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

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

FORM 10-Q

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

EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2018

OR

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

FOR THE TRANSITION PERIOD FROM _______________ TO _________________

COMMISSION FILE NUMBER: 1-13447

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

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

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

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

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at July 31, 2018
Common Stock, $.01 par value	1,166,658,384

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

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

	June 30, 2018 (Unaudited)	December 31, 2017 [1]
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $1,042,671 and $579,213, respectively) [2]	$1,135,329	$706,589
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of $80,997,975 and $83,628,132, respectively)	86,593,058	90,551,763
Credit risk transfer securities (including pledged assets of $417,403 and $363,944, respectively)	563,796	651,764
Non-Agency mortgage-backed securities (including pledged assets of $435,877 and $516,078, respectively) [3]	1,006,785	1,097,294
Residential mortgage loans (including pledged assets of $1,608,935 and $1,169,496, respectively) [4]	1,666,157	1,438,322
Mortgage servicing rights (including pledged assets of $4,164 and $5,224, respectively)	599,014	580,860
Commercial real estate debt investments (including pledged assets of $2,733,405 and $3,070,993, respectively) [5]	2,857,463	3,089,108
Commercial real estate debt and preferred equity, held for investment (including pledged assets of $652,897 and $520,329, respectively)	1,251,138	1,029,327
Loans held for sale, net	42,458	—
Investments in commercial real estate	477,887	485,953
Corporate debt (including pledged assets of $642,016 and $600,049, respectively)	1,256,276	1,011,275
Interest rate swaps, at fair value	82,458	30,272
Other derivatives, at fair value	129,680	283,613
Reverse repurchase agreements	259,762	—
Receivable for investments sold	21,728	1,232
Accrued interest and dividends receivable	323,769	323,526
Other assets	475,230	384,117
Goodwill	71,815	71,815
Intangible assets, net	19,194	23,220
Total assets	$98,832,997	$101,760,050
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$75,760,655	$77,696,343
Other secured financing	3,760,487	3,837,528
Securitized debt of consolidated VIEs [6]	2,728,692	2,971,771
Mortgages payable	309,878	309,686
Interest rate swaps, at fair value	376,106	569,129
Other derivatives, at fair value	117,931	38,725
Dividends payable	349,300	347,876

Payable for investments purchased	1,108,834	656,581
Accrued interest payable	478,439	253,068
Accounts payable and other liabilities	68,819	207,770
Total liabilities	85,059,141	86,888,477
Stockholders’ Equity:		
7.625% Series C Cumulative Redeemable Preferred Stock: 12,000,000 authorized, 7,000,000 and 12,000,0000 issued and outstanding, respectively	169,466	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock: 11,500,000 authorized, 0 and 11,500,000 issued and outstanding, respectively	—	287,500
6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock: 28,800,000 authorized, issued and outstanding	696,910	696,910
6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock: 19,550,000 and 0 authorized, 17,000,000 and 0 issued, and outstanding, respectively	411,335	—
Common stock, par value $0.01 per share, 1,909,750,000 and 1,929,300,000 authorized, 1,164,333,831 and 1,159,585,078 issued and outstanding, respectively	11,643	11,596
Additional paid-in capital	17,268,596	17,221,265
Accumulated other comprehensive income (loss)	(3,434,447)	(1,126,020)
Accumulated deficit	(1,800,370)	(2,961,749)
Total stockholders’ equity	13,768,590	14,865,473
Noncontrolling interest	5,266	6,100
Total equity	13,773,856	14,871,573
Total liabilities and equity	$98,832,997	$101,760,050

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

(2) Includes cash of consolidated Variable Interest Entities (“VIEs”) of $32.4 million and $42.3 million at June 30, 2018 and December 31, 2017, respectively.

(3) Excludes $57.7 million and $66.3 million at June 30, 2018 and December 31, 2017, respectively, of non-Agency mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company’s Consolidated Statements of Financial Condition.

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(4) Includes securitized residential mortgage loans transferred or pledged to a consolidated VIE carried at fair value of $523.0 million and $478.8 million at June 30, 2018 and December 31, 2017, respectively.

(5) Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $2.5 billion and $2.8 billion at June 30, 2018 and December 31, 2017, respectively. Excludes $182.5 million at June 30, 2018 of commercial mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

(6) Includes securitized debt of consolidated VIEs carried at fair value of $2.7 billion and $3.0 billion at June 30, 2018 and December 31, 2017, respectively.

See notes to consolidated financial statements.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net interest income:				
Interest income	$776,806	$ 537,426	$1,656,293	$ 1,125,153
Interest expense	442,692	222,281	810,113	420,706
Net interest income	334,114	315,145	846,180	704,447
Realized and unrealized gains (losses):				
Net interest component of interest rate swaps	31,475	(96,470)	(16,685)	(200,626)
Realized gains (losses) on termination or maturity of interest rate swaps	—	(58)	834	(58)
Unrealized gains (losses) on interest rate swaps	343,475	(177,567)	1,320,760	(28,383)
Subtotal	374,950	(274,095)	1,304,909	(229,067)
Net gains (losses) on disposal of investments	(66,117)	(5,516)	(52,649)	(281)
Net gains (losses) on other derivatives	34,189	(14,423)	(12,956)	(14,104)
Net unrealized gains (losses) on instruments measured at fair value through earnings	(48,376)	16,240	(99,969)	39,923
Subtotal	(80,304)	(3,699)	(165,574)	25,538
Total realized and unrealized gains (losses)	294,646	(277,794)	1,139,335	(203,529)
Other income (loss):				
Other income (loss)	34,170	30,865	68,193	62,511
Total other income (loss)	34,170	30,865	68,193	62,511
General and administrative expenses:				
Compensation and management fee	45,579	38,938	90,108	78,200
Other general and administrative expenses	18,202	15,085	36,183	29,651
Total general and administrative expenses	63,781	54,023	126,291	107,851
Income (loss) before income taxes	599,149	14,193	1,927,417	455,578
Income taxes	3,262	(329)	3,826	648
Net income (loss)	595,887	14,522	1,923,591	454,930
Net income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Net income (loss) attributable to Annaly	595,919	14,624	1,923,719	455,135
Dividends on preferred stock	31,377	23,473	65,143	46,946
Net income (loss) available (related) to common stockholders	$564,542	$ (8,849)	$1,858,576	$ 408,189
Net income (loss) per share available (related) to common stockholders:				
Basic	$0.49	$ (0.01)	$1.60	$ 0.40
Diluted	$0.49	$ (0.01)	$1.60	$ 0.40
Weighted average number of common shares outstanding:				
Basic	1,160,436,777	1,019,000,817	1,160,029,575	1,018,971,942
Diluted	1,160,979,415	1,019,000,817	1,160,543,580	1,019,357,697
Dividends declared per share of common stock	$0.30	$ 0.30	$0.60	$ 0.60
Net income (loss)	$595,887	$ 14,522	$1,923,591	$ 454,930
Other comprehensive income (loss):				

Unrealized gains (losses) on available-for-sale securities	(505,130)	261,964	(2,384,609)	202,349
Reclassification adjustment for net (gains) losses included in net income (loss)	70,763	13,360	76,182	32,777
Other comprehensive income (loss)	(434,367)	275,324	(2,308,427)	235,126
Comprehensive income (loss)	161,520	289,846	(384,836)	690,056
Comprehensive income (loss) attributable to noncontrolling interest	(32)	(102)	(128)	(205)
Comprehensive income (loss) attributable to Annaly	161,552	289,948	(384,708)	690,261
Dividends on preferred stock	31,377	23,473	65,143	46,946
Comprehensive income (loss) attributable to common stockholders	$130,175	$ 266,475	$(449,851)	$643,315

See notes to consolidated financial statements.

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2018 and 2017
(dollars in thousands, except per share data)
(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	7.625% Series E Cumulative Redeemable Preferred Stock	6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit
BALANCE, December 31, 2016	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,189	$15,579,342	$(1,085,893)	$(3,136,01
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	455,135
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	202,349	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	32,777	—
Stock compensation expense	—	—	—	—	—	—	—	1,149	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	1,269	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
	—	—	—	—	—	—	—	—	—	(7,296

Preferred Series A dividends, declared $0.984 per share										
Preferred Series C dividends, declared $0.953 per share	—	—	—	—	—	—	—	—	—	(11,438
Preferred Series D dividends, declared $0.938 per share	—	—	—	—	—	—	—	—	—	(17,250
Preferred Series E dividends, declared $0.953 per share	—	—	—	—	—	—	—	—	—	(10,962
Common dividends declared, $0.60 per share	—	—	—	—	—	—	—	—	—	(611,400
BALANCE, June 30, 2017	$177,088	$290,514	$445,457	$287,500	$—	$—	$10,190	$15,581,760	$(850,767)	$(3,339,22
BALANCE, December 31, 2017	$—	$290,514	$445,457	$287,500	$696,910	$—	$11,596	$17,221,265	$(1,126,020)	$(2,961,74
Net income (loss) attributable to Annaly	—	—	—	—	—	—	—	—	—	1,923,719
Net income (loss) attributable to noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Unrealized gains (losses) on available-for-sale securities	—	—	—	—	—	—	—	—	(2,384,609)	—
Reclassification adjustment for net (gains) losses included in net income (loss)	—	—	—	—	—	—	—	—	76,182	—
Stock compensation expense	—	—	—	—	—	—	—	1,621	—	—
Redemption of Preferred Stock	—	(121,048)	—	(287,500)	—	—	—	(3,952)	—	—
Net proceeds from direct purchase and dividend reinvestment	—	—	—	—	—	—	1	1,545	—	—

Net proceeds from issuance of common stock	—	—	—	—	—	—	46	48,117	—	—
Net proceeds from issuance of preferred stock	—	—	—	—	—	411,335	—	—	—	—
Equity contributions from (distributions to) noncontrolling interest	—	—	—	—	—	—	—	—	—	—
Preferred Series C dividends, declared $0.953 per share [(1)]	—	—	—	—	—	—	—	—	—	(7,652
Preferred Series D dividends, declared $0.938 per share	—	—	—	—	—	—	—	—	—	(17,250
Preferred Series E dividends, declared $0.196 per share	—	—	—	—	—	—	—	—	—	(2,253
Preferred Series F dividends, declared $0.869 per share	—	—	—	—	—	—	—	—	—	(25,020
Preferred Series G dividends, declared $0.763 per share	—	—	—	—	—	—	—	—	—	(12,968
Common dividends declared, $0.60 per share	—	—	—	—	—	—	—	—	—	(697,197
BALANCE, June 30, 2018	$—	$169,466	$445,457	$—	$696,910	$411,335	$11,643	$17,268,596	$(3,434,447)	$(1,800,37

(1) Represents dividends declared per share for shares outstanding at June 30, 2018.

See notes to consolidated financial statements.

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

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

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$1,923,591	$454,930
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of premiums and discounts of investments, net	289,693	450,031
Amortization of securitized debt premiums and discounts and deferred financing costs	(202)	789
Depreciation, amortization and other noncash expenses	12,907	14,846
Net (gains) losses on disposals of investments	52,649	281
Net (gains) losses on investments and derivatives	(1,207,835)	2,564
Income from unconsolidated joint ventures	5,067	1,651
Payments on purchases of loans held for sale	(110,350)	(69,093)
Proceeds of sales and repayments of loans held for sale	46,721	176,921
Net payments on derivatives	1,286,408	(797,580)
Net change in:		
Other assets	(98,456)	(65,053)
Accrued interest and dividends receivable	759	8,475
Accrued interest payable	225,371	22,707
Accounts payable and other liabilities	(136,273)	(88,818)
Net cash provided by (used in) operating activities	$2,290,050	$112,651
Cash flows from investing activities:		
Payments on purchases of Residential Investment Securities	$(7,309,307)	$(7,682,326)
Proceeds from sales of Residential Investment Securities	3,365,971	4,629,227
Principal payments on Residential Investment Securities	5,664,811	5,846,683
Purchase of MSRs	(381)	(10,000)
Payments on purchases of corporate debt	(464,496)	(252,452)
Principal payments on corporate debt	226,723	254,318
Originations and purchases of commercial real estate related assets	(358,179)	(169,001)
Proceeds from sales on commercial real estate related assets	28,079	11,960
Principal repayments on commercial real estate related assets	395,325	589,499
Proceeds from reverse repurchase agreements	41,248,786	38,955,000
Payments on reverse repurchase agreements	(41,508,548)	(38,955,000)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	4,133	4,227
Payments on purchases of residential mortgage loans held for investment	(373,051)	(512,146)
Proceeds from repayments from residential mortgage loans held for investment	153,722	85,643
Payments on purchases of equity securities	—	(2,104)
Net cash provided by (used in) investing activities	$1,073,588	$2,793,528
Cash flows from financing activities:		
Proceeds from repurchase agreements and other secured financing	$2,727,664,289	$1,613,527,631
Principal payments on repurchase agreements and other secured financing	(2,729,676,977)	(1,616,345,278)
Proceeds from issuance of securitized debt	279,203	—

Principal repayments on securitized debt	(488,335)	(255,927)
Payment of deferred financing cost	—	(1,079)
Net proceeds from stock offerings, direct purchases and dividend reinvestments	461,044	1,270
Redemption of preferred stock	(412,500)	—
Principal payments on participation sold	—	(12,827)
Principal payments on mortgages payable	—	(36)
Net contributions/(distributions) from/(to) noncontrolling interests	(706)	(676)
Dividends paid	(760,916)	(658,311)
Net cash provided by (used in) financing activities	$(2,934,898)	$(3,745,233)
Net (decrease) increase in cash and cash equivalents	$428,740	$(839,054)
Cash and cash equivalents including cash pledged as collateral, beginning of period	706,589	1,539,746
Cash and cash equivalents including cash pledged as collateral, end of period	$1,135,329	$700,692
Supplemental disclosure of cash flow information:		
Interest received	$1,879,931	$1,582,650
Dividends received	$3,355	$2,511
Interest paid (excluding interest paid on interest rate swaps)	$740,186	$454,110
Net interest paid (received) on interest rate swaps	$(141,772)	$195,973
Taxes paid	$136	$1,336
Noncash investing activities:		
Receivable for investments sold	$21,728	$9,784
Payable for investments purchased	$1,108,834	$1,043,379
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$(2,308,427)	$235,126
Noncash financing activities:		
Dividends declared, not yet paid	$349,300	$305,709

See notes to consolidated financial statements.

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

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

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1. DESCRIPTION OF BUSINESS

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

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

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

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

Pending Acquisition of MTGE Investment Corp.

As previously disclosed in a Form 8-K filed with the SEC on May 3, 2018 (the "Merger 8-K"), on May 2, 2018, the Company, Mountain Merger Sub Corporation, a wholly-owned subsidiary of the Company ("Purchaser"), and MTGE Investment Corp. ("MTGE") entered into an agreement and plan of merger (the "Merger Agreement"), pursuant to which, subject to the terms and conditions contained therein, the Company agreed to acquire MTGE (the "MTGE Acquisition"), an externally managed hybrid mortgage REIT,

for aggregate consideration to MTGE common shareholders of approximately $900.0 million based on the closing price of the Company's common stock on April 30, 2018. Approximately 50% of such consideration will be payable in shares of the Company's common stock, and approximately 50% will be payable in cash. On May 16, 2018, Purchaser commenced an exchange offer (the "Offer") to purchase all of MTGE's issued and outstanding shares of common stock and, upon the closing of the Offer, subject to customary closing conditions as set forth in the Merger Agreement, MTGE will be merged with and into Purchaser (the "Merger"), with Purchaser surviving the Merger. In addition, as part of the MTGE Acquisition, each share of MTGE 8.125% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share (each, a "MTGE Preferred Share"), that is outstanding as of immediately prior to the completion of the MTGE Acquisition will be converted into one share of a newly-designated series of the Company's preferred stock, par value $0.01 per share, which the Company expects will be classified and designated as 8.125% Series H Cumulative Redeemable Preferred Stock, and which will have rights, preferences, privileges and voting powers substantially the same as a MTGE Preferred Share.

The closing of the MTGE Acquisition is subject to a number of conditions, including the receipt of specified regulatory approvals.

Prior to closing the MTGE Acquisition, MTGE will declare a prorated common dividend to its stockholders with a record date on the fourth business day prior to the completion of the Offer, and payable upon the date of the completion of the Offer. In addition, the Company expects to declare and pay a prorated common dividend to its stockholders, with a record date on the last business day prior to the completion of the Offer. Each of the dividends will be prorated based on the number of days that elapsed since the record date for the most recent quarterly dividend paid to MTGE's and the Company's stockholders, respectively, and the amount of such prior quarterly dividend, as applicable.

The MTGE Acquisition is expected to be completed during the third quarter of 2018.

For additional details regarding the terms and conditions of the Merger Agreement and related matters, please refer to the Merger Agreement and the Merger 8-K and the other documentation filed as exhibits thereto. Additional information regarding the transactions contemplated by the Merger Agreement, including associated risks, is contained in a registration statement on Form S-4 that the Company filed with the SEC in connection with the MTGE Acquisition.

2. BASIS OF PRESENTATION

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

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2017 has been derived from audited consolidated financial statements included in the Company’s annual report on Form 10-K for the fiscal year ended December 31, 2017.

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

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

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

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

is deemed to have the power to direct the activities of the VIE.

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

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

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

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. In accordance with a clearing organization's rulebook, the Company presents the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. At June 30, 2018, $1.2 billion of variation margin was reported as a reduction to interest rate swaps, at fair value. Arcola Securities, Inc. (formerly RCap Securities, Inc.), the Company's wholly-owned broker-dealer ("Arcola") is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled $1.0 billion and $579.2 million at June 30, 2018 and December 31, 2017, respectively.

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

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

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

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

The Company elected the fair value option for interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities as this election simplifies the accounting. Interest-only securities

and inverse interest-only securities are collectively referred to as "interest-only securities." These interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific mortgage-backed securities. Interest-only mortgage-backed securities, non-Agency mortgage-backed securities, reverse mortgages and CRT securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on instruments measured at fair value through earnings in the Company's Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.
The Company recognizes coupon income, which is a component of interest income, based upon the outstanding principal amounts of the Residential Investment Securities and their contractual terms. In addition, the Company amortizes or accretes premiums or discounts into interest income for its Agency mortgage-backed securities (other than multifamily securities), taking into account estimates of future principal prepayments in the calculation of the effective yield. The Company recalculates the effective yield as differences between anticipated and actual prepayments occur. Using third-party model and market information to project future cash flows and expected remaining lives of securities, the effective interest rate determined for each security is applied as if it had been in place

from the date of the security's acquisition. The amortized cost of the security is then adjusted to the amount that would have existed had the new effective yield been applied since the acquisition date, which results in a cumulative premium amortization adjustment in each period. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

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

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

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

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

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

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

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

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

There was no real estate acquired in settlement of residential mortgage loans at June 30, 2018 or December 31, 2017 other than real estate held by securitization trusts that the Company was required to consolidate. The Company would be considered to have received physical possession of residential real estate property collateralizing a residential mortgage loan, so that the loan is derecognized and the real estate property would be recognized, if either (i) the Company obtains legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveys all interest in the residential real estate property to the Company to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

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

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

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

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

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

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

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

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

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

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

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

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

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

by which the carrying amount of goodwill exceeds its fair value.
Finite life intangible assets are amortized over their expected useful lives.

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

The Company enters into reverse repurchase agreements to earn a yield on excess cash balances. The Company obtains collateral in connection with the reverse repurchase agreements in order to mitigate credit risk exposure to its counterparties.

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

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

Income Taxes – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not incur federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including Arcola and certain subsidiaries of ACREG and Hatteras Financial Corp., have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries ("TRSs"). As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.
The provisions of ASC 740, Income Taxes ("ASC 740"), clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any

unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were deemed necessary at June 30, 2018 and December 31, 2017.

Commercial Real Estate Investments

Commercial Real Estate Debt Investments – The Company's commercial real estate debt investments are comprised of commercial mortgage-backed securities and loans held by consolidated collateralized financing entities. Certain commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss). Management evaluates such commercial mortgage-backed securities for other-than-temporary impairment at least quarterly. The Company elected the fair value option on certain commercial mortgage-backed securities, including conduit commercial mortgage-backed securities, to simplify the accounting where the unrealized gains and losses on these financial instruments are recorded through earnings. See the "Commercial Real Estate Investments" Note for additional information regarding the consolidated collateralized financing entities.

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

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

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

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

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

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

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

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

The Company’s real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property’s value is considered impaired if the Company’s estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company

considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.

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

Corporate Debt
Corporate Loans – The Company’s investments in corporate loans are designated as held for investment when the Company has the intent and ability to hold the investment until maturity or payoff. These investments are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. Interest income

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

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

Impairment of Securities and Loans

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

When the fair value of an available-for-sale security is less than its amortized cost, the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of Other comprehensive income (loss). If the fair value is less than the cost of a held-to-maturity security, the Company performs an analysis to determine whether it expects to recover the entire cost basis of the security. There was no other-than-temporary impairment recognized for the three and six months ended June 30, 2018 and 2017.

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

other risks associated with each investment. The Company's investment underwriting procedures include evaluation of the underlying borrowers' ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics at origination or acquisition of a new investment and if events occur that trigger re-evaluation by management.

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

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

Nonaccrual Status – If collection of a loan’s principal or interest is in doubt or the loan is 90 days or more past due, interest income is not accrued. For nonaccrual status loans carried at fair value or held for sale, interest is not accrued, but is recognized on a cash basis. For nonaccrual status loans carried at amortized cost, if collection of principal is not in doubt, but collection of interest is in doubt, interest income is recognized on a cash basis. If collection of principal is in doubt, any interest received is applied against principal until collectability of the remaining balance is no longer in doubt; at that point, any interest income is recognized on a cash basis. Generally, a loan is returned to accrual status when the borrower has resumed paying the full amount of the scheduled contractual obligation, if all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period of time and there is a sustained period of repayment performance by the borrower. The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing at June 30, 2018 and December 31, 2017. There were no allowances for loan losses at June 30, 2018 or December 31, 2017.

Broker Dealer Activities

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

Recent Accounting Pronouncements

The Company considers the applicability and impact of all Accounting Standards Updates ("ASUs"). ASUs not listed below were not applicable, not expected to have a significant

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

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

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

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

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4. FINANCIAL INSTRUMENTS

The following table presents characteristics for certain of the Company's financial instruments at June 30, 2018 and December 31, 2017.

Financial Instruments [(1)]

Balance Sheet Location	Form	Measurement Basis	June 30, 2018	December 31, 2017
Assets		(dollars in thousands)		
Agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through other comprehensive income	$85,593,158	$89,426,437
Agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through earnings	999,900	1,125,326
Total agency mortgage-backed securities			86,593,058	90,551,763
Credit risk transfer securities	Securities	Fair value, with unrealized gains (losses) through earnings	563,796	651,764
Non-agency mortgage-backed securities	Securities	Fair value, with unrealized gains (losses) through earnings	1,006,785	1,097,294
Residential mortgage loans	Loans	Fair value, with unrealized gains (losses) through earnings	1,666,157	1,438,322
Commercial real estate debt investments	Loans	Fair value, with unrealized gains (losses) through earnings	2,542,413	2,826,357
Commercial real estate debt investments	Securities	Fair value, with unrealized gains (losses) through other comprehensive income	204,319	244,636
Commercial real estate debt investments	Securities	Fair value, with unrealized gains (losses) through earnings	110,731	18,115
Total commercial real estate debt investments			2,857,463	3,089,108
Commercial real estate debt and preferred equity, held for investment	Loans	Amortized cost	1,251,138	1,029,327
Loans held for sale, net	Loans	Lower of amortized cost or fair value	42,458	—
Corporate debt	Loans	Amortized cost	1,256,276	1,011,275
Reverse repurchase agreements	Reverse repurchase agreements	Amortized cost	259,762	—
Liabilities				
Repurchase agreements	Repurchase agreements	Amortized cost	75,760,655	77,696,343
Other secured financing	Loans	Amortized cost	3,760,487	3,837,528
Securitized debt of consolidated VIEs	Securities	Fair value, with unrealized gains (losses) through earnings	2,728,692	2,971,771
Mortgages payable	Loans	Amortized cost	309,878	309,686

(1) Receivable for investments sold, Accrued interest and dividends receivable, Dividends payable, Payable for investments purchased and Accrued interest payable are accounted for at cost.

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5. RESIDENTIAL INVESTMENT SECURITIES

The following tables present the Company's Residential Investment Securities portfolio that was carried at their fair value at June 30, 2018 and December 31, 2017:

	June 30, 2018						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$77,646,763	$4,442,937	$(1,556)	$82,088,144	$43,095	$(3,309,253)	$78,821,986
Adjustable-rate pass-through	5,847,337	277,049	(1,100)	6,123,286	10,478	(156,983)	5,976,781
Interest-only	6,537,051	1,273,388	—	1,273,388	2,447	(315,482)	960,353
Multifamily	816,976	4,872	(7,237)	814,611	1,065	(21,285)	794,391
Reverse mortgages	35,392	4,341	—	39,733	33	(219)	39,547
Total Agency investments	$90,883,519	$6,002,587	$(9,893)	$90,339,162	$57,118	$(3,803,222)	$86,593,058
Residential Credit							
CRT	$528,869	$18,234	$(1,079)	$546,024	$18,429	$(657)	$563,796
Alt-A	191,939	378	(32,845)	159,472	11,539	(89)	170,922
Prime	270,226	1,926	(23,127)	249,025	15,588	(122)	264,491
Subprime	449,644	1,827	(71,425)	380,046	46,511	(108)	426,449
NPL/RPL	3,431	—	(44)	3,387	60	—	3,447
Prime Jumbo (>= 2010 Vintage)	130,544	598	(4,113)	127,029	107	(2,995)	124,141
Prime Jumbo (>= 2010 Vintage) Interest-Only	910,065	13,731	—	13,731	3,616	(12)	17,335
Total residential credit investments	$2,484,718	$36,694	$(132,633)	$1,478,714	$95,850	$(3,983)	$1,570,581
Total Residential Investment Securities	$93,368,237	$6,039,281	$(142,526)	$91,817,876	$152,968	$(3,807,205)	$88,163,639

	December 31, 2017						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$78,509,335	$4,514,815	$(1,750)	$83,022,400	$140,115	$(1,178,673)	$81,983,842
Adjustable-rate pass-through	6,760,991	277,212	(1,952)	7,036,251	15,776	(103,121)	6,948,906
Interest-only	6,804,715	1,326,761	—	1,326,761	1,863	(242,862)	1,085,762
Multifamily	490,753	5,038	(341)	495,450	84	(1,845)	493,689
Reverse mortgages	35,000	4,527	—	39,527	37	—	39,564
Total Agency investments	$92,600,794	$6,128,353	$(4,043)	$91,920,389	$157,875	$(1,526,501)	$90,551,763
Residential Credit							
CRT	$593,027	$25,463	$(3,456)	$615,034	$36,730	$—	$651,764
Alt-A	204,213	499	(34,000)	170,712	13,976	(802)	183,886
Prime	197,756	358	(24,158)	173,956	18,804	—	192,760
Subprime	554,470	2,037	(78,561)	477,946	56,024	(90)	533,880
NPL/RPL	42,585	14	(117)	42,482	506	—	42,988
	130,025	627	(3,956)	126,696	1,038	(1,112)	126,622

Prime Jumbo (>= 2010 Vintage)							
Prime Jumbo (>= 2010 Vintage) Interest-Only	989,052	15,287	—	15,287	1,871	—	17,158
Total residential credit investments	$2,711,128	$44,285	$(144,248)	$1,622,113	$128,949	$(2,004)	$1,749,058
Total Residential Investment Securities	$95,311,922	$6,172,638	$(148,291)	$93,542,502	$286,824	$(1,528,505)	$92,300,821

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The following table presents the Company's Agency mortgage-backed securities portfolio concentration by issuing Agency at June 30, 2018 and December 31, 2017:

Investment Type	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Fannie Mae	$61,012,468	$63,361,415
Freddie Mac	25,490,083	27,091,978
Ginnie Mae	90,507	98,370
Total	$86,593,058	$90,551,763

Actual maturities of the Company's Residential Investment Securities portfolio are generally shorter than stated contractual maturities because actual maturities of the portfolio are generally affected by periodic payments and prepayments of principal on underlying mortgages.

The following table summarizes the Company's available-for-sale Residential Investment Securities at June 30, 2018 and December 31, 2017, according to their estimated weighted average life classifications:

Weighted Average Life	June 30, 2018 Estimated Fair Value	June 30, 2018 Amortized Cost	December 31, 2017 Estimated Fair Value	December 31, 2017 Amortized Cost
	(dollars in thousands)			
Less than one year	$6,224	$6,304	$471,977	$476,538
Greater than one year through five years	10,712,094	10,950,207	13,838,890	13,925,749
Greater than five years through ten years	76,435,458	79,830,605	77,273,833	78,431,852
Greater than ten years	1,009,863	1,030,760	716,121	708,363
Total	$88,163,639	$91,817,876	$92,300,821	$93,542,502

The weighted average lives of the Agency mortgage-backed securities at June 30, 2018 and December 31, 2017 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than projected.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities, accounted for as available-for-sale where the fair value option has not been elected, by length of time that such securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017.

	June 30, 2018 Estimated Fair Value [(1)]	June 30, 2018 Gross Unrealized Losses [(1)]	June 30, 2018 Number of Securities [(1)]	December 31, 2017 Estimated Fair Value [(1)]	December 31, 2017 Gross Unrealized Losses [(1)]	December 31, 2017 Number of Securities [(1)]
	(dollars in thousands)					
Less than 12 Months	$43,845,297	$(1,386,377)	1,360	$39,878,158	$(272,234)	1,114
12 Months or More	38,372,979	(2,101,144)	1,102	39,491,238	(1,011,405)	911
Total	$82,218,276	$(3,487,521)	2,462	$79,369,396	$(1,283,639)	2,025

(1) Excludes interest-only mortgage-backed securities and reverse mortgages.

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

The Company is also guaranteed payment of the principal amount of the securities by the respective issuing government agency.

During the three and six months ended June 30, 2018, the Company disposed of $2.9 billion and $3.4 billion of Residential Investment Securities, resulting in net realized (losses) of ($63.1) million and ($50.0) million, respectively. During the three and six months ended June 30, 2017, the Company disposed of $2.5 billion and $4.6 billion of Residential Investment Securities, resulting in net realized losses of ($5.2) million and ($4.0) million, respectively.

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6. RESIDENTIAL MORTGAGE LOANS

The following table presents the fair value and the unpaid principal balances of the residential mortgage loan portfolio at June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Fair value	$1,666,157	$ 1,438,322
Unpaid principal balance	$1,658,358	$ 1,419,807

The following table provides information regarding the line items and amounts recognized in the Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2018 and 2017 for these investments:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Net interest income	$15,784	$7,120	$29,279	$10,709
Net gains (losses) on disposal of investments	(3,191)	(321)	(4,949)	(1,314)
Net unrealized gains (losses) on instruments measured at fair value through earnings	(1,305)	5,310	(11,169)	6,125
Total included in net income (loss)	$11,288	$12,109	$13,161	$15,520

The following table provides the geographic concentrations based on the unpaid principal balances at June 30, 2018 and December 31, 2017, for the residential mortgage loans, including loans held in securitization trusts:

Geographic Concentrations of Residential Mortgage Loans

June 30, 2018		December 31, 2017	
Property Location	% of Balance	Property Location	% of Balance
California	53.1 %	California	49.8 %
New York	9.3 %	Florida	9.3 %
Florida	7.2 %	New York	7.1 %
All other (none individually greater than 5%)	30.4 %	All other (none individually greater than 5%)	33.8 %
Total	100.0 %	Total	100.0 %

The following table provides additional data on the Company’s residential mortgage loans, including loans held in securitization trusts, at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
	Portfolio Range	Portfolio Weighted Average	Portfolio Range	Portfolio Weighted Average
	(dollars in thousands)		(dollars in thousands)	

Unpaid principal balance	$0 - $3,635	$539	$1 - $3,663	$514
Interest rate	2.00% - 7.50%	4.53%	1.63% - 7.50%	4.25%
Maturity	1/1/2028 - 6/1/2058	2/5/2044	1/1/2028 - 5/1/2057	2/1/2043
FICO score at loan origination	498 - 823	750	468 - 823	748
Loan-to-value ratio at loan origination	11% - 100%	67%	11% - 100%	68%

At June 30, 2018 and December 31, 2017, approximately 66% and 78%, respectively, of the carrying value of the Company's residential mortgage loans, including loans held in securitization trusts, were adjustable-rate.

7. MORTGAGE SERVICING RIGHTS

The Company invests in MSRs and has elected to carry them at fair value. The following table presents activity related to MSRs for the three and six months ended June 30, 2018 and 2017:

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	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(dollars in thousands)			
Fair value, beginning of period	$596,378	$632,166	$580,860	$652,216
Purchases [1]	—	(210)	—	3
Change in fair value due to:				
Changes in valuation inputs or assumptions [2]	22,578	(9,205)	59,252	(15,438)
Other changes, including realization of expected cash flows	(19,942)	(17,098)	(41,098)	(31,128)
Fair value, end of period	$599,014	$605,653	$599,014	$605,653

(1) Includes adjustments to original purchase price from early payoffs, defaults, or loans that were delivered but were deemed to be not acceptable.

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

For the three and six months ended June 30, 2018, the Company recognized $27.6 million and $56.2 million, respectively, and for the three and six months ended June 30, 2017, the Company recognized $33.3 million and $67.8 million, respectively,

of net servicing income from MSRs in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

8. COMMERCIAL REAL ESTATE INVESTMENTS

CRE Debt and Preferred Equity Investments

At June 30, 2018 and December 31, 2017, commercial real estate investments held for investment were comprised of the following:

	June 30, 2018			December 31, 2017		
	Outstanding Principal	Carrying Value [1]	Percentage of Loan Portfolio [2]	Outstanding Principal	Carrying Value [1]	Percentage of Loan Portfolio [2]
	(dollars in thousands)					
Senior mortgages	$887,728	$882,570	70.6 %	$629,143	$625,900	60.9 %
Mezzanine loans	360,095	359,574	28.7 %	395,015	394,442	38.2 %
Preferred equity	9,000	8,994	0.7 %	9,000	8,985	0.9 %
Total	$1,256,823	$1,251,138	100.0 %	$1,033,158	$1,029,327	100.0 %

(1) Carrying value includes unamortized origination fees of $5.7 million and $3.8 million at June 30, 2018 and December 31, 2017, respectively.

(2) Based on outstanding principal.

June 30, 2018			
Senior Mortgages	Mezzanine Loans	Preferred Equity	Total

	(dollars in thousands)			
Beginning balance (January 1, 2018)	$625,900	$394,442	$ 8,985	$1,029,327
Originations & advances (principal)	286,017	24,193	—	310,210
Principal payments	(27,432)	(59,113)	—	(86,545)
Net (increase) decrease in origination fees	(3,130)	(147)	—	(3,277)
Amortization of net origination fees	1,215	199	9	1,423
Net carrying value (June 30, 2018)	$882,570	$359,574	$ 8,994	$1,251,138

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	December 31, 2017			
	Senior Mortgages	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)			
Beginning balance (January 1, 2017)	$510,071	$451,467	$ 8,967	$970,505
Originations & advances (principal)	338,242	69,121	—	407,363
Principal payments	(221,421)	(127,799)	—	(349,220)
Amortization & accretion of (premium) discounts	(44)	28	—	(16)
Net (increase) decrease in origination fees	(3,317)	(605)	—	(3,922)
Amortization of net origination fees	2,369	2,230	18	4,617
Net carrying value (December 31, 2017)	$625,900	$394,442	$ 8,985	$1,029,327

Internal CRE Debt and Preferred Equity Investment Ratings

The Company’s internal loan risk ratings are based on the guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The Company’s internal risk rating categories include “Performing”, “Performing - Closely Monitored”, “Performing - Special Mention”, “Substandard”, “Doubtful” or “Loss”. Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans meet all present contractual obligations, but

exhibit potential weakness that deserves management’s close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible. The Company did not have any impaired loans, nonaccrual loans, or loans in default in the commercial loans portfolio as all of the loans were performing at June 30, 2018 and December 31, 2017. As such, no provision for loan losses was deemed necessary at June 30, 2018 and December 31, 2017.

	June 30, 2018		Internal Ratings						
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard (1)	Doubtful	Loss	Total
	(dollars in thousands)								
Senior mortgages	$887,728	70.6 %	$513,610	$272,928	$36,800	$ 64,390	$ —	$ —	$887,728
Mezzanine loans	360,095	28.7 %	160,173	51,608	111,711	36,603	—	—	360,095
Preferred equity	9,000	0.7 %	—	—	9,000	—	—	—	9,000
Total	$1,256,823	100.0 %	$673,783	$324,536	$157,511	$ 100,993	$ —	$ —	$1,256,823

	December 31, 2017		Internal Ratings						
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred	Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard (1)	Doubtful	Loss	Total

		Equity Portfolio							
	(dollars in thousands)								
Senior mortgages	$629,143	60.9 %	$409,878	$115,075	$36,800	$67,390	$—	$—	$629,143
Mezzanine loans	395,015	38.2 %	206,169	66,498	122,348	—	—	—	395,015
Preferred equity	9,000	0.9 %	—	—	9,000	—	—	—	9,000
Total	$1,033,158	100.0 %	$616,047	$181,573	$168,148	$67,390	$—	$—	$1,033,158

(1) The Company rated two loans as Substandard as of June 30, 2018. The Company evaluated whether an impairment exists and determined in each case that, based on quantitative and qualitative factors, the Company expects repayment of contractual amounts due.

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At June 30, 2018 and December 31, 2017, approximately 85% of the carrying value of the Company’s CRE Debt and Preferred Equity Investments, excluding loans held for sale, was comprised of floating-rate debt investments.

Investments in Commercial Real Estate

There were no acquisitions of real estate holdings during the three and six months ended June 30, 2018 and 2017. The Company sold one of its wholly-owned triple net leased properties during the six months ended June 30, 2017 for $12.0 million and recognized a gain on sale of $5.1 million.

The weighted average amortization period for intangible assets and liabilities at June 30, 2018 is 4.4 years. Above market leases and leasehold intangible assets are included in Intangible assets, net and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	$111,012	$ 111,012
Buildings and improvements	331,879	330,959
Subtotal	442,891	441,971
Less: accumulated depreciation	(56,315)	(48,920)
Total real estate held for investment, at amortized cost, net	386,576	393,051
Equity in unconsolidated joint ventures	91,311	92,902
Investments in commercial real estate, net	$477,887	$ 485,953

Depreciation expense was $3.6 million and $7.4 million for the three and six months ended June 30, 2018, respectively. Depreciation expense was $3.9 million and $7.8 million for the three and six months ended June 30, 2017, respectively.
Depreciation expense is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

Rental Income

The minimum rental amounts due under leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the tenants reimburse the Company for certain operating costs.

Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at June 30, 2018 for consolidated investments in real estate are as follows:

	June 30, 2018

	(dollars in thousands)
2018 (remaining)	$ 14,895
2019	27,384
2020	22,653
2021	18,271
2022	13,278
Later years	22,002
Total	$ 118,483

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Mortgage loans payable at June 30, 2018 and December 31, 2017, were as follows:

June 30, 2018

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$286,546	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,311	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,021	11,025	3.58%	Fixed	6/6/2019	First liens
Total	$309,878	$312,500				

December 31, 2017

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$286,373	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,294	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,019	11,025	3.58%	Fixed	6/6/2019	First liens
Total	$309,686	$312,500				

The following table details future mortgage loan principal payments at June 30, 2018:

	Mortgage Loan Principal Payments (dollars in thousands)
2018 (remaining)	$ —
2019	23,375
2020	—
2021	—
2022	—
Later years	289,125
Total	$ 312,500

On December 11, 2015, the Company originated a $335.0 million recapitalization financing with respect to eight class A/B office properties in Orange County, California. The Company previously classified the senior mortgage loan as held for sale.

During the six months ended June 30, 2017, the Company sold the remaining balance of $115.0 million ($114.4 million, net of origination fees) of the senior loan to unrelated third parties at carrying value. Accordingly, no gain or loss was recorded in connection with the sale.

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9. CORPORATE DEBT

The Company invests in corporate loans and corporate debt securities through AMML. The industry and rate sensitivity dispersion of the portfolio at June 30, 2018 and December 31, 2017 are as follows:

	Industry Dispersion					
	June 30, 2018			December 31, 2017		
	Fixed Rate	Floating Rate	Total	Fixed Rate	Floating Rate	Total
	(dollars in thousands)					
Aircraft and Parts	$—	$38,022	$38,022	$—	$34,814	$34,814
Coating, Engraving and Allied Services	—	60,049	60,049	—	64,034	64,034
Computer Programming, Data Processing & Other Computer Related Services	—	212,750	212,750	—	209,624	209,624
Drugs	—	38,730	38,730	—	38,708	38,708
Electrical Work	—	39,457	39,457	—	—	—
Electronic Components & Accessories	—	23,995	23,995	—	23,916	23,916
Engineering, Architectural & Surveying	—	10,635	10,635	—	—	—
Groceries and Related Products	—	14,745	14,745	—	14,794	14,794
Grocery Stores	—	23,486	23,486	—	23,531	23,531
Home Health Care Services	—	—	—	—	23,779	23,779
Insurance Agents, Brokers and Services	—	49,480	49,480	—	28,872	28,872
Mailing, Reproduction, Commercial Art and Photography, and Stenographic	—	14,863	14,863	—	—	—
Management and Public Relations Services	—	210,511	210,511	—	94,871	94,871
Medical and Dental Laboratories	—	26,904	26,904	—	26,956	26,956
Miscellaneous Business Services	—	19,677	19,677	—	19,723	19,723
Miscellaneous Equipment Rental and Leasing	—	49,375	49,375	—	49,129	49,129
Miscellaneous Health and Allied Services, not elsewhere classified	—	54,196	54,196	—	25,963	25,963
Miscellaneous Nonmetallic Minerals, except Fuels	—	—	—	—	25,992	25,992
Miscellaneous Plastic Products	—	9,937	9,937	—	9,879	9,879
Motor Vehicles and Motor Vehicle Equipment	—	17,138	17,138	—	—	—
Motor Vehicles and Motor Vehicle Parts and Supplies	—	23,546	23,546	—	12,212	12,212
Offices and Clinics of Doctors of Medicine	—	97,722	97,722	—	60,000	60,000
Offices and Clinics of Other Health Practitioners	—	20,053	20,053	—	18,979	18,979
Public Warehousing and Storage	—	55,057	55,057	—	48,890	48,890
Research, Development and Testing Services	—	33,282	33,282	—	33,155	33,155
Schools and Educational Services, not elsewhere classified	—	19,806	19,806	—	20,625	20,625
Services Allied with the Exchange of Securities	—	14,909	14,909	—	13,960	13,960
Surgical, Medical, and Dental Instruments and Supplies	—	16,658	16,658	—	29,687	29,687
Telephone Communications	—	61,293	61,293	—	59,182	59,182
Total	$—	$1,256,276	$1,256,276	$—	$1,011,275	$1,011,275

The table below reflects the Company's aggregate positions by their respective place in the capital structure of the borrowers at June 30, 2018 and December 31, 2017.

	June 30, 2018	December 31, 2017

	(dollars in thousands)	
First lien loans	$753,373	$ 582,724
Second lien loans	502,903	428,551
Total	$1,256,276	$ 1,011,275

10. VARIABLE INTEREST ENTITIES

In February 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KLSF ("FREMF 2015-KLSF") for $102.1 million. The underlying portfolio is a pool of 11 floating rate multifamily mortgage loans with a cut-off principal balance of $1.4 billion. The Company is required to consolidate the FREMF 2015-KLSF Trust's assets and liabilities of $547.0 million and $507.0 million, respectively, at June 30, 2018.

In April 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KF07 ("FREMF 2015-KF07") for $89.4 million. The underlying portfolio is a pool of 40 floating rate multifamily mortgage loans with a cut-off principal balance of $1.2 billion. The Company is required to consolidate the FREMF 2015-KF07 Trust's assets and liabilities of $484.9 million and $449.7 million, respectively, at June 30, 2018.

In February 2016, the Company purchased the junior- most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2016-KLH1 ("FREMF 2016-KLH1") for $107.6 million, net of a $4.4 million discount to face value of $112.0 million. The underlying portfolio is a pool of 28 floating rate multifamily mortgage loans with a cut-off principal balance of $1.5 billion. The Company is required to consolidate the FREMF 2016-KLH1 Trust's assets and liabilities of $1.5 billion and $1.4 billion, respectively, at June 30, 2018. FREMF 2015-KLSF, FREMF 2015-KF07 and FREMF 2016-KLH1 are collectively referred to herein as the FREMF Trusts.

The FREMF Trusts are structured as pass-through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The FREMF Trusts are VIEs and the Company is considered to be the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership of the Class C Certificates and its current designation as the directing certificate holder. The Company's exposure to the obligations of the VIEs is generally limited to the Company's investment in the FREMF Trusts of $188.0 million. Assets of the FREMF Trusts may only be used to settle obligations of the FREMF Trusts. Creditors of the FREMF Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the FREMF Trusts. No gain or loss was recognized upon initial consolidation of the FREMF Trusts, but $0.8 million of related costs were expensed. The FREMF Trusts' assets are included in Commercial real estate debt investments and the FREMF Trusts' liabilities are included in Securitized debt of consolidated VIEs in the accompanying Consolidated Statements of Financial Condition.

Upon consolidation, the Company elected the fair value option for the financial assets and liabilities of the FREMF Trusts in order to avoid an accounting mismatch, and to more faithfully represent the economics of its interest in the entities. The fair value option requires that changes in fair value be reflected in the Company's Consolidated Statements of Comprehensive Income (Loss). The Company applied the practical expedient under ASU 2014-07, whereby the Company determines whether the fair value of the financial assets or financial liabilities is more observable as a basis for measuring the less observable financial instruments. The Company has determined that the fair value of the financial liabilities of the FREMF Trusts are more observable, since the prices for these liabilities are primarily available from third-party pricing services utilized for multifamily mortgage-backed securities, while the individual assets of the trusts are inherently less capable of precise measurement given their illiquid nature and the limitations on available information related to these assets. Given that the Company's methodology for valuing the financial assets of the FREMF Trusts are an aggregate fair value derived from the fair value of the financial liabilities, the Company has determined that the fair value of each of the financial assets in their entirety should be classified in Level 2 of the fair value measurement hierarchy.

The FREMF Trusts mortgage loans had an unpaid principal balance of $2.5 billion at June 30, 2018. At June 30, 2018, there are no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities at June 30, 2018 based upon the Company’s process of monitoring events of default on the underlying mortgage loans.

The Company consolidates a residential mortgage trust that issued residential mortgage-backed securities that are collateralized by residential mortgage loans that had been transferred to the trust by one of the Company’s subsidiaries. The Company owns most of the mortgage-backed securities issued by this VIE, including the subordinate securities, and a subsidiary of the Company continues to be the master servicer. As such, the Company is deemed to be the primary beneficiary of the residential mortgage trust and consolidates the entity. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust’s debt held by third parties was $32.9 million at June 30, 2018. The Company also consolidates a residential securitization trust in which it had purchased subordinated securities because its liquidation rights over the trust became exercisable in December 2017. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt held by third parties was $85.2 million at June 30, 2018.

In March 2018, the Company closed OBX 2018-01 Trust ("OBX Trust"), with a face value of $327.5 million. The securitization represented a financing transaction which provided non-recourse financing to the Company collateralized by residential mortgage loans purchased by the Company. A total of $279.2 million of bonds were issued to third parties and the Company retained $60.9 million of mortgage-backed securities. The Company is deemed to be the primary beneficiary and consolidates the OBX Trust because it has power to direct the activities that most significantly impact the OBX Trust's performance and holds a variable interest that could be potentially significant to this VIE. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The Company incurred approximately $1.5 million of costs in connection with the securitization that were expensed as incurred during the first quarter ended March 31, 2018. The contractual principal amount of the OBX Trust's debt held by third parties was $257.5 million at June 30, 2018.

Although the loans have been sold for bankruptcy and state law purposes, the transfers of the residential mortgage loans to the OBX Trust did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation.

In June 2016, a consolidated subsidiary of the Company entered into a $300.0 million credit facility with a third party financial institution. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as collateral manager and because it holds a variable interest in the entity that could be potentially significant to the entity. The Company has pledged corporate loans with a carrying amount of $433.5 million at June 30, 2018 as collateral for this credit facility. The transfers did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation. At June 30, 2018, the subsidiary had an intercompany receivable of $70.7 million, which eliminates upon consolidation and an Other secured financing of $70.7 million to the third party financial institution.

In July 2017, a consolidated subsidiary of the Company entered into a $150.0 million credit facility with a third party financial institution. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as servicer and because it holds a variable interest in the entity that could potentially be significant to the entity. The Company has transferred corporate loans to the subsidiary with a carrying amount of $208.5 million at June 30, 2018, which continue to be reflected in the Company's Consolidated Statements of Financial Condition in Corporate debt. At June 30, 2018, the subsidiary had an Other secured financing of $75.1 million to the third party financial institution.

The Company also owns variable interests in an entity that invests in MSRs and has structured its operations, funding and capitalization into pools of assets and liabilities, each referred to as a "silo." Owners of variable interests in a given silo are entitled to all of the returns and risk of loss on the investments and operations of that silo and have no substantive recourse to the assets of any other silo. While the Company previously held 100% of the voting interests in this entity, in August 2017, the Company sold 100% of such interests, and entered into an agreement with the entity's affiliated portfolio manager giving the Company the power over the silo in which it owns all of the beneficial interests. As a result, the Company is considered to be the primary beneficiary and consolidates this silo.

As of June 30, 2018, the Company had entered into an agreement to purchase approximately $94 million of a subordinated tranche in a CMBS securitization trust. The securitization closed in July 2018, and the Company consolidated the securitization trust on the closing date. The underlying commercial mortgage loans had a cut-off date principal balance of approximately $933 million.

The Company’s exposure to the obligations of its VIEs is generally limited to the Company’s investment in the VIEs of $1.6 billion at June 30, 2018. Assets of the VIEs may only be used to settle obligations of the VIEs. Creditors of the VIEs have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the VIEs. No gains or losses were recognized upon consolidation of existing VIEs. Interest income and expense are recognized using the effective interest method.

The statements of financial condition of the Company’s VIEs, excluding the credit facility VIEs and OBX Trust, that are reflected in the Company’s Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017 are as follows:

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	June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Assets			
Cash and cash equivalents	$—	$—	$32,443
Commercial real estate debt investments	2,542,413	—	—
Residential mortgage loans	—	214,694	37,842
Mortgage servicing rights	—	—	599,014
Accrued interest receivable	10,951	918	—
Other assets	—	87	33,642
Total assets	$2,553,364	$215,699	$702,941
Liabilities			
Securitized debt (non-recourse) at fair value	$2,354,380	$117,864	$—
Other secured financing	—	—	26,369
Accrued interest payable	4,572	330	—
Accounts payable and other liabilities	—	140	1,693
Total liabilities	$2,358,952	$118,334	$28,062

	December 31, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Assets			
Cash and cash equivalents	$—	$—	$42,293
Commercial real estate debt investments	2,826,357	—	—
Residential mortgage loans	—	478,811	19,667
Mortgage servicing rights	—	—	580,860
Accrued interest receivable	10,339	1,599	—
Other derivatives, at fair value	—	—	1
Other assets	—	1,418	32,354
Total assets	$2,836,696	$481,828	$675,175
Liabilities			
Securitized debt (non-recourse) at fair value	$2,620,952	$350,819	$—
Other secured financing	—	—	10,496
Accrued interest payable	4,554	931	—
Accounts payable and other liabilities	—	112	4,856
Total liabilities	$2,625,506	$351,862	$15,352

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The statements of comprehensive income (loss) of the Company's VIEs, excluding the credit facility VIEs and OBX Trust, that are reflected in the Company's Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2018 and 2017 are as follows:

	Three Months Ended June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$25,100	$ 2,184	$813
Interest expense	15,363	1,089	245
Net interest income	9,737	1,095	568
Realized gain (loss) on disposal of investments	—	(140)	(739)
Net gains (losses) on other derivatives	—	—	1
Net unrealized gains (losses) on instruments measured at fair value through earnings	820	(351)	1,850
Other income (loss)	(4,292)	(74)	28,342
Less: General and administration expenses	—	15	455
Net income (loss)	$6,265	$ 515	$29,567

	Three Months Ended June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$24,948	$ 1,171	$491
Interest expense	11,679	298	57
Net interest income	13,269	873	434
Realized gain (loss) on disposal of investments	—	(121)	24
Net unrealized gains (losses) on instruments measured at fair value through earnings	4,387	720	(26,848)
Other income (loss)	(6,224)	(94)	33,338
Less: General and administration expenses	1	17	838
Net income (loss)	$11,431	$ 1,361	$6,110

	Six Months Ended June 30, 2018		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$48,938	$ 4,557	$1,448

Interest expense	29,197	2,848	437
Net interest income	19,741	1,709	1,011
Realized gain (loss) on disposal of investments	—	1,902	(1,310)
Net gains (losses) on trading assets	—	—	70
Net unrealized gains (losses) on instruments measured at fair value through earnings	1,112	(1,167)	16,465
Other income (loss)	(8,769)	(151)	57,058
Less: General and administration expenses	—	29	927
Net income (loss)	$12,084	$ 2,264	$72,367

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	Six Months Ended June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trusts	MSR Silo
	(dollars in thousands)		
Net interest income:			
Interest income	$52,667	$ 2,540	$491
Interest expense	26,255	572	122
Net interest income	26,412	1,968	369
Realized gain (loss) on disposal of investments	—	(382)	(485)
Net unrealized gains (losses) on instruments measured at fair value through earnings	5,089	1,702	(47,112)
Other income (loss)	(12,522)	(191)	67,926
Less: General and administration expenses	1	37	1,940
Net income (loss)	$18,978	$ 3,060	$18,758

The geographic concentrations of credit risk exceeding 5% of the total loan unpaid principal balances related to the Company's VIEs, excluding the credit facility VIEs and OBX Trust, at June 30, 2018 are as follows:

Securitized Loans at Fair Value Geographic Concentration of Credit Risk

FREMF Trusts			Residential Mortgage Loan Trusts		
Property Location	Principal Balance	% of Balance	Property Location	Principal Balance	% of Balance
(dollars in thousands)					
Maryland	$437,110	17.3 %	California	$71,095	32.7 %
Texas	361,075	14.4 %	Florida	18,596	8.6 %
Virginia	329,250	13.1 %	Texas	17,616	8.1 %
New York	280,925	11.2 %	Illinois	15,133	7.0 %
North Carolina	231,335	9.2 %	New Jersey	13,156	6.0 %
Pennsylvania	225,810	9.0 %	Other (1)	81,901	37.6 %
Massachusetts	179,440	7.1 %			
Ohio	156,138	6.2 %			
Other (1)	314,514	12.5 %			
Total	$2,515,597	100.0 %		$217,497	100.0 %

(1) No individual state greater than 5%.

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11. FAIR VALUE MEASUREMENTS

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

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

If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest priority input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

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

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

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

The Company designates its securities as trading, available-for-sale or held-to-maturity depending upon the type of security and the Company’s intent and ability to hold such security to maturity. Securities classified as available-for-sale and trading are reported at fair value on a recurring basis.

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

Residential Investment Securities, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of

the security in its estimates of fair value. Fair value estimates for residential mortgage loans are generated by a discounted cash flow model and are primarily based on observable market-based inputs including discount rates, prepayment speeds, delinquency levels, and credit losses. Management reviews and indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. Certain liquid asset classes, such as Agency fixed-rate pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

Futures contracts are valued using quoted prices for identical instruments in active markets and are classified as Level 1.

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

The fair value of commercial mortgage-backed securities classified as available-for-sale is determined based upon quoted prices of similar assets in recent market transactions and requires the application of judgment due to differences in the underlying collateral. Consequently, Commercial real estate debt investments carried at fair value are classified as Level 2.

For the fair value of securitized debt of consolidated VIEs, refer to the Note titled "Variable Interest Entities" for additional information.

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

The following tables present the estimated fair values of financial instruments measured at fair value on a recurring basis. There were no transfers between levels of the fair value hierarchy during the periods presented.

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	$—	$86,593,058	$—	$86,593,058
Credit risk transfer securities	—	563,796	—	563,796
Non-Agency mortgage-backed securities	—	1,006,785	—	1,006,785
Residential mortgage loans	—	1,666,157	—	1,666,157
Mortgage servicing rights	—	—	599,014	599,014
Commercial real estate debt investments	—	2,857,463	—	2,857,463
Interest rate swaps	—	82,458	—	82,458
Other derivatives	4,857	124,823	—	129,680
Total assets	$4,857	$92,894,540	$599,014	$93,498,411
Liabilities:				
Securitized debt of consolidated VIEs	$—	$2,728,692	$—	$2,728,692
Interest rate swaps	—	376,106	—	376,106
Other derivatives	111,610	6,321	—	117,931
Total liabilities	$111,610	$3,111,119	$—	$3,222,729

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets:				
Agency mortgage-backed securities	$—	$90,551,763	$—	$90,551,763
Credit risk transfer securities	—	651,764	—	651,764
Non-Agency mortgage-backed securities	—	1,097,294	—	1,097,294
Residential mortgage loans	—	1,438,322	—	1,438,322
Mortgage servicing rights	—	—	580,860	580,860
Commercial real estate debt investments	—	3,089,108	—	3,089,108
Interest rate swaps	—	30,272	—	30,272
Other derivatives	218,361	65,252	—	283,613
Total assets	$218,361	$96,923,775	$580,860	$97,722,996
Liabilities:				
Securitized debt of consolidated VIEs	$—	$2,971,771	$—	$2,971,771
Interest rate swaps	—	569,129	—	569,129
Other derivatives	12,285	26,440	—	38,725
Total liabilities	$12,285	$3,567,340	$—	$3,579,625

Quantitative Information about Level 3 Fair Value Measurements

The Company considers unobservable inputs to be those for which market data is not available and that are developed using the best information available to us about the assumptions that market participants would use when pricing the asset. Relevant inputs vary depending on the nature of the instrument being measured at fair value. The following paragraph provides a general description of sensitivities of significant unobservable inputs along with interrelationships between and among the significant unobservable inputs and

their impact on the fair value measurements. The effect of a change in a particular assumption in the sensitivity analysis below is considered independently of changes in any other assumptions. In practice, simultaneous changes in assumptions may not always have a linear effect on the inputs discussed below. Interrelationships may also exist between observable and unobservable inputs. Such relationships have not been included in the discussion below. For each of the individual relationships described below, the inverse relationship would also generally apply. For MSRs, in general, increases in the discount, prepayment or delinquency rates or in annual servicing costs in isolation would result in a lower fair value measurement. A decline in interest rates could lead to higher-than-expected prepayments of mortgages underlying the Company's investments in MSRs, which in turn could result in a decline in the estimated fair value of MSRs. Refer to the Note titled "Mortgage Servicing Rights" for additional information.

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

	June 30, 2018		December 31, 2017	
Valuation Technique	Unobservable Input [(1)]	Range (Weighted Average)	Unobservable Input [(1)]	Range (Weighted Average)
Discounted cash flow	Discount rate	9.0% -12.0% (9.4%)	Discount rate	10.0% -15.0% (10.4%)
	Prepayment rate	4.5% - 12.2% (7.4%)	Prepayment rate	4.6% - 22.3% (9.4%)
	Delinquency rate	0.0% - 5.0% (2.4%)	Delinquency rate	0.0% - 13.0% (2.2%)
	Cost to service	$82 - $134 ($106)	Cost to service	$84 - $181 ($102)

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

The following table summarizes the estimated fair values for financial assets and liabilities at June 30, 2018 and December 31, 2017.

		June 30, 2018		December 31, 2017	
	Level in Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:		(dollars in thousands)			
Cash and cash equivalents	1	$1,135,329	$1,135,329	$706,589	$706,589
Agency mortgage-backed securities	2	86,593,058	86,593,058	90,551,763	90,551,763
Credit risk transfer securities	2	563,796	563,796	651,764	651,764
Non-Agency mortgage-backed securities	2	1,006,785	1,006,785	1,097,294	1,097,294
Residential mortgage loans	2	1,666,157	1,666,157	1,438,322	1,438,322
Mortgage servicing rights	3	599,014	599,014	580,860	580,860
Commercial real estate debt investments	2	2,857,463	2,857,463	3,089,108	3,089,108
Commercial real estate debt and preferred equity, held for investment	3	1,251,138	1,258,236	1,029,327	1,035,095
Loans held for sale, net	3	42,458	42,495	—	—
Corporate debt	2	1,256,276	1,254,072	1,011,275	1,014,139
Interest rate swaps	2	82,458	82,458	30,272	30,272
Other derivatives	1,2	129,680	129,680	283,613	283,613
Reverse repurchase agreements	1	259,762	259,762	—	—
Financial liabilities:					
Repurchase agreements	1,2	$75,760,655	$75,760,655	$77,696,343	$77,697,828
Other secured financing	1,2	3,760,487	3,759,980	3,837,528	3,837,595
Securitized debt of consolidated VIEs	2	2,728,692	2,728,692	2,971,771	2,971,771
Mortgage payable	3	309,878	302,149	309,686	310,218
Interest rate swaps	2	376,106	376,106	569,129	569,129
Other derivatives	1,2	117,931	117,931	38,725	38,725

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12. SECURED FINANCING

The Company had outstanding $75.8 billion and $77.7 billion of repurchase agreements with weighted average borrowing rates of 1.91% and 1.89%, after giving effect to the Company's interest rate swaps used to hedge cost of funds, and weighted average remaining maturities of 71 days and

58 days at June 30, 2018 and December 31, 2017, respectively.

At June 30, 2018 and December 31, 2017, the repurchase agreements had the following remaining maturities, collateral types and weighted average rates:

June 30, 2018

	Agency Mortgage-Backed Securities	CRTs	Non-Agency Mortgage-Backed Securities	Commercial Loans	Commercial Mortgage-Backed Securities	Total Repurchase Agreements	Weighted Average Rate	
	(dollars in thousands)							
1 day	$—	$—	$ —	$ —	$ —	$—	—	
2 to 29 days	30,476,466	263,467	161,587	—	17,996	30,919,516	2.15	%
30 to 59 days	6,314,836	7,950	—	—	6,155	6,328,941	2.11	%
60 to 89 days	14,105,633	64,443	105,187	—	—	14,275,263	2.15	%
90 to 119 days	9,278,603	—	—	—	—	9,278,603	2.08	%
Over 120 days (1)	14,321,748	—	—	488,579	148,005	14,958,332	2.32	%
Total	$74,497,286	$335,860	$ 266,774	$ 488,579	$ 172,156	$75,760,655	2.17	%

December 31, 2017

	Agency Mortgage-Backed Securities	CRTs	Non-Agency Mortgage-Backed Securities	Commercial Loans	Commercial Mortgage-Backed Securities	Total Repurchase Agreements	Weighted Average Rate	
	(dollars in thousands)							
1 day	$—	$—	$ —	$ —	$ —	$—	—	
2 to 29 days	33,421,609	263,528	253,290	—	18,125	33,956,552	1.69	%
30 to 59 days	10,811,515	7,229	3,658	—	6,375	10,828,777	1.44	%
60 to 89 days	13,800,743	7,214	47,830	—	—	13,855,787	1.59	%
90 to 119 days	10,128,006	—	—	—	—	10,128,006	1.39	%
Over 120 days (1)	8,542,108	—	—	385,113	—	8,927,221	1.77	%
Total	$76,703,981	$277,971	$ 304,778	$ 385,113	$ 24,500	$77,696,343	1.61	%

(1) Approximately 0% and 1% of the total repurchase agreements had a remaining maturity over 1 year at June 30, 2018 and December 31, 2017, respectively.

Repurchase agreements and reverse repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The following table summarizes the gross amounts of reverse repurchase agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net

amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017. Refer to the "Derivative Instruments" Note for information related to the effect of netting arrangements on the Company’s derivative instruments.

	June 30, 2018		December 31, 2017	
	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
	(dollars in thousands)			
Gross Amounts	$2,909,762	$78,410,655	$1,250,000	$78,946,343
Amounts Offset	(2,650,000)	(2,650,000)	(1,250,000)	(1,250,000)
Netted Amounts	$259,762	$75,760,655	$—	$77,696,343

The Company also finances a portion of its financial assets with advances from the Federal Home Loan Bank of Des Moines (“FHLB Des Moines”). Borrowings from FHLB Des Moines are reported in Other secured financing in the Company’s Consolidated Statements of Financial Condition.

At June 30, 2018, $3.6 billion of the advances matures between one to three years. At December 31, 2017, $2.1 billion of advances from the FHLB Des Moines matured beyond three years and $1.4 billion matures between one to three years. The weighted average rate of the advances from the FHLB Des Moines was 2.40% and 1.49% at June 30, 2018 and December 31, 2017, respectively. The Company held $147.9 million of membership and activity-based stock in the FHLB Des Moines at June 30, 2018 and December 31, 2017, which is reported at cost and included in Other assets on the Company's Consolidated Statements of Financial Condition.

Investments pledged as collateral under secured financing arrangements and interest rate swaps, excluding senior securitized commercial mortgage loans of consolidated VIEs, had an estimated fair value and accrued interest of $85.0 billion and $270.6 million, respectively, at June 30, 2018 and $87.0 billion and $267.3 million, respectively, at December 31, 2017.

The fair value of collateral received in connection with reverse repurchase agreements was $261.1 million as of June 30, 2018. The Company did not sell or repledge any of the collateral received as of June 30, 2018.

13. DERIVATIVE INSTRUMENTS

In connection with the Company's investment/market rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts, which include interest rate swaps, swaptions and futures contracts. The

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

The table below summarizes fair value information about our derivative assets and liabilities at June 30, 2018 and December 31, 2017:

Derivatives Instruments	Balance Sheet Location	June 30, 2018	December 31, 2017
Assets:		(dollars in thousands)	
Interest rate swaps	Interest rate swaps, at fair value	$82,458	$ 30,272
Interest rate swaptions	Other derivatives, at fair value	82,034	36,150
TBA derivatives	Other derivatives, at fair value	36,394	29,067
Futures contracts	Other derivatives, at fair value	4,857	218,361
Purchase commitments	Other derivatives, at fair value	258	35
Credit derivatives (1)	Other derivatives, at fair value	6,137	—
		$212,138	$ 313,885
Liabilities:			

Interest rate swaps	Interest rate swaps, at fair value	$376,106	$ 569,129
TBA derivatives	Other derivatives, at fair value	63	21,776
Futures contracts	Other derivatives, at fair value	111,610	12,285
Purchase commitments	Other derivatives, at fair value	25	157
Credit derivatives [(1)]	Other derivatives, at fair value	6,233	4,507
		$494,037	$ 607,854

(1) The notional amount of the credit derivatives in which the Company purchased protection was $60.0 million at June 30, 2018. The maximum potential amount of future payments is the notional amount of $357.6 million and $125.0 million at June 30, 2018 and December 31, 2017, respectively. The credit derivative tranches referencing the basket of bonds had a range of ratings between AAA and BBB-.

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The following table summarizes certain characteristics of the Company's interest rate swaps at June 30, 2018 and December 31, 2017:
June 30, 2018

Maturity	Current Notional (1)	Weighted Average Pay Rate		Weighted Average Receive Rate		Weighted Average Years to Maturity
(dollars in thousands)						
0 - 3 years	$32,086,800	1.76	%	2.34	%	1.62
3 - 6 years	15,449,650	2.27	%	2.31	%	4.67
6 - 10 years	12,476,900	2.45	%	2.24	%	8.59
Greater than 10 years	4,076,400	3.58	%	2.21	%	17.48
Total / Weighted Average	$64,089,750	2.08	%	2.31	%	4.43

December 31, 2017

Maturity	Current Notional (1)	Weighted Average Pay Rate (2) (3)		Weighted Average Receive Rate (2)		Weighted Average Years to Maturity (2)
(dollars in thousands)						
0 - 3 years	$6,532,000	1.56	%	1.62	%	2.08
3 - 6 years	14,791,800	2.12	%	1.57	%	4.51
6 - 10 years	10,179,000	2.35	%	1.58	%	8.04
Greater than 10 years	3,826,400	3.65	%	1.51	%	18.47
Total / Weighted Average	$35,329,200	2.22	%	1.58	%	6.72

(1) There were no forward starting swaps at June 30, 2018. Notional amount includes $8.1 billion of forward starting pay fixed swaps at December 31, 2017.
(2) Excludes forward starting swaps.
(3) Weighted average fixed rate on forward starting pay fixed swaps was 1.86% at December 31, 2017.

The following table presents swaptions outstanding at June 30, 2018 and December 31, 2017.

June 30, 2018	Current Underlying Notional	Weighted Average Underlying Pay Rate		Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
(dollars in thousands)						
Long	$3,250,000	2.75	%	3M LIBOR	10.28	3.16

December 31, 2017	Current Underlying Notional	Weighted Average Underlying Pay Rate		Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
(dollars in thousands)						
Long	$6,000,000	2.62	%	3M LIBOR	9.97	4.49

The following table summarizes certain characteristics of the Company's TBA derivatives at June 30, 2018 and December 31, 2017:

June 30, 2018

Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	$8,000,000	$8,144,363	$8,180,694	$36,331

December 31, 2017

Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	$15,828,000	$16,381,826	$16,390,251	$8,425
Sale contracts	(250,000)	(254,804)	(255,938)	(1,134)
Net TBA derivatives	$15,578,000	$16,127,022	$16,134,313	$7,291

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The following table summarizes certain characteristics of the Company's futures derivatives at June 30, 2018 and December 31, 2017:

	June 30, 2018		
	Notional - Long Positions	Notional - Short Positions	Weighted Average Years to Maturity
	(dollars in thousands)		
U.S. Treasury futures - 2 year	$—	$(480,000)	2.00
U.S. Treasury futures - 5 year	$—	$(4,987,400)	4.42
U.S. Treasury futures - 10 year and greater	—	(10,274,500)	7.13
Total	$—	$(15,741,900)	6.12

	December 31, 2017		
	Notional - Long Positions	Notional - Short Positions	Weighted Average Years to Maturity
	(dollars in thousands)		
2-year swap equivalent Eurodollar contracts	$—	$(17,161,000)	2.00
U.S. Treasury futures - 5 year	—	(4,217,400)	4.41
U.S. Treasury futures - 10 year and greater	—	(4,914,500)	7.01
Total	$—	$(26,292,900)	3.32

The Company presents derivative contracts on a gross basis on the Consolidated Statements of Financial Condition. Derivative contracts may contain legally enforceable provisions that allow for netting or setting off receivables and payables with each counterparty.

The following tables present information about derivative assets and liabilities that are subject to such provisions and can potentially be offset on our Consolidated Statements of Financial Condition at June 30, 2018 and December 31, 2017, respectively.

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	June 30, 2018			
		Amounts Eligible for Offset		
	Gross Amounts	Financial Instruments	Cash Collateral	Net Amounts
Assets:	(dollars in thousands)			
Interest rate swaps, at fair value	$82,458	$(44,260)	$ —	$38,198
Interest rate swaptions, at fair value	82,034	—	—	82,034
TBA derivatives, at fair value	36,394	(63)	—	36,331
Futures contracts, at fair value	4,857	(4,857)	—	—
Purchase commitments	258	—	—	258
Credit derivatives	6,137	(5,736)	—	401
Liabilities:				
Interest rate swaps, at fair value	$376,106	$(44,260)	$ —	$331,846
TBA derivatives, at fair value	63	(63)	—	—
Futures contracts, at fair value	111,610	(4,857)	(106,753)	—
Purchase commitments	25	—	—	25
Credit derivatives	6,233	(5,736)	(497)	—

December 31, 2017