EASTMAN CHEMICAL CO
Form 8-K
October 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 8-K
CURRENT REPORT

Pursuant to Section 13 or 15 (d) of the Securities and Exchange Act of 1934

Date of report (Date of earliest event reported):
October 4, 2006

EASTMAN CHEMICAL COMPANY
(Exact Name of Registrant as Specified in Its Charter)

Delaware	1-12626	62-1539359
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

200 South Wilcox Drive, Kingsport, TN	37660
(Address of Principal Executive Offices)	(Zip Code)

(423) 229-2000
(Registrant's Telephone Number, Including Area Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

EASTMAN CHEMICAL
COMPANY - EMN October 4, 2006

Item 5.02(d) -- Election of Directors

The Board of Directors of Eastman Chemical Company on October 4, 2006 elected Lewis M. Kling as a director. Mr. Kling will serve in the class of directors for which the term in office expires at the company's Annual Meeting of Stockholders in May 2009, and will serve as a member of the Compensation and Management Development Committee, the Finance Committee, the Health, Safety, Environmental and Security Committee, and the Nominating and Corporate Governance Committee, of the Board.

Item 5.03(a) -- Amendment to Bylaws

The Board of Directors of Eastman Chemical Company on October 4, 2006 amended the company's Bylaws so that directors are elected by a majority vote of stockholders. Before the amendment, the company's directors were elected by a plurality of the votes cast by stockholders. Under the new director election provision, any nominee who does not receive more than 50 percent of the votes cast would not be elected, and any incumbent director who does not receive majority support for reelection and whose successor has not been elected by stockholders would offer to resign from the Board. Votes cast include votes to withhold authority and exclude abstentions. The Board of Directors would act on the tendered resignation of an incumbent director who was not reelected and publicly disclose its decision within 90 days from the date of certification of the election results.

The text of the majority election Bylaw amendment is filed as an exhibit to this Current Report on Form 8-K, and the company's Bylaws are posted on the company's Internet website (www.eastman.com) in the "Investors -- Corporate Governance -- Bylaws" section.

Item 9.01(d) -- Exhibits

The following exhibit is furnished pursuant to Item 9.01(d):

3(ii) Text of Amendment to Bylaws

EASTMAN CHEMICAL COMPANY - EMN

October 4, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

Eastman Chemical Company

By: /s/ Curtis E. Espeland
Curtis E. Espeland
Vice President and Chief Accounting Officer

Date: October 10, 2006

e:10pt;">1,992,499

$
10,748,250

Coupon interest
460,881

65,321

526,202

395,005

54,618

449,623

Net (premium amortization)/discount accretion
(162,229
)

143,207

(19,022
)

(137,484
)

136,481

(1,003
)
Interest income
$
298,652

$
208,528

$
507,180

$
257,521

$
191,099

$
448,620

Net asset yield
2.8
%

9.0
%

3.9
%

2.9
%

9.6
%

4.2
%

(1) Excludes Agency Derivatives. For the years ended December 31, 2013 and 2012, our average yield on our Agency RMBS, including Agency Derivatives, was 2.9% and 3.1%, respectively.

The decrease in gross and net yields for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was due primarily to the deployment of new capital in both Agency and non-Agency RMBS AFS with lower loss adjusted yields.

Interest Expense and the Cost of Funds

The following table presents the components of interest expense and average annualized cost of funds on borrowings incurred by investment type on our AFS securities, Agency Derivatives, trading securities, mortgage loans held-for-sale and mortgage loans held-for-investment in securitization trusts for the years ended December 31, 2013 and 2012:

	Year Ended December 31, 2013			Year Ended December 31, 2012		
(dollars in thousands)	Average Balance (1)	Interest Expense	Cost of Funds (2)	Average Balance (1)	Interest Expense	Cost of Funds (2)
Available-for-sale securities						
Agency (3)	$10,226,860	$49,230	0.5 %	$8,481,173	$41,766	0.5 %
Non-Agency	1,488,727	33,412	2.2 %	1,038,720	25,478	2.5 %
	11,715,587	82,642	0.7 %	9,519,893	67,244	0.7 %
Agency derivatives	202,079	2,196	1.1 %	197,656	2,317	1.2 %
Trading securities	999,519	1,275	0.1 %	998,027	2,252	0.2 %
Mortgage loans held-for-sale	121,944	3,357	2.8 %	10,859	293	2.7 %
Mortgage loans held-for-investment in securitization trusts	414,373	10,937	2.6 %	—	—	— %
Total	$13,453,502	$100,407	0.7 %	$10,726,435	$72,106	0.7 %

(1) Average balance represents average total repurchase agreements and FHLB advances on AFS securities, Agency Derivatives, trading securities and mortgage loans held-for-sale, and average collateralized borrowings for mortgage loans held-for-investment in securitization trusts.

(2) Cost of funds by investment type is based on the underlying investment type of the asset assigned as collateral. Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive income. For the years ended December 31, 2013 and 2012, our total average cost of funds on the assets assigned as collateral for repurchase agreements, FHLB advances and collateralized borrowings shown in the table above, including interest spread expense associated with interest rate swaps, was 1.2% and 1.0%, respectively.

(3) Excludes Agency Derivatives. For the years ended December 31, 2013 and 2012, our average cost of funds on total Agency RMBS, including Agency Derivatives, was 0.5% for both respective periods.

The increase in interest expense on our borrowed funds collateralized by both Agency and non-Agency AFS securities for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was primarily due to our increased capital base. The decrease in interest expense and average cost of funds associated with the financing of both Agency Derivatives and trading securities during the year ended December 31, 2013, as compared to the year ended

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December 31, 2012, was due to decreases in the borrowing rates offered by counterparties, which are generally based on a specified margin over one-month LIBOR.

The increase in interest expense associated with the financing of mortgage loans held-for-sale during the year ended December 31, 2013, as compared to the year ended December 31, 2012, was the result of an increase in the outstanding balance under repurchase agreements. We did not hold any mortgage loans held-for-investment in securitization trusts during the year ended December 31, 2012.

Net Interest Income

The following table presents the components of net interest income and average annualized net interest rate spread earned by investment type on our AFS securities, trading securities, mortgage loans held-for-sale, mortgage loans held-for-investment in securitization trusts and Agency Derivatives for the years ended December 31, 2013 and 2012:

	Year Ended December 31, 2013			Year Ended December 31, 2012		
(dollars in thousands)	Net Interest Income	Net Interest Rate Spread (1)		Net Interest Income	Net Interest Rate Spread (1)	
Available-for-sale securities						
Agency (2)	$249,423	2.3	%	$215,755	2.4	%
Non-Agency	175,115	6.8	%	165,621	7.1	%
	424,538	3.2	%	381,376	3.5	%
Trading securities	4,688	0.5	%	2,621	0.3	%
Mortgage loans held-for-sale	18,828	2.0	%	316	1.7	%
Mortgage loans held-for-investment in securitization trusts	8,283	1.4	%	—	—	%
	456,337	3.1	%	384,313	3.2	%
Agency derivatives (3)	11,819	4.5	%	23,731	8.9	%
Total	$468,156	3.2	%	$408,044	3.3	%

(1) Net interest rate spread does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive income. For the years ended December 31, 2013 and 2012, our total average net interest rate spread on the assets shown in the table above, including interest spread expense associated with interest rate swaps, was 2.7% and 3.0%, respectively.

(2) Excludes Agency Derivatives. For the years ended December 31, 2013 and 2012, our average annualized net interest rate spread on total Agency RMBS, including Agency Derivatives, was 2.4% and 2.6%, respectively.

(3) Interest income on Agency Derivatives is included in (loss) gain on other derivative instruments on the statements of comprehensive income, while interest expense on Agency Derivatives is included in interest expense on repurchase agreements on the statements of other comprehensive income.

The decrease in net interest spread for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was due primarily to the deployment of new capital in both Agency and non-Agency RMBS AFS with lower loss adjusted yields and tighter spreads. The increase in net interest spread on trading securities for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was the result of increases in Treasury rates. The increase in net interest spread on mortgage loans held-for-sale for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was the result of acquisitions of higher-yielding CSL, combined with securitization of prime nonconforming residential mortgage loans during 2013. We did not hold any mortgage loans held-for-investment in securitization trusts during the year ended December 31, 2012.

Other-Than-Temporary Impairments

We review each of our securities on a quarterly basis to determine if an OTTI charge is necessary. For the year ended December 31, 2013, we recognized $1.7 million of OTTI losses, compared to $11.0 million for the year ended December 31, 2012. The decrease in OTTI during the year ended December 31, 2013, as compared to the year ended December 31, 2012, was generally driven by recovery in the non-Agency market from December 31, 2012 to December 31, 2013. For further information about evaluating AFS securities for other-than-temporary impairments, refer to Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the consolidated financial statements.

Gain (Loss) on Investment Securities

During the year ended December 31, 2013, we sold AFS securities for $4.4 billion with an amortized cost of $4.5 billion, for a net realized loss of $64.5 million. We also sold U.S. Treasuries for $1.0 billion with an amortized cost of $1.0 billion, for a net realized gain $3.0 million for the year ended December 31, 2013. During the year ended December 31, 2012, we sold AFS securities for $3.4 billion with an amortized cost of $3.3 billion, for a net realized gain of $112.9 million. We also sold U.S. Treasuries for $1.0 billion with an amortized cost of $1.0 billion, for a net realized gain of $1.7 million for the year ended December 31, 2012. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that our management believes have higher risk-adjusted returns.

For the years ended December 31, 2013 and 2012, trading securities experienced unrealized losses of $1.0 million and gains of $2.0 million, respectively. The decrease in change in unrealized gains for the year ended December 31, 2013, as compared to the year ended December 31, 2012, was primarily due to the realization of gains on trading securities sold during the year ended December 31, 2013.

On March 18, 2013, we declared a special dividend pursuant to which we distributed 17,824,647 shares of Silver Bay common stock, on a pro rata basis, to our stockholders of record as of April 2, 2013. The dividend was distributed on or about April 24, 2013. As a result, we recognized $13.7 million of realized gains on distribution as well as $5.9 million of change in unrealized losses within gain (loss) on investment securities for the year ended December 31, 2013, respectively. For the year ended December 31, 2012, we recognized $5.9 million of change in unrealized gains on these equity securities within gain (loss) on investment securities. Also included in gain (loss) on investment securities for the year ended December 31, 2013 was $0.2 million in dividend income from Silver Bay's $0.01 per share dividend declared on March 21, 2013.

(Loss) Gain on Interest Rate Swap and Swaption Agreements

For the years ended December 31, 2013 and 2012 we recognized $58.5 million and $38.4 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $17.0 billion and $9.9 billion notional, respectively, to hedge a portion of our interest rate risk on our short-term repurchase agreements, funding costs, and macro-financing risk and receiving either LIBOR interest or a fixed interest rate.

During the years ended December 31, 2013 and 2012, we terminated, had agreements mature or had options expire on 155 and 26 notional interest rate swap and swaption positions of $33.8 billion and $4.5 billion, respectively. Upon settlement of the early terminations and option expirations, we paid $34.5 million and $1.6 million, in 2013 and 2012 respectively, in full settlement of our net interest spread liability and recognized $12.3 million in realized gains and $29.6 million in realized losses on the swaps and swaptions in 2013 and 2012, respectively, including early termination penalties. We elected to terminate certain swaps during these periods to align with our investment portfolio.

Also included in our financial results for the years ended December 31, 2013 and 2012 was the recognition of a change in unrealized valuation gains of $291.5 million and losses of $91.7 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. The change in fair value of interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the year ended December 31, 2013. Since these swaps and swaptions are generally used for purposes of hedging our interest rate exposure, their unrealized valuation losses are generally offset by unrealized gains in our Agency RMBS AFS portfolio, which are recorded directly to stockholders' equity through other comprehensive income.

The following table provides the net interest spread and gains and losses associated with our interest rate swap and swaption positions:

(in thousands)	Year Ended December 31,	
	2013	2012
Net interest spread	$(58,522)	$(38,448)
Early termination, agreement maturation and option expiration losses	12,293	(29,579)
Change in unrealized loss on interest rate swap and swaption agreements, at fair value	291,458	(91,748)
Gain (loss) on interest rate swap and swaption agreements	$245,229	$(159,775)

(Loss) Gain on Other Derivative Instruments

Included in our financial results for the years ended December 31, 2013 and 2012 was the recognition of $95.3 million of gains and $40.9 million of losses, respectively, on other derivative instruments we held for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs, put and call options for TBAs, constant maturity swaps, Markit IOS total return swaps and inverse interest-only securities. Included within these year ended December 31, 2013 and 2012 results was the recognition of $14.0 million and $26.0 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $251.1 million and $257.6 million, respectively. The remainder represented realized and unrealized gains and losses on other derivative instruments. As these derivative instruments are considered trading instruments, our financial results include both realized and unrealized gains (losses) associated with these instruments. Since our derivative instruments are generally used for purposes of hedging our interest rate and credit risk exposure, their unrealized valuation gains and losses are generally offset by unrealized losses and gains in our RMBS AFS and mortgage loan portfolios.

Gain (Loss) on Mortgage Loans Held-for-Sale

For the years ended December 31, 2013 and 2012, we recorded losses on mortgage loans held-for-sale of $33.8 million and gains of $2.3 million, respectively. Included within these results was the recognition of losses of $13.8 million and $0.1 million, respectively, on mortgage loans held-for-sale, and losses of $20.0 million and gains of $2.4 million on commitments to purchase mortgage loans held-for-sale for the years ended December 31, 2013 and 2012. The decrease in gains on mortgage loans held-for-sale during the year ended December 31, 2013, as compared to the year ended December 31, 2012, was due primarily to the rising rate environment.

Servicing Income

For the year ended December 31, 2013, we recognized total servicing income of $12.0 million, which includes servicing fee income of $11.8 million and ancillary fee income of $0.2 million. Because we purchased our first MSR during 2013, we did not recognize any servicing income in 2012.

(Loss) Gain on Servicing Asset

For the year ended December 31, 2013, gain on servicing asset of $13.9 million includes a decrease in fair value of MSR due to realization of cash flows (runoff) of $6.8 million and an increase in fair value of MSR due to changes in valuation inputs or assumptions of $20.7 million. Because we purchased our first MSR during 2013, we did not recognize any gains or losses on servicing assets in 2012.

Other (Loss) Income

For the year ended December 31, 2013, we recorded other income of $14.6 million, which includes $22.9 million in losses on mortgage loans held-for-investment in securitization trusts and $37.1 million in gains on collateralized borrowings in securitization trusts. Also included in other income for the year ended December 31, 2013 was other mortgage loan revenue of $0.4 million. Because we participated in our first securitization deal during 2013, we did not recognize any of the above items in the other income line item in 2012.

Management Fees

We incurred management fees of $41.7 million and $33.2 million for the years ended December 31, 2013 and 2012, which are payable to PRCM Advisers under our management agreement. The management fee is calculated based on our stockholders’ equity with certain adjustments outlined in the management agreement. However, these fees were reduced by $4.3 million, on the consolidated statements of comprehensive income for the year ended December 31, 2013, in accordance with the contribution transaction entered into with Silver Bay. See further discussion of the management fee calculation as well as this adjustment in Note 24 - Related Party Transactions of the notes to the consolidated financial statements.

Securitization Deal Costs

For the year ended December 31, 2013, we recognized $2.1 million in upfront costs related to the sponsoring of a securitization trust, and $2.0 million in upfront costs related to the subordinated debt and excess servicing rights acquired from a securitization trust issued by a third party, which was paid upon settlement of the acquisitions. These costs are included when evaluating the economics of a securitization; however, the election of the fair value option for the assets and liabilities held in the securitization trusts requires the expense to be recognized upfront on the consolidated statements of comprehensive income. Because we did not participate in any securitization deals during the year ended December 31, 2012, we did not incur any securitization deal costs. Changes in securitization deal costs are directly related to the size and number of securitization trusts sponsored by either third parties or our subsidiaries.

Servicing Expenses

For the year ended December 31, 2013, we recognized $3.8 million in servicing expenses generally related to the subservicing of mortgage loans held-for-sale and MSR. Because we purchased our first MSR during 2013, we did not recognize any gains or losses on servicing assets in 2012.

Other Operating Expenses

For the years ended December 31, 2013 and 2012, we recognized $37.3 million and $17.7 million, respectively, of other operating expenses, which represents an expense ratio of 1.0% and 0.9% of average equity for the respective periods. The increase of our operating expense ratio resulted primarily from an increase in expenses related to the personnel, infrastructure and volume-based transaction costs to support our mortgage loan and MSR activities. Included in other operating expenses are direct and allocated costs incurred by PRCM Advisers on our behalf and reimbursed by us. For the years ended December 31, 2013 and 2012, these direct and allocated costs totaled approximately $9.9 million and $11.8 million, respectively. Included in these reimbursed costs was compensation paid to employees of Pine River serving as our executive officers, including our principal financial officer and general counsel of $0.8 million for the year ended December 31, 2013 and $0.8 million for the year ended December 31, 2012. The allocation of compensation paid to employees

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of Pine River serving as our principal financial officer and general counsel is based on time spent overseeing our company's activities in accordance with the management agreement. Equity based compensation expense for the year ended December 31, 2013 also includes the amortization of the restricted stock awarded to our executive officers in conjunction with the Plan (see discussion in Note 21 - Equity Incentive Plan), including our chief executive officer, chief investment officer, principal financial officer and general counsel of $2.1 million.

We have established an accounts payable function and direct relationships with the majority of our third-party vendors. We will continue to have certain costs allocated to us by PRCM Advisers for compensation, data services and proprietary technology, but most of our expenses with third-party vendors are paid directly by us.

Income Taxes

For the years ended December 31, 2013 and 2012, we recognized a provision for income taxes of $84.4 million and a benefit from income taxes of $42.2 million, respectively. The provision in 2013 was primarily due to income generated from derivative instruments held in our TRSs, and the benefit in 2012 was primarily due to losses incurred on derivative instruments held in our TRSs. We currently intend to distribute 100% of our REIT taxable income and comply with all requirements to continue to qualify as a REIT.

Financial Condition

Available-for-Sale Securities, at Fair Value

Agency RMBS

Our Agency RMBS AFS portfolio is comprised of adjustable rate and fixed rate mortgage-backed securities backed by single-family and multi-family mortgage loans. All of our principal and interest Agency RMBS AFS were Fannie Mae or Freddie Mac mortgage pass-through certificates or collateralized mortgage obligations that carry an implied "AAA" rating, or Ginnie Mae mortgage pass-through certificates, which are backed by the guarantee of the U.S. Government. The majority of these securities consist of whole pools in which we own all of the investment interests in the securities.

The tables below summarize certain characteristics of our Agency RMBS AFS securities at December 31, 2014 and December 31, 2013:

	December 31, 2014							
(dollars in thousands, except purchase price)	Principal/Current Face	Net (Discount)/ Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities:								
Fixed	$10,065,570	$639,377	$10,704,947	$209,952	$(26,651)	$10,888,248	4.34 %	$107.69
Hybrid/ARM	118,379	5,494	123,873	4,412	—	128,285	3.52 %	$106.11
Total P&I Securities	10,183,949	644,871	10,828,820	214,364	(26,651)	11,016,533	4.33 %	$107.67
Interest-only securities								
Fixed	377,179	(338,747)	38,432	9,705	(380)	47,757	4.27 %	$14.97
Fixed Other [1]	2,860,427	(2,639,265)	221,162	14,222	(7,357)	228,027	1.63 %	$9.25
Total	$13,421,555	$(2,333,141)	$11,088,414	$238,291	$(34,388)	$11,292,317		

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(dollars in thousands, except purchase price)	December 31, 2013 Principal/Current Face	Net (Discount)/ Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities:								
Fixed	$7,781,471	$609,933	$8,391,404	$78,920	$(235,954)	$8,234,370	4.42 %	$109.03
Hybrid/ARM	993,891	6,795	1,000,686	6,803	(868)	1,006,621	2.54 %	$100.92
Total P&I Securities	8,775,362	616,728	9,392,090	85,723	(236,822)	9,240,991	4.22 %	$108.15
Interest-only securities								
Fixed	541,027	(486,071)	54,956	12,466	(366)	67,056	4.26 %	$14.34
Fixed Other (1)	2,603,201	(2,406,600)	196,601	4,411	(11,650)	189,362	1.63 %	$8.90
Total	$11,919,590	$(2,275,943)	$9,643,647	$102,600	$(248,838)	$9,497,409		

(1) Fixed Other represents weighted-average coupon interest-only securities that are not generally used for our interest-rate risk management purposes. These securities pay variable coupon interest based on the weighted average of the fixed rates of the underlying loans of the security, less the weighted average rates of the applicable issued principal and interest securities.

Our three-month average CPR experienced by Agency RMBS AFS owned by us as of December 31, 2014 and December 31, 2013, on an annualized basis, was 7.4% and 7.6%, respectively.
The following table summarizes the number of months until the next reset for our floating or adjustable rate Agency RMBS AFS portfolio at December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013
0-12 months	$125,280	$147,670
13-36 months	2,081	3,088
37-60 months	924	2,604
61-84 months	—	853,259
Greater than 84 months	—	—
Total	$128,285	$1,006,621

Non-Agency RMBS
Our non-Agency RMBS portfolio is comprised of senior and mezzanine tranches of mortgage-backed securities, and excludes the retained interests from our on-balance sheet securitizations, as they are eliminated in consolidation in accordance with U.S. GAAP. The following tables provide investment information on our non-Agency RMBS as of December 31, 2014 and December 31, 2013:

(in thousands)	As of December 31, 2014 Principal/current face	Accretable purchase discount	Credit reserve purchase discount	Amortized cost	Unrealized gain	Unrealized loss	Carrying value
Principal and interest securities:							

Senior	$3,213,104	$(531,531)	$(843,106)	$1,838,467	$532,574	$(606)	$2,370,435
Mezzanine	794,798	(158,465)	(84,499)	551,834	119,624	(1,037)	670,421
Total P&I Securities	4,007,902	(689,996)	(927,605)	2,390,301	652,198	(1,643)	3,040,856
Interest-only securities	283,970	(277,372)	—	6,598	1,331	—	7,929
Total	$4,291,872	$(967,368)	$(927,605)	$2,396,899	$653,529	$(1,643)	$3,048,785

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(in thousands)	As of December 31, 2013 Principal/current face	Accretable purchase discount	Credit reserve purchase discount	Amortized cost	Unrealized gain	Unrealized loss	Carrying value
Principal and interest securities:							
Senior	$3,496,359	$(594,726)	$(1,124,838)	$1,776,795	$507,601	$(2,264)	$2,282,132
Mezzanine	644,636	(151,187)	(109,611)	383,838	86,771	(1,942)	468,667
Total P&I Securities	4,140,995	(745,913)	(1,234,449)	2,160,633	594,372	(4,206)	2,750,799
Interest-only securities	333,358	(325,646)	—	7,712	807	—	8,519
Total	$4,474,353	$(1,071,559)	$(1,234,449)	$2,168,345	$595,179	$(4,206)	$2,759,318

The majority of our non-Agency RMBS were rated at December 31, 2014. Note that credit ratings are based on the par value of the non-Agency RMBS, whereas the distressed non-Agency RMBS assets in our portfolio were acquired at a heavily discounted price. The following table summarizes the credit ratings of our non-Agency RMBS portfolio, based on the Bloomberg Index Rating, a composite of each of the four major credit rating agencies (i.e., DBRS Ltd., Moody’s Investors Services, Inc., Standard & Poor’s Corporation and Fitch, Inc.), as of December 31, 2014 and December 31, 2013:

	December 31, 2014	December 31, 2013
AAA	6.4 %	— %
AA	— %	— %
A	— %	— %
BBB	0.7 %	0.1 %
BB	0.9 %	0.2 %
B	3.9 %	4.2 %
Below B	74.9 %	88.0 %
Not rated	13.2 %	7.5 %
Total	100.0 %	100.0 %

Our allocation of non-Agency securities based on credit ratings has shifted slightly since December 31, 2013. The portfolio is now allocated 6.4% to AAA-rated securities backed by new issue high quality mortgages. This shift is due to the sale of lower-rated bonds that we believe had reached maximum value which were replaced with AAA-rated new issue bonds backed by high quality prime jumbo mortgage loans.

Our non-Agency RMBS portfolio has increased approximately 10.5% since December 31, 2013. Our allocation of non-Agency RMBS to prime securities has increased from 5.0% at December 31, 2013 to 12.9% at December 31, 2014. Conversely, our allocation to subprime securities has decreased from 83.5% at December 31, 2013 to 73.0% at December 31, 2014. As a result, our designated credit reserve as a percentage of total discount and total face value has also decreased (as disclosed in Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the consolidated financial statements). When focused on principal and interest securities, from December 31, 2013 to December 31, 2014, our designated credit reserve as a percentage of total discount decreased from 62.3% to 57.3%, and our designated credit reserve as a percentage of total face value decreased from 29.8% to 23.1%. As our allocation of non-Agency RMBS to subprime securities has decreased over the period from December 31, 2013 to December 31, 2014, we believe these comparable portfolio metrics are reflective of our investment profile, regardless of portfolio size.

A subprime bond may generally be considered higher risk; however, if purchased at a discount that reflects a high expectation of credit losses, it could be viewed less risky than a prime bond, which is subject to unanticipated credit loss performance. Accordingly, we believe our risk profile in owning a heavily discounted subprime bond with known delinquencies affords us the ability to assume a higher percentage of expected credit loss with comparable risk-adjusted returns to a less discounted prime bond with a lower percentage of expected credit loss.

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The following tables present certain information by investment type and, if applicable, their respective underlying loan characteristics for our senior and mezzanine non-Agency RMBS, excluding our non-Agency interest-only portfolio, at December 31, 2014 and December 31, 2013:

	At December 31, 2014					
Non-Agency Principal and Interest (P&I) RMBS Characteristics	Senior Bonds		Mezzanine Bonds		Total P&I Bonds	
Carrying Value (in thousands)	$2,370,435		$670,421		$3,040,856	
% of Non-Agency Portfolio	78.0	%	22.0	%	100.0	%
Average Purchase Price [1]	$56.45		$68.74		$59.16	
Average Coupon	2.4	%	2.1	%	2.3	%
Average Fixed Coupon	4.2	%	5.7	%	4.3	%
Average Floating Coupon	1.9	%	2.0	%	1.9	%
Average Hybrid Coupon	5.2	%	—	%	5.2	%
Collateral Attributes						
Average Loan Age (months)	91		93		91	
Average Loan Size (in thousands)	$374		$304		$359	
Average Original Loan-to-Value	70.1	%	71.5	%	70.4	%
Average Original FICO [2]	628		669		636	
Current Performance						
60+ day delinquencies	27.4	%	20.2	%	25.9	%
Average Credit Enhancement [3]	8.4	%	18.0	%	10.4	%
3-Month CPR [4]	3.4	%	7.3	%	4.2	%

	At December 31, 2013					
Non-Agency Principal and Interest (P&I) RMBS Characteristics	Senior Bonds		Mezzanine Bonds		Total P&I Bonds	
Carrying Value (in thousands)	$2,282,132		$468,667		$2,750,799	
% of Non-Agency Portfolio	83.0	%	17.0	%	100.0	%
Average Purchase Price [1]	$52.58		$59.09		$53.69	
Average Coupon	2.5	%	1.6	%	2.3	%
Average Fixed Coupon	5.6	%	5.6	%	5.6	%
Average Floating Coupon	1.9	%	1.4	%	1.8	%
Average Hybrid Coupon	4.0	%	—	%	4.0	%
Collateral Attributes						
Average Loan Age (months)	86		99		88	
Average Loan Size (in thousands)	$263		$196		$252	
Average Original Loan-to-Value	73.1	%	72.6	%	73.0	%
Average Original FICO [2]	614		647		620	
Current Performance						
60+ day delinquencies	32.7	%	26.6	%	31.7	%
Average Credit Enhancement [3]	9.0	%	20.8	%	11.0	%
3-Month CPR [4]	3.5	%	5.6	%	3.8	%

(1) Average purchase price utilized carrying value for weighting purposes. If current face were utilized for weighting purposes, the average purchase price for senior, mezzanine, and total non-Agency RMBS, excluding our non-Agency interest-only portfolio, would be $52.11, $65.59, and $54.78, respectively, at December 31, 2014 and $47.97, $56.37, and $49.28, respectively at December 31, 2013.

(2)

FICO represents a mortgage industry accepted credit score of a borrower, which was developed by Fair Isaac Corporation.

(3) Average credit enhancement remaining on our non-Agency RMBS portfolio, which is the average amount of protection available to absorb future credit losses due to defaults on the underlying collateral.

(4) Three-month CPR is reflective of the prepayment speed on the underlying securitization; however, it does not necessarily indicate the proceeds received on our investment tranche. Proceeds received for each security are dependent on the position of the individual security within the structure of each deal.

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Non-Agency RMBS Characteristics	December 31, 2014								
(dollars in thousands)	Senior Bonds			Mezzanine Bonds			Total Bonds		
Loan Type	Carrying Value	% of Senior Bonds		Carrying Value	% of Mezzanine Bonds		Carrying Value	% of Non-Agency Portfolio	
Prime	$290,893	12.3	%	$101,290	15.1	%	$392,183	12.9	%
Alt-A	79,785	3.3	%	23,873	3.6	%	103,658	3.4	%
POA	172,938	7.3	%	33,681	5.0	%	206,619	6.8	%
Subprime	1,826,819	77.1	%	391,952	58.5	%	2,218,771	73.0	%
Other	—	—	%	119,625	17.8	%	119,625	3.9	%
Total	$2,370,435	100.0	%	$670,421	100.0	%	$3,040,856	100.0	%

Non-Agency RMBS Characteristics	December 31, 2013								
(dollars in thousands)	Senior Bonds			Mezzanine Bonds			Total Bonds		
Loan Type	Carrying Value	% of Senior Bonds		Carrying Value	% of Mezzanine Bonds		Carrying Value	% of Non-Agency Portfolio	
Prime	$94,491	4.1	%	$42,150	9.0	%	$136,641	5.0	%
Alt-A	81,264	3.6	%	24,797	5.3	%	106,061	3.9	%
POA	200,182	8.8	%	10,340	2.2	%	210,522	7.6	%
Subprime	1,906,195	83.5	%	391,380	83.5	%	2,297,575	83.5	%
Other	—	—	%	—	—	%	—	—	%
Total	$2,282,132	100.0	%	$468,667	100.0	%	$2,750,799	100.0	%

Non-Agency RMBS Characteristics	December 31, 2014								
(dollars in thousands)	Senior Bonds			Mezzanine Bonds			Total Bonds		
Coupon Type	Carrying Value	% of Senior Bonds		Carrying Value	% of Mezzanine Bonds		Carrying Value	% of Non-Agency Portfolio	
Fixed Rate	$466,624	19.7	%	$23,329	3.5	%	$489,953	16.1	%
Hybrid or Floating	1,903,811	80.3	%	647,092	96.5	%	2,550,903	83.9	%
Total	$2,370,435	100.0	%	$670,421	100.0	%	$3,040,856	100.0	%

Non-Agency RMBS Characteristics	December 31, 2013								
(dollars in thousands)	Senior Bonds			Mezzanine Bonds			Total Bonds		
Coupon Type	Carrying Value	% of Senior Bonds		Carrying Value	% of Mezzanine Bonds		Carrying Value	% of Non-Agency Portfolio	
Fixed Rate	$336,635	14.8	%	$19,605	4.2	%	$356,240	13.0	%
Hybrid or Floating	1,945,497	85.2	%	449,062	95.8	%	2,394,559	87.0	%
Total	$2,282,132	100.0	%	$468,667	100.0	%	$2,750,799	100.0	%

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Non-Agency RMBS Characteristics	December 31, 2014					
(dollars in thousands)	Senior Bonds		Mezzanine Bonds		Total Bonds	
Loan Origination Year	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
2006+	$2,014,544	85.0 %	$265,267	39.6 %	$2,279,811	75.0 %
2002-2005	351,577	14.8 %	397,360	59.3 %	748,937	24.6 %
Pre-2002	4,314	0.2 %	7,794	1.1 %	12,108	0.4 %
Total	$2,370,435	100.0 %	$670,421	100.0 %	$3,040,856	100.0 %
Non-Agency RMBS Characteristics	December 31, 2013					
(dollars in thousands)	Senior Bonds		Mezzanine Bonds		Total Bonds	
Loan Origination Year	Carrying Value	% of Senior Bonds	Carrying Value	% of Mezzanine Bonds	Carrying Value	% of Non-Agency Portfolio
2006+	$1,894,672	83.0 %	$70,721	15.1 %	$1,965,393	71.4 %
2002-2005	384,238	16.8 %	390,771	83.4 %	775,009	28.2 %
Pre-2002	3,222	0.2 %	7,175	1.5 %	10,397	0.4 %
Total	$2,282,132	100.0 %	$468,667	100.0 %	$2,750,799	100.0 %

The underlying mortgage loans collateralizing our non-Agency RMBS are located across the U.S. The following table presents the five largest geographic concentrations of the mortgages collateralizing these RMBS at December 31, 2014 and December 31, 2013:

	December 31, 2014		December 31, 2013	
(dollars in thousands)	Carrying Value	% of Non-Agency RMBS	Carrying Value	% of Non-Agency RMBS
California	$790,489	25.9 %	$679,935	24.6 %
Florida	291,700	9.6 %	310,041	11.2 %
New York	288,797	9.5 %	292,624	10.6 %
Texas	142,184	4.7 %	127,183	4.6 %
New Jersey	119,400	3.9 %	112,159	4.1 %
Total	$1,632,570	53.6 %	$1,521,942	55.1 %

Trading Securities, at Fair Value

We hold U.S. Treasuries in a TRS and classify these securities as trading instruments due to short-term investment objectives. As of December 31, 2014 and December 31, 2013, we held U.S. Treasuries with an amortized cost of $2.0 billion and $996.1 million and a fair value of $2.0 billion and $1.0 billion, respectively, classified as trading securities. The unrealized gains included within trading securities were $1.4 million and $4.1 million as of December 31, 2014 and December 31, 2013, respectively.

Mortgage Loans Held-for-Sale, at Fair Value

We acquire prime nonconforming residential mortgage loans from select mortgage loan originators and secondary market institutions. As of December 31, 2014 and December 31, 2013, we held prime nonconforming residential mortgage loans with a carrying value of $500.2 million and $119.9 million, respectively, and had outstanding commitments to purchase $554.8 million and $12.1 million of mortgage loans, respectively, subject to fallout if the loans do not close. Our intention is to securitize these loans and/or exit through a whole loan sale.

In 2013, we acquired a portfolio of CSL, which are loans that are currently performing, but where the borrower has previously experienced payment delinquencies and is more likely to be underwater (i.e., the amount owed on a mortgage loan exceeds the current market value of the home). As a result, there is a higher probability of default than on newly originated

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mortgage loans. We subsequently sold substantially all of our CSL portfolio during the first quarter of 2014. As of December 31, 2014, we had CSL with a carrying value of $35.6 million remaining.

The following table presents our mortgage loans held-for-sale portfolio by loan type as of December 31, 2014 and December 31, 2013:

	December 31, 2014			
(in thousands)	Unpaid Principal Balance	Fair Value - Purchase Price	Fair Value - Unrealized	Carrying Value
Prime nonconforming residential mortgage loans	$486,878	$10,730	$2,551	$500,159
Credit sensitive residential mortgage loans	47,223	(8,486)	(3,184)	35,553
Mortgage loans held-for-sale	$534,101	$2,244	$(633)	$535,712

	December 31, 2013			
(in thousands)	Unpaid Principal Balance	Fair Value - Purchase Price	Fair Value - Unrealized	Carrying Value
Prime nonconforming residential mortgage loans	$122,571	$841	$(3,557)	$119,855
Credit sensitive residential mortgage loans	558,269	(133,572)	29	424,726
Mortgage loans held-for-sale	$680,840	$(132,731)	$(3,528)	$544,581

Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value

We purchase subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or our subsidiaries. The underlying residential mortgage loans held by the trusts, which are consolidated on our consolidated balance sheet, are classified as mortgage loans held-for-investment in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the consolidated financial statements for additional information regarding consolidation of the securitization trusts. As of December 31, 2014 and December 31, 2013, mortgage loans held-for-investment in securitization trusts had a carrying value of $1.7 billion and $792.4 million, respectively.

Mortgage Servicing Rights, at Fair Value

On April 30, 2013, one of our wholly owned subsidiaries acquired a company that holds approvals from Fannie Mae, Freddie Mac and Ginnie Mae to hold and manage MSR. The MSR acquired in conjunction with this acquisition and those subsequently purchased represent the right to control the servicing of mortgage loans. We do not directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying our MSR. As of December 31, 2014 and December 31, 2013, our MSR had a fair market value of $452.0 million and $514.4 million, respectively.

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As of December 31, 2014 and December 31, 2013, our MSR portfolio included MSR on approximately 224,000 and 210,000 loans with an unpaid principal balance of approximately $44.9 billion and $42.3 billion, respectively. The following tables summarize certain characteristics of the loans underlying our MSR at December 31, 2014 and December 31, 2013:

	At December 31, 2014							
	Government FHA (1)		Government VA/USDA (1)		Conventional Loans (2)		Total	
Unpaid principal balance (in thousands)	$9,107,538		$3,058,051		$32,783,472		$44,949,061	
Number of loans	61,071		16,022		146,980		224,073	
Average Coupon	4.4	%	3.9	%	3.8	%	3.9	%
Average Loan Age (months)	45		33		26		31	
Average Loan Size (in thousands)	$149		$191		$223		$201	
Average Original Loan-to-Value	92.4	%	96.1	%	66.7	%	73.9	%
Average Original FICO	700		718		764		748	
60+ day delinquencies	5.5	%	2.9	%	0.3	%	1.5	%
3-Month CPR	13.1	%	11.8	%	8.2	%	9.5	%

	At December 31, 2013							
	Government FHA (1)		Government VA/USDA (1)		Conventional Loans (2)		Total	
Unpaid principal balance (in thousands)	$10,672,987		$3,516,087		$28,135,254		$42,324,328	
Number of loans	68,782		17,873		123,786		210,441	
Average Coupon	4.4	%	3.9	%	3.7	%	3.9	%
Average Loan Age (months)	33		21		15		20	
Average Loan Size (in thousands)	$155		$197		$227		$201	
Average Original Loan-to-Value	92.4	%	96.2	%	66.6	%	75.6	%
Average Original FICO	700		717		766		745	
60+ day delinquencies	2.9	%	1.5	%	0.1	%	0.9	%

(1) Includes loans issued by Ginnie Mae.
(2) Includes loans issued by Fannie Mae, Freddie Mac or private investors.

Repurchase Agreements and Federal Home Loan Bank of Des Moines Advances

Our borrowings consist primarily of repurchase agreements and FHLB advances collateralized by our pledge of AFS and trading securities, derivative instruments, mortgage loans and certain cash balances. Substantially all of our Agency RMBS AFS are currently pledged as collateral, and the majority of our non-Agency RMBS have been pledged, either through repurchase agreements or FHLB advances. As of December 31, 2014, our total consolidated debt-to-equity ratio was 4.1:1.0. The debt-to-equity ratio funding our RMBS AFS, residential mortgage loans and Agency Derivatives only was 3.3:1.0. We believe our debt-to-equity ratio provides unused borrowing capacity and, thus, improves our liquidity and the strength of our balance sheet.

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As of December 31, 2014 and December 31, 2013, repurchase agreements and FHLB advances had the following characteristics:

(dollars in thousands)	December 31, 2014					December 31, 2013				
Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate		Weighted Average Haircut on Collateral Value		Amount Outstanding	Weighted Average Borrowing Rate		Weighted Average Haircut on Collateral Value	
U.S. Treasuries	$1,996,250	0.23	%	0.5	%	$997,500	0.03	%	0.5	%
Agency RMBS AFS	10,577,735	0.40	%	6.0	%	9,109,510	0.46	%	5.9	%
Non-Agency RMBS (1)	2,395,615	1.74	%	28.7	%	1,829,709	2.01	%	32.6	%
Agency derivatives	138,133	0.99	%	26.5	%	166,438	1.05	%	27.2	%
Mortgage loans held-for-sale	324,730	0.47	%	21.5	%	147,293	2.85	%	23.9	%
Total	$15,432,463	0.60	%	9.3	%	$12,250,450	0.69	%	9.9	%

(1) Includes repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

As of December 31, 2014, we had outstanding $12.9 billion of repurchase agreements, including repurchase agreements funding our U.S. Treasuries of $2.0 billion. As of December 31, 2014, the term to maturity of our repurchase agreements ranged from one day to over 17 months. Excluding the debt associated with our U.S. Treasuries, repurchase agreements had a weighted average borrowing rate of 0.72% and weighted average remaining maturities of 64 days as of December 31, 2014.

As of December 31, 2014, we had outstanding $2.5 billion of FHLB advances. As of December 31, 2014, the weighted average term to maturity of our FHLB advances was 119 months, ranging from 15 days to over 19 years. The weighted average cost of funds for our advances was 0.3% at December 31, 2014.

The following table provides the quarterly average balances, the quarter-end balances, and the maximum balances at any month-end within that quarterly period, of repurchase agreements and FHLB advances (total borrowings) for the three months ended December 31, 2014, and the four immediately preceding quarters:

(dollars in thousands)	Quarterly Average (1)	End of Period Balance (1)	Maximum Balance of Any Month-End (1)	Total Borrowings to Equity Ratio
For the Three Months Ended December 31, 2014	$12,726,721	$13,436,213	$13,436,213	3.3:1.0
For the Three Months Ended September 30, 2014	$11,626,507	$11,788,628	$11,788,628	2.9:1.0
For the Three Months Ended June 30, 2014	$11,527,349	$11,891,187	$11,891,187	2.9:1.0
For the Three Months Ended March 31, 2014	$11,254,004	$11,489,403	$11,489,403	2.9:1.0
For the Three Months Ended December 31, 2013	$11,268,720	$11,252,950	$11,389,908	2.9:1.0

(1) Includes repurchase agreements and FHLB advances collateralized by RMBS AFS, residential mortgage loans held-for-sale and Agency Derivatives and excludes repurchase agreements collateralized by U.S. Treasuries and collateralized borrowings in securitization trusts.

Collateralized Borrowings in Securitization Trusts, at Fair Value

We purchase subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or our subsidiaries. The underlying debt held by the trusts, which are consolidated on our consolidated balance sheet, is classified as collateralized borrowings in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the consolidated financial statements for additional information regarding consolidation of the securitization trusts. As of December 31, 2014 and December 31, 2013 the collateralized borrowings in securitization trusts had a carrying value of $1.2 billion and $639.7 million with a weighted average interest rate of 3.6% and 2.8%, respectively. The stated maturity dates for all collateralized borrowings are greater than five years from December 31, 2014.

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Equity

As of December 31, 2014, our stockholders' equity was $4.1 billion and our diluted book value per share was $11.10. As of December 31, 2013, our stockholders' equity was $3.9 billion and our diluted book value per share was $10.56. The following table provides details of our changes in stockholders' equity from December 31, 2012 to December 31, 2014:

(dollars in millions, except per share amounts)	Book Value	Common Shares Outstanding (Diluted Basis)	Book Value Per Common Share (Diluted Basis)
Stockholders' equity at December 31, 2012 - basic[1]	$3,450.6	298.8	$11.55
GAAP net income:			
Core Earnings, net of tax expense of $1.8 million [2]	311.9		
Realized gains and losses, net of tax expense of $24.5 million	7.5		
Unrealized mark-to-market gains and losses, net of tax expense of $58.1 million	255.6		
Discontinued operations	4.0		
Total GAAP net income	579.0		
Other comprehensive loss	(251.7)		
Dividend declaration [3]	(770.6)		
Other	0.5	1.0	
Balance before capital transactions	3,007.8	299.8	
Repurchase of common stock	(23.9)	(2.4)	
Issuance of common stock, net of offering costs	763.6	57.6	
Issuance of common stock through warrant exercise	107.5	9.9	
Stockholders' equity at December 31, 2013 - basic and diluted[4]	$3,855.0	364.9	$10.56
GAAP net income:			
Core Earnings, net of tax expense of $6.8 million [2]	343.8		
Realized gains and losses, net of tax benefit of $20.9 million	15.9		
Unrealized mark-to-market gains and losses, net of tax benefit of $59.6 million	(192.5)		
Discontinued operations	—		
Total GAAP net income	167.2		
Other comprehensive income	411.0		
Dividend declaration	(380.8)		
Other	15.0	1.4	
Balance before capital transactions	4,067.4	366.3	
Issuance of common stock, net of offering costs	0.6	0.1	
Issuance of common stock through warrant exercise [4]	—	—	
Stockholders' equity at December 31, 2014 - basic and diluted[4]	$4,068.0	366.4	$11.10

(1) Using the treasury stock method, $0.1 million shares would be considered outstanding and dilutive to book value per share at December 31, 2012. However, for purposes of presenting an accurate rollforward of stockholders' equity, only basic book value and shares outstanding are shown above.

(2) Core Earnings is a non-U.S. GAAP measure that we define as GAAP net income, excluding impairment losses, realized and unrealized gains or losses on the aggregate portfolio, gains and losses related to discontinued operations, amortization of business combination intangible assets, reserve expense for representation and warranty obligations on MSR and certain upfront costs related to securitization transactions. As defined, Core Earnings

includes interest income or expense and premium income or loss on derivative instruments and servicing income, net of estimated amortization on MSR. Core Earnings is provided for purposes of comparability to other peer issuers.

(3) Includes distribution of Silver Bay common stock amounting to $343.5 million, as measured in accordance with U.S. GAAP.

(4) As of December 31, 2013 and for the year ended December 31, 2014, there were no longer any warrants outstanding due to their expiration on November 7, 2013. As a result, basic and diluted shares outstanding were equal.

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U.S. GAAP to Taxable Income

The following tables provide reconciliations of our GAAP net (loss) income to our taxable income (loss) split between our REIT and taxable REIT subsidiaries for the years ended December 31, 2014 and December 31, 2013:

	Year Ended December 31, 2014			
(dollars in millions)	TRS	REIT	Securitization Trusts	Consolidated
GAAP net (loss) income, pre-tax	$(214.7)	$308.7	$(0.6)	$93.4
Permanent differences				
Securitization trusts consolidated for U.S. GAAP purposes only	—	—	0.6	0.6
Other permanent differences	0.2	(2.0)	—	(1.8)
Temporary differences				
Net accretion of OID and market discount	(5.8)	38.1	—	32.3
Unrealized loss on trading securities and derivatives	175.4	54.3	—	229.7
Other temporary differences	2.3	(11.0)	—	(8.7)
Capital loss deferral	60.7	(50.1)	—	10.6
Net operating loss carryover	(3.8)	—	—	(3.8)
Taxable income	14.3	338.0	—	352.3
Dividend declaration deduction	—	(338.0)	—	(338.0)
Taxable income post-dividend deduction	$14.3	$—	$—	$14.3

	Year Ended December 31, 2013			
(dollars in millions)	TRS	REIT	Securitization Trusts	Consolidated
GAAP net income, pre-tax	$248.5	$398.6	$16.3	$663.4
Permanent differences				
Silver Bay stock distribution	—	2.3	—	2.3
Securitization trusts consolidated for U.S. GAAP purposes only	—	—	(16.3)	(16.3)
Temporary differences				
Net accretion of OID and market discount	—	34.8	—	34.8
Unrealized gain on trading securities and derivatives	(174.6)	(125.6)	—	(300.2)
Taxable dividends from TRS to REIT	—	50.0	—	50.0
Other temporary differences	0.4	4.7	—	5.1
Capital loss deferral	(42.9)	50.1	—	7.2
Net operating loss carryover	(52.7)	—	—	(52.7)
Taxable (loss) income	(21.3)	414.9	—	393.6
Prior year undistributed taxable income	—	10.7	—	10.7
Dividend declaration deduction	—	(425.6)	—	(425.6)
Taxable loss post-dividend deduction	$(21.3)	$—	$—	$(21.3)

The permanent tax differences recorded in 2013 and 2014 include a recurring difference in the income recognized from the securitization trusts that are consolidated for U.S. GAAP purposes only. The permanent tax differences recorded in 2014 also include a recurring difference in compensation expense related to restricted stock dividends, and the permanent tax differences recorded in 2013 include a non-recurring difference in the gain recognized on the Silver Bay common stock distribution. Temporary differences are principally timing differences between U.S. GAAP and tax accounting related to unrealized gains and losses from derivative instruments and accretion and amortization from RMBS.

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Change in Accumulated Other Comprehensive Income

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of securities do not impact our GAAP net income (loss) or taxable income but are recognized on our balance sheet as a change in stockholder's equity under "accumulated other comprehensive income." As a result of this fair value accounting through stockholder's equity, we expect our net income to have less significant fluctuations and result in less U.S. GAAP to taxable income timing differences, than if the portfolio were accounted as trading instruments.

Dividends

For the 2014 taxable year, we declared dividends totaling $1.04 per share. As a REIT, we are required to distribute at least 90% of our taxable income to stockholders, subject to certain distribution requirements. For the fiscal year ended 2014, our board of directors elected to distribute the majority of our taxable income to avoid U.S. Federal Income taxes. As such, temporary differences between GAAP net income (loss) and taxable income can generate deterioration in book value on a permanent and temporary basis as taxable income is distributed that has not been earned for U.S. GAAP purposes. The following table presents cash dividends declared on our common stock for the fiscal years ended December 31, 2014, 2013 and 2012:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share (1)
December 16, 2014	December 30, 2014	January 20, 2015	$0.26
September 16, 2014	September 30, 2014	October 21, 2014	$0.26
June 17, 2014	July 2, 2014	July 22, 2014	$0.26
March 17, 2014	March 31, 2014	April 21, 2014	$0.26
December 17, 2013	December 27, 2013	December 31, 2013	$0.26
September 11, 2013	September 26, 2013	October 23, 2013	$0.28
June 18, 2013	June 28, 2013	July 23, 2013	$0.31
March 18, 2013	April 2, 2013	April 24, 2013	$0.32
December 17, 2012	December 31, 2012	January 18, 2013	$0.55
September 12, 2012	September 24, 2012	October 22, 2012	$0.36
June 12, 2012	June 22, 2012	July 20, 2012	$0.40
March 14, 2012	March 26, 2012	April 20, 2012	$0.40

(1) Per share amounts represent cash dividends only and exclude the distribution of Silver Bay common stock declared on March 18, 2013 and distributed on or about April 24, 2013 to our common stockholders of record as of April 2, 2013 amounting to $1.01 per share, as measured in accordance with U.S. GAAP.

The following table summarizes dividends declared for the years ended December 31, 2014, 2013 and 2012 and their related tax characterization (per share amounts):

		Tax Characterization of Dividends			
Year Ended December 31,	Dividends Declared	Ordinary Dividends (Non-Qualified)	Qualified Ordinary Dividends	Capital Gain Distribution	Nondividend Distribution
2014	$1.04	$0.96	$—	$0.08	$—
2013	$2.12	$1.03	$0.14	$—	$0.95
2012	$1.71	$1.40	$—	$0.31	$—

Liquidity and Capital Resources

Our liquidity and capital resources are managed and forecast on a daily basis to ensure that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls and to ensure that we have the flexibility to manage our portfolio to take advantage of market opportunities.

Our principal sources of cash consist of borrowings under repurchase agreements and FHLB advances, payments of principal and interest we receive on our target assets, cash generated from our operating results, and proceeds from capital market transactions. We typically use cash to repay principal and interest on our repurchase agreements, to purchase our target assets, to make dividend payments on our capital stock, and to fund our operations.

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To the extent that we raise additional equity capital through capital market transactions, we anticipate using cash proceeds from such transactions to purchase additional RMBS, residential mortgage loans, MSR, commercial real estate debt and related assets and other target assets, and for other general corporate purposes.

As of December 31, 2014, we held $1.0 billion in cash and cash equivalents available to support our operations, $19.5 billion of AFS, trading securities, mortgage loans held-for-sale, mortgage loans held-for-investment in securitization trusts, MSR and derivative assets held at fair value, and $16.6 billion of outstanding debt in the form of repurchase agreements, FHLB advances and collateralized borrowings in securitization trusts. During the year ended December 31, 2014, our total consolidated debt-to-equity ratio increased from 3.3:1.0 to 4.1:1.0. The debt-to-equity ratio funding our RMBS AFS, mortgage loans held-for-sale and Agency Derivatives only also increased from 2.9:1.0 to 3.3:1.0 due to an increase in FHLB advances and repurchase agreements to fund our RMBS and mortgage loan purchases during the year ended December 31, 2014. We believe the debt-to-equity ratio funding our RMBS AFS, mortgage loans held-for-sale and Agency Derivatives is the most meaningful debt-to-equity measure as U.S. Treasuries are viewed to be highly liquid in nature and collateralized borrowings on mortgage loans held-for-investment in securitization trusts represents term financing with no stated maturity.

As of December 31, 2014, we had approximately $109.8 million of unpledged Agency RMBS AFS and Agency Derivatives and $148.5 million of unpledged non-Agency securities and retained interest from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP. As a result, we had an overall estimated unused borrowing capacity on unpledged RMBS and retained interests of approximately $202.6 million. We also had approximately $87.8 million of unpledged prime nonconforming residential mortgage loans and $31.2 million of unpledged CSL and an overall estimated unused borrowing capacity on unpledged mortgage loans held-for-sale of approximately $96.1 million. On a daily basis, we monitor and forecast our available, or excess, liquidity. Additionally, we frequently perform shock analyses against various market events to monitor the adequacy of our excess liquidity. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than a more leveraged organization.

During the year ended December 31, 2014, we did not experience any restrictions to our funding sources and have generally experienced an increase in available financing in the RMBS marketplace, including repurchase agreements with maturities greater than one year. We expect ongoing sources of financing to be primarily repurchase agreements and similar financing arrangements. We plan to finance our assets with a moderate amount of leverage, the level of which may vary based upon the particular characteristics of our portfolio and market conditions. We may deploy, on a debt-to-equity basis, up to ten times leverage on our Agency RMBS assets. We also deploy some leverage on our non-Agency RMBS assets utilizing repurchase agreements as the source of financing.

As of December 31, 2014, we have master repurchase agreements in place with 30 counterparties, the majority of which are U.S. domiciled financial institutions, and we continue to evaluate further counterparties to manage and reduce counterparty risk. Under our repurchase agreements, we are required to pledge additional assets as collateral to our counterparties (lenders) when the estimated fair value of the existing pledged collateral under such agreements declines and such lenders, through a margin call, demand additional collateral. Lenders generally make margin calls because of a perceived decline in the value of our assets collateralizing the repurchase agreements. This may occur following the monthly principal reduction of assets due to scheduled amortization and prepayments on the underlying mortgages, or may be caused by changes in market interest rates, a perceived decline in the market value of the investments and other market factors. To cover a margin call, we may pledge additional securities or cash. At maturity, any cash on deposit as collateral is generally applied against the repurchase agreement balance, thereby reducing the amount borrowed. Should the value of our assets suddenly decrease, significant margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes our repurchase agreements and counterparty geographical concentration at December 31, 2014 and December 31, 2013:

	December 31, 2014	December 31, 2013
(dollars in thousands)		

	Amount Outstanding	Net Counterparty Exposure[1]	Percent of Funding		Amount Outstanding	Net Counterparty Exposure[1]	Percent of Funding	
North America	$8,331,244	$974,519	57.9	%	$7,125,934	$889,018	52.9	%
Europe [2]	2,950,991	604,711	35.9	%	3,493,315	711,748	42.4	%
Asia [2]	1,650,228	103,571	6.2	%	1,631,201	79,657	4.7	%
Total	$12,932,463	$1,682,801	100.0	%	$12,250,450	$1,680,423	100.0	%

(1) Represents the net carrying value of the securities or mortgage loans sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest.
(2) Exposure to European- and Asian-domiciled banks and their U.S. subsidiaries.

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In addition to our master repurchase agreements to fund RMBS, we have two facilities that provide short-term financing for our mortgage loan collateral during our aggregation period. An overview of the facilities is presented in the tables below:

(dollars in thousands)
As of December 31, 2014

Expiration Date		Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
May 12, 2015	(1)	No	9,234	90,766	100,000	Prime nonconforming residential mortgage loans
May 21, 2015	(1)	No	5,879	194,121	200,000	Prime nonconforming residential mortgage loans Credit sensitive residential mortgage loans

(dollars in thousands)
As of December 31, 2013

Expiration Date	Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
May 13, 2014	No	97,571	2,429	100,000	Prime nonconforming residential mortgage loans
May 22, 2014	No	49,721	150,279	200,000	Prime nonconforming residential mortgage loans Credit sensitive residential mortgage loans

(1) The facilities are set to mature on the stated expiration date, unless extended pursuant to their terms.

We also had one facility that provided short-term financing for our prime nonconforming residential mortgage loans held-for-sale expire during the year ended December 31, 2013, in conjunction with the sale of our prime nonconforming residential mortgage loan collateral into a securitization trust sponsored by one of our subsidiaries.

In December 2013, our wholly owned subsidiary, TH Insurance, was accepted for membership in the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of December 31, 2014, TH Insurance had $2.5 billion in outstanding secured advances with a weighted average borrowing rate of 0.3%, and no additional unused capacity to borrow. Subsequent to December 31, 2014, TH Insurance’s aggregate borrowing capacity was increased to $4.0 billion. To the extent TH Insurance has unused capacity, it may be adjusted at the sole discretion of the FHLB.

The ability to borrow from the FHLB is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, commercial real estate loans, Agency RMBS and certain non-Agency RMBS with a rating of A and above.

In 2014, the FHFA published a proposed rulemaking regarding membership in the Federal Home Loan Bank system. Among other effects, the rulemaking would exclude captive insurers from membership. We believe we have a strong relationship with the FHLB and our mission aligns well with that of the Federal Home Loan Bank system. Even if the rulemaking were implemented in its current form, it appears that final rules would not take effect for some time. We continue to closely monitor matters that could impact our FHLB membership.

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We are subject to a variety of financial covenants under our lending agreements. The following represents the most restrictive covenant calculations across the agreements as of December 31, 2014:

(a) As of the last business day of each calendar quarter, total indebtedness to net worth must be less than the specified threshold ratio in the repurchase agreement. As of December 31, 2014, our debt to net worth, as defined, was 3.6:1.0 while our threshold ratio, as defined, was 5.7:1.0.

(b) As of the last business day of each calendar quarter, liquidity must be greater than $100 million and the aggregate amount of unrestricted cash or cash equivalents must be greater than $35 million. As of December 31, 2014, our liquidity, as defined, was $1.4 billion and our total unrestricted cash and cash equivalents, as defined, was $1.0 billion.

(c) As of the last business day of each calendar quarter, net worth must be greater than $1.75 billion. As of December 31, 2014, our net worth, as defined, was $4.1 billion.

We are also subject to financial covenants in connection with various other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants.

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements and FHLB advances.

(in thousands)	December 31, 2014	December 31, 2013
Available-for-sale securities, at fair value	$14,159,315	$12,295,302
Trading securities, at fair value	1,997,656	1,000,180
Mortgage loans held-for-sale, at fair value	416,779	200,839
Net economic interests in consolidated securitization trusts (1)	367,468	—
Cash and cash equivalents	14,117	15,000
Restricted cash	112,435	201,194
Due from counterparties	38,200	21,579
Derivative assets, at fair value	185,067	216,365
Total	$17,291,037	$13,950,459

(1) Includes the retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

Although we generally intend to hold our target assets as long-term investments, we may sell certain of our assets in order to manage our interest rate risk and liquidity needs, to meet other operating objectives and to adapt to market conditions. Our RMBS are generally publicly traded and, thus, readily liquid. However, certain of our assets, including mortgage loans and MSR, are subject to longer trade timelines, and, as a result, market conditions could significantly and adversely affect the liquidity of our assets. Any illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises. Our ability to quickly sell certain assets, such as mortgage loans and MSR, may be limited by delays encountered while obtaining certain regulatory approvals required for such dispositions and may be further limited by delays due to the time period needed for negotiating transaction documents, conducting diligence, and complying with regulatory requirements regarding the transfer of such assets before settlement may occur. Consequently, even if we identify a buyer for our mortgage loans and MSR, there is no assurance that we would be able to quickly sell such assets if the need or desire arises.

In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we previously recorded our assets. Assets that are illiquid are more difficult to finance, and to the extent that we use leverage to finance assets that become illiquid, we may lose that leverage or have it reduced. Assets tend to become less liquid during times of financial stress, which is often the time that liquidity is most needed. As a result, our ability to sell assets or vary our portfolio in response to changes in economic and other conditions may

be limited by liquidity constraints, which could adversely affect our results of operations and financial condition.
We cannot predict the timing and impact of future sales of our assets, if any. Because many of our assets are financed with repurchase agreements and FHLB advances, and may be financed with credit facilities (including term loans and revolving facilities), a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization are used to repay balances under these financing sources.

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The following table provides the maturities of our repurchase agreements and FHLB advances as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013
Within 30 days	$4,013,055	$3,831,917
30 to 59 days	4,595,425	2,013,733
60 to 89 days	903,286	2,225,967
90 to 119 days	434,550	1,386,371
120 to 364 days (1)	1,929,164	1,594,962
One to three years	744,459	200,000
Three to five years	815,024	—
Five to ten years	—	—
Ten years and over	1,000,000	—
Open maturity (2)	997,500	997,500
Total	$15,432,463	$12,250,450

(1) 120 to 364 days includes the amounts outstanding under the uncommitted mortgage loan warehouse facilities.
(2) Includes repurchase agreements collateralized by U.S. Treasuries with an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.

For the year ended December 31, 2014, our unrestricted cash balance decreased approximately $19.7 million to $1.0 billion at December 31, 2014. The cash movements can be summarized by the following:

- Cash flows from operating activities. For the year ended December 31, 2014, operating activities reduced our cash balances by approximately $764.1 million, primarily driven by purchases of mortgage loans either held-for-sale or transferred to held-for-investment in securitization trusts, offset by our financial results for the year.
- Cash flows from investing activities. For the year ended December 31, 2014, investing activities reduced our cash balances by approximately $2.7 billion, primarily driven by purchases of AFS and trading securities.
- Cash flows from financing activities. For the year ended December 31, 2014, financing activities increased our cash balance by approximately $3.4 billion, resulting from the proceeds from borrowings under repurchase agreements, FHLB advances and collateralized borrowings in securitization trusts to fund our RMBS and mortgage loan portfolios.

Off-Balance Sheet Arrangements

We have no obligations, assets or liabilities which would be considered off-balance sheet arrangements. We have not participated in transactions that create relationships with unconsolidated entities or financial partnerships which would have been established for the purpose of facilitating off-balance sheet arrangements.

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Aggregate Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements, our non-cancelable office lease and management fees payable under our management agreement:

	Due During the Year Ended December 31,						
(in thousands)	2015	2016	2017	2018	2019	Thereafter	Total
Repurchase agreements [1]	$12,839,242	$93,221	$—	$—	$—	$—	$12,932,463
Federal Home Loan Bank advances	33,738	—	651,238	—	815,024	1,000,000	2,500,000
Interest expense on borrowings [2]	24,390	9,849	6,656	6,107	4,040	39,556	90,598
Long-term operating lease obligations	2,250	1,902	1,468	1,187	1,205	2,988	11,000
Management fee - PRCM Advisers [3]	187,597	—	—	—	—	—	187,597
Total	$13,087,217	$104,972	$659,362	$7,294	$820,269	$1,042,544	$15,721,658

(1) Obligations for repurchase agreements due in 2015 includes $997.5 million collateralized by U.S. Treasuries that have an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.

(2) Interest expense on borrowings, including repurchase agreements and FHLB advances, are calculated based on rates at December 31, 2014.

(3) Contractual obligation for the management fee is estimated through the contract expiration date of October 28, 2015, inclusive of the termination fee as defined in the management agreement between us and PRCM Advisers. Disclosure assumes agreement not renewed or terminated without cause.

We are party to a management agreement with PRCM Advisers, pursuant to which PRCM Advisers is entitled to receive a management fee and the reimbursement of certain expenses from us. We reimburse PRCM Advisers for (i) our allocable share of the compensation paid by PRCM Advisers to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us, and (ii) any amounts for personnel of PRCM Advisers' affiliates arising under a shared facilities and services agreement.

We are also party to contracts that contain a variety of indemnification obligations, principally with brokers, underwriters and counterparties to repurchase agreements and investors in the RMBS we issue and the loans underlying our MSR assets. The maximum potential future payment amount we could be required to pay under these indemnification obligations may be unlimited.

Recently Issued Accounting Standards

Refer to Note 2 of the notes to the consolidated financial statements included in Item 8 of this Form 10-K.

Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with

U.S. GAAP and dividends are based upon net ordinary income and capital gains as calculated for tax purposes; in each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

Other Matters

We intend to conduct our business so as to maintain our exempt status under, and not to become regulated as an investment company for purposes of the 1940 Act. If we failed to maintain our exempt status under the 1940 Act and became regulated as an investment company, our ability to, among other things, use leverage would be substantially reduced and, as a result, we would be unable to conduct our business as described in Item 1 - Business - Other Business - Regulation of this Form 10-K. Accordingly, we monitor our compliance with both the 55% Test and the 80% Tests of the 1940 Act in order to maintain our exempt status. As of December 31, 2014, we determined that we maintained compliance with both the 55% Test and the 80% Test requirements.

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the year ended December 31, 2014. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the year ended December 31, 2014. Consequently, we met the REIT income and asset tests. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, for the year ended December 31, 2014, we believe that we qualified as a REIT under the Code.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while providing an opportunity to stockholders to realize attractive risk-adjusted total return through ownership of our capital stock. Although we do not seek to avoid risk completely, we believe that risk can be quantified from historical experience and we seek to manage our risk levels in order to earn sufficient compensation to justify the risks we undertake and to maintain capital levels consistent with taking such risks.

To reduce the risks to our portfolio, we employ portfolio-wide and asset-specific risk measurement and management processes in our daily operations. PRCM Advisers and its affiliates’ risk management tools include software and services licensed or purchased from third parties and proprietary software and analytical methods developed by Pine River. There can be no guarantee that these tools will protect us from market risks.

Interest Rate Risk

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

We utilize U.S. Treasuries as well as derivative financial instruments, currently limited to interest rate swaps, swaptions, TBAs, put and call options for TBAs, constant maturity swaps, Markit IOS total return swaps and, to a certain extent, inverse interest-only securities, as of December 31, 2014, to hedge the interest rate risk associated with our portfolio. In addition, because MSR are negative duration assets, they provide a natural hedge to interest rate exposure on our RMBS portfolio. We seek to hedge interest rate risk with respect to both the fixed income nature of our assets and the financing of our portfolio. In hedging interest rates with respect to our fixed income assets, we seek to reduce the risk of losses on the value of our investments that may result from changes in interest rates in the broader markets. In utilizing interest rate hedges with respect to our financing, we seek to improve risk-adjusted returns and, where possible, to obtain a favorable spread between the yield on our assets and the cost of our financing. We implement part of our hedging strategy through our TRSs, which are subject to U.S. federal, state and, if applicable, local income tax.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate RMBS and mortgage loans held-for-sale will remain static. Moreover, interest rates may rise at a faster pace than the yields earned on our leveraged adjustable-rate and hybrid RMBS and adjustable-rate mortgage loans held-for-sale. Both of these factors could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Our hedging techniques are partly based on assumed levels of prepayments of our target assets. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

We acquire adjustable-rate and hybrid RMBS. These are assets in which some of the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate and hybrid RMBS could effectively be limited by caps. This issue will be magnified to the extent we acquire adjustable-rate and hybrid RMBS that are not based on mortgages that are fully indexed. In addition, adjustable-rate and hybrid RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. If this happens, we could receive less cash income on such assets than we would need to pay for interest costs on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

We also acquire adjustable-rate mortgage loans held-for-sale. These assets are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the loan's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate mortgage loans held-for-sale could effectively be limited by caps.

Interest Rate Mismatch Risk

We fund the majority of our adjustable-rate and hybrid Agency RMBS and adjustable-rate mortgage loans held-for-sale with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to other index rates, such as the one-year Constant Maturity Treasury index, or CMT, the Monthly Treasury Average index, or MTA, or the 11th District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to these indices may result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we utilize the hedging strategies discussed above.

The following table provides the indices of our variable rate RMBS AFS and mortgage loans held-for-sale as of December 31, 2014 and December 31, 2013, respectively, based on carrying value (dollars in thousands).

	As of December 31, 2014				As of December 31, 2013			
Index Type	Floating	Hybrid (1)	Total	Index %	Floating	Hybrid (1)	Total	Index %
CMT	$1,121	$115,619	$116,740	4 %	$11,972	$134,075	$146,047	4 %
LIBOR	2,762,807	42,530	2,805,337	93 %	2,376,144	488,469	2,864,613	83 %
Other (2)	68,244	19,228	87,472	3 %	58,239	397,775	456,014	13 %
Total	$2,832,172	$177,377	$3,009,549	100 %	$2,446,355	$1,020,319	$3,466,674	100 %

(1) "Hybrid" amounts reflect those assets with greater than twelve months to reset.

(2) "Other" includes COFI, MTA and other indices.

Our analysis of risks is based on PRCM Advisers' and its affiliates' experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of decisions by PRCM Advisers may produce results that differ significantly from the estimates and assumptions used in our models.

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We use a variety of recognized industry models, as well as proprietary models, to perform sensitivity analyses which are derived from primary assumptions for prepayment rates, discount rates and credit losses. The primary assumption used in this model is implied market volatility of interest rates. The information presented in the following interest rate sensitivity table projects the potential impact of sudden parallel changes in interest rates on our financial results and financial condition over the next twelve months, based on our interest sensitive financial instruments at December 31, 2014.

All changes in value are measured as the change from the December 31, 2014 financial position. All projected changes in annualized net interest income are measured as the change from the projected annualized net interest income based off current performance returns.

	Changes in Interest Rates							
(dollars in thousands)	-100 bps		-50 bps		+50 bps		+100 bps	
Change in value of financial position:								
Available-for-sale securities	$319,474		$173,687		$(303,349	)	$(638,334	)
As a % of December 31, 2014 equity	7.8	%	4.2	%	(7.5	)%	(15.7	)%
Trading securities	$49,219		$24,219		$(30,781	)	$(52,968	)
As a % of December 31, 2014 equity	1.2	%	0.6	%	(0.7	)%	(1.3	)%
Mortgage loans held-for-sale	$15,044		$9,132		$(16,975	)	$(37,530	)
As a % of December 31, 2014 equity	0.4	%	0.2	%	(0.4	)%	(0.9	)%
Mortgage loans held-for-investment in securitization trusts	$50,461		$31,339		$(59,226	)	$(131,465	)
As a % of December 31, 2014 equity	1.2	%	0.8	%	(1.4	)%	(3.2	)%
Mortgage servicing rights	$(264,974	)	$(91,178	)	$74,662		$116,946	
As a % of December 31, 2014 equity	(6.5	)%	(2.3	)%	1.8	%	2.9	%
Derivatives, net	$(222,244	)	$(166,976	)	$216,724		$493,085	
As a % of December 31, 2014 equity	(5.5	)%	(4.1	)%	5.3	%	12.1	%
Repurchase Agreements	$(5,330	)	$(5,330	)	$9,480		$18,959	
As a % of December 31, 2014 equity	(0.1	)%	(0.1	)%	0.2	%	0.5	%
Collateralized borrowings in securitization trusts	$(37,034	)	$(21,286	)	$44,875		$101,974	
As a % of December 31, 2014 equity	(0.9	)%	(0.5	)%	1.1	%	2.5	%
Federal Home Loan Bank advances	$(413	)	$(413	)	$945		$1,890	
As a % of December 31, 2014 equity	—	%	—	%	—	%	—	%
Total Net Assets	$(95,797	)	$(46,806	)	$(63,645	)	$(127,443	)
As a % of December 31, 2014 total assets	(0.5	)%	(0.2	)%	(0.3	)%	(0.6	)%
As a % of December 31, 2014 equity	(2.4	)%	(1.2	)%	(1.6	)%	(3.1	)%
	-100 bps		-50 bps		+50 bps		+100 bps	
Change in annualized net interest income:	$(9,539	)	$(9,420	)	$8,289		$16,579	
% change in net interest income	(2.3	)%	(2.3	)%	2.0	%	4.1	%

The interest rate sensitivity table quantifies the potential changes in net interest income and portfolio value, which includes the value of swaps and our other derivatives, should interest rates immediately change. The interest rate sensitivity table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with the portfolio for each rate change are calculated based on assumptions, including prepayment speeds, yield on future acquisitions, slope of the yield curve, and size of the portfolio. Assumptions made on the interest rate sensitive liabilities include anticipated interest rates, collateral requirements as a percentage of borrowings and amount and term of borrowing.

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at December 31, 2014. The analysis utilizes assumptions and estimates based on management's judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

The change in annualized net interest income does not include any benefit or detriment from faster or slower prepayment rates on our Agency premium RMBS, non-Agency discount RMBS, and instruments that represent the interest payments (but not the principal) on a pool of mortgages, or interest-only securities. We anticipate that faster prepayment speeds in lower

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interest rate scenarios will generate lower realized yields on Agency and non-Agency premium and interest-only securities and higher realized yields on Agency and non-Agency discount RMBS. Similarly, we anticipate that slower prepayment speeds in higher interest rate scenarios will generate higher realized yields on Agency premium and interest-only bonds and lower realized yields on non-Agency discount RMBS. Although we have sought to construct the portfolio to limit the effect of changes in prepayment speeds, there can be no assurance this will actually occur, and the realized yield of the portfolio may be significantly different than we anticipate in changing interest rate scenarios.

Given the low interest rate environment at December 31, 2014, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs. However, because prepayments speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and interest-only securities purchased at a premium, and accretion of discount on our non-Agency RMBS purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

Prepayment Risk

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated. As we receive prepayments of principal on our RMBS assets, premiums paid on such assets will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the assets. Conversely, discounts on such assets are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the assets.

We believe that we will be able to reinvest proceeds from scheduled principal payments and prepayments at acceptable yields; however, no assurances can be given that, should significant prepayments occur, market conditions would be such that acceptable investments could be identified and the proceeds timely reinvested.

MSR are also subject to prepayment risk in that, generally, an increase in prepayment rates would result in a decline in value of the MSR.

Market Risk

Market Value Risk. Our AFS securities are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value reflected in accumulated other comprehensive income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, market valuation of credit risks, and other factors. Generally, in a rising interest rate environment, we would expect the fair value of these securities to decrease; conversely, in a decreasing interest rate environment, we would expect the fair value of these securities to increase. As market volatility increases or liquidity decreases, the fair value of our assets may be adversely impacted.

Our mortgage loans held-for-sale and held-for-investment are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates, market valuation of credit risks and other factors. Generally in a rising rate environment, we would expect the fair value of these loans to decrease; conversely, in a decreasing rate environment, we would expect the fair value of these loans to increase. However, the fair value of the CSL included in mortgage loans held-for-sale is generally less sensitive to interest rate changes.

Our MSR are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, we would expect prepayments to decrease, resulting in an increase in the fair value of our MSR. Conversely, in a decreasing interest rate environment, we would expect prepayments to increase, resulting in a decline in fair value.

Real estate risk. Residential property values are subject to volatility and may be affected adversely by a number of factors, including national, regional and local economic conditions; local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. Decreases in property values reduce the value of the collateral for mortgage loans and the potential proceeds available to borrowers to repay the loans, which could cause us to suffer losses on our non-Agency RMBS investments.

Liquidity Risk

Our liquidity risk is principally associated with our financing of long-maturity assets with shorter-term borrowings in the form of repurchase agreements and FHLB advances. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

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Should the value of our assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Additionally, if the FHLB or one or more of our repurchase agreement counterparties chose not to provide ongoing funding, our ability to finance would decline or exist at possibly less advantageous terms. As such, we cannot assure that we will always be able to roll over our repurchase agreements and FHLB advances. See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources” in this Annual Report on Form 10-K for further information about our liquidity and capital resource management.

Credit Risk

We believe that our investment strategy will generally keep our risk of credit losses low to moderate. However, we retain the risk of potential credit losses on all of the loans underlying our non-Agency RMBS and on our mortgage loans. With respect to our non-Agency RMBS that are senior in the credit structure, credit support contained in RMBS deal structures provide a level of protection from losses. We seek to manage the remaining credit risk through our pre-acquisition due diligence process, and by factoring assumed credit losses into the purchase prices we pay for non-Agency RMBS and mortgage loans. In addition, with respect to any particular target asset, we evaluate relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral. We further mitigate credit risk in our mortgage loan portfolio through (1) selecting servicers whose specialties are well matched against the underlying attributes of the mortgage borrowers contained in the loan pools, and (2) an actively managed internal servicer oversight and surveillance program. At times, we enter into credit default swaps or other derivative instruments in an attempt to manage our credit risk. Nevertheless, unanticipated credit losses could adversely affect our operating results.

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Item 8. Financial Statements and Supplementary Data

TWO HARBORS INVESTMENT CORP.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
of Two Harbors Investment Corp.

We have audited the accompanying consolidated balance sheets of Two Harbors Investment Corp. (the Company) as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Two Harbors Investment Corp. at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Two Harbors Investment Corp.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 27, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Minneapolis, Minnesota
February 27, 2015

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31, 2014	December 31, 2013
ASSETS		
Available-for-sale securities, at fair value	$14,341,102	$12,256,727
Trading securities, at fair value	1,997,656	1,000,180
Mortgage loans held-for-sale, at fair value	535,712	544,581
Mortgage loans held-for-investment in securitization trusts, at fair value	1,744,746	792,390
Mortgage servicing rights, at fair value	452,006	514,402
Cash and cash equivalents	1,005,792	1,025,487
Restricted cash	336,771	401,647
Accrued interest receivable	65,529	50,303
Due from counterparties	35,625	25,087
Derivative assets, at fair value	380,791	549,859
Other assets	188,579	13,199
Total Assets [(1)]	$21,084,309	$17,173,862
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	$12,932,463	$12,250,450
Collateralized borrowings in securitization trusts, at fair value	1,209,663	639,731
Federal Home Loan Bank advances	2,500,000	—
Derivative liabilities, at fair value	90,233	22,081
Accrued interest payable	23,772	20,277
Due to counterparties	124,206	318,848
Dividends payable	95,263	—
Other liabilities	40,667	67,480
Total liabilities [(1)]	17,016,267	13,318,867
Stockholders' Equity		
Preferred stock, par value $0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value $0.01 per share; 900,000,000 shares authorized and 366,395,920 and 364,935,168 shares issued and outstanding, respectively	3,664	3,649
Additional paid-in capital	3,811,027	3,795,372
Accumulated other comprehensive income	855,789	444,735
Cumulative earnings	1,195,536	1,028,397
Cumulative distributions to stockholders	(1,797,974)	(1,417,158)
Total stockholders' equity	4,068,042	3,854,995
Total Liabilities and Stockholders' Equity	$21,084,309	$17,173,862

(1) The consolidated balance sheets include assets of consolidated variable interest entities, or VIEs, that can only be used to settle obligations of these VIEs and liabilities of the consolidated VIEs for which creditors do not have recourse to Two Harbors Investment Corp. At December 31, 2014 and December 31, 2013, assets of the VIEs totaled $1,754,943 and $796,896, and liabilities of the VIEs totaled $1,219,821 and $644,051, respectively. See Note 3 - Variable Interest Entities for additional information.

The accompanying notes are an integral part of these consolidated financial statements.

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Year Ended December 31, 2014	2013	2012
Interest income:			
Available-for-sale securities	$506,268	$507,180	$448,620
Trading securities	12,913	5,963	4,873
Mortgage loans held-for-sale	16,089	22,185	609
Mortgage loans held-for-investment in securitization trusts	41,220	19,220	—
Cash and cash equivalents	717	1,043	944
Total interest income	577,207	555,591	455,046
Interest expense:			
Repurchase agreements	76,177	89,470	72,106
Collateralized borrowings in securitization trusts	26,760	10,937	—
Federal Home Loan Bank advances	4,513	—	—
Total interest expense	107,450	100,407	72,106
Net interest income	469,757	455,184	382,940
Other-than-temporary impairments:			
Total other-than temporary impairment losses	(392)	(1,662)	(10,952)
Non-credit portion of loss recognized in other comprehensive income (loss)	—	—	—
Net other-than-temporary credit impairment losses	(392)	(1,662)	(10,952)
Other income:			
Gain (loss) on investment securities	87,201	(54,430)	122,466
(Loss) gain on interest rate swap and swaption agreements	(345,647)	245,229	(159,775)
(Loss) gain on other derivative instruments	(17,529)	95,345	(40,906)
Gain (loss) on mortgage loans held-for-sale	17,297	(33,846)	2,270
Servicing income	128,160	12,011	—
(Loss) gain on servicing asset	(128,388)	13,881	—
Other income	18,539	14,619	—
Total other (loss) income	(240,367)	292,809	(75,945)
Expenses:			
Management fees	48,803	41,707	33,168
Securitization deal costs	4,638	4,153	—
Servicing expenses	25,925	3,761	—
Other operating expenses	56,231	37,259	17,678
Total expenses	135,597	86,880	50,846
Income from continuing operations before income taxes	93,401	659,451	245,197
(Benefit from) provision for income taxes	(73,738)	84,411	(42,219)
Net income from continuing operations	167,139	575,040	287,416
Income from discontinued operations	—	3,999	4,490
Net income	$167,139	$579,039	$291,906

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME, continued
(in thousands, except share data)

	Year Ended December 31, 2014	2013	2012
Basic earnings per weighted average common share:			
Continuing operations	$0.46	$1.64	$1.19
Discontinued operations	—	0.01	0.02
Net income	$0.46	$1.65	$1.21
Diluted earnings per weighted average common share:			
Continuing operations	$0.46	$1.64	$1.18
Discontinued operations	—	0.01	0.02
Net income	$0.46	$1.65	$1.20
Weighted average number of shares of common stock:			
Basic	366,011,855	350,361,827	242,014,751
Diluted	366,011,855	350,992,387	242,432,156
Comprehensive income:			
Net income	$167,139	$579,039	$291,906
Other comprehensive income (loss):			
Unrealized gain (loss) on available-for-sale securities, net	411,054	(251,723)	755,174
Other comprehensive income (loss)	411,054	(251,723)	755,174
Comprehensive income	$578,193	$327,316	$1,047,080

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity
Balance, December 31, 2011	140,596,708	$1,406	$1,373,099	$(58,716)	$157,452	$(203,155)	$1,270,086
Net income	—	—	—	—	291,906	—	291,906
Other comprehensive income before reclassifications	—	—	—	867,756	—	—	867,756
Amounts reclassified from accumulated other comprehensive loss	—	—	—	(112,582)	—	—	(112,582)
Net other comprehensive income	—	—	—	755,174	—	—	755,174
Issuance of common stock, net of offering costs	138,744,410	1,388	1,361,359	—	—	—	1,362,747
Issuance of common stock in connection with exercise of warrants	19,440,119	194	213,399	—	—	—	213,593
Common dividends declared	—	—	—	—	—	(443,417)	(443,417)
Non-cash equity award compensation	32,021	—	488	—	—	—	488
Balance, December 31, 2012	298,813,258	$2,988	$2,948,345	$696,458	$449,358	$(646,572)	$3,450,577
Net income	—	—	—	—	579,039	—	579,039
Other comprehensive loss before reclassifications	—	—	—	(298,165)	—	—	(298,165)
Amounts reclassified from accumulated other comprehensive income	—	—	—	46,442	—	—	46,442
Net other comprehensive loss	—	—	—	(251,723)	—	—	(251,723)
Issuance of common stock, net of offering costs	57,571,961	576	762,981	—	—	—	763,557
	9,939,648	99	107,415	—	—	—	107,514

Issuance of common stock in connection with exercise of warrants							
Repurchase of common stock	(2,450,700)	(25)	(23,869)	—	—	—	(23,894)
Common dividends declared	—	—	—	—	—	(427,105)	(427,105)
Special dividends declared	—	—	—	—	—	(343,481)	(343,481)
Non-cash equity award compensation	1,061,001	11	500	—	—	—	511
Balance, December 31, 2013	364,935,168	$3,649	$3,795,372	$ 444,735	$1,028,397	$(1,417,158)	$3,854,995
Net income	—	—	—	—	167,139	—	167,139
Other comprehensive income before reclassifications	—	—	—	463,593	—	—	463,593
Amounts reclassified from accumulated other comprehensive income	—	—	—	(52,539)	—	—	(52,539)
Net other comprehensive income	—	—	—	411,054	—	—	411,054
Issuance of common stock, net of offering costs	57,218	1	587	—	—	—	588
Common dividends declared	—	—	—	—	—	(380,816)	(380,816)
Non-cash equity award compensation	1,403,534	14	15,068	—	—	—	15,082
Balance, December 31, 2014	366,395,920	$3,664	$3,811,027	$ 855,789	$1,195,536	$(1,797,974)	$4,068,042

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31, 2014	2013	2012
Cash Flows From Operating Activities:			
Net income	$167,139	$579,039	$291,906
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Amortization of premiums and discounts on investment securities, net	12,012	17,640	47
Other-than-temporary impairment losses	392	1,662	10,952
Realized and unrealized (gains) losses on investment securities, net	(87,201)	54,608	(122,466)
(Gain) loss on mortgage loans held-for-sale	(17,297)	33,846	(2,270)
Gain on mortgage loans held-for-investment and collateralized borrowings in securitization trusts	(16,840)	(14,204)	—
Loss (gain) on servicing asset	128,388	(13,881)	—
Loss (gain) on termination and option expiration of interest rate swaps and swaptions	55,389	(12,293)	29,579
Unrealized loss (gain) on interest rate swaps and swaptions	198,504	(291,458)	91,748
Unrealized (gain) loss on other derivative instruments	(8,011)	(95)	542
Gain on contribution of entity	—	—	(10,641)
Equity based compensation	15,082	511	488
Depreciation of fixed assets	1,083	607	212
Depreciation of real estate	—	—	1,520
Amortization of intangible assets	533	1,067	—
Purchases of mortgage loans held-for-sale	(1,469,074)	(993,813)	(57,954)
Proceeds from sales of mortgage loans held-for-sale	432,749	25,113	—
Proceeds from repayment of mortgage loans held-for-sale	38,545	35,267	5,521
Net change in assets and liabilities:			
Increase in accrued interest receivable	(15,226)	(7,690)	(19,176)
(Increase)/decrease in deferred income taxes, net	(80,261)	83,598	(37,793)
Decrease/(increase) in income taxes receivable	—	4,323	(4,166)
Increase in prepaid and fixed assets	(2,536)	(1,658)	(1,401)
(Increase)/decrease in other receivables	(10,421)	29,772	(31,872)
Increase in servicing advances	(20,192)	(7,298)	—
Increase in Federal Home Loan Bank stock	(100,000)	(10)	—
Increase in equity investments	(3,000)	—	—
Increase in accrued interest payable	3,495	1,217	12,604
Increase/(decrease) in income taxes payable	618	757	(3,898)
Increase in accrued expenses and other liabilities	11,983	14,014	4,383
Net change in assets and liabilities due to purchase of entity	—	3,306	—
Net change in assets and liabilities of discontinued operations	—	—	4,313
Net cash (used in) provided by operating activities	(764,147)	(456,053)	162,178

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Year Ended December 31, 2014	2013	2012
Cash Flows From Investing Activities:			
Purchases of available-for-sale securities	(6,126,579)	(4,471,289)	(10,799,062)
Proceeds from sales of available-for-sale securities	3,479,329	4,432,696	3,411,580
Principal payments on available-for-sale securities	1,044,487	1,111,906	825,889
Short sales and purchases of other derivative instruments	(81,330)	(55,038)	(388,171)
Proceeds from sales of other derivative instruments, net	73,966	163,657	138,171
Purchases of trading securities	(2,138,647)	(995,625)	(996,016)
Proceeds from sales of trading securities	1,145,410	1,000,946	1,001,904
Purchases of beneficial interests in securitization trusts	—	(30,550)	—
Proceeds from repayment of mortgage loans held-for-investment in securitization trusts	111,129	41,314	—
Purchases of mortgage servicing rights, net of purchase price adjustments	(65,704)	(499,024)	—
Purchases of investments in real estate	—	—	(293,745)
Purchase of entity	—	(6,404)	—
(Decrease)/increase in due to counterparties, net	(205,180)	(79,126)	359,909
Decrease/(increase) in restricted cash	64,876	(99,325)	(135,735)
Increase in escrow deposits of discontinued operations	—	—	(30,208)
Contribution of cash to Silver Bay Realty Trust Corp.	—	—	(995)
Net cash (used in) provided by investing activities	(2,698,243)	514,138	(6,906,479)
Cash Flows From Financing Activities:			
Proceeds from repurchase agreements	$213,091,865	$214,649,749	$70,643,808
Principal payments on repurchase agreements	(212,409,852)	(215,023,809)	(64,679,446)
Proceeds from issuance of collateralized borrowings in securitization trusts	728,519	307,119	—
Principal payments on collateralized borrowings in securitization trusts	(182,872)	(42,490)	—
Proceeds from Federal Home Loan Bank advances	4,796,411	—	—
Principal payments on Federal Home Loan Bank advances	(2,296,411)	—	—
Proceeds from issuance of common stock, net of offering costs	588	763,557	1,362,747
Proceeds from exercise of warrants	—	107,514	213,593
Repurchase of common stock	—	(23,894)	—
Dividends paid on common stock	(285,553)	(591,452)	(335,309)
Net cash provided by financing activities	3,442,695	146,294	7,205,393
Net (decrease) increase in cash and cash equivalents	(19,695)	204,379	461,092
Cash and cash equivalents at beginning of period	1,025,487	821,108	360,016
Cash and cash equivalents at end of period	$1,005,792	$1,025,487	$821,108

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Year Ended December 31, 2014	2013	2012
Supplemental Disclosure of Cash Flow Information:			
Cash paid for interest	$79,276	$99,189	$11,766
Cash paid (received) for taxes	$5,905	$(4,266)	$3,637
Noncash Investing and Financing Activities:			
Transfers of mortgage loans held-for-sale to mortgage loans held-for-investment in securitization trusts	$1,022,360	$413,848	$—
Consolidation of mortgage loans held-for-investment in securitization trusts	$—	$442,767	$—
Consolidation of collateralized borrowings in securitization trusts	$—	$412,217	$—
Additions to mortgage servicing rights due to sale of mortgage loans held-for-sale	$288	$—	$—
Contribution of Two Harbors Property Investment LLC to Silver Bay Realty Trust Corp.	$—	$—	$(319,040)
Equity securities and other assets received from Silver Bay Realty Trust Corp.	$—	$—	$330,676
Distribution of Silver Bay Realty Trust Corp. common stock	$—	$343,481	$—
Cashless exercise of warrants	$—	$75	$268
Dividends declared but not paid at end of period	$95,263	$—	$164,347
Reconciliation of mortgage loans held-for-sale:			
Mortgage loans held-for-sale at beginning of period	$544,581	$58,607	$5,782
Purchases of mortgage loans held-for-sale	1,469,074	993,813	57,954
Transfers to mortgage loans held-for-investment in securitization trusts	(1,022,360)	(413,848)	—
Proceeds from sales of mortgage loans held-for-sale	(432,749)	(25,113)	—
Proceeds from repayment of mortgage loans held-for-sale	(38,545)	(35,267)	(5,521)
Realized and unrealized gains (losses) on mortgage loans held-for-sale	15,711	(33,611)	392
Mortgage loans held-for-sale at end of period	$535,712	$544,581	$58,607

The accompanying notes are an integral part of these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 1. Organization and Operations

Two Harbors Investment Corp., or the Company, is a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, mortgage servicing rights, or MSR, and other financial assets. The Company is externally managed and advised by PRCM Advisers LLC, or PRCM Advisers, which is a subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm. The Company's common stock is listed on the New York Stock Exchange, or NYSE, under the symbol "TWO".

The Company was incorporated on May 21, 2009 and commenced operations as a publicly traded company on October 28, 2009, upon completion of a merger with Capitol Acquisition Corp., or Capitol, which became a wholly owned indirect subsidiary as a result of the merger.

The Company has elected to be treated as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code, for U.S. federal income tax purposes commencing with its initial taxable period ended December 31, 2009. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income which will not be qualifying income for REIT purposes. The Company has designated certain of its subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and the Company may in the future form additional TRSs.

On December 19, 2012, the Company completed the contribution of its portfolio of single-family rental properties to Silver Bay Realty Trust Corp., or Silver Bay, a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single-family residential properties for rental income and long-term capital appreciation. The Company contributed its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay, and in exchange for its contribution, received shares of common stock of Silver Bay. Silver Bay completed its initial public offering, or IPO, of its common stock on December 19, 2012. Because the Company will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the years ended December 31, 2014, 2013 and 2012. See Note 4 - Discontinued Operations for additional information.

On April 30, 2013, one of the Company's wholly owned subsidiaries acquired a company that holds approvals from the Federal National Mortgage Association, or Fannie Mae, the Federal Home Loan Mortgage Corporation, or Freddie Mac, and the Government National Mortgage Association, or Ginnie Mae, to hold and manage MSR. The MSR acquired in conjunction with the acquisition of this entity and those subsequently purchased represent the right to service mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company's MSR. See Note 9 - Servicing Activities for additional information.

Note 2. Basis of Presentation and Significant Accounting Policies

Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of all subsidiaries; intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation. The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles, or U.S. GAAP.

The legal entities used in securitization (i.e., the securitization trusts), which are considered VIEs for financial reporting purposes, were also reviewed for consolidation under the applicable consolidation guidance. Because the Company has both the power to direct the activities of the securitization trusts that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. The accounting is consistent with a secured financing, where the loans and securitized debt are both carried on the Company's consolidated balance sheets.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, the period of time during which the Company anticipates an increase in the fair values of real estate securities sufficient to recover unrealized losses in those securities, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

and expenses during the reported period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. The Company's estimates are inherently subjective in nature and actual results could differ from its estimates and the differences may be material.

Significant Accounting Policies

Available-for-Sale Securities, at Fair Value and Trading Securities, at Fair Value

The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other residential mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively "RMBS") issued by Fannie Mae, Freddie Mac, and Ginnie Mae, or collectively, the government sponsored entities, or GSEs. The Company also invests in residential mortgage-backed securities that are not issued by the GSEs, or non-Agency RMBS, and U.S. Treasuries.

Designation

The Company classifies its RMBS securities, excluding inverse interest-only Agency securities classified as derivatives for purposes of U.S. GAAP, as available-for-sale, or AFS, investments. Although the Company generally intends to hold most of its investment securities until maturity, it may, from time to time, sell any of its investment securities as part of its overall management of its portfolio. Accordingly, the Company classifies all of its RMBS investment securities as AFS, including its interest-only strips, which represent the Company's right to receive a specified portion of the contractual interest flows of specific Agency securities. All assets classified as AFS are reported at estimated fair value, with unrealized gains and losses, excluding other than temporary impairments, included in accumulated other comprehensive income, a separate component of stockholders' equity, on an after-tax basis.

The Company classifies its U.S. Treasuries as trading securities. The Company's trading securities are carried at estimated fair value with changes in fair value recorded as a component of net gain on investment securities in the consolidated statement of income.

Balance Sheet Presentation

Investment securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. The cost basis for realized gains and losses on sales of investment securities are determined on the first-in, first-out, or FIFO, method.

Determination of RMBS Fair Value

Fair value is determined under the guidance of Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, or ASC 820. The Company determines the fair value of its RMBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae (collectively, "Agency RMBS"), and U.S. Treasuries based upon prices obtained from third-party pricing providers or broker quotes received using the bid price, which are both deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency RMBS, management judgment is used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data.

If listed price data is not available or insufficient, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs. The Company classifies these securities as Level 3 assets. As of December 31, 2014, none of the investment securities portfolio is categorized as Level 3.

The Company's application of ASC 820 guidance is discussed in further detail in Note 15 - Fair Value of these notes to the consolidated financial statements.

Revenue Recognition, Premium Amortization and Discount Accretion

Interest income on securities is accrued based on the outstanding principal balance and their contractual terms. Premiums and discounts associated with Agency RMBS and non-Agency RMBS rated AA and higher at the time of purchase, are amortized into interest income over the life of such securities using the effective yield method. Adjustments to premium amortization are made for actual prepayment activity. The Company estimates prepayments for its Agency interest-only securities, which represent the Company’s right to receive a specified portion of the contractual interest flows of specific Agency and CMO securities. As a result, if prepayments increase (or are expected to increase), the Company will accelerate the rate of amortization on the premiums.

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Notes to the Consolidated Financial Statements

Interest income on the non-Agency RMBS that were purchased at a discount to par value and were rated below AA at the time of purchase is recognized based on the security's effective interest rate. The effective interest rate on these securities is based on the projected cash flows from each security, which are estimated based on the Company's observation of current information and events and include assumptions related to interest rates, prepayment rates, and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the AFS securities are affected by the contractual lives of the associated mortgage collateral, periodic payments of principal, and prepayments of principal. Therefore actual maturities of AFS securities are generally shorter than stated contractual maturities. Stated contractual maturities are generally greater than ten years.

Based on the projected cash flows from the Company's non-Agency RMBS purchased at a discount to par value, a portion of the purchase discount may be designated as credit protection against future credit losses and, therefore, not accreted into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions, and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively. Conversely, if the performance of a security with a credit discount is less favorable than forecasted, an impairment charge and write-down of such security to a new cost basis results.

Impairment

The Company evaluates its investment securities, on a quarterly basis, to assess whether a decline in the fair value of an AFS security below the Company's amortized cost basis is an other-than-temporary impairment, or OTTI. The presence of OTTI is based upon a fair value decline below a security's amortized cost basis and a corresponding adverse change in expected cash flows due to credit related factors as well as non-credit factors, such as changes in interest rates and market spreads. Impairment is considered other-than-temporary if an entity (i) intends to sell the security, (ii) will more likely than not be required to sell the security before it recovers in value, or (iii) does not expect to recover the security's amortized cost basis, even if the entity does not intend to sell the security. Under these scenarios, the impairment is other-than-temporary and the full amount of impairment should be recognized currently in earnings and the cost basis of the investment security is adjusted. However, if an entity does not intend to sell the impaired debt security and it is more likely than not that it will not be required to sell before recovery, the OTTI is separated into (i) the estimated amount relating to credit loss, or credit component, and (ii) the amount relating to all other factors, or non-credit component. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. The difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income in accordance with the effective interest method.

Mortgage Loans Held-for-Sale, at Fair Value

Mortgage loans held-for-sale are reported at fair value as a result of a fair value option election. Fair value is determined under the guidance of ASC 820. The Company determines the fair value of its mortgage loans held-for-sale by type of loan and the determination is generally based on current secondary market pricing or cash flow models using market-based yield requirements. See Note 15 - Fair Value of these notes to the financial statements for details on fair value measurement. The Company classifies mortgage loans held-for-sale based on management's intent to sell them in the secondary whole loan market or include them in a securitization.

Interest income on mortgage loans held-for-sale is recognized at the loan coupon rate. Loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when mortgage loans are placed on nonaccrual status. Generally, mortgage loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date mortgage loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Mortgage loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Securitizations and Variable Interest Entities

The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. The securitization trusts are considered VIEs for financial reporting purposes and, thus, are reviewed for consolidation under the applicable consolidation guidance. As the Company has both the power to direct the activities of the securitization trusts that most significantly impact the entities’ performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. The underlying loans are classified as mortgage loans held-for-investment in securitization trusts and the underlying debt is classified as collateralized borrowings in securitization trusts on the consolidated balance sheets. The interest income on mortgage loans held-for-investment and interest expense on collateralized borrowings are recorded on the consolidated statements of comprehensive income. See Note 15 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.

Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value

Mortgage loans held-for-investment in securitization trusts related to the Company's on-balance sheet securitizations are reported at fair value as a result of a fair value option election. These securitized mortgage loans are legally isolated from the Company and have been structured to be beyond the reach of creditors of the Company. Fair value is determined under the guidance of ASC 820. The Company determines the fair value of its mortgage loans held-for-investment in securitization trusts by type of loan and the determination is generally based on current secondary market pricing or cash flow models using market-based yield requirements. See Note 15 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.

Interest income on mortgage loans held-for-investment is recognized at the loan coupon rate. Loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when mortgage loans are placed on nonaccrual status. Generally, mortgage loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date mortgage loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Mortgage loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Mortgage Servicing Rights, at Fair Value

The Company’s MSR represent the right to service mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company’s MSR. However, as an owner and manager of MSR, the Company may be obligated to fund advances of principal and interest payments due to third-party owners of the loans, but not yet received from the individual borrowers. These advances are reported as servicing advances within the other assets line item on the consolidated balance sheets.

MSR are reported at fair value on the consolidated balance sheets. Although MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels and discount rates). Changes in the fair value of MSR as well as servicing fee income and servicing expenses are reported on the consolidated statements of comprehensive income.

Cash and Cash Equivalents

Cash and cash equivalents include cash held in bank accounts and cash held in money market funds on an overnight basis.

Restricted Cash

Restricted cash represents the Company’s cash held by counterparties as collateral against the Company’s securities, derivatives and/or repurchase agreements. Also included is the cash balance held pursuant to a letter of credit on the New York office lease. Cash held by counterparties as collateral, which resides in non-interest bearing accounts, is not available to the Company for general corporate purposes, but may be applied against amounts due to securities, derivatives or repurchase counterparties or returned to the Company when the collateral requirements are exceeded or, at the maturity of the derivative or repurchase agreement.

Accrued Interest Receivable

Accrued interest receivable represents interest that is due and payable to the Company. Cash interest is generally received within 30 days of recording the receivable.

Due from/to Counterparties, net

Due from Counterparties includes cash held by counterparties for payment of principal and interest as well as cash held by counterparties as collateral against the Company's derivatives and/or repurchase agreements but represents excess capacity and deemed unrestricted and a receivable from the counterparty as of the balance sheet date. Due to counterparties includes cash payable by the Company upon settlement of trade positions as well as cash deposited to and held by the Company as collateral against the Company's derivatives and/or repurchase agreements but represents a payable to the counterparty as of the balance

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sheet date. Due to counterparties also includes purchase price holdbacks on MSR acquisitions for missing documents and early prepayments.

Derivative Financial Instruments, at Fair Value

In accordance with ASC 815, Derivatives and Hedging, as amended and interpreted, or ASC 815, all derivative financial instruments, whether designated for hedging relationships or not, are recorded on the consolidated balance sheet as assets or liabilities and carried at fair value.

At the inception of a derivative contract, the Company determines whether the instrument will be part of a qualifying hedge accounting relationship or whether the Company will account for the contract as a trading instrument. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments. Changes in fair value as well as the accrual and settlement of interest associated with derivatives accounted for as trading instruments are reported in the consolidated statements of comprehensive income as gain (loss) on interest rate swap and swaption agreements or gain (loss) on other derivative instruments depending on the type of derivative instrument.

The Company enters into interest rate derivative contracts for a variety of reasons, including minimizing fluctuations in earnings or market values on certain assets or liabilities that may be caused by changes in interest rates. The Company may, at times, enter into various forward contracts including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, and caps. Due to the nature of these instruments, they may be in a receivable/asset position or a payable/liability position at the end of an accounting period. Amounts payable to, and receivable from, the same party under contracts may be offset as long as the following conditions are met: (a) each of the two parties owes the other determinable amounts; (b) the reporting party has the right to offset the amount owed with the amount owed by the other party; (c) the reporting party intends to offset; and (d) the right of offset is enforceable by law. If the aforementioned conditions are not met, amounts payable to and receivable from are presented by the Company on a gross basis in the consolidated balance sheet.

The Company has provided specific disclosure regarding the location and amounts of derivative instruments in the financial statements and how derivative instruments and related hedged items are accounted for. See Note 12 - Derivative Instruments and Hedging Activities of these notes to the consolidated financial statements.

Property and Equipment

Property and equipment, stated at cost, net of accumulated depreciation, are reported in other assets in the Company's consolidated balance sheets. Included in property and equipment are certain furniture and fixtures, leasehold improvements, and information technology hardware and software. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets, which is generally three years.

Repurchase Agreements

The Company finances the acquisition of certain of its investment securities and mortgage loans through the use of repurchase agreements. These repurchase agreements are generally short-term debt, which expire within one year. As of December 31, 2014, certain of the Company's repurchase agreements have contractual terms of greater than one year, and are considered long-term debt. Borrowings under repurchase agreements generally bear interest rates of a specified margin over one-month LIBOR and are generally uncommitted. The repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, as specified in the respective agreements.

Collateralized Borrowings in Securitization Trusts, at Fair Value

Collateralized borrowings in securitization trusts related to the Company's on-balance sheet securitizations are reported at fair value as a result of a fair value option election. This long-term debt is nonrecourse to the Company beyond the assets held in the trusts. Fair value is determined under the guidance of ASC 820. The Company determines the fair value of its collateralized borrowings in securitization trusts based on prices obtained from third-party pricing providers, broker quotes received and other applicable market data. See Note 15 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.

Federal Home Loan Bank Advances

In December 2013, the Company's wholly owned subsidiary, TH Insurance Holdings Company LLC, or TH Insurance, was accepted for membership in the Federal Home Loan Bank of Des Moines, or the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances.

As of December 31, 2014, the Company had FHLB advances with both short-term and long-term maturities. The advances with less than five year terms generally bear interest rates of one- or three-month LIBOR and the advances with 20-year terms generally bear interest rates of or one- or three-month MOVR, or the FHLB member option variable-rate. FHLB advances are treated as secured financing transactions and are carried at their contractual amounts.

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Accrued Interest Payable
Accrued interest payable represents interest that is due and payable to third parties. Interest is generally paid within 30 days to three months of recording the payable, based upon the Company's remittance requirements.
Deferred Tax Assets and Liabilities
Income recognition for U.S. GAAP and tax differ in certain respects. These differences often reflect differing accounting treatments for tax and U.S. GAAP, such as accounting for discount and premium amortization, credit losses, asset impairments, recognition of certain operating expenses and certain valuation estimates. Some of these differences are temporary in nature and create timing mismatches between when taxable income is earned and the tax is paid versus when the earnings (losses) for U.S. GAAP purposes, or GAAP net income (loss), are recognized and the tax provision is recorded. Some of these differences are permanent since certain income (or expense) may be recorded for tax purposes but not for U.S. GAAP purposes (or vice-versa). One such significant permanent difference is the Company's ability as a REIT to deduct dividends paid to stockholders as an expense for tax purposes, but not for U.S. GAAP purposes.
As a result of these temporary differences, the Company's taxable REIT subsidiaries, or TRSs, may recognize taxable income in periods prior or subsequent to when it recognizes income for U.S. GAAP purposes. When this occurs, the TRSs pay or defer the tax liability and establish deferred tax assets or deferred tax liabilities, respectively, for U.S. GAAP purposes.
As the income is subsequently realized in future periods under U.S. GAAP, the deferred tax asset is recognized as an expense. Alternatively, as the TRSs realize the deferred taxable income, the deferred tax liability is recognized as a reduction to taxable income. The Company's deferred tax assets and/or liabilities are generated solely by differences in GAAP net income (loss) and taxable income (loss) at our taxable subsidiaries. U.S. GAAP and tax differences in the REIT may create additional deferred tax assets and/or liabilities to the extent the Company does not distribute all of its taxable income.
Income Taxes
The Company has elected to be taxed as a REIT under the Code and the corresponding provisions of state law. To qualify as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to stockholders (not including taxable income retained in its taxable subsidiaries) within the time frame set forth in the tax Code and the Company must also meet certain other requirements. In addition, because certain activities, if performed by the Company, may cause the Company to earn income which is not qualifying for the REIT gross income tests, the Company has formed TRSs, as defined in the Code, to engage in such activities. These TRSs' activities are subject to income taxes as well as any REIT taxable income not distributed to stockholders.
The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with ASC 740, Income Taxes. The Company records these liabilities to the extent the Company deems them more likely than not to be incurred. The Company classifies interest and penalties on material uncertain tax positions as interest expense and operating expense, respectively, in its consolidated statements of comprehensive income.
Earnings Per Share
Basic and diluted earnings per share are computed by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period. For both basic and diluted per share calculations, potential common shares represents issued and unvested shares of restricted stock, which have full rights to the common stock dividend declarations of the Company. For diluted per share calculations, potential common shares also includes dilutive warrants if the weighted average market value per share of the Company's common stock was above the strike price of the warrants during the period presented. In accordance with ASC 260, Earnings Per Share, or ASC 260, if there is a loss from continuing operations, the common stock equivalents are deemed anti-dilutive and earnings (loss) per share is calculated excluding the potential common shares. At 5:00 p.m. EST on November 7, 2013, all outstanding warrants expired, pursuant to the terms of the warrant agreement. No warrants

remain outstanding as of December 31, 2014.
Other Comprehensive Income (Loss)
Current period net unrealized gains and losses on available-for-sale securities are reported as components of accumulated other comprehensive income (loss) on our consolidated statements of stockholders' equity and in the statement of comprehensive income. Net unrealized gains and losses on securities held by our taxable subsidiaries that are reported in accumulated other comprehensive income (loss) are adjusted for the effects of taxation and may create deferred tax assets or liabilities.
Equity Incentive Plan
The Company's Restated 2009 Equity Incentive Plan, or the Plan, was approved by its stockholders on May 21, 2013. The Plan provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and its affiliates. The Plan is administered by the compensation committee of the

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Company's board of directors. The Plan permits the granting of restricted shares of common stock, phantom shares, dividend equivalent rights and other equity-based awards. See Note 21 - Equity Incentive Plan for further details regarding the Plan.

The cost of equity-based compensation awarded to employees provided by our manager is measured at fair value at each reporting date based on the price of the Company's stock as of period end in accordance with ASC 505, Equity, or ASC 505, and amortized over the vesting term.

Offsetting Assets and Liabilities

Certain of the Company's repurchase agreements are governed by underlying agreements that provide for a right of setoff in the event of default of either party to the agreement. The Company also has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty.

Under U.S. GAAP, if the Company has a valid right of setoff, it may offset the related asset and liability and report the net amount. The Company presents repurchase agreements subject to master netting arrangements or similar agreements on a gross basis, and derivative assets and liabilities subject to such arrangements on a net basis, based on derivative type and counterparty, in its consolidated balance sheets. Separately, the Company presents cash collateral subject to such arrangements on a net basis, based on counterparty, in its consolidated balance sheets. However, the Company does not offset financial assets and liabilities with the associated cash collateral on its consolidated balance sheets.

The following tables present information about the Company's assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company's consolidated balance sheets as of December 31, 2014 and December 31, 2013:

	December 31, 2014					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$443,490	$(62,699)	$380,791	$(90,233)	$—	$290,558
Total Assets	$443,490	$(62,699)	$380,791	$(90,233)	$—	$290,558
Liabilities						
Repurchase agreements	$(12,932,463)	$—	$(12,932,463)	$12,932,463	$—	$—
Derivative liabilities	(152,932)	62,699	(90,233)	90,233	—	—
Total Liabilities	$(13,085,395)	$62,699	$(13,022,696)	$13,022,696	$—	$—

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December 31, 2013						
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$572,050	$(22,191)	$549,859	$(22,081)	$—	$527,778
Total Assets	$572,050	$(22,191)	$549,859	$(22,081)	$—	$527,778
Liabilities						
Repurchase agreements	$(12,250,450)	$—	$(12,250,450)	$12,250,450	$—	$—
Derivative liabilities	(44,272)	22,191	(22,081)	22,081	—	—
Total Liabilities	$(12,294,722)	$22,191	$(12,272,531)	$12,272,531	$—	$—

(1) Amounts presented are limited in total to the net amount of assets or liabilities presented in the consolidated balance sheets by instrument. Excess cash collateral or financial assets that are pledged to counterparties may exceed the financial liabilities subject to a master netting arrangement or similar agreement, or counterparties may have pledged excess cash collateral to the Company that exceed the corresponding financial assets. These excess amounts are excluded from the table above, although separately reported within restricted cash, due from counterparties, or due to counterparties in the Company's consolidated balance sheets.

Recently Issued and/or Adopted Accounting Standards
Presentation of an Unrecognized Tax Benefit
In July 2013, the FASB issued ASU No. 2013-11, which requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss, or NOL, carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require any new recurring disclosures. It is effective prospectively for fiscal years, and interim periods within those years, beginning on or after December 15, 2013, with early adoption permitted. Adopting this ASU did not have any impact on the Company's consolidated financial condition or results of operations.
Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity
In August 2014, the FASB issued ASU No. 2014-13, which updates the guidance on measuring the financial assets and financial liabilities of consolidated collateralized financing entities, or CFEs. The update will allow an entity to measure both the financial assets and financial liabilities of a qualifying CFE it consolidates using the fair value of either the CFE's financial assets or financial liabilities, whichever is more observable. The ASU will require certain recurring disclosures and is effective for annual periods beginning on or after December 15, 2015, with early adoption permitted as of the beginning of an annual period. The Company will early adopt this ASU for the 2015 annual period

and has determined this ASU will not have a material impact on the Company's consolidated financial condition or results of operations.

Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

In August 2014, the FASB issued ASU No. 2014-14, which requires that, upon foreclosure, a mortgage loan that is fully guaranteed under certain government programs be derecognized and a separate receivable be recognized when specific criteria are met. The ASU will require certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2014, with early adoption permitted. The Company will adopt this ASU for the 2015 annual period and has determined this ASU will not have a material impact on the Company's consolidated financial condition or results of operations.

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Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern
In August 2014, the FASB issued ASU No. 2014-15, which requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity’s ability to continue as a going concern for both annual and interim reporting periods. The ASU will require certain disclosures if it concludes that substantial doubt exists and plans to alleviate that doubt. It is effective for annual periods ending after December 15, 2016, and for both annual and interim periods thereafter, with early adoption permitted. The Company does not expect this ASU to have any impact on the Company’s consolidated financial condition or results of operations.

Note 3. Variable Interest Entities
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. These securitization trusts are considered VIEs for financial reporting purposes and, thus, were reviewed for consolidation under the applicable consolidation guidance. Since the Company has both the power to direct the activities of the securitization trusts that most significantly impact the entities’ performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. As the Company is required to reassess VIE consolidation guidance each quarter, new facts and circumstances may change the Company’s determination. A change in the Company’s determination could result in a material impact to the Company’s financial statements during subsequent reporting periods.
The following table presents a summary of the assets and liabilities of the consolidated securitization trusts as reported on the consolidated balance sheets:

(in thousands)	December 31, 2014	December 31, 2013
Mortgage loans held-for-investment in securitization trusts	$1,744,746	$792,390
Accrued interest receivable	10,197	4,506
Total Assets	$1,754,943	$796,896
Collateralized borrowings in securitization trusts	1,209,663	639,731
Accrued interest payable	3,678	1,596
Other liabilities	6,480	2,724
Total Liabilities	$1,219,821	$644,051

Note 4. Discontinued Operations
On December 19, 2012, the Company completed the contribution of its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay. Two Harbors Property Investment LLC previously housed the Company’s portfolio of single-family rental properties. Because the Company will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the years ended December 31, 2013 and 2012.

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Summarized financial information for the discontinued operations are presented below.

	Year Ended December 31, 2014	2013	2012
Income:			
Gain on contribution of entity	$—	$3,861	$10,641
Real estate related revenues	—	—	2,730
Total income	—	3,861	13,371
Expenses:			
Management fees	—	—	1,579
Real estate related expenses	—	—	4,731
Other operating expenses	—	(138)	2,571
Total expenses	—	(138)	8,881
Income (loss) from discontinued operations	$—	$3,999	$4,490

In addition to the gain on contribution of entity that was recorded in 2012 in connection with the closing of the contribution, certain adjustments were agreed to be recognized in 2013. These included an installment sales gain of approximately $4.0 million from Silver Bay, a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay. Of these amounts, $3.9 million of the installment sales gain was recorded as a gain on contribution of entity within discontinued operations, and the full $4.3 million of the reduction of 2013 management fees payable to PRCM Advisers was recorded within management fees, on the consolidated statements of comprehensive income for the year ended December 31, 2013. The remaining $0.1 million recorded within discontinued operations on the consolidated statements of comprehensive income for the year ended December 31, 2013 relates to accrual adjustments for transaction expenses related to the contribution. No further adjustments were recognized during 2014. See Note 24 - Related Party Transactions for additional information.

Note 5. Available-for-Sale Securities, at Fair Value

The Company holds available-for-sale, or AFS, investment securities, which are carried at fair value. AFS securities exclude the retained interests from the Company's on-balance sheet securitizations, as they are eliminated in consolidation in accordance with U.S. GAAP. The following table presents the Company's AFS investment securities by collateral type as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013
Mortgage-backed securities:		
Agency		
Federal Home Loan Mortgage Corporation	$2,418,546	$2,977,291
Federal National Mortgage Association	6,768,875	4,435,820
Government National Mortgage Association	2,104,896	2,084,298
Non-Agency	3,048,785	2,759,318
Total mortgage-backed securities	$14,341,102	$12,256,727

At December 31, 2014 and December 31, 2013, the Company pledged AFS securities with a carrying value of $14.2 billion and $12.3 billion, respectively, as collateral for repurchase agreements and FHLB advances. See Note 16 - Repurchase Agreements and Note 18 - Federal Home Loan Bank of Des Moines Advances.

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At December 31, 2014 and December 31, 2013, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, Transfers and Servicing, or ASC 860, to be considered linked transactions and therefore classified as derivatives.
The following tables present the amortized cost and carrying value (which approximates fair value) of AFS securities by collateral type as of December 31, 2014 and December 31, 2013:

	December 31, 2014		
(in thousands)	Agency	Non-Agency	Total
Face Value	$13,421,555	$4,291,872	$17,713,427
Unamortized premium	676,641	—	676,641
Unamortized discount			
Designated credit reserve	—	(927,605)	(927,605)
Net, unamortized	(3,009,782)	(967,368)	(3,977,150)
Amortized Cost	11,088,414	2,396,899	13,485,313
Gross unrealized gains	238,291	653,529	891,820
Gross unrealized losses	(34,388)	(1,643)	(36,031)
Carrying Value	$11,292,317	$3,048,785	$14,341,102

	December 31, 2013		
(in thousands)	Agency	Non-Agency	Total
Face Value	$11,919,590	$4,474,353	$16,393,943
Unamortized premium	621,279	—	621,279
Unamortized discount			
Designated credit reserve	—	(1,234,449)	(1,234,449)
Net, unamortized	(2,897,222)	(1,071,559)	(3,968,781)
Amortized Cost	9,643,647	2,168,345	11,811,992
Gross unrealized gains	102,600	595,179	697,779
Gross unrealized losses	(248,838)	(4,206)	(253,044)
Carrying Value	$9,497,409	$2,759,318	$12,256,727

The following tables present the carrying value of the Company's AFS investment securities by rate type as of December 31, 2014 and December 31, 2013:

	December 31, 2014		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$128,285	$2,558,832	$2,687,117
Fixed Rate	11,164,032	489,953	11,653,985
Total	$11,292,317	$3,048,785	$14,341,102

	December 31, 2013		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$1,006,621	$2,403,078	$3,409,699
Fixed Rate	8,490,788	356,240	8,847,028
Total	$9,497,409	$2,759,318	$12,256,727

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When the Company purchases a credit-sensitive AFS security at a significant discount to its face value, the Company often does not amortize into income a significant portion of this discount that the Company is entitled to earn because it does not expect to collect it due to the inherent credit risk of the security. The Company may also record an other-than-temporary impairment, or OTTI, for a portion of its investment in the security to the extent the Company believes that the amortized cost will exceed the present value of expected future cash flows. The amount of principal that the Company does not amortize into income is designated as a credit reserve on the security, with unamortized net discounts or premiums amortized into income over time to the extent realizable.
The following table presents the changes for the years ended December 31, 2014 and 2013 of the unamortized net discount and designated credit reserves on non-Agency AFS securities.

	Year Ended December 31,					
	2014			2013		
(in thousands)	Designated Credit Reserve	Unamortized Net Discount	Total	Designated Credit Reserve	Unamortized Net Discount	Total
Beginning balance at January 1	$(1,234,449)	$(1,071,559)	$(2,306,008)	$(1,290,946)	$(996,490)	$(2,287,436)
Acquisitions	(77,506)	(58,007)	(135,513)	(179,678)	(369,651)	(549,329)
Accretion of net discount	—	127,352	127,352	886	142,321	143,207
Realized credit losses	16,528	—	16,528	33,130	—	33,130
Reclassification adjustment for other-than-temporary impairments	(392)	—	(392)	(1,662)	—	(1,662)
Transfers from (to)	115,894	(115,894)	—	97,101	(97,101)	—
Sales, calls, other	252,320	150,740	403,060	106,720	249,362	356,082
Ending balance at December 31	$(927,605)	$(967,368)	$(1,894,973)	$(1,234,449)	$(1,071,559)	$(2,306,008)

The following table presents the components comprising the carrying value of AFS securities not deemed to be other than temporarily impaired by length of time the securities had an unrealized loss position as of December 31, 2014 and December 31, 2013. At December 31, 2014, the Company held 1,452 AFS securities, of which 57 were in an unrealized loss position for less than twelve consecutive months and 172 were in an unrealized loss position for more than twelve consecutive months. At December 31, 2013, the Company held 1,431 AFS securities, of which 447 were in an unrealized loss position for less than twelve months and 114 were in an unrealized loss position for more than twelve consecutive months.

	Unrealized Loss Position for					
	Less than 12 Months		12 Months or More		Total	
(in thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2014	$413,102	$(3,146)	$1,323,688	$(32,885)	$1,736,790	$(36,031)
December 31, 2013	$4,902,813	$(171,651)	$1,186,692	$(81,393)	$6,089,505	$(253,044)

Evaluating AFS Securities for Other-Than-Temporary Impairments
In evaluating AFS securities for OTTI, the Company determines whether there has been a significant adverse quarterly change in the cash flow expectations for a security. The Company compares the amortized cost of each security in an unrealized loss position against the present value of expected future cash flows of the security. The

Company also considers whether there has been a significant adverse change in the regulatory and/or economic environment as part of this analysis. If the amortized cost of the security is greater than the present value of expected future cash flows using the original yield as the discount rate, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and is not more likely than not required to sell the security, the credit loss is recognized in earnings and the balance of the unrealized loss is

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recognized in other comprehensive income. If the Company intends to sell the security or will be more likely than not required to sell the security, the full unrealized loss is recognized in earnings.

The Company recorded a $0.4 million other-than-temporary credit impairment during the year ended December 31, 2014 on a total of three non-Agency RMBS where the future expected cash flows for each security were less than its amortized cost. As of December 31, 2014, impaired securities with a carrying value of $161.1 million had actual weighted average cumulative losses of 10.9%, a weighted average three-month prepayment speed of 3.7%, weighted average 60+ day delinquencies of 29.7% of the pool balance, and weighted average FICO score of 664. At December 31, 2014, the Company did not intend to sell the securities and determined that it was not more likely than not that the Company will be required to sell the securities, therefore, only the projected credit loss was recognized in earnings. During the years ended December 31, 2013 and 2012, the Company recorded $1.7 million and $11.0 million in other-than-temporary credit impairments on four and 33 non-Agency RMBS, respectively, where the future expected cash flows for each security were less than its amortized cost.

The following table presents the changes in OTTI included in earnings for the years ended December 31, 2014, 2013 and 2012:

(in thousands)	Year Ended December 31, 2014	2013	2012
Cumulative credit loss at beginning of year	$(9,467)	$(15,561)	$(5,102)
Additions:			
Other-than-temporary impairments not previously recognized	(91)	—	(9,537)
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	(301)	(1,662)	(1,415)
Reductions:			
Decreases related to other-than-temporary impairments on securities paid down	464	1,677	250
Decreases related to other-than-temporary impairments on securities sold	1,154	6,079	243
Cumulative credit loss at end of year	$(8,241)	$(9,467)	$(15,561)

Cumulative credit losses related to OTTI may be reduced for securities sold as well as for securities that mature, pay down, or are prepaid such that the outstanding principal balance is reduced to zero. Additionally, increases in cash flows expected to be collected over the remaining life of the security cause a reduction in the cumulative credit loss.

Gross Realized Gains and Losses

Gains and losses from the sale of AFS securities are recorded as realized gains (losses) within gain (loss) on investment securities in the Company’s consolidated statements of comprehensive income. For the years ended December 31, 2014, 2013 and 2012, the Company sold AFS securities for $3.5 billion, $4.4 billion and $3.4 billion with an amortized cost of $3.4 billion, $4.5 billion and $3.3 billion, for net realized gains of $84.4 million, losses of $64.5 million, and gains of $112.9 million, respectively.

The following table presents the gross realized gains and losses on sales of AFS securities for the years ended December 31, 2014, 2013 and 2012:

(in thousands)	Year Ended December 31, 2014	2013	2012
Gross realized gains	$162,235	$202,112	$115,750
Gross realized losses	(77,820)	(266,620)	(2,859)

Total realized gains (losses) on sales, net	$84,415	$(64,508)	$112,891

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Note 6. Trading Securities, at Fair Value
The Company holds U.S. Treasuries in a TRS and classifies these securities as trading instruments due to short-term investment objectives. As of December 31, 2014 and December 31, 2013, the Company held U.S. Treasuries with an amortized cost of $2.0 billion and $996.1 million, and a fair value of $2.0 billion and $1.0 billion, respectively, classified as trading securities. Included within trading securities were unrealized gains of $1.4 million and $4.1 million as of December 31, 2014 and December 31, 2013, respectively.
For the years ended December 31, 2014, 2013 and 2012, the Company sold trading securities for $1.1 billion, $1.0 billion and $1.0 billion with an amortized cost of $1.1 billion, $997.9 million and $1.0 billion, resulting in realized gains of $5.5 million, $3.0 million and $1.7 million, respectively, on the sale of these securities.
For the years ended December 31, 2014, 2013 and 2012, trading securities experienced change in unrealized losses of $2.7 million and $1.0 million and gains of $2.0 million, respectively. Both realized and unrealized gains and losses are recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive income.
At December 31, 2014 and December 31, 2013, the Company pledged trading securities with a carrying value of $2.0 billion and $1.0 billion, respectively, as collateral for repurchase agreements. See Note 16 - Repurchase Agreements.

Note 7. Mortgage Loans Held-for-Sale, at Fair Value
Mortgage loans held-for-sale consists of residential mortgage loans carried at fair value as a result of a fair value option election. The following table presents the carrying value of the Company's mortgage loans held-for-sale as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013	
Unpaid principal balance	$534,101	$680,840	
Fair value adjustment	1,611	(136,259	)
Carrying value	$535,712	$544,581	

At December 31, 2014 and December 31, 2013, the Company pledged mortgage loans with a carrying value of $416.8 million and $200.8 million, respectively, as collateral for repurchase agreements and FHLB advances. See Note 16 - Repurchase Agreements and Note 18 - Federal Home Loan Bank of Des Moines Advances.

Note 8. Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company's subsidiaries. The underlying residential mortgage loans held by the trusts, which are consolidated on the Company's consolidated balance sheet, are classified as mortgage loans held-for-investment in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. The following table presents the carrying value of the Company's mortgage loans held-for-investment in securitization trusts as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013	
Unpaid principal balance	$1,699,748	$812,538	
Fair value adjustment	44,998	(20,148	)
Carrying value	$1,744,746	$792,390	

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Note 9. Servicing Activities
Mortgage Servicing Rights, at Fair Value
On April 30, 2013, one of the Company's wholly owned subsidiaries acquired a company that holds approvals from Fannie Mae, Freddie Mac and Ginnie Mae to hold and manage MSR. The MSR acquired in conjunction with this acquisition and those subsequently purchased represent the right to service mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company's MSR. The following table summarizes activity related to MSR for the years ended December 31, 2014 and 2013.

	Year Ended December 31,	
(in thousands)	2014	2013
Balance at beginning of period	$514,402	$—
Additions from purchases of servicing rights	67,533	500,521
Additions from sales of mortgage loans	288	—
Changes in fair value due to:		
Changes in valuation inputs or assumptions used in the valuation model	(73,573)	20,651
Other changes in fair value (1)	(54,815)	(6,770)
Other changes (2)	(1,829)	—
Balance at end of period	$452,006	$514,402

(1) Other changes in fair value primarily represents changes due to the realization of expected cash flows.
(2) Other changes includes purchase price adjustments, principally contractual prepayment protection, and changes due to the Company's repurchase of the underlying collateral.

As of December 31, 2014 and December 31, 2013, the Company's key economic assumptions and the sensitivity of the fair value of its MSR to immediate 10% and 20% adverse changes in these assumptions were as follows:

(in thousands)	December 31, 2014	December 31, 2013
Weighted average prepayment speed:	11.9%	9.5%
Impact on fair value of 10% adverse change	$(14,012)	$(19,305)
Impact on fair value of 20% adverse change	$(31,640)	$(37,187)
Weighted average delinquency:	5.6%	4.0%
Impact on fair value of 10% adverse change	$(3,616)	$(8,835)
Impact on fair value of 20% adverse change	$(6,780)	$(17,642)
Weighted average discount rate:	9.5%	9.0%
Impact on fair value of 10% adverse change	$(16,272)	$(21,037)
Impact on fair value of 20% adverse change	$(31,640)	$(40,642)

These assumptions and sensitivities are hypothetical and should be considered with caution. Changes in fair value based on 10% and 20% variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of MSR is calculated without changing any other assumptions. In reality, changes in one factor may result in changes in another (e.g., increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities. Further, these sensitivities show only the change in the asset balances and do not show any expected change in the fair value of the instruments used to manage the interest rates and prepayment risks associated with these assets.
Risk Mitigation Activities

The primary risk of the Company’s MSR is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher-than-expected prepayments that could reduce the value of the MSR. The Company

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economically hedges the impact of these risks with AFS securities and derivative financial instruments. Refer to Note 12 - Derivative Instruments and Hedging Activities for additional information regarding the derivative financial instruments used to economically hedge MSR.

Mortgage Servicing Income

The following table presents the components of servicing income recorded on the Company's consolidated statements of comprehensive income for the years ended December 31, 2014 and 2013:

	Year Ended December 31,	
(in thousands)	2014	2013
Servicing fee income	$125,061	$11,807
Ancillary fee income	2,210	204
Float income	889	—
Total	$128,160	$12,011

Mortgage Servicing Advances

In connection with the servicing of loans, the Company's subservicers make certain payments for property taxes and insurance premiums, default and property maintenance payments, as well as advances of principal and interest payments before collecting them from individual borrowers. Servicing advances, including contractual interest, are priority cash flows in the event of a loan principal reduction or foreclosure and ultimate liquidation of the real estate-owned property, thus making their collection reasonably assured. These servicing advances, which are funded by the Company, totaled $27.5 million and $7.3 million and were included in other assets on the consolidated balance sheet as of December 31, 2014 and December 31, 2013, respectively.

Serviced Mortgage Assets

The Company's total serviced mortgage assets consist of loans owned and classified as mortgage loans held-for-sale, loans held in consolidated VIEs classified as mortgage loans held-for-investment in securitization trusts and loans underlying MSR. The following table presents the number of loans and unpaid principal balance of the mortgage assets for which the Company manages the servicing as of December 31, 2014 and December 31, 2013:

	December 31, 2014		December 31, 2013	
(dollars in thousands)	Number of Loans	Unpaid Principal Balance	Number of Loans	Unpaid Principal Balance
Mortgage loans held-for-sale	1,008	$534,101	2,890	$680,840
Mortgage loans held-for-investment in securitization trusts	487	358,458	537	425,209
Mortgage servicing rights [(1)]	224,073	44,949,061	210,441	42,324,328
Total serviced mortgage assets	225,568	$45,841,620	213,868	$43,430,377

(1) Includes mortgage loans held-for-investment in securitization trusts for which the Company is the named servicing administrator.

Note 10. Restricted Cash

The Company is required to maintain certain cash balances with counterparties for securities and derivatives trading activity and collateral for the Company's repurchase agreements and FHLB advances in restricted accounts. The Company has also placed cash in a restricted account pursuant to a letter of credit on an office space lease.

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The following table presents the Company's restricted cash balances as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013
Restricted cash balances held by trading counterparties:		
For securities trading activity	$12,000	$9,000
For derivatives trading activity	211,989	191,107
As restricted collateral for repurchase agreements and Federal Home Loan Bank advances	112,435	201,194
	336,424	401,301
Restricted cash balance pursuant to letter of credit on office lease	347	346
Total	$336,771	$401,647

Note 11. Accrued Interest Receivable

The following table presents the Company's accrued interest receivable by collateral type:

(in thousands)	December 31, 2014	December 31, 2013
Accrued Interest Receivable:		
U.S. Treasuries	$8,084	$2,361
Mortgage-backed securities:		
Agency		
Federal Home Loan Mortgage Corporation	8,734	10,583
Federal National Mortgage Association	22,392	15,034
Government National Mortgage Association	10,290	10,007
Non-Agency	3,835	3,676
Total mortgage-backed securities	45,251	39,300
Mortgage loans held-for-sale	1,997	4,136
Mortgage loans held-for-investment in securitization trusts	10,197	4,506
Total	$65,529	$50,303

Note 12. Derivative Instruments and Hedging Activities

The Company enters into a variety of derivative and non-derivative instruments in connection with its risk management activities. The Company's primary objective for executing these derivatives and non-derivative instruments is to mitigate the Company's economic exposure to future events that are outside its control. The Company's derivative financial instruments are utilized principally to manage market risk and cash flow volatility associated with interest rate risk (including associated prepayment risk) related to certain assets and liabilities. As part of its risk management activities, the Company may, at times, enter into various forward contracts including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps, credit default swaps and total return swaps. In executing on the Company's current risk management strategy, the Company has entered into interest rate swap and swaption agreements, TBAs, put and call options for TBAs, constant maturity swaps, credit default swaps and total return swaps (based on the Markit IOS Index). The Company has also entered into a number of non-derivative instruments to manage interest rate risk, principally U.S. Treasuries and Agency interest-only securities.

The following summarizes the Company's significant asset and liability classes, the risk exposure for these classes, and the Company's risk management activities used to mitigate certain of these risks. The discussion includes both derivative and non-derivative instruments used as part of these risk management activities. While the Company uses non-derivative and derivative instruments to achieve the Company's risk management activities, it is possible that these instruments will not effectively mitigate all or a substantial portion of the Company’s market rate risk. In addition, the Company might elect, at times, not to enter into certain hedging arrangements in order to maintain compliance with REIT requirements.

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Balance Sheet Presentation
In accordance with ASC 815, the Company records derivative financial instruments on its consolidated balance sheet as assets or liabilities at fair value. Changes in fair value are accounted for depending on the use of the derivative instruments and whether they qualify for hedge accounting treatment. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments.
The following tables present the gross fair value and notional amounts of the Company's derivative financial instruments treated as trading instruments as of December 31, 2014 and December 31, 2013.

(in thousands)	December 31, 2014			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$188,592	$1,168,226	$—	$—
Interest rate swap agreements	55,471	9,569,000	(65,392)	9,015,000
Credit default swaps	—	—	(1,672)	125,000
Swaptions, net	121,591	9,550,000	(4,999)	2,860,000
TBAs	10,350	875,000	(17,687)	2,200,000
Put and call options for TBAs, net	90	2,000,000	—	—
Constant maturity swaps	2,013	12,000,000	(483)	2,000,000
Markit IOS total return swaps	1,387	598,459	—	—
Forward purchase commitments	1,297	554,838	—	—
Total	$380,791	$36,315,523	$(90,233)	$16,200,000

(in thousands)	December 31, 2013			
	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$221,364	$1,525,845	$—	$—
Interest rate swap agreements	25,325	19,619,000	—	—
Credit default swaps	—	—	(18,049)	427,073
Swaptions, net	269,745	5,130,000	—	—
TBAs	33,425	4,097,000	(125)	400,000
Constant maturity swaps	—	—	(3,773)	10,000,000
Markit IOS total return swaps	—	—	(134)	49,629
Forward purchase commitments	—	12,063	—	—
Total	$549,859	$30,383,908	$(22,081)	$10,876,702

Comprehensive Income Statement Presentation
The Company has not applied hedge accounting to its current derivative portfolio held to mitigate the interest rate risk and credit risk associated with its portfolio. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its interest rate swaps and its other derivative instruments.

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The following table summarizes the location and amount of gains and losses on derivative instruments reported in the consolidated statements of comprehensive income on its derivative trading instruments:
(in thousands)

Trading Instruments	Location of Gain/(Loss) Recognized in Income on Derivatives	Amount of Gain/(Loss) Recognized in Income on Derivatives Year Ended December 31, 2014	2013	2012
Interest rate risk management				
TBAs [1]	(Loss) gain on other derivative instruments	$(69,921)	$151,021	$(30,897)
Put and call options for TBAs [1]	(Loss) gain on other derivative instruments	(14,070)	7,798	—
Constant maturity swaps [1]	(Loss) gain on other derivative instruments	6,340	(11,438)	—
Short U.S. Treasuries [1]	(Loss) gain on other derivative instruments	(8)	(991)	(1,768)
Interest rate swap agreements - Receivers [1]	(Loss) gain on interest rate swap and swaption agreements	201,536	(14,472)	—
Interest rate swap agreements - Payers [1]	(Loss) gain on interest rate swap and swaption agreements	(114,121)	6,400	(13,056)
Swaptions [1]	(Loss) gain on interest rate swap and swaption agreements	(242,795)	123,033	(35,012)
Markit IOS total return swaps [1]	(Loss) gain on other derivative instruments	8,061	(1,087)	—
Forward sale commitments [1]	Gain (loss) on mortgage loans held-for-sale	—	—	(26)
Interest rate swap agreements - Payers [2]	(Loss) gain on interest rate swap and swaption agreements	(190,267)	130,268	(111,707)
Credit risk management				
Credit default swaps - Receive protection [3]	(Loss) gain on other derivative instruments	1,742	(74,840)	(61,935)
Non-risk management				
TBAs	(Loss) gain on other derivative instruments	(4,701)	38,297	—
Inverse interest-only securities	(Loss) gain on other derivative instruments	55,028	(13,415)	41,706
Credit default swaps - Provide protection	(Loss) gain on other derivative instruments	—	—	11,988
Forward purchase commitments	Gain (loss) on mortgage loans held-for-sale	4,729	(20,015)	2,396
Total		$(358,447)	$320,559	$(198,311)

(1) Includes derivative instruments held to mitigate interest rate risk associated with the Company’s investment portfolio.

(2) Includes derivative instruments held to mitigate interest rate risk associated with the Company’s repurchase agreements and FHLB advances.

(3) Includes derivative instruments held to mitigate credit risk associated with the Company's non-Agency RMBS and mortgage loans held-for-sale.

For the years ended December 31, 2014, 2013 and 2012, the Company recognized $91.8 million, $58.5 million and $38.4 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with its interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $23.3 billion, $17.0 billion and $9.9 billion notional, respectively, and receiving either LIBOR interest or a fixed interest rate.

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The following table presents information with respect to the volume of activity in the Company's derivative instruments during the years ended December 31, 2014 and 2013:
(in thousands)

Year Ended December 31,	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net (1)
2014						
Inverse interest-only securities	$1,525,845	$29,372	$(386,991)	$1,168,226	$1,324,581	$414
Interest rate swap agreements	19,619,000	24,215,598	(25,250,598)	18,584,000	23,329,504	(803)
Credit default swaps	427,073	—	(302,073)	125,000	138,418	(13,705)
Swaptions, net	5,130,000	15,860,000	(8,580,000)	12,410,000	9,460,438	(54,586)
TBAs, net	603,000	(10,882,000)	8,954,000	(1,325,000)	827,140	(33,985)
Put and call options for TBAs, net	—	5,500,000	(3,500,000)	2,000,000	772,603	(13,555)
Constant maturity swaps	10,000,000	46,000,000	(42,000,000)	14,000,000	11,715,068	1,037
Markit IOS total return swaps	49,629	586,550	(37,720)	598,459	437,604	—
Short U.S. Treasuries	—	(125,000)	125,000	—	342	2
Forward purchase commitments	12,063	2,753,280	(2,210,505)	554,838	361,326	3,431
Total	$37,366,610	$83,937,800	$(73,188,887)	$48,115,523	$48,367,024	$(111,750)
2013						
Inverse interest-only securities	$1,909,351	$245,260	$(628,766)	$1,525,845	$1,782,306	$—
Interest rate swap agreements	14,070,000	27,787,000	(22,238,000)	19,619,000	16,965,918	41,096
Credit default swaps	438,440	2,500,000	(2,511,367)	427,073	1,031,857	(53,154)
Swaptions, net	4,950,000	420,000	(240,000)	5,130,000	5,592,274	(28,803)
TBAs, net	953,000	2,734,000	(3,084,000)	603,000	677,180	157,696
Put and call options for TBAs, net	—	3,748,000	(3,748,000)	—	420,334	7,798
Constant maturity swaps	—	31,000,000	(21,000,000)	10,000,000	7,972,527	(7,665)
Markit IOS total return swaps	—	50,574	(945)	49,629	12,313	—
Short U.S. Treasuries	—	(400,000)	400,000	—	6,658	(876)
Forward purchase commitments	56,865	529,582	(574,384)	12,063	57,489	(19,780)
Total	$22,377,656	$68,614,416	$(53,625,462)	$37,366,610	$34,518,856	$96,312

(1) Excludes net interest paid or received in full settlement of the net interest spread liability.

Cash flow activity related to derivative instruments is reflected within the operating activities and investing activities sections of the consolidated statements of cash flows. Derivative fair value adjustments are reflected within the unrealized loss (gain) on interest rate swaps and swaptions, unrealized (gain) loss on other derivative instruments, and (gain) loss on mortgage loans held-for-sale line items within the operating activities section of the consolidated statements of cash flows. Realized losses on interest rate swap and swaption agreements are reflected within the loss (gain) on termination and option expiration of interest rate swaps and swaptions line item within the operating activities section of the consolidated statements of cash flows. The remaining cash flow activity related to derivative instruments is reflected within the short sales and purchases of other derivative instruments, proceeds from sales of other derivative instruments, net and (decrease) increase in due to counterparties, net line items within the investing activities section of the consolidated statements of cash flows.

Interest Rate Sensitive Assets/Liabilities

The Company’s RMBS investment securities and MSR are generally subject to change in value when mortgage rates decline or increase, depending on the type of investment. Rising mortgage rates generally result in a slowing of refinancing activity, which slows prepayments and results in a decline in the value of the Company’s fixed-rate Agency pools and an increase in the value of the Company’s MSR. To mitigate the impact of this risk, the Company maintains a portfolio of

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financial instruments, primarily fixed-rate interest-only securities, which increase in value when interest rates increase. In addition, the Company has initiated TBA positions, put and call options for TBAs, constant maturity swaps and interest rate swap agreements to further mitigate its exposure to higher interest rates, decreased prepayment speeds and widening mortgage spreads. The objective is to reduce the risk of losses to the portfolio caused by interest rate changes and changes in prepayment speeds.

As of December 31, 2014 and December 31, 2013, the Company had outstanding fair value of $55.7 million and $75.6 million, respectively, of interest-only securities in place to economically hedge its investment securities. These interest-only securities are included in AFS securities, at fair value, in the consolidated balance sheets.

The Company is exposed to interest rate risk on mortgage loans from the time it commits to purchase a mortgage loan until it acquires the loan from the originator and subsequently sells the loan to a third party. Changes in interest rates impact the market price for the mortgage loans. For example, as market interest rates decline, the value of mortgage loans held-for-sale increases, and vice versa. To mitigate the impact of this risk, the Company may enter into derivative contracts to hedge the interest rate risk related to its commitments to purchase mortgage loans and mortgage loans held-for-sale, such as interest rate swaps, swaptions, TBA positions, put and call options for TBAs and constant maturity swaps.

TBAs. At times, the Company may use TBAs for risk management purposes or as a means of deploying capital until targeted investments are available and to take advantage of temporary displacements in the marketplace. TBAs are forward contracts for the purchase (long notional positions) or sale (short notional positions) of Agency RMBS. The issuer, coupon and stated maturity of the Agency RMBS are predetermined as well as the trade price, face amount and future settle date (published each month by the Securities Industry and Financial Markets Association). However, the specific Agency RMBS to be delivered upon settlement is not known at the time of the TBA transaction. As a result, and because physical delivery of the Agency RMBS upon settlement cannot be assured, the Company accounts for TBAs as derivative instruments.

As of December 31, 2014, $0.9 billion of the Company’s long notional TBA positions and $2.2 billion of the Company’s short notional TBA positions were held in order to economically hedge portfolio risk. As of December 31, 2013, $0.4 billion of the Company’s long notional TBA positions and $1.9 billion of the Company’s short notional TBA positions were held in order to economically hedge portfolio risk, while the remaining $2.2 billion long notional TBA positions were held for non-risk management purposes (see discussion of “Non-Risk Management Activities” below).

The Company discloses these positions on a gross basis according to the unrealized gain or loss position of each TBA contract regardless of long or short notional position. The following tables present the notional amount, cost basis, market value and carrying value (which approximates fair value) of the Company’s TBA positions as of December 31, 2014 and December 31, 2013:

	As of December 31, 2014				
				Net Carrying Value (4)	
(in thousands)	Notional Amount (1)	Cost Basis (2)	Market Value (3)	Derivative Assets	Derivative Liabilities
Purchase contracts	$875,000	$862,868	$873,218	$10,350	$—
Sale contracts	(2,200,000)	(2,294,813)	(2,312,500)	—	(17,687)
TBAs, net	$(1,325,000)	$(1,431,945)	$(1,439,282)	$10,350	$(17,687)

	As of December 31, 2013				
				Net Carrying Value (4)	
(in thousands)	Notional Amount (1)	Cost Basis (2)	Market Value (3)	Derivative Assets	Derivative Liabilities
Purchase contracts	$2,550,000	$2,749,648	$2,767,295	$17,771	$(125)
Sale contracts	(1,947,000)	(1,959,256)	(1,943,602)	15,654	—
TBAs, net	$603,000	$790,392	$823,693	$33,425	$(125)

(1) Notional amount represents the face amount of the underlying Agency RMBS.
(2) Cost basis represents the forward price to be paid/(received) for the underlying Agency RMBS.
(3) Market value represents the current market value of the TBA (or of the underlying Agency RMBS) as of period-end.
(4) Net carrying value represents the difference between the market value of the TBA as of period-end and its cost basis, and is reported in derivative assets / (liabilities), at fair value, in the consolidated balance sheets.

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Put and Call Options for TBAs. As of December 31, 2014, the Company had purchased put options for TBAs with a total notional amount of $2.0 billion and paid upfront premiums of approximately $0.6 million. Each of the options will expire in February 2015. The put options had a net fair market value of $0.1 million, included in derivative assets, at fair value, in the consolidated balance sheet as of December 31, 2014. During the year ended December 31, 2013, the Company had purchased and sold put and call options for TBAs; however, the Company did not hold any put or call options for TBAs as of December 31, 2013.

Constant Maturity Swaps. The Company has also entered into constant maturity swaps between the 10-year interest rate swap curve and the yield to maturity on a 30-year Fannie Mae TBA to economically hedge mortgage spread widening risk. The Company had the following constant maturity swaps agreements in place at December 31, 2014 and December 31, 2013:

(notional and dollars in thousands)
December 31, 2014

Determination Date	Average Strike Swap Rate	Notional Amount	Fair Value	Upfront Premium Paid	Unrealized Gain/(Loss)
January 2015	0.538 %	$7,000,000	$1,502	$—	$1,502
February 2015	0.572 %	2,000,000	(13)	—	(13)
March 2015	0.552 %	5,000,000	41	—	41
Total	0.548 %	$14,000,000	$1,530	$—	$1,530

(notional and dollars in thousands)
December 31, 2013

Determination Date	Average Strike Swap Rate	Notional Amount	Fair Value	Upfront Premium Paid	Unrealized Gain/(Loss)
February 2014	0.768 %	$3,000,000	$625	$—	$625
March 2014	0.850 %	5,000,000	(3,171)	—	(3,171)
June 2014	0.828 %	2,000,000	(1,227)	—	(1,227)
Total	0.821 %	$10,000,000	$(3,773)	$—	$(3,773)

Interest Rate Swap Agreements. As of December 31, 2014 and December 31, 2013, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company's investment portfolio whereby the Company receives interest at a 3-month LIBOR rate:

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2017	$2,000,000	1.070 %	0.229 %	2.54
2018	2,040,000	1.563 %	0.238 %	3.94
2019 and Thereafter	900,000	2.378 %	0.255 %	6.24
Total	$4,940,000	1.512 %	0.237 %	3.80

(notional in thousands)
December 31, 2013

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2016	1,000,000	0.955 %	0.239 %	2.67
2018 and Thereafter	2,040,000	1.563 %	0.241 %	4.94
Total	$3,040,000	1.363 %	0.240 %	4.20

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Additionally, as of December 31, 2014 and December 31, 2013, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company's investment portfolio whereby the Company pays interest at a 3-month LIBOR rate:

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amounts	Average Pay Rate		Average Fixed Receive Rate		Average Maturity (Years)
2018	$575,000	0.231	%	1.440	%	3.89
2019 and Thereafter	1,579,000	0.239	%	2.794	%	9.19
Total	$2,154,000	0.237	%	2.433	%	7.77

(notional in thousands)
December 31, 2013

Swaps Maturities	Notional Amounts	Average Pay Rate		Average Fixed Receive Rate		Average Maturity (Years)
2018 and Thereafter	2,154,000	0.240	%	2.337	%	7.84
Total	$2,154,000	0.240	%	2.337	%	7.84

The Company monitors its borrowings under repurchase agreements and FHLB advances, which are generally floating rate debt, in relation to the rate profile of its investment securities. When it is cost effective to do so, the Company may enter into interest rate swap arrangements to align the interest rate composition of its borrowings under repurchase agreements and FHLB advances with that of its investment securities and debt portfolios. This particularly applies to borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (i.e., LIBOR) of the interest rate swaps match the terms of the underlying debt, resulting in an effective conversion of the rate of the related repurchase agreement or FHLB advance from floating to fixed.
As of December 31, 2014 and December 31, 2013, the Company had the following outstanding interest rate swaps that were utilized as economic hedges of interest rate exposure (or duration) risk associated with the Company's short-term repurchase agreements and FHLB advances:

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2016	$4,100,000	0.667	%	0.249	%	1.65
2017	5,285,000	1.063	%	0.248	%	2.55
2018	625,000	0.945	%	0.233	%	3.08
2019 and Thereafter	1,480,000	2.408	%	0.235	%	7.70
Total	$11,490,000	1.089	%	0.246	%	2.92

(notional in thousands)
December 31, 2013

Swaps Maturities	Notional Amount	Average Fixed Pay Rate		Average Receive Rate		Average Maturity (Years)
2014	3,900,000	0.300	%	0.245	%	0.76
2015	1,000,000	0.383	%	0.244	%	1.04
2016	2,950,000	0.626	%	0.246	%	2.42
2017	5,300,000	0.920	%	0.217	%	3.49
2018 and Thereafter	1,275,000	1.406	%	0.242	%	5.04
Total	$14,425,000	0.698	%	0.235	%	2.50

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Interest Rate Swaptions. As of December 31, 2014 and December 31, 2013, the Company had the following outstanding interest rate swaptions (agreements to enter into interest rate swaps in the future for which the Company would either pay or receive a fixed rate) that were utilized as macro-economic hedges:

December 31, 2014 (notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	≥ 6 Months	$255,358	$130,120	56.62	$8,210,000	4.12 %	3M Libor	7.4
Total Payer		$255,358	$130,120	56.62	$8,210,000	4.12 %	3M Libor	7.4
Receiver	< 6 Months	$10,715	$6,462	3.38	$5,000,000	3M Libor	1.35 %	5.0
Total Receiver		$10,715	$6,462	3.38	$5,000,000	3M Libor	1.35 %	5.0
Sale contracts:								
Payer	≥ 6 Months	$(81,248)	$(19,990)	30.02	$(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(81,248)	$(19,990)	30.02	$(800,000)	3.44 %	3M Libor	10.0

December 31, 2013 (notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	< 6 Months	$10,431	$10,458	2.78	$675,000	3.33 %	3M Libor	10.0
Payer	≥ 6 Months	223,504	353,108	39.14	6,000,000	4.27 %	3M Libor	9.0
Total Payer		$233,935	$363,566	38.16	$6,675,000	4.18 %	3M Libor	9.1
Receiver	< 6 Months	$3,991	$681	1.93	$275,000	3M Libor	2.89 %	10.0
Total Receiver		$3,991	$681	1.93	$275,000	3M Libor	2.89 %	10.0
Sale contracts:								
Payer	< 6 Months	$(3,455)	$(7,679)	1.93	$(510,000)	1.60 %	3M Libor	5.0
Payer	≥ 6 Months	(81,248)	(86,361)	42.02	(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(84,703)	$(94,040)	33.68	$(1,310,000)	2.72 %	3M Libor	8.1
Receiver	< 6 Months	$(3,455)	$(462)	1.93	$(510,000)	3M Libor	1.60 %	5.0
Total Receiver		$(3,455)	$(462)	1.93	$(510,000)	3M Libor	1.60 %	5.0

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Markit IOS Total Return Swaps. The Company also enters into total return swaps (agreements whereby the Company receives or makes payments based on the total return of an underlying instrument or index, such as the Markit IOS Index, in exchange for fixed or floating rate interest payments) to help mitigate the potential impact of larger increases or decreases in interest rates on the performance of our investment portfolio (referred to as "convexity risk"). Total return swaps based on the Markit IOS Index are intended to synthetically replicate the performance of interest-only securities. The Company had the following total return swap agreements in place at December 31, 2014 and December 31, 2013:

(notional and dollars in thousands)
December 31, 2014

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain/(Loss)
1/12/2043	$(411,281)	$763	$(1,457)	$(694)
1/12/2044	(187,178)	624	(275)	349
Total	$(598,459)	$1,387	$(1,732)	$(345)

(notional and dollars in thousands)
December 31, 2013

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain/(Loss)
1/12/2043	$(49,629)	$(134)	$(453)	$(587)
Total	$(49,629)	$(134)	$(453)	$(587)

Credit Risk

The Company's exposure to credit losses on its U.S. Treasuries and Agency portfolio of investment securities is limited due to implicit or explicit backing from the U.S. Department of the Treasury or the GSEs. The payment of principal and interest on the Freddie Mac and Fannie Mae mortgage-backed securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

Credit Default Swaps. For non-Agency investment securities and mortgage loans, the Company may enter into credit default swaps to hedge credit risk. In future periods, the Company could enhance its credit risk protection, enter into further paired derivative positions, including both long and short credit default swaps and/or seek opportunistic trades in the event of a market disruption (see discussion of "Non-Risk Management Activities" below). The Company also has processes and controls in place to monitor, analyze, manage and mitigate its credit risk with respect to non-Agency RMBS and mortgage loans.

As of December 31, 2014 and December 31, 2013, the Company held credit default swaps whereby the Company received credit protection for a fixed premium. The maximum payouts for these credit default swaps are limited to the current notional amounts of each swap contract. Maximum payouts for credit default swaps do not represent the expected future cash requirements, as the Company's credit default swaps are typically liquidated or expire and are not exercised by the holder of the credit default swaps.

The following tables present credit default swaps where the Company is receiving protection held as of December 31, 2014 and December 31, 2013:

(notional and dollars in thousands)
December 31, 2014

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain/(Loss)
Receive	6/20/2016	105.50	$(100,000)	$(1,350)	$(260)	$(1,610)

12/20/2016	496.00	(25,000)	(322)	(4,062)	(4,384)
Total	183.60	$(125,000)	$(1,672)	$(4,322)	$(5,994)

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(notional and dollars in thousands)
December 31, 2013

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain/(Loss)
Receive	6/20/2016	105.50	(100,000)	(2,149)	(260)	(2,409)
	12/20/2016	496.00	(25,000)	(401)	(4,062)	(4,463)
	12/20/2018	393.31	(270,000)	(23,568)	12,838	(10,730)
	5/25/2046	356.00	(32,073)	8,069	(15,026)	(6,957)
	Total	329.13	$(427,073)	$(18,049)	$(6,510)	$(24,559)

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe the Company under such contracts completely fail to perform under the terms of these contracts, assuming there are no recoveries of underlying collateral, as measured by the market value of the derivative financial instruments. As of December 31, 2014, the fair value of derivative financial instruments as an asset and liability position was $380.8 million and $90.2 million, respectively.

The Company attempts to mitigate its credit risk exposure on derivative financial instruments by limiting its counterparties to banks and financial institutions that meet established credit guidelines. The Company also seeks to spread its credit risk exposure across multiple counterparties in order to reduce the exposure to any single counterparty. Additionally, the Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty or clearing agency, in the case of centrally cleared interest rate swaps, upon occurrence of certain events. To further mitigate the risk of counterparty default, the Company maintains collateral agreements with certain of its counterparties and clearing agencies, which require both parties to maintain cash deposits in the event the fair values of the derivative financial instruments exceed established thresholds. As of December 31, 2014, the Company has received cash deposits from counterparties of $71.4 million and placed cash deposits of $216.4 million in accounts maintained by counterparties, of which the amounts are netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the consolidated balance sheet.

Non-Risk Management Activities

The Company has entered into certain financial instruments that are considered derivative contracts under ASC 815 that are not for purposes of hedging. These contracts are currently limited to forward purchase commitments, TBAs and inverse interest-only RMBS.

Commitments to Purchase Mortgage Loans Held-for-Sale. Prior to a mortgage loan purchase, the Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing the loans at a particular interest rate, provided the borrower elects to close the loan. These commitments to purchase mortgage loans have been defined as derivatives and are therefore recorded on the balance sheet as assets or liabilities and measured at fair value. Subsequent changes in fair value are recorded on the balance sheet as adjustments to the carrying value of these assets or liabilities with a corresponding adjustment recognized in current period earnings. As of December 31, 2014 and December 31, 2013, the Company had outstanding commitments to purchase $554.8 million and $12.1 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $1.3 million at December 31, 2014. As of December 31, 2013, no fair value was assigned to the derivative as there was not a meaningful change in market value change from commitment date to December 31, 2013.

TBAs. As of December 31, 2013, the Company held $2.2 billion notional TBAs as a means of deploying capital until targeted investments are available, and to take advantage of temporary displacements in the marketplace. None of the Company's TBAs were held for this purpose as of December 31, 2014.

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Inverse Interest-Only Securities. As of December 31, 2014 and December 31, 2013, inverse interest-only securities with a carrying value of $188.6 million and $221.4 million, including accrued interest receivable of $2.2 million and $2.9 million, respectively, were accounted for as derivative financial instruments in the consolidated financial statements. The following table presents the amortized cost and carrying value (which approximates fair value) of inverse interest-only securities as of December 31, 2014 and December 31, 2013:

(in thousands)	December 31, 2014	December 31, 2013
Face Value	$1,168,226	$1,525,845
Unamortized premium	—	—
Unamortized discount		
Designated credit reserve	—	—
Net, unamortized	(991,715)	(1,292,785)
Amortized Cost	176,511	233,060
Gross unrealized gains	14,162	5,891
Gross unrealized losses	(4,269)	(20,442)
Carrying Value	$186,404	$218,509

Note 13. Other Assets

Other assets as of December 31, 2014 and December 31, 2013 are summarized in the following table:

(in thousands)	December 31, 2014	December 31, 2013
Property and equipment at cost	$4,849	$2,285
Accumulated depreciation [(1)]	(1,941)	(858)
Net property and equipment	2,908	1,427
Prepaid expenses	1,790	1,818
Deferred tax assets, net	40,847	—
Intangible assets	—	533
Servicing advances	27,490	7,298
Federal Home Loan Bank stock	100,010	10
Equity investments	3,000	—
Other receivables	12,534	2,113
Total other assets	$188,579	$13,199

(1) Depreciation expense for the years ended December 31, 2014 and 2013 was $1.1 million and $0.6 million, respectively.

Note 14. Other Liabilities

Other liabilities as of December 31, 2014 and December 31, 2013 are summarized in the following table:

(in thousands)	December 31, 2014	December 31, 2013
Accrued expenses	$29,819	$20,025
Deferred tax liabilities, net	—	39,414
Income taxes payable	1,375	757
Other	9,473	7,284
Total other liabilities	$40,667	$67,480

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Note 15. Fair Value

Fair Value Measurements

ASC 820 defines fair value as the price 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. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability.

ASC 820 establishes a three level hierarchy to be used when measuring and disclosing fair value. An instrument's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

Level 1	Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.
Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

Following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

Investment securities. The Company holds a portfolio of AFS and trading securities that are carried at fair value in the consolidated balance sheet. AFS securities are primarily comprised of Agency and non-Agency RMBS while the Company's U.S. Treasuries are classified as trading securities. The Company determines the fair value of its U.S. Treasuries and Agency RMBS based upon prices obtained from third-party pricing providers or broker quotes received using bid price, which are deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency RMBS, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due to principally illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its U.S. Treasuries as Level 1 fair value assets at December 31, 2014. The Company classified 100% of its RMBS AFS securities reported at fair value as Level 2 at December 31, 2014. AFS and trading securities account for 73.7% and 10.3% of all assets reported at fair value at December 31, 2014, respectively.

Equity securities. The Company previously held shares of Silver Bay common stock that were carried at fair value in the consolidated balance sheet as a result of a fair value option election. The Company determined fair value of these equity securities based on the closing market price at period end. Because the shares were distributed to the Company's stockholders in April 2013, equity securities are no longer recognized on the consolidated balance sheet.

Mortgage loans held-for-sale. The Company holds mortgage loans held-for-sale that are carried at fair value in the consolidated balance sheet as a result of a fair value option election. The Company determines fair value of its mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 93.4% and 6.6% of its mortgage loans held-for-sale as Level 2 and Level 3 fair value assets, respectively, at December 31, 2014.

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Mortgage loans held-for-investment in securitization trusts. The Company recognizes on its consolidated balance sheet mortgage loans held-for-investment in securitization trusts that are carried at fair value as a result of a fair value option election. The Company determines fair value of its mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 100% of its mortgage loans held-for-investment in securitization trusts as Level 2 fair value assets at December 31, 2014.

Mortgage servicing rights. The Company holds a portfolio of MSR that are reported at fair value on the consolidated balance sheet. The Company determines fair value of its MSR based on prices obtained from third-party pricing providers. Although MSR transactions are observable in the marketplace, the valuation is based upon cash flow models that include unobservable market data inputs (including prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its MSR as Level 3 fair value assets at December 31, 2014.

Derivative instruments. The Company may enter into a variety of derivative financial instruments as part of its hedging strategies. The Company principally executes over-the-counter, or OTC, derivative contracts, such as interest rate swaps, swaptions, put and call options for TBAs, credit default swaps, constant maturity swaps and Markit IOS total return swaps. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps, swaptions put and call options for TBAs, credit default swaps, constant maturity swaps and total return swaps reported at fair value as Level 2 at December 31, 2014.

The Company also enters into certain other derivative financial instruments, such as TBAs and inverse interest-only securities. These instruments are similar in form to the Company’s AFS securities and the Company utilizes a pricing service to value TBAs and broker quotes to value inverse interest-only securities. The Company classified 100% of its inverse interest-only securities at fair value as Level 2 at December 31, 2014. The Company reported 100% of its TBAs as Level 1 as of December 31, 2014.

The Company may also enter into forward purchase commitments on mortgage loans whereby the Company commits to purchasing the loans at a particular interest rate. The fair value of these derivatives is determined based on prices currently offered in the marketplace for new commitments. Fallout assumptions if the borrower elects not to close the loan are applied to the pricing. As of December 31, 2014, the Company had outstanding commitments to purchase $554.8 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $1.3 million. The Company classified 100% of the forward purchase commitments reported at fair value as Level 2 at December 31, 2014.

The Company’s risk management committee governs trading activity relating to derivative instruments. The Company’s policy is to minimize credit exposure related to financial derivatives used for hedging by limiting the hedge counterparties to major banks, financial institutions, exchanges, and private investors who meet established capital and credit guidelines as well as by limiting the amount of exposure to any individual counterparty.

The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, both the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company’s open positions with the counterparty. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or to the counterparty or clearing agency is considered materially mitigated. Based on the Company’s assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Collateralized borrowings in securitization trusts. The Company recognizes on its consolidated balance sheet collateralized borrowings that are carried at fair value as a result of a fair value option election. In determining the fair value of its collateralized borrowings, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due to principally illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its collateralized borrowings in securitization trusts as Level 2 fair value liabilities at December 31, 2014.

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The following tables display the Company's assets and liabilities measured at fair value on a recurring basis. The Company often economically hedges the fair value change of its assets or liabilities with derivatives and other financial instruments. The tables below display the hedges separately from the hedged items, and therefore do not directly display the impact of the Company's risk management activities.

	Recurring Fair Value Measurements At December 31, 2014			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$14,341,102	$—	$14,341,102
Trading securities	1,997,656	—	—	1,997,656
Mortgage loans held-for-sale	—	500,159	35,553	535,712
Mortgage loans held-for-investment in securitization trusts	—	1,744,746	—	1,744,746
Mortgage servicing rights	—	—	452,006	452,006
Derivative assets	10,350	370,441	—	380,791
Total assets	$2,008,006	$16,956,448	$487,559	$19,452,013
Liabilities				
Collateralized borrowings in securitization trusts	$—	$1,209,663	$—	$1,209,663
Derivative liabilities	17,687	72,546	—	90,233
Total liabilities	$17,687	$1,282,209	$—	$1,299,896

	Recurring Fair Value Measurements At December 31, 2013			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$12,256,727	$—	$12,256,727
Trading securities	1,000,180	—	—	1,000,180
Mortgage loans held-for-sale	—	119,855	424,726	544,581
Mortgage loans held-for-investment in securitization trusts	—	792,390	—	792,390
Mortgage servicing rights	—	—	514,402	514,402
Derivative assets	33,425	516,434	—	549,859
Total assets	$1,033,605	$13,685,406	$939,128	$15,658,139
Liabilities				
Collateralized borrowings in securitization trusts	$—	$639,731	$—	$639,731
Derivative liabilities	125	21,956	—	22,081
Total liabilities	$125	$661,687	$—	$661,812

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under U.S. GAAP. These items would constitute nonrecurring fair value measures under ASC 820. As of December 31, 2014, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.
The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and/or management. The third-party pricing providers and/or management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the

third-party pricing provider in the absence of market information. Assumptions used by the third-party pricing provider due to lack of observable inputs may significantly impact the resulting fair value and therefore the Company's financial statements. The Company's valuation committee reviews all

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valuations that are based on pricing information received from a third-party pricing provider. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable. In addition, the Company performs back-testing of pricing information to validate price information and identify any pricing trends of a third-party price provider.

In determining fair value, third-party pricing providers use various valuation approaches, including market and income approaches. Inputs that are used in determining fair value of an instrument may include pricing information, credit data, volatility statistics, and other factors. In addition, inputs can be either observable or unobservable.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. The third-party pricing provider uses prices and inputs that are current as of the measurement date, including during periods of market dislocations. In periods of market dislocation, the availability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified to or from various levels within the fair value hierarchy.

Securities for which market quotations are readily available are valued at the bid price (in the case of long positions) or the ask price (in the case of short positions) at the close of trading on the date as of which value is determined. Exchange-traded securities for which no bid or ask price is available are valued at the last traded price. OTC derivative contracts, including interest rate swaps, swaptions, credit default swaps and Markit IOS total return swaps are valued by the Company using observable inputs, specifically quotations received from third-party pricing providers, and are therefore classified within Level 2.

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The following table presents the reconciliation for all of the Company's Level 3 assets measured at fair value on a recurring basis:

	Level 3 Recurring Fair Value Measurements					
	Year Ended December 31,					
	2014			2013		
(in thousands)	Available-For-Sale Securities	Mortgage Loans Held-For-Sale	Mortgage Servicing Rights	Available-For-Sale Securities	Mortgage Loans Held-For-Sale	Mortgage Servicing Rights
Beginning of period level 3 fair value	$—	$ 424,726	$514,402	$1,871	$ —	$—
Gains/(losses) included in net income:						
Realized gains (losses)	— (1)	7,734	(54,815)	74 (1)	907	—
Unrealized (losses) gains	—	(3,213) (2)	(73,573) (4)	—	29 (2)	13,881 (4)
Total net gains/(losses) included in net income	—	4,521	(128,388)	74	936	13,881
Other comprehensive income	—	—	—	1,426	—	—
Purchases	—	66,793	67,821	—	440,352	500,521
Sales	—	(433,603)	—	—	—	—
Settlements	—	(26,884)	(1,829)	—	(16,562)	—
Gross transfers into level 3	—	—	—	3,000	—	—
Gross transfers out of level 3	—	—	—	(6,371)	—	—
End of period level 3 fair value	$—	$ 35,553	$452,006	$—	$ 424,726	$514,402
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$—	$ (3,028) (3)	$(73,573) (5)	$—	$ 29 (3)	$13,881 (5)

(1) Realized gains (losses) on available-for-sale securities represent net (premium amortization)/discount accretion recorded in interest income on the consolidated statements of comprehensive income.
(2) The change in unrealized gains or losses on mortgage loans held-for-sale was recorded in gain on mortgage loans held-for-sale on the consolidated statements of comprehensive income.
(3) The change in unrealized gains or losses on mortgage loans held-for-sale that were held at the end of the reporting period was recorded in gain on mortgage loans held-for-sale on the consolidated statements of comprehensive income.
(4) The change in unrealized gains or losses on MSR was recorded in gain on servicing asset on the consolidated statements of comprehensive income.
(5) The change in unrealized gains or losses on MSR that were held at the end of the reporting period was recorded in gain on servicing asset on the consolidated statements of comprehensive income.

The Company did not incur transfers between Level 1, Level 2 or Level 3 for the year ended December 31, 2014. Transfers between Levels are deemed to take place on the first day of the reporting period in which the transfer has taken place.

The Company transferred one Level 2 asset in the amount of $3.0 million into Level 3 during the three months ended March 31, 2013. The asset was deemed to be Level 3 based on the limited availability of third-party pricing. However, during the year ended December 31, 2013, the Company transferred this asset along with two other Level 3 assets in the amount of $6.4 million into Level 2. The assets were deemed to be Level 2 based on the availability of third-party pricing and corroborating market data.

The Company used a third-party pricing provider in the fair value measurement of its Level 3 mortgage loans held-for-sale. The significant unobservable inputs used by the third-party pricing provider included expected default, severity and

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discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

The Company also used a third-party pricing provider in the fair value measurement of its Level 3 MSR. The table below presents information about the significant unobservable inputs used by the third-party pricing provider in the fair value measurement of the Company's MSR classified as Level 3 fair value assets at December 31, 2014:

December 31, 2014							
Valuation Technique	Unobservable Input (1)	Range				Weighted Average	
Discounted cash flow	Constant prepayment speed	10.6	-	13.1	%	11.9	%
	Delinquency	5.3	-	6.1	%	5.6	%
	Discount rate	8.1	-	10.7	%	9.5	%

(1) Significant increases/(decreases) in any of the inputs in isolation may result in significantly lower/(higher) fair value measurement. A change in the assumption used for discount rates may be accompanied by a directionally similar change in the assumption used for the probability of delinquency and a directionally opposite change in the assumption used for prepayment rates.

Fair Value Option for Financial Assets and Financial Liabilities

The Company elected the fair value option for the residential mortgage loans it has acquired. The fair value option was elected to mitigate earnings volatility by better matching the accounting for the assets with the related hedges. The residential mortgage loans are carried within mortgage loans held-for-sale on the consolidated balance sheet. The Company's policy is to separately record interest income on these fair value elected loans. Upfront fees and costs related to the fair value elected loans are not deferred or capitalized. Fair value adjustments are reported in gain (loss) on mortgage loans held-for-sale on the consolidated statements of comprehensive income. The fair value option is irrevocable once the loan is acquired.

The Company also elected the fair value option for the equity securities previously carried on the consolidated balance sheet, which consisted solely of shares of Silver Bay common stock. The Company determined fair value of these equity securities based on the closing market price at period end. Fair value adjustments were reported in gain (loss) on investment securities on the consolidated statements of comprehensive income.

The Company also elected the fair value option for both the mortgage loans held-for-investment in securitization trusts and the collateralized borrowings in securitization trusts carried on the consolidated balance sheet. The fair value option was elected to better reflect the economics of the Company's retained interests. The Company's policy is to separately record interest income on the fair value elected loans and interest expense on the fair value elected borrowings. Upfront fees and costs are not deferred or capitalized. Fair value adjustments are reported in other income on the consolidated statements of comprehensive income.

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The following table summarizes the fair value option elections and information regarding the amounts recognized in earnings for each fair value option-elected item.

(in thousands)	Changes included in the Consolidated Statements of Comprehensive Income								
Year Ended December 31,	Interest income (expense)		Gain (loss) on investment securities	Gain (loss) on mortgage loans held-for-sale	Other income	Total included in net income	Change in fair value due to credit risk	
2014								
Assets								
Mortgage loans held-for-sale	$16,089	(1)	$—	$12,568	$—	$28,657	$1,295	(3)
Mortgage loans held-for-investment in securitization trusts	41,220	(1)	—	—	41,125	82,345	—	(2)
Liabilities								
Collateralized borrowings in securitization trusts	(26,760)		—	—	(24,285)	(51,045)	—	(2)
Total	$30,549		$—	$12,568	$16,840	$59,957	$1,295	
2013								
Assets								
Equity securities	$—		$7,843	$—	$—	$7,843	$—	(2)
Mortgage loans held-for-sale	22,185	(1)	—	(13,831)	—	8,354	6,677	(3)
Mortgage loans held-for-investment in securitization trusts	19,220	(1)	—	—	(22,910)	(3,690)	—	(2)
Liabilities								
Collateralized borrowings in securitization trusts	(10,937)		—	—	37,114	26,177	—	(2)
Total	$30,468		$7,843	$(13,831)	$14,204	$38,684	$6,677	
2012								
Assets								
Equity securities	$—		$5,822	$—	$—	$5,822	$—	(2)
Mortgage loans held-for-sale	609	(1)	—	(100)	—	509	—	(3)
Mortgage loans held-for-investment in securitization trusts	—	(1)	—	—	—	—	—	(2)
Liabilities								
Collateralized borrowings in securitization trusts	—		—	—	—	—	—	(2)
Total	$609		$5,822	$(100)	$—	$6,331	$—	

(1) Interest income on mortgage loans held-for-sale and held-for-investment in securitization trusts is measured by multiplying the unpaid principal balance on the loans by the coupon rate and the number of days of interest due.

(2) The change in fair value on equity securities, mortgage loans held-for-investment in securitization trusts and collateralized borrowings in securitization trusts was due entirely to changes in market interest rates.

(3) The change in fair value due to credit risk on mortgage loans held-for-sale was quantified by holding yield constant in the cash flow model in order to isolate the credit risk component.

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The table below provides the fair value and the unpaid principal balance for the Company's fair value option-elected loans and collateralized borrowings.

	December 31, 2014		December 31, 2013	
(in thousands)	Unpaid Principal Balance	Fair Value (1)	Unpaid Principal Balance	Fair Value (1)
Mortgage loans held-for-sale				
Total loans	$534,101	$535,712	$680,840	$544,581
Nonaccrual loans	$26,405	$20,574	$80,486	$62,185
Loans 90+ days past due	$25,263	$19,675	$63,152	$48,786
Mortgage loans held-for-investment in securitization trusts				
Total loans	$1,699,748	$1,744,746	$812,538	$792,390
Nonaccrual loans	$—	$—	$—	$—
Loans 90+ days past due	$—	$—	$—	$—
Collateralized borrowings in securitization trusts				
Total borrowings	$1,218,589	$1,209,663	$686,233	$639,731

(1) Excludes accrued interest receivable.

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the consolidated balance sheet, for which fair value can be estimated. The following describes the Company's methods for estimating the fair value for financial instruments. Descriptions are not provided for those items that have zero balances as of the current balance sheet date.

- AFS securities, trading securities, mortgage loans held-for-sale, mortgage loans held-for-investment in securitization trusts, MSR, derivative assets and liabilities, and collateralized borrowings in securitization trusts are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the Fair Value Measurements section of this footnote.
- Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments. The Company categorizes the fair value measurement of these assets as Level 1.
- As a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is considered a non-marketable, long-term investment, and is carried at cost. Because this stock can only be redeemed or sold at its par value, and only to the FHLB, carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- Equity investments include cost method investments for which fair value is not estimated. Carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- The carrying value of repurchase agreements and FHLB advances that mature in less than one year generally approximates fair value due to the short maturities. The Company holds $93.2 million of repurchase agreements and $2.5 billion of FHLB advances that are considered long-term. The Company's long-term repurchase agreements and FHLB advances have floating rates based on an index plus a spread and the credit spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these borrowings are at market and thus carrying value approximates fair value. The Company categorizes the fair value measurement of these liabilities as Level 2.

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The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at December 31, 2014 and December 31, 2013.

	December 31, 2014		December 31, 2013	
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Available-for-sale securities	$14,341,102	$14,341,102	$12,256,727	$12,256,727
Trading securities	$1,997,656	$1,997,656	$1,000,180	$1,000,180
Mortgage loans held-for-sale	$535,712	$535,712	$544,581	$544,581
Mortgage loans held-for-investment in securitization trusts	$1,744,746	$1,744,746	$792,390	$792,390
Mortgage servicing rights	$452,006	$452,006	$514,402	$514,402
Cash and cash equivalents	$1,005,792	$1,005,792	$1,025,487	$1,025,487
Restricted cash	$336,771	$336,771	$401,647	$401,647
Derivative assets	$380,791	$380,791	$549,859	$549,859
Federal Home Loan Bank stock	$100,010	$100,010	$10	$10
Equity investments	$3,000	$3,000	$—	$—
Liabilities				
Repurchase agreements	$12,932,463	$12,932,463	$12,250,450	$12,250,450
Collateralized borrowings in securitization trusts	$1,209,663	$1,209,663	$639,731	$639,731
Federal Home Loan Bank advances	$2,500,000	$2,500,000	$—	$—
Derivative liabilities	$90,233	$90,233	$22,081	$22,081

Note 16. Repurchase Agreements

As of December 31, 2014, the Company had outstanding $12.9 billion of repurchase agreements, including repurchase agreements funding the Company's U.S. Treasuries of $2.0 billion. Excluding the debt associated with the Company's U.S. Treasuries and the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 0.72% and weighted average remaining maturities of 64 days as of December 31, 2014. As of December 31, 2013, the Company had outstanding $12.3 billion of repurchase agreements, including repurchase agreements funding the Company's U.S. Treasuries of $997.5 million. Excluding the debt associated with the Company's U.S. Treasuries and the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 0.75% and weighted average remaining maturities of 72 days as of December 31, 2013. As of December 31, 2014 and December 31, 2013, the debt associated with the Company's U.S. Treasuries had a weighted average borrowing rate of 0.23% and 0.03%, respectively.

At December 31, 2014 and December 31, 2013, the repurchase agreement balances were as follows:

(in thousands)	December 31, 2014	December 31, 2013
Short-term	$12,839,242	$12,050,450
Long-term	93,221	200,000
Total	$12,932,463	$12,250,450

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At December 31, 2014 and December 31, 2013, the repurchase agreements had the following characteristics:

(dollars in thousands)	December 31, 2014		December 31, 2013	
Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate	Amount Outstanding	Weighted Average Borrowing Rate
U.S. Treasuries	$1,996,250	0.23 %	$997,500	0.03 %
Agency RMBS	8,458,572	0.42 %	9,109,510	0.46 %
Non-Agency RMBS (1)	2,324,395	1.79 %	1,829,709	2.01 %
Agency derivatives	138,133	0.99 %	166,438	1.05 %
Mortgage loans held-for-sale	15,113	3.03 %	147,293	2.85 %
Total	$12,932,463	0.64 %	$12,250,450	0.69 %

(1) Includes repurchase agreements collateralized by retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

At December 31, 2014 and December 31, 2013, the repurchase agreements had the following remaining maturities:

(in thousands)	December 31, 2014	December 31, 2013
Within 30 days	$3,979,317	$3,831,917
30 to 59 days	4,595,425	2,013,733
60 to 89 days	903,286	2,225,967
90 to 119 days	434,550	1,386,371
120 to 364 days	1,929,164	1,594,962
Open maturity (1)	997,500	997,500
One year and over	93,221 (2)	200,000
Total	$12,932,463	$12,250,450

(1) Includes repurchase agreements collateralized by U.S. Treasuries with an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.
(2) One year and over includes repurchase agreements with a maturity date of June 25, 2016.

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements:

(in thousands)	December 31, 2014	December 31, 2013
Available-for-sale securities, at fair value	$11,874,783	$12,295,302
Trading securities, at fair value	1,997,656	1,000,180
Mortgage loans held-for-sale	19,123	200,839
Net economic interests in consolidated securitization trusts (1)	363,564	—
Cash and cash equivalents	14,117	15,000
Restricted cash	112,435	201,194
Due from counterparties	32,495	21,579
Derivative assets, at fair value	185,067	216,365
Total	$14,599,240	$13,950,459

(1)

Includes the retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

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Although the transactions under repurchase agreements represent committed borrowings until maturity, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls.
The following table summarizes certain characteristics of the Company's repurchase agreements and counterparty concentration at December 31, 2014 and December 31, 2013:

(dollars in thousands)	December 31, 2014					December 31, 2013				
	Amount Outstanding	Net Counterparty Exposure [1]	Percent of Equity		Weighted Average Days to Maturity	Amount Outstanding	Net Counterparty Exposure [1]	Percent of Equity		Weighted Average Days to Maturity
Royal Bank of Canada	$1,373,549	$401,194	10	%	83.8	$980,464	$264,746	7	%	88.2
Barclays Capital Inc.	1,346,085	365,879	9	%	50.5	1,453,396	302,744	8	%	74.6
All other counterparties [2] [3]	9,215,329	907,066	22	%	57.7	8,819,090	1,107,340	29	%	71.2
Total	$11,934,963	$1,674,139				$11,252,950	$1,674,830			

(1) Represents the net carrying value of the securities and mortgage loans held-for-sale sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest.
(2) Excludes $997.5 million and $997.5 million of repurchase agreements collateralized by U.S. Treasuries with a rolling 1-day maturity as of December 31, 2014 and December 31, 2013, respectively.
(3) Represents amounts outstanding to 23 and 18 counterparties at December 31, 2014 and December 31, 2013, respectively.

The Company does not anticipate any defaults by its repurchase agreement counterparties.

Note 17. Collateralized Borrowings in Securitization Trusts, at Fair Value
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company's subsidiaries. The debt associated with the underlying residential mortgage loans held at the trusts, which are consolidated on the Company's consolidated balance sheet, is classified as collateralized borrowings in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. As of December 31, 2014 and December 31, 2013, the collateralized borrowings in securitization trusts had a carrying value of $1.2 billion and $639.7 million with a weighted average interest rate of 3.6% and 2.8%, respectively. The stated maturity dates for all collateralized borrowings were more than five years from both December 31, 2014 and December 31, 2013.

Note 18. Federal Home Loan Bank of Des Moines Advances
In December 2013, the Company's wholly owned subsidiary, TH Insurance, was accepted for membership in the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of December 31, 2014, TH Insurance had $2.5 billion in outstanding secured advances with a weighted average borrowing rate of 0.3%, and no additional unused capacity to borrow. Subsequent to December 31, 2014, TH Insurance's aggregate borrowing capacity was increased to $4.0 billion. To the extent TH Insurance has unused capacity, it may be adjusted at the sole discretion of the FHLB. As of December 31, 2013, TH Insurance had not requested any secured advances and had $1.0 billion of available uncommitted credit for

borrowings.

The ability to borrow from the FHLB is subject to the Company’s continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, commercial real estate loans, Agency RMBS and non-Agency RMBS with an A rating and above.

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At December 31, 2014 and December 31, 2013, FHLB advances had the following remaining maturities:

(in thousands)	December 31, 2014	December 31, 2013
≤ 1 year	$33,738	$—
> 1 and ≤ 3 years	651,238	—
> 3 and ≤ 5 years	815,024	—
> 5 and ≤ 10 years	—	—
> 10 years	1,000,000	—
Total	$2,500,000	$—

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of FHLB advances:

(in thousands)	December 31, 2014	December 31, 2013
Available-for-sale securities, at fair value	$2,284,532	$—
Mortgage loans held-for-sale, at fair value	397,656	—
Net economic interests in consolidated securitization trusts [1]	80,732	
Total	$2,762,920	$—

(1) Includes the retained interests from the Company's on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

The FHLB retains the right to mark the underlying collateral for FHLB advances to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral. In addition, as a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2014 and December 31, 2013, the Company had stock in the FHLB totaling $100.0 million and $10,000, respectively, which is included in other assets on the consolidated balance sheet. FHLB stock is considered a non-marketable, long-term investment, is carried at cost and is subject to recoverability testing under applicable accounting standards. This stock can only be redeemed or sold at its par value, and only to the FHLB. Accordingly, when evaluating FHLB stock for impairment, the Company considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of December 31, 2014 and December 31, 2013, the Company had not recognized an impairment charge related to its FHLB stock.

Note 19. Commitments and Contingencies
The following represent the material commitments and contingencies of the Company as of December 31, 2014:
Management agreement. The Company pays PRCM Advisers a management fee equal to 1.5% per annum, calculated and payable quarterly in arrears, of the Company's stockholders' equity. For purposes of calculating the management fee, the Company's stockholders' equity means the sum of the net proceeds from all issuances of the Company's equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus the Company's retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that the Company pays for repurchases of the Company's common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in U.S. GAAP, and certain non-cash items after discussions between PRCM Advisers and the

Company’s independent directors and approval by a majority of the Company’s independent directors. To the extent asset impairment reduces the Company’s retained earnings at the end of any completed calendar quarter; it will reduce the management fee for such quarter. The Company’s stockholders’ equity for the purposes of calculating the management fee could be greater than the amount of stockholders’ equity shown on the consolidated financial

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statements. The current term of the management agreement expires on October 28, 2015, and automatically renews for successive one-year terms annually until terminated in accordance with the terms of the agreement.

The Company reimburses PRCM Advisers for (i) the Company's allocable share of the compensation paid by PRCM Advisers to its personnel serving as the Company's principal financial officer and general counsel and personnel employed by PRCM Advisers as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to the Company, and (ii) any amounts for personnel of PRCM Adviser's affiliates arising under a shared facilities and services agreement.

Upon termination of the management agreement by the Company without cause or by PRCM Advisers due to the Company's material breach of the management agreement, the Company is required to pay a termination fee equal to three times the sum of the average annual base management fee earned by PRCM Advisers during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

Employment contracts. The Company does not directly employ any personnel. Instead, the Company relies on the resources of PRCM Advisers to conduct the Company's operations. Expense reimbursements to PRCM Advisers are made in cash on a quarterly basis following the end of each quarter.

Operating leases. As of December 31, 2014, the Company was obligated under non-cancelable operating leases for office space. Future minimum rental payments, including escalation clauses, under leases with terms of one year or more at December 31, 2014 were as follows:

(in thousands)

Year	Minimum Payment
2015	$2,250
2016	1,902
2017	1,468
2018	1,187
2019	1,205
Thereafter	2,988
Total	$11,000

Expenses under the lease agreements were $2.0 million, $1.3 million and $0.6 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Legal and regulatory. From time to time, the Company may be subject to liability under laws and government regulations and various claims and legal actions arising in the ordinary course of business. Liabilities are established for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts established for those claims. Based on information currently available, management is not aware of any legal or regulatory claims that would have a material effect on the Company's consolidated financial statements and therefore no accrual is required as of December 31, 2014.

Commitments to purchase mortgage loans. During the years ended December 31, 2014, 2013 and 2012, the Company entered into forward purchase commitments with counterparties whereby the Company committed to purchasing loans at a particular interest rate, provided the borrower elects to close the loan. All of these commitments were accounted for as derivatives at December 31, 2014 and December 31, 2013. See Note 12 - Derivative Instruments and Hedging Activities for additional information.

Representation and warranty obligations. The Company has exposure to representation and warranty obligations in its capacity as owner of MSR and its mortgage loan sales and securitization activities. The specific representations and warranties, or R&W, vary among different transactions and investors, but typically relate to, among other things, the ownership of the loan, the validity of the lien securing the loan, the loan's compliance with the criteria for inclusion in the transaction, including compliance with underwriting standards or loan criteria established by the investor, the ability to deliver required documentation and compliance with applicable laws. In general, the representations and warranties may be enforced at any time unless a sunset provision is in place.

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The reserve for R&W obligations reflect management's best estimate of probable lifetime loss. The methodology used to estimate the reserve considers a variety of assumptions including borrower performance (both actual and estimated future defaults), historical loan defect experience, historical and estimated future loss experience, which includes projections of future home price changes as well as other qualitative factors including investor behavior.
In accordance with the purchase and sale agreement with our MSR and conduit counterparties, we have contractually mirrored our R&W obligations to the GSEs and private investors. As a result, we possess the ability to seek indemnification from our counterparties in the event of a realized loss from the fulfillment of our R&W obligation. At December 31, 2014 and December 31, 2013, the reserve (liability) for representation and warranty obligations was $2.5 million and $0.6 million, respectively.

Note 20. Stockholders' Equity
Common Stock
As of December 31, 2014, the Company had 366,395,920 shares of common stock outstanding. The following table presents a reconciliation of the common shares outstanding from December 31, 2011 through December 31, 2014:

	Number of common shares
Common shares outstanding, December 31, 2011	140,596,708
Issuance of common stock	158,184,529
Issuance of restricted stock (1)	32,021
Common shares outstanding, December 31, 2012	298,813,258
Issuance of common stock	67,511,609
Issuance of restricted stock (1)	1,061,001
Repurchase of common stock	(2,450,700)
Common shares outstanding, December 31, 2013	364,935,168
Issuance of common stock	57,218
Issuance of restricted stock (1)	1,403,534
Common shares outstanding, December 31, 2014	366,395,920

(1) Represents shares of restricted stock granted under the Restated 2009 Equity Incentive Plan, of which 2,002,406 restricted shares remained subject to vesting requirements at December 31, 2014.

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Distributions to Stockholders
The following table presents cash dividends declared by the Company on its common stock for the years ended December 31, 2014, 2013 and 2012:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share
December 16, 2014	December 30, 2014	January 20, 2015	$0.26
September 16, 2014	September 30, 2014	October 21, 2014	$0.26
June 17, 2014	July 2, 2014	July 22, 2014	$0.26
March 17, 2014	March 31, 2014	April 21, 2014	$0.26
December 17, 2013	December 27, 2013	December 31, 2013	$0.26
September 11, 2013	September 26, 2013	October 23, 2013	$0.28
June 18, 2013	June 28, 2013	July 23, 2013	$0.31
March 18, 2013	April 2, 2013	April 24, 2013	$0.32
December 17, 2012	December 31, 2012	January 18, 2013	$0.55
September 12, 2012	September 24, 2012	October 22, 2012	$0.36
June 12, 2012	June 22, 2012	July 20, 2012	$0.40
March 14, 2012	March 26, 2012	April 20, 2012	$0.40

Special Dividend of Silver Bay Common Stock
On March 18, 2013, the Company’s board of directors declared a special dividend pursuant to which the Company distributed 17,824,647 shares of Silver Bay common stock the Company received in exchange for the contribution of its equity interests in Two Harbors Property Investment LLC to Silver Bay on December 19, 2012, on a pro rata basis, to the Company’s stockholders of record as of April 2, 2013. The final distribution ratio for the stock dividend was determined to be 0.048825853 shares of Silver Bay common stock for each share of the Company’s common stock outstanding as of April 2, 2013. The dividend was distributed on or about April 24, 2013.
Accumulated Other Comprehensive Income
Accumulated other comprehensive income at December 31, 2014 and December 31, 2013 was as follows:

(in thousands)	December 31, 2014	December 31, 2013
Available-for-sale securities, at fair value		
Unrealized gains	$891,820	$697,779
Unrealized losses	(36,031)	(253,044)
Accumulated other comprehensive income	$855,789	$444,735

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Reclassifications out of Accumulated Other Comprehensive Income
The following table summarizes reclassifications out of accumulated other comprehensive income for the years ended December 31, 2014, 2013 and 2012:

(in thousands)	Affected Line Item in the Consolidated Statements of Comprehensive Income	Amount Reclassified out of Accumulated Other Comprehensive Income		
		Year Ended December 31,		
		2014	2013	2012
Other-than-temporary-impairments on AFS securities	Total other-than-temporary impairment losses	$392	$1,662	$10,952
Realized losses (gains) on sales of AFS securities	(Loss) gain on investment securities	(52,931)	44,780	(123,534)
Total		$(52,539)	$46,442	$(112,582)

Public Offering
On March 22, 2013, the Company completed a public offering of 50,000,000 shares of its common stock and issued an additional 7,500,000 shares of common stock pursuant to the underwriters' over-allotments at a price of $13.46 per share, for gross proceeds of approximately $774.0 million. Net proceeds to the Company were approximately $762.9 million, net of issuance costs of approximately $11.1 million.
Dividend Reinvestment and Direct Stock Purchase Plan
The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of the Company's common stock by reinvesting some or all of the cash dividends received on shares of the Company's common stock. Stockholders may also make optional cash purchases of shares of the Company's common stock subject to certain limitation detailed in the plan prospectus. An aggregate of 7.5 million shares of the Company's common stock were originally reserved for issuance under the plan. As of December 31, 2014, 213,466 shares have been issued under the plan for total proceeds of $2.3 million, of which 57,218 shares were issued for total proceeds of $0.6 million during the year ended December 31, 2014. During the years ended December 31, 2013 and 2012, 71,961 and 84,287 shares were issued for total proceeds of $0.8 million and $0.9 million, respectively.
Share Repurchase Program
On October 5, 2011, the Company's board of directors authorized a share repurchase program, which allows the Company to repurchase up to 10,000,000 shares of its common stock. On November 14, 2012, the board of directors authorized an increase in the share repurchase program of 15,000,000, for a total of 25,000,000 shares. Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules. The share repurchase program does not require the purchase of any minimum number of shares, and purchases may be commenced or suspended at any time without prior notice. As of December 31, 2014, 2,450,700 shares had been repurchased by the Company under the program for a total cost of $23.9 million; however, no shares were repurchased during the year ended December 31, 2014. All 2,450,700 shares were repurchased during the year ended December 31, 2013 for a total cost of $23.9 million. No shares were repurchased during the year ended December 31, 2012.
At-the-Market Offering
On May 25, 2012, the Company entered into an equity distribution agreement under which the Company may sell up to an aggregate of 20,000,000 shares of its common stock from time to time in any method permitted by law deemed

to be an “at the market” offering as defined in Rule 415 under the Securities Act of 1933, as amended, or the Securities Act. As of December 31, 2014, 7,585,869 shares of common stock have been sold under the equity distribution agreement for total accumulated net proceeds of approximately $77.6 million; however, no shares were sold during the years ended December 31, 2014 and 2013. All 7,585,869 shares were sold during the year ended December 31, 2012 for total accumulated net proceeds of $77.6 million.

Warrants

During the year ended December 31, 2012, warrant holders exercised 19,417,571 warrants to purchase 19,417,571 shares of the Company’s common stock, at an exercise price of $11.00 per share. From January 1, 2013 to April 2, 2013, warrant holders

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exercised 8,720,690 warrants to purchase 8,720,690 shares of the Company's common stock, at an exercise price of $11.00 per share.

On April 2, 2013, the exercise price of the warrants was lowered to $10.25 per warrant share and the number of shares of the Company's common stock issuable for each warrant share exercised was increased to 1.0727 shares. These adjustments were required under the terms of the warrant agreement as a result of the special dividend of Silver Bay common stock. Calculation of the adjustments was determined based on, among other things, the closing price of the Company's common stock on the business day immediately preceding the ex-dividend date for the stock dividend and the fair market value of the stock dividend to be received for each share of the Company's common stock on the ex-dividend date.

From April 3, 2013 to the warrant expiration date, November 7, 2013, warrant holders exercised 1,130,460 warrants to purchase 1,212,607 shares of the Company's common stock, at an exercise price of $10.25 per share. Total proceeds to the Company for warrant exercises during the years ended December 31, 2013 and 2012 were approximately $107.5 million and $213.6 million, respectively.

Additionally, certain Capitol founders holding warrants containing cashless exercise provisions exercised 100,000 and 300,000 warrants on a cashless basis, resulting in the surrender of 93,649 and 277,452 shares of common stock and the issuance of 6,351 and 22,548 shares of common stock during the years ended December 31, 2013 and 2012, respectively. No proceeds were received by the Company as a result of the cashless exercises.

At 5:00 p.m. EST on November 7, 2013, 3,580,279 warrants expired pursuant to the terms of the warrant agreement. No warrants remain outstanding as of December 31, 2013.

Note 21. Equity Incentive Plan

The Company's Plan was adopted in 2009 and amended in May 2013. The Company adopted the Plan to provide incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and employees of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company.

On May 21, 2013, the Company's stockholders approved the Plan, which effectuated, among other changes, an increase in the number of shares available for issuance under the Plan from 200,000 to 3,000,000 shares of common stock. Other amendments provide for the possibility of making grants of equity-based compensation to the Company's executive officers and other key employees of PRCM Advisers and its affiliates upon a determination by the compensation committee, and the implementation of certain best practices of equity-based compensation.

The Plan is administered by the compensation committee of the Company's board of directors. The compensation committee has the full authority to administer and interpret the Plan, to authorize the granting of awards, to determine the eligibility of directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and personnel of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company, to receive an award, to determine the number of shares of common stock to be covered by each award (subject to the individual participant limitations provided in the Plan), to determine the terms, provisions and conditions of each award (which may not be inconsistent with the terms of the Plan), to prescribe the form of instruments evidencing awards and to take any other actions and make all other determinations that it deems necessary or appropriate in connection with the Plan or the administration or interpretation thereof. In connection with this authority, the compensation committee may, among other things, establish performance goals that must be met in order for awards to be granted or to vest, or for the restrictions on any such awards to lapse.

The Company's Plan provides for grants of restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 3,000,000 shares available for issuance under the Plan. The Plan allows for the Company's board of directors to expand the types of awards available under the Plan to include long-term incentive plan units in the future. If an award granted under the Plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards. Unless earlier terminated by the Company's board of directors, no new award may be granted under the Plan after the tenth anniversary of the date that such Plan was initially approved by the Company's board of directors. No award may be granted under the Plan to any person who, assuming payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company's common stock.

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On May 23, 2012, May 21, 2013 and May 20, 2014, the Company granted 32,021, 36,335 and 52,180 shares of restricted common stock, respectively, to its independent directors pursuant to the Plan. The estimated fair value of these awards was $10.15, $11.56 and $10.31 per share, respectively, based on the closing price of the Company's common stock on the NYSE on such date. The shares underlying the grants vested immediately. Additionally, on December 18, 2013, the Company granted 3,697 shares of restricted common stock to a newly appointed independent director pursuant to the Plan. The estimated fair value of these awards was $9.19 per share, based on the closing price of the Company's common stock on the NYSE on such date. The shares underlying these grants also vested immediately.

On May 29, 2013 and February 5, 2014, the Company granted 1,020,969 and 1,374,989 shares of restricted common stock to its executive officers and other key employees of PRCM Advisers pursuant to the Plan. The estimated fair value of these awards was $11.23 and $9.90 per share on grant date, based on the closing price of the Company's common stock on the NYSE on such date. However, as the cost of these awards is measured at fair value at each reporting date based on the price of the Company's stock as of period end in accordance with ASC 505, the fair value of these awards as of December 31, 2014 was $10.02 per share based on the closing market price of the Company's common stock on the NYSE on such date. The shares underlying the grants vest in three annual installments commencing on the date of the grant, as long as such grantee complies with the terms and conditions of his or her applicable restricted stock award agreement.

The following table summarizes the activity related to restricted common stock for the years ended December 31, 2014 and 2013:

	Year Ended December 31,			
	2014		2013	
	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value
Outstanding at Beginning of Period	1,024,459	$11.22	25,325	$9.69
Granted	1,427,169	9.91	1,061,001	11.23
Vested	(443,093)	(11.12)	(61,867)	(10.71)
Forfeited	(6,129)	(9.79)	—	—
Outstanding at End of Period	2,002,406	$10.32	1,024,459	$11.22

For the years ended December 31, 2014, 2013 and 2012, the Company recognized compensation costs related to restricted common stock of $11.7 million, $3.9 million, and $0.5 million, respectively.

Note 22. Income Taxes

For the years ended December 31, 2014, 2013 and 2012, the Company qualified to be taxed as a REIT under the Code for U.S. federal income tax purposes. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes its net taxable income to stockholders and does not engage in prohibited transactions. The Company intends to distribute 100% of its REIT taxable income and comply with all requirements to continue to qualify as a REIT. The majority of states also recognize the Company's REIT status. The Company's TRSs file separate tax returns and are fully taxed as standalone U.S. C-Corporations. The tables below reflect the net taxes accrued at the TRS level and the tax attributes included in the consolidated financial statements. It is assumed that the Company will retain its REIT status and will incur no REIT level taxation as it intends to comply with the REIT regulations and annual distribution requirements.

Certain activities the Company performs may produce income that will not be qualifying income for REIT purposes. These activities include the designated portion of MSR treated as normal mortgage servicing, swaptions, credit default swaps, TBAs and other risk-management instruments. The Company has designated its TRSs to engage in these activities. The Company also purchases and sells mortgage loans through the secondary whole loan market and/or securitization market and has designated its TRSs to engage in these activities.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table summarizes the tax (benefit) provision recorded at the taxable subsidiary level for the years ended December 31, 2014, 2013 and 2012:

	Year Ended December 31,		
(in thousands)	2014	2013	2012
Current tax provision (benefit):			
Federal	$6,507	$808	$(4,586)
State	16	5	3
Total current tax provision (benefit)	6,523	813	(4,583)
Deferred tax (benefit) provision	(80,261)	83,598	(37,636)
Total (benefit from) provision for income taxes	$(73,738)	$84,411	$(42,219)

The Company's taxable income before dividend distributions differs from its pre-tax net income for U.S. GAAP purposes primarily due to unrealized gains and losses, the recognition of credit losses for U.S. GAAP purposes but not tax purposes, differences in timing of income recognition due to market discount, and original issue discount and the calculations surrounding each. These book to tax differences in the REIT are not reflected in the financial statements as the Company intends to retain its REIT status.
The following is a reconciliation of the statutory federal and state rates to the effective rates, for the years ended December 31, 2014, 2013 and 2012:

	Year Ended December 31,					
	2014		2013		2012	
(dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent
Computed income tax expense at federal rate	$32,691	35 %	$225,573	34 %	$84,894	34 %
State taxes, net of federal benefit, if applicable	10	— %	4	— %	2	— %
Permanent differences in taxable income from GAAP net income	1,636	2 %	17,681	3 %	118	— %
Dividends paid deduction	(108,075)	(116)%	(158,847)	(24)%	(127,233)	(51)%
(Benefit from) provision for income taxes/Effective Tax Rate[1]	$(73,738)	(79)%	$84,411	13 %	$(42,219)	(17)%

(1) The (benefit from) provision for income taxes is recorded at the taxable subsidiary level.

The Company's permanent differences in taxable income from GAAP net income in the year ended December 31, 2014 were due primarily to the statutory federal rate change from 34% to 35% and corresponding adjustment to the measurement of beginning deferred tax assets and liabilities. The Company's permanent differences in taxable income from GAAP net income in the year ended December 31, 2013 were due primarily to dividends received by the REIT from the TRSs.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The Company's consolidated balance sheet, as of December 31, 2014 and December 31, 2013, contains the following current and deferred tax liabilities and assets, which are included in other liabilities and other assets, respectively, and are recorded at the taxable subsidiary level:

(in thousands)	December 31, 2014	December 31, 2013
Income taxes (payable) receivable		
Federal income taxes (payable) receivable	$(1,375)	$(757)
State and local income taxes (payable) receivable	—	—
Income taxes (payable) receivable, net	(1,375)	(757)
Deferred tax assets (liabilities)		
Deferred tax asset	60,575 (1)	14,927
Deferred tax liability	(19,728)	(54,341)
Total net deferred tax assets (liabilities)	40,847	(39,414)
Total tax assets and liabilities, net	$39,472	$(40,171)

(1) Net of valuation allowance of $0.1 million.

Deferred Tax Assets and Liabilities

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting and tax purposes at the TRS level. Components of the Company's deferred tax assets and liabilities as of December 31, 2014 and December 31, 2013 are as follows:

(in thousands)	December 31, 2014	December 31, 2013
Derivative assets and liabilities	$5,978	$(45,740)
Trading securities	(478)	(1,380)
Mortgage servicing rights	4,494	(846)
Other assets	16	—
Other liabilities	859	—
Capitalized start-up and organizational costs	277	515
Alternative minimum tax credit	98	—
Net operating loss carryforward	9,448	7,986
Capital loss carryforward	20,155	51
Total net deferred tax assets (liabilities)	$40,847	$(39,414)

At December 31, 2014, a $0.1 million valuation allowance was established because the Company determined that it is more likely than not that the associated deferred tax asset will not be realized. At December 31, 2013, the Company had not recorded a valuation allowance for any portion of its deferred tax assets as it did not believe, at a more likely than not level, that any portion of its deferred tax assets would not be realized. Of the TRS net operating loss carryforward of $9.4 million, $6.9 million is scheduled to expire December 31, 2033 and $2.5 million is scheduled to expire December 31, 2034. The TRS net capital loss carryforward of $20.2 million is scheduled to expire December 31, 2019. The Company estimates, based on existence of sufficient evidence, the ability to realize the remainder of its deferred tax assets. Any adjustments to such estimates will be made in the period such determination is made.
Based on the Company's evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements of a contingent tax liability for uncertain tax positions. Additionally, there were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 23. Earnings Per Share
The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted earnings per share, or EPS, for the years ended December 31, 2014, 2013 and 2012:

	Year Ended December 31,		
(in thousands, except share data)	2014	2013	2012
Numerator:			
Net income from continuing operations	$167,139	$575,040	$287,416
Income (loss) from discontinued operations	—	3,999	4,490
Net income	$167,139	$579,039	$291,906
Denominator:			
Weighted average common shares outstanding	364,181,059	349,741,902	241,975,433
Weighted average restricted stock shares	1,830,796	619,925	39,318
Basic weighted average shares outstanding	366,011,855	350,361,827	242,014,751
Dilutive weighted average warrants	—	630,560	417,405
Diluted weighted average shares outstanding	366,011,855	350,992,387	242,432,156
Basic Earnings (Loss) Per Share:			
Continuing operations	$0.46	$1.64	$1.19
Discontinued operations	—	0.01	0.02
Net income	$0.46	$1.65	$1.21
Diluted Earnings (Loss) Per Share:			
Continuing operations	$0.46	$1.64	$1.18
Discontinued operations	—	0.01	0.02
Net income	$0.46	$1.65	$1.20

No warrants were outstanding during the year ended December 31, 2014; however, during the year ended December 31, 2013, the weighted average market value per share of the Company’s common stock, after factoring in the number of shares of the Company’s common stock issuable for each warrant of 1.0727 shares, was above the exercise price of the warrants, making the warrants dilutive. During the year ended December 31, 2012, the weighted average market value per share of the Company’s common stock was above the exercise price of the warrants, making the warrants dilutive.

Note 24. Related Party Transactions
The following summary provides disclosure of the material transactions with affiliates of the Company.
In accordance with the Management Agreement with PRCM Advisers, the Company incurred $48.8 million, $46.0 million and $33.2 million as a management fee to PRCM Advisers for the years ended December 31, 2014, 2013 and 2012, respectively, which represents approximately 1.5% of stockholders’ equity on an annualized basis as defined by the Management Agreement. For purposes of calculating the management fee, stockholders’ equity is adjusted to exclude any common stock repurchases as well as any unrealized gains, losses or other items that do not affect realized net income, among other adjustments, in accordance with the Management Agreement. Management fees for the year ended December 31, 2013 were also reduced by $4.3 million on the consolidated statements of comprehensive income in accordance with the contribution transaction entered into with Silver Bay. See further discussion of this adjustment below. In addition, the Company reimbursed PRCM Advisers for direct and allocated costs incurred by PRCM Advisers on behalf of the Company. These direct and allocated costs totaled approximately $15.5 million, $9.9 million and $11.8 million for the years ended December 31, 2014, 2013 and 2012, respectively. The Company has established an accounts payable function and direct relationships with the majority of its third-party vendors. The Company will continue to have certain costs allocated to it by PRCM Advisers for compensation, data

services and proprietary technology, but most direct expenses with third-party vendors are paid directly by the Company.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The Company recognized $11.7 million, $3.9 million and $0.5 million of compensation expense during the years ended December 31, 2014, 2013 and 2012, respectively, related to restricted stock. See Note 21 - Equity Incentive Plan for additional information.

On February 3, 2012, a subsidiary of the Company entered into an acquisition services agreement, a property management agreement and a side letter agreement regarding certain fees with Silver Bay Property Management LLC, or Silver Bay Property Management, which is a joint venture between Provident Real Estate Advisors LLC and an affiliate of PRCM Advisers and Pine River. Under the acquisition services agreement, Silver Bay Property Management assisted the Company's subsidiaries in identifying and acquiring a portfolio of residential real properties in various geographic areas throughout the U.S. Under the property management agreement, Silver Bay Property Management operated, maintained, repaired, managed and leased the residential properties and collected rental income for the benefit of the Company and its subsidiaries. Pursuant to the side letter, the Company's subsidiary was obligated to pay Silver Bay Property Management for various services provided under the acquisition services and property management agreements. These agreements were terminated on December 19, 2012 in connection with the contribution of the Company's single family rental property business to Silver Bay, as described below.

On December 19, 2012, the Company completed the contribution of its portfolio of single-family rental properties to Silver Bay, a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single-family residential properties for rental income and long-term capital appreciation. The Company contributed its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC to Silver Bay, and in exchange for its contribution, received shares of common stock of Silver Bay. Silver Bay completed its IPO of its common stock on December 19, 2012. See Note 4 - Discontinued Operations for additional information. In connection with the closing of the contribution, the acquisition services agreement, property management agreement and side letter agreement referenced above were each terminated, except for certain designated provisions (e.g., protection of confidential information and indemnification), which the parties agreed would survive the termination. Not included in the gain that was recorded on the contribution in 2012 are certain adjustments to be recognized in 2013. These include an installment sales gain of approximately $4.0 million from Silver Bay, a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay. Of these amounts, $3.9 million of the installment sales gain was recorded in gain on contribution of entity within discontinued operations, and the full $4.3 million of the reduction of 2013 management fees payable to PRCM Advisers was recorded within management fees, on the consolidated statements of comprehensive income for the year ended December 31, 2013. No further adjustments were recognized during 2014.

Note 25. Subsequent Events

Events subsequent to December 31, 2014 were evaluated through the date these financial statements were issued and no additional events were identified requiring further disclosure in these Consolidated Financial Statements.

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TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 26. Quarterly Financial Data - Unaudited

	2014 Quarter Ended			
(in thousands, except share data)	March 31	June 30	September 30	December 31
Total interest income	$138,535	$140,149	$142,303	$156,220
Total interest expense	26,078	24,950	24,718	31,704
Net interest income	112,457	115,199	117,585	124,516
Other-than-temporary impairment losses	(212)	—	—	(180)
Total other (loss) income	(143,422)	(65,432)	111,697	(143,210)
Total expenses	31,870	33,370	40,550	29,807
Benefit from income taxes	(33,902)	(23,260)	(4,858)	(11,718)
Net (loss) income from continuing operations	(29,145)	39,657	193,590	(36,963)
Income from discontinued operations	—	—	—	—
Net (loss) income	$(29,145)	$39,657	$193,590	$(36,963)
Basic (loss) earnings per weighted average share:				
Continuing operations	$(0.08)	$0.11	$0.53	$(0.10)
Discontinued operations	—	—	—	—
Net (loss) income	$(0.08)	$0.11	$0.53	$(0.10)
Diluted (loss) earnings per weighted average share:				
Continuing operations	$(0.08)	$0.11	$0.53	$(0.10)
Discontinued operations	—	—	—	—
Net (loss) income	$(0.08)	$0.11	$0.53	$(0.10)

	2013 Quarter Ended			
(in thousands, except share data)	March 31	June 30	September 30	December 31
Total interest income	$134,835	$145,325	$137,974	$137,457
Total interest expense	23,836	24,722	24,927	26,922
Net interest income	110,999	120,603	113,047	110,535
Other-than-temporary impairment losses	(236)	(1,426)	—	—
Total other income (loss)	49,890	339,640	(258,742)	162,021
Total expenses	13,350	22,077	24,178	27,275
Provision for income taxes	4,964	49,119	23,726	6,602
Net income (loss) from continuing operations	142,339	387,621	(193,599)	238,679
Income from discontinued operations	1,377	1,016	871	735
Net income (loss)	$143,716	$388,637	$(192,728)	$239,414
Basic earnings (loss) per weighted average share:				
Continuing operations	$0.47	$1.06	$(0.53)	$0.66
Discontinued operations	—	—	—	—
Net income (loss)	$0.47	$1.06	$(0.53)	$0.66
Diluted earnings (loss) per weighted average share:				
Continuing operations	$0.47	$1.06	$(0.53)	$0.66
Discontinued operations	—	—	—	—
Net income (loss)	$0.47	$1.06	$(0.53)	$0.66

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures
None.

Item 9A. Controls and Procedures
A review and evaluation was performed by our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Annual Report on Form 10-K. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, were effective. Although our CEO and CFO have determined our disclosure controls and
procedures were effective at the end of the period covered by this Annual Report on Form 10-K, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the reports we submit under the Exchange Act.
There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Management's Report On Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. In making this assessment the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013 framework). Based on its assessment, the Company's management believes that, as of December 31, 2014, the Company's internal control over financial reporting was effective based on those criteria.

The Company's independent auditors, Ernst & Young LLP, have issued an attestation report on the effectiveness of the Company's internal control over financial reporting. This report appears on page 153 of this annual report on Form 10-K.

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Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
of Two Harbors Investment Corp.

We have audited Two Harbors Investment Corp.'s (the Company's) internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Two Harbors Investment Corp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Two Harbors Investment Corp. as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014 of Two Harbors Investment Corp. and our report dated February 27, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Minneapolis, Minnesota
February 27, 2015

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Item 9B. Other Information
None.

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PART III

Items 10, 11, 12 and 13.
The information required by Items 10, 11, 12 and 13 of Part III of this Annual Report is incorporated by reference to information to be set forth in the Company’s definitive Proxy Statement for its 2015 Annual Meeting of Stockholders, which will be filed with the SEC, pursuant to Regulation 14A, not later than 120 days after December 31, 2014.

Item 14. Principal Accounting Fees and Services
We retained Ernst & Young LLP, or EY, to audit our consolidated financial statements for the years ended December 31, 2014 and 2013. We also retained EY, as well as other accounting and consulting firms, to provide various other services in during the years ended December 31, 2014 and 2013.
The table below presents the aggregate fees billed to us for professional services performed by EY for the years ended December 31, 2014 and 2013:

	Year Ended December 31,	
	2014	2013
Audit fees[(a)]	$1,160,644	$792,750
Audit-related fees[(b)]	272,975	82,200
Tax fees[(c)]	115,648	169,948
Total principal accountant fees	$1,549,267	$1,044,898

(a) Audit fees pertain to the audit of our annual Consolidated Financial Statements, including review of the interim financial statements contained in our Quarterly Reports on Form 10-Q, comfort letters to underwriters in connection with our registration statements and common stock offerings, attest services, consents to the incorporation of the EY audit report in publicly filed documents and assistance with and review of documents filed with the SEC.

(b) Audit-related fees pertain to assurance and related services that are traditionally performed by the principal accountant, including accounting consultations and audits in connection with proposed or consummated acquisitions, internal control reviews and consultation concerning financial accounting and reporting standard.

(c) Tax fees pertain to services performed for tax compliance, including REIT compliance, tax planning and tax advice, including preparation of tax returns and claims for refund and tax-payment planning services. Tax planning and advice also includes assistance with tax audits and appeals, and tax advice related to specific transactions.

The services performed by EY in 2014 were pre-approved by our Audit Committee in accordance with the pre-approval policy set forth in our Audit Committee Charter. This policy requires that all engagement fees and the terms and scope of all auditing and non-auditing services be reviewed and approved by the Audit Committee in advance of their formal initiation.

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PART IV

Item 15. Exhibits, Financial Statement Schedules
(a) The following documents are filed as part of this Annual Report on Form 10-K:
(1)Consolidated Financial Statements:
The consolidated financial statements of the Company, together with the independent registered public accounting firm's report thereon, are set forth in Part II, Item 8 on pages 92 through 100 of this Annual Report on Form 10-K and are incorporated herein by reference.
(2)Schedules to Consolidated Financial Statements:
All Consolidated Financial Statements schedules not included have been omitted because they are either inapplicable or the information required is provided in the Company's Consolidated Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.
(3)Exhibits:
The exhibits listed on the accompanying Exhibits Index are filed or incorporated by reference as part of this Annual Report on Form 10-K.

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Exhibit Number	Exhibit Index
1.1	Equity Distribution Agreement among Two Harbors Investment Corp., JMP Securities LLC and Keefe, Bruyette & Woods, Inc. dated May 25, 2012 (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 25, 2012).
2.1	Agreement and Plan of Merger, dated as of June 11, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A filed with Pre Effective Amendment No. 4 to the Registrant's Registration Statement on Form S-4 (File No. 333-160199) filed with the Securities and Exchange Commission, or SEC, on October 8, 2009, or Amendment No. 4).
2.2	Amendment No. 1 to Agreement and Plan of Merger, dated as of August 17, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-2 filed with Amendment No. 4).
2.3	Amendment No. 2 to Agreement and Plan of Merger, dated as of September 20, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-3 filed with Amendment No. 4).
3.1	Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to Annex B filed with Amendment No. 4).
3.2	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 19, 2012).
3.3	Amended and Restated Bylaws of Two Harbors Investment Corp. (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 19, 2013).
4.1	Specimen Common Stock Certificate of Two Harbors Investment Corp. (incorporated by reference to Exhibit 4.2 to Amendment No. 4).
10.1	Management Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-K for the year ended December 31, 2009, filed with the SEC on March 4, 2010).
10.2	Sub-Management Agreement (incorporated by reference to Exhibit 10.3 to the Registrant's Form 10-K for the year ended December 31, 2009, filed with the SEC on March 4, 2010).
10.3	Shared Facilities and Services Agreement (incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-K for the year ended December 31, 2009, filed with the SEC on March 4, 2010).
10.4*	Restated 2009 Equity Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement filed with the SEC on March 8, 2013).
10.5*	Form of Restricted Stock Agreement under the Restated 2009 Equity Incentive Plan (incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 filed with the SEC on May 28, 2013).
10.6*	Form of Phantom Share Award (incorporated by reference to Exhibit 10.10.2 to Amendment No. 4).
10.7	Letter Agreement, dated as of October 28, 2009, by and between Two Harbors Investment Corp. and Integrated Holding Group LP (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on October 30, 2009 ("Merger Closing 8-K")).
10.8	Letter Agreement, dated as of October 27, 2009, by and among Two Harbors Investment Corp., Federated Kaufmann Fund, Federated Kaufmann Fund II and Federated Kaufmann Growth Fund (incorporated by reference to Exhibit 10.3 to the Merger Closing 8-K).
10.9	Letter Agreement, dated as of October 28, 2009, by and between Two Harbors Investment Corp. and Whitebox Special Opportunities Fund, LP Series A (incorporated by reference to Exhibit 10.4 to the Merger Closing 8-K).
10.10	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on November 19, 2009).

10.11	Amendment to Management Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on December 19, 2012).
10.12	Second Amendment to Management Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on November 7, 2014).

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Exhibit Number	Exhibit Index
21.1	Subsidiaries of registrant. (filed herewith)
23.1	Consent of Independent Registered Public Accounting Firm of Ernst & Young LLP. (filed herewith)
24.1	Powers of Attorney (included on signature page).
31.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
31.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
101	Financial statements from the Annual Report on Form 10-K of Two Harbors Investment Corp. for the year ended December 31, 2014, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Comprehensive Income (Loss), (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statement of Cash Flows, and (v) the Notes to the Consolidated Financial Statements. (filed herewith)

*Management or compensatory agreement

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SIGNATURES

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

		TWO HARBORS INVESTMENT CORP.
Dated: February 27, 2015	By:	/s/ Thomas Siering
		Thomas Siering
		Chief Executive Officer, President and
		Director (principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Each of the undersigned hereby appoints Thomas E. Siering and Brad Farrell, and each of them (with full power to act alone), as attorneys and agents for the undersigned, with full power of substitution, for and in the name, place and stead of the undersigned, to sign and file with the Securities and Exchange Commission under the Securities Act of 1934, any and all amendments and exhibits to this annual report on Form 10-K and any and all applications, instruments, and other documents to be filed with the Securities and Exchange Commission pertaining to this annual report on Form 10-K or any amendments thereto, with full power and authority to do and perform any and all acts and things whatsoever requisite and necessary or desirable.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 27, 2015.

Signature	Title	Date
/s/ Thomas Siering Thomas Siering	Chief Executive Officer, President and Director (principal executive officer)	February 27, 2015
/s/ Brad Farrell Brad Farrell	Chief Financial Officer and Treasurer (principal accounting and financial officer)	February 27, 2015
/s/ Brian C. Taylor Brian C. Taylor	Chairman of the Board of Directors	February 27, 2015
/s/ Mark D. Ein Mark D. Ein	Non-Executive Vice Chairman of the Board of Directors	February 27, 2015
/s/ E. Spencer Abraham E. Spencer Abraham	Director	February 27, 2015
/s/ James J. Bender James J. Bender	Director	February 27, 2015
/s/ Stephen G. Kasnet Stephen G. Kasnet	Director	February 27, 2015
/s/ Jacques R. Rolfo Jacques R. Rolfo	Director	February 27, 2015
/s/ W. Reid Sanders W. Reid Sanders	Director	February 27, 2015

/s/ Hope B. Woodhouse Hope B. Woodhouse	Director	February 27, 2015

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