

MFA FINANCIAL, INC.
Form 10-K
February 15, 2018

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

FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2017

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: 1-13991
MFA FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland 13-3974868
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

350 Park Avenue, 20th Floor, New York, New York 10022
(Address of principal executive offices) (Zip Code)
(212) 207-6400
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	New York Stock Exchange
7.50% Series B Cumulative Redeemable Preferred Stock, par value \$0.01 per share	New York Stock Exchange
8.00% Senior Notes due 2042	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

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

On June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$3.3 billion based on the closing sales price of our common stock on such date as reported on the New York Stock Exchange.

On February 8, 2018, the registrant had a total of 398,423,464 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the Annual Meeting of Stockholders scheduled to be held on or about May 23, 2018, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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In this Annual Report on Form 10-K, references to “we,” “us,” “our” or “the Company” refer to MFA Financial, Inc. and its subsidiaries unless specifically stated otherwise or the context otherwise indicates. The following defines certain of the commonly used terms in this Annual Report on Form 10-K: MBS generally refers to mortgage-backed securities secured by pools of residential mortgage loans; Agency MBS refers to MBS that are issued or guaranteed by a federally chartered corporation, such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”), or an agency of the U.S. Government, such as the Government National Mortgage Association (“Ginnie Mae”); Non-Agency MBS refers to MBS that are not guaranteed by any agency of the U.S. Government or any federally chartered corporation and include (i) Legacy Non-Agency MBS, which are Non-Agency MBS issued prior to 2008, and (ii) RPL/NPL MBS, which refers to MBS backed by securitized re-performing and non-performing loans and are structured with a contractual coupon step-up feature where the coupon increases up to 300 basis points at 36 months from issuance or sooner. Hybrids refer to hybrid mortgage loans that have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; ARMs refer to adjustable-rate mortgage loans and to Hybrids that are past their fixed-rate period, both of which typically have interest rates that adjust annually to an increment over a specified interest rate index; CRT securities refer to credit risk transfer securities which are debt obligations issued by Fannie Mae and Freddie Mac; and MSRs refer to mortgage servicing rights with respect to residential loans.

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are subject to risks and uncertainties. The forward-looking statements contain words such as “will,” “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “could,” “would,” “expressions.

These forward-looking statements include information about possible or assumed future results with respect to our business, financial condition, liquidity, results of operations, plans and objectives. Statements regarding the following subjects, among others, may be forward-looking: changes in interest rates and the market (i.e., fair) value of our MBS, residential whole loans, CRT securities and other assets; changes in the prepayment rates on the mortgage loans securing our MBS, an increase of which could result in a reduction of the yield on MBS in our portfolio and an increase of which could require us to reinvest the proceeds received by us as a result of such prepayments in MBS with lower coupons; credit risks underlying our assets, including changes in the default rates and management’s assumptions regarding default rates on the mortgage loans securing our Non-Agency MBS and relating to our residential whole loan portfolio; our ability to borrow to finance our assets and the terms, including the cost, maturity and other terms, of any such borrowings; implementation of or changes in government regulations or programs affecting our business; our estimates regarding taxable income the actual amount of which is dependent on a number of factors, including, but not limited to, changes in the amount of interest income and financing costs, the method elected by us to accrete the market discount on Non-Agency MBS and residential whole loans and the extent of prepayments, realized losses and changes in the composition of our Agency MBS, Non-Agency MBS and residential whole loan portfolios that may occur during the applicable tax period, including gain or loss on any MBS disposals and whole loan modification foreclosure and liquidation; the timing and amount of distributions to stockholders, which are declared and paid at the discretion of our Board and will depend on, among other things, our taxable income, our financial results and overall financial condition and liquidity, maintenance of our REIT qualification and such other factors as the Board deems relevant; our ability to maintain our qualification as a REIT for federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (or the Investment Company Act), including statements regarding the concept release issued by the SEC relating to interpretive issues under the Investment Company Act with respect to the status under the Investment Company Act of certain companies that are engaged in the business of acquiring mortgages and mortgage-related interests; our ability to successfully implement our strategy to grow our residential whole loan portfolio, which is dependent on, among other things, the supply of loans offered for sale in the market; expected returns on our

investments in nonperforming loans (or NPLs), which are affected by, among other things, the length of time required to foreclose upon, sell, liquidate or otherwise reach a resolution of the property underlying the NPL, home price values, amounts advanced to carry the asset (e.g., taxes, insurance, maintenance expenses, etc. on the underlying property) and the amount ultimately realized upon resolution of the asset; risks associated with our investments in MSR related assets, including servicing, regulatory and economic risks, and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that we file with the SEC, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements are based on beliefs, assumptions and expectations of our future performance, taking into account all information currently available. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. (See Part I, Item 1A. "Risk Factors" of this Annual Report on Form 10-K)

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PART I

Item 1. Business.

GENERAL

We are primarily engaged in the real estate finance business. We engage in our business through subsidiaries that invest, on a leveraged basis, in residential mortgage assets, including Non-Agency MBS, Agency MBS, residential whole loans, CRT securities and MSR related assets. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals. We selectively invest in residential mortgage assets with a focus on credit analysis, projected prepayment rates, interest rate sensitivity and expected return.

We were incorporated in Maryland on July 24, 1997, and began operations on April 10, 1998. We have elected to be treated as a real estate investment trust (or REIT) for U.S. federal income tax purposes. In order to maintain our qualification as a REIT, we must comply with a number of requirements under federal tax law, including that we must distribute at least 90% of our annual REIT taxable income to our stockholders. We have elected to treat certain of our subsidiaries as a taxable REIT subsidiary (or TRS). In general, a TRS may hold assets and engage in activities that a REIT or qualified REIT subsidiary (or QRS) may not hold or engage in directly and generally may engage in any real estate or non-real estate related business.

We are a holding company and conduct our real estate finance businesses primarily through wholly-owned subsidiaries, so as to maintain an exemption from registration under the Investment Company Act of 1940, as amended (or the Investment Company Act) by ensuring that less than 40% of the value of our total assets, exclusive of U.S. Government securities and cash items (which we refer to as our adjusted total assets for Investment Company Act purposes), on an unconsolidated basis consist of “investment securities” as defined by the Investment Company Act. We refer to this test as the “40% Test.”

INVESTMENT STRATEGY

As stated above, we primarily invest through subsidiaries in Non-Agency MBS, Agency MBS, residential whole loans, CRT securities and MSR related assets.

Our Non-Agency MBS portfolio primarily consists of (i) Legacy Non-Agency MBS and (ii) RPL/NPL MBS. In addition to Non-Agency MBS investments, we invest in re-performing and non-performing residential whole loans through our consolidated trusts. Our strategy of combining investments in Agency MBS, Non-Agency MBS and residential whole loans is designed to generate attractive returns with less overall sensitivity to changes in the yield curve, the general level of interest rates and prepayments. The investment landscape is challenging, as market pricing for all asset classes remains high, thereby making it difficult to purchase assets at attractive risk/reward levels. In addition, unlike Agency MBS, certain of our other asset classes are not always available for purchase, as sellers offer these investments from time to time as opposed to more liquid markets which feature active buyers and sellers at nearly all times. We expect that our purchase focus will be primarily on additional residential mortgage assets, including residential whole loans.

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Our Legacy Non-Agency MBS have been acquired primarily at discounts to face/par value, which we believe serves to mitigate our exposure to credit risk. A portion of the purchase discount on substantially all of our Legacy Non-Agency MBS is designated as a non-accretable discount (also referred to hereafter as Credit Reserve), which effectively mitigates our risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The portion of the purchase discount that is designated as accretable discount is accreted into interest income over the life of the security. The mortgages collateralizing our Legacy Non-Agency MBS consist primarily of ARMs, 30-year fixed-rate mortgages and Hybrids. Legacy Non-Agency ARMs and Hybrids typically exhibit reduced interest rate sensitivity (as compared to fixed-rate Legacy Non-Agency MBS) due to their interest rate adjustments (similar to Agency ARMs and Hybrids). However, yields on Legacy Non-Agency MBS, unlike Agency MBS, also exhibit sensitivity to changes in credit performance. If credit performance improves, the Credit Reserve may be decreased (and accretable discount increased), resulting in a higher yield over the remaining life of the security. Similarly, deteriorating credit performance could increase the Credit Reserve and decrease the yield over the remaining life of the security or other-than-temporary impairment could result. To the extent that higher interest rates in the future are indicative of an improving economy, better employment data and/or higher home prices, it is possible that these factors will improve the credit performance of Legacy Non-Agency MBS and therefore mitigate the interest rate sensitivity of these securities.

Our RPL/NPL MBS were purchased primarily at prices around par and represent the senior and mezzanine tranches of the related securitizations. The majority of these securities are structured with significant credit enhancement (typically approximately 50%) and the subordinate tranches absorb all credit losses (until those tranches are extinguished) and typically receive no cash flow (interest or principal) until the senior tranche is paid off. Prior to purchase, we analyze the deal structure in order to assess the associated credit risk. Subsequent to purchase, the ongoing credit risk associated with the deal is evaluated by analyzing the extent to which actual credit losses occur that result in a reduction in the amount of subordination enjoyed by our bond. Based on the recent performance of the collateral underlying our RPL/NPL MBS and current subordination levels, we do not believe that we are currently exposed to significant risk of credit loss on these investments. In addition, the structures of these investments contain a contractual coupon step-up feature, where the coupon increases up to 300 basis points at 36 months or sooner. We expect that the combination of the priority cash flow of the senior tranche and the 36-month step-up will result in these securities' exhibiting short average lives and, accordingly, reduced interest rate sensitivity. Consequently, we believe that RPL/NPL MBS provide attractive returns given our assessment of the interest rate and credit risks associated with these securities.

The mortgages collateralizing our Agency MBS portfolio are predominantly Hybrids, 15-year fixed-rate mortgages and ARMs. Our Agency MBS were selected to generate attractive returns relative to interest rate and prepayment risks. The Hybrid loans collateralizing our MBS typically have initial fixed-rate periods at origination of three, five, seven or ten years. At the end of this fixed-rate period, these mortgages become adjustable and their interest rates adjust based on the London Interbank Offered Rate (or LIBOR) or in some cases the one-year constant maturity treasury rate (or CMT). These interest rate adjustments are typically limited by periodic caps (which limit the amount of the interest rate change from the prior rate) and lifetime caps (which are maximum interest rates permitted for the life of the mortgage). As coupons earned on Agency Hybrids and ARMs adjust over time as interest rates change, these assets are generally less sensitive to changes in interest rates than are fixed-rate MBS. In general, Hybrid loans and ARMs have 30-year final maturities and they amortize over this 30-year period. While the coupons on 15-year fixed-rate mortgages do not adjust, they amortize according to a 15-year amortization schedule and have a 15-year final maturity. Due to their accelerated amortization and shorter final maturity, these assets are generally less sensitive to changes in long-term interest rates as compared to fixed-rate mortgages with a longer final maturity, such as 30-year mortgages.

During 2017, we continued to invest in more credit sensitive, less interest rate sensitive residential whole loans, which we acquired through interests in certain trusts established to acquire the loans, that are consolidated on our balance

sheet for financial reporting purposes. We expect this trend to continue during 2018. To date, we have focused primarily on purchasing packages of both re-performing and non-performing whole loans. Re-performing loans are typically characterized by borrowers who have experienced payment delinquencies in the past and the amount owed on the mortgage loan may exceed the value of the property pledged as collateral. The majority of these loans are purchased at purchase prices that are discounted (often substantially so) to the contractual loan balance to reflect the impaired credit history of the borrower, the loan-to-value (or LTV) of the loan and the coupon. Non-performing loans are typically characterized by borrowers who have defaulted on their obligations and/or have payment delinquencies of 60 days or more at the time we acquire the loan. The majority of these loans are also purchased at purchase prices that are discounted (often substantially so) to the contractual loan balance that reflects primarily the non-performing nature of the loan. Typically, this purchase price is a discount to the expected value of the collateral securing the loan, such value to be realized after foreclosure and liquidation of the property. The majority of the residential whole loans were purchased on a servicing-released basis (i.e., the sellers of such loans transferred the right to service the loans as part of the sale). Because we do not directly service any loans, we have contracted with loan servicing companies with specific expertise in working with delinquent borrowers in an effort to cure delinquencies through, among other things, loan modification and third-party refinancing. To the extent these efforts are successful, we believe our investments in residential whole loans will yield attractive returns. In addition, to the extent that it is not possible to achieve a successful outcome for a particular borrower and the real property collateral must be foreclosed on and liquidated, we believe that the discounted purchase price at which the asset was acquired provides us

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with a level of protection against financial loss. Given the increase in the size of our residential whole loan investments and our ongoing focus on this asset class, we expect that balances of real estate owned (or REO) property to increase in the short- to medium-term.

During the past several years, we have also invested in CRT securities. CRT securities are debt obligations issued by Fannie Mae and Freddie Mac. The payments of principal and interest on the CRT securities are paid by Fannie Mae or Freddie Mac, as the case may be, on a monthly basis and are dependent on the performance of loans in a reference pool of Agency MBS securitized by the issuing entity. As an investor in a CRT security, we may incur a loss if losses on the mortgage loans in the reference pool exceed the credit enhancement on the underlying CRT security owned by us. We assess the credit risk associated with CRT securities by assessing the current and expected future performance of the associated reference pool. We pledge a portion of our CRT securities as collateral against our borrowings under repurchase agreements.

Although we do not own or otherwise invest directly in MSRs, we have made investments in MSR related assets, which are financial instruments whose cash flows are considered to be largely dependent on cash flows generated by underlying MSRs that either directly or indirectly act as collateral for the investment. Credit risk on these investments is mitigated by structural credit support in the form of over-collateralization as well as a corporate guarantee from the ultimate parent or sponsor of the MSR related asset that is intended to provide for payment of interest and principal to the holders of the investments should cash flows generated by the underlying MSRs be insufficient.

FINANCING STRATEGY

Our financing strategy is designed to increase the size of our investment portfolio by borrowing against a substantial portion of the market value of the assets in our portfolio. We primarily use repurchase agreements to finance our holdings of residential mortgage assets. We enter into interest rate derivatives to hedge the interest rate risk associated with a portion of our repurchase agreement borrowings. Going forward, in connection with our current and any future investment in residential whole loans, our financing strategy may include the use of additional loan securitization transactions or the use of other forms of structured financing.

Repurchase agreements, although legally structured as sale and repurchase transactions, are financing contracts (i.e., borrowings) under which we pledge our residential mortgage assets as collateral to secure loans with repurchase agreement counterparties (i.e., lenders). Repurchase agreements involve the transfer of the pledged collateral to a lender at an agreed upon price in exchange for such lender's simultaneous agreement to return the same security back to the borrower at a future date (i.e., the maturity of the borrowing) at a higher price. The difference between the sale price that we receive and the repurchase price that we pay represents interest paid to the lender. Our cost of borrowings under repurchase agreements is generally LIBOR based. Under our repurchase agreements, we pledge our securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while we retain beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, we are required to repay the loan including any accrued interest and concurrently receive back our pledged collateral from the lender. With the consent of the lender, we may renew a repurchase financing at the then prevailing financing terms. Margin calls, whereby a lender requires that we pledge additional securities or cash as collateral to secure borrowings under our repurchase financing with such lender, are routinely experienced by us when the value of the MBS pledged as collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. We also may make margin calls on counterparties when collateral values increase.

In order to reduce our exposure to counterparty-related risk, we generally seek to enter into repurchase agreements and other financing arrangements, and derivatives, with a diversified group of financial institutions. At December 31, 2017, we had outstanding balances under repurchase agreements with 31 separate lenders.

In addition to repurchase agreements and 8% Senior Notes due 2042 (or Senior Notes), we may also use other sources of funding in the future to finance our residential mortgage assets, including, but not limited to, other types of

collateralized borrowings, loan agreements, lines of credit or the issuance of debt and/or equity securities.

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COMPETITION

We operate in the mortgage REIT industry. We believe that our principal competitors in the business of acquiring and holding residential mortgage assets of the types in which we invest are financial institutions, such as banks, savings and loan institutions, specialty finance companies, insurance companies, institutional investors, including mutual funds and pension funds, hedge funds and other mortgage REITs, as well as the U.S. Federal Reserve as part of its monetary policy activities. Some of these entities may not be subject to the same regulatory constraints (i.e., REIT compliance or maintaining an exemption under the Investment Company Act) as we are. In addition, many of these entities have greater financial resources and access to capital than we have. The existence of these entities, as well as the possibility of additional entities forming in the future, may increase the competition for the acquisition of residential mortgage assets, resulting in higher prices and lower yields on such assets.

EMPLOYEES

At December 31, 2017, we had 54 full-time and one part-time employee. We believe that our relationship with our employees is good. None of our employees is unionized or represented under a collective bargaining agreement.

AVAILABLE INFORMATION

We maintain a website at www.mfafinancial.com. We make available, free of charge, on our website our (a) Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K (including any amendments thereto), proxy statements and other information (or, collectively, the Company Documents) filed with, or furnished to, the Securities and Exchange Commission (or SEC), as soon as reasonably practicable after such documents are so filed or furnished, (b) Corporate Governance Guidelines, (c) Code of Business Conduct and Ethics and (d) written charters of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee of our Board of Directors (or our Board). Our Company Documents filed with, or furnished to, the SEC are also available at the SEC's website at www.sec.gov. We also provide copies of the foregoing materials, free of charge, to stockholders who request them. Requests should be directed to the attention of our General Counsel at MFA Financial, Inc., 350 Park Avenue, 20th Floor, New York, New York 10022.

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Item 1A. Risk Factors.

This section highlights specific risks that could affect our Company and its business. Readers should carefully consider each of the following risks and all of the other information set forth in this Annual Report on Form 10-K. Based on the information currently known to us, we believe the following information identifies the most significant risk factors affecting our Company. However, the risks and uncertainties we face are not limited to those described below. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business.

If any of the following risks and uncertainties develops into actual events or if the circumstances described in the risks and uncertainties occur or continue to occur, these events or circumstances could have a material adverse effect on our business, prospects, financial condition, results of operations, cash flows or liquidity. These events could also have a negative effect on the trading price of our securities.

General

The results of our business operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, which is driven by numerous factors, including the supply and demand for residential mortgage assets in the marketplace, the terms and availability of adequate financing, general economic and real estate conditions (both on a national and local level), the impact of government actions in the real estate and mortgage sector, and the credit performance of our credit sensitive residential mortgage assets. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and conditional prepayment rates (or CPRs) (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance) vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results also depend upon our ability to effectively manage the risks associated with our business operations, including interest rate, prepayment, financing and credit risks, while maintaining our qualification as a REIT.

We may change our investment strategy, operating policies and/or asset allocations without stockholder consent, which could materially adversely affect our results of operations.

We may change our investment strategy, operating policies and/or asset allocation with respect to investments, acquisitions, leverage, growth, operations, indebtedness, capitalization and distributions at any time without the consent of our stockholders. A change in our investment strategy may increase our exposure to interest rate risk, credit risk, default risk and/or real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset categories different from our historical investments. For example, in recent years, we have made new investments principally in credit sensitive assets such as residential whole loans, RPL/NPL MBS, CRT securities and MSR related assets, while we have let our investments in more interest-rate sensitive assets, such as Agency MBS, run-off. We expect this trend to continue in the near, and possibly the long, term. These changes could materially adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or make distributions.

Credit and Other Risks Related to Our Investments

Our investments in Non-Agency MBS (including RPL/NPL MBS) involve credit risk, which could materially adversely affect our results of operations.

The holder of a mortgage or MBS assumes the risk that the related borrowers may default on their obligations to make full and timely payments of principal and interest. Under our investment policy, we have the ability to acquire Non-Agency MBS, residential whole loans and other investment assets of lower credit quality. In general, our portfolios of Legacy Non-Agency MBS and RPL/NPL MBS (which, as of December 31, 2017 represented 32.3% of our total assets) carry greater investment risk than Agency MBS because the former are not guaranteed as to principal or interest by the U.S. Government, any federal agency or any federally chartered corporation. Higher-than-expected rates of default and/or higher-than-expected loss severities on the mortgages underlying these investments could adversely affect the value of these assets. Accordingly, defaults in the payment of principal and/or interest on our Legacy Non-Agency MBS, RPL/NPL MBS and other investment assets of less-than-high credit quality would likely result in our incurring losses of income from, and/or losses in market value relating to, these assets, which could materially adversely affect our results of operations.

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Our investments in re-performing and non-performing residential whole loans involve credit risks, some of which are different from our Non-Agency MBS, which could materially adversely affect our results of operations.

Our portfolio of residential whole loans continued to be our fastest growing asset class during 2017, and represented approximately 20.4% of our total assets as of December 31, 2017. We expect that our investment portfolio in residential whole loans will continue to increase during 2018, as we seek opportunities in these credit sensitive assets. As a holder of residential whole loans, we are subject to the risk that the related borrowers may default or have defaulted on their obligations to make full and timely payments of principal and interest. (In addition to the credit risk associated with these assets, residential whole loans are less liquid than certain of our other credit sensitive assets, such as Non-Agency MBS, which may make them more difficult to dispose of if the need or desire arises.) If actual results are different from our assumptions in determining the prices paid to acquire such loans, particularly if the market value of the underlying properties decreases significantly subsequent to purchase, we may incur significant losses, which could materially adversely affect our results of operations.

A significant portion of our Non-Agency MBS and residential whole loans are secured by properties in a small number of geographic areas and may be disproportionately affected by economic or housing downturns, natural disasters, terrorist events, regulatory changes, adverse climate changes or other adverse events specific to those markets.

A significant number of the mortgages underlying our Non-Agency MBS and residential whole loan investments are concentrated in certain geographic areas. For example, we have significant exposure in California, New York, Florida, New Jersey and Maryland. (For a discussion of the percentage of these assets in these states, see “Credit Risk” included under Part II, Item 7A “Quantitative and Qualitative Disclosures About Market Risk” in this Annual Report on Form 10-K.) Certain markets within these states (particularly in California and Florida) have experienced significant decreases in residential home values from time to time. Any event that adversely affects the economy or real estate market in any of these states could have a disproportionately adverse effect on our Non-Agency MBS and residential whole loan investments. In general, any material decline in the economy or significant problems in a particular real estate market would likely cause a decline in the value of residential properties securing the mortgages in that market, thereby increasing the risk of delinquency, default and foreclosure of re-performing loans and the loans underlying our Non-Agency MBS and the risk of loss upon liquidation of these assets. This could, in turn, have a material adverse effect on our credit loss experience on our Non-Agency MBS and residential whole loan investments in the affected market if higher-than-expected rates of default and/or higher-than-expected loss severities on our re-performing loan investments or the mortgages underlying our Non-Agency MBS were to occur.

In addition, the occurrence of a natural disaster (such as an earthquake, tornado, hurricane, flood or wildfires), terrorist attack or a significant adverse climate change may cause a sudden decrease in the value of real estate in the area or areas affected and would likely reduce the value of the properties securing the mortgages collateralizing our Non-Agency MBS or residential whole loans. Because certain natural disasters are not typically covered by the standard hazard insurance policies maintained by borrowers (such as hurricanes or certain flooding), or the proceeds payable under any such policy are not sufficient to cover the related repairs, the affected borrowers may have to pay for any repairs themselves. Under these circumstances, borrowers may decide not to repair their property or may stop paying their mortgages under those circumstances. This would cause defaults and credit loss severities to increase.

Changes in governmental laws and regulations, fiscal policies, property taxes and zoning ordinances can also have a negative impact on property values, which could result in borrowers’ deciding to stop paying their mortgages. This circumstance could cause defaults and loss severities to increase, thereby adversely impacting our results of operations.

We have investments in Non-Agency MBS collateralized by Alt A loans and may also have investments collateralized by subprime mortgage loans, which, due to lower underwriting standards, are subject to increased risk of losses.

We have certain investments in Non-Agency MBS backed by collateral pools containing mortgage loans that were originated under underwriting standards that were less strict than those used in underwriting “prime mortgage loans.” These lower standards permitted mortgage loans, often with LTV ratios in excess of 80%, to be made to borrowers having impaired credit histories, lower credit scores, higher debt-to-income ratios and/or unverified income. Difficult economic conditions, including increased interest rates and lower home prices, can result in Alt A and subprime mortgage loans having increased rates of delinquency, foreclosure, bankruptcy and loss, and are likely to otherwise experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of higher delinquency rates and losses associated with Alt A and subprime mortgage loans, the performance of our Non-Agency MBS that are backed by these types of loans could be correspondingly adversely affected, which could materially adversely impact our results of operations, financial condition and business.

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We are subject to counterparty risk and may be unable to seek indemnity or require counterparties to repurchase residential whole loans if they breach representations and warranties, which could cause us to suffer losses.

In connection with our residential whole loan investments, we typically enter into a loan purchase agreement, as buyer, of the loans from a seller. When we invest in mortgage loans, sellers typically make very limited representations and warranties about such loans that are very limited both in scope and duration. Residential mortgage loan purchase agreements may entitle the purchaser of the loans to seek indemnity or demand repurchase or substitution of the loans in the event the seller of the loans breaches a representation or warranty given to the purchaser. However, there can be no assurance that a mortgage loan purchase agreement will contain appropriate representations and warranties, that we or the trust that purchases the mortgage loans would be able to enforce a contractual right to repurchase or substitution, or that the seller of the loans will remain solvent or otherwise be able to honor its obligations under its mortgage loan purchase agreements. The inability to obtain or enforce an indemnity or require repurchase of a significant number of loans could require us to absorb the associated losses, and adversely affect our results of operations, financial condition and business.

The due diligence we undertake on potential investments may be limited and/or not reveal all of the risks associated with such investments and may not reveal other weaknesses in such assets, which could lead to losses.

Before making an investment, we typically conduct (either directly or using third parties) certain due diligence. There can be no assurance that we will conduct any specific level of due diligence, or that, among other things, our due diligence processes will uncover all relevant facts, which could result in losses on these assets to the extent we ultimately acquire them, which, in turn, could adversely affect our results of operations, financial condition and business.

We have experienced and may experience in the future increased volatility in our GAAP results of operations due in part to the increasing contribution to financial results of assets accounted for under the fair value option.

Over the past several years the proportion of our overall investment portfolio that is accounted for under GAAP using the fair value option has grown. Changes in the fair value of assets accounted for using the fair value option are recorded in our consolidated statements of operations each period. The increased contribution of these assets to net income resulted in volatility in our reported quarterly financial results during 2017. There can be no assurance that such volatility in periodic financial results will not continue during 2018 or in future periods.

We have experienced, and may in the future experience, declines in the market value of certain of our investment securities resulting in our recording impairments, which have had, and may in the future have, an adverse effect on our results of operations and financial condition.

A decline in the market value of our MBS or other investment securities may require us to recognize an “other-than-temporary impairment” (or OTTI) against such assets under U.S. generally accepted accounting principles (or GAAP). When the fair value of an available-for-sale (or AFS) security is less than its amortized cost at the balance sheet date, the security is considered impaired. We assess our impaired securities on at least a quarterly basis and designate such impairments as either “temporary” or “other-than-temporary.” If we intend to sell an impaired security, or it is more likely than not that we will be required to sell the impaired security before any anticipated recovery, then we must recognize an OTTI through charges to earnings equal to the entire difference between the investment’s amortized cost and its fair value at the balance sheet date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through accumulated other comprehensive income/(loss) (or AOCI) on our consolidated balance sheets. Impairments recognized through other comprehensive income/(loss) (or OCI) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established

for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTI's recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as on our estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTI's constitute material estimates that are susceptible to significant change.

Our use of models in connection with the valuation of our assets subjects us to potential risks in the event that such models are incorrect, misleading or based on incomplete information.

As part of our risk management process, we may use models to evaluate, depending on the asset class, house price appreciation and depreciation by county, region, prepayment speeds and foreclosure frequency, cost and timing. Certain assumptions used as inputs to the models may be based on historical trends. These trends may not be indicative of future results. Furthermore, the assumptions underlying the models may prove to be inaccurate, causing the model output also to be incorrect. In the event models

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and data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose us to potential risks. For example, by relying on incorrect models and data, we may be induced to buy certain assets at prices that are too high, to sell certain other assets at prices that are too low or to miss favorable opportunities altogether, which could have a material adverse impact on our business and growth prospects.

Valuations of some of our assets are subject to inherent uncertainty, may be based on estimates, may fluctuate over short periods of time and may differ from the values that would have been used if a ready market for these assets existed.

While the determination of the fair value of our investment assets takes into consideration valuations provided by third-party dealers and pricing services, the final determination of exit price fair values for our investment assets is based on our judgment, and such valuations may differ from those provided by third-party dealers and pricing services. Valuations of certain assets may be difficult to obtain or may not be reliable (particularly as related to residential whole loans, as discussed below). In general, dealers and pricing services heavily disclaim their valuations as such valuations are not intended to be binding bid prices. Additionally, dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability arising out of any inaccuracy or incompleteness in valuations. Depending on the complexity and illiquidity of an asset, valuations of the same asset can vary substantially from one dealer or pricing service to another.

Our investments in residential whole loans are difficult to value and are dependent upon the ability to finance and refinance such investments. The inability to do so could materially and adversely affect our liquidity and results of operations.

The difficulty in valuation is particularly significant with respect to our less liquid investments such as our re-performing loans (or RPLs) and non-performing loans (or NPLs). RPLs are loans on which a borrower was previously delinquent but has resumed repaying. Our ability to sell RPLs for a profit depends on the borrower continuing to make payments. An RPL could become a NPL, which could reduce our earnings. Our investments in residential whole loans may require us to engage in workout negotiations, restructuring and/or the possibility of foreclosure. These processes may be lengthy and expensive. If loans become REO, we, through a designated servicer that we retain, will have to manage these properties and may not be able to sell them. See “Our Ability to Sell REO on Terms Acceptable to Us or at All May Be Limited.”

We may work with our third-party servicers and seek to refinance an NPL or RPL to realize greater value from such loan. However, there may be impediments to executing a refinancing strategy for NPLs and RPLs. For example, many mortgage lenders have adjusted their loan programs and underwriting standards, which has reduced the availability of mortgage credit to prospective borrowers. This has resulted in reduced availability of financing alternatives for borrowers seeking to refinance their mortgage loans. In addition, the value of some borrowers' homes may have declined below the amount of the mortgage loans on such homes resulting in higher loan-to-value ratios, which has left the borrowers with insufficient equity in their homes to permit them to refinance. To the extent prevailing mortgage interest rates rise from their current low levels, these risks would be exacerbated. The effect of the above would likely serve to make refinancing of NPLs and RPLs potentially more difficult and less profitable for us.

Our results of operations, financial condition and business could be materially adversely affected if our fair value determinations of these assets is materially higher than the values that would exist if a ready market existed for these assets.

Mortgage loan modification and refinancing programs and future legislative action may materially adversely affect the value of, and the returns on, our MBS and residential whole loan investments.

The U.S. Government, through the U.S. Federal Reserve, the U.S. Treasury Department, the Federal Housing Administration (or the FHA) and other agencies implemented a number of federal programs designed to assist homeowners, including the Home Affordable Modification Program (or HAMP), which provided homeowners with assistance in avoiding residential mortgage loan foreclosures, the Hope for Homeowners Program (or H4H Program), which allowed certain distressed borrowers to refinance their mortgages into FHA-insured loans in order to avoid foreclosure, and the Home Affordable Refinance Program (or HARP), which allows borrowers who are current on their mortgage payments to refinance and reduce their monthly mortgage payments without new mortgage insurance, up to an unlimited loan-to-value ratio for fixed-rate mortgages. While some of these programs (such as HAMP and the H4H Program) have expired, the U.S. Treasury Department, Federal Housing Finance Agency (or FHFA), FHA, and Consumer Financial Protection Bureau (CFPB) have issued guiding principles for future loss mitigation programs. In addition, Fannie Mae and Freddie Mac implemented their Flex Modification foreclosure prevention program, developed at the direction of FHFA. Federal loss mitigation programs, as well as proprietary loss mitigation programs offered by investors and servicers, may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or to extend the payment terms of the loans. Especially with our Non-Agency MBS and residential whole loan investments, a continuing number of loan modifications with respect to a given underlying loan, including, but not limited to, those related to principal forgiveness and coupon reduction, could negatively impact

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the realized yields and cash flows on such investments. These loan modification programs, future legislative or regulatory actions, including possible amendments to the bankruptcy laws, that result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may materially adversely affect the value of, and the returns on, these assets.

We may be adversely affected by risks affecting borrowers or the asset or property types in which certain of our investments may be concentrated at any given time, as well as from unfavorable changes in the related geographic regions.

We are not required to limit our assets in terms of geographic location, diversification or concentration, except that we concentrate in residential mortgage-related investments. Accordingly, our investment portfolio may be concentrated by geography, asset type, property type and/or borrower, increasing the risk of loss to us if the particular concentration in our portfolio is subject to greater risks or is undergoing adverse developments. In addition, adverse conditions in the areas where the properties securing or otherwise underlying our investments are located (including business layoffs or downsizing, industry slowdowns, changing demographics and other factors) and local real estate conditions (such as oversupply or reduced demand) may have an adverse effect on the value of our investments. A material decline in the demand for real estate in these areas may materially and adversely affect us. Lack of diversification can increase the correlation of non-performance and foreclosure risks to these investments.

The Recent Passage of H.R. 1, the Tax Cuts and Jobs Act May Adversely Affect our Business.

H.R. 1, informally known as the Tax Cuts and Jobs Act (or TCJA), includes changes that could have an adverse impact on the U.S. residential housing market and potentially impact the market value of our investments. The TCJA includes, among other items, the reduction of the deduction of interest on mortgage debt, the elimination of the deduction for state and local taxes and a limitation on property tax deductions, which may reduce home affordability and adversely affect home prices nationally or in local markets. In addition, such changes may increase taxes payable by certain borrowers, thereby reducing their available cash and adversely impacting their ability to make payments, which in turn, could cause losses on our investments.

Our investments in residential whole loans subject us to servicing-related risks, including those associated with foreclosure and liquidation.

The majority of the residential whole loans that have been acquired to date were purchased together with the related mortgage servicing rights. We rely on third-party servicers to service and manage the mortgages underlying our residential whole loans. The ultimate returns generated by these investments may depend on the quality of the servicer. If a servicer is not vigilant in seeing that borrowers make their required monthly payments, borrowers may be less likely to make these payments, resulting in a higher frequency of default. If a servicer takes longer to liquidate non-performing mortgages, our losses related to those loans may be higher than originally anticipated. Any failure by servicers to service these mortgages and/or to competently manage and dispose of REO properties could negatively impact the value of these investments and our financial performance. In addition, while we have contracted with third-party servicers to carry out the actual servicing of the loans (including all direct interface with the borrowers), we are nevertheless ultimately responsible, vis-à-vis the borrowers and state and federal regulators, for ensuring that the loans are serviced in accordance with the terms of the related notes and mortgages and applicable law and regulation. (See “Regulatory Risk and Risks Related to the Investment Company Act of 1940 -- Our business is subject to extensive regulation”) In light of the current regulatory environment, such exposure could be significant even though we might have contractual claims against our servicers for any failure to service the loans to the required standard.

When one of our residential whole loans is foreclosed upon, title to the underlying property is taken by a Company subsidiary. The foreclosure process, especially in judicial foreclosure states such as New York, Florida and New Jersey, can be lengthy and expensive, and the delays and costs involved in completing a foreclosure, and then

subsequently liquidating the REO property through sale, may materially increase any related loss. In addition, at such time as title is taken to a foreclosed property, it may require more extensive rehabilitation than we estimated at acquisition. Thus, a material amount of foreclosed residential mortgage loans, particularly in the states mentioned above, could result in significant losses in our residential whole loan portfolio and could materially adversely affect our results of operations.

The expanding body of federal, state and local regulations and the investigations of servicers may increase their cost of compliance and the risks of noncompliance, and may adversely affect their ability to perform their servicing obligations.

We work with and rely on third-party servicers to service the residential mortgage loans that we acquire through consolidated trusts. The mortgages underlying the MBS that we acquire are also serviced by third-party servicers that have been hired by the bond issuers. The mortgage servicing business is subject to extensive regulation by federal, state and local governmental authorities and is subject to various laws and judicial and administrative decisions imposing requirements and restrictions and increased compliance costs on a substantial portion of their operations. The volume of new or modified laws and regulations has increased

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in recent years. Some jurisdictions and municipalities have enacted laws that restrict loan servicing activities, including delaying or preventing foreclosures or forcing the modification of certain mortgages. Federal laws and regulations have also been proposed or adopted which, among other things, could hinder the ability of a servicer to foreclose promptly on defaulted residential loans, and which could result in assignees being held responsible for violations in the residential loan origination process. Certain mortgage lenders and third-party servicers have voluntarily, or as part of settlements with law enforcement authorities, established loan modification programs relating to loans they hold or service. These federal, state and local legislative or regulatory actions that result in modifications of our outstanding mortgages, or interests in mortgages acquired by us either directly through consolidated trusts or through our investments in residential MBS, may adversely affect the value of, and returns on, such investments. Mortgage servicers may be incented by the federal government to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgages. As a consequence of the foregoing matters, our business, financial condition, results of operations and ability to pay dividends, if any, to our stockholders may be adversely affected.

The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. Government, may materially adversely affect our business.

The payments of principal and interest we receive on our Agency MBS, which depend directly upon payments on the mortgages underlying such securities, are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Fannie Mae and Freddie Mac are U.S. Government-sponsored entities (or GSEs), but their guarantees are not backed by the full faith and credit of the United States (although the FHFA largely controls their actions through its conservatorship of the two GSEs, which occurred in the wake of the 2007-2008 financial crisis). Ginnie Mae is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the United States.

Although the U.S. Government has undertaken several measures to support the positive net worth of Fannie Mae and Freddie Mac since the financial crisis of 2007-2008, there is no guarantee of continuing capital support if such support were to become necessary. These uncertainties lead to questions about the availability of, and trading market for, Agency MBS. Despite the steps taken by the U.S. Government, Fannie Mae and Freddie Mac could default on their guarantee obligations which would materially and adversely affect the value of our Agency MBS. Accordingly, if these government actions are inadequate in the future and the GSEs were to suffer losses, be significantly reformed, or cease to exist (as discussed below), our business, operations and financial condition could be materially and adversely affected.

In addition, the problems faced by Fannie Mae and Freddie Mac resulting in their being placed into federal conservatorship and receiving significant U.S. Government support have sparked serious debate among federal policy makers regarding the continued role of the U.S. Government in providing liquidity for mortgage loans. In 2011, the Obama administration proposed a plan to wind down the GSEs, and both houses of Congress have considered legislation to reform the GSEs, their functions and their missions. President Trump's Secretary of the Treasury has made comments indicating that housing finance reform may be on the agenda for the Trump administration, but no detailed proposals have yet been put forth. However, in December 2017, FHFA and the U.S. Treasury Department announced that Fannie Mae and Freddie Mac will each be allowed to retain \$3 billion in capital reserve in order to cover ordinary income fluctuations. The future roles of Fannie Mae and Freddie Mac may be reduced (perhaps significantly) and the nature of their guarantee obligations could be limited relative to historical measurements. Alternatively, it is still possible that Fannie Mae and Freddie Mac could be dissolved entirely or privatized, and, as mentioned above, the U.S. Government could determine to stop providing liquidity support of any kind to the mortgage market. Any changes to the nature of the GSEs or their guarantee obligations could redefine what constitutes an Agency MBS and could have broad adverse implications for the market and our business, operations

and financial condition. If Fannie Mae or Freddie Mac were to be eliminated, or their structures were to change radically (in particular a limitation or removal of the guarantee obligation), we could be unable to acquire additional Agency MBS and our existing Agency MBS could be materially and adversely impacted.

We could be negatively affected in a number of ways depending on the manner in which events unfold for Fannie Mae and Freddie Mac. We rely on our Agency MBS as collateral for a significant portion of our financings under our repurchase agreements. Any decline in their value, or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on our Agency MBS on acceptable terms or at all, or to maintain our compliance with the terms of any financing transactions.

As indicated above, future legislation could, among other things, reform the GSEs and their functions, or nationalize, privatize, or eliminate them entirely. Any law affecting the GSEs may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on our investments in Agency MBS guaranteed by Fannie Mae and/or Freddie Mac. It also is possible that such

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laws could adversely impact the market for such securities and the spreads at which they trade. All of the foregoing could materially and adversely affect our business, operations and financial condition.

Rapid changes in the values of our residential mortgage investments and other assets may make it more difficult for us to maintain our qualification as a REIT or exemption from registration under the Investment Company Act. If the market value or income potential of our MBS, residential mortgage investments and other assets declines as a result of increased interest rates, prepayment rates or other factors, we may need to increase certain real estate investments and income and/or liquidate our non-qualifying assets in order to maintain our REIT qualification or exemption from registration under the Investment Company Act. If the decline in real estate asset values and/or income occurs quickly, this may be especially difficult to accomplish. This difficulty could be exacerbated by the illiquid nature of certain investments. We might have to make investment decisions that we otherwise would not make absent our REIT qualification and Investment Company Act considerations. (See “Regulatory Risk and Risks Related to the Investment Company Act of 1940” and “Risks Related to Our Taxation as a REIT and the Taxation of Our Assets.”)

Our ability to sell REO on terms acceptable to us or at all may be limited.

REO properties are illiquid relative to other assets we own. Furthermore, real estate markets are affected by many factors that are beyond our control, such as general and local economic conditions, availability of financing, interest rates and supply and demand. We cannot predict whether we will be able to sell any REO for the price or on the terms set by us or whether any price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of an REO. In certain circumstances, we may be required to expend cash to correct defects or to make improvements before a property can be sold, and we cannot assure that we will have cash available to correct defects or make improvements. As a result, our ownership of REOs could materially and adversely affect our liquidity and results of operations.

Our indirect investments in MSR related assets expose us to additional risks.

As of December 31, 2017, we had approximately \$492.1 million of investments in financial instruments whose cash flows are considered to be largely dependent on underlying MSRs that either directly or indirectly act as collateral for the investment. Generally, we have the right to receive certain cash flows from the owner of the MSRs that are generated from the servicing fees and/or excess servicing spread associated with the MSRs. While we do not directly own MSRs, our investments in MSR related assets indirectly expose us to risks associated with MSRs, such as the illiquidity of MSRs, the risks associated with servicing MSRs (that include, for example, significant regulatory risks and costs) and the ability of the owner to successfully manage its MSR portfolio. If these or other MSR related risks come to fruition, the value of our MSR related assets could decline significantly.

Prepayment and Reinvestment Risk

Prepayment rates on the mortgage loans underlying our MBS may materially adversely affect our profitability or result in liquidity shortfalls that could require us to sell assets in unfavorable market conditions.

The MBS that we acquire are secured by pools of mortgages on residential properties. In general, the mortgages collateralizing our MBS may be prepaid at any time without penalty. Prepayments on our MBS result when borrowers satisfy (i.e., pay off) the mortgage upon selling or refinancing their mortgaged property. When we acquire a particular MBS, we anticipate that the underlying mortgage loans will prepay at a projected rate which, together with expected coupon income, provides us with an expected yield on that MBS. If we purchase MBS at a premium to par value, and borrowers then prepay the underlying mortgage loans at a faster rate than we expected, the increased prepayments on the MBS would result in a yield lower than expected on such securities because we would be required to amortize the related premium on an accelerated basis. Conversely, if we purchase MBS at a discount to par value,

and borrowers then prepay the underlying mortgage loans at a slower rate than we expected, the decreased prepayments on the MBS would result in a lower yield than expected on such securities and/or may result in OTTI if the fair value of the security is less than its amortized cost.

Prepayment rates on mortgage loans are influenced by changes in mortgage and market interest rates and a variety of economic, geographic, governmental and other factors beyond our control. Consequently, prepayment rates cannot be predicted with certainty and no strategy can completely insulate us from prepayment risks. In periods of declining interest rates, prepayment rates on mortgage loans generally increase. Because of prepayment risk, the market value of our MBS (and in particular our Agency MBS) may benefit less than other fixed income securities from a decline in interest rates. If general interest rates decline at the same time, we would likely not be able to reinvest the proceeds of the prepayments that we receive in assets yielding as much as those yields on the assets that were prepaid.

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With respect to Agency MBS, we have, at times, purchased securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire such securities. In accordance with GAAP, we amortize premiums on our MBS over the life of the related MBS. If the underlying mortgage loans securing these securities prepay at a more rapid rate than anticipated, we will be required to amortize the related premiums on an accelerated basis, which could adversely affect our profitability. Defaults on the mortgages underlying Agency MBS typically have the same effect as loan prepayments because of the underlying Agency guarantee. As of December 31, 2017, we had net purchase premiums on our Agency MBS of \$104.0 million (or 3.8% of current par value) and net purchase discounts on our Non-Agency MBS of \$808.5 million (or 21.7% of current par value).

Prepayments, which are the primary feature of MBS that distinguishes them from other types of bonds, are difficult to predict and can vary significantly over time. As the holder of MBS, we receive a monthly payment equal to a portion of our investment principal in a particular MBS as the underlying mortgages are prepaid. With respect to Agency MBS, we typically receive notice of monthly principal prepayments on the fifth business day of each month (such day is commonly referred to as “factor day”) and receive the related scheduled payment on a specified later date, which for (a) our Agency ARM-MBS and fixed-rate Agency MBS guaranteed by Fannie Mae is the 25th day of the month (or next business day thereafter), (b) our Agency ARM-MBS guaranteed by Freddie Mac is the 15th day of the following month (or next business day thereafter), (c) our fixed-rate Agency MBS guaranteed by Freddie Mac is the 15th day of the month (or next business day thereafter), and (d) our Agency ARM-MBS guaranteed by Ginnie Mae is the 20th day of that month (or next business day thereafter). With respect to our Non-Agency MBS, we typically receive notice of monthly principal prepayments and the related scheduled payment on the 25th day of each month (or next business day thereafter). In general, on the date each month that principal prepayments are announced (i.e., factor day for Agency MBS), the value of our MBS pledged as collateral under our repurchase agreements is reduced by the amount of the prepaid principal and, as a result, our lenders will typically initiate a margin call that requires us to pledge additional collateral in the form of cash or additional MBS, in an amount equal to the prepaying principal, in order to re-establish the required ratio of borrowing to collateral value under such repurchase agreements. Accordingly, in the case of Agency MBS, the announcement on factor day of principal prepayments occurs prior to our receipt of the related scheduled payment. This timing differential creates a short-term receivable for us in the amount of any such principal prepayments; however, under our repurchase agreements, we may receive a margin call in the amount of the related reduction in value of the Agency MBS and be required to post on or about factor day additional cash or other collateral in the amount of the prepaying principal to be received, which thereby would reduce our liquidity during the period in which the short-term receivable is outstanding. As a result, in order to meet any such margin calls, we might be forced to sell assets in order to maintain adequate liquidity. Forced sales, particularly under adverse market conditions, may result in lower sales prices than sales made under ordinary market conditions in the normal course of business. If our MBS were to be liquidated at prices below our amortized cost (i.e., our cost basis) of such assets, we would incur losses, which could materially adversely affect our earnings. In addition, in order to continue to earn a return on this prepaid principal, we must reinvest it in additional MBS or other assets; however, in a declining interest rate environment, we might earn a lower return on our reinvested funds as compared to the return earned on the MBS that had prepaid.

Prepayments may have a materially negative impact on our financial results, the effects of which depend on, among other things, the timing and amount of the prepayment delay on Agency MBS, the amount of unamortized premium on MBS prepayments, the rate at which prepayments are made on our Non-Agency MBS, the reinvestment lag and the availability of suitable reinvestment opportunities.

Risks Related to Our Use of Leverage

Our business strategy involves the use of leverage, and we may not achieve what we believe to be optimal levels of leverage or we may become overleveraged, which may materially adversely affect our liquidity, results of operations or financial condition.

Our business strategy involves the use of borrowing or “leverage.” Pursuant to our leverage strategy, we borrow against a substantial portion of the market value of our residential mortgage investments and use the borrowed funds to finance our investment portfolio and the acquisition of additional investment assets. Although we are not required to maintain any particular debt-to-equity ratio, certain of our borrowing agreements contain provisions requiring us not to have a debt-to-equity ratio exceeding specified levels. Future increases in the amount by which the collateral value is required to contractually exceed the repurchase transaction loan amount, decreases in the market value of our residential mortgage investments, increases in interest rate volatility and changes in the availability of acceptable financing could cause us to be unable to achieve the amount of leverage we believe to be optimal. The return on our assets and cash available for distribution to our stockholders may be reduced to the extent that changes in market conditions prevent us from achieving the desired amount of leverage on our investments or cause the cost of our financing to increase relative to the income earned on our leveraged assets. If the interest income on the residential mortgage investments that we have purchased with borrowed funds fails to cover the interest expense of the related borrowings, we will

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experience net interest losses and may experience net losses from operations. Such losses could be significant as a result of our leveraged structure. The use of leverage to finance our residential mortgage investments involves a number of other risks, including, among other things, the following:

Adverse developments involving major financial institutions or involving one of our lenders could result in a rapid reduction in our ability to borrow and materially adversely affect our business, profitability and liquidity. As of December 31, 2017, we had amounts outstanding under repurchase agreements with 31 separate lenders. A material adverse development involving one or more major financial institutions or the financial markets in general could result in our lenders reducing our access to funds available under our repurchase agreements or terminating such repurchase agreements altogether. Because all of our repurchase agreements are uncommitted and renewable at the discretion of our lenders, our lenders could determine to reduce or terminate our access to future borrowings at virtually any time, which could materially adversely affect our business and profitability. Furthermore, if a number of our lenders became unwilling or unable to continue to provide us with financing, we could be forced to sell assets, including MBS in an unrealized loss position, in order to maintain liquidity. Forced sales, particularly under adverse market conditions may result in lower sales prices than ordinary market sales made in the normal course of business. If our residential mortgage investments were liquidated at prices below our amortized cost (i.e., the cost basis) of such assets, we would incur losses, which could adversely affect our earnings. In addition, uncertainty in the global finance market and weak economic conditions in Europe, including as a result of the United Kingdom's decision to exit from the European Union (commonly referred to as "Brexit"), could cause the conditions described above to have a more pronounced affect on our European counterparties.

Our profitability may be materially adversely affected by a reduction in our leverage. As long as we earn a positive spread between interest and other income we earn on our leveraged assets and our borrowing costs, we believe that we can generally increase our profitability by using greater amounts of leverage. There can be no assurance, however, that repurchase financing will remain an efficient source of long-term financing for our assets. The amount of leverage that we use may be limited because our lenders might not make funding available to us at acceptable rates or they may require that we provide additional collateral to secure our borrowings. If our financing strategy is not viable, we will have to find alternative forms of financing for our assets which may not be available to us on acceptable terms or at acceptable rates. In addition, in response to certain interest rate and investment environments or to changes in market liquidity, we could adopt a strategy of reducing our leverage by selling assets or not reinvesting principal payments as MBS amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Such an action could reduce interest income, interest expense and net income, the extent of which would be dependent on the level of reduction in assets and liabilities as well as the sale prices for which the assets were sold.

If we are unable to renew our borrowings at acceptable interest rates, it may force us to sell assets under adverse market conditions, which may materially adversely affect our liquidity and profitability. Since we rely primarily on borrowings under repurchase agreements to finance our residential mortgage investments, our ability to achieve our investment objectives depends on our ability to borrow funds in sufficient amounts and on acceptable terms, and on our ability to renew or replace maturing borrowings on a continuous basis. Our repurchase agreement credit lines are renewable at the discretion of our lenders and, as such, do not contain guaranteed roll-over terms. Our ability to enter into repurchase transactions in the future will depend on the market value of our residential mortgage investments pledged to secure the specific borrowings, the availability of acceptable financing and market liquidity and other conditions existing in the lending market at that time. If we are not able to renew or replace maturing borrowings, we could be forced to sell assets, including MBS in an unrealized loss position, in order to maintain liquidity. Forced sales, particularly under adverse market conditions, could result in lower sales prices than ordinary market sales made in the normal course of business. If our residential mortgage investments were liquidated at prices below our amortized cost (i.e., the cost basis) of such assets, we would incur losses, which could materially adversely affect our earnings.

A decline in the market value of our assets may result in margin calls that may force us to sell assets under adverse market conditions, which may materially adversely affect our liquidity and profitability. In general, the market value of our residential mortgage investments is impacted by changes in interest rates, prevailing market yields and other market conditions, including general economic conditions, home prices and the real estate market generally. A decline in the market value of our residential mortgage investments may limit our ability to borrow against such assets or result in lenders initiating margin calls, which require a pledge of additional collateral or cash to re-establish the required ratio of borrowing to collateral value, under our repurchase agreements. Posting additional collateral or cash to support our credit will reduce our liquidity and limit our ability to leverage our assets, which could materially adversely affect our business. As a result, we could be forced to sell a portion of our assets, including MBS in an unrealized loss position, in order to maintain liquidity.

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If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term or if we default on our obligations under the repurchase agreement, we could incur losses. When we engage in repurchase transactions, we generally transfer securities to lenders (i.e., repurchase agreement counterparties) and receive cash from such lenders. Because the cash we receive from the lender when we initially transfer the securities to the lender is less than the value of those securities (this difference is referred to as the “haircut”), if the lender defaults on its obligation to transfer the same securities back to us, we would incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K, for further discussion regarding risks related to exposure to financial institution counterparties in light of recent market conditions. Our exposure to defaults by counterparties may be more pronounced during periods of significant volatility in the market conditions for mortgages and mortgage-related assets as well as the broader financial markets. At December 31, 2017, we had greater than 5% stockholders’ equity at risk to the following repurchase agreement counterparties: Goldman Sachs (approximately 7.3%), Wells Fargo (approximately 5.8%), RBC (approximately 5.7%), Credit Suisse (approximately 5.3%) and UBS (approximately 5.1%).

In addition, generally, if we default on one of our obligations under a repurchase transaction with a particular lender, that lender can elect to terminate the transaction and cease entering into additional repurchase transactions with us. In addition, some of our repurchase agreements contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other repurchase agreements could also declare a default. Any losses we incur on our repurchase transactions could materially adversely affect our earnings and thus our cash available for distribution to our stockholders.

Our use of repurchase agreements to borrow money may give our lenders greater rights in the event of bankruptcy. Borrowings made under repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code. If a lender under one of our repurchase agreements defaults on its obligations, it may be difficult for us to recover our assets pledged as collateral to such lender. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lender’s insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur. In addition, in the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the Bankruptcy Code, the effect of which, among other things, would be to allow the creditor under the agreement to avoid the automatic stay provisions of the Bankruptcy Code and take possession of, and liquidate, our collateral under our repurchase agreements without delay. Our risks associated with the insolvency or bankruptcy of a lender maybe more pronounced during periods of significant volatility in the market conditions for mortgages and mortgage-related assets as well as the broader financial markets.

An increase in our borrowing costs relative to the interest we receive on our MBS or our re-performing residential whole loans may materially adversely affect our profitability.

Our earnings are primarily generated from the difference between the interest income we earn on our investment portfolio, less net amortization of purchase premiums and discounts, and the interest expense we pay on our borrowings. We rely primarily on borrowings under repurchase agreements to finance the acquisition of residential mortgage investments, which have longer-term contractual maturities. Even though the majority of our investments have interest rates that adjust over time based on changes in corresponding interest rate indexes, the interest we pay on our borrowings may increase at a faster pace than the interest we earn on our investments. In general, if the interest expense on our borrowings increases relative to the interest income we earn on our investments, our profitability may

be materially adversely affected, including due to the following reasons:

Changes in interest rates, cyclical or otherwise, may materially adversely affect our profitability. Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political conditions, as well as other factors beyond our control. In general, we finance the acquisition of our investments through borrowings in the form of repurchase transactions, which exposes us to interest rate risk on the financed assets. The cost of our borrowings is based on prevailing market interest rates. Because the terms of our repurchase transactions typically range from one to six months at inception, the interest rates on our borrowings generally adjust more frequently (as new repurchase transactions are entered into upon the maturity of existing repurchase transactions) than the interest rates on our investments. During a period of rising interest rates (such as during 2017, which is expected to continue during 2018), our borrowing costs generally will increase at a faster pace than our interest earnings on the leveraged

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portion of our investment portfolio, which could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition, including the impact of hedging transactions, at the time as well as the magnitude and period over which interest rates increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our residential mortgage investments. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which may negatively impact our distributions to stockholders.

Interest rate caps on the mortgages collateralizing our MBS may materially adversely affect our profitability if short-term interest rates increase. The coupons earned on ARM-MBS adjust over time as interest rates change (typically after an initial fixed-rate period for Hybrids). The financial markets primarily determine the interest rates that we pay on the repurchase transactions used to finance the acquisition of our MBS; however, the level of adjustment to the interest rates earned on our ARM-MBS is typically limited by contract (or in certain cases by state or federal law). The interim and lifetime interest rate caps on the mortgages collateralizing our MBS limit the amount by which the interest rates on such assets can adjust. Interim interest rate caps limit the amount interest rates on a particular ARM can adjust during the next adjustment period. Lifetime interest rate caps limit the amount interest rates can adjust upward from inception through maturity of a particular ARM. Our repurchase transactions are not subject to similar restrictions. Accordingly, in a sustained period of rising interest rates or a period in which interest rates rise rapidly, we could experience a decrease in net income or a net loss because the interest rates paid by us on our borrowings (excluding the impact of hedging transactions) could increase without limitation (as new repurchase transactions are entered into upon the maturity of existing repurchase transactions) while increases in the interest rates earned on the mortgages collateralizing our MBS could be limited due to interim or lifetime interest rate caps.

Adjustments of interest rates on our borrowings may not be matched to interest rate indexes on our MBS. In general, the interest rates on our repurchase transactions are based on LIBOR, while the interest rates on our ARM-MBS may be indexed to LIBOR or CMT rate. Accordingly, any increase in LIBOR relative to one-year CMT rates will generally result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earned on our ARM-MBS tied to these other index rates. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact our distributions to stockholders.

A flat or inverted yield curve may adversely affect ARM-MBS prepayment rates and supply. Our net interest income varies primarily as a result of changes in interest rates as well as changes in interest rates across the yield curve. When the differential between short-term and long-term benchmark interest rates narrows, the yield curve is said to be “flattening.” In addition, a flatter yield curve generally leads to fixed-rate mortgage rates that are closer to the interest rates available on ARMs, potentially decreasing the supply of ARM-MBS. At times, short-term interest rates may increase and exceed long-term interest rates, causing an inverted yield curve. When the yield curve is inverted, fixed-rate mortgage rates may approach or be lower than mortgage rates on ARMs, further increasing ARM-MBS prepayments and further negatively impacting ARM-MBS supply. Increases in prepayments on our MBS portfolio cause our premium amortization to accelerate, lowering the yield on such assets. If this happens, we could experience a decrease in net income or incur a net loss during these periods, which may negatively impact our distributions to stockholders.

Changes in banks’ inter-bank lending rate reporting practices or the method pursuant to which LIBOR is determined may adversely affect our profitability.

As discussed above, the interest rates on our repurchase transactions are generally based on LIBOR. LIBOR and other indices which are deemed “benchmarks” have been the subject of recent national, international, and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause such benchmarks to perform differently than in the past, or have other consequences which cannot be predicted. In particular, regulators and law enforcement agencies in the United

Kingdom and elsewhere are conducting criminal and civil investigations into whether the banks that contribute information to the British Bankers' Association (the "BBA") in connection with the daily calculation of LIBOR may have been under-reporting or otherwise manipulating or attempting to manipulate LIBOR. A number of BBA member banks have reached settlements with their regulators and law enforcement agencies with respect to this alleged manipulation of LIBOR. Actions by the regulators or law enforcement agencies, as well as ICE Benchmark Administration (the current administrator of LIBOR), may result in changes to the manner in which LIBOR is determined or the establishment of alternative reference rates. For example, on July 27, 2017, the United Kingdom Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021.

At this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be implemented in the United Kingdom or elsewhere. Uncertainty as to the nature of such

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potential changes, alternative reference rates or other reforms may adversely affect our profitability, which may negatively impact our distributions to stockholders.

Certain of our current lenders require, and future lenders may require, us to enter into restrictive covenants relating to our operations.

The various agreements pursuant to which we borrow money to finance our residential mortgage investments generally include customary representations, warranties and covenants, but may also contain more restrictive supplemental terms and conditions. Although specific to each master repurchase or loan agreement, typical supplemental terms include requirements of minimum equity, leverage ratios and performance triggers relating to a decline in equity or net income over a period of time. If we fail to meet or satisfy any covenants, supplemental terms or representations and warranties, we could be in default under the affected agreements and those lenders could elect to declare all amounts outstanding under the agreements to be immediately due and payable, enforce their respective interests against collateral pledged under such agreements and restrict our ability to make additional borrowings. Certain of our financing agreements contain cross-default or cross-acceleration provisions, so that if a default or acceleration of indebtedness occurs under any one agreement, the lenders under our other agreements could also declare a default. Further, under our agreements, we are typically required to pledge additional assets to our lenders in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral, which may take the form of additional securities, loans or cash. Future lenders may impose similar or additional restrictions and other covenants on us. If we fail to meet or satisfy any of these covenants, we could be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, require the posting of additional collateral and enforce their interests against then-existing collateral. We could also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. Further, this could also make it difficult for us to satisfy the qualification requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes.

Risks Associated with Adverse Developments in the Mortgage Finance and Credit Markets and Financial Markets Generally

Market conditions for mortgages and mortgage-related assets as well as the broader financial markets may materially adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including MBS, as well as the broader financial markets and the economy generally. Significant adverse changes in financial market conditions leading to the forced sale of large quantities of mortgage-related and other financial assets, would result in significant volatility in the market for mortgages and mortgage-related assets and potentially significant losses for ourselves and certain other market participants. In addition, concerns over actual or anticipated low economic growth rates, higher levels of unemployment or uncertainty regarding future U.S. monetary policy (particularly in light of the current presidential administration and related uncertainties) may contribute to increased interest rate volatility. Declines in the value of our investments, or perceived market uncertainty about their value, may make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Additionally, increased volatility and/or deterioration in the broader residential mortgage and MBS markets could materially adversely affect the performance and market value of our investments.

A lack of liquidity in our investments may materially adversely affect our business.

The assets that comprise our investment portfolio and that we acquire are not traded on an exchange. A portion of our investments are subject to legal and other restrictions on resale and are otherwise generally less liquid than exchange-traded securities. Any illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. Further, we may face other restrictions on our ability to liquidate an investment in a business entity to the extent that we have or could be attributed with material, non-public information regarding such business entity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

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Actions by the U.S. Government designed to stabilize or reform the financial markets may not achieve their intended effect or otherwise benefit our business, and could materially adversely affect our business.

In July 2010, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (or the Dodd-Frank Act), in part to impose significant investment restrictions and capital requirements on banking entities and other organizations that are significant to U.S. financial markets. For instance, the Dodd-Frank Act imposes significant restrictions on the proprietary trading activities of certain banking entities and subjects other systemically significant entities and activities regulated by the U.S. Federal Reserve to increased capital requirements and quantitative limits for engaging in such activities. The Dodd-Frank Act also seeks to reform the asset-backed securitization market (including the MBS market) by requiring the retention of a portion of the credit risk inherent in the pool of securitized assets and by imposing additional registration and disclosure requirements. The Dodd-Frank Act also imposes significant regulatory restrictions on the origination of residential mortgage loans. The Dodd-Frank Act's extensive requirements, and implementation by regulatory agencies such as the Commodity Futures Trading Commission (or CFTC), the Federal Deposit Insurance Corporation (or FDIC), Federal Reserve Board, and the SEC may have a significant effect on the financial markets, and may affect the availability or terms of financing from our lender counterparties and the availability or terms of MBS, both of which could have a material adverse effect on our business.

In addition, the U.S. Government, U.S. Federal Reserve, U.S. Treasury and other governmental and regulatory bodies have taken and continue to consider additional actions in response to the 2007-2008 financial and credit crisis domestically and internationally. International financial regulators are examining standard setting for systemically significant entities, such as those considered by the Third Basel Accords (Basel III) to be incorporated by domestic entities. We cannot predict whether or when such actions may occur or what effect, if any, such actions could have on our business, results of operations and financial condition.

Regulatory Risk and Risks Related to the Investment Company Act of 1940

Our business is subject to extensive regulation.

Our business is subject to extensive regulation by federal and state governmental authorities, self-regulatory organizations and securities exchanges. We are required to comply with numerous federal and state laws. The laws, rules and regulations comprising this regulatory framework change frequently, as can the interpretation and enforcement of existing laws, rules and regulations. Some of the laws, rules and regulations to which we are subject are intended primarily to safeguard and protect consumers, rather than stockholders or creditors. From time to time, we may receive requests from federal and state agencies for records, documents and information regarding our policies, procedures and practices regarding our business activities. We incur significant ongoing costs to comply with these government regulations.

Although we do not originate or directly service residential mortgage loans, we must comply with various federal and state laws, rules and regulations as a result of owning MBS and residential whole loans. These rules generally focus on consumer protection and include, among others, rules promulgated under the Dodd-Frank Act, and the Gramm-Leach-Bliley Financial Modernization Act of 1999 (or Gramm-Leach-Bliley). These requirements can and do change as statutes and regulations are enacted, promulgated, amended and interpreted, and the recent trend among federal and state lawmakers and regulators has been toward increasing laws, regulations and investigative proceedings in relation to the mortgage industry generally. Although we believe that we have structured our operations and investments to comply with existing legal and regulatory requirements and interpretations, changes in regulatory and legal requirements, including changes in their interpretation and enforcement by lawmakers and regulators, could materially and adversely affect our business and our financial condition, liquidity and results of operations.

Maintaining our exemption from registration under the Investment Company Act imposes significant limits on our operations.

We conduct our operations so that neither we nor any of our subsidiaries are required to register as an investment company under the Investment Company Act. Section 3(a)(1)(A) of the Investment Company Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis (i.e., the 40% Test). Excluded from the term "investment securities" are, among other things, U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company for private funds set forth in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

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We are a holding company and conduct our real estate businesses primarily through wholly-owned subsidiaries. We conduct our real estate business so that we do not come within the definition of an investment company because less than 40% of the value of our adjusted total assets on an unconsolidated basis will consist of “investment securities.” The securities issued by any wholly-owned or majority-owned subsidiaries that we may form in the future that are excepted from the definition of “investment company” based on Section 3(c)(1) or 3(c)(7) of the Investment Company Act, together with any other investment securities we may own, may not have a value in excess of 40% of the value of our adjusted total assets on an unconsolidated basis. We monitor our holdings to ensure continuing and ongoing compliance with this test. In addition, we believe we will not be considered an investment company under Section 3(a)(1)(A) of the Investment Company Act because we will not engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our wholly-owned subsidiaries, we will be primarily engaged in the non-investment company businesses of these subsidiaries.

If the value of securities issued by our subsidiaries that are excepted from the definition of “investment company” by Section 3(c)(1) or 3(c)(7) of the Investment Company Act, together with any other investment securities we own, exceeds 40% of our adjusted total assets on an unconsolidated basis, or if one or more of such subsidiaries fail to maintain an exception or exemption from the Investment Company Act, we could, among other things, be required either (a) to substantially change the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so or (c) to register as an investment company under the Investment Company Act, any of which could have an adverse effect on us and the market price of our securities. If we were required to register as an investment company under the Investment Company Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the Investment Company Act), portfolio composition, including restrictions with respect to diversification and industry concentration, and other matters.

We expect that our subsidiaries that invest in residential mortgage loans (whether through a consolidated trust or otherwise) will rely upon the exemption from registration as an investment company under the Investment Company Act pursuant to Section 3(c)(5)(C) of the Investment Company Act, which is available for entities “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” This exemption generally requires that at least 55% of each of these subsidiaries’ assets be comprised of qualifying real estate assets and at least 80% of each of their portfolios be comprised of qualifying real estate assets and real estate-related assets under the Investment Company Act. Mortgage loans that were fully and exclusively secured by real property are generally qualifying real estate assets for purposes of the exemption. All or substantially all of our residential mortgage loans are fully and exclusively secured by real property with a loan-to-value ratio of less than 100%. As a result, we believe our residential mortgage loans that are fully and exclusively secured by real property meet the definition of qualifying real estate assets. To the extent we own any residential mortgage loans with a loan-to-value ratio of greater than 100%, we intend to classify, depending on guidance from the SEC staff, only the portion of the value of such loans that does not exceed the value of the real estate collateral as qualifying real estate assets and the excess as real estate-related assets.

In August 2011, the SEC issued a “concept release” pursuant to which they solicited public comments on a wide range of issues relating to companies engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on Section 3(c)(5)(C) of the Investment Company Act. The concept release and the public comments thereto have not yet resulted in SEC rulemaking or interpretative guidance and we cannot predict what form any such rulemaking or interpretive guidance may take. There can be no assurance, however, that the laws and regulations governing the Investment Company Act status of REITs, or guidance from the SEC or its staff regarding the exemption from registration as an investment company on which we rely, will not change in a manner that adversely affects our operations. We expect each of our subsidiaries relying on Section 3(c)(5)(C) to rely on guidance published by the SEC staff or on our analyses of guidance published with respect to other types of assets, if any, to determine

which assets are qualifying real estate assets and real estate-related assets. To the extent that the SEC staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. In addition, we may be limited in our ability to make certain investments and these limitations could result in us holding assets we might wish to sell or selling assets we might wish to hold.

Certain of our subsidiaries may rely on the exemption provided by Section 3(c)(6) to the extent that they hold residential mortgage loans through majority owned subsidiaries that rely on Section 3(c)(5)(C). The SEC staff has issued little interpretive guidance with respect to Section 3(c)(6) and any guidance published by the staff could require us to adjust our strategy accordingly.

To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon the exceptions we and our subsidiaries rely on from registration under the Investment Company Act, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies we have chosen.

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There can be no assurance that the laws and regulations governing the Investment Company Act status of REITs, including the Division of Investment Management of the SEC providing more specific or different guidance regarding these exemptions, will not change in a manner that adversely affects our operations.

Risks Related to Our Use of Hedging Strategies

Our use of hedging strategies to mitigate our interest rate exposure may not be effective.

In accordance with our operating policies, we pursue various types of hedging strategies, including interest rate swap agreements (or Swaps), to seek to mitigate or reduce our exposure to losses from adverse changes in interest rates. Our hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and financing sources used and other changing market conditions. No hedging strategy, however, can completely insulate us from the interest rate risks to which we are exposed and there is no guarantee that the implementation of any hedging strategy would have the desired impact on our results of operations or financial condition. Certain of the U.S. federal income tax requirements that we must satisfy in order to qualify as a REIT may limit our ability to hedge against such risks. We will not enter into derivative transactions if we believe that they will jeopardize our qualification as a REIT.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the party owing money in the hedging transaction may default on its obligation to pay.

We primarily use Swaps to hedge against future increases in interest rates on our repurchase agreements. Should a Swap counterparty be unable to make required payments pursuant to such Swap, the hedged liability would cease to be hedged for the remaining term of the Swap. In addition, we may be at risk for any collateral held by a hedging counterparty to a Swap, should such counterparty become insolvent or file for bankruptcy. Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

We may enter into hedging instruments that could expose us to contingent liabilities in the future, which could materially adversely affect our results of operations.

Subject to maintaining our qualification as a REIT, part of our financing strategy involves entering into hedging instruments that could require us to fund cash payments in certain circumstances (e.g., the early termination of a hedging instrument caused by an event of default or other voluntary or involuntary termination event or the decision by a hedging counterparty to request the posting of collateral that it is contractually owed under the terms of a hedging instrument). With respect to the termination of an existing Swap, the amount due would generally be equal to the unrealized loss of the open Swap position with the hedging counterparty and could also include other fees and charges. These economic losses will be reflected in our financial results of operations and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time. Any losses we incur on our

hedging instruments could materially adversely affect our earnings and thus our cash available for distribution to our stockholders.

The characteristics of hedging instruments present various concerns, including illiquidity, enforceability, and counterparty risks, which could adversely affect our business and results of operations.

As indicated above, from time to time we enter into Swaps. Entities entering into Swaps are exposed to credit losses in the event of non-performance by counterparties to these transactions. The CFTC issued new rules that became effective in October 2012 regarding Swaps under the authority granted to it pursuant to the Dodd-Frank Act. Although the new rules do not directly affect the negotiations and terms of individual Swap transactions between counterparties, they do require that the clearing of all Swap transactions through registered derivatives clearing organizations, or swap execution facilities, through standardized documents under which each Swap counterparty transfers its position to another entity whereby the centralized clearinghouse effectively becomes the counterparty to each side of the Swap. It is the intent of the Dodd-Frank Act that the clearing of Swaps

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in this manner is designed to avoid concentration of swap risk in any single entity by spreading and centralizing the risk in the clearinghouse and its members. In addition to greater initial and periodic margin (collateral) requirements and additional transaction fees both by the swap execution facility and the clearinghouse, the Swap transactions are now subjected to greater regulation by both the CFTC and the SEC. These additional fees, costs, margin requirements, documentation, and regulation could adversely affect our business and results of operations. Additionally, for all Swaps we entered into prior to June 2013, we are not required to clear them through the central clearinghouse and these Swaps are still subject to the risks of non-performance by any of the individual counterparties with which we entered into these transactions. If the Swap counterparty cannot perform under the terms of a Swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the Swap, and the hedged liability would cease to be hedged by the Swap. We may also be at risk for any collateral we have pledged to secure our obligation under the Swap if the counterparty becomes insolvent or files for bankruptcy. Default by a party with whom we enter into a hedging transaction may result in a loss and force us to cover our commitments, if any, at the then-current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that there will always be a liquid secondary market that will exist for hedging instruments purchased or sold and we may be required to maintain a position until exercise or expiration, which could result in losses.

Clearing facilities or exchanges upon which some of our hedging instruments are traded may increase margin requirements on our hedging instruments in the event of adverse economic developments.

In response to events having or expected to have adverse economic consequences or which create market uncertainty, clearing facilities or exchanges upon which some of our hedging instruments (i.e., interest rate swaps) are traded may require us to post additional collateral against our hedging instruments. For example, in response to the U.S. approaching its debt ceiling without resolution and the federal government shutdown, in October 2013, the Chicago Mercantile Exchange announced that it would increase margin requirements by 12% for all over-the-counter interest rate swap portfolios that its clearinghouse guaranteed. This increase was subsequently rolled back shortly thereafter upon the news that Congress passed legislation to temporarily suspend the national debt ceiling and reopen the federal government, and provide a time period for broader negotiations concerning federal budgetary issues. In the event that future adverse economic developments or market uncertainty (including those due to governmental, regulatory, or legislative action or inaction) result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

We may fail to qualify for hedge accounting treatment, which could materially adversely affect our results of operations.

We record derivative and hedge transactions in accordance with GAAP, specifically according to the Financial Accounting Standards Board (or FASB) Accounting Standards Codification Topic on Derivatives. Under these standards, we may fail to qualify for hedge accounting treatment for a number of reasons, including if we use instruments that do not meet the definition of a derivative, we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or our instruments are not highly effective. If we fail to qualify for hedge accounting treatment, though the fundamental economic performance of our business would be unaffected, our operating results for financial reporting purposes may be materially adversely affected because losses on the derivatives we enter into would be recorded in net income, rather than AOCI, a component of stockholders' equity.

Risks Related to Our Taxation as a REIT and the Taxation of Our Assets

If we fail to remain qualified as a REIT, we will be subject to tax as a regular corporation and could face a substantial tax liability, which would reduce the amount of cash available for distribution to our stockholders.

We have elected to qualify as a REIT and intend to comply with the provisions of the Internal Revenue Code of 1986, as amended (or the Code), related to REIT qualification. Accordingly, we will not be subject to U.S. federal income tax to the extent we distribute 100% of our REIT taxable income (which is generally our taxable income, computed without regard to the dividends paid deduction, any net income from prohibited transactions, and any net income from foreclosure property) to stockholders within the timeframe permitted under the Code and provided that we comply with certain income, asset ownership and other tests applicable to REITs. We believe that we currently meet all of the REIT requirements and intend to continue to qualify as a REIT under the provisions of the Code. Many of the REIT requirements, however, are highly technical and complex. The determination of whether we are a REIT requires an analysis of various factual matters and circumstances, some of which may not be totally within our control and some of which involve interpretation. For example, if we are to qualify as a REIT, annually at least 75% of our gross income must come from, among other sources, interest on obligations secured by mortgages on real property or interests in real property, gain from the disposition of real property, including mortgages or interests in real property (other than sales or dispositions of real property, including mortgages on real property, or securities that are treated as mortgages on real property, that we hold primarily for sale to customers in the ordinary course of a trade or business (i.e., prohibited transactions)), dividends or other

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distributions on, and gains from the disposition of shares in other REITs, commitment fees received for agreements to make real estate loans and certain temporary investment income. In addition, the composition of our assets must meet certain requirements at the close of each quarter. There can be no assurance that we will be able to satisfy these or other requirements or that the Internal Revenue Service (or IRS) or a court would agree with any conclusions or positions we have taken in interpreting the REIT requirements.

Even a technical or inadvertent mistake could jeopardize our REIT qualification unless we meet certain statutory relief provisions. If we were to fail to qualify as a REIT in any taxable year for any reason, we would be subject to U.S. federal income tax (at a 35% tax rate through 2017 and a 21% tax rate beginning in 2018), including any applicable alternative minimum tax (for taxable years prior to 2018), on our taxable income, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Any resulting corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year in which we failed to qualify as a REIT.

We may lose our REIT status if the IRS successfully challenges our characterization of our income from foreign TRSs.

We have elected to treat a foreign subsidiary as a TRS. We have included and will likely be required to include in our income, even without the receipt of actual distributions, earnings from our investment in the foreign TRS. Thus, we do not expect to have any deferred foreign income that will be deemed repatriated in 2018. Income inclusions from equity investments in foreign corporations are technically neither actual dividends nor any of the other enumerated categories of qualifying income for the 95% gross income test. However, the IRS, based on discretionary authority granted to it under the Code, has issued private letter rulings to other REITs holding that income inclusions from equity investments in foreign corporations would be treated as qualifying income for purposes of the 95% gross income test. Private letter rulings may be relied upon only by the taxpayers to whom they are issued and the IRS may revoke a private letter ruling. Based on those private letter rulings and advice of counsel, we generally intend to treat such income inclusions as qualifying income for purposes of the 95% gross income test. Nevertheless, no assurance can be provided that the IRS would not successfully challenge our treatment of such income as qualifying income. In the event that such income was determined not to qualify for the 95% gross income test, we could be subject to a penalty tax with respect to such income to the extent it exceeds 5% of our gross income or we could fail to continue to qualify as a REIT.

REIT distribution requirements could adversely affect our ability to execute our business plan.

To maintain our qualification as a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and excluding any net capital gain) to our stockholders within the timeframe permitted under the Code. We generally must make these distributions in the taxable year to which they relate, or in the following taxable year if declared before we timely (including extensions) file our tax return for the year and if paid with or before the first regular dividend payment after such declaration. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal income tax on our undistributed taxable income at regular corporate income tax rates. In addition, if we should fail to distribute during each calendar year at least the sum of (a) 85% of our REIT ordinary income for such year, (b) 95% of our REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, we would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (x) the amounts actually distributed, plus (y) the amounts of income we retained and on which we have paid corporate income tax.

The dividend distribution requirement limits the amount of cash we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of differences in timing between the recognition of taxable income and the actual receipt of cash, we may have to borrow funds on unfavorable terms, sell investments at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to maintain our qualification as a REIT or avoid corporate income tax and the 4% excise tax in a particular year. These alternatives could increase our costs or reduce our stockholders' equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we qualify as a REIT for U.S. federal income tax purposes, we may be required to pay certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification requirements, to prevent the recognition of certain types of non-

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cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory (i.e., prohibited transactions tax) we may hold some of our assets through TRSs or other subsidiary corporations that will be subject to corporate level income tax at regular rates. In addition, if we lend money to a TRS, the TRS may be unable to deduct all or a portion of the interest paid to us, which could result in an even higher corporate level tax liability. Any of these taxes would reduce our operating cash flow and thus our cash available for distribution to our stockholders.

If our foreign TRS is subject to U.S. federal income tax at the entity level, it would greatly reduce the amounts those entities would have available to pay its creditors and distribute to us.

There is a specific exemption from regular U.S. federal income tax for non-U.S. corporations that restrict their activities in the United States to trading stock and securities (or any activity closely related thereto) for their own account, whether such trading (or such other activity) is conducted by the corporation or its employees through a resident broker, commission agent, custodian or other agent. We intend that our foreign TRS will rely on that exemption or otherwise operate in a manner so that it will not be subject to regular U.S. federal income tax on its net income at the entity level. If the IRS succeeded in challenging that tax treatment, it would greatly reduce the amount that the foreign TRS would have available to pay to its creditors and to distribute to us. In addition, even if our foreign TRS qualifies for that exemption, it may nevertheless be subject to U.S. federal withholding tax on certain types of income.

Complying with REIT requirements may cause us to forgo otherwise attractive opportunities.

To remain qualified as a REIT for U.S. federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. In addition, in certain cases, the modification of a debt instrument could result in the conversion of the instrument from a qualifying real estate asset to a wholly or partially non-qualifying asset that must be contributed to a TRS or disposed of in order for us to maintain our qualification as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

Our ownership of and relationship with any TRS which we may form or acquire will be limited, and a failure to comply with the limits would jeopardize our REIT status and may result in the application of a 100% excise tax. A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. A corporation (other than a REIT) of which a TRS directly or indirectly owns more than 35% of the voting power or value of the stock will automatically be treated as a TRS. Overall, no more than 20% of the value of a REIT's total assets may consist of stock or securities of one or more TRSs. A domestic TRS will pay federal, state and local income tax at regular corporate rates on any income that it earns. In addition, the TRS rules limit the deductibility of interest paid or accrued by a TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation, and in certain circumstances, the ability of our TRSs to deduct net business interest expenses generally may be limited. The rules also impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm's-length basis. Any domestic TRS that we may form will pay federal, state and local income tax on its taxable income, and its after-tax net income will be available for distribution to us but is not required to be distributed to us unless necessary to maintain our REIT qualification.

We may generate taxable income that differs from our GAAP income on our Non-Agency MBS and residential whole loan investments purchased at a discount to par value, which may result in significant timing variances in the recognition of income and losses.

We have acquired and intend to continue to acquire Non-Agency MBS and residential whole loans at prices that reflect significant market discounts on their unpaid principal balances. For financial statement reporting purposes, we generally establish a portion of the purchase discount on Non-Agency MBS as a Credit Reserve. This Credit Reserve is generally not accreted into income for financial statement reporting purposes. For tax purposes, however, we are not permitted to anticipate, or establish a reserve for, credit losses prior to their occurrence. As a result, discount on securities acquired in the primary or secondary market is included in the determination of taxable income and is not impacted by losses until such losses are incurred. Such differences in accounting for tax and GAAP can lead to significant timing variances in the recognition of income and losses. Taxable income on Non-Agency MBS purchased at a discount to their par value may be higher than GAAP earnings in early periods (before losses are actually incurred) and lower than GAAP earnings in periods during and subsequent to when realized credit losses are incurred. Dividends will be declared and paid at the discretion of our Board and will depend on REIT taxable earnings, our financial results

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and overall financial condition, maintenance of our REIT qualification and such other factors as our Board may deem relevant from time to time.

The tax on prohibited transactions may limit our ability to engage in transactions, including certain methods of securitizing mortgage loans, that would be treated as sales for U.S. federal income tax purposes.

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, but including mortgage loans, held primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to dispose of or securitize loans or MBS securities in a manner that was treated as a sale of the loans or MBS for U.S. federal income tax purposes. Therefore, to avoid the prohibited transactions tax, we may choose to engage in certain sales of loans through a TRS and not at the REIT level, and we may be limited as to the structures we are able to utilize for our securitization transactions, even though the sales or structures might otherwise be beneficial to us. We do not believe that our securitizations to date have been subject to this tax, but there can be no assurances that the IRS would agree with such treatment. If the IRS successfully challenged such treatment, our results of operations could be materially adversely affected.

The "taxable mortgage pool" rules may increase the taxes that we or our stockholders may incur and may limit the manner in which we effect future securitizations.

Securitizations by us or our subsidiaries could result in the creation of taxable mortgage pools for U.S. federal income tax purposes. The real estate mortgage investment conduit (or REMIC) provisions of the Code generally provide that REMICs are the only form of pass-through entity permitted to issue debt obligations with two or more maturities if the payments on those obligations bear a relationship to the mortgage obligations held by such entity. If we engage in a non-REMIC securitization transaction, directly or indirectly through a QRS, in which the assets held by the securitization vehicle consist largely of mortgage loans or MBS, in which the securitization vehicle issues to investors two or more classes of debt instruments that have different maturities, and in which the timing and amount of payments on the debt instruments is determined in large part by the amounts received on the mortgage loans or MBS held by the securitization vehicle, the securitization vehicle will be a taxable mortgage pool. As long as we or another REIT holds a 100% interest in the equity interests in a taxable mortgage pool, either directly or through a QRS, the taxable mortgage pool will not be subject to tax. A portion of the income that we realize with respect to the equity interest we hold in a taxable mortgage pool will, however, be considered to be excess inclusion income and, as a result, a portion of the dividends that we pay to our stockholders will be considered to consist of excess inclusion income. Such excess inclusion income is treated as unrelated business taxable income (or UBTI) for tax-exempt stockholders, is subject to withholding for foreign stockholders (without the benefit of any treaty reduction), and is not subject to reduction by net operating loss carryovers. In addition to the extent that our stock is owned by tax-exempt "disqualified organizations," such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax. Historically, we have not generated excess inclusion income; however, despite our efforts, we may not be able to avoid creating or distributing excess inclusion income to our stockholders in the future. In addition, we could face limitations in selling equity interests to outside investors in securitization transactions that are taxable mortgage pools or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

We have not established a minimum dividend payment level, and there is no guarantee that we will maintain current dividend payment levels or pay dividends in the future.

In order to maintain our qualification as a REIT, we must comply with a number of requirements under U.S. federal tax law, including that we distribute at least 90% of our REIT taxable income within the timeframe permitted under the Code, which is calculated generally before the dividends paid deduction and excluding net capital gain. Dividends will be declared and paid at the discretion of our Board and will depend on our REIT taxable earnings, our financial results and overall condition, maintenance of our REIT qualification and such other factors as our Board may deem relevant from time to time. We have not established a minimum dividend payment level for our common stock and our ability to pay dividends may be negatively impacted by adverse changes in our operating results. Therefore, our dividend payment level may fluctuate significantly, and, under some circumstances, we may not pay dividends at all.

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Our reported GAAP net income may differ from the amount of REIT taxable income and dividend distribution requirements and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income which can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of REIT taxable income and our dividend distribution requirements, and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Over time, accounting principles, conventions, rules, and interpretations may change, which could affect our reported GAAP and taxable earnings, and stockholders' equity.

Accounting rules for the various aspects of our business change from time to time. Changes in GAAP, or the accepted interpretation of these accounting principles, can affect our reported income, earnings, and stockholders' equity. In addition, changes in tax accounting rules or the interpretations thereof could affect our REIT taxable income and our dividend distribution requirements. These changes may materially adversely affect our results of operations.

The failure of assets subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to remain qualified as a REIT.

We enter into certain financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We generally believe that we would be treated for REIT asset and income test purposes as the owner of the assets that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we could fail to remain qualified as a REIT.

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code could substantially limit our ability to hedge our liabilities. Any income from a properly designated hedging transaction we enter into to manage risk of interest rate changes with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets, or from certain other limited types of hedging transactions, generally does not constitute "gross income" for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we may have to limit our use of advantageous hedging techniques or implement those hedges through a TRS. This could increase the cost of our hedging activities because a TRS would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in a TRS will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRS.

We may be required to report taxable income for certain investments in excess of the economic income we ultimately realize from them.

We may acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectability rather than current market interest rates. The amount of such discount will nevertheless generally be treated as “market discount” for U.S. federal income tax purposes. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made, and under the new rules regarding the timing of income on such assets that apply beginning in 2018 (or, with respect to debt securities with original issue discount, 2019), may be included sooner based on when such income is included in our financial statements. If we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions.

Some of the debt instruments that we acquire may have been issued with original issue discount. We will be required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such debt instruments will be made, and under the new rules regarding the timing of income on such assets that apply in 2019 with respect to debt securities with original issue discount, may be included sooner based on when such

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income is included in our financial statements. If such debt instruments turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year that uncollectability is provable.

In addition, we may acquire debt instruments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding instrument are “significant modifications” under the applicable Treasury regulations, the modified instrument will be considered to have been reissued to us in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified instrument exceeds our adjusted tax basis in the unmodified instrument, even if the value of the instrument or the payment expectations have not changed. Following such a taxable modification, we would hold the modified loan with a cost basis equal to its principal amount for U.S. federal income tax purposes.

Finally, in the event that any debt instruments acquired by us are delinquent as to mandatory principal and interest payments, or in the event payments with respect to a particular instrument are not made when due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectability. Similarly, we may be required to accrue interest income with respect to debt instruments at its stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

For these and other reasons, we may have difficulty making distributions sufficient to maintain our qualification as a REIT or avoid corporate income tax and the 4% excise tax in a particular year.

Dividends paid by REITs do not qualify for the reduced tax rates available for “qualified dividend income.”

The maximum regular U.S. federal income tax rate for qualified dividend income paid to domestic stockholders that are individuals, trusts and estates is currently 20%. Dividends paid by REITs, however, are generally not eligible for the reduced qualified dividend rates. For taxable years beginning after December 31, 2017 and before January 1, 2026, under the recently enacted law informally known as the Tax Cuts and Jobs Act (or TCJA), non-corporate taxpayers may deduct up to 20% of certain pass-through business income, including “qualified REIT dividends” (generally, dividends received by a REIT stockholder that are not designated as capital gain dividends or qualified dividend income), subject to certain limitations, resulting in an effective maximum U.S. federal income tax rate of 29.6% on such income. Although the reduced U.S. federal income tax rate applicable to qualified dividend income does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends and the reduced corporate tax rate (currently 21%) could cause certain non-corporate investors to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our common stock.

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to remain qualified as a REIT.

The present U.S. federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the U.S. federal income tax treatment of an investment in us. Revisions in U.S. federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us. The TCJA significantly changes the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. Technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming at any time. We cannot predict the long-term effect of the TCJA or any future law changes

on REITs and their stockholders. Any such changes could have an adverse effect on an investment in our stock or on the market value or the resale potential of our assets.

Risks Related to Our Corporate Structure

Our ownership limitations may restrict business combination opportunities.

To qualify as a REIT under the Code, no more than 50% of the value of our outstanding shares of capital stock may be owned, directly or under applicable attribution rules, by five or fewer individuals (as defined by the Code to include certain entities) during the last half of each taxable year. To preserve our REIT qualification, among other things, our charter generally prohibits direct or indirect ownership by any person of more than 9.8% of the number or value of the outstanding shares of our capital stock or more than 9.8% of the number or value, whichever is more restrictive, of the outstanding shares of our preferred stock. Generally, shares owned by affiliated owners will be aggregated for purposes of the ownership limit. Any transfer of shares of our capital stock or other event that, if effective, would violate the ownership limit will be void as to that number of shares of capital stock

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in excess of the ownership limit and the intended transferee will acquire no rights in such shares. Shares issued or transferred that would cause any stockholder to own more than the ownership limit or cause us to become “closely held” under Section 856(h) of the Code will automatically be converted into an equal number of shares of excess stock. All excess stock will be automatically transferred, without action by the prohibited owner, to a trust for the exclusive benefit of one or more charitable beneficiaries that we select, and the prohibited owner will not acquire any rights in the shares of excess stock. The restrictions on ownership and transfer contained in our charter could have the effect of delaying, deferring or preventing a change in control or other transaction in which holders of shares of common stock might receive a premium for their shares of common stock over the then current market price or that such holders might believe to be otherwise in their best interests. The ownership limit provisions also may make our shares of common stock an unsuitable investment vehicle for any person seeking to obtain, either alone or with others as a group, ownership of more than 9.8% of the number or value of our outstanding shares of capital stock.

Provisions of Maryland law and other provisions of our organizational documents may limit the ability of a third party to acquire control of the Company.

Certain provisions of the Maryland General Corporation Law (or MGCL) may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests, including:

“business combination” provisions that, subject to limitations, prohibit certain business combinations between us and an “interested stockholder” (defined generally as any person who beneficially owns 10% or more of the voting power of our outstanding voting stock or an affiliate or associate of ours who, at any time within the two-year period immediately prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding stock) or an affiliate of an interested stockholder for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter impose two supermajority stockholder voting requirements to approve these combinations (unless our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares); and

“control share” provisions that provide that holders of “control shares” of our company (defined as voting shares of stock which, when aggregated with all other shares controlled by the acquiring stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of “control shares”) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

Our bylaws provide that we are not subject to the “control share” provisions of the MGCL. However, our Board may elect to make the “control share” statute applicable to us at any time, and may do so without stockholder approval.

Title 3, Subtitle 8 of the MGCL permits our Board, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to elect on behalf of our company to be subject to statutory provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interest. Our Board may elect to opt in to any or all of the provisions of Title 3, Subtitle 8 of the MGCL without stockholder approval at any time. In addition, without our having elected to be subject to Subtitle 8, our charter and bylaws already (1) provide for a classified board, (2) require the affirmative vote of the holders of at least 80% of the votes entitled to be cast in the election of directors for the removal of any director from our Board, which removal will be allowed only for cause, (3) vest in our Board the exclusive power to fix the number of directorships and (4) require, unless called by our Chairman of the Board, Chief Executive Officer or President or our Board, the written request of stockholders entitled

to cast not less than a majority of all votes entitled to be cast at such a meeting to call a special meeting. These provisions may delay or prevent a change of control of our company.

Future offerings of debt securities, which would rank senior to our common stock upon liquidation, and future offerings of equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common stock.

In the future, we may attempt to increase our capital resources by making offerings of debt or additional offerings of equity securities, including commercial paper, senior or subordinated notes and series or classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock, if any, and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Preferred stock could have a

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preference on liquidating distributions or a preference on dividend payments or both that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

Our Board may approve the issuance of capital stock with terms that may discourage a third party from acquiring the Company.

Our charter permits our Board to issue shares of preferred stock, issuable in one or more classes or series. We may issue a class of preferred stock to individual investors in order to comply with the various REIT requirements or to finance our operations. Our charter further permits our Board to classify or reclassify any unissued shares of preferred or common stock and establish the preferences and rights (including, among others, voting, dividend and conversion rights) of any such shares of stock, which rights may be superior to those of shares of our common stock. Thus, our Board could authorize the issuance of shares of preferred or common stock with terms and conditions that could have the effect of discouraging a takeover or other transaction in which holders of the outstanding shares of our common stock might receive a premium for their shares over the then current market price of our common stock.

Future issuances or sales of shares could cause our share price to decline.

Sales of substantial numbers of shares of our common stock in the public market, or the perception that such sales might occur, could adversely affect the market price of our common stock. In addition, the sale of these shares could impair our ability to raise capital through a sale of additional equity securities. Other issuances of our common stock could have an adverse effect on the market price of our common stock. In addition, future issuances of our common stock may be dilutive to existing stockholders.

Other Business Risks

We are dependent on our executive officers and other key personnel for our success, the loss of any of whom may materially adversely affect our business.

Our success is dependent upon the efforts, experience, diligence, skill and network of business contacts of our executive officers and key personnel. The departure of any of our executive officers and/or key personnel could have a material adverse effect on our operations and performance.

We are dependent on information systems and their failure (including in connection with cyber attacks) could significantly disrupt our business.

Our business is highly dependent on our information and communications systems. Any failure or interruption of our systems or cyber attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on operating results, the market price of our common stock and other securities and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions.

Computer malware, viruses, and computer hacking and phishing and cyber attacks have become more prevalent in our industry and may occur on our systems in the future. Although we are regularly working to install new, and upgrade our existing, information technology systems and provide employee awareness training around computer malware,

phishing, and other cyber risks, there can be no assurance that we are or will be fully protected against cyber risks and security breaches and not be vulnerable to new and evolving threats to our information technology systems. We rely heavily on financial, accounting and other data processing systems. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber attacks or security breaches of our networks or systems (or networks or systems of, among other third parties, our lenders) or any failure to maintain performance, reliability and security of our technical infrastructure. As a result, any such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations.

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We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments, which could materially adversely affect our results of operations.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire residential mortgage assets or other investments at favorable prices. In acquiring our investments, we compete with a variety of institutional investors, including other REITs, public and private funds, commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Some competitors may have a lower cost of funds and access to funding sources that are not available to us. Many of our competitors are not subject to the operating constraints associated with REIT compliance or maintenance of an exemption from the Investment Company Act similar to ours. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish additional business relationships than us. Furthermore, government or regulatory action and competition for investment securities of the types and classes which we acquire may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

Deterioration in the condition of European banks and financial institutions could have a material adverse effect on our business.

In the years following the financial and credit crisis of 2007-2008, certain of our repurchase agreement counterparties in the United States and Europe experienced financial difficulty and were either rescued by government assistance or otherwise benefited from accommodative monetary policy of central banks. Several European governments implemented measures to attempt to shore up their financial sectors through loans, credit guarantees, capital infusions, promises of continued liquidity funding and interest rate cuts. Additionally, other governments of the world's largest economic countries also implemented interest rate cuts. Although economic and credit conditions have stabilized in the past few years, there is no assurance that these and other plans and programs will be successful in the longer term, and, in particular, when governments and central banks begin to significantly unwind or otherwise reverse these programs and policies. If unsuccessful, this could materially adversely affect our financing and operations as well as those of the entire mortgage sector in general.

Several of our financing counterparties are European banks (or their U.S. based subsidiaries) that have provided financing to us, particularly repurchase agreement financing for the acquisition of residential mortgage assets. If European banks and financial institutions experience a deterioration in financial condition, there is the possibility that this would also negatively affect the operations of their U.S. banking subsidiaries. This risk could be more pronounced in light of Brexit. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

Any downgrade, or perceived potential of a downgrade, of U.S. sovereign credit ratings or the credit ratings of the GSEs by the various credit rating agencies may materially adversely affect our the value of our Agency MBS and our business more generally.

During the summer of 2011, Standard & Poor's Ratings Services (or S&P), one of the major credit rating agencies, downgraded the U.S. sovereign credit rating in response to the protracted debate over the "U.S. debt ceiling limit" and S&P's perception of the U.S. Government's ability to address its long-term budget deficit. At the same time, S&P also

lowered the credit ratings of the GSEs in response to the downgrade in the U.S. sovereign credit rating, as the value of the Agency MBS issued by the GSEs and their ability to meet their obligations under such Agency MBS are largely determined by the support provided to them by the U.S. Government and market perceptions of the strength of such support and the likelihood of its continuity.

We could be adversely affected in a number of ways in the event of a default by the U.S. Government, a further downgrade by S&P or a downgrade of the U.S. sovereign credit rating by another credit rating agency. Such adverse effects could include higher financing costs and/or a reduction in the amount of financing provided based on the market value of collateral posted under our repurchase agreements and other financing arrangements. In addition, although the rating agencies have more recently determined that the GSEs' outlook is generally stable, to the extent that the credit rating of any or all of the GSEs were to be downgraded in the future, the value of our Agency MBS could be adversely affected. These outcomes could in turn materially adversely affect our operations and financial condition in a number of ways, including a reduction in the net interest spread between our assets and associated repurchase agreement borrowings or a decrease in our ability to obtain repurchase agreement financing on acceptable terms, or at all.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Office Leases

We pay monthly rent pursuant to two operating leases. Our lease for our corporate headquarters in New York, New York extends through June 30, 2020. The lease provides for aggregate cash payments ranging over time of approximately \$2.6 million per year, paid on a monthly basis, exclusive of escalation charges. In addition, as part of this lease agreement, we have provided the landlord a \$785,000 irrevocable standby letter of credit fully collateralized by cash. The letter of credit may be drawn upon by the landlord in the event that we default under certain terms of the lease. In addition, we have a lease through December 31, 2021, for our off-site back-up facility located in Rockville Centre, New York, which provides for, among other things, lease payments totaling \$32,000, annually.

Item 3. Legal Proceedings.

There are no material legal proceedings to which we are a party or to which any of our assets are subject.

Item 4. Mine Safety Disclosures.

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock is listed on the New York Stock Exchange, under the symbol "MFA." On February 8, 2018, the last sales price for our common stock on the New York Stock Exchange was \$6.93 per share. The following table sets forth the high and low sales prices per share of our common stock during each calendar quarter for the years ended December 31, 2017 and 2016:

Quarter Ended	2017		2016	
	High	Low	High	Low
March 31	\$8.18	\$7.63	\$6.98	\$5.61
June 30	8.66	7.80	7.38	6.69
September 30	8.90	8.38	7.86	7.21
December 31	8.86	7.92	8.05	7.03

Holders

As of February 8, 2018, we had 553 registered holders of our common stock. Such information was obtained through our registrar and transfer agent, based on the results of a broker search.

Dividends

No dividends may be paid on our common stock unless full cumulative dividends have been paid on our preferred stock. We have paid full cumulative dividends on our preferred stock on a quarterly basis through December 31, 2017. We have historically declared cash dividends on our common stock on a quarterly basis. During 2017 and 2016, we declared total cash dividends to holders of our common stock of \$312.8 million (\$0.80 per share) and \$297.0 million (\$0.80 per share), respectively. In general, our common stock dividends have been characterized as ordinary income to our stockholders for income tax purposes. However, a portion of our common stock dividends may, from time to time, be characterized as capital gains or return of capital. For the years ended December 31, 2017, 2016 and 2015 a portion of our dividends were deemed to be capital gains. (For additional dividend information, see Notes 11(a) and 11(b) to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

We elected to be taxed as a REIT for U.S. federal income tax purposes commencing with our taxable year ended December 31, 1998 and, as such, anticipate distributing at least 90% of our REIT taxable income within the timeframe permitted by the Code. Although we may borrow funds to make distributions, cash for such distributions has generally been, and is expected to continue to be, largely generated from our results of our operations.

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We declared and paid the following dividends on our common stock during the years 2017 and 2016:

Year	Declaration Date	Record Date	Payment Date	Dividend per Share
2017	December 13, 2017	December 28, 2017	January 31, 2018	\$ 0.20 (1)
	September 14, 2017	September 28, 2017	October 31, 2017	0.20
	June 12, 2017	June 29, 2017	July 28, 2017	0.20
	March 8, 2017	March 29, 2017	April 28, 2017	0.20
2016	December 14, 2016	December 28, 2016	January 31, 2017	\$ 0.20
	September 15, 2016	September 28, 2016	October 31, 2016	0.20
	June 14, 2016	June 28, 2016	July 29, 2016	0.20
	March 11, 2016	March 28, 2016	April 29, 2016	0.20

(1) At December 31, 2017, we had accrued dividends and dividend equivalents payable of \$79.8 million related to the common stock dividend declared on December 13, 2017.

Dividends are declared and paid at the discretion of our Board and depend on our cash available for distribution, financial condition, ability to maintain our qualification as a REIT, and such other factors that our Board may deem relevant. We have not established a minimum payout level for our common stock. (See Part I, Item 1A., “Risk Factors” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K, for information regarding the sources of funds used for dividends and for a discussion of factors, if any, which may adversely affect our ability to pay dividends.)

Purchases of Equity Securities

As previously disclosed, in August 2005, our Board authorized a stock repurchase program (or Repurchase Program), to repurchase up to 4.0 million shares of our outstanding common stock under the Repurchase Program. The Board reaffirmed such authorization in May 2010. In December 2013, our Board increased the number of shares authorized for repurchase to an aggregate of 10.0 million shares (under which approximately 6.6 million shares remain available for repurchase). Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program are made at times and in amounts as we deem appropriate (including, in our discretion, through the use of one or more plans adopted under Rule 10b5-1 promulgated under the Securities Exchange Act of 1934, as amended (or 1934 Act)), using available cash resources. Shares of common stock repurchased by us under the Repurchase Program are cancelled and, until reissued by us, are deemed to be authorized but unissued shares of our common stock. The Repurchase Program may be suspended or discontinued by us at any time and without prior notice.

We did not repurchase any shares of our common stock under the Repurchase Program during the years ended December 31, 2017 and 2016.

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We engaged in no share repurchase activity during the fourth quarter of 2017 pursuant to the Repurchase Program. We did, however, withhold restricted shares (under the terms of grants under our Equity Compensation Plan (or Equity Plan)) to offset tax withholding obligations that occur upon the vesting and release of restricted stock awards and/or restricted stock units (or RSUs). The following table presents information with respect to (i) such withheld restricted shares, and (ii) eligible shares remaining for repurchase under the Repurchase Program:

Month	Total Number of Shares Purchased	Weighted Average Price Paid Per Share (1)	Total Number of Shares Repurchased as Part of Publicly Announced Repurchase Program or Employee Plan	Maximum Number of Shares that May Yet be Purchased Under the Repurchase Program or Employee Plan
October 1-31, 2017:				
Repurchase Program (2)	—	\$ —	—	6,616,355
Employee Transactions (3)	—	—	N/A	N/A
November 1-30, 2017:				
Repurchase Program (2)	—	—	—	6,616,355
Employee Transactions (3)	—	—	N/A	N/A
December 1-31, 2017:				
Repurchase Program (2)	—	—	—	6,616,355
Employee Transactions (3)	103,840	\$ 8.06	N/A	N/A
Total Repurchase Program (2)	—	\$ —	—	6,616,355
Total Employee Transactions (3)	103,840	\$ 8.06	N/A	N/A

(1) Includes brokerage commissions.

(2) As of December 31, 2017, we had repurchased an aggregate of 3,383,645 shares under the Repurchase Program.

(3) Our Equity Plan provides that the value of the shares delivered or withheld be based on the price of our common stock on the date the relevant transaction occurs.

Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan

In September 2003, we initiated a Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan (or the DRSP) to provide existing stockholders and new investors with a convenient and economical way to purchase shares of our common stock. Under the DRSP, existing stockholders may elect to automatically reinvest all or a portion of their cash dividends in additional shares of our common stock and existing stockholders and new investors may make optional cash purchases of shares of our common stock in amounts ranging from \$50 (or \$1,000 for new investors) to \$10,000 on a monthly basis and, with our prior approval, in excess of \$10,000. At our discretion, we may issue shares of our common stock under the DRSP at discounts of up to 5% from the prevailing market price at the time of purchase. Computershare Shareowner Services LLC is the administrator of the DRSP (or the Plan Agent). Stockholders who own common stock that is registered in their own name and who want to participate in the DRSP must deliver a completed enrollment form to the Plan Agent. Stockholders who own common stock that is registered in a name other than their own (e.g., broker, bank or other nominee) and who want to participate in the DRSP must either request such nominee holder to participate on their behalf or request that such nominee holder re-register our common stock in the stockholder's name and deliver a completed enrollment form to the Plan Agent. During the years ended 2017 and 2016, we issued 2,293,192 and 653,793 shares of common stock through the DRSP generating net proceeds of approximately \$18.5 million and \$4.7 million, respectively.

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Securities Authorized For Issuance Under Equity Compensation Plans

During 2015, we adopted the Equity Plan, as approved by our stockholders. The Equity Plan amended and restated our 2010 Equity Compensation Plan. (For a description of the Equity Plan, see Note 13(a) to the consolidated financial statements included under Item 8 of this Annual Report on Form 10-K.)

The following table presents certain information with respect to our equity compensation plans as of December 31, 2017:

Award (1)	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column of this table)
RSUs	2,046,278		
Total	2,046,278	(2)	6,714,900 (3)

(1) All equity based compensation is granted pursuant to plans that have been approved by our stockholders.

(2) A weighted average exercise price is not applicable for our RSUs, as such equity awards result in the issuance of shares of our common stock provided that such awards vest and, as such, do not have an exercise price. At December 31, 2017, 861,419 RSUs were vested, 438,609 RSUs were subject to time based vesting and 746,250 RSUs will vest subject to achieving a market condition.

(3) Number of securities remaining available for future issuance under equity compensation plans excludes RSUs presented in the table which were issued and outstanding at December 31, 2017.

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Item 6. Selected Financial Data.

Our selected financial data set forth below is derived from our audited financial statements and should be read in conjunction with our consolidated financial statements and the accompanying notes, included under Item 8 of this Annual Report on Form 10-K.

(Dollars in Thousands, Except per Share Amounts)	At or/For the Year Ended December 31,				
	2017	2016	2015	2014	2013
Operating Data:					
Interest income	\$433,448	\$457,450	\$492,143	\$463,817	\$482,940
Interest expense	(197,141)	(193,355)	(176,948)	(159,808)	(164,013)
Net impairment losses recognized in earnings (1)	(1,032)	(485)	(705)	—	—
Net gain on residential whole loans held at fair value	90,019	62,605	19,575	116	—
Net gain on sales of MBS and U.S. Treasury securities (2)	39,577	35,837	34,900	37,497	25,825
Unrealized net gains and net interest income from Linked Transactions	—	—	—	17,092	3,225
Other income/(loss), net	29,423	10,600	(3,310)	80	(7,298)
Operating and other expense	(71,901)	(59,984)	(52,429)	(45,290)	(37,970)
Net income	\$322,393	\$312,668	\$313,226	\$313,504	\$302,709
Preferred stock dividends	15,000	15,000	15,000	15,000	13,750
Issuance costs of redeemed preferred stock (3)	—	—	—	—	3,947
Net income available to common stock and participating securities	\$307,393	\$297,668	\$298,226	\$298,504	\$285,012
Earnings per share — basic and diluted	\$0.79	\$0.80	\$0.80	\$0.81	\$0.78
Dividends declared per share of common stock (4)	\$0.80	\$0.80	\$0.80	\$0.80	\$1.64
Dividends declared per share of preferred stock (5)	\$1.875	\$1.875	\$1.875	\$1.875	\$2.136
Balance Sheet Data:					
MBS, CRT securities and MSR related assets	\$7,515,130	\$10,054,963	\$11,356,643	\$10,762,622	\$11,371,3
Residential whole loans, at carrying value	908,516	590,540	271,845	207,923	—
Residential whole loans, at fair value	1,325,115	814,682	623,276	143,472	—
Cash and cash equivalents	449,757	260,112	165,007	182,437	565,370
Linked Transactions	—	—	—	398,336	28,181
Total assets	10,954,734	12,484,022	13,162,551	12,354,242	12,469,379
Repurchase agreements and other advances	6,614,701	8,687,268	9,387,622	8,267,388	8,339,297
Securitized debt (6)	363,944	—	21,868	110,072	363,676
Swaps (in a liability position) (7)	—	46,954	70,526	62,198	28,217
Total liabilities	7,693,098	9,450,120	10,195,290	9,150,970	9,327,128
Preferred stock, liquidation preference	200,000	200,000	200,000	200,000	200,000
Total stockholders' equity	3,261,636	3,033,902	2,967,261	3,203,272	3,142,251
Other Data:					
Average total assets	\$11,619,174	\$12,836,580	\$13,669,055	\$12,542,584	\$13,192,2
Average total stockholders' equity	\$3,203,814	\$2,965,570	\$3,129,461	\$3,230,932	\$3,262,45
Return on average total assets (8)	2.65	% 2.32	% 2.18	% 2.38	% 2.16
Return on average total stockholders' equity (9)	10.06	% 10.54	% 10.01	% 9.70	% 9.28
	27.57	% 23.10	% 22.89	% 25.75	% 24.73

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Total average stockholders' equity to total average assets (10)

Dividend payout ratio (11)	1.01	1.00	1.00	0.99	1.10
Book value per share of common stock (12)	\$7.70	\$7.62	\$7.47	\$8.12	\$8.06

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- (1) Reflects OTTI recognized through earnings related to Non-Agency MBS.
2017: We sold Non-Agency MBS for \$104.0 million, realizing gross gains of \$39.9 million and sold U.S. Treasury securities for \$139.1 million, realizing gross losses of approximately \$309,000. 2016: We sold Non-Agency MBS for \$85.6 million, realizing gross gains of \$35.8 million. 2015: We sold Non-Agency MBS for \$70.7 million, realizing gross gains of \$34.9 million. 2014: We sold Non-Agency MBS for \$123.9 million, realizing gross gains of \$37.5 million. 2013: We sold Non-Agency MBS for \$152.6 million, realizing gross gains of \$25.8 million and sold U.S. Treasury securities for \$422.2 million, realizing net losses of approximately \$24,000.
- (2) Issuance costs of redeemed preferred stock represent the original offering costs related to the 8.50% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), which was redeemed on May 16, 2013.
- (3) 2013: Includes special cash dividends paid totaling \$0.78 per share.
- (4) 2013: Reflects dividends declared per share on Series A Preferred Stock and 7.50% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock") of \$0.80 and \$1.33, respectively.
- (5) 2017: Reflects securitized debt from our 2017 loan securitization transactions. 2015, 2014 and 2013: Reflects securitized debt from our MBS resecuritization transactions.
Beginning in January 2017, variation margin payments on our cleared Swaps are treated as a legal settlement of the exposure under the Swap contract. Previously such payments were treated as collateral pledged against the exposure under the Swap contract. The effect of this change is to reduce what would have otherwise been reported as fair value of the Swap.
- (6) Reflects net income available to common stock and participating securities divided by average total assets.
- (7) Reflects net income divided by average total stockholders' equity.
- (8) Reflects total average stockholders' equity divided by total average assets.
- (9) Reflects dividends declared per share of common stock (excluding special dividends) divided by earnings per share.
- (10) Reflects total stockholders' equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our financial statements and accompanying notes included in Item 8 of this Annual Report on Form 10-K.

GENERAL

We are a REIT primarily engaged in the business of investing, on a leveraged basis, in residential mortgage assets, including Agency MBS, Non-Agency MBS, residential whole loans, CRT securities and MSR related assets. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals. We selectively invest in residential mortgage assets with a focus on credit analysis, projected prepayment rates, interest rate sensitivity and expected return.

At December 31, 2017, we had total assets of approximately \$11.0 billion, of which \$6.4 billion, or 58.0%, represented our MBS portfolio. At such date, our MBS portfolio was comprised of \$2.8 billion of Agency MBS and \$3.5 billion of Non-Agency MBS, which includes \$2.6 billion of Legacy Non-Agency MBS and \$923.1 million of RPL/NPL MBS that are primarily structured with a contractual coupon step-up feature where the coupon increases up to 300 basis points at 36 months from issuance or sooner. These RPL/NPL MBS are primarily backed by securitized re-performing and non-performing loans. In addition, at December 31, 2017, we had approximately \$2.2 billion in residential whole loans acquired through interests in certain trusts established to acquire the loans, which represented approximately 20.4% of our total assets. Residential whole loans was our fastest growing asset class during 2017, and we continue to seek opportunities to purchase these assets subject to market conditions. Our remaining investment-related assets were primarily comprised of collateral obtained in connection with reverse repurchase agreements, cash and cash equivalents (including restricted cash), CRT securities, MSR related assets, REO and MBS-related receivables.

The results of our business operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, which is driven by numerous factors, including the supply and demand for residential mortgage assets in the marketplace, the terms and availability of adequate financing, general economic and real estate conditions (both on a national and local level), the impact of government actions in the real estate and mortgage sector, and the credit performance of our credit sensitive residential mortgage assets. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and conditional prepayment rates (or CPRs) (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

With respect to our business operations, increases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to increase; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to decline; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to higher interest rates; (iv) prepayments on our MBS to decline, thereby slowing the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders' equity to increase. Conversely, decreases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to decrease; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to increase; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to lower interest rates; (iv) prepayments on our MBS to increase, thereby accelerating the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders' equity to decrease. In addition, our borrowing costs and credit lines are further

affected by the type of collateral we pledge and general conditions in the credit market.

Our investments in residential mortgage assets expose us to credit risk, generally meaning that we are subject to credit losses due to the risk of delinquency, default and foreclosure on the underlying real estate collateral. (See Part I, Item 1A., “Risk Factors - Credit and Other Risks Related to our Investments”, of this Annual Report on Form 10-K.) We believe the discounted purchase prices paid on certain of these investments mitigate our risk of loss in the event that, as we expect on most such investments, we receive less than 100% of the par value of these investments. Our investment process for credit sensitive assets focuses primarily on quantifying and pricing credit risk.

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The table below presents the composition of our MBS portfolios with respect to repricing characteristics as of December 31, 2017:

Underlying Mortgages (In Thousands)	December 31, 2017		Total MBS (1)(2)	Percent of Total
	Agency MBS Fair Value (1)	Non-Agency MBS Fair Value (2)		
Hybrids in contractual fixed-rate period	\$591,664	\$ —	\$591,664	10.9 %
Hybrids in adjustable period	1,046,166	1,695,220	2,741,386	50.4
15-year fixed rate	1,142,583	2,969	1,145,552	21.1
Greater than 15-year fixed rate	—	880,434	880,434	16.2
Floater	42,378	32,232	74,610	1.4
Total	\$2,822,791	\$ 2,610,855	\$5,433,646	100.0%

(1) Does not include principal payments receivable in the amount of \$1.9 million.

(2) Does not reflect \$923.1 million of RPL/NPL MBS, which are securitized financial instruments primarily backed by both fixed-rate and hybrid re-performing and non-performing loans. These deal structures contain a step-up feature where the coupon increases up to 300 basis points at 36 months from issuance or sooner.

As of December 31, 2017, approximately \$2.6 billion, or 48.2%, of our MBS portfolio was in its contractual fixed-rate period or were fixed-rate MBS and approximately \$2.8 billion, or 51.8%, was in its contractual adjustable-rate period, or were floating rate MBS with interest rates that reset monthly. Our ARM-MBS in their contractual adjustable-rate period primarily include MBS collateralized by Hybrids for which the initial fixed-rate period has elapsed, such that the interest rate will typically adjust on an annual or semiannual basis.

Premiums arise when we acquire an MBS at a price in excess of the aggregate principal balance of the mortgages securing the MBS (i.e., par value). Conversely, discounts arise when we acquire an MBS at a price below the aggregate principal balance of the mortgages securing the MBS or when we acquire residential whole loans at a price below their aggregate principal balance. Premiums paid on our MBS are amortized against interest income and accretible purchase discounts on these investments are accreted to interest income. Purchase premiums, which are primarily carried on our Agency MBS and certain CRT securities, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will typically accelerate the amortization of purchase premiums, thereby reducing the internal rate of return (or IRR)/interest income earned on these assets.

CPR levels are impacted by, among other things, conditions in the housing market, new regulations, government and private sector initiatives, interest rates, availability of credit to home borrowers, underwriting standards and the economy in general. In particular, CPR reflects the conditional repayment rate (or CRR), which measures voluntary prepayments of mortgages collateralizing a particular MBS, and the conditional default rate (or CDR), which measures involuntary prepayments resulting from defaults. CPRs on Agency MBS and Legacy Non-Agency MBS may differ significantly. For the year ended December 31, 2017, our Agency MBS portfolio experienced a weighted average CPR of 15.5%, and our Legacy Non-Agency MBS portfolio experienced a weighted average CPR of 17.5%. For the year ended December 31, 2016, our Agency MBS portfolio experienced a weighted average CPR of 14.4%, and our Legacy Non-Agency MBS portfolio experienced a weighted average CPR of 15.6%. Over the last consecutive eight quarters, ending with December 31, 2017, the monthly weighted average CPR on our Agency and Legacy Non-Agency MBS portfolios ranged from a high of 18.4% experienced during the month ended July 31, 2017 to a low of 11.3%, experienced during the month ended February 29, 2016, with an average CPR over such quarters of 15.7%.

Our method of accounting for Non-Agency MBS purchased at significant discounts to par value, requires us to make assumptions with respect to each security. These assumptions include, but are not limited to, future interest rates, voluntary prepayment rates, default rates, mortgage modifications and loss severities. As part of our Non-Agency MBS surveillance process, we track and compare each security's actual performance over time to the performance expected at the time of purchase or, if we have modified our original purchase assumptions, to our revised performance expectations. To the extent that actual performance or our expectation of future performance of our Non-Agency MBS deviates materially from our expected performance parameters, we may revise our performance expectations, such that the amount of purchase discount designated as credit discount may be increased or decreased over time. Nevertheless, credit losses greater than those anticipated or in excess of the recorded purchase discount could occur, which could materially adversely impact our operating results.

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It is our business strategy to hold our residential mortgage assets as long-term investments. On at least a quarterly basis, excluding investments for which the fair value option has been elected or for which specialized loan accounting is otherwise applied, we assess our ability and intent to continue to hold each asset and, as part of this process, we monitor our MBS, CRT securities and MSR related assets that are designated as AFS for OTTI. A change in our ability and/or intent to continue to hold any of these securities that are in an unrealized loss position, or a deterioration in the underlying characteristics of these securities, could result in our recognizing future impairment charges or a loss upon the sale of any such security. At December 31, 2017, we had net unrealized gains on our Non-Agency MBS of \$623.7 million, comprised of gross unrealized gains of \$624.2 million and gross unrealized losses of \$453,000 and net unrealized losses of \$19.7 million on our Agency MBS, comprised of gross unrealized losses of \$43.1 million and gross unrealized gains of \$23.4 million. At December 31, 2017, we did not intend to sell any securities in our portfolio that are designated as AFS and that were in an unrealized loss position, and we believe it is more likely than not that we will not be required to sell those securities before recovery of their amortized cost basis, which may be at their maturity.

We rely primarily on borrowings under repurchase agreements to finance our residential mortgage assets. Our residential mortgage investments have longer-term contractual maturities than our borrowings under repurchase agreements. Even though the majority of our investments have interest rates that adjust over time based on short-term changes in corresponding interest rate indices (typically following an initial fixed-rate period for our Hybrids), the interest rates we pay on our borrowings will typically change at a faster pace than the interest rates we earn on our investments. In order to reduce this interest rate risk exposure, we may enter into derivative instruments, which at December 31, 2017 were comprised of Swaps.

Our Swap derivative instruments are designated as cash-flow hedges against a portion of our current and forecasted LIBOR-based repurchase agreements. Our Swaps do not extend the maturities of our repurchase agreements; they do, however, lock in a fixed rate of interest over their term for the notional amount of the Swap corresponding to the hedged item. During 2017, we did not enter into any new Swaps and had Swaps with an aggregate notional amount of \$350.0 million and a weighted average fixed-pay rate of 0.58% amortize and/or expire. At December 31, 2017, we had Swaps designated in hedging relationships with an aggregate notional amount of \$2.6 billion with a weighted average fixed-pay rate of 2.04% and a weighted average variable interest rate received of 1.50%.

Recent Market Conditions and Our Strategy

At December 31, 2017, our residential mortgage asset portfolio, which includes MBS, residential whole loans, CRT securities and MSR related assets was approximately \$9.7 billion compared to \$11.5 billion at December 31, 2016. During the year ended December 31, 2017 we purchased, through certain entities established to acquire the loans, for approximately \$1.0 billion, residential whole loans with an unpaid principal balance of approximately \$1.3 billion. In addition, we acquired approximately \$727.3 million of RPL/NPL MBS, \$405.6 million of MSR related assets, \$60.1 million of Legacy Non-Agency MBS and \$238.8 million of CRT securities.

At December 31, 2017, \$3.5 billion, or 36.3% of our residential mortgage asset portfolio, was invested in Non-Agency MBS. During the year ended December 31, 2017, the fair value of our Non-Agency MBS holdings decreased by \$2.2 billion. The primary components of the change during the year in these Non-Agency MBS include \$3.0 billion of principal repayments and other principal reductions and the sale of Non-Agency MBS with a fair value of \$103.9 million partially offset by \$787.4 million of purchases (at a weighted average purchase price of 99% of par), and an increase reflecting Non-Agency MBS price changes of \$145.1 million.

At December 31, 2017, \$2.8 billion, or 29.0% of our residential mortgage asset portfolio, was invested in Agency MBS. During the year ended 2017, the fair value of our Agency MBS decreased by \$913.8 million. This was due to \$855.3 million of principal repayments, \$31.3 million of premium amortization and \$39.2 million in net unrealized

losses partially offset by \$12.0 million of asset purchases.

At December 31, 2017, our total recorded investment in residential whole loans was \$2.2 billion or 22.9% of our residential mortgage asset portfolio. Of this amount, \$908.5 million is presented as Residential whole loans, at carrying value and \$1.3 billion as Residential whole loans, at fair value in our consolidated balance sheets. For the year ended December 31, 2017, we recognized approximately \$36.2 million of income on residential whole loans held at carrying value in Interest Income on our consolidated statements of operations, representing an effective yield of 5.93% (excluding servicing costs). In addition, we recorded a net gain on residential whole loans held at fair value of \$90.0 million in Other Income, net in our consolidated statements of operations for the year ended December 31, 2017.

During the year ended December 31, 2017, we completed two loan securitization transactions. As a part of the transactions, we sold residential whole loans with an aggregate unpaid principal balance of \$620.9 million (including \$193.3 million of loans at carrying value and \$296.5 million of loans at fair value) to two entities which we consolidate as variable interest entities (or

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VIEs). In connection with the transactions, third-party investors purchased \$382.8 million face amount of senior and mezzanine bonds (or Senior Bonds) with a weighted average fixed coupon of 3.12%. As a result of the transactions, we acquired \$127.0 million face amount of rated and non-rated certificates issued by the securitization vehicle, and received \$382.8 million in cash, excluding expenses, accrued interest, and underwriting fees. Certain of the Senior Bonds sold in connection with one of our securitization transactions contain a contractual coupon step-up feature whereby the coupon increases by 300 basis points at 36 months from issuance if the bond is not redeemed before such date.

At December 31, 2017 our total investment in MSR related assets was \$492.1 million. During the year ended December 31, 2017 we acquired \$405.6 million of MSR related assets and had \$141.0 million of principal repayments on term notes backed by MSR related collateral. We also acquired \$238.8 million of CRT securities, bringing our total investment in these securities to \$664.4 million. During 2017 our CRT portfolio increased in value, with unrealized gains recognized in net income on this portfolio for the year of \$27.7 million. At December 31, 2017, our CRT portfolio was in an overall unrealized gain position of \$56.3 million.

We will continue to seek investments in residential mortgage assets during 2018. The investment landscape is challenging, as market pricing for all asset classes remains high, thereby making it difficult to purchase assets at attractive risk/reward levels. In addition, unlike Agency MBS, certain of our other asset classes are not always available for purchase, as sellers offer these investments from time to time as opposed to more liquid markets which feature active buyers and sellers at nearly all times. We expect that our purchase focus will be primarily on additional residential whole loans, RPL/NPL MBS and MSR related assets. We experienced significant run-off during 2017 in our RPL/NPL MBS and we could experience further reduction in this portfolio if issuers continue to call these securities.

Our book value per common share was \$7.70 as of December 31, 2017. Book value per common share increased from \$7.62 as of December 31, 2016 due primarily to the impact of fair value changes of Legacy Non-Agency MBS, CRT securities and Swaps, partially offset by a decline in fair value changes on our Agency MBS and the impact of discount accretion income on Legacy Non-Agency MBS that was recognized and declared as dividends during the year.

At the end of 2017, the average coupon on mortgages underlying our Agency MBS was higher compared to the end of 2016, due to upward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio increased to 2.95% for 2017 from 2.82% for 2016 and the net Agency MBS yield increased to 2.00% for 2017, from 1.95% for 2016. The net yield for our Legacy Non-Agency MBS portfolio was 8.95% for 2017 compared to 7.90% for 2016. The increase in the net yield on our Legacy Non-Agency MBS portfolio reflects the impact of the cash proceeds received during 2016 in connection with the settlement of litigation related to certain Countrywide and Citigroup sponsored residential mortgage backed securitization trusts, the improved performance of loans underlying the Legacy Non-Agency MBS portfolio, which has resulted in credit reserve releases and the impact of redemptions during 2017 of certain securities that had been previously purchased at a discount. The net yield for our RPL/NPL MBS portfolio was 4.14% for the year ended December 31, 2017 compared to 3.88% for the year ended December 31, 2016. The increase in the net yield primarily reflects an increase in the average coupon yield to 4.05% for 2017 from 3.80% for 2016 and higher accretion income recognized in 2017 due to the impact of redemptions of certain securities that had been previously purchased at a discount.

We believe that our \$593.2 million Credit Reserve and OTTI appropriately factors in remaining uncertainties regarding underlying mortgage performance and the potential impact on future cash flows for our existing Legacy Non-Agency MBS portfolio. In addition, while the majority of our Legacy Non-Agency MBS will not return their full face value due to loan defaults, we believe that they will deliver attractive loss adjusted yields due to our discounted amortized cost of 71% of face value at December 31, 2017. Home price appreciation and underlying

mortgage loan amortization have decreased the LTV for many of the mortgages underlying our Legacy Non-Agency portfolio. Home price appreciation during the past few years has generally been driven by a combination of limited housing supply, low mortgage rates and demographic-driven U.S. household formation. Lower LTVs lessen the likelihood of defaults and simultaneously decrease loss severities. Further, during 2016 and 2017, we have also observed faster voluntary prepayment (i.e. prepayment of loans in full with no loss) speeds than originally projected. The yields on our Legacy Non-Agency MBS that were purchased at a discount are generally positively impacted if prepayment rates on these securities exceed our prepayment assumptions. Based on these current conditions, we have reduced estimated future losses within our Legacy Non-Agency portfolio. As a result, during the year ended 2017, \$50.8 million was transferred from Credit Reserve to accretable discount. This increase in accretable discount is expected to increase the interest income realized over the remaining life of our Legacy Non-Agency MBS. The remaining average contractual life of such assets is approximately 30 years, but based on scheduled loan amortization and prepayments (both voluntary and involuntary), loan balances will decline substantially over time. Consequently, we believe that the majority of the impact on interest income from the reduction in Credit Reserve will occur over the next ten years.

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At December 31, 2017, we have access to various sources of liquidity which we estimate to be in excess of \$1.1 billion. This amount includes (i) \$449.8 million of cash and cash equivalents; (ii) \$170.2 million in estimated financing available from unpledged Agency MBS and from other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$452.1 million in estimated financing available from unpledged Non-Agency MBS and from other Non-Agency MBS and CRT collateral that is currently pledged in excess of contractual requirements. Our sources of liquidity do not include restricted cash. We believe that we are positioned to continue to take advantage of investment opportunities within the residential mortgage marketplace.

Repurchase agreement funding for our residential mortgage investments continued to be available to us from multiple counterparties in 2017. Typically, repurchase agreement funding involving credit sensitive investments is available at terms requiring higher collateralization and higher interest rates, than for repurchase agreement funding involving Agency MBS. At December 31, 2017, our debt consisted of borrowings under repurchase agreements with 31 counterparties, securitized debt, Senior Notes outstanding and an obligation to return securities obtained as collateral, resulting in a debt-to-equity multiple of 2.3 times. (See table on page 57 under Results of Operations that presents our quarterly leverage multiples since March 31, 2016.)

Information About Our Assets

The table below presents certain information about our asset allocation at December 31, 2017:

ASSET ALLOCATION

	Agency MBS	Legacy Non-Agency MBS	RPL/NPL MBS (1)	Credit Risk Transfer Securities	MSR Related Assets	Residential Whole Loans, at Carrying Value (2)	Residential Whole Loans, at Fair Value	Other, net (3)	Total
(Dollars in Millions)									
Fair Value/Carrying Value	\$2,825	\$ 2,611	\$ 923	\$ 664	\$ 492	\$ 909	\$ 1,325	\$ 588	\$ 10,337
Less Repurchase Agreements	(2,501)	(1,726)	(567)	(459)	(317)	(348)	(696)	—	(6,614)
Less Securitized Debt	—	—	—	—	—	(156)	(208)	—	(364)
Less Senior Notes	—	—	—	—	—	—	—	(97)	(97)
Net Equity Allocated	\$324	\$ 885	\$ 356	\$ 205	\$ 175	\$ 405	\$ 421	\$ 491	\$ 3,262
Debt/Net Equity Ratio (4)	7.7	x 2.0	x 1.6	x 2.2	x 1.8	x 1.2	x 2.1	x	2.3

RPL/NPL MBS are backed primarily by securitized re-performing and non-performing loans. The securities are (1) structured such that the coupon increases up to 300 basis points at 36 months from issuance or sooner. Included with the balance of Non-Agency MBS reported on our consolidated balance sheets.

The carrying value of such loans reflects the purchase price, accretion of income, cash received and provision for (2) loan losses since acquisition. At December 31, 2017, the fair value of such loans is estimated to be approximately \$988.7 million.

(3) Includes cash and cash equivalents and restricted cash, securities obtained and pledged as collateral, other assets, obligation to return securities obtained as collateral of and other liabilities.

Represents the sum of borrowings under repurchase agreements and securitized debt as a multiple of net equity (4) allocated. The numerator of our Total Debt/Net Equity Ratio also includes the obligation to return securities obtained as collateral of \$504.1 million and Senior Notes.

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Agency MBS

The following table presents certain information regarding the composition of our Agency MBS portfolio as of December 31, 2017 and 2016:

December 31, 2017

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Coupon (2)	3 Month Average CPR
15-Year Fixed Rate:							
Low Loan Balance (3)	\$948,225	104.3 %	101.7 %	\$964,373	67	2.95 %	10.3 %
HARP (4)	91,131	104.7	101.8	92,800	66	2.95	8.2
Other (Post June 2009) (5)	81,428	104.0	104.5	85,094	87	4.14	10.7
Other (Pre June 2009) (6)	303	104.9	104.4	316	103	4.50	2.0
Total 15-Year Fixed Rate	\$1,121,087	104.3 %	101.9 %	\$1,142,583	68	3.04 %	10.2 %
Hybrid:							
Other (Post June 2009) (5)	\$1,028,630	104.4 %	103.6 %	\$1,065,312	78	3.17 %	17.7 %
Other (Pre June 2009) (6)	511,801	101.7	104.7	535,795	132	3.44	16.0
Total Hybrid	\$1,540,431	103.5 %	103.9 %	\$1,601,107	96	3.26 %	17.1 %
CMO/Other	\$76,944	102.5 %	102.8 %	\$79,100	198	3.16 %	9.9 %
Total Portfolio	\$2,738,462	103.8 %	103.1 %	\$2,822,790	88	3.16 %	14.1 %

December 31, 2016

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Coupon (2)	3 Month Average CPR
15-Year Fixed Rate:							
Low Loan Balance (3)	\$1,170,788	104.3 %	103.0 %	\$1,206,174	55	2.97 %	11.2 %
HARP (4)	116,790	104.7	103.0	120,290	54	2.96	12.1
Other (Post June 2009) (5)	106,343	104.0	105.7	112,400	75	4.14	14.3
Other (Pre June 2009) (6)	564	104.9	105.9	597	91	4.50	28.8
Total 15-Year Fixed Rate	\$1,394,485	104.3 %	103.2 %	\$1,439,461	57	3.06 %	11.5 %
Hybrid:							
Other (Post June 2009) (5)	\$1,370,019	104.4 %	104.8 %	\$1,436,184	67	2.99 %	19.9 %
Other (Pre June 2009) (6)	720,419	101.7	105.6	761,052	120	3.03	17.0
Total Hybrid	\$2,090,438	103.5 %	105.1 %	\$2,197,236	86	3.01 %	18.9 %
CMO/Other	\$96,379	102.5 %	102.9 %	\$99,196	187	2.81 %	14.7 %
Total Portfolio	\$3,581,302	103.8 %	104.3 %	\$3,735,893	77	3.02 %	15.9 %

(1) Does not include principal payments receivable of \$1.9 million and \$2.6 million at December 31, 2017 and 2016, respectively.

(2) Weighted average is based on MBS current face at December 31, 2017 and 2016, respectively.

(3) Low loan balance represents MBS collateralized by mortgages with an original loan balance of less than or equal to \$175,000.

- (4) Home Affordable Refinance Program (or HARP) MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.
- (5) MBS issued in June 2009 or later. Majority of underlying loans are ineligible to refinance through the HARP program.
- (6) MBS issued before June 2009.

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The following table presents certain information regarding our 15-year fixed-rate Agency MBS as of December 31, 2017 and 2016:

December 31, 2017

Coupon	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Loan Rate	Low Loan Balance and/or HARP (3)	3 Month Average CPR
(Dollars in Thousands)								
15-Year Fixed Rate:								
2.5%	\$579,003	104.0 %	100.5 %	\$581,866	60	3.04 %	100 %	9.3 %
3.0%	231,325	105.9	102.2	236,316	66	3.49	100	9.5
3.5%	5,402	103.5	103.4	5,587	86	4.18	100	23.0
4.0%	263,447	103.5	104.3	274,783	85	4.40	80	12.4
4.5%	41,910	105.2	105.1	44,031	89	4.88	34	10.2
Total 15-Year Fixed Rate	\$1,121,087	104.3 %	101.9 %	\$1,142,583	68	3.52 %	93 %	10.2 %

December 31, 2016

Coupon	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Loan Rate	Low Loan Balance and/or HARP (3)	3 Month Average CPR
(Dollars in Thousands)								
15-Year Fixed Rate:								
2.5%	\$700,388	104.0 %	101.6 %	\$711,696	48	3.04 %	100 %	9.9 %
3.0%	288,648	105.9	103.3	298,311	54	3.49	100	11.3
3.5%	7,244	103.5	104.6	7,576	74	4.18	100	15.7
4.0%	343,105	103.5	105.9	363,258	73	4.40	80	14.2
4.5%	55,100	105.2	106.4	58,620	77	4.88	34	14.5
Total 15-Year Fixed Rate	\$1,394,485	104.3 %	103.2 %	\$1,439,461	57	3.54 %	92 %	11.5 %

(1) Does not include principal payments receivable of \$1.9 million and \$2.6 million at December 31, 2017 and 2016, respectively.

(2) Weighted average is based on MBS current face at December 31, 2017 and 2016, respectively.

(3) Low Loan Balance represents MBS collateralized by mortgages with an original loan balance less than or equal to \$175,000. HARP MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.

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The following table presents certain information regarding our Hybrid Agency MBS as of December 31, 2017 and 2016:

December 31, 2017

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Coupon (2)	Weighted Average Loan Age (Months)	Weighted Average Months to Reset (3)	Interest Only (4)	3 Month Average CPR
Hybrid Post June 2009:									
Agency 5/1	\$398,801	104.3 %	104.6 %	\$416,978	3.47 %	89	5	27 %	16.7 %
Agency 7/1	456,295	104.4	103.3	471,142	2.94	73	13	25	20.8
Agency 10/1	173,534	104.6	102.1	177,192	3.08	68	51	64	11.8
Total Hybrids Post June 2009	\$1,028,630	104.4 %	103.6 %	\$1,065,312	3.17 %	78	16	32 %	17.7 %
Hybrid Pre June 2009:									
Coupon < 4.5% (5)	\$509,290	101.6 %	104.7 %	\$533,183	3.43 %	132	6	19 %	16.1 %
Coupon >= 4.5% (6)	2,511	103.2	104.0	2,612	5.13	119	2	42	1.0
Total Hybrids Pre June 2009	\$511,801	101.7 %	104.7 %	\$535,795	3.44 %	132	5	19 %	16.0 %
Total Hybrids	\$1,540,431	103.5 %	103.9 %	\$1,601,107	3.26 %	96	13	28 %	17.1 %

December 31, 2016

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Coupon (2)	Weighted Average Loan Age (Months)	Weighted Average Months to Reset (3)	Interest Only (4)	3 Month Average CPR
Hybrid Post June 2009:									
Agency 5/1	\$551,736	104.3 %	105.7 %	\$583,318	2.93 %	76	6	25 %	17.7 %
Agency 7/1	618,414	104.5	104.3	645,200	3.00	62	21	24	22.8
Agency 10/1	199,869	104.7	103.9	207,666	3.13	58	61	64	17.1
Total Hybrids Post June 2009	\$1,370,019	104.4 %	104.8 %	\$1,436,184	2.99 %	67	21	30 %	19.9 %
Hybrid Pre June 2009:									
Coupon < 4.5% (5)	\$691,572	101.7 %	105.6 %	\$730,626	2.92 %	121	6	33 %	16.9 %
Coupon >= 4.5% (6)	28,847	101.4	105.5	30,426	5.71	112	7	69	18.1
Total Hybrids Pre June 2009	\$720,419	101.7 %	105.6 %	\$761,052	3.03 %	120	6	34 %	17.0 %
Total Hybrids	\$2,090,438	103.5 %	105.1 %	\$2,197,236	3.01 %	86	15	32 %	18.9 %

(1) Does not include principal payments receivable of \$1.9 million and \$2.6 million at December 31, 2017 and 2016, respectively.

(2) Weighted average is based on MBS current face at December 31, 2017 and 2016, respectively.

(3) Weighted average months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or lifetime caps. The months to reset do not reflect scheduled amortization or prepayments.

(4) Interest only represents MBS backed by mortgages currently in their interest only period. Percentage is based on MBS current face at December 31, 2017 and 2016, respectively.

- (5) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon less than 4.5%.
- (6) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon greater than or equal to 4.5%.

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Non-Agency MBS

The following table presents information with respect to our Non-Agency MBS at December 31, 2017 and 2016:

(In Thousands)	December 31,	
	2017	2016
Non-Agency MBS		
Face/Par	\$3,718,743	\$6,065,618
Fair Value	3,533,966	5,684,836
Amortized Cost	2,910,241	5,093,243
Purchase Discount Designated as Credit Reserve and OTTI	(593,227)	(1)(694,241)
Purchase Discount Designated as Accretable	(215,325)	(278,191)
Purchase Premiums	50	57

(1) Includes discount designated as Credit Reserve of \$579.0 million and OTTI of \$14.2 million.

(2) Includes discount designated as Credit Reserve of \$675.6 million and OTTI of \$18.6 million.

Purchase Discounts on Non-Agency MBS

The following table presents the changes in the components of purchase discount on Non-Agency MBS with respect to purchase discount designated as Credit Reserve and OTTI, and accretable purchase discount for the years ended December 31, 2017 and 2016:

(In Thousands)	For the Year Ended December 31,			
	2017		2016	
	Discount	Discount	Discount	Discount
	Designated as Credit Reserve and OTTI	Accretable Discount (1)	Designated as Credit Reserve and OTTI	Accretable Discount (1)
Balance at beginning of period	\$(694,241)	\$(278,191)	\$(787,541)	\$(312,182)
Impact of RMBS Issuer settlement (2)	—	—	—	(59,900)
Accretion of discount	—	77,513	—	80,548
Realized credit losses	49,291	—	64,217	—
Purchases	(29,810)	18,386	(25,999)	13,094
Sales	31,730	17,802	17,863	37,953
Net impairment losses recognized in earnings	(1,032)	—	(485)	—
Transfers/release of credit reserve	50,835	(50,835)	37,704	(37,704)
Balance at end of period	\$(593,227)	\$(215,325)	\$(694,241)	\$(278,191)

(1) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

Includes the impact of approximately \$61.8 million and \$7.0 million of cash proceeds (a one-time payment)

(2) received by us during the year ended December 31, 2016 in connection with the settlements of litigation related to certain Countrywide and Citigroup sponsored residential mortgage backed securitization trusts, respectively.

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The following table presents information with respect to the yield components of our Non-Agency MBS for the periods presented:

	For the Year Ended December 31,					
	2017		2016		2015	
	Legacy Non-Agency MBS	RPL/NPL MBS	Legacy Non-Agency MBS	RPL/NPL MBS	Legacy Non-Agency MBS	RPL/NPL MBS
Non-Agency MBS						
Coupon Yield (1)	5.61 %	4.05 %	5.24 %	3.80 %	5.08 %	3.61 %
Effective Yield Adjustment (2)	3.34	0.09	2.66	0.08	2.54	0.07
Net Yield	8.95 %	4.14 %	7.90 %	3.88 %	7.62 %	3.68 %

(1) Reflects coupon interest income divided by the average amortized cost. The discounted purchase price on Legacy Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.

The effective yield adjustment is the difference between the net yield, calculated utilizing management's estimates (2) of timing and amount of future cash flows for Legacy Non-Agency MBS and RPL/NPL MBS, less the current coupon yield.

Actual maturities of MBS are generally shorter than stated contractual maturities because actual maturities of MBS are affected by the contractual lives of the underlying mortgage loans, periodic payments of principal and prepayments of principal. The following table presents certain information regarding the amortized costs, weighted average yields and contractual maturities of our MBS at December 31, 2017 and does not reflect the effect of prepayments or scheduled principal amortization on our MBS:

(Dollars in Thousands)	Within						Total MBS	Total Fair Value	Weighted Average Yield		
	One Year		One to Five Years		Five to Ten Years						
	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield					
Agency MBS:											
Fannie Mae	\$—	—	\$141	2.33 %	\$586,126	2.22 %	\$1,666,938	2.24 %	\$2,253,205	\$2,246,600	2.23 %
Freddie Mac	—	—	—	—	249,277	1.98	335,643	1.87	584,920	571,748	1.91
Ginnie Mae	—	—	—	—	98	2.32	6,156	2.01	6,254	6,333	2.02
Total Agency MBS	\$—	—	\$141	2.33 %	\$835,501	2.15 %	\$2,008,737	2.17 %	\$2,844,379	\$2,824,681	2.17 %
Non-Agency MBS	\$—	—	\$271,115	3.90 %	\$2,904	3.88 %	\$2,636,222	8.35 %	\$2,910,241	\$3,533,966	7.93 %
Total MBS	\$—	—	\$271,256	3.90 %	\$838,405	2.15 %	\$4,644,959	5.68 %	\$5,754,620	\$6,358,647	5.08 %

CRT Securities

At December 31, 2017, our CRT securities had an amortized cost of \$608.1 million, a fair value of \$664.4 million, a weighted average yield of 6.02% and weighted average time to maturity of 9.2 years. At December 31, 2016, our CRT securities had an amortized cost of \$382.7 million, a fair value of \$404.9 million, a weighted average yield of 5.86% and weighted average time to maturity of 9.0 years.

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Residential Whole Loans

The following table presents the contractual maturities of our residential whole loans held by consolidated trusts and certain entities established in connection with our loan securitization transactions at December 31, 2017 and does not reflect estimates of prepayments or scheduled amortization. For residential whole loans at carrying value, amounts presented are estimated based on the underlying loan contractual amounts.

(In Thousands)	Residential Whole Loans, at Carrying Value	Residential Whole Loans, at Fair Value
Amount due:		
Within one year	\$ 43,418	\$9,985
After one year:		
Over one to five years	18,646	14,559
Over five years	846,452	1,300,571
Total due after one year	\$ 865,098	\$ 1,315,130
Total residential whole loans	\$ 908,516	\$ 1,325,115

The following table presents at December 31, 2017, the dollar amount of our residential whole loans held at fair value, contractually maturing after one year, and indicates whether the loans have fixed interest rates or adjustable interest rates:

(In Thousands)	Residential Whole Loans at Fair Value (1)
Interest rates:	
Fixed	\$695,145
Adjustable	619,985
Total	\$ 1,315,130

(1) Includes loans on which borrowers have defaulted and are not making payments of principal and/or interest as of December 31, 2017.

Information is not presented for purchase credit impaired residential whole loans at carrying value as income is recognized based on pools of assets with similar risk characteristics using an estimated yield based on cash flows expected to be collected over the lives of the loans in such pools rather than on the contractual coupons of the underlying loans.

The following table presents additional information regarding our residential whole loans held at fair value at December 31, 2017 and 2016:

(Dollars in Thousands)	Residential Whole Loans at Fair Value December 31,	December 31,
	2017	2016

Loans 90 days or more past due:

Number of Loans	3,984	2,560
Aggregate Amount Outstanding	\$840,572	\$ 570,025

Income on credit impaired residential whole loans held at carrying value is recognized based on pools of assets with similar credit risk characteristics using an estimated yield based on cash flows expected to be collected over the lives of the loans in such pools rather than the contractual coupons of the underlying loans. As the unit of account is at the pool level rather than the individual loan level, none of our residential whole loans held at carrying value are currently considered 90 days or more past due.

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Exposure to Financial Counterparties

We finance a significant portion of our residential mortgage assets with repurchase agreements and other advances. In connection with these financing arrangements, we pledge our assets as collateral to secure the borrowing. The amount of collateral pledged will typically exceed the amount of the financing with the extent of over-collateralization ranging from 1% - 8% of the amount borrowed (U.S. Treasury and Agency MBS collateral) to up to 35% (Non-Agency MBS collateral). Consequently, while repurchase agreement financing results in us recording a liability to the counterparty in our consolidated balance sheets, we are exposed to the counterparty, if during the term of the repurchase agreement financing, a lender should default on its obligation and we are not able to recover our pledged assets. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

The table below summarizes our exposure to our counterparties at December 31, 2017, by country:

Country	Number of Counterparties	Repurchase Agreement Financing and Other Advances	Exposure (1)	Exposure as a Percentage of MFA Total Assets	
(Dollars in Thousands)					
European Countries: (2)					
Switzerland (3)	3	\$1,030,090	373,254	3.41	%
France	2	617,536	157,368	1.44	
United Kingdom	3	414,361	135,147	1.23	
Holland	1	120,220	9,488	0.09	
Total European	9	2,182,207	675,257	6.17	%
Other Countries:					
United States	15	\$3,180,405	775,617	7.08	%
Canada (4)	3	732,278	189,163	1.73	
Japan (5)	3	441,160	35,928	0.33	
China (5)	1	398,187	13,993	0.13	
South Korea	1	180,670	12,490	0.11	
Total Other	23	4,932,700	1,027,191	9.38	%
Total	32	\$7,114,907 (6)	1,702,448	15.55	%

(1) Represents for each counterparty the amount of cash and/or securities pledged as collateral less the aggregate of repurchase agreement financing and net interest receivable/payable on all such instruments.

(2) Includes European-based counterparties as well as U.S.-domiciled subsidiaries of the European parent entity.

(3) Includes London branch of one counterparty and Cayman Islands branch of the other counterparty.

(4) Includes Canada-based counterparties as well as U.S.-domiciled subsidiaries of Canadian parent entities. In the case of one counterparty, also includes exposure of \$168.6 million to Barbados-based affiliate of the Canadian parent entity.

(5) Exposure is to U.S.-domiciled subsidiary of the Japanese or Chinese parent entity, as the case may be.

(6) Includes \$500.0 million of repurchase agreements entered into in connection with contemporaneous repurchase and reverse repurchase agreements with a single counterparty.

At December 31, 2017, we did not use credit default swaps or other forms of credit protection to hedge the exposures summarized in the table above.

Uncertainty in the global financial market and weak economic conditions in Europe, including as a result of the United Kingdom's recent vote to leave the European Union (commonly known as "Brexit"), could potentially impact our major European financial counterparties, with the possibility that this would also impact the operations of their U.S. domiciled subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general. Management monitors our exposure to our repurchase agreement counterparties on a regular basis, using various methods, including review of recent rating agency actions or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements with our counterparties. We intend to make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements, or take other necessary actions to reduce the amount of our exposure to a counterparty when such actions are considered necessary.

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Tax Considerations

Current period estimated taxable income and items expected to impact future taxable income

We estimate that for 2017, our taxable income was approximately \$331.4 million. Based on dividends paid or declared during 2017, we have undistributed taxable income of approximately \$57.9 million, or \$0.15 per share. We have until the filing of our 2017 tax return (due not later than October 15, 2018) to declare the distribution of any 2017 REIT taxable income not previously distributed.

During the first quarter of 2017 we unwound our remaining MBS resecuritization transaction. We currently estimate that the unwind will generate taxable income (but not GAAP income) of an amount in excess of \$0.13 per share. During the second quarter of 2017 we entered into our first securitization of residential whole loans. As part of this transaction, loans deemed to be sold for tax purposes are estimated to generate 2017 taxable income in excess of \$0.01 per share.

Key differences between GAAP net income and REIT Taxable Income for Non-Agency MBS and Residential Whole Loans

Our total Non-Agency MBS portfolio for tax differs from our portfolio reported for GAAP primarily due to the fact that for tax purposes; (i) certain of the MBS contributed to the VIEs used to facilitate MBS resecuritization transactions were deemed to be sold; and (ii) the tax basis of underlying MBS considered to be reacquired in connection with the unwind of such transactions becomes the fair value of such securities at the time of the unwind. For GAAP reporting purposes the underlying MBS that were included in these MBS resecuritization transactions were not considered to be sold. Similarly, for tax purposes the residential whole loans contributed to the VIE used to facilitate our second quarter 2017 loan securitization transaction were deemed to be sold for tax purposes, but not for GAAP reporting purposes. In addition, for our Non-Agency MBS and residential whole loan tax portfolios, potential timing differences arise with respect to the accretion of market discount into income and recognition of realized losses for tax purposes as compared to GAAP. Consequently, our REIT taxable income calculated in a given period may differ significantly from our GAAP net income.

The determination of taxable income attributable to Non-Agency MBS and residential whole loans is dependent on a number of factors, including principal payments, defaults, loss mitigation efforts and loss severities. In estimating taxable income for Non-Agency MBS and residential whole loans during the year, management considers estimates of the amount of discount expected to be accreted. Such estimates require significant judgment and actual results may differ from these estimates. Moreover, the deductibility of realized losses from Non-Agency MBS and residential whole loans, and their effect on market discount accretion is analyzed on an asset-by-asset basis and while they will result in a reduction of taxable income, this reduction tends to occur gradually and primarily for Non-Agency MBS in periods after the realized losses are reported. In addition, for MBS resecuritization transactions that were treated as sale of the underlying MBS for tax purposes, taxable gain or loss, if any, resulting from the unwind of such transactions is not recognized in GAAP net income.

Securitization transactions result in differences between GAAP net income and REIT Taxable Income

For tax purposes, depending on the transaction structure, a securitization and/or resecuritization transaction may be treated either as a sale or a financing of the underlying collateral. Income recognized from securitization and resecuritization transactions will differ for tax and GAAP purposes. For tax purposes, we own and may in the future acquire interests in securitization and /or resecuritization trusts, in which several of the classes of securities are or will be issued with Original Issue Discount (or OID). As the holder of the retained interests in the trust, we generally will be required to include OID in our current gross interest income over the term of the applicable securities as the OID

accrues. The rate at which the OID is recognized into taxable income is calculated using a constant rate of yield to maturity, with realized losses impacting the amount of OID recognized in REIT taxable income once they are actually incurred. Under the TCJA, the timing of such income may be affected by when we include such income for financial accounting purposes. For tax purposes, REIT taxable income may be recognized in excess of economic income (i.e., OID) or in advance of the corresponding cash flow from these assets, thereby affecting our dividend distribution requirement to stockholders. In addition, for securitization and/or resecuritization transactions that were treated as a sale of the underlying collateral for tax purposes, the unwind of any such transaction will likely result in a taxable gain or loss that is likely not recognized in GAAP net income since securitization and resecuritization transactions are typically accounted for as financing transactions for GAAP purposes. The tax basis of underlying residential whole loans or MBS re-acquired in connection with the unwind of such transactions becomes the fair market value of such assets at the time of the unwind.

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Regulatory Developments

The U.S. Congress, Board of Governors of the Federal Reserve System, U.S. Treasury, FDIC, SEC and other governmental and regulatory bodies have taken and continue to consider additional actions in response to the 2007-2008 financial crisis. In particular, the Dodd-Frank Act created a new regulator, an independent bureau housed within the Federal Reserve System, and known as the Consumer Financial Protection Bureau (or the CFPB). The CFPB has broad authority over a wide range of consumer financial products and services, including mortgage lending and servicing. One portion of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (or Mortgage Reform Act), contains underwriting and servicing standards for the mortgage industry, restrictions on compensation for mortgage loan originators, and various other requirements related to mortgage origination. In addition, the Dodd-Frank Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also affects the securitization of mortgages (and other assets) with requirements for risk retention by securitizers and requirements for regulating rating agencies.

The Dodd-Frank Act requires that numerous regulations be issued, many of which (including those mentioned above regarding servicing, underwriting and mortgage loan originator compensation) have only recently been implemented and operationalized. As a result, we are unable to fully predict at this time how the Dodd-Frank Act, as well as other laws or regulations that may be adopted in the future, will affect our business, results of operations and financial condition, or the environment for repurchase financing and other forms of borrowing, the investing environment for Agency MBS, Non-Agency MBS and/or residential mortgage loans, the securitization industry, Swaps and other derivatives. However, at a minimum, we believe that the Dodd-Frank Act and the regulations promulgated thereunder are likely to continue to increase the economic and compliance costs for participants in the mortgage and securitization industries, including us.

In addition to the regulatory actions being implemented under the Dodd-Frank Act, on August 31, 2011, the SEC issued a concept release under which it is reviewing interpretive issues related to Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) excludes from the definition of “investment company” entities that are primarily engaged in, among other things, “purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” Many companies that engage in the business of acquiring mortgages and mortgage-related instruments seek to rely on existing interpretations of the SEC Staff with respect to Section 3(c)(5)(C) so as not to be deemed an investment company for the purpose of regulation under the Investment Company Act. In connection with the concept release, the SEC requested comments on, among other things, whether it should reconsider its existing interpretation of Section 3(c)(5)(C). To date the SEC has not taken or otherwise announced any further action in connection with the concept release. (For additional discussion of the SEC’s concept release and its potential impact on us, please see Part I, Item 1A. “Risk Factors” of this Annual Report on Form 10-K.)

The FHFA and both houses of Congress have discussed and considered separate measures intended to restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac. Congress may continue to consider legislation that would significantly reform the country’s mortgage finance system, including, among other things, eliminating Freddie Mac and Fannie Mae and replacing them with a single new MBS insurance agency. Many details remain unsettled, including the scope and costs of the agencies’ guarantee and their affordable housing mission, some of which could be addressed even in the absence of large-scale reform. While the likelihood of enactment of major mortgage finance system reform in the short term remains uncertain, it is possible that the adoption of any such reforms could adversely affect the types of assets we can buy, the costs of these assets and our business operations. As the FHFA and both houses of Congress continue to consider various measures intended to dramatically restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, we expect debate and discussion on the topic to continue throughout 2018. However, we cannot be certain if any housing and/or mortgage-related

legislation will emerge from committee, or be approved by Congress, and if so, what the effect will be on our business.

Additional Material U.S. Federal Income Tax Considerations

The following is a summary of certain additional material federal income tax considerations with respect to the ownership of our stock. This summary supplements and should be read together with “Material U.S. Federal Income Tax Considerations” in the prospectus dated November 16, 2016 and filed as part of our registration statement on Form S-3 (No. 333-214659).

Recent Legislation

The recently passed tax law informally known as the TCJA made many significant changes to the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders, and may lessen the relative competitive advantage of operating as a REIT rather than as a C corporation. Pursuant to this legislation, as of January 1, 2018, (1) the federal income tax rate applicable to corporations is reduced to 21%, (2) the highest marginal individual income tax rate is reduced to

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37%, (3) the corporate alternative minimum tax is repealed and (4) the backup withholding rate for Domestic Owners is reduced to 24%. In addition, individuals, estates and trusts may deduct up to 20% of certain pass-through income, including ordinary REIT dividends that are not “capital gain dividends” or “qualified dividend income,” subject to certain limitations. For taxpayers qualifying for the full deduction, the effective maximum tax rate on ordinary REIT dividends would be 29.6% (through taxable years ending in 2025). The maximum rate of withholding with respect to our distributions to Foreign Owners that are treated as attributable to gains from the sale or exchange of U.S. real property interests is also reduced from 35% to 21%. The deduction of net interest expense is limited for all businesses; provided that certain businesses, including real estate businesses, may elect not to be subject to such limitations and instead to depreciate their real property related assets over longer depreciable lives. To the extent that a taxable REIT subsidiary has interest expense that exceeds its interest income, the net interest expense limitation could potentially apply to such taxable REIT subsidiary. The reduced corporate tax rate will apply to our taxable REIT subsidiaries.

Under the TCJA, we generally will be required to take certain amounts in income no later than the time such amounts are reflected on certain financial statements. The application of this rule may require the accrual of income with respect to our debt instruments or MBS, such as original issue discount or market discount, earlier than would be the case under the general tax rules, although the precise application of this rule is unclear at this time. This rule generally will be effective for tax years beginning after December 31, 2017 or, for debt instruments or MBS issued with original issue discount, for tax years beginning after December 31, 2018. To the extent that this rule requires the accrual of income earlier than under the general tax rules, it could increase our “phantom income,” which may make it more likely that we could be required to borrow funds or take other action to satisfy the REIT distribution requirements for the taxable year in which this “phantom income” is recognized.

Under the TCJA, deferred foreign income of our foreign TRSs that has not previously been subject to tax would be deemed repatriated and would be included in income. Any income deemed repatriated would be excluded from both the 75% and 95% gross income tests, but would increase our REIT distribution requirement. REITs are permitted to elect to include such income in taxable income over an eight year period. Because we have included earnings of our foreign TRS in our income, we do not expect our foreign TRS to have any deferred foreign income.

We urge you to consult your tax advisors regarding the impact of the TCJA on the purchase, ownership and sale of our stock.

Taxation of Foreign Owners

Foreign Owners that are “qualified shareholders” or “qualified foreign pension funds” may be eligible for additional exemptions from Foreign Investment in Real Property Tax Act of 1980 (or FIRPTA) withholding. REIT distributions that are exempt from FIRPTA withholding may still be subject to regular U.S. withholding tax.

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Results of Operations

Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

General

For 2017, we had net income available to our common stock and participating securities of \$307.4 million, or \$0.79 per basic and diluted common share, compared to net income available to common stock and participating securities for 2016 of \$297.7 million, or \$0.80 per basic and diluted common share. The increase in net income available to common stock and participating securities primarily reflects higher other income, driven primarily by higher net gains realized on residential whole loans held at fair value, unrealized gains on CRT securities accounted for at fair value, gains on the liquidation of certain residential whole loans accounted for at carrying value and higher gains on sales of Legacy Non-Agency MBS. This increase was partially offset by a decrease in our net interest income primarily on our Agency and Non-Agency MBS portfolios. In addition, operating and other expenses were higher primarily due to increases in loan servicing and other related operating expenses, and non-recurring expenses in relation to our contractual obligation to accelerate the vesting of certain share based awards and to make a death benefit payment to the estate of our former Chief Executive Officer. The decrease in net income available to common stock and participating securities on a per share basis primarily reflects an increase in our common shares issued through a public offering during the second quarter of 2017.

Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends primarily upon the volume of interest-earning assets and interest-bearing liabilities and the corresponding interest rates earned or paid. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS. Interest rates and CPRs (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance) vary according to the type of investment, conditions in the financial markets, and other factors, none of which can be predicted with any certainty.

The changes in average interest-earning assets and average interest-bearing liabilities and their related yields and costs are discussed in greater detail below under “Interest Income” and “Interest Expense.”

For 2017, our net interest spread and margin were 2.09% and 2.55%, respectively, compared to a net interest spread and margin of 2.12% and 2.45%, respectively, for 2016. Our net interest income decreased by \$27.8 million, or 10.5%, to \$236.3 million from \$264.1 million for 2016. For 2017 net interest income from Agency MBS and Legacy Non-Agency MBS declined compared to 2016 by approximately \$36.7 million, primarily due to lower average amounts invested in these securities and higher funding costs, partially offset by higher yields earned on these securities. In addition, net interest income on RPL/NPL MBS was approximately \$21.2 million lower compared to 2016 primarily due to lower average amounts invested in these securities and higher funding costs partially offset by higher yields earned on these securities. These decreases were partially offset by higher net interest income on MSR related assets, CRT securities, and residential whole loans at carrying value of approximately \$32.4 million compared to 2016, primarily due to higher average amounts invested in these assets and higher yields earned on CRT securities. In addition, net interest income for 2017 also includes \$19.7 million of interest expense associated with residential whole loans at fair value, reflecting a \$5.8 million increase in borrowing costs related to these investments compared to 2016. Coupon interest income received from residential whole loans at fair value is presented as a component of the total income earned on these investments and therefore is included in Other Income, net rather than net interest income.

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Analysis of Net Interest Income

The following table sets forth certain information about the average balances of our assets and liabilities and their related yields and costs for the years ended December 31, 2017, 2016 and 2015. Average yields are derived by dividing interest income by the average amortized cost of the related assets, and average costs are derived by dividing interest expense by the daily average balance of the related liabilities, for the periods shown. The yields and costs include premium amortization and purchase discount accretion which are considered adjustments to interest rates.

(Dollars in Thousands)	For the Year Ended December 31,								
	2017			2016			2015		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:									
Interest-earning assets:									
Agency MBS (1)	\$3,272,766	\$65,355	2.00%	\$4,258,744	\$83,069	1.95%	\$5,282,198	\$105,835	2.00%
Legacy Non-Agency MBS (1)	2,276,247	203,650	8.95	2,941,507	232,500	7.90	3,600,339	274,352	7.62
RPL/NPL MBS (1)	1,629,573	67,462	4.14	2,586,495	100,321	3.88	2,423,808	89,218	3.68
Total MBS	7,178,586	336,467	4.69	9,786,746	415,890	4.25	11,306,345	469,405	4.15
CRT securities (1)	543,360	31,715	5.84	271,566	14,770	5.44	133,458	6,572	4.92
MSR related assets (1)	392,948	24,830	6.32	36,013	2,100	5.83	—	—	—
Residential whole loans, at carrying value (2)	610,420	36,187	5.93	389,910	23,916	6.13	241,801	16,036	6.63
Cash and cash equivalents (3)	546,579	4,249	0.78	291,064	774	0.27	212,917	130	0.06
Total interest-earning assets	9,271,893	433,448	4.67	10,775,299	457,450	4.25	11,894,521	492,143	4.14
Total non-interest-earning assets (2)	2,347,281			2,061,281			1,774,534		
Total assets	\$11,619,174			\$12,836,580			\$13,669,055		
Liabilities and stockholders' equity:									
Interest-bearing liabilities:									
Total repurchase agreements and other advances (4)	\$7,441,607	\$186,347	2.50	\$8,972,475	\$184,986	2.06	\$9,596,407	\$166,918	1.74
Securitized debt (5)	96,311	2,755	2.86	6,700	333	4.97	65,319	1,996	3.06
Senior Notes	96,751	8,039	8.31	96,714	8,036	8.31	96,680	8,034	8.31
Total interest-bearing liabilities	7,634,669	197,141	2.58	9,075,889	193,355	2.13	9,758,406	176,948	1.81
Total non-interest-bearing liabilities	780,691			795,121			781,188		
Total liabilities	8,415,360			9,871,010			10,539,594		
Stockholders' equity	3,203,814			2,965,570			3,129,461		

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Total liabilities and stockholders' equity	\$11,619,174		\$12,836,580		\$13,669,055	
Net interest income/net interest rate spread (6)	\$236,307	2.09%	\$264,095	2.12%	\$315,195	2.33%
Net interest-earning assets/net interest margin (7)	\$1,637,224	2.55%	\$1,699,410	2.45%	\$2,136,115	2.65%
Ratio of interest-earning assets to interest-bearing liabilities	1.21	x	1.19	x	1.22	x

- Yields presented throughout this Annual Report on Form 10-K are calculated using average amortized cost data for securities which excludes unrealized gains and losses and includes principal payments receivable on securities. For GAAP reporting purposes, purchases and sales are reported on the trade date. Average amortized cost data used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased assets and continues to be earned on sold assets until settlement date. Includes Non-Agency MBS transferred to consolidated VIEs.
- (1)
 - (2) Excludes residential whole loans held at fair value that are reported as a component of total non-interest-earning assets.
 - (3) Includes average interest-earning cash, cash equivalents and restricted cash.
 - (4) Average cost of repurchase agreements includes the cost of Swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration.
 - (5) Securitized debt for 2017 reflects securitized debt from our 2017 loan securitization transactions. Securitized debt for 2016 and 2015 reflects securitized debt from our MBS resecuritization transactions.
 - (6) Net interest rate spread reflects the difference between the yield on average interest-earning assets and average cost of funds.
 - (7) Net interest margin reflects net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following table presents the extent to which changes in interest rates (yield/cost) and changes in the volume (average balance) of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) the changes attributable to changes in volume (changes in average balance multiplied by prior rate); (ii) the changes attributable to changes in rate (changes in rate multiplied by prior average balance); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately, based on absolute values, to the changes due to rate and volume.

(In Thousands)	Year Ended December 31, 2017 Compared to Year Ended December 31, 2016			Year Ended December 31, 2016 Compared to Year Ended December 31, 2015		
	Increase/(Decrease) due to Volume	Increase/(Decrease) due to Rate	Total Net Change in Interest Income/Expense	Increase/(Decrease) due to Volume	Increase/(Decrease) due to Rate	Total Net Change in Interest Income/Expense
Interest-earning assets:						
Agency MBS	\$(19,762)	\$2,048	\$ (17,714)	\$(20,028)	\$(2,738)	\$ (22,766)
Legacy Non-Agency MBS	(57,019)	28,169	(28,850)	(51,758)	9,906	(41,852)
RPL/NPL MBS	(39,233)	6,374	(32,859)	6,148	4,955	11,103
CRT securities	15,790	1,155	16,945	7,446	752	8,198
MSR related assets	22,539	191	22,730	2,100	—	2,100
Residential whole loans, at carrying value (1)	13,097	(826)	12,271	9,166	(1,286)	7,880
Cash and cash equivalents	1,088	2,387	3,475	64	580	644
Total net change in income from interest-earning assets	\$(63,500)	\$39,498	\$ (24,002)	\$(46,862)	\$12,169	\$ (34,693)
Interest-bearing liabilities:						
Agency repurchase agreements and FHLB advances	\$(13,779)	\$11,470	\$ (2,309)	\$(11,046)	\$8,578	\$ (2,468)
Legacy Non-Agency repurchase agreements	(13,682)	6,456	(7,226)	(8,937)	3,646	(5,291)
RPL/NPL MBS repurchase agreements	(18,944)	7,260	(11,684)	1,551	8,356	9,907
CRT securities repurchase agreements	4,507	891	5,398	2,102	375	2,477
MSR related assets repurchased agreements	7,332	85	7,417	632	—	632
Residential whole loan at carrying value repurchase agreements	3,919	1,133	5,052	3,562	327	3,889
Residential whole loan at fair value repurchase agreements	3,337	1,376	4,713	8,036	886	8,922
Securitized debt	2,621	(199)	2,422	(2,452)	789	(1,663)
Senior Notes	3	—	3	2	—	2
Total net change in expense from interest-bearing liabilities	\$(24,686)	\$28,472	\$ 3,786	\$(6,550)	\$22,957	\$ 16,407
Net change in net interest income	\$(38,814)	\$11,026	\$ (27,788)	\$(40,312)	\$(10,788)	\$ (51,100)

(1) Excludes residential whole loans held at fair value which are reported as a component of non-interest-earning assets.

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The following table presents certain quarterly information regarding our net interest spread and net interest margin for the quarterly periods presented:

Quarter Ended	Total Interest-Earning Assets and Interest-Bearing Liabilities	
	Net Interest Spread (1)	Net Interest Margin (2)
December 31, 2017	2.08 %	2.54 %
September 30, 2017	2.02	2.54
June 30, 2017	2.10	2.58
March 31, 2017	2.27	2.63
December 31, 2016	2.12	2.46
September 30, 2016	2.13	2.46
June 30, 2016	2.14	2.46
March 31, 2016	2.18	2.51

(1) Reflects the difference between the yield on average interest-earning assets and average cost of funds.

(2) Reflects annualized net interest income divided by average interest-earning assets.

The following table presents the components of the net interest spread earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Legacy Non-Agency MBS			RPL/NPL MBS			Total MBS		
	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
December 31, 2017	2.08 %	1.79 %	0.29 %	9.12 %	3.29 %	5.83 %	4.27 %	2.72 %	1.55 %	4.85 %	2.44 %	2.41 %
September 30, 2017	1.97	1.75	0.22	8.93	3.26	5.67	4.43	2.69	1.74	4.74	2.41	2.33
June 30, 2017	1.96	1.57	0.39	8.85	3.28	5.57	4.18	2.46	1.72	4.68	2.29	2.39
March 31, 2017	1.98	1.49	0.49	8.90	3.05	5.85	3.87	2.27	1.60	4.58	2.15	2.43
December 31, 2016	1.92	1.41	0.51	8.24	3.01	5.23	3.85	2.14	1.71	4.35	2.07	2.28
September 30, 2016	1.83	1.28	0.55	8.09	2.98	5.11	3.86	2.05	1.81	4.24	1.96	2.28
June 30, 2016	1.96	1.26	0.70	7.72	2.88	4.84	3.83	2.01	1.82	4.19	1.91	2.28
March 31, 2016	2.07	1.27	0.80	7.61	2.86	4.75	3.97	2.07	1.90	4.23	1.91	2.32

(1) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(2) Reflects annualized interest expense divided by average balance of repurchase agreements and other advances, including the cost of Swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration and securitized debt. Agency cost of funding includes 43, 44, 49, 60, 65, 62, 63 and 65 basis points and Legacy Non-Agency cost of funding includes 45, 45, 58, 58, 69, 74, 69 and 65 basis points associated with Swaps to hedge interest rate sensitivity on these assets for the quarters

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ended December 31, 2017, September 30, 2017, June 30, 2017, March 31, 2017, December 31, 2016, September 30, 2016, June 30, 2016 and March 31, 2016, respectively.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

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Interest Income

Interest income on our Agency MBS for 2017 decreased by \$17.7 million, or 21.3% to \$65.4 million from \$83.1 million for 2016. This change primarily reflects a \$986.0 million decrease in the average amortized cost of our Agency MBS portfolio to \$3.3 billion for 2017 from \$4.3 billion for 2016 partially offset by an increase in the net yield on our Agency MBS to 2.00% for 2017 from 1.95% for 2016. At the end of 2017, the average coupon on mortgages underlying our Agency MBS was higher compared to the end of 2016. However, during 2017, our Agency MBS portfolio experienced a 15.5% CPR and we recognized a \$31.3 million of net premium amortization compared to a CPR of 14.4% and \$36.9 million of net premium amortization in 2016. At December 31, 2017, we had net purchase premiums on our Agency MBS of \$104.0 million, or 3.8% of current par value, compared to net purchase premiums of \$135.1 million, or 3.8% of par value at December 31, 2016.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) decreased \$61.7 million, or 18.5%, for 2017 to \$271.1 million compared to \$332.8 million for 2016, primarily due to the decrease in the average amortized cost of our Non-Agency portfolio of \$1.6 billion or 29.3%, to \$3.9 billion for 2017, from \$5.5 billion for 2016. This decrease more than offset that impact of the higher yields generated on our Legacy Non-Agency MBS portfolio, which were 8.95% for 2017 compared to 7.90% for 2016. The increase in the net yield on our Legacy Non-Agency MBS reflects the impact of the cash proceeds received during 2016 in connection with the settlement of litigation related to certain Countrywide and Citigroup sponsored residential mortgage backed securitization trusts, the improved performance of loans underlying the Legacy Non-Agency MBS portfolio, which has resulted in credit reserve releases and the impact of redemptions during 2017 of certain securities that had been previously purchased at a discount. Our RPL/NPL MBS portfolio yielded 4.14% for 2017 compared to 3.88% for 2016. The increase in the net yield reflects an increase in the average coupon yield to 4.05% for 2017 from 3.80% for 2016 and higher accretion income recognized in the current year due to the impact of redemptions of certain securities that had been previously purchased at a discount.

During 2017, we recognized net purchase discount accretion of \$77.5 million on our Non-Agency MBS, compared to \$80.6 million for 2016. At December 31, 2017, we had net purchase discounts of \$806.5 million, including Credit Reserve and previously recognized OTTI of \$593.2 million, on our Legacy Non-Agency MBS, or 28.8% of par value. During 2017, we reallocated \$50.8 million of purchase discount designated as Credit Reserve to accretable purchase discount.

The following table presents the coupon yield and net yields earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS and weighted average CPRs experienced for such MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Legacy Non-Agency MBS			RPL/NPL MBS		
	Coupon Yield (1)	Net Yield (2)	3 Month Average CPR (3)	Coupon Yield (1)	Net Yield (2)	3 Month Average CPR (3)	Coupon Yield (1)	Net Yield (2)	3 Month Average Bond CPR (4)
December 31, 2017	3.00%	2.08%	14.1 %	5.82%	9.12%	16.3 %	4.24%	4.27%	20.1 %
September 30, 2017	2.98	1.97	16.2	5.63	8.93	18.7	4.24	4.43	26.2
June 30, 2017	2.94	1.96	16.3	5.52	8.85	18.2	4.03	4.18	36.2
March 31, 2017	2.90	1.98	15.1	5.50	8.90	16.8	3.84	3.87	27.1
December 31, 2016	2.86	1.92	15.9	5.40	8.24	17.3	3.82	3.85	25.8
September 30, 2016	2.83	1.83	16.7	5.28	8.09	15.9	3.83	3.86	32.2
June 30, 2016	2.80	1.96	13.9	5.19	7.72	16.1	3.81	3.83	25.4

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March 31, 2016 2.78 2.07 11.7 5.09 7.61 13.3 3.73 3.97 23.0

- (1) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Legacy Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.
- (2) Reflects annualized interest income on MBS divided by average amortized cost of MBS.
- (3) 3 month average CPR weighted by positions as of the beginning of each month in the quarter.
- (4) All principal payments are considered to be prepayments for CPR purposes.

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Interest Expense

Our interest expense for 2017 increased by \$3.8 million or 1.96% to \$197.1 million, from \$193.4 million for 2016. This increase primarily reflects an increase in financing rates on our repurchase agreement financings, an increase in our average borrowings to finance residential whole loans, MSR related assets and CRT securities, which was partially offset by a decrease in our average repurchase agreement borrowings and other advances to finance Agency MBS and Non-Agency MBS. The effective interest rate paid on our borrowings increased to 2.58% for the year ended December 31, 2017, from 2.13% for the year ended December 31, 2016.

At December 31, 2017, we had repurchase agreement borrowings of \$6.6 billion of which \$2.6 billion was hedged with Swaps. At December 31, 2017, our Swaps designated in hedging relationships had a weighted average fixed-pay rate of 2.04% and extended 27 months on average with a maximum remaining term of approximately 68 months.

Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of \$24.5 million or 32 basis points, for 2017, compared to interest expense of \$40.9 million, or 45 basis points, for 2016. The weighted average fixed-pay rate on our Swaps designated as hedges increased to 1.98% for 2017 from 1.82% for 2016. The weighted average variable interest rate received on our Swaps designated as hedges increased to 1.07% for 2017 from 0.48% for 2016. During 2017, we did not enter into any new Swaps and had Swaps with an aggregate notional amount of \$350.0 million and a weighted average fixed-pay rate of 0.58% amortize and/or expire.

We expect that our interest expense and funding costs for 2018 will be impacted by market interest rates, the amount of our borrowings and incremental hedging activity, existing and future interest rates on our hedging instruments and the extent to which we execute additional longer-term structured financing transactions. As a result of these variables, our borrowing costs cannot be predicted with any certainty. (See Notes 5(b), 6 and 14 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

OTTI

During 2017 and 2016, we recognized OTTI charges through earnings against certain of our Non-Agency MBS of \$1.0 million and \$485,000, respectively. These impairment charges reflected changes in our estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the securities and changes in the expected timing of receipt of cash flows. At December 31, 2017, we had 433 Agency MBS with a gross unrealized loss of \$43.1 million and 15 Non-Agency MBS with a gross unrealized loss of \$453,000. Impairments on Agency MBS in an unrealized loss position at December 31, 2017 are considered temporary and not credit related. Unrealized losses on Non-Agency MBS for which no OTTI was recorded during the year are considered temporary based on an assessment of changes in the expected cash flows for such securities, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in our analysis of expected cash flows for our Legacy Non-Agency MBS and any determination of the credit component of OTTI. (See “Critical Accounting Policies and Estimates” for more information regarding OTTI.)

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Other Income, net

For 2017, Other Income, net, increased by \$50.0 million, or 45.8% to \$159.0 million compared to \$109.0 million for 2016. Other Income, net for 2017 primarily reflects a \$90.0 million net gain recorded on residential whole loans held at fair value, \$39.6 million of net gains realized on the sale of \$243.1 million Non-Agency MBS and U.S. Treasury securities and \$27.7 million of unrealized gains on CRT securities accounted for at fair value. Other Income, net for 2016 primarily reflects a net gain of \$62.6 million on residential whole loans held at fair value, \$35.8 million, of gross gains realized on the sale of \$85.6 million of Non-Agency MBS and \$13.0 million of unrealized gains on CRT securities accounted for at fair value.

Operating and Other Expense

For 2017, we had compensation and benefits and other general and administrative expenses of \$49.6 million, or 1.55% of average equity, compared to \$45.6 million, or 1.54% of average equity, for 2016. Compensation and benefits expense increased \$2.4 million to \$31.7 million for 2017, compared to \$29.3 million for 2016, primarily reflecting non-recurring expenses recorded in relation to our contractual obligation to accelerate the vesting of certain share based awards and to make a death benefit payment to the estate of our former Chief Executive Officer. Our other general and administrative expenses increased by \$1.6 million to \$18.0 million for 2017 compared to \$16.3 million for 2016. The increase was primarily due to higher costs related to stock-based compensation awards to Directors, higher professional services related costs and higher costs associated with the loan securitization transactions and other structured financing transactions completed during 2017.

Operating and Other Expense during 2017 also includes \$22.3 million of loan servicing and other related operating expenses related to our residential whole loan activities. These expenses increased compared to the prior year period by approximately \$7.9 million, primarily due to increases in non-recoverable advances on REO, increased loan servicing and modification fees and higher loan acquisition related expenses, which were partially offset by a decrease in the provision for loan losses recognized for 2017.

Selected Financial Ratios

The following table presents information regarding certain of our financial ratios at or for the dates presented:

At or for the Quarter Ended	Return on Average Total Assets (1)	Return on Average Total Stockholders' Equity (2)	Total Average Stockholders' Equity to Total Average Assets (3)	Dividend Payout Ratio (4)	Leverage Multiple (5)	Book Value per Share of Common Stock (6)
December 31, 2017	3.47 %	12.29 %	29.33 %	0.83	2.3	\$ 7.70
September 30, 2017	2.10	7.78	28.60	1.33	2.4	7.70
June 30, 2017	2.63	10.01	27.59	1.00	2.5	7.76
March 31, 2017	2.42	10.19	24.95	1.00	2.9	7.66
December 31, 2016	2.18	9.52	24.19	1.11	3.1	7.62
September 30, 2016	2.47	11.05	23.46	0.95	3.1	7.64
June 30, 2016	2.33	10.83	22.58	1.00	3.3	7.41
March 31, 2016	2.29	10.82	22.19	1.00	3.4	7.17

(1) Reflects annualized net income available to common stock and participating securities divided by average total assets.

(2) Reflects annualized net income divided by average total stockholders' equity.

(3) Reflects total average stockholders' equity divided by total average assets.

(4) Reflects dividends declared per share of common stock divided by earnings per share.

Represents the sum of borrowings under repurchase agreements, FHLB advances, securitized debt, payable for
(5) unsettled purchases, and obligations to return securities obtained as collateral and Senior Notes divided by
stockholders' equity.

(6) Reflects total stockholders' equity less the preferred stock liquidation preference divided by total shares of common
stock outstanding.

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Results of Operations

Year Ended December 31, 2016 Compared to the Year Ended December 31, 2015

General

For 2016, we had net income available to our common stock and participating securities of \$297.7 million, or \$0.80 per basic and diluted common share, unchanged compared to net income available to common stock and participating securities for 2015 of \$298.2 million, or \$0.80 per basic and diluted common share.

Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends primarily upon the volume of interest-earning assets and interest-bearing liabilities and the corresponding interest rates earned or paid. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS. Interest rates and CPRs (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance) vary according to the type of investment, conditions in the financial markets, and other factors, none of which can be predicted with any certainty.

The changes in average interest-earning assets and average interest-bearing liabilities and their related yields and costs are discussed in greater detail below under “Interest Income” and “Interest Expense.”

For 2016, our net interest spread and margin were 2.12% and 2.45%, respectively, compared to a net interest spread and margin of 2.33% and 2.65%, respectively, for 2015. Our net interest income decreased by \$51.1 million, or 16.2%, to \$264.1 million from \$315.2 million for 2015. For 2016 net interest income from Agency MBS and Legacy Non-Agency MBS declined compared to 2015 by approximately \$55.2 million, primarily due to lower average amounts invested in these securities and higher funding costs, partially offset by higher yields earned on Legacy Non-Agency MBS. This decrease was partially offset by higher net interest income on residential whole loans at carrying value, RPL/NPL MBS and CRT securities of approximately \$10.9 million, primarily due to higher average balances and yields on RPL/NPL MBS and CRT securities and higher average balances of residential loans at carrying value. In addition, net interest income also included \$13.9 million of interest expense associated with residential whole loans at fair value, reflecting an \$8.9 million increase in borrowing costs related to these investments compared to 2015, consistent with the overall growth of this asset class during 2016. Coupon interest income received from residential whole loans at fair value is presented as a component of the total income earned on these investment and therefore is included in Other income, net interest income.

The following table presents certain quarterly information regarding our net interest spread and net interest margin for the quarterly periods presented:

Quarter Ended	Total Interest-Earning Assets and Interest-Bearing Liabilities			
	Net Interest Spread (1)		Net Interest Margin (2)	
		%		%
December 31, 2016	2.12	%	2.46	%
September 30, 2016	2.13		2.46	
June 30, 2016	2.14		2.46	
March 31, 2016	2.18		2.51	

December 31, 2015	2.22	2.54
September 30, 2015	2.24	2.58
June 30, 2015	2.33	2.66
March 31, 2015	2.44	2.77

(1) Reflected the difference between the yield on average interest-earning assets and average cost of funds.

(2) Reflected annualized net interest income divided by average interest-earning assets.

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The following table presents the components of the net interest spread earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Legacy Non-Agency MBS			RPL/NPL MBS			Total MBS		
	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
December 31, 2016	1.92%	1.41%	0.51%	8.24%	3.01%	5.23%	3.85%	2.14%	1.71%	4.35%	2.07%	2.28%
September 30, 2016	1.83	1.28	0.55	8.09	2.98	5.11	3.86	2.05	1.81	4.24	1.96	2.28
June 30, 2016	1.96	1.26	0.70	7.72	2.88	4.84	3.83	2.01	1.82	4.19	1.91	2.28
March 31, 2016	2.07	1.27	0.80	7.61	2.86	4.75	3.97	2.07	1.90	4.23	1.91	2.32
December 31, 2015	2.04	1.17	0.87	7.64	2.90	4.74	3.70	1.81	1.89	4.17	1.81	2.36
September 30, 2015	1.84	1.13	0.71	7.60	2.76	4.84	3.74	1.73	2.01	4.08	1.73	2.35
June 30, 2015	1.89	1.06	0.83	7.59	2.77	4.82	3.66	1.60	2.06	4.09	1.65	2.44
March 31, 2015	2.22	1.13	1.09	7.64	2.85	4.79	3.62	1.52	2.10	4.26	1.69	2.57

(1) Reflected annualized interest income on MBS divided by average amortized cost of MBS.

Reflected annualized interest expense divided by average balance of repurchase agreements and other advances, including the cost of Swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration and securitized debt. Agency cost of funding included 65, 62, 63, 65, 74, 74, 70 and 78 basis points and Legacy Non-Agency cost of funding included 69, 74, 69, 65, 69, 66, 68 and 78 basis points associated with Swaps to hedge interest rate sensitivity on these assets for the quarters ended December 31, 2016, September 30, 2016, June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, June 30, 2015 and March 31, 2015, respectively.

(3) Reflected the difference between the net yield on average MBS and average cost of funds on MBS.

Interest Income

Interest income on our Agency MBS for 2016 decreased by \$22.8 million, or 21.5% to \$83.1 million from \$105.8 million for 2015. This change primarily reflected a \$1.0 billion decrease in the average amortized cost of our Agency MBS portfolio to \$4.3 billion for 2016 from \$5.3 billion for 2015. In addition, the net yield on our Agency MBS decreased to 1.95% for 2016 from 2.00% for 2015. At the end of 2016, the average coupon on mortgages underlying our Agency MBS was slightly higher compared to the end of 2015. However, during 2016, our Agency MBS portfolio experienced a 14.4% CPR and we recognized a \$36.9 million of net premium amortization compared to a CPR of 13.2% and \$41.2 million of net premium amortization in 2015, which resulted in the year on year decline in net yield. At December 31, 2016, we had net purchase premiums on our Agency MBS of \$135.1 million, or 3.8% of current par value, compared to net purchase premiums of \$172.0 million, or 3.8% of par value at December 31, 2015.

Interest income on our Non-Agency MBS (which included Non-Agency MBS transferred to consolidated VIEs) decreased \$30.7 million, or 8.5%, for 2016 to \$332.8 million compared to \$363.6 million for 2015, primarily due to the decrease in the average amortized cost of our Non-Agency portfolio of \$496.1 million or 8.2%, to \$5.5 billion for 2016, from \$6.0 billion for 2015. This decrease more than offset that impact of the higher yields generated on our

Legacy Non-Agency MBS portfolio, which were 7.90% for 2016 compared to 7.62% for 2015. The increase in the yield on our Legacy Non-Agency MBS reflected the impact of the cash proceeds (a one-time payment) received during the quarter ended June 30, 2016 in connection with the settlements of litigation related to certain Countrywide and Citigroup sponsored residential mortgage backed securitization trusts and the improved performance of loans underlying the Legacy Non-Agency MBS portfolio, resulting in credit reserve releases, in the current and prior year. Our RPL/NPL MBS portfolio yielded 3.88% for 2016 compared to 3.68% for 2015. The increase in the net yield on this portfolio was primarily due to the addition of higher yielding securities since 2015 and the impact of redemptions during 2016 of certain securities that had been previously purchased at a discount.

During 2016, we recognized net purchase discount accretion of \$80.6 million on our Non-Agency MBS, compared to \$92.8 million for 2015. At December 31, 2016, we had net purchase discounts of \$970.8 million, including Credit Reserve and previously recognized OTTI of \$694.2 million, on our Legacy Non-Agency MBS, or 27.3% of par value. During 2016, we reallocated \$37.7 million of purchased discount designated as Credit Reserve to accretable purchase discount.

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The following table presents the coupon yield and net yields earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS and weighted average CPRs experienced for such MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Legacy Non-Agency MBS			RPL/NPL MBS		
	Coupon Yield (1)	Net Yield (2)	3 Month Average CPR (3)	Coupon Yield (1)	Net Yield (2)	3 Month Average CPR (3)	Coupon Yield (1)	Net Yield (2)	3 Month Average Bond CPR (4)
December 31, 2016	2.86%	1.92%	15.9%	5.40%	8.24%	17.3%	3.82%	3.85%	25.8%
September 30, 2016	2.83	1.83	16.7	5.28	8.09	15.9	3.83	3.86	32.2
June 30, 2016	2.80	1.96	13.9	5.19	7.72	16.1	3.81	3.83	25.4
March 31, 2016	2.78	2.07	11.7	5.09	7.61	13.3	3.73	3.97	23.0
December 31, 2015	2.76	2.04	11.8	5.09	7.64	14.6	3.68	3.70	21.5
September 30, 2015	2.74	1.84	15.4	5.10	7.60	16.3	3.62	3.74	29.5
June 30, 2015	2.77	1.89	14.8	5.06	7.59	14.8	3.57	3.66	28.6
March 31, 2015	2.99	2.22	10.9	5.11	7.64	11.1	3.56	3.62	19.6

(1) Reflected the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Legacy Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.

(2) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(3) 3 month average CPR weighted by positions as of the beginning of each month in the quarter.

(4) All principal payments are considered to be prepayments for CPR purposes.

Interest Expense

Our interest expense for 2016 increased by \$16.4 million, or 9.3% to \$193.4 million, from \$176.9 million for 2015. This increase primarily reflected an increase in financing rates on our repurchase agreement financings, an increase in our average borrowings to finance residential whole loans, CRT securities and RPL/NPL MBS, which was partially offset by a decrease in our average repurchase agreement borrowings to finance Agency MBS and Legacy Non-Agency MBS, and a decrease in the average balance of FHLB advances and securitized debt.

At December 31, 2016, we had repurchase agreement borrowings of \$8.5 billion of which \$2.9 billion was hedged with Swaps and FHLB advances of \$215.0 million. At December 31, 2016, our Swaps designated in hedging relationships had a weighted average fixed-pay rate of 1.87% and extended 35 months on average with a maximum remaining term of approximately 80 months.

The effective interest rate paid on our borrowings increased to 2.13% for 2016 from 1.81% for 2015. This increase reflected higher financing rates on our repurchase agreement financings, the increase in our average balance of repurchase agreements to finance residential whole loans, CRT securities and RPL/NPL MBS, partially offset by the lower average balance of Agency and Legacy Non-Agency repurchase agreements, FHLB advances and securitized debt.

Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of \$40.9 million or 45 basis points, for 2016, compared to interest expense of \$53.8 million, or 57 basis points, for 2015. The weighted average fixed-pay rate on our Swaps designated as hedges decreased to 1.82% for 2016 from 1.86% for 2015. The weighted average variable interest rate received on our Swaps designated as hedges increased to 0.48% for 2016 from 0.19% for 2015. During 2016, we did not enter into any new Swaps and had Swaps

with an aggregate notional amount of \$150.0 million and a weighted average fixed-pay rate of 1.03% amortize and/or expire.

OTTI

During 2016 and 2015, we recognized OTTI charges through earnings against certain of our Non-Agency MBS of \$485,000 and \$705,000, respectively. These impairment charges reflected changes in our estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the securities and changes in the expected timing of receipt of cash flows. At December 31, 2016, we had 344 Agency MBS with a gross unrealized loss of \$31.2 million and 55 Non-Agency MBS with a gross unrealized loss of \$5.2 million. Impairments on Agency MBS in an unrealized loss position at December 31, 2016 are considered temporary and not credit related.

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Unrealized losses on Non-Agency MBS for which no OTTI was recorded during the year are considered temporary based on an assessment of changes in the expected cash flows for such securities, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in our analysis of expected cash flows for our Legacy Non-Agency MBS and any determination of the credit component of OTTI. (See “Critical Accounting Policies and Estimates” for more information regarding OTTI.)

Other Income, net

For 2016, Other income, net, increased by \$57.9 million, or 113.1% to \$109.0 million from \$51.2 million for 2015. Other income, net for 2016 primarily reflected a \$62.6 million net gain recorded on residential whole loans held at fair value and \$35.8 million of gross gains realized on the sale of \$85.6 million Non-Agency MBS and \$13.0 million of unrealized gains on CRT securities accounted for at fair value. During 2015, we sold Non-Agency MBS for \$70.7 million, realizing gross gains of \$34.9 million and recorded a net gain on residential whole loans held at fair value of \$19.6 million.

Operating and Other Expense

For 2016, we had compensation and benefits and other general and administrative expenses of \$45.6 million, or 1.54% of average equity, compared to \$42.0 million, or 1.34% of average equity, for 2015. Compensation and benefits expense increased \$3.0 million to \$29.3 million for 2016, compared to \$26.3 million for 2015, which primarily reflected higher headcount and recognition for accounting purposes of additional expense associated with long term incentive awards. Our other general and administrative expenses increased by \$579,000 to \$16.3 million for 2016 compared to \$15.8 million for 2015. The increase was primarily due to higher IT development and related expenses.

Operating and Other Expense during 2016 also included \$14.4 million of loan servicing and other related operating expenses related to our residential whole loan activities. These expenses increased compared to the prior year period by approximately \$4.0 million, consistent with the overall growth in this asset class during 2016. The overall increase was primarily due to increased loan servicing and modification fees and non-recoverable advances on REO which were partially offset by a decrease in the provision for loan losses recognized and lower loan acquisition related expenses for 2016.

Selected Financial Ratios

The following table presents information regarding certain of our financial ratios at or for the dates presented:

At or for the Quarter Ended	Return on Average Total Assets (1)	Return on Average Total Stockholders' Equity (2)	Total Average Stockholders' Equity to Total Average Assets (3)	Dividend Payout Ratio (4)	Leverage Multiple (5)	Book Value per Share of Common Stock (6)
December 31, 2016	2.18 %	9.52 %	24.19 %	1.11	3.1	\$ 7.62
September 30, 2016	2.47	11.05	23.46	0.95	3.1	7.64
June 30, 2016	2.33	10.83	22.58	1.00	3.3	7.41
March 31, 2016	2.29	10.82	22.19	1.00	3.4	7.17
December 31, 2015	2.10	9.80	22.56	1.05	3.4	7.47
September 30, 2015	2.22	10.21	22.85	1.00	3.3	7.70
June 30, 2015	2.16	9.78	23.18	1.00	3.3	7.96
March 31, 2015	2.25	10.26	22.97	0.95	3.3	8.13

- (1) Reflected annualized net income available to common stock and participating securities divided by average total assets.
- (2) Reflected annualized net income divided by average total stockholders' equity.
- (3) Reflected total average stockholders' equity divided by total average assets.
- (4) Reflected dividends declared per share of common stock divided by earnings per share.
Represented the sum of borrowings under repurchase agreements, FHLB advances, securitized debt, payable for
- (5) unsettled purchases, and obligations to return securities obtained as collateral and Senior Notes divided by stockholders' equity.
- (6) Reflected total stockholders' equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements include our accounts and all majority owned and controlled subsidiaries. In addition, we consolidate the special purpose entities (or SPEs) created to facilitate the resecuritization transactions completed in prior years and the acquisition of residential whole loans. The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. In preparing these consolidated financial statements, management has made estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Our accounting policies are described in Note 2 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K. Management believes the more significant of these to be as follows:

Classifications of Investment Securities and Assessment for Other-Than-Temporary Impairments

Our investments in securities are primarily comprised of Agency MBS and Non-Agency MBS, as discussed and detailed in Notes 2(b) and 3 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K. All of our MBS are designated as available-for-sale (or AFS) and, accordingly, are carried on our consolidated balance sheets at their fair value with unrealized gains and losses excluded from earnings (except when an OTTI is recognized, as discussed below) and reported in AOCI, a component of Stockholders' Equity. We do not intend to hold any of our investment securities for trading purposes; however, if available-for-sale securities were classified as trading securities, there could be substantially greater volatility in our earnings.

When the fair value of an AFS security is less than its amortized cost at the balance sheet date, the security is considered impaired. We assess our impaired securities on at least a quarterly basis and designates such impairments as either "temporary" or "other-than-temporary." If we intend to sell an impaired security, or it is more likely than not that we will be required to sell the impaired security before its anticipated recovery, then we must recognize an OTTI through charges to earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets.

In making our assessments about OTTIs, we review and consider certain information relating to our financial position and the impaired securities, including the nature of such securities, the contractual collateral requirements impacting us and our investment and leverage strategies, as well as subjective information, including our current and targeted liquidity position, the credit quality and expected cash flows of the underlying assets collateralizing such securities, and current and anticipated market conditions. In determining the OTTI related to credit losses for securities that were purchased at significant discounts to par and/or are considered to be of less than high credit quality, we compare the present value of the remaining cash flows expected to be collected at the purchase date (or last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as management's estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that may be susceptible to significant change.

During 2017, we recognized credit-related OTTI losses through earnings related to our Non-Agency MBS of \$1.0 million. At December 31, 2017, we did not intend to sell any MBS that were in an unrealized loss position, and it is "more likely than not" that we will not be required to sell these MBS before recovery of their amortized cost basis,

which may be at their maturity.

Gross unrealized losses on our Agency MBS were \$43.1 million at December 31, 2017. Agency MBS are issued by GSEs and enjoy either the implicit or explicit backing of the full faith and credit of the U.S. Government. While our Agency MBS are not rated by any rating agency, they are currently perceived by market participants to be of high credit quality, with risk of default limited to the unlikely event that the U.S. Government would not continue to support the GSEs. Given the credit quality inherent in Agency MBS, we do not consider any of the current impairments on its Agency MBS to be credit related. In assessing whether it is more likely than not that we will be required to sell any impaired security before its anticipated recovery, which may be at its maturity, we consider for each impaired security, the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as our current and anticipated leverage capacity and liquidity position. Based on these analyses, we determined that at December 31, 2017 any unrealized losses on its Agency MBS were temporary.

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The payments of principal and interest we receive on our Agency MBS, which depend directly upon payments on the mortgages underlying such securities, are guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. Fannie Mae and Freddie Mac are GSEs, but their guarantees are not explicitly backed by the full faith and credit of the United States. Ginnie Mae is part of a U.S. Government agency and its guarantees are explicitly backed by the full faith and credit of the United States. We believe that the stronger backing for the guarantors of Agency MBS resulting from the conservatorship of Fannie Mae and Freddie Mac has further strengthened their credit worthiness; however, there can be no assurance that these actions will be adequate for their needs. Accordingly, if these government actions are inadequate and the GSEs suffer losses in the future or cease to exist, our view of the credit worthiness of our Agency MBS could materially change, which may affect our assessment of OTTI for Agency MBS in future periods. (See Part I, Item 1A., Risk Factors, “The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. Government, may materially adversely affect our business.”)

Gross unrealized losses on our Non-Agency MBS were \$453,000 at December 31, 2017. Based upon the most recent evaluation, we do not consider these unrealized losses to be indicative of OTTI and do not believe that these unrealized losses are credit related, but are rather a reflection of current market yields and/or marketplace bid-ask spreads. We have reviewed our Non-Agency MBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such securities, which considers recent bond performance and, where possible, expected future performance of the underlying collateral.

Our expectations with respect to our securities in an unrealized loss position may change over time, given, among other things, the dynamic nature of markets and other variables. Future sales or changes in our expectations with respect to securities in an unrealized loss position could result in us recognizing OTTI charges or realizing losses on sales of MBS in the future. (See Notes 2(b) and 3 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

Fair Value Measurements

A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of valuation hierarchy are defined as follows:

Level 1 — Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or 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 the fair value measurement.

The following describes the valuation methodologies used for our financial instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

The fair value of U.S. Treasury securities obtained as collateral and the associated obligation to return securities obtained as collateral are based upon prices obtained from a third-party pricing service, which are indicative of market activity. Securities obtained as collateral are classified as Level 1 in the fair value hierarchy.

MBS and CRT Securities

We determine the fair value of our Agency MBS, based upon prices obtained from third-party pricing services, which are indicative of market activity and repurchase agreement counterparties.

For Agency MBS, the valuation methodology of our third-party pricing services incorporate commonly used market pricing methods, trading activity observed in the marketplace and other data inputs. The methodology also considers the underlying characteristics of each security, which are also observable inputs, including: collateral vintage, coupon, maturity date, loan age, reset date, collateral type, periodic and life cap, geography, and prepayment speeds.

Management analyzes pricing data received from third-party pricing services and compares it to other indications of fair value including data received from repurchase agreement counterparties and its own observations of trading activity observed in the marketplace.

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In determining the fair value of our Non-Agency MBS and CRT securities, management considers a number of observable market data points, including prices obtained from pricing services and brokers as well as dialogue with market participants. In valuing Non-Agency MBS, we understand that pricing services use observable inputs that include, in addition to trading activity observed in the marketplace, loan delinquency data, credit enhancement levels and vintage, which are taken into account to assign pricing factors such as spread and prepayment assumptions. For tranches of Legacy Non-Agency MBS that are cross-collateralized, performance of all collateral groups involved in the tranche are considered. We collect and consider current market intelligence on all major markets, including benchmark security evaluations and bid-lists from various sources, when available.

Our Legacy Non-Agency MBS, RPL/NPL MBS and CRT securities are valued using various market data points as described above, which management considers directly or indirectly observable parameters. Accordingly, these securities are classified as Level 2 in the fair value hierarchy.

Term Notes Backed by MSR Related Collateral

Our valuation process for term notes backed by MSR related collateral considers a number of factors, including a comparable bond analysis performed by a third-party pricing service which involves determining a pricing spread at issuance of the term note. The pricing spread is used at each subsequent valuation date to determine an implied yield to maturity of the term note, which is used to derive an indicative market value for the security. This indicative market value is further reviewed by us and may be adjusted to ensure it reflects a realistic exit price at the valuation date given the structural features of these securities. At December 31, 2017, the indicative implied yields used in the valuation of these securities ranged from 5.8% to 6.6%. The weighted average indicative yield to maturity was 6.12%. Other factors taken into consideration include indicative values provided by repurchase agreement counterparties, estimated changes in fair value of the related underlying MSR collateral and the financial performance of the ultimate parent or sponsoring entity of the issuer, who has provided a guarantee that is intended to provide for payment of interest and principal to the holders of the term notes should cash flows generated by the related underlying MSR collateral be insufficient. As this process includes significant unobservable inputs, these securities are classified as Level 3 in the fair value hierarchy.

Residential Whole Loans, at Fair Value

We determine the fair value of our residential whole loans held at fair value after considering valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans trading activity observed in the marketplace. Our residential whole loans held at fair value are classified as Level 3 in the fair value hierarchy.

Swaps

As of December 31, 2017, all of our Swaps are cleared by a central clearing house. Valuations provided by the clearing house are used for purposes of determining the fair value of our Swaps. Such valuations obtained are tested with internally developed models that apply readily observable market parameters. As our Swaps are subject to the clearing house's margin requirements, no credit valuation adjustment was considered necessary in determining the fair value of such instruments. Beginning in January 2017, variation margin payments on our cleared Swaps are treated as a legal settlement of the exposure under the Swap contract. Previously such payments were treated as collateral pledged against the exposure under the Swap contract. The effect of this change is to reduce what would have otherwise been reported as fair value of the Swap. Swaps are classified as Level 2 in the fair value hierarchy.

Interest Income on our Non-Agency MBS

Interest income on the Non-Agency MBS that were purchased at a discount to par value and/or are considered to be of less than high credit quality is recognized based on the security's effective interest rate which is the security's IRR. The IRR is determined using management's estimate of the projected cash flows for each security, which are based on our observation of current information and events and include assumptions related to fluctuations in interest rates, prepayment speeds and the timing and amount of credit losses. On at least a quarterly basis, we review and, if appropriate, make adjustments to our cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the IRR/ interest income recognized on these securities or in the recognition of OTTIs.

Based on the projected cash flows from our Non-Agency MBS purchased at a discount to par value, a portion of the purchase discount may be designated as Credit Reserve, which effectively mitigates our risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The amount designated as Credit Reserve may be adjusted over

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time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a Credit Reserve is more favorable than forecasted, a portion of the amount designated as Credit Reserve may be reallocated to accretable discount and recognized into interest income over time. Conversely, if the performance of a security with a Credit Reserve is less favorable than forecasted, the amount designated as Credit Reserve may be increased, or impairment charges and write-downs of such securities to a new cost basis could result.

Residential Whole Loans

Residential whole loans included in our consolidated balance sheets are comprised of pools of fixed and adjustable rate residential mortgage loans acquired through consolidated trusts in secondary market transactions, with the majority at discounted purchase prices. The accounting model utilized by us is determined at the time each loan package is initially acquired and is generally based on the delinquency status of the majority of the underlying borrowers in the package at acquisition. The accounting model described below under “Residential Whole Loans at Carrying Value” is typically utilized by us for loans where the underlying borrower has a delinquency status of less than 60 days at the acquisition date. The accounting model described below under “Residential Whole Loans at Fair Value” is typically utilized by us for loans where the underlying borrower has a delinquency status of 60 days or more at the acquisition date. The accounting model initially applied is not subsequently changed.

Our residential whole loans pledged as collateral against repurchase agreements are included in the consolidated balance sheets with the amounts pledged disclosed parenthetically. Purchases and sales of residential whole loans are recorded on the trade date, with amounts recorded reflecting management’s current estimate of assets that will be acquired or disposed at the closing of the transaction. This estimate is subject to revision at the closing of the transaction, pending the outcome of due diligence performed prior to closing. Recorded amounts of residential whole loans for which the closing of the purchase transaction is yet to occur are not eligible to be pledged as collateral against any repurchase agreement financing until the closing of the purchase transaction.

Residential Whole Loans at Carrying Value

We have generally elected to account for these loans as credit impaired as they were acquired at discounted prices that reflect, in part, the impaired credit history of the borrower. Substantially all of the underlying borrowers have previously experienced payment delinquencies and the amount owed on the mortgage loan may exceed the value of the property pledged as collateral. Consequently, these loans generally have a higher likelihood of default than newly originated mortgage loans with LTVs of 80% or less to creditworthy borrowers. We believe that amounts paid to acquire these loans represent fair market value at the date of acquisition. Loans considered credit impaired are initially recorded at the purchase price with no allowance for loan losses. Subsequent to acquisition, the recorded amount for these loans reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received. These loans are presented on our consolidated balance sheets at carrying value, which reflects the recorded amount reduced by any allowance for loan losses established subsequent to acquisition.

Under the application of the accounting model for credit impaired loans, we may aggregate into pools loans acquired in the same fiscal quarter that are assessed as having similar risk characteristics. For each pool established, or on an individual loans basis for loans not aggregated into pools, we estimate at acquisition and periodically on at least a quarterly basis, the principal and interest cash flows expected to be collected. The difference between the cash flows expected to be collected and the carrying amount of the loans is referred to as the “accretable yield.” This amount is accreted as interest income over the life of the loans using an effective interest rate (level yield) methodology. Interest income recorded each period reflects the amount of accretable yield recognized and not the coupon interest payments received on the underlying loans. The difference between contractually required principal and interest payments and the cash flows expected to be collected is referred to as the “non-accretable difference,” and includes estimates of both

the effect of prepayments and expected credit losses over the life of the underlying loans.

A decrease in expected cash flows in subsequent periods may indicate impairment at the pool and/or individual loan level, thus requiring the establishment of an allowance for loan losses by a charge to the provision for loan losses. The allowance for loan losses generally represents the present value of cash flows expected at acquisition, adjusted for any increases due to changes in estimated cash flows, that are subsequently no longer expected to be received at the relevant measurement date. Under the accounting model applied to credit impaired loans, a significant increase in expected cash flows in subsequent periods first reduces any previously recognized allowance for loan losses and then will result in a recalculation in the amount of accretable yield. The adjustment of accretable yield due to a significant increase in expected cash flows is accounted for prospectively as a change in estimate and results in reclassification from nonaccretable difference to accretable yield.

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Residential Whole Loans at Fair Value

Certain of our residential whole loans are presented at fair value on our consolidated balance sheets as a result of a fair value election made at time of acquisition. For the majority of these loans, there is significant uncertainty associated with estimating the timing of and amount of cash flows that will be collected. Further, the cash flows ultimately collected may be dependent on the value of the property securing the loan. Consequently, we consider that accounting for these loans at fair value should result in a better reflection over time of the economic returns for the majority of these loans. We determine the fair value of our residential whole loans held at fair value after considering portfolio valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans and trading activity observed in the market place. Subsequent changes in fair value are reported in current period earnings and presented in Net gain on residential whole loans held at fair value on our consolidated statements of operations.

Cash received reflecting coupon payments on residential whole loans held at fair value is not included in Interest Income, but rather is presented in Net gain on residential whole loans held at fair value on our consolidated statements of operations. Cash outflows associated with loan related advances made by us on behalf of the borrower are included in the basis of the loan and are reflected in Net gain on residential whole loans held at fair value.

Hedging Activities

We may use a variety of derivative instruments to economically hedge a portion of our exposure to market risks, including interest rate risk and prepayment risk. The objective of our risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates. Our derivative instruments are currently comprised of Swaps, which are designated as cash flow hedges against the interest rate risk associated with our borrowings.

Our Swaps designated as hedging transactions have the effect of modifying the repricing characteristics of our repurchase agreements and cash flows for such liabilities. To date, no cost has been incurred at the inception of a Swap (except for certain transaction fees related to entering into Swaps cleared through a central clearing house), pursuant to which we agree to pay a fixed rate of interest and receive a variable interest rate, generally based on one-month or three-month LIBOR, on the notional amount of the Swap. We document our risk-management policies, including objectives and strategies, as they relate to our hedging activities and the relationship between the hedging instrument and the hedged liability for all Swaps designated as hedging transactions. We assess, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is “highly effective.”

Swaps are carried on our consolidated balance sheets at fair value, in Other assets, if their fair value is positive, or in Other liabilities, if their fair value is negative. Beginning in January 2017, variation margin payments on our Swaps that have been novated to a clearing house are treated as a legal settlement of the exposure under the Swap contract. Previously such payments were treated as collateral pledged against the exposure under the Swap contract. The effect of this change is to reduce what would have otherwise been reported as fair value of the Swap. Changes in the fair value of our Swaps designated in hedging transactions are recorded in OCI provided that the hedge remains effective. Changes in fair value for any ineffective amount of a Swap are recognized in earnings. We have not recognized any change in the value of our existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness.

We discontinue hedge accounting on a prospective basis and recognizes changes in fair value through earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a hedge is no longer appropriate.

As of December 31, 2017, all of our Swaps have been novated to a central clearing house.

Income Taxes

We believe that we operate in, and intend to continue to operate in, a manner that allows and will continue to allow us to be taxed as a REIT. Provided that we distribute all of our REIT taxable income (including net long-term capital gains) to stockholders in the timeframe permitted by the Code, we do not generally expect to pay corporate level taxes and/or excise taxes. However, such taxes may arise from time to time in the normal course of our business. Many of the REIT requirements, however, are highly technical and complex. In addition, REIT taxable income calculated at the time our financial statements are prepared is based on certain estimates that may be revised as our tax return, which is not required to be filed until October in the following year, is

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completed. If we were to fail to meet certain of the REIT requirements, we would be subject to U.S. federal, state and local income taxes.

In addition, we have elected to treat certain of our subsidiaries as a TRS. In general, a TRS may hold assets and engage in activities that we cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. Generally, a TRS is subject to U.S. federal, state and local corporate income taxes. Since a portion of our business may be conducted through one or more TRS, our income earned by TRS may be subject to corporate income taxation. To maintain our REIT election, no more than 20% of the value of our assets at the end of each calendar quarter may consist of stock or securities in TRS. For purposes of the determination of U. S. federal and state income taxes, our subsidiaries that elected to be treated as a TRS record current or deferred income taxes based on differences (both permanent and timing) between the determination of their taxable income and net income under GAAP. No deferred tax benefit was recorded by us in 2017 or 2016, as a valuation allowance for the full amount of the associated deferred tax asset was recognized as its recovery is not considered more likely than not.

Accounting for Equity-Based Compensation

We expense our equity-based compensation awards that are subject to vesting conditions, ratably over the vesting period of such awards, based upon the fair value of such awards at the grant date. For certain awards granted prior to January 1, 2017, compensation expense included the impact of estimated forfeitures, with any changes in estimated forfeiture rates accounted for as a change in estimate. Upon adoption of new accounting guidance that was effective for us on January 1, 2017, we made a policy election to account for forfeitures as they occur. (See Notes 2(m) and 13 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

From 2011 through 2013, we granted certain RSUs that vested annually over a one or three-year period, provided that certain criteria were met, which were based on a formula tied to our achievement of average total stockholder return during that three-year period. Starting in 2014, we have made annual grants of RSUs certain of which cliff vest after a three-year period and others of which cliff vest after a three-year period, subject to the achievement of certain performance criteria based on a formula tied to our achievement of average total stockholder return during that three-year period. The features in these awards related to the attainment of total stockholder return over a specified period constitute a “market condition” which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding the achievement of the market condition was reflected in the grant date fair valuation of the RSUs, which is recognized as compensation expense over the relevant vesting period. The amount of compensation expense recognized is not dependent on whether the market condition was or will be achieved.

We have awarded dividend equivalents in connection with our equity-based awards. Payments pursuant to dividend equivalents are generally charged to Stockholders’ Equity to the extent that the attached equity awards are expected to vest. Compensation expense is recognized for payments made for dividend equivalents to the extent that the attached equity awards do not or are not expected to vest and grantees are not required to return payments of dividends or dividend equivalents to us.

RECENT ACCOUNTING STANDARDS TO BE ADOPTED IN FUTURE PERIODS

Derivatives and Hedging - Targeted Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued Accounting Standards Update (or ASU) 2017-12, Targeted Improvements to Accounting for Hedging Activities (or ASU 2017-12). The amendments in this ASU expand an entity’s ability to hedge non-financial and financial risk components and reduce complexity in fair value hedges of interest rate risk. The

new guidance eliminates the requirement to separately measure and report hedge ineffectiveness and requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. ASU 2017-12 also simplifies certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. ASU 2017-12 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted in any interim period or fiscal year before the effective date. An entity should apply the amendments of this ASU to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach. The presentation and disclosure requirements of ASU 2017-12 should be applied prospectively. In addition, certain transition elections may be made by an entity upon adoption to allow for existing hedging relationships to transition to the newly allowable alternatives within this ASU. We are currently evaluating our adoption timing and the effect that ASU 2017-12 will have on our consolidated financial statements and related disclosures, but do not anticipate that adoption of the new standard would have a significant impact.

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Compensation - Stock Compensation - Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09, Scope of Modification Accounting (or ASU 2017-09). The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Pursuant to this ASU, an entity should account for the effects of a modification unless all of the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award date is modified. ASU 2017-09 is effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period for which financial statements have not yet been issued or made available for issuance. The amendments of this ASU should be applied prospectively to an award modified on or after the adoption date. We adopted the ASU on January 1, 2018 and its adoption did not have a significant impact on our financial position or financial statement disclosures.

Statement of Cash Flows - Restricted Cash

In November 2016, the FASB issued ASU 2016-18, Restricted Cash (or ASU 2016-18). ASU 2016-18 clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows with the objective of reducing the existing diversity in practice. The amendments in ASU 2016-18 require restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, provided that all of the amendments are adopted in the same period. The amendments of this ASU should generally be applied using a retrospective transition method to each period presented. We adopted ASU 2016-18 on January 1, 2018 and its adoption did not have a significant impact on our financial position or financial statement disclosures.

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments (or ASU 2016-15). The amendments in ASU 2016-15 provide guidance for eight specific cash flow classification issues, certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, provided that all of the amendments are adopted in the same period. The amendments of this ASU should generally be applied using a retrospective transition method to each period presented. We adopted ASU 2016-15 on January 1, 2018 and its adoption did not have a significant impact on our financial position or financial statement disclosures.

Financial Instruments - Credit Losses - Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, Measurements of Credit Losses on Financial Instruments (or ASU 2016-13). The amendments in ASU 2016-13 require entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Entities will now use forward-looking information to better inform their credit loss estimates. ASU 2016-13 also requires enhanced financial statement disclosures to help financial statement users better understand significant

estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. Under ASU 2016-13 credit losses for available-for-sale debt securities should be measured in a manner similar to current GAAP. However, the amendments in this ASU require that credit losses be recorded through an allowance for credit losses, which will allow subsequent reversals in credit loss estimates to be recognized in current income. In addition, the allowance on available-for-sale debt securities will be limited to the extent that the fair value is less than the amortized cost.

ASU 2016-13 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for all entities for annual periods beginning after December 15, 2018, and interim periods therein. The amendments in this ASU are required to be applied by recording a cumulative-effect adjustment to equity as of the beginning of the first reporting period in which the guidance is effective. A prospective transition approach is required for debt securities for which an OTTI had been recognized before the effective date. Based on our initial evaluation of the amendments in this ASU, we anticipate being required to make changes to the way we account for credit impairment losses on our available-for-sale debt securities. Under our current accounting, credit impairment losses are generally required to be

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recorded as OTTI, which directly reduce the carrying amount of impaired securities, and are recorded in earnings and are not reversed if expected cash flows subsequently recover. Under the new guidance, credit impairments on such securities will be recorded as an allowance for credit losses that are also recorded in earnings, but the allowance can be reversed through earnings in a subsequent period if expected cash flows subsequently recover. In addition, we expect that the new guidance will also result in changes to the accounting and presentation of our residential whole loans held at carrying value. We currently anticipate that upon adoption, the guidance will result in an increase in the gross carrying amount of our residential whole loans at carrying value by the amount of the allowance for loan losses calculated under the new guidance. Thereafter, changes in the expected cash flows of such assets are expected to result in the recognition (or reversal) of an allowance for loan losses that will impact earnings. We will continue to monitor and evaluate the potential effects that ASU 2016-13 will have on our consolidated financial statements and related disclosures.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases (or ASU 2016-02). The amendments in this ASU establish a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Our significant lease contracts are discussed in Note 10(a) of the accompanying consolidated financial statements included under Item 8 of this Annual Report on Form 10-K. While we continue to evaluate the potential impact that adoption of ASU 2016-02 will have on our financial reporting, given the relatively limited nature and extent of lease financing transactions that we have entered into, we do not expect that the adoption of ASU 2016-02 will have a significant impact on our financial position or financial statement disclosures.

Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (or ASU 2016-01). The amendments in this ASU affect all entities that hold financial assets or owe financial liabilities, and address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The classification and measurement guidance of investments in debt securities and loans are not affected by the amendments in this ASU. ASU 2016-01 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is not permitted for public business entities, except for a provision related to financial statements of fiscal years or interim periods that have not yet been issued, to recognize in other comprehensive income, the change in fair value of a liability resulting from a change in the instrument-specific credit risk measured using the fair value option. The amendments in this ASU are required to be applied by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. We adopted the ASU on January 1, 2018 and its adoption did not have a significant impact on our financial position or financial statement disclosures as the classification and measurement of our investments in debt securities and loans were not affected by the amendments in this ASU.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (or ASU 2014-09). The ASU requires an entity to recognize revenue in an amount that reflects the consideration to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 originally would have been effective for

public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. On April 29, 2015, the FASB proposed a one-year deferral of the effective date for ASU 2014-09. On July 9, 2015 the FASB affirmed its proposal to defer the effective date of the new revenue standard for all entities by one year. As a result, public entities would apply the new revenue standard to annual reporting periods beginning after December 15, 2017 and interim periods therein. The FASB also permitted entities to adopt the standard early, but not before the original public entity effective date. We adopted the ASU on January 1, 2018 and its adoption did not have a material impact on our financial position or financial statement disclosures as the majority of our revenues are generated by financial instruments that are explicitly scoped out of this ASU.

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LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of cash generally consist of borrowings under repurchase agreements and other collateralized financings, payments of principal and interest we receive on our investment portfolio, cash generated from our operating results and, to the extent such transactions are entered into, proceeds from capital market and structured financing transactions. Our most significant uses of cash are generally to pay principal and interest on our financing transactions, to purchase residential mortgage assets, to make dividend payments on our capital stock, to fund our operations and to make other investments that we consider appropriate.

We seek to employ a diverse capital raising strategy under which we may issue capital stock and other types of securities. To the extent we raise additional funds through capital market transactions, we currently anticipate using the net proceeds from such transactions to acquire additional residential mortgage-related assets, consistent with our investment policy, and for working capital, which may include, among other things, the repayment of our financing transactions. There can be no assurance, however, that we will be able to access the capital markets at any particular time or on any particular terms. We have available for issuance an unlimited amount (subject to the terms and limitations of our charter) of common stock, preferred stock, depositary shares representing preferred stock, warrants, debt securities, rights and/or units pursuant to our automatic shelf registration statement and, at December 31, 2017, we had 12.0 million shares of common stock available for issuance pursuant to our DRSPS shelf registration statement. During 2017, we issued 2,293,192 shares of common stock through our DRSPS, raising net proceeds of approximately \$18.5 million. On May 10, 2017, we closed on the sale of 23,000,000 shares of common stock, including 3,000,000 shares purchased pursuant to the exercise of the underwriters' option to purchase additional shares, for gross proceeds of approximately \$178.7 million before deducting estimated offering expenses.

Our borrowings under repurchase agreements are uncommitted and renewable at the discretion of our lenders and, as such, our lenders could determine to reduce or terminate our access to future borrowings at virtually any time. The terms of the repurchase transaction borrowings under our master repurchase agreements, as such terms relate to repayment, margin requirements and the segregation of all securities that are the subject of repurchase transactions, generally conform to the terms contained in the standard master repurchase agreement published by the Securities Industry and Financial Markets Association (or SIFMA) or the global master repurchase agreement published by SIFMA and the International Capital Market Association. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions, which differ by lender, may include changes to the margin maintenance requirements, required haircuts (as defined below), purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default and setoff provisions.

With respect to margin maintenance requirements for repurchase agreements secured by harder to value assets, such as Non-Agency MBS and residential whole loans, margin calls are typically determined by our counterparties based on their assessment of changes in the fair value of the underlying collateral and in accordance with the agreed upon haircuts specified in the transaction confirmation with the counterparty. We address margin call requests in accordance with the required terms specified in the applicable repurchase agreement and such requests are typically satisfied by posting additional cash or collateral on the same business day. We review margin calls made by counterparties and assess them for reasonableness by comparing the counterparty valuation against our valuation determination. When we believe that a margin call is unnecessary because our assessment of collateral value differs from the counterparty valuation, we typically hold discussions with the counterparty and are able to resolve the matter. In the unlikely event that resolution cannot be reached, we will look to resolve the dispute based on the remedies available to us under the terms of the repurchase agreement, which in some instances may include the engagement of a third party to review collateral valuations. For other agreements that do not include such provisions, we could resolve the matter by substituting collateral as permitted in accordance with the agreement or otherwise request the counterparty to return the collateral in exchange for cash to unwind the financing.

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The following table presents information regarding the margin requirements, or the percentage amount by which the collateral value is contractually required to exceed the loan amount (this difference is referred to as the “haircut”), on our repurchase agreements at December 31, 2017 and 2016:

At December 31, 2017	Weighted		
	Average	Low	High
	Haircut		
Repurchase agreement borrowings secured by:			
Agency MBS	4.65 %	3.00 %	8.00 %
Legacy Non-Agency MBS	21.87	15.00	35.00
RPL/NPL MBS	22.05	20.00	27.50
U.S. Treasury securities	1.47	1.00	2.00
CRT securities	22.16	15.00	25.00
MSR related assets	33.19	30.00	50.00
Residential whole loans	26.10	20.00	35.00

At December 31, 2016	Weighted		
	Average	Low	High
	Haircut		
Repurchase agreement borrowings secured by:			
Agency MBS	4.67 %	3.00 %	6.00 %
Legacy Non-Agency MBS	24.01	15.00	60.00
RPL/NPL MBS	20.98	15.00	30.00
U.S. Treasury securities	1.60	1.00	2.00
CRT securities	23.22	20.00	25.00
MSR related assets	41.40	35.00	50.00
Residential whole loans	25.03	20.00	35.00

Over the course of 2017, the weighted average haircut requirements for the respective underlying collateral types for our repurchase agreements have remained fairly consistent compared to the end of 2016. Weighted average haircuts have decreased on MSR related assets, Legacy Non-Agency MBS and CRT securities and have increased on Residential whole loans and RPL/NPL MBS.

Repurchase agreement funding for our residential mortgage investments has been available to us at generally attractive market terms from multiple counterparties. Typically, due to the risks inherent in credit sensitive residential mortgage investments, repurchase agreement funding involving such investments is available at terms requiring higher collateralization and higher interest rates, than repurchase agreement funding secured by Agency MBS and U.S. Treasury securities. Therefore, we generally expect to be able to finance our acquisitions of Agency MBS on more favorable terms than financing for credit sensitive investments.

We maintain cash and cash equivalents, unpledged Agency and Non-Agency MBS and collateral in excess of margin requirements held by our counterparties (or collectively, “cash and other unpledged collateral”) to meet routine margin calls and protect against unforeseen reductions in our borrowing capabilities. Our ability to meet future margin calls will be impacted by our ability to use cash or obtain financing from unpledged collateral, which can vary based on the market value of such collateral, our cash position and margin requirements. Our cash position fluctuates based on the timing of our operating, investing and financing activities and is managed based on our anticipated cash needs. (See “Interest Rate Risk” included under Item 7A. of this Annual Report on Form 10-K and our Consolidated Statements of Cash Flows, included under Item 8 of this Annual Report on Form 10-K.)

At December 31, 2017, we had a total of \$8.1 billion of MBS, U.S. Treasury securities, CRT securities, residential whole loans and MSR related assets and \$13.3 million of restricted cash pledged against our repurchase agreements and Swaps. At December 31, 2017 we have access to various sources of liquidity which we estimate exceeds \$1.1 billion. This includes (i) \$449.8 million of cash and cash equivalents; (ii) \$170.2 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$452.1 million in estimated financing available from unpledged Non-Agency MBS and from other Non-Agency MBS and CRT collateral that is currently pledged in excess of contractual requirements. Our sources of liquidity do not include restricted cash.

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The table below presents certain information about our borrowings under repurchase agreements and other advances, and securitized debt:

	Repurchase Agreements and Other Advances	Securitized Debt (1)
Quarter Ended (2)		