuing the financial assets of the FREMF Trusts is an aggregate fair value derived from the fair value of the financial liabilities, the Company has determined that the fair value of each of the financial assets in their entirety should be classified in Level 2 of the fair value measurement hierarchy.

The FREMF Trusts mortgage loans had an unpaid principal balance of \$3.9 billion at September 30, 2016. As of September 30, 2016 there are no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities as of September 30, 2016 based upon the Company's process of monitoring events of default on the underlying mortgage loans.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The Company consolidates a residential mortgage trust that issued residential mortgaged-backed securities that are collateralized by residential mortgage whole loans that had been transferred to the trust by one of the Company's subsidiaries. The Company owns most of the mortgaged-backed securities issued by this VIE, including the subordinate securities, and a subsidiary of the Company continues to be the servicer. As such, the Company is deemed to be the primary beneficiary of the residential mortgage trust and consolidates the entity. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial liabilities and financial assets of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt was \$50.5 million as of September 30, 2016.

In June 2016, a consolidated subsidiary of the Company (the "Borrower") entered into a \$300.0 million credit facility with a third party financial institution. The Borrower was determined to be a VIE and the Company was determined to be the primary beneficiary due to its role as collateral manager and because it holds a variable interest in the entity that could be potentially significant to the entity. The Company has transferred corporate loans with a carrying amount of \$475.5 million at September 30, 2016 that are pledged as collateral for the credit facility. The transfers did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation. As of September 30, 2016, the Borrower had an intercompany receivable of \$212.2 million, which eliminates upon consolidation and an Other secured financing of \$212.2 million to the third party financial institution.

The Company also owns variable interests in an entity that invests in MSR's and has structured its operations, funding and capitalization into three pools of assets and liabilities referred to as "silos." Owners of variable interests in a given silo are entitled to all of the returns and risk of loss on the investments and operations of that silo and have no substantive recourse to the assets of any other silo. While the Company has power over all silos because it holds 100% of the voting interests in the entity, it has variable interests only in two of the silos. The Company is the primary beneficiary of those two silos because it holds 100% of their variable interests.

The Company's exposure to the obligations of its VIEs is generally limited to the Company's investment in the VIEs of \$ 1.1 billion at September 30, 2016. Assets of the VIEs may only be used to settle obligations of the VIE Trusts. Creditors of the VIE Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the VIEs. No gain or loss was recognized upon initial consolidation of the VIEs. Interest income and expense are recognized using the effective interest method.

The statement of financial condition of the Company's VIEs that is reflected in the Company's Consolidated Statements of Financial Condition at September 30, 2016 and December 31, 2015 are as follows:

	September 30, 2016			
	NLY			
	FREMF	Commercial	Residential	MSR
	Trusts	Mortgage	Mortgage	Silos
		Trust	Loan Trust	
	(dollars in thousands)			
Assets				
Cash	\$-	\$ 185	\$ -	\$31,163
Senior securitized commercial mortgages carried at fair value	3,953,150	-	-	-
Commercial real estate and debt and preferred equity, held for investment	-	128,896	-	-

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Residential mortgages loans carried at fair value	-	-	176,748	9,631
Mortgage servicing rights	-	-	-	492,169
Accrued interest receivable	8,519	49	356	4
Other assets	-	9	3,149	29,586
Total assets	\$3,961,669	\$ 129,139	\$ 180,253	\$562,553
<b>Liabilities</b>				
Securitized debt (non-recourse) at fair value	\$3,661,884	\$ -	\$ 50,937	\$-
Other secured financing	-	-	-	4,186
Other derivatives, at fair value	-	-	-	9
Accrued interest payable	4,288	200	127	-
Other liabilities	-	-	44	25,363
Total liabilities	\$3,666,172	\$ 200	\$ 51,108	\$29,558

27

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	December 31, 2015	
	FREMF Trusts	NLY Commercial Mortgage Trust
	(dollars in thousands)	
<b>Assets</b>		
Cash	\$-	\$ 49,025
Senior securitized commercial mortgages carried at fair value	2,554,023	-
Commercial real estate and debt and preferred equity, held for investment	-	262,703
Accrued interest receivable	4,994	431
Other Assets	-	169
Total assets	\$2,559,017	\$ 312,328
<b>Liabilities</b>		
Securitized debt (non-recourse) at fair value	\$2,366,878	\$ -
Securitized debt (non-recourse) at amortized cost	-	173,833
Accrued interest payable	4,183	191
Other liabilities	-	290
Total liabilities	\$2,371,061	\$ 174,314

The statement of comprehensive income (loss) of the Company's VIEs that is reflected in the Company's Consolidated Statements of Comprehensive Income

(Loss) for the quarter and nine months ended September 30, 2016 are as follows:

	For the Quarter Ended September 30, 2016			
	FREMF Trusts	NLY Commercial Mortgage Trust	Residential Mortgage Loan Trust	MSR Silos
	(dollars in thousands)			
<b>Net interest income:</b>				
Interest income	\$25,148	\$ 1,691	\$ 932	\$57
Interest expense	11,375	105	404	22
Net interest income	13,773	1,586	528	35
Realized gain (loss) on disposal of investments	-	-	(329)	) 184
Unrealized gain (loss) on investments at fair value <sup>(1)</sup>	(3,201)	-	(109)	) 4,218
Other income (loss)	(6,773)	-	(79)	) 25,716
General and administration expenses	-	-	17	1,555
Net income (loss)	\$3,799	\$ 1,586	\$ (6)	) \$28,598

	For the Nine Months Ended September 30, 2016			
	FREMF Trusts	NLY Commercial	Residential Mortgage	MSR Silos

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

	Mortgage Trust		Loan Trust	
	(dollars in thousands)			
Net interest income:				
Interest income	\$69,972	\$ 8,543	\$ 932	\$57
Interest expense	29,598	2,302	404	22
Net interest income	40,374	6,241	528	35
Realized gain (loss) on disposal of investments	-	-	(329	) 184
Unrealized gain (loss) on investments at fair value <sup>(1)</sup>	3,784	-	(109	) 4,218
Other income (loss)	(18,861)	-	(79	) 25,716
General and administration expenses	2	(2	) 17	1,555
Net income (loss)	\$25,295	\$ 6,243	\$ (6	) \$28,598

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The geographic concentrations of credit risk exceeding 5% of the total loan unpaid principal balances related to the Company's VIEs as of September 30, 2016 are as follows:

## Securitized Loans at Fair Value Geographic Concentration of Credit Risk

FREMF Trusts			NLY Commercial Mortgage Trust			Residential Mortgage Loan Trust		
Property Location	Principal Balance	% of Balance	Property Location	Principal Balance	% of Balance	Property Location	Principal Balance	% of Balance
(dollars in thousands)								
Texas	\$724,035	18.4 %	Illinois	\$111,396	86.4 %	California	\$80,023	46.3 %
North Carolina	537,375	13.6 %	Oklahoma	17,500	13.6 %	Texas	19,114	11.1 %
Maryland	499,495	12.7 %				Washington	10,734	6.3 %
Florida	456,516	11.6 %				Illinois	10,799	6.2 %
Other <sup>(1)</sup>	1,723,146	43.7 %				Florida	9,392	5.4 %
						Other <sup>(1)</sup>	42,664	24.7 %
Total	\$3,940,567	100.0 %	Total	\$128,896	100.0 %	Total	\$172,726	100.0 %

(1) No individual state greater than 5%

## 11. FAIR VALUE MEASUREMENTS

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

GAAP requires classification of financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

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

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

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

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



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

Futures contracts are valued using quoted prices for identical instruments in active markets. Residential Investment Securities, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of the security in its estimates of fair value. Fair value estimates for residential mortgage loans are generated by a discounted cash flow model and are primarily based on observable market-based inputs including discount rates, prepayment speeds, delinquency levels, and credit losses. Management reviews and indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities, third party pricing services and/or other applicable market data. Certain liquid asset classes, such as Agency fixed-rate pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

Residential Investment Securities, residential mortgage loans, interest rate swap and swaption markets and MBS options are considered to be active markets such that participants transact with sufficient frequency and volume to provide transparent pricing information on an ongoing basis. The liquidity of the Residential Investment Securities, residential mortgage loans, interest rate swaps, swaptions, TBA derivatives and MBS options markets and the similarity of the Company's securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair value measurements. Consequently, the Company has classified Residential Investment Securities, residential mortgage loans, interest rate swaps, swaptions, TBA derivatives and MBS options as Level 2 inputs in the fair value hierarchy. Additionally, as discussed in the "Commercial Real Estate Investments" Note, Commercial real estate debt investments carried at fair value are classified as Level 2.

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

The Company classifies its investments in MSRs as Level 3 in the fair value measurements hierarchy. Fair value estimates for these investments are obtained from internal models, which use significant unobservable inputs in their valuations. These valuations primarily utilize discounted cash flow models that incorporate unobservable market data inputs including prepayment rates, delinquency levels, costs to service and discount rates. Model valuations are then compared to external valuations obtained from third-party pricing providers. Management reviews the valuations received from third-party pricing providers and uses them as a point of comparison to its internally modeled values. The valuation of MSRs requires significant judgment by management and the third-party pricing providers. Assumptions used for which there is a lack of observable inputs may significantly impact the resulting fair value and therefore the Company's financial statements.

The following table presents the estimated fair values of investments measured at fair value on a recurring basis. There were no transfers between levels of the fair value hierarchy during the periods presented.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	Level 1	Level 2	Level 3	Total
September 30, 2016	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	\$-	73,476,105	\$-	\$73,476,105
Credit risk transfer securities	-	669,295	-	669,295
Non-Agency mortgage-backed securities	-	1,460,261	-	1,460,261
Residential mortgage loans	-	310,148	-	310,148
Mortgage servicing rights	-	-	492,169	492,169
Commercial real estate debt investments	-	4,319,077	-	4,319,077
Interest rate swaps	-	113,253	-	113,253
Other derivatives	26,985	60,936	-	87,921
Total assets	\$26,985	\$80,409,075	\$492,169	\$80,928,229
Liabilities:				
Securitized debt of consolidated VIEs	\$-	\$3,712,821	\$-	\$3,712,821
Interest rate swaps	-	2,919,492	-	2,919,492
Other derivatives	70,784	2,661	-	73,445
Total liabilities	\$70,784	\$6,634,974	\$-	\$6,705,758

	Level 1	Level 2	Level 3	Total
December 31, 2015	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	\$-	\$65,718,224	\$-	\$65,718,224
Agency debentures	-	152,038	-	152,038
Credit risk transfer securities	-	456,510	-	456,510
Non-Agency mortgage-backed securities	-	906,722	-	906,722
Commercial real estate debt investments	-	2,911,828	-	2,911,828
Interest rate swaps	-	19,642	-	19,642
Other derivatives	12,443	9,623	-	22,066
Total assets	\$12,443	\$70,174,587	\$-	\$70,187,030
Liabilities:				
Securitized debt of consolidated VIEs	\$-	\$2,366,878	\$-	\$2,366,878
Interest rate swaps	-	1,677,571	-	1,677,571
Other derivatives	32,778	17,185	-	49,963
Total liabilities	\$32,778	\$4,061,634	\$-	\$4,094,412

## Quantitative Information about Level 3 Fair Value Measurements

The Company considers unobservable inputs to be those for which market data is not available and that are developed using the best information available to us about the assumptions that market participants would use when pricing the asset. Relevant inputs vary depending on the nature of the instrument being measured at fair value. The following paragraph provides a general description of sensitivities of significant unobservable inputs along with interrelationships between and among the significant unobservable inputs and their impact on the fair value measurements. The effect of a change in a particular assumption in the sensitivity analysis below is considered independently of changes in any other assumptions. In practice, simultaneous changes in assumptions may not always have a linear effect on the inputs discussed below. Interrelationships may also exist between observable and unobservable inputs. Such relationships have not been included in the discussion below. For each of the individual relationships described

below, the inverse relationship would also generally apply.

For MSRs, in general, increases in the discount, prepayment or delinquency rates or in annual servicing costs in isolation would result in a lower fair value measurement. A decline in interest rates could lead to higher-than-expected prepayments of mortgages underlying the Company's investments in MSRs, which in turn could result in a decline in the estimated fair value of MSRs. Refer to the Note titled "Mortgage Servicing Rights" for additional information.

The table below presents information about the significant unobservable inputs used for recurring fair value measurements for Level 3 MSRs. The table does not give effect to the Company's risk management practices that might offset risks inherent in these Level 3 investments.

31

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

		September 30, 2016
Valuation Technique	Unobservable Input <sup>(1)</sup>	Range (Weighted Average )
Discounted cash flow	Discount rate	10.0% -15.0% (10.4 %)
	Prepayment rate	6.3% - 43.2% (20.1 %)
	Delinquency rate	0.0% - 8.0% (2.0 %)
	Cost to service	\$84 - \$146 (\$100)

(1)  
Represents  
rates,  
estimates  
and  
assumptions  
that the  
Company  
believes  
would be  
used by  
market  
participants  
when  
valuing  
these assets.

## Fair Value Information about Financial Instruments Not Carried At Fair Value

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the financial statements, for which it is practical to estimate the value. In cases where quoted market prices are not available, fair values are based upon discounted cash flows using market yields, methodologies that incorporate market-based transactions or other valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair values. Accordingly, fair values are not necessarily indicative of the amount the Company would realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

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

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

Estimates of fair value of corporate debt require the use of judgments and inputs including, but not limited to, the enterprise value of the borrower (i.e., an estimate of the total fair value of the borrower's debt and equity), the nature and realizable value of any collateral, the borrower's ability to make payments when due and its earnings history. Management also considers factors that affect the macro and local economic markets in which the borrower operates.

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

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

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

The following table summarizes the estimated fair value for financial assets and liabilities as of September 30, 2016 and December 31, 2015.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	Level in Fair Value Hierarchy	September 30, 2016		December 31, 2015	
		Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>					
Cash and cash equivalents	1	\$2,382,188	\$2,382,188	\$1,769,258	\$1,769,258
Agency mortgage-backed securities	2	73,476,105	73,476,105	65,718,224	65,718,224
Agency debentures	2	-	-	152,038	152,038
Credit risk transfer securities	2	669,295	669,295	456,510	456,510
Non-Agency mortgage-backed securities	2	1,460,261	1,460,261	906,722	906,722
Residential mortgage loans	2	310,148	310,148	-	-
Mortgage servicing rights	3	492,169	492,169	-	-
Commercial real estate debt investments	2	4,319,077	4,319,077	2,911,828	2,911,828
Commercial real estate debt and preferred equity, held for investment	3	1,070,197	1,069,089	1,348,817	1,350,968
Commercial loans held for sale, net	3	144,275	144,275	278,600	278,600
Corporate debt <sup>(1)</sup>	2	716,831	714,672	488,508	470,894
Interest rate swaps	2	113,253	113,253	19,642	19,642
Other derivatives	1,2	87,921	87,921	22,066	22,066
<b>Financial liabilities:</b>					
Repurchase agreements	1,2	\$61,784,121	\$61,857,552	\$56,230,860	\$56,361,623
Other secured financing	1,2	3,804,742	3,806,477	1,845,048	1,846,095
Securitized debt of consolidated VIEs	2	3,712,821	3,712,821	2,540,711	2,541,193
Participation sold	2	12,976	12,908	13,286	13,138
Mortgage payable	3	327,632	346,718	334,707	339,849
Interest rate swaps	2	2,919,492	2,919,492	1,677,571	1,677,571
Other derivatives	1,2	73,445	73,445	49,963	49,963

(1) Includes a held-to-maturity debt security carried at amortized cost of \$84.4 million and \$74.7 million as of September 30, 2016 and December 31, 2015, respectively. The held-to-maturity debt security had a fair value of \$84.6 million and \$61.3 million as of September 30, 2016 and December 31, 2015, respectively.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 12. SECURED FINANCING

The Company had outstanding \$61.8 billion and \$56.2 billion of repurchase agreements with weighted average borrowing rates of 1.71% and 1.83%, after giving effect to the Company's interest rate swaps used to hedge cost of funds, and weighted average remaining maturities of 128 days and 151 days as of September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016 and December 31, 2015, the repurchase agreements had the following remaining maturities, collateral types and weighted average rates:

	September 30, 2016				Total Repurchase Agreements	Weighted Average Rate	
	Agency Mortgage-backed Securities	CRTs	Non-Agency Mortgage-backed Securities	Commercial Loans			
	(dollars in thousands)						
1 day	\$-	\$-	\$ -	\$ -	\$-	-	
2 to 29 days	25,761,193	250,347	496,798	-	26,508,338	0.99	%
30 to 59 days	4,937,568	71,650	191,132	-	5,200,350	0.86	%
60 to 89 days	6,057,659	-	115,939	-	6,173,598	0.85	%
90 to 119 days	5,309,103	-	-	-	5,309,103	0.79	%
Over 120 days <sup>(1)</sup>	18,297,615	-	-	295,117	18,592,732	1.39	%
Total	\$60,363,138	\$321,997	\$ 803,869	\$ 295,117	\$61,784,121	1.07	%
	December 31, 2015						
	Agency Mortgage-backed Securities	CRTs	Non-Agency Mortgage-backed Securities	Commercial Loans	Total Repurchase Agreements	Weighted Average Rate	
	(dollars in thousands)						
1 day	\$-	\$-	\$ -	\$ -	\$-	-	
2 to 29 days	20,123,464	83,664	260,359	-	20,467,487	0.69	%
30 to 59 days	7,898,646	59,189	65,374	-	8,023,209	0.74	%
60 to 89 days	4,046,593	-	78,833	-	4,125,426	0.74	%
90 to 119 days	4,846,580	-	-	-	4,846,580	0.60	%
Over 120 days <sup>(1)</sup>	18,557,715	-	31,015	179,428	18,768,158	1.33	%
Total	\$55,472,998	\$142,853	\$ 435,581	\$ 179,428	\$56,230,860	0.90	%

Repurchase agreements and reverse repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The following table summarizes the gross amounts of reverse repurchase agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition as of September 30, 2016 and December 31, 2015. Refer to "Derivative Instruments" Note for



information related to the effect of netting arrangements on the Company's derivative instruments.

	September 30, 2016		December 31, 2015	
	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
	(dollars in thousands)			
Gross Amounts	\$500,000	\$62,284,121	\$-	\$56,230,860
Amounts Offset	(500,000)	(500,000 )	-	-
Netted Amounts	\$-	\$61,784,121	\$-	\$56,230,860

The Company also finances a portion of its financial assets with advances from the Federal Home Loan Bank of Des Moines ("FHLB Des Moines"). Borrowings from FHLB Des Moines are reported in Other secured financing in the Company's Consolidated Statements of Financial Condition. As of September 30, 2016, \$3.6 billion matures beyond three years. As of December 31, 2015, \$402.8 million matures within 90 days and \$1.4 billion extends beyond three years. The weighted average rate of the advances from the FHLB Des Moines was 0.65% and 0.59% at September 30, 2016 and December 31, 2015, respectively.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

Financial instruments pledged as collateral under secured financing arrangements and interest rate swaps had an estimated fair value and accrued interest of \$71.1 billion and \$214.3 million, respectively, at September 30, 2016 and \$62.3 billion and \$171.7 million, respectively, at December 31, 2015.

## 13. DERIVATIVE INSTRUMENTS

In connection with the Company's investment/market rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts, which include interest rate swaps, swaptions and futures contracts. The Company may also enter into TBA derivatives, MBS options, U.S. Treasury or Eurodollar futures contracts and certain forward purchase commitments to economically hedge its exposure to market risks. The purpose of using derivatives is to manage overall portfolio risk with the potential to generate additional income for distribution to stockholders. These derivatives are subject to changes in market values resulting from changes in interest rates, volatility, Agency mortgage-backed security spreads to U.S. Treasuries and market liquidity. The use of derivatives also creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the stated contract. Additionally, the Company may have to pledge cash or assets as collateral for the derivative transactions, the amount of which may vary based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by the counterparty, the Company could have difficulty obtaining its cash or Residential Investment Securities pledged as collateral as well as receiving payments in accordance with the terms of the derivative contracts.

The table below summarizes fair value information about our derivative assets and liabilities as of September 30, 2016 and December 31, 2015:

Derivatives Instruments Balance Sheet Location		September 30, 2016	December 31, 2015
Assets:		(dollars in thousands)	
Interest rate swaps	Interest rate swaps, at fair value	\$113,253	\$19,642
Interest rate swaptions	Other derivatives, at fair value	1,527	-
TBA derivatives	Other derivatives, at fair value	59,360	9,622
Futures contracts	Other derivatives, at fair value	26,986	12,444
Purchase commitments	Other derivatives, at fair value	48	-
		\$201,174	\$41,708

Liabilities:

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Interest rate swaps	Interest rate swaps, at fair value	\$2,919,492	\$1,677,571
Interest rate swaptions	Other derivatives, at fair value	2,105	-
TBA derivatives	Other derivatives, at fair value	547	17,185
Futures contracts	Other derivatives, at fair value	70,784	32,778
Purchase commitments	Other derivatives, at fair value	9	-
		\$2,992,937	\$1,727,534

35

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The following table summarizes certain characteristics of the Company's interest rate swaps at September 30, 2016 and December 31, 2015:

September 30, 2016

Maturity (dollars in thousands)	Current Notional <sup>(1)</sup>	Weighted Average Pay Rate (2) (3)	Weighted Average Receive Rate <sup>(2)</sup>	Weighted Average Years to Maturity (2)
0 - 3 years	\$4,552,383	1.74 %	0.76 %	2.77
3 - 6 years	9,675,000	1.92 %	0.88 %	4.14
6 - 10 years	7,363,550	2.34 %	0.98 %	7.81
Greater than 10 years	3,634,400	3.70 %	0.67 %	18.62
Total / Weighted Average	\$25,225,333	2.25 %	0.88 %	6.89

December 31, 2015

Maturity (dollars in thousands)	Current Notional <sup>(1)</sup>	Weighted Average Pay Rate (2) (3)	Weighted Average Receive Rate <sup>(2)</sup>	Weighted Average Years to Maturity (2)
0 - 3 years	\$3,240,436	1.85 %	0.36 %	1.80
3 - 6 years	11,675,000	1.82 %	0.55 %	4.25
6 - 10 years	11,635,250	2.44 %	0.57 %	7.92
Greater than 10 years	3,634,400	3.70 %	0.43 %	19.37
Total / Weighted Average	\$30,185,086	2.26 %	0.53 %	7.02

(1) There were no forward starting swaps as of September 30, 2016. Notional amount includes \$500.0 million in forward starting pay fixed swaps as of December 31, 2015.

(2) Excludes forward starting swaps.

(3) There were no forward starting swaps as of September 30, 2016. Weighted average fixed rate on forward starting pay fixed swaps was 1.44% as of December 31, 2015.

The following table presents swaptions outstanding as of September 30, 2016. There were no swaptions as of December 31, 2015.

September 30, 2016 (dollars in thousands)	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
Long	\$ 950,000	1.08%	3M LIBOR	2.24	2.77
Short	\$(200,000)	3M LIBOR	1.54%	10.25	2.77

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

The following table summarizes certain characteristics of the Company's TBA derivatives as of September 30, 2016 and December 31, 2015:

September 30, 2016

Purchase and sale contracts for derivative TBAs (dollars in thousands)	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
Purchase contracts	\$15,950,000	\$16,671,196	\$16,730,009	\$58,813

December 31, 2015

Purchase and sale contracts for derivative TBAs (dollars in thousands)	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
Purchase contracts	\$13,761,000	\$14,177,338	\$14,169,775	\$(7,563 )

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The following table summarizes certain characteristics of the Company's futures derivatives as of September 30, 2016 and December 31, 2015:

	September 30, 2016	
	Notional	Weighted
	- Notional -	Average
	Long	Short
	Positions	Years to
	(dollars in	Maturity
	thousands)	
2-year swap equivalent Eurodollar contracts	\$- \$(14,991,375)	2.00
U.S. Treasury futures - 5 year	- (1,247,200 )	4.42
Total	\$- \$(16,238,575)	2.19

	December 31, 2015	
	Notional	Weighted
	- Notional -	Average
	Long	Short
	Positions	Years to
	(dollars in	Maturity
	thousands)	
2-year swap equivalent Eurodollar contracts	\$- \$(7,000,000 )	2.00
U.S. Treasury futures - 5 year	- (1,847,200 )	4.42
U.S. Treasury futures - 10 year and greater	- (655,600 )	6.92
Total	\$- \$(9,502,800 )	2.81

The Company presents derivative contracts on a gross basis on the Consolidated Statements of Financial Condition. Derivative contracts may contain legally enforceable provisions that allow for netting or setting off receivables and payables with each counterparty. The following tables present information about derivative assets and liabilities that are subject to such provisions and can potentially be offset on our Consolidated Statements of Financial Condition as of September 30, 2016 and December 31, 2015, respectively.

September 30, 2016	Gross	Amounts Eligible for		Net
		Financial	Cash	
	Amounts	Instruments	Collateral	Amounts
Assets:	(dollars in thousands)			
Interest rate swaps, at fair value	\$113,253	\$(113,253)	\$-	\$-
Interest rate swaptions, at fair value	1,527	(1,527 )	-	-
TBA derivatives, at fair value	59,360	(406 )	-	58,954
Futures contracts, at fair value	26,986	(26,986 )	-	-
Purchase commitments	48	-	-	48

## Liabilities:

Interest rate swaps, at fair value	\$2,919,492	\$(113,253)	\$(1,657,612)	\$1,148,627
Interest rate swaptions, at fair value	2,105	(1,527 )	-	578
TBA derivatives, at fair value	547	(406 )	-	141
Futures contracts, at fair value	70,784	(26,986 )	(43,798 )	-
Purchase commitments	9	-	-	9

December 31, 2015	Gross Amounts	Amounts Eligible for Offset		Net Amounts
		Financial Instruments	Cash Collateral	
(dollars in thousands)				
Assets:				
Interest rate swaps, at fair value	\$19,642	\$(18,040 )	\$-	\$1,602
TBA derivatives, at fair value	9,622	(7,367 )	-	2,255
Futures contracts, at fair value	12,443	(10,868 )	-	1,575
Liabilities:				
Interest rate swaps, at fair value	\$1,677,571	\$(18,040 )	\$(913,576 )	\$745,955
TBA derivatives, at fair value	17,185	(7,367 )	-	9,818
Futures contracts, at fair value	32,778	(10,868 )	(21,910 )	-

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

The effect of interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss) is as follows:

	Location on Consolidated Statements of Comprehensive Income (Loss)		
	Realized Gains (Losses) on Interest Rate Swaps <sup>(1)</sup> (dollars in thousands)	Realized Gains (Losses) on Termination of Interest Rate Swaps	Unrealized Gains (Losses) on Interest Rate Swaps
Quarters Ended:			
September 30, 2016	\$(124,572)	\$ 1,337	\$256,462
September 30, 2015	\$(162,304)	\$ -	\$(822,585 )
Nine Months Ended:			
September 30, 2016	\$(402,809)	\$(58,727 )	\$(1,148,478)
September 30, 2015	\$(465,008)	\$(226,462 )	\$(587,995 )

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss).

The effect of other derivative contracts on the Company's Consolidated Statements of Comprehensive Income (Loss) is as follows:

Quarter Ended September 30, 2016			Amount of Gain/(Loss) Recognized in Net Gains
Derivative Instruments (dollars in thousands)	Realized Gain (Loss)	Unrealized Gain (Loss)	(Losses) on Trading Assets
Net TBA derivatives <sup>(1)</sup>	\$174,086	\$(78,677 )	\$ 95,409
Net interest rate swaptions	4,180	93	4,273
Futures	(47,035 )	110,218	63,183
Purchase commitments	-	116	116
			\$ 162,981

Quarter Ended September 30, 2015			Amount of Gain/(Loss) Recognized in Net Gains
Derivative Instruments (dollars in thousands)	Realized Gain (Loss)	Unrealized Gain (Loss)	(Losses) on Trading Assets



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net TBA derivatives <sup>(1)</sup>	\$ 168,292	\$ 81,560	\$ 249,852
Net interest rate swaptions	(11,525 )	11,519	(6 )
Futures	(36,468 )	(105,199 )	(141,667 )
			\$ 108,179

(1) Includes options on TBA contracts.

Nine Months Ended September 30, 2016

	Realized Gain (Loss)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Derivative Instruments (dollars in thousands)			
Net TBA derivatives <sup>(1)</sup>	492,450	66,376	\$ 558,826
Net interest rate swaptions	4,180	93	4,273
Futures	(169,716)	(23,465 )	(193,181 )
Purchase Commitments	-	116	116
			\$ 370,034

Nine Months Ended September 30, 2015

	Realized Gain (Loss)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Derivative Instruments (dollars in thousands)			
Net TBA derivatives <sup>(1)</sup>	\$61,846	\$91,773	\$ 153,619
Net interest rate swaptions	(41,016 )	35,634	(5,382 )
Futures	(51,205 )	(109,974 )	(161,179 )
			\$ (12,942 )

(1) Includes options on TBA contracts.

Certain of the Company's derivative contracts are subject to International Swaps and Derivatives Association Master Agreements or other similar agreements which may contain provisions that grant counterparties certain rights with respect to the applicable agreement upon the occurrence of certain events such as (i) a decline in stockholders' equity in excess of specified thresholds or dollar amounts over set

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange (NYSE). Upon the occurrence of any one of items (i) through (iv), or another default under the agreement, the counterparty to the applicable agreement has a right to terminate the agreement in accordance with its provisions. The aggregate fair value of all derivative instruments with the aforementioned features that are in a net liability position at September 30, 2016 was approximately \$2.7 billion, which represents the maximum amount the Company would be required to pay upon termination. This amount is fully collateralized.

14. CONVERTIBLE SENIOR NOTES

In 2010, the Company issued \$600.0 million in aggregate principal amount of its 4% Convertible Senior Notes for net proceeds of approximately \$582.0 million. In 2012, the Company repurchased \$492.5 million in aggregate principal amount of its 4% Convertible Senior Notes. In February 2015, the 4% Convertible Senior Notes matured and the Company repaid the remaining 4% Convertible Senior Notes for the face amount of \$107.5 million.

In May 2012, the Company issued \$750.0 million in aggregate principal amount of its 5% Convertible Senior Notes due 2015 for net proceeds of approximately \$727.5 million. In May 2015, the 5% Convertible Senior Notes matured and the Company repaid the 5% Convertible Senior Notes for the face amount of \$750.0 million.

15. COMMON STOCK AND PREFERRED STOCK

The Company's authorized shares of capital stock, par value of \$0.01 per share, consists of 1,945,437,500 shares classified as common stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock, 12,650,000 shares classified as 7.625% Series C Cumulative Redeemable Preferred Stock, 18,400,000 shares classified as 7.50% Series D Cumulative Redeemable Preferred Stock and 11,500,000 shares classified as 7.625% Series E Cumulative Redeemable Preferred Stock.

(A) Common Stock

At September 30, 2016 and December 31, 2015, the Company had issued and outstanding 1,018,857,866 and 935,929,561 shares of common stock, respectively, with a par value of \$0.01 per share.

In July 2016, the Company issued 93.9 million shares of common shares as part of the consideration for the Hatteras Acquisition.

No options were exercised during the nine months ended September 30, 2016 and 2015.

During the nine months ended September 30, 2016, the Company raised \$1.8 million, by issuing 172,000 shares, through the Direct Purchase and Dividend Reinvestment Program. During the nine months ended September 30, 2015, the Company raised \$1.7 million, by issuing 168,000 shares, through the Direct Purchase and Dividend Reinvestment Program.

In August 2015, the Company announced that its board of directors ("Board") had authorized the repurchase of up to \$1.0 billion of its outstanding common shares through December 31, 2016 ("Repurchase Program"). During the nine months ended September 30, 2016, the Company repurchased 11,132,226 shares of its common stock under the Repurchase Program for an aggregate amount of \$102.7 million. All common shares purchased were part of a publicly announced plan in open-market transactions.

In March 2012, the Company entered into six separate Distribution Agency Agreements (“Distribution Agency Agreements”) with each of Merrill Lynch; Pierce, Fenner & Smith Incorporated; Credit Suisse Securities (USA) LLC; Goldman, Sachs & Co.; J.P. Morgan Securities LLC; Morgan Stanley & Co. LLC; and RCap Securities, Inc. (together, the Agents). Pursuant to the terms of the Distribution Agency Agreements, the Company may sell from time to time through the Agents, as its sales agents, up to 125,000,000 shares of the Company’s common stock. The Company did not make any sales under the Distribution Agency Agreements during the nine months ended September 30, 2016 and 2015.

(B) Preferred Stock

At September 30, 2016 and December 31, 2015, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock (“Series A Preferred Stock”), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock is entitled to a dividend at a rate of 7.875% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). Through September 30, 2016, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

At September 30, 2016 and December 31, 2015, the Company had issued and outstanding 12,000,000 shares of Series C Cumulative Redeemable Preferred Stock ("Series C Preferred Stock"), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series C Preferred Stock is entitled to a dividend at a rate of 7.625% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series C Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on May 16, 2017 (subject to the Company's right under limited circumstances to redeem the Series C Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through September 30, 2016, the Company had declared and paid all required quarterly dividends on the Series C Preferred Stock.

At September 30, 2016 and December 31, 2015, the Company had issued and outstanding 18,400,000 shares of Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock"), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series D Preferred Stock is entitled to a dividend at a rate of 7.50% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series D Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on September 13, 2017 (subject to the Company's right under limited circumstances to redeem the Series D Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through September 30, 2016, the Company had declared and paid all required quarterly dividends on the Series D Preferred Stock.

At September 30, 2016, the Company had issued and outstanding 11,500,000 shares of Series E Cumulative Redeemable Preferred Stock ("Series E Preferred Stock"), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series E Preferred Stock is entitled to a dividend at a rate of 7.625% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series E Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on August 27, 2017 (subject to the Company's right under limited circumstances to redeem the Series E Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). The Series E Preferred Stock was issued in July 2016 as part of the Hatteras Acquisition, refer to the "Acquisition of Hatteras" Note for additional information. Through September 30, 2016, the Company had declared and paid all required quarterly dividends on the Series E Preferred Stock.

The 7.875% Series A Preferred Stock, 7.625% Series C Preferred Stock, 7.50% Series D Preferred Stock and 7.625% Series E Preferred Stock rank senior to the common stock of the Company.

(C) Distributions to Stockholders

The following table provides a summary of the Company's dividend distribution activity for the periods presented:



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	For the Nine Months Ended:	
	September 30, 2016	September 30, 2015
	(dollars in thousands, except per share data)	
Distributions declared to common stockholders	\$857,223	\$852,989
Distributions declared per common share	\$0.90	\$0.90
Distributions paid to common stockholders after period end	\$269,111	\$284,348
Distributions paid per common share after period end	\$0.26	\$0.30
	October 31, 2016	October 30, 2015
Date of distributions paid to common stockholders after period end	31, 2016	30, 2015
Dividends declared to Series A Preferred stockholders	\$10,944	\$10,944
Dividends declared per Series A Preferred share	\$1.477	\$1.477
Dividends declared to Series C Preferred stockholders	\$17,157	\$17,157
Dividends declared per Series C Preferred share	\$1.430	\$1.430
Dividends declared to Series D Preferred stockholders	\$25,875	\$25,875
Dividends declared per Series D Preferred share	\$1.406	\$1.406
Dividends declared to Series E Preferred stockholders	\$4,811	\$-
Dividends declared per Series E Preferred share	\$0.477	\$-

## 16. INTEREST INCOME AND INTEREST EXPENSE

The table below presents the components of the Company's interest income and interest expense for the quarters and nine months ended September 30, 2016 and 2015.

	For the Quarters Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands)			
Interest income:				
Residential Investment Securities	\$493,226	\$399,702	\$1,203,793	\$1,448,434
Residential mortgage loans	1,608	-	1,608	-
Commercial investment portfolio <sup>(1)</sup>	61,240	50,204	191,005	142,969
Reverse repurchase agreements	2,594	820	7,523	2,714
Total interest income	558,668	450,726	1,403,929	1,594,117
Interest expense:				
Repurchase agreements	154,083	103,823	423,150	307,796
Convertible Senior Notes	-	-	-	29,740
Securitized debt of consolidated VIEs	12,046	6,111	32,305	14,468
Participation sold	157	161	472	479
Other	7,868	202	18,429	306
Total interest expense	174,154	110,297	474,356	352,789
Net interest income	\$384,514	\$340,429	\$929,573	\$1,241,328

<sup>(1)</sup> Includes commercial real estate debt, preferred equity and corporate debt.

17. GOODWILL

At September 30, 2016 and December 31, 2015, goodwill totaled \$71.8 million.

18. NET INCOME (LOSS) PER COMMON SHARE

The following table presents a reconciliation of net income (loss) and shares used in calculating basic and diluted net income (loss) per share for the quarters and nine months ended September 30, 2016 and 2015.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	For the Quarters Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(dollars in thousands, except per share data)			
Net income (loss)	\$730,880	\$(627,491 )	\$(415,697 )	\$(203,919 )
Less: Net income (loss) attributable to noncontrolling interest	(336 )	(197 )	(883 )	(436 )
Net income (loss) attributable to Annaly	731,216	(627,294 )	(414,814 )	(203,483 )
Less: Preferred stock dividends	22,803	17,992	58,787	53,976
Net income (loss) available (related) to common stockholders, prior to adjustment for dilutive potential common shares, if necessary	708,413	(645,286 )	(473,601 )	(257,459 )
Add: Interest on Convertible Senior Notes, if dilutive	-	-	-	-
Net income (loss) available to common stockholders, as adjusted	\$708,413	\$(645,286 )	\$(473,601 )	\$(257,459 )
Weighted average shares of common stock outstanding-basic	1,007,607,893	947,795,500	953,301,855	947,732,735
Add: Effect of stock awards and Convertible Senior Notes, if dilutive	355,513	-	-	-
Weighted average shares of common stock outstanding-diluted	1,007,963,406	947,795,500	953,301,855	947,732,735
Net income (loss) per share available (related) to common share:				
Basic	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )
Diluted	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )

Options to purchase 1.1 million shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the quarter and nine months ended September 30, 2016.

Options to purchase 1.7 million shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the quarter and nine months ended September 30, 2015.

#### 19. LONG-TERM STOCK INCENTIVE PLAN

The Company adopted the 2010 Equity Incentive Plan (the "Plan"), which authorizes the Compensation Committee of the Board to grant options, stock appreciation rights, dividend equivalent rights, or other share-based awards, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the 2010 Equity Incentive Plan. The

Company had previously adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Prior Plan"). The Prior Plan authorized the Compensation Committee of the Board to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Prior Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to a ceiling of 8,932,921 shares. No further awards will be made under the Prior Plan, although existing awards remain effective.

Stock options were issued at the market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years.

The following table sets forth activity related to the Company's stock options awarded under the Plan:

	For the Nine Months Ended			
	September 30, 2016		September 30, 2015	
	Number of	Weighted	Number of	Weighted
	Shares	Average	Shares	Average
		Exercise		Exercise
		Price		Price
Options outstanding at the beginning of period	1,168,775	\$ 15.34	2,259,335	\$ 15.35
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	(6,400 )	14.69	(266,399 )	15.24
Expired	(36,750 )	12.90	(294,750 )	17.07
Options outstanding at the end of period	1,125,625	\$ 15.43	1,698,186	\$ 15.07
Options exercisable at the end of period	1,125,625	\$ 15.43	1,698,186	\$ 15.07

The weighted average remaining contractual term was approximately 1.7 years and 2.8 years for stock options outstanding and exercisable as of September 30, 2016 and 2015, respectively.

As of September 30, 2016 and 2015, there was no unrecognized compensation cost related to nonvested share-based compensation awards.

## 20. INCOME TAXES

For the quarter ended September 30, 2016 the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

stockholders and meet certain other requirements such as assets it may hold, income it may generate and its stockholder composition. It is generally the Company's policy to distribute 100% of its REIT taxable income.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees as well as certain excise, franchise or business taxes. The Company's TRSs are subject to federal, state and local taxes.

During the quarter and nine months ended September 30, 2016, the Company recorded \$1.9 million and \$2.8 million, respectively, of income tax benefit for losses attributable to its TRSs. During the quarter and nine months ended September 30, 2015, the Company recorded a net income tax benefit of \$0.4 million and \$8.0 million, respectively, for losses attributable to its TRSs.

The Company's federal, state and local tax returns from 2013 and forward remain open for examination.

## 21. LEASE COMMITMENTS AND CONTINGENCIES

## Commitments

The Company had a non-cancelable lease for office space which commenced in May 2002 and expired in December 2014. In September 2014, the Company entered into a non-cancelable lease for office space which commenced in July 2014 and expires in September 2025. FIDAC had a lease for office space which commenced in October 2010 and expired in February 2016, which was not renewed. The lease expense for each of the quarters ended September 30, 2016 and 2015 was \$0.8 million. The Company's aggregate future minimum lease payments totaled \$33.8 million. The following table details the future lease payments.

Years Ending December 31,	Lease Commitments (dollars in thousands)
2016 (remaining)	\$ 924
2017	3,697
2018	3,641
2019	3,565

2020	3,652
Later years	18,343
	\$ 33,822

## Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. There were no material contingencies as of September 30, 2016 and December 31, 2015.

## 22. RISK MANAGEMENT

The primary risks to the Company are liquidity, investment/market risk and credit risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on Interest Earning Assets and the interest expense incurred in connection with the Interest Bearing Liabilities and hedges, by affecting the spread between the Interest Earning Assets and Interest Bearing Liabilities. Changes in the level of interest rates can also affect the value of the Interest Earning Assets and the Company's ability to realize gains from the sale of these assets. A decline in the value of the Interest Earning Assets pledged as collateral for borrowings under repurchase agreements and derivative contracts could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels.

The Company may seek to mitigate the potential financial impact by entering into interest rate agreements such as interest rate swaps, interest rate swaptions and other hedges.

Weakness in the mortgage market, the shape of the yield curve and changes in the expectations for the path and volatility of future interest rates may adversely affect the performance and market value of the Company's investments. This could negatively impact the Company's book value. Furthermore, if the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its investments at an inopportune time when prices are depressed. The Company has established policies and procedures for mitigating risks, including conducting scenario analyses and utilizing a range of hedging strategies.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

The payment of principal and interest on the Freddie Mac and Fannie Mae Agency mortgage-backed securities, excluding CRT securities issued by Freddie Mac and Fannie Mae, are guaranteed by those respective agencies and the payment of principal and interest on Ginnie Mae Agency mortgage-backed securities are backed by the full faith and credit of the U.S. government. Principal and interest on Agency debentures are guaranteed by the Agency issuing the debenture. The majority of the Company's Residential Investment Securities have an actual or implied "AAA" rating.

The Company faces credit risk on the portions of its portfolio which are not guaranteed by the respective Agency or by the full faith and credit of the U.S. government. The Company is exposed to credit risk on CRE Debt and Preferred Equity Investments, investments in commercial real estate, commercial mortgage-backed securities, CRT securities, other non-Agency mortgage-backed securities, whole loans, and corporate debt. MSR values may also be adversely impacted if overall costs to service the underlying mortgage loans increase due to borrower performance. The Company is exposed to risk of loss if an issuer, borrower, tenant or counterparty fails to perform its obligations under contractual terms. The Company has established policies and procedures for mitigating credit risk, including reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and periodically assessing the creditworthiness of issuers, borrowers, tenants and counterparties.

23. RCAP REGULATORY REQUIREMENTS

RCap is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees.

As a self-clearing, registered broker dealer, RCap is required to maintain minimum net capital by FINRA. As of September 30, 2016 RCap had a minimum net capital requirement of \$0.3 million. RCap consistently operates with capital in excess of its regulatory capital requirements. RCap's regulatory net capital as defined by SEC Rule 15c3-1, as of September 30, 2016 was \$391.2 million with excess net capital of \$390.9 million.

24. RELATED PARTY TRANSACTIONS

Investment in Affiliate and Advisory Fees

In August 2015, FIDAC entered into an agreement with Chimera Investment Corporation ("Chimera") to internalize the management of Chimera. As part of the agreement, the companies agreed to terminate the management agreement between FIDAC and Chimera effective August 5, 2015.

In connection with the transaction, Annaly and Chimera entered into a share repurchase agreement pursuant to which Chimera purchased the Company's approximate 9.0 million shares of Chimera at an aggregate price of \$126.4 million. The share repurchase agreement closed in August 2015.

For the quarter and nine months ended September 30, 2016, the Company did not record any advisory fees. For the quarter and nine months ended September 30, 2015, the Company recorded advisory fees from Chimera totaling \$3.8 million and \$24.8 million, respectively. In August 2014, the management agreement between FIDAC and Chimera was amended and restated to amend certain of the terms and conditions of the prior agreement. Among other amendments to the terms of the prior agreement, effective August 8, 2014, the management fee was increased from 0.75% to 1.20% of Chimera's gross stockholders' equity (as defined in the amended and restated management agreement).

Management Agreement

The Company and the Manager have entered into a management agreement pursuant to which the Company's management is conducted by the Manager through the authority delegated to it in the Management Agreement and

pursuant to the policies established by the Board (the “Externalization”). The management agreement was effective as of July 1, 2013 and applicable for the entire 2013 calendar year and was subsequently amended on November 5, 2014 and April 11, 2016 (the management agreement, as amended and restated, is referred to as “Management Agreement”).

Pursuant to the terms of the Management Agreement, the Company pays the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of stockholders’ equity, as defined in the Management Agreement, for its management services. For the quarters ended September 30, 2016 and 2015, the compensation and management fee was \$38.7 million and \$37.5 million, respectively. For the nine months ended September 30, 2016 and 2015, the compensation and management fee was \$111.8 million and \$113.1 million, respectively. At September 30, 2016 and December 31, 2015, the Company had amounts payable to the Manager of \$12.7 million and \$12.1 million, respectively.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

The Management Agreement provides for a term ending December 31, 2016 with automatic two-year renewals unless at least two-thirds of the Company's independent directors or the holders of a majority of the Company's outstanding shares of common stock elect to terminate the agreement in their sole discretion for any or no reason. At any time during the term or any renewal term the Company may deliver to the Manager written notice of the Company's intention to terminate the Management Agreement. The Company must designate a date not less than one year from the date of the notice on which the Management Agreement will terminate. The Management Agreement also provides that the Manager may terminate the Management Agreement by providing to the Company prior written notice of its intention to terminate the Management Agreement no less than one year prior to the date designated by the Manager on which the Manager would cease to provide services or such earlier date as determined by the Company in its sole discretion.

Following the Externalization, the Company continues to retain employees at certain of the Company's subsidiaries for regulatory or corporate efficiency reasons. All compensation expenses associated with such retained employees reduce the amount paid to the Manager.

The Management Agreement may be amended or modified by agreement between the Company and the Manager. There is no termination fee for a termination of the Management Agreement by either the Company or the Manager.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

---

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the SEC or the Commission), in our press releases or in our other public or stockholder communications contain or incorporate by reference certain forward-looking statements which are based on various assumptions (some of which are beyond our control) and may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates; changes in the yield curve; changes in prepayment rates; the availability of mortgage-backed securities and other securities for purchase; the availability of financing and, if available, the terms of any financings; changes in the market value of our assets; changes in business conditions and the general economy; our ability to grow our commercial business; our ability to grow our residential mortgage credit business; credit risks related to our investments in credit risk transfer securities, residential mortgage-backed securities and related residential mortgage credit assets, commercial real estate assets and corporate debt; risks related to investments in mortgage servicing rights

and ownership of a servicer; any potential business disruption following the acquisition of Hatteras Financial Corp.; our ability to consummate any contemplated investment opportunities; changes in government regulations affecting our business; our ability to maintain our qualification as a REIT; and our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in our most recent Annual Report on Form 10-K and Item 1A "Risk Factors" in this quarterly report on Form 10-Q. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements, except as required by law.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our most recent annual report on Form 10-K. All references to "Annaly," "we," "us" or "our" mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. Refer to the section titled "Glossary of Terms" located at the end of this Item 2 for definitions of commonly used terms in this quarterly report on Form 10-Q.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management’s Discussion and Analysis

INDEX TO ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS

	Page
Overview	48
Acquisition of Hatteras	48
Business Environment	48
Economic Environment	49
Financial Regulatory Reform	50
Results of Operations	50
Net Income (Loss) Summary	50
Non-GAAP Financial Measures	52
Core Earnings, Core Earnings Per Common Share and Annualized Core Return on Average Equity	52
Core Interest Income, Economic Interest Expense, and Economic Core Net Interest Income	53
Experienced and Projected Long-term CPR	54
Core Interest Income and Core Average Yield on Interest Earning Assets	55
Economic Interest Expense and Average Cost of Interest Bearing Liabilities	55
Economic Core Net Interest Income	56
Realized and Unrealized Gains (Losses)	56
Other Income (Loss)	57
General and Administrative Expenses	58
Unrealized Gains and Losses	58
Return on Average Equity	59
Financial Condition	59
Residential Investment Securities	60
Contractual Obligations	62
Off-Balance Sheet Arrangements	62
Capital Management	62
Stockholders’ Equity	64
Common and Preferred Stock	64
Leverage and Capital	65
Risk Management	65
Risk Appetite	65
Governance	66
Description of Risks	66
Liquidity Risk Management	66
Funding	67
Excess Liquidity	68
Maturity Profile	69
Stress Testing	70
Liquidity Management Policies	71
Investment/Market Risk Management	71
Credit Risk Management	72
Counterparty Risk Management	73
Operational Risk Management	73
Compliance, Regulatory and Legal Risk Management	73
Critical Accounting Policies and Estimates	74
Valuation of Financial Instruments	74

Residential Investment Securities	74
Commercial Real Estate Investments	74
Interest Rate Swaps	75
Revenue Recognition	75
Consolidation of Variable Interest Entities	75
Use of Estimates	75
Glossary of Terms	76

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### Overview

Annaly is a leading real estate finance company whose principal business objectives are to generate net income for distribution to its shareholders from its investments and capital preservation. Annaly is a Maryland corporation that has elected to be taxed as a real estate investment trust ("REIT"). Annaly is externally managed by Annaly Management Company LLC (or Manager). Our common stock is listed on the New York Stock Exchange under the symbol "NLY." Since our founding in 1997, we have strived to generate net income for distribution to our stockholders through the prudent selection and management of our investments.

We own a portfolio of primarily real estate related investments. We use our capital coupled with borrowed funds to invest primarily in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities.

We are primarily organized around the following operations:

Annaly, the parent company	Invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments. Its portfolio also includes residential credit investments such as CRTs and non-Agency mortgage-backed securities.
Annaly Commercial Real Estate Group, Inc. (or ACREG)	Wholly-owned subsidiary that specializes in originating or acquiring, financing and managing commercial loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
Annaly Middle Market Lending LLC (or MML)	Wholly-owned subsidiary that engages in corporate middle market lending transactions.
Hatteras Financial Corp. (or Hatteras)	Wholly-owned subsidiary that primarily engages in acquiring, owning and managing residential whole mortgage loans and MSRs.
RCap Securities, Inc. (or RCap)	Wholly-owned subsidiary that operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (or FINRA).

For a full discussion of our business, refer to the section titled "Business Overview" in our most recent Annual Report on Form 10-K.

#### Acquisition of Hatteras

As previously disclosed in our filings with the SEC, the acquisition of Hatteras, an externally managed mortgage REIT that invested primarily in single-family residential mortgage real estate assets, closed on July 12, 2016 for an aggregate consideration to Hatteras common shareholders of approximately \$1.5 billion. Annaly issued 93.9 million common shares as part of the consideration for the Hatteras Acquisition.

Refer to the note titled "Acquisition of Hatteras" located in Item 1. Financial Statements for additional details.

#### Business Environment

Financial market developments during the third quarter of 2016 were generally supportive of our residential and

commercial investment securities portfolios. Security performance was helped by low volatility across markets and a modest rise in interest rates from multi-decade lows, continued monetary policy support, and strong demand for mortgage assets by both banks and foreigners. The share of equity capital related to our credit businesses remained roughly unchanged, although the portfolio assets grew modestly in an effort to further enhance portfolio diversification. Meanwhile, the agency MBS portfolio grew after the integration of the Hatteras adjustable-rate MBS portfolio.

In addition to sound performance of our assets, the dynamics related to 2a-7 money market reform, which saw a shift of nearly \$1 trillion of assets from prime- to government-only money market funds, lowered secured funding rates relative to unsecured ones. As a result, our funding costs have fallen relative to payments received on our swap hedges, a net benefit to our business. Beyond the passing of the money market reform implementation date, we expect the spread between repo and LIBOR rates to contract somewhat, but remain elevated relative to historical levels.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Economic Environment

Throughout the third quarter of 2016, investors continued to face a weak growth and middling inflation environment in which asset prices remained supported by unprecedented central bank accommodation. Headline risks abroad abated somewhat during the third quarter of 2016, as U.S. growth appeared to improve from a weak first half and downside risk from abroad diminished. Early readings of third quarter of 2016 economic growth, as measured by real gross domestic product (or GDP) according to the Bureau of Economic Analysis, suggest that the U.S. economy expanded at a weak seasonally-adjusted annualized rate of 2.9%, compared to 1.4% in second quarter of 2016.

Amidst the modest increase in growth pace, unemployment rose slightly during third quarter of 2016, though remained around the Fed's long-run target. The pace of hiring rebounded, as the economy added 196,000 jobs per month during the third quarter of 2016 according to the Bureau of Labor Statistics (or BLS), above the monthly average of 146,000 in the second quarter of 2016. Meanwhile, the unemployment rate reversed the drop in the second quarter of 2016 to rise to 5.0% from 4.9%, largely due to a slowing in the pace of retirements. Measures of wage growth remained stable through the third quarter of 2016, with average hourly earnings growth at 2.6% year-over-year, according to the BLS, while median workers saw a larger increase at 3.6% year-over-year, according to the Atlanta Fed.

Realized inflation remained below the Federal Reserve's (or Fed's) 2% target as measured by their official target, the headline Personal Consumer Expenditure Chain Price Index (or PCE), which rose 1.2% year-over-year in September compared to 0.9% in June. This measure continues to be weighed down by energy prices, but the impact of the large decline in oil prices in 2014/15 should fade in coming months. The more stable core PCE measure, which excludes food and energy prices, rose 1.7% year-over-year in 2016 compared to the 2015, an increase from 1.6% in June 2016. Market-based measures of inflation expectations rose over the third quarter of 2016, with the expected 10-year inflation rate increasing to 1.61% on September 30, 2016, from 1.44% at June 30, 2016.

During the third quarter of 2016, the Federal Open Market Committee (FOMC) maintained the federal funds rate target at a range of  $\frac{1}{4}$  to  $\frac{1}{2}$  percent, while simultaneously reinvesting the runoff of its portfolio of U.S. Treasury and agency mortgage-backed securities. At their meeting on September 21, 2016, the Fed faced both diminished downside risks from abroad but also a series of reports which indicated little economic momentum, including an unchanged unemployment rate. They opted to once again delay raising interest rates, though not without contest: three FOMC voters dissented, wanting to hike, revealing a contentious meeting. The Minutes for the meeting, released October 12, 2016 revealed general agreement that another hike would be needed in the near-term should progress continue, raising the market's pricing for a hike by the end of the year to over 50%.

Interest rates rose by as much as 18 basis points led by the front end of the yield curve over the course of the third quarter of 2016, with relatively low volatility as global risks subsided but with little prospect of a growth pickup. The mortgage basis, or the spread between the 30-year Agency mortgage-backed security coupon and 10-year U.S. Treasury, narrowed 7 bps in the third quarter of 2016 to a level similar to one year ago as mortgages performed strongly in the low volatility environment.

The following table below presents interest rates at each date presented:

	September 30, 2016	December 31, 2015	September 30, 2015
30-Year mortgage current coupon	2.36%	3.00%	2.80%
Mortgage basis	77 bps	73 bps	76 bps

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

10-Year U.S. Treasury rate	1.59%	2.27%	2.04%
LIBOR:			
1-Month	0.53%	0.43%	0.19%
6-Month	1.24%	0.84%	0.53%

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

Financial Regulatory Reform

Uncertainty remains surrounding financial regulatory reform and its impact on the markets and the broader economy. In particular, the U.S. government is attempting to change its involvement through the Agencies in the mortgage market. There have been numerous legislative initiatives introduced regarding the Agencies, and it is unclear which approach, if any, may become law. In addition, regulators remain focused on the wholesale funding markets, bank capital levels and shadow banking. It is difficult to predict the ultimate legislative and other regulatory outcomes of these efforts. We continue to monitor these legislative and regulatory developments to evaluate their potential impact on our business.

On January 12, 2016, the Federal Housing Finance Administration (or FHFA) issued final rules relating to captive insurance company membership in the Federal Home Loan Bank (or FHLB) System, which provide that these entities will no longer be eligible for membership in the FHLB System. As part of their membership in the FHLB System, captive insurance companies typically pledge assets as collateral for advances by the FHLB. The rules provide for extensions of the advances outstanding prior to February 19, 2016 until their scheduled maturity for existing members as well as continued membership in the FHLB System for either one or five years depending on when an existing member was admitted as a member of the FHLB System. Our captive insurance subsidiary Truman Insurance Company LLC (or Truman) was admitted as a member of the FHLB System prior to September 2014 and, therefore, is eligible under the rules to remain as a member of the FHLB of Des Moines (or FHLB Des Moines) through February 2021.

Results of Operations

The results of our operations are affected by various factors, many of which are beyond our control. Some of these risks and uncertainties are described herein (see "Special Note Regarding Forward-Looking Statements") and in Part I, Item 1A. "Risk Factors" of our most recent annual report on Form 10-K and subsequent quarterly reports on Form 10-Q.

Net Income (Loss) Summary

The following table presents summarized financial information related to our results of operations as of and for the quarters and nine months ended September 30, 2016 and 2015.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
	(dollars in thousands, except per share data)			
Interest income	\$558,668	\$450,726	\$1,403,929	\$1,594,117
Interest expense	174,154	110,297	474,356	352,789
Net interest income	384,514	340,429	929,573	1,241,328
Realized and unrealized gains (losses)	412,906	(909,158 )	(1,166,432 )	(1,297,612 )
Other income (loss)	29,271	(9,675 )	13,226	(3,270 )
General and administrative expenses	97,737	49,457	194,903	152,404
Income (loss) before income taxes	728,954	(627,861 )	(418,536 )	(211,958 )
Income taxes	(1,926 )	(370 )	(2,839 )	(8,039 )
Net income (loss)	730,880	(627,491 )	(415,697 )	(203,919 )
Net income (loss) attributable to noncontrolling interest	(336 )	(197 )	(883 )	(436 )
Net income (loss) attributable to Annaly	731,216	(627,294 )	(414,814 )	(203,483 )
Dividends on preferred stock	22,803	17,992	58,787	53,976
Net income (loss) available (related) to common stockholders	\$708,413	\$(645,286 )	\$(473,601 )	\$(257,459 )
Net income (loss) per share available (related) to common stockholders:				
Basic	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )
Diluted	\$0.70	\$(0.68 )	\$(0.50 )	\$(0.27 )
Weighted average number of common shares outstanding:				
Basic	1,007,607,893	947,795,500	953,301,855	947,732,735
Diluted	1,007,963,406	947,795,500	953,301,855	947,732,735
Other information:				
Asset portfolio at period-end	\$83,158,385	\$72,441,744	\$83,158,385	\$72,441,744
Average total assets	\$82,312,889	\$75,442,184	\$79,315,159	\$79,478,853
Average equity	\$12,411,839	\$12,439,569	\$12,096,902	\$12,834,377
Leverage at period-end <sup>(1)</sup>	5.3:1	4.8:1	5.3:1	4.8:1
Economic leverage at period-end <sup>(2)</sup>	6.1:1	5.8:1	6.1:1	5.8:1
Capital ratio <sup>(3)</sup>	13.3	% 14.0	% 13.3	% 14.0
Annualized return on average total assets	3.55	% (3.33	%) (0.70	%) (0.34
Annualized return (loss) on average equity	23.55	% (20.18	%) (4.58	%) (2.12
Annualized core return on average equity <sup>(4)(5)</sup>	10.09	% 9.67	% 9.73	% 10.12
Net interest margin <sup>(6)</sup>	1.40	% 1.27	% 1.12	% 1.54
Core net interest margin <sup>(4)(5)</sup>	1.42	% 1.65	% 1.50	% 1.68
Average yield on interest earning assets	2.70	% 2.48	% 2.44	% 2.77
Core average yield on interest earning assets <sup>(4)(5)</sup>	2.72	% 2.94	% 2.88	% 2.93
Average cost of interest bearing liabilities	1.57	% 1.65	% 1.66	% 1.63
Net interest spread	1.13	% 0.83	% 0.78	% 1.14
Core net interest spread <sup>(4)(5)</sup>	1.15	% 1.29	% 1.22	% 1.30
Constant prepayment rate	15.9	% 11.5	% 12.5	% 10.9



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Long-term constant prepayment rate <sup>(7)</sup>	14.4	%	9.2	%	14.4	%	9.2	%
Common stock book value per share	\$11.83		\$11.99		\$11.83		\$11.99	
Core interest income <sup>(4)(5)</sup>	\$562,559		\$533,862		\$1,661,811		\$	