ANNALY CAPITAL MANAGEMENT INC
Form 10-K
February 26, 2015

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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2014

OR

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

FOR THE TRANSITION PERIOD FROM _________________TO ______________

COMMISSION FILE NUMBER: 1-13447

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

MARYLAND (State or other jurisdiction of incorporation of organization)	22-3479661 (I.R.S. Employer Identification Number)
1211 Avenue of the Americas New York, New York (Address of Principal Executive Offices)	10036 (Zip Code)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	New York Stock Exchange
7.875% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange

7.625% Series C Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.50% Series D Cumulative Redeemable Preferred Stock	New York Stock Exchange

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

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

At June 30, 2014, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $10.8 billion.

The number of shares of the Registrant's Common Stock outstanding on February 20, 2015 was 947,675,799.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2014. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ANNALY CAPITAL MANAGEMENT, INC.
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PART I

ITEM 1. BUSINESS

“Annaly,” “we,” “us,” or “our” refers to Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company.

Refer to the section titled “Glossary of Terms” located at the end of Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” for definitions of certain of the commonly used terms in this annual report on Form 10-K

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Business

Business Overview

We are a leading mortgage real estate investment trust (or REIT) that is externally managed by Annaly Management Company LLC (or Manager). Our common stock is listed on the New York Stock Exchange under the ticker symbol "NLY". Since our founding in 1997, we have strived to generate net income for distribution to our stockholders through the prudent selection and management of our investments.

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

Our business operations are primarily comprised of the following:

Business Operations	Year Formed	Description
Annaly, the parent company (NYSE: NLY)	1997	Invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
Annaly Commercial Real Estate Group, Inc. (ACREG)	2009	Wholly-owned subsidiary that was acquired during the second quarter of 2013 and specializes in acquiring, financing and managing commercial mortgage loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
RCap Securities, Inc. (RCap)	2008	Wholly-owned subsidiary that operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (or FINRA).
Fixed Income Discount Advisory Company (FIDAC)	1994	Wholly-owned subsidiary that operates as a SEC Registered Investment Advisor and manages an affiliated REIT for which it earns fee income.
Annaly Middle Market Lending LLC (MML)	2010	Wholly-owned subsidiary that engages in corporate middle market lending transactions.
Shannon Funding LLC (Shannon)	2010	Wholly-owned subsidiary that acquires residential mortgage loans and provides warehouse financing to residential mortgage originators in the United States.

We believe that our business objectives are supported by our size and conservative financial posture relative to the industry, the extensive experience of our Manager's employees, a comprehensive risk management approach, the availability and diversification of financing sources, our corporate structure and our cost efficiencies.

Investment Strategy

We own a portfolio of real estate related investments, including mortgage pass-through certificates, securities and short-term investments. High quality securities are:

rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies;

unrated but are guaranteed by the United States government or by an agency of the United States government; or collateralized mortgage obligations (CMOs), Agency callable debentures, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate assets and corporate debt. Our principal business objective is to generate net income for distribution to our stockholders from our investments. Under our investment policy, at least 75% of our total assets are comprised of high-quality mortgage-backed unrated but we determine them to be of comparable quality to high-quality rated mortgage-backed securities.

The remainder of our assets may generally consist of other qualified REIT real estate assets.

In addition, we may directly or indirectly invest part of our assets in other types of securities, including, unrated debt and equity securities and derivative instruments, to the extent consistent with our REIT qualification requirements.

We may acquire Agency mortgage-backed securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. As part of our current diversification strategy, we may allocate up to 25% of our stockholders' equity to assets other than Agency mortgage-backed securities.

We maintain a firm-wide risk appetite statement which defines the level and types of risk that we are willing to take in order to achieve our business objectives and reflects our risk management philosophy. Fundamentally, we will only engage in risk activities that are expected to enhance value for our stockholders based on our core expertise. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage posture.

Our risk appetite statement asserts the following key risk parameters to guide our investment management activities:

Risk Parameter	Description
Portfolio composition	We will maintain a high quality asset portfolio with (1) at least 75% of the portfolio to be high quality mortgage-backed securities and short term investments (equivalency rating of AA+ or better) and (2) an aggregate weighted average equivalency rating of single "A" or better.
Leverage	We will operate at a debt-to-equity ratio no greater than 12:1.
Capital buffer	We will seek to maintain an excess capital buffer, of which at least 25% will be invested in AAA rated mortgage-backed securities (or assets of similar or better liquidity characteristics), to meet the liquidity needs of the firm.
Interest rate risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements.
Hedging	We will use swaps and other derivatives to hedge market risk, targeting both income and capital preservation.
Capital preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

Our board of directors has reviewed and approved the investment and operating policies and strategies established by our Manager and set forth in this Form 10-K. The board of directors has the power to modify or waive these policies and strategies without the consent of the stockholders to the extent that the board of directors determines that the modification or waiver is in the best interests of our stockholders. Among other factors, developments in the market which affect our policies and strategies or which change our assessment of the market may cause our board of directors to revise our policies and strategies.

We may seek to expand our capital base in order to further increase our ability to acquire new and different types of assets when the potential returns from new investments appear attractive relative to the targeted risk-adjusted returns. We may in the future acquire assets by offering our debt or equity securities in exchange for the assets.

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Target Assets

Within the confines of the risk appetite statement, we seek to generate the highest risk-adjusted returns on capital invested, after consideration of the following:

The amount, nature and variability of anticipated cash flows from the asset across a variety of interest rate, yield spread, financing cost, credit loss and prepayment scenarios;

The liquidity of the asset;

The ability to pledge the asset to secure collateralized borrowings;

When applicable, the credit of the underlying borrower;

The costs of financing, hedging and managing the asset;

The impact of the asset to our REIT compliance and our exemption from the Investment Company Act of 1940; and

The capital requirements associated with the purchase and financing of the asset.

We target the purchase and sale of the following assets as part of our investment strategy. Our targeted assets and asset acquisition strategy may change over time as market conditions change and as our business evolves.

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Targeted Asset Class	Description
Agency mortgage-backed securities	Our primary investments consist of Agency pass-through certificates, CMOs issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae, interest-only securities and inverse floaters. These securities are backed by single-family or multi-family residences with loan maturities typically ranging from 15 to 40 years and may have fixed or floating coupons.
To-be-announced forward contracts (or TBAs)	We purchase and sell TBAs which are forward contracts for Agency mortgage-backed securities. TBA contracts specify a few basic characteristics of the agency mortgage-backed securities, such as the coupon rate, the issuer, and the approximate face value of the bonds to be delivered, with the actual bonds to be delivered only identified shortly before the TBA settlement date.
Agency debentures	We invest in debt issued by Freddie Mac, Fannie Mae or the Federal Home Loan Banks. These debentures are not backed by collateral, but by the creditworthiness of the issuer.
Commercial real estate	Through our subsidiary ACREG, we originate and acquire commercial real estate debt including commercial mortgage loans, commercial mortgage-backed securities, B-notes, mezzanine loans, preferred equity and other commercial real estate-related debt investments. We also acquire real property for current cash flow, long-term appreciation and earnings growth. In implementing this strategy, we continually evaluate potential acquisition opportunities. These acquisitions may come through joint venture interests or from other equity investments. Although we continuously review our acquisition pipeline, there is not a specific metric that we apply to acquisitions that are under consideration, and our analysis may vary based on property type, transaction structure and other factors.
Other mortgage related investments	On a limited basis we may invest in other mortgage related investments including: investments in individual residential loans, pools of loans, single-family and multi-family privately-issued certificates that are not issued by one of the Agencies, including Agency risk sharing transactions issued by Fannie Mae and Freddie

	Mac and similarly structured transactions arranged by third party market participants.
Corporate debt	Through our subsidiary MML, we invest a small percentage of our assets directly in the ownership of corporate loans for middle market companies.

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We generally hold assets we acquire until maturity. We believe that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, we seek to acquire assets which we believe will provide attractive returns over a broad range of interest rate and prepayment scenarios.

Our Portfolio

Our portfolio composition as of December 31, 2014 and 2013 was as follows:

Asset Portfolio (using balance sheet values)

Category	2014		2013	
Agency mortgage-backed securities(1)	96.2	%	93.7	%
Agency debentures	1.6	%	4.0	%
Commercial real estate debt and equity investments(2)	2.0	%	2.1	%
Other mortgage-backed-securities	0.0	%	0.0	%
Corporate debt, held for investment	0.2	%	0.2	%

(1) Including TBAs held for delivery.
(2) Net of unamortized origination fees.

Capital Structure

Our capital structure is designed to offer an efficient compliment of funding sources to generate positive risk-adjusted returns for our stockholders while maintaining appropriate liquidity to support our business and meet our financial obligations under periods of market stress. We utilize a mix of debt and equity funding. Debt funding may include the use of repurchase agreements, loans, securitizations, participations sold, lines of credit, asset backed commercial paper conduits, corporate bond issuance, or other liabilities. Equity capital primarily consists of common and preferred stock.

We finance our Agency mortgage-backed securities with repurchase agreements. We enter into repurchase agreements primarily with national broker-dealers, commercial banks and other lenders that typically offer this type of financing. We enter into collateralized borrowings with financial institutions meeting internal credit standards and we monitor the financial condition of these institutions on a regular basis. We seek to diversify our exposure and limit concentrations by entering into repurchase agreements with multiple counterparties. At December 31, 2014, we had $71.4 billion of repurchase agreements outstanding.

Equity capital is made up primarily of common stock. It also consists of preferred stock and may in the future include the use of other equity capital issuance.

We generally expect to maintain a ratio of debt-to-equity of no greater than 12:1. This ratio varies from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions. Since the financial crisis beginning in 2007, we have maintained a debt-to-equity ratio of below 8:1, which is generally lower than our debt-to-equity ratio had been prior to 2007. For purposes of calculating this ratio, our debt is equal to our repurchase agreements, convertible senior notes, securitized debt of consolidated VIE, loan participation sold and mortgages payable (which are non-recourse to us, subject to customary carveouts) as presented on our Consolidated Statements of Financial Condition.

Our target debt-to-equity ratio is determined under our capital management policy. Should our actual debt-to-equity ratio increase above the target level due

Our borrowings pursuant to repurchase transactions have maturities that range from overnight to greater than four years. While shorter term agreements generally have lower interest rates, they increase liquidity risk. To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements and a conservative weighted average days to maturity. As of December 31, 2014, the weighted average days to maturity was 141 days.

to asset acquisition or market value fluctuations in assets, we would cease to acquire new assets. Our management would, at that time, present a plan to our board of directors to return to our target debt-to-equity ratio.

The following table presents our debt-to-equity and capital at December 31, 2014 and 2013.

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	2014	2013
Debt-to-equity ratio	5.4:1	5.0:1
Capital ratio	15.1%	15.1%

Risk Management

Risk is a natural element of the business and related activities that we conduct. Effective risk management is of critical importance to the success of the firm. The objective of our risk management framework is to measure, monitor and manage the key risks to which we are subject. Our approach to risk management is comprehensive and has been designed to foster a holistic view of risk. For a full discussion of our risk management process and policies please refer to the section titled "Risk Management" of Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Management Agreement

We have entered into a management agreement with the Manager pursuant to which our management is conducted by the Manager through the authority delegated to it in the Management Agreement and pursuant to the policies established by our board of directors. The management agreement was effective as of July 1, 2013 and applicable for the entire 2013 calendar year and was amended on November 5, 2014 (the management agreement, as amended, is referred to as "Management Agreement").

Pursuant to the terms of the Management Agreement, we pay the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of our stockholders' equity, as defined in the Management Agreement, for its management services.

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

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

Executive Officers

Our executive officers are provided and compensated by our Manager. The following table sets forth certain information as of February 25, 2015 concerning our executive officers:

Name	Age	Title
Wellington J. Denahan	51	Chairman of the Board and Chief Executive Officer
Kevin G. Keyes	47	President and Director

Glenn A. Votek	56	Chief Financial Officer
R. Nicholas Singh	56	Chief Legal Officer and Secretary

Wellington J. Denahan is Chairman of the Board and Chief Executive Officer of Annaly. Ms. Denahan was appointed Chairman of the Board and Chief Executive Officer of Annaly in November 2012. Previously, Ms. Denahan was appointed to serve as Co-Chief Executive Officer of Annaly in October 2012. Ms. Denahan was elected in December 1996 to serve as Vice Chairman of the Board. Ms. Denahan was Annaly's Chief Operating Officer from January 2006 to October 2012 and Chief Investment Officer from 2000 to November 2012. She was a co-founder of Annaly. Ms. Denahan has a B.A. in Finance from Florida State University.

Kevin G. Keyes is President of Annaly and a member of the board of directors. Prior to being named to his current role, Mr. Keyes served as Chief Strategy

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Officer and Head of Capital Markets at Annaly. Mr. Keyes has over 20 years of Capital Markets and Investment Banking experience. He joined Annaly in 2009 from Bank of America Merrill Lynch where he served in various senior management and business origination roles since 2005. Prior to that, Mr. Keyes also worked at Credit Suisse First Boston from 1997 until 2005 in various capital markets roles and Morgan Stanley Dean Witter from 1990 until 1997 in various investment banking positions. Mr. Keyes has a B.A. in Economics and a B.S. in Business Administration (ALPA Program) from the University of Notre Dame.

Glenn A. Votek was appointed to serve as Chief Financial Officer of Annaly and FIDAC in August 2013. Mr. Votek joined Annaly in May 2013 from CIT Group where he was an Executive Vice President and Treasurer since 1999 and President of Consumer Finance since 2012. Prior to that, Mr. Votek worked at AT&T and its finance subsidiary from 1986 until 1999 in various financial management roles. Mr. Votek has a B.S. in Finance and Economics from the University of Arizona/Kean College and a M.B.A. in Finance from Rutgers University.

R. Nicholas Singh is Chief Legal Officer and Secretary of Annaly and FIDAC. Mr. Singh joined Annaly in February 2005. From 2001 until he joined Annaly, he was a partner in the law firm of McKee Nelson LLP. Mr. Singh has a B.A. from Carleton College, a M.A. from Columbia University and a J.D. from American University.

Employees

Effective July 1, 2013, all of Annaly's employees were terminated by us and were hired by the Manager. However, a limited number of employees of our subsidiaries remain as employees of our subsidiaries for regulatory or corporate efficiency reasons. As of December 31, 2014, our subsidiaries employed 25 employees. All compensation expenses associated with the employees of our subsidiaries reduce the management fee. For information about the management, see the discussion in the "Management

We regularly monitor our investments and the income from these investments and, to the extent we enter into hedging transactions, we monitor income from our hedging transactions as well, so as to ensure at all times that we maintain our qualification as a REIT and our exemption from registration under the Investment Company Act.

RCap is a member of FINRA and is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees. As a self-clearing, registered broker dealer, RCap is required to maintain minimum net capital by FINRA. RCap consistently operates with capital in excess of its regulatory capital requirements as defined by SEC Rule 15c3-1.

The financial services industry has been the subject of intense regulatory scrutiny in recent years. Financial institutions have been subject to increasing regulation and supervision in the U.S. In particular, the Dodd-Frank Act, which was enacted in July 2010, significantly altered the financial regulatory regime within which financial institutions operate. The implications of the Dodd-Frank Act for our business will depend to a large extent on the rules that will be adopted by the Federal Reserve Board, the FDIC, the Securities and Exchange Commission (or SEC), the Commodity and Futures Trading Commission (or CFTC) and other agencies to implement the legislation, as well as the development of market practices and structures under the regime established by the legislation and the implementation of the rules. Other reforms have been adopted or are being considered by other regulators and policy makers worldwide. We will continue to assess our business, risk management, and compliance practices to conform to developments in the regulatory environment.

Competition

We operate in a highly competitive market for investment opportunities and competition may limit our

Agreement” section.

Regulatory Requirements

We have elected and believe that we are organized and have operated in a manner that qualifies us to be taxed as a REIT under the Internal Revenue Code of 1986, as amended and regulations promulgated thereunder (or the Code). If we qualify for taxation as a REIT, we generally will not be subject to federal income tax on our taxable income that is distributed to our stockholders. Furthermore, substantially all of our assets, other than our taxable REIT subsidiaries, consist of qualified REIT real estate assets (of the type described in Section 856(c)(5) of the Code).

ability to acquire desirable investments in our target assets and could also affect the pricing of these securities. In acquiring our target assets, we will compete with financial institutions, institutional investors, other lenders, government entities and certain other mortgage REITs. For a full discussion of the risks associated with competition see the “Risks Related to Our Investing, Portfolio Management and Financing Activities” section in Item 1A. “Risk Factors.”

Distributions

As a requirement for maintaining REIT status, we will distribute to stockholders aggregate dividends equaling at least 90% of our REIT taxable income for each taxable year. We may make additional returns of capital when the potential risk-adjusted returns from new investments fail to exceed our cost of capital. Subject to the limitations of applicable securities and state corporation laws, we can return capital by making purchases of our own capital stock or through payment of dividends.

Available Information

Our website is www.annaly.com. We make available on this website under "Investors - SEC Filings," free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC.

Also posted on our website, and available in print upon request of any stockholder to our Investor Relations Department, are charters for our Audit Committee, Risk Committee, Compensation Committee, and Nominating/Corporate Governance Committee, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics governing our directors and officers as well as the employees of our subsidiaries and our Manager. Within the time period required by the SEC, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to any executive officer, director or senior financial officer.

Our Investor Relations Department can be contacted at:

Annaly Capital Management, Inc.
1211 Avenue of the Americas
New York, New York 10036
Attn: Investor Relations
Telephone: 888-8ANNALY
E-mail: investor@annaly.com.

The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at www.sec.gov. Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at publicinfo@sec.gov, or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ITEM 1A. RISK FACTORS

An investment in our stock involves a number of risks. Before making an investment decision, you should carefully consider all of the risks described in this Form 10-K. If any of the risks discussed in this Form 10-K actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the trading price of our stock could decline significantly and you may lose all or part of your investment. Readers should not consider any descriptions of these factors to be a complete set of all potential risks that could affect us.

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Risks Related to Our Investing, Portfolio Management and Financing Activities

We may change our policies without stockholder approval.

Our Manager is authorized to follow very broad investment guidelines that may be amended from time to time. Our board of directors and management determine all of our significant policies, including our investment, financing and distribution policies. They may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or distributions.

Our ongoing investment in new business strategies and new assets is inherently risky, and could disrupt our ongoing businesses.

To date our total assets have consisted primarily of Agency mortgage-backed securities and Agency Such endeavors may involve significant risks and uncertainties, including credit risk, diversion of management from current operations, expenses associated with these new investments, inadequate return of capital on our investments, and unidentified issues not discovered in our due diligence of such strategies and assets. Because these new ventures are inherently risky, no assurance can be given that such strategies will be successful and will not materially adversely affect our reputation, financial condition, and operating results.

Our strategy involves the use of leverage, which increases the risk that we may incur substantial losses.

We expect our leverage to vary with market conditions and our assessment of risk/return on investments. We incur this leverage by borrowing against a substantial portion of the market value of our assets. Leverage, which is fundamental to our investment strategy, creates significant risks.

debentures which carry an implied or actual "AAA" rating. Nevertheless, pursuant to our investment policy, we have the ability to acquire assets of lower credit quality.

While we remain committed to the Agency market, given the current environment, we believe it is prudent to diversify a portion of our investment portfolio. We have begun investing in new business strategies and assets and expect to continue to do so in the future. We currently may allocate up to 25% of our stockholders' equity to assets other than Agency mortgage-backed securities.

Because of our leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

short-term interest rates increase;
the market value of our investments decreases;
the "haircut" applied to our assets under the repurchase agreements we are party to increases;
interest rate volatility increases; or
the availability of financing in the market decreases.

Our leverage may cause margin calls and defaults and force us to sell assets under adverse market conditions.

Because of our leverage, a decline in the value of our interest earning assets may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. Our fixed-rate mortgage-backed securities generally are more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate securities.

If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. This could force us to sell our interest earning assets under adverse market conditions. Additionally, in the event of our bankruptcy, our borrowings, which are generally made under repurchase agreements, may qualify for special treatment under the Bankruptcy Code. This special treatment would allow the lenders under these agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under these agreements without delay.

We may exceed our target leverage ratios.

We generally expect to maintain a ratio of debt-to-equity of less than 12:1. However, we are not required to stay below this leverage ratio. We may exceed this ratio by incurring additional debt without increasing the amount of equity we have. For example, if we increase the amount of borrowings under our master repurchase agreements with our existing or new counterparties or the market value of our portfolio holdings declines, our leverage ratio would increase. If we increase our debt-to-equity ratio, the adverse impact on our financial condition and results of operations from the types of risks associated with the use of leverage would likely be more severe.

We may not be able to achieve our optimal leverage.

Failure to procure or renew funding on favorable terms, or at all, would adversely affect our results and financial condition.

One or more of our lenders could be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. If one or more major market participants fails or otherwise experiences a major liquidity crisis it could negatively impact the marketability of all fixed income securities, including Agency mortgage-backed securities, and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if any of our potential lenders or existing lenders is unwilling or unable to provide us with financing or if we are not able to renew or replace maturing borrowings, we could be forced to sell our assets at an inopportune time when prices are depressed.

Failure to effectively manage our liquidity would adversely affect our results and financial condition.

Our ability to meet cash needs depends on many factors, several of which are beyond our control. Ineffective management of liquidity levels could cause us to be unable to meet certain financial obligations. Potential conditions that could impair our liquidity include: unwillingness or inability of any of our potential lenders to provide us with or renew financing, calls on margin, additional capital requirements, a disruption in the financial markets or declining confidence in our reputation or in financial markets in general. These conditions could force us to sell our assets at inopportune times or otherwise cause us to potentially revise our strategic business initiatives.

Purchases and sales of Agency mortgage-backed securities by the Federal Reserve may adversely affect the price and return associated with Agency mortgage-backed securities.

The Federal Reserve owns approximately $1.7 trillion of Agency mortgage-backed securities as of December

We use leverage as a strategy to increase the return to our investors. However, we may not be able to achieve our desired leverage for any of the following reasons:

- we determine that the leverage would expose us to excessive risk;
- our lenders do not make funding available to us at acceptable rates; or
- our lenders require that we provide additional collateral to cover our borrowings.

31, 2014. The Federal Reserve's existing policy is to reinvest principal payments from its holdings of Agency mortgage-backed securities into new Agency mortgage-backed securities purchases. While we cannot predict the impact of this program or any future actions by the Federal Reserve on the prices and liquidity of Agency mortgage-backed securities, we expect that during periods in which the Federal Reserve purchases significant volumes of Agency mortgage-backed securities, yields on Agency mortgage-backed securities will be lower and refinancing volumes will be higher than would have been absent their large scale purchases. As a result, returns on Agency mortgage-backed securities may be adversely affected. There is also a risk that as the Federal Reserve reduces their purchases of Agency mortgage-backed securities or if they decide to sell some or all of their holdings of Agency mortgage-backed securities, the pricing of our Agency mortgage-backed securities portfolio may be adversely affected.

New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of Agency mortgage-backed securities.

The interest and principal payments we expect to receive on the Agency mortgage-backed securities in which we invest will be guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Principal and interest payments on Ginnie Mae certificates are directly guaranteed by the U.S. government. Principal and interest payments relating to the securities issued by Fannie Mae and Freddie Mac are only guaranteed by each respective Agency.

In September 2008, Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity and ensure their financial stability.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency mortgage-backed security and could have broad adverse market implications. If Fannie Mae or Freddie Mac were eliminated, or their structures were to change

The U.S. Government's efforts to encourage refinancing of certain loans may affect prepayment rates for mortgage loans in mortgage-backed securities.

In addition to the increased pressure upon residential mortgage loan investors and servicers to engage in loss mitigation activities, the U.S. Government has encouraged the refinancing of certain loans, and this action may affect prepayment rates for mortgage loans in Agency mortgage-backed securities. To the extent these and other economic stabilization or stimulus efforts are successful in increasing prepayment speeds for residential mortgage loans, such as those in Agency mortgage-backed securities, such efforts could potentially have a negative impact on our income and operating results, particularly in connection with loans or Agency mortgage-backed securities purchased at a premium or our interest-only securities.

Volatile market conditions for mortgages and mortgage-related assets as well as the broader financial markets can result in a significant contraction in liquidity for mortgages and mortgage-related assets, which may adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including Agency mortgage-backed securities, as well as the broader financial markets and the economy generally.

Significant adverse changes in financial market conditions can result in a deleveraging of the global financial system and the forced sale of large quantities of mortgage-related and other financial assets. Concerns over economic recession, geopolitical issues, unemployment, the availability and cost of financing, the mortgage market and a declining real estate market may contribute to increased volatility and diminished expectations for the economy and markets.

radically, we would not be able to acquire Agency mortgage-backed securities from these entities, which could adversely affect our business operations.

For example, as a result of the financial market conditions beginning in the summer of 2007, many traditional mortgage investors suffered severe losses in their residential mortgage portfolios and several major market participants failed or have been impaired, resulting in a significant contraction in market liquidity for mortgage-related assets. This illiquidity negatively affected both the terms and availability of financing for all mortgage-related assets. Further increased volatility and deterioration in the markets for mortgages and mortgage-related assets as well as the broader financial markets may adversely affect the performance and market value of our Agency mortgage-backed securities. If these conditions persist, institutions from which we seek financing for our investments may tighten their lending standards or become insolvent, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability and financial condition may be adversely affected if we are unable to obtain cost-effective financing for our investments.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these assets.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we will compete with a variety of institutional investors, including other REITs (as well as another REIT externally managed by our wholly owned subsidiary, FIDAC), specialty finance companies, public and private funds, government entities, commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Other REITs with investment objectives that overlap with ours may elect to raise significant amounts of capital, which may create additional competition for investment target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

An increase in the interest payments on our borrowings relative to the interest we earn on our interest earning assets may adversely affect our profitability.

We earn money based upon the spread between the interest payments we earn on our interest earning assets and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our interest earning assets, our profitability may be adversely affected.

Differences in timing of interest rate adjustments on our interest earning assets and our borrowings may adversely affect our profitability.

We rely primarily on short-term borrowings to acquire interest earning assets with long-term maturities. Some of the interest earning assets we acquire are adjustable-rate interest earning assets. This means that their interest rates may vary over time based upon changes in an objective index, such as:

LIBOR. The interest rate that banks in London offer for deposits in London of U.S. dollars.

Treasury Rate. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate interest earning assets, which are also typically subject to periodic and lifetime interest rate caps. Accordingly, opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the Investment Company Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot provide assurance that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our

in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate interest earning assets.

An increase in interest rates may adversely affect the market value of our interest earning assets and, therefore, also our book value.

Increases in interest rates may negatively affect the market value of our interest earning assets because in a period of rising interest rates, the value of certain interest earning assets may fall and reduce our book value. In addition, our fixed-rate interest earning assets are generally more negatively affected by increases in interest rates because in a period of rising rates, the coupon we earn on our fixed-rate interest earning assets would not change. Our book value would be reduced by the amount of decreases in the market value of our interest earning assets.

We may experience declines in the market value of our assets resulting in us recording impairments, which may have an adverse effect on our results of operations and financial condition.

A decline in the market value of our mortgage-backed securities or other assets may require us to recognize an "other-than-temporary" impairment (OTTI) against such assets under U.S. generally accepted accounting principles (GAAP). For a discussion of the assessment of OTTI, see the section titled "Significant Accounting Policies" in the Notes to the Consolidated Financial Statements included in Item 15 "Exhibits, Financial Statement Schedules." The determination as to whether an other-than-temporary impairment exists and, if so, the amount we consider other-than-temporarily impaired is subjective, as such determinations are based on both factual and subjective information available at the time of assessment. As a result, the timing and amount of other-than-temporary impairments constitute material estimates that are susceptible to significant change.

We are subject to reinvestment risk.

We also are subject to reinvestment risk as a result of changes in interest rates. Declines in interest rates are generally accompanied by increased prepayments of Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

The viability of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or, in certain instances, our counterparty's customers. There is no assurance that any such losses would not materially and adversely impact our revenues, financial condition and earnings.

Our hedging strategies may be costly, and may not hedge our risks as intended.

Our policies permit us to enter into interest rate swaps, caps and floors, interest rate swaptions, Treasury futures and other derivative transactions to help us mitigate our interest rate and prepayment risks described above. We have used interest rate swaps to provide a level of protection against interest rate risks as well as options to enter into interest rate swaps (commonly referred to as interest rate swaptions). We may also purchase or sell to-be-announced forward contracts on Agency mortgage-backed securities mortgage loans, which in turn results in a prepayment of the related mortgage-backed securities. An increase in prepayments could result in the reinvestment of the proceeds we receive from such prepayments into lower yielding assets.

An increase in prepayment rates may adversely affect our profitability.

The Agency mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on these underlying mortgage loans. We often purchase mortgage-backed securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these mortgage-backed securities. In accordance with GAAP, we amortize the premiums on our mortgage-backed securities over the life of the related mortgage-backed securities. If the mortgage loans securing these mortgage-backed securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis that may adversely affect our profitability. Defaults on mortgage loans underlying Agency mortgage-backed securities typically have the same effect as prepayments because of the underlying Agency guarantee.

(commonly referred to as TBAs) purchase or write put or call options on TBA securities and invest in other types of mortgage derivatives, such as interest-only securities. No hedging strategy can protect us completely. Entering into interest rate hedging may fail to protect or could adversely affect us because, among other things: interest rate hedging can be expensive, particularly during periods of volatile interest rates; available hedges may not correspond directly with the risk for which protection is sought; and the duration of the hedge may not match the duration of the related asset or liability.

Our use of derivatives may expose us to counterparty and liquidity risks.

The CFTC has and continues to issue new rules regarding swaps and swaptions, under the authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank. These new rules change, but do not eliminate, the risks we face in our hedging activities.

Most swaps that we enter into must be cleared by a Derivatives Clearing Organization, or DCO. DCOs are subject to regulatory oversight, use extensive risk management processes, and might receive “too big to fail” support from the government in the case of insolvency. We access the DCO through several Futures Commission Merchants, or FCMs. For any cleared swap, we bear the credit risk of both the DCO and the relevant FCM, in the form of potential late or unrecoverable payments, potential difficulty or delay in accessing collateral that we have posted, and potential loss of any positive market value of the swap position. In the event of a default by the DCO or FCM, we also bear market risk, because the asset being hedged is no longer effectively hedged.

Most swaps must be cleared through a DCO. Most swaps must be or are traded on a Swap Execution Facility. We bear additional fees for use of the DCO. We also bear fees for use of the Swap Execution Facility, and bear increased risk of trade errors. Because the standardized swaps available on Swap Execution Facilities and cleared through DCOs are not as customizable as the swaps available before the implementation of Dodd-Frank, we may bear additional basis risk from hedge positions that do not exactly reflect the interest rate risk on the asset being hedged.

Futures transactions are subject to risks analogous to those of cleared swaps, except that for futures transactions we bear a higher risk that collateral we have posted is unavailable to us if the FCM defaults.

Some derivatives transactions, such as swaptions, are not currently required to be cleared through a DCO. Therefore, we bear the credit risk of the dealer with which we executed the swaption. TBA contracts are also not cleared, and we bear the credit risk of the dealer.

Derivative transactions are subject to margin requirements. The relevant contract or clearinghouse rules dictate the method of determining the required amount of margin, the types of collateral accepted, and the timing required to meet margin calls. Additionally, for cleared swaps and futures, FCMs may have the right to require more margin than the clearinghouse requires. The requirement to meet margin calls can create liquidity risks, and we bear the cost of funding the margin that we post. Also, as discussed above, we bear credit risk if a dealer, FCM, or clearinghouse is holding collateral we have posted.

Generally, we attempt to retain the ability to close out of a hedging position or create an offsetting position. However, in some cases we may not be able to do so at economically viable prices, or we may be unable to do so without consent of the counterparty. Therefore, in some situations a derivative position can be illiquid, forcing us to hold it to its maturity or scheduled termination date.

Regulations relating to derivatives continue to be issued and come into effect. Ongoing regulatory change in this area could increase costs, increase risks, and adversely affect our business and results of operations.

We use analytical models and data in connection with the valuation of our assets, and any incorrect, misleading or incomplete information used in connection therewith would subject us to potential risks.

Given our strategies and the complexity of the valuation of our assets, we must rely heavily on analytical models (both proprietary models developed by us and those supplied by third parties) and information and data supplied by our third party vendors and servicers. Models and data are used to value assets or potential asset purchases and also in connection with hedging our assets. When models and data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose us to potential risks. For example, by relying on models and data, especially valuation models, we may be induced to buy certain assets at prices that are too high, to sell certain other assets at prices that are too low or to miss favorable opportunities altogether. Similarly, any hedging based on faulty models and data may prove to be unsuccessful. Furthermore, any valuations of our assets that are based on valuation models may prove to be incorrect.

Some of the risks of relying on analytical models and third-party data are particular to analyzing tranches from securitizations, such as commercial mortgage-backed securities or residential mortgage-backed securities. These risks include, but are not limited to, the following: (i) collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral or bond historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (e.g., different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); or (iv) collateral or bond information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

Some of the analytical models used by us, such as mortgage prepayment models or mortgage default models, are predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses on a cash flow and/or a mark-to-market basis. In addition, the predictive models used by us may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain assets than actual market prices. Furthermore, since predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data and the ability of these historical models to accurately reflect future periods.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is inputted correctly, “model prices” will often differ substantially from market prices, especially for securities with complex characteristics, such as

Accounting rules for valuations of financial instruments, mortgage loan sales and securitizations, investment consolidations, acquisitions of real estate and other aspects of our anticipated operations are highly complex and involve significant judgment and assumptions. These complexities could lead to a delay in preparation of financial information and the delivery of this information to our stockholders. Changes in accounting interpretations or assumptions could impact our financial statements and our ability to prepare our financial statements in a timely fashion. Our inability to prepare our financial statements in a timely fashion in the future would likely adversely affect our share price significantly.

The fair value at which our assets may be recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our common shares could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

We are highly dependent on information systems and third parties, and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to pay dividends to our stockholders.

Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, including mortgage-backed securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our derivative instruments or structured notes.

Accounting rules related to certain of our transactions are highly complex and involve significant judgment and assumptions, and changes in accounting treatment may adversely affect our profitability and impact our financial results.

common stock and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective systems experience failure, interruption, cyber-attacks, or security breaches.

Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in our industry and may occur on our systems in the future. We rely heavily on our financial, accounting and other data processing systems. Although we have not detected a breach to date, other financial services institutions have reported breaches of their systems, some of which have been significant. Even with all reasonable security efforts, not every breach can be prevented or even detected. It is possible that we have experienced an undetected breach, and it is likely that other financial institutions have experienced more breaches than have been detected and reported. There is no assurance that we, or the third parties that facilitate our business activities, have not or will not experience a breach. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems (or the networks or systems of third parties that facilitate our business activities) or any failure to maintain performance, reliability and security of our technical infrastructure, but such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations.

Our use of non-recourse securitizations may expose us to risks which could result in losses to us.

We may utilize non-recourse securitizations of our assets in mortgage loans, especially loan originations, when they are available. Prior to any such financing, we may seek to finance assets with relatively short-term facilities until a sufficient portfolio is accumulated. As a result, we would be subject to the risk that we would not be able to acquire, during the period that any short-term facilities are available, sufficient eligible assets to maximize the efficiency of a securitization. We also would bear the risk that we would not be able to obtain a new short-term facility or would not be able to renew any short-term facilities after they expire should we need more time to seek and acquire sufficient eligible assets for a securitization. In addition, conditions in the capital markets, including the recent unprecedented volatility and disruption in the capital and credit markets, may not permit a non-recourse securitization at Securitizations expose us to additional risks.

In a securitization structure, we convey a pool of assets to a special purpose vehicle, the issuing entity, and the issuing entity would issue one or more classes of non-recourse notes pursuant to the terms of an indenture. The notes are secured by the pool of assets. In exchange for the transfer of assets to the issuing entity, we receive the cash proceeds of the sale of non-recourse notes and a 100% interest in the subordinate interests of the issuing entity. The securitization of all or a portion of our commercial mortgage loan portfolio might magnify our exposure to losses because any subordinate interest we retain in the issuing entity would be subordinate to the notes issued to investors and we would, therefore, absorb all of the losses sustained with respect to a securitized pool of assets before the owners of the notes experience any losses. Moreover, we cannot be assured that we will be able to access the securitization market or be able to do so at favorable rates. The inability to securitize our portfolio could adversely affect our performance and our ability to grow our business.

Counterparties may require us to enter into restrictive covenants relating to our operations that may inhibit our ability to grow our business and increase revenues.

If or when we obtain debt financing, lenders (especially in the case of credit facilities) may impose restrictions on us that would affect our ability to incur additional debt, make certain allocations or acquisitions, reduce liquidity below certain levels, make distributions to our stockholders, redeem debt or equity securities and impact our flexibility to determine our operating policies and strategies. For example, our loan documents may contain negative covenants that limit, among other things, our ability to repurchase our common shares, distribute more than a certain amount of our net income or funds from operations to our stockholders, employ leverage beyond certain amounts, sell assets, engage in mergers or consolidations, grant liens and enter into transactions with affiliates. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their any particular time or may make the issuance of any such securitization less attractive to us even when we do have sufficient eligible assets. While we would intend to retain the non-investment grade tranches of securitizations and, therefore, still have exposure to any assets included in such securitizations, our inability to enter into such securitizations would increase our overall exposure to risks associated with direct ownership of such assets, including the risk of default. Our inability to refinance any short-term facilities would also increase our risk because borrowings thereunder would likely be recourse to us as an entity. If we are unable to obtain and renew short-term facilities or to consummate securitizations to finance our assets on a long-term basis, we may be required to seek other forms of potentially less attractive financing or to liquidate assets at an inopportune time or price.

commitments, require the posting of additional collateral and enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. Furthermore, this could also make it difficult for us to satisfy the qualification requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes. A default and resulting repayment acceleration could significantly reduce our liquidity, which could require us to sell our assets to repay amounts due and outstanding. This could also significantly harm our business, financial condition, results of operations and ability to make distributions, which could cause our share price to decline. A default could also significantly limit our financing alternatives such that we would be unable to pursue our leverage strategy, which could adversely affect our returns.

We invest in securities in the developing Agency risk transfer sector that are subject to mortgage credit risk

We invest in securities in the developing Agency risk transfer sector ("CRT Sector"). The CRT Sector is comprised of the risk sharing transactions issued by Fannie Mae ("CAS") and Freddie Mac ("STACR"), and similarly structured transactions arranged by third party market participants. The securities issued in the CRT Sector are designed to synthetically transfer mortgage credit risk from Fannie Mae and Freddie Mac to private investors. Currently, CAS and STACR transactions are structured as unsecured and unguaranteed bonds issued by Fannie Mae or Freddie Mac, respectively, whose principal payments are determined by the delinquency and prepayment experience of a reference pool of mortgages originated and guaranteed by Fannie Mae or Freddie Mac, respectively, in a particular quarter. Transactions arranged by third party market participants in the CRT Sector are similarly structured to reference a specific pool of loans that have been securitized by Fannie Mae or Freddie Mac and synthetically transfer mortgage credit risk related to those loans to the purchaser of the securities. The holder of the securities in the CRT Sector has the risk that the borrowers may default on their obligations to make full and timely payments of principal and interest. Investments in securities in the CRT Sector could cause us to incur losses of income from, and/or losses in market value relating to, these assets if there are defaults of principal and/or interest on the pool of mortgages referenced in the transaction.

Risks Related To Commercial Real Estate Debt, Preferred Equity Investments, Net Lease Real Estate Assets and Other Equity Ownership of Real Estate Assets

The real estate assets we acquire are subject to risks particular to real property, which may adversely affect our returns from certain assets and our ability to make distributions to our stockholders.

We own assets secured by real estate and own real estate directly through direct purchases or upon a default of mortgage loans. Real estate assets are subject to various risks, including:

- acts of God, including earthquakes, hurricanes, floods and other natural disasters, which may result in uninsured losses;
- acts of war or terrorism, including the consequences of terrorist attacks, such as those that occurred on September 11, 2001;
- adverse changes in national and local economic and market conditions;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the potential for uninsured or under-insured property losses; and
- environmental conditions of the real estate.

Under various U.S. federal, state and local environmental laws, ordinances and regulations, a current or previous owner of real estate (including, in certain circumstances, a secured lender that succeeds to ownership or control of a property) may become liable for the costs of removal or remediation of certain hazardous or toxic substances at, on, under or in its property.

If any of these or similar events occurs, it may reduce our return from an affected property or investment and reduce or eliminate our ability to make distributions to stockholders.

A prolonged economic slowdown or declining real estate values could impair the assets we may own and adversely affect our operating results.

Many of the commercial real estate debt, preferred equity, and real estate assets we may own may be susceptible to economic slowdowns or recessions, which could lead to financial losses in our assets and a decrease in revenues, net income and asset values. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us. These events could result in significant diminution in the value of our assets, prevent us from acquiring additional assets and have an adverse effect on our operating results.

The commercial assets we originate and/or acquire depend on the ability of the property owner to generate net income from operating the property. Failure to do so may result in delinquency and/or foreclosure.

Commercial loans are secured by property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the income of the property is reduced, the borrower's ability to repay the loan may be impaired. The income of an income-producing property can be adversely affected by, among other things,

- changes in national, regional or local economic conditions or specific industry segments, including the credit and securitization markets;
- declines in regional or local real estate values;
- declines in regional or local rental or occupancy rates;
- increases in interest rates, real estate tax rates and other operating expenses;
- tenant mix;
- the nonrecourse nature of the mortgage loans;
- litigation and condemnation proceedings regarding the properties; and
- bankruptcy proceedings.

In the event of any default under a mortgage loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations and limit amounts available for distribution to our stockholders. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan.

Borrowers May Be Unable To Repay the Remaining Principal Balance on the Maturity Date.

Many commercial loans are non-amortizing balloon loans that provide for substantial payments of principal due at their stated maturities. Commercial loans with substantial remaining principal balances at their stated maturity date involve greater risk than fully-amortizing loans. This is because the borrower may be unable to repay the loan at that time.

A borrower's ability to repay a mortgage loan on its stated maturity date typically will depend upon its ability either to refinance the mortgage loan or to sell the mortgaged property at a price sufficient to permit repayment. A borrower's ability to achieve either of these goals will be affected by a number of factors, including:

- the availability of, and competition for, credit for commercial real estate projects, which fluctuate over

success of tenant businesses and the tenant's ability to meet their lease obligations;
property management decisions;
property location, condition and design;
competition from comparable types of properties;
changes in laws that increase operating expenses or limit rents that may be charged;
costs of remediation and liabilities associated with environmental conditions;
the potential for uninsured or underinsured property losses;
changes in governmental laws and regulations, including fiscal policies, zoning ordinances and environmental legislation and the related costs of compliance;
acts of God, terrorist attacks, social unrest and civil disturbances;
time;
the prevailing interest rates;
the net operating income generated by the mortgaged properties;
the fair market value of the related mortgaged properties;
the borrower's equity in the related mortgaged properties;
significant tenant rollover at the related mortgaged properties;

the borrower's financial condition;
the operating history and occupancy level of the related mortgaged property;
reductions in applicable government assistance/rent subsidy programs;
changes in zoning or tax laws;
changes in competition in the relevant location;
changes in rental rates in the relevant location;
changes in government regulation and fiscal policy;
the state of fixed income and mortgage markets;
the availability of credit for multi-family and commercial properties;
prevailing general and regional economic conditions; and
the availability of funds in the credit markets which fluctuates over time.

Whether or not losses are ultimately sustained, any delay in the collection of a balloon payment on the maturity date will likely extend the weighted average life of our investment.

Commercial mortgage-backed securities we acquire may be subject to losses.

In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by the holder of a mezzanine loan or B-Note, if any, then by the "first loss" subordinated security holder generally, the "B-Piece" buyer, and then by the holder of a higher-rated security. In the event of default and the exhaustion of any equity support, mezzanine loans or B-Notes, and any classes of securities junior to those that we acquire, we may not be able to recover all of our capital in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline, less collateral is available to satisfy interest and principal payments due on the related mortgage-backed securities. The prices of lower credit quality commercial mortgage-backed securities are generally less sensitive to interest rate changes than more highly rated commercial mortgage-backed securities, but more sensitive to adverse economic downturns or individual existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

The B-Notes that we acquire may be subject to additional risks related to the privately negotiated structure and terms of the transaction, which may result in losses to us.

We may acquire B-Notes. A B-Note is a mortgage loan typically (1) secured by a first mortgage on a single large commercial property or group of related properties and (2) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. However, because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes typically are secured by a single property and so reflect the risks associated with significant concentration. Significant losses related to our B-Notes would result in operating losses for us and may limit our ability to make distributions to our stockholders.

The mezzanine loan assets that we acquire involve greater risks of loss than senior loans.

We acquire mezzanine loans, which take the form of subordinated loans secured by a pledge of the ownership interests of the entity that owns the interest in the entity owning the property. These types of assets involve a higher degree of risk than senior mortgage lending secured by income-producing real property, because the loan may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our issuer developments. The projection of an economic downturn, for example, could cause a decline in the price of lower credit quality commercial mortgage-backed securities because the ability of obligors of mortgages underlying commercial mortgage-backed securities to make principal and interest payments may be impaired. In such event, mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our initial investment. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal. Significant losses related to our mezzanine loans would result in operating losses for us and may limit our ability to make distributions to our stockholders.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1A. Risk Factors

We are subject to additional risks associated with loan participations.

Some of our loans may be participation interests or co-lender arrangements in which we share the rights, obligations and benefits of the loan with other lenders. We may need the consent of these parties to exercise our rights under such loans, including rights with respect to amendment of loan documentation, enforcement proceedings upon a default and the institution of, and control over, foreclosure proceedings. Similarly, certain participants may be able to take actions to which we object but to which we will be bound if our participation interest represents a minority interest. We may be adversely affected by this lack of control.

Construction loans involve an increased risk of loss.

We acquire and/or originate construction loans. If we fail to fund our entire commitment on a construction loan or if a borrower otherwise fails to complete the construction of a project, there could be adverse consequences associated with the loan, including: a loss of the value of the property securing the loan, especially if the borrower is unable to raise funds to complete it from other sources; a borrower claim against us for failure to perform under the loan documents; increased costs to the borrower that the borrower is unable to pay; a bankruptcy filing by the borrower; and abandonment by the borrower of the collateral for the loan.

If we do not have an adequate completion guarantee, risks of cost overruns and non-completion of renovation of the properties underlying rehabilitation loans may result in significant losses. The renovation, refurbishment or expansion by a borrower under a mortgaged property involves risks of cost overruns and non-completion. Estimates of the costs of improvements to bring an acquired property up to standards established for the market position intended for that property may prove inaccurate. Other risks may include rehabilitation costs exceeding original estimates, possibly making a project uneconomical, environmental risks and rehabilitation and subsequent leasing of the property not being completed on schedule. If such renovation is not

Geographic concentration exposes investors to greater risk of default and loss.

Repayments by borrowers and the market value of the related assets could be affected by economic conditions generally or specific to geographic areas or regions of the United States, and concentrations of mortgaged properties in particular geographic areas may increase the risk that adverse economic or other developments or natural or man-made disasters affecting a particular region of the country could increase the frequency and severity of losses on mortgage loans secured by those properties. In recent periods, several regions of the United States have experienced significant real estate downturns when others have not. Regional economic declines or conditions in regional real estate markets could adversely affect the income from, and market value of, the mortgaged properties. In addition, local or regional economies may be adversely affected to a greater degree than other areas of the country by developments affecting industries concentrated in such area. A decline in the general economic condition in the region in which mortgaged properties securing the related mortgage loans are located would result in a decrease in consumer demand in the region, and the income from and market value of the mortgaged properties may be adversely affected.

Other regional factors – e.g., earthquakes, floods, forest fires or hurricanes or changes in governmental rules or fiscal policies – also may adversely affect the mortgaged properties. Assets in certain regional areas may be more susceptible to certain hazards (such as earthquakes, widespread fires, floods or hurricanes) than properties in other parts of the country and mortgaged properties located in coastal states may be more susceptible to hurricanes than properties in other parts of the country. As a result, areas affected by such events often experience disruptions in travel, transportation and tourism, loss of jobs and an overall decrease in consumer activity, and often a decline in real estate-related investments. There can be no assurance that the economies in such impacted areas will recover sufficiently to support income producing real estate at pre-event levels or that the costs of the related clean-up completed in a timely manner, or if it costs more than expected, the borrower may experience a prolonged impairment of net operating income and may not be able to make payments on our investment, which could result in significant losses.

will not have a material adverse effect on the local or national economy.

Inadequate property insurance coverage could have an adverse impact on our operating results.

Assets may suffer casualty losses due to risks (including acts of terrorism) that are not covered by insurance or for which insurance coverage is not adequate or available at commercially reasonable rates or has otherwise been contractually limited by the related mortgage loan documents. Moreover, if reconstruction or major repairs are required following a casualty, changes in laws that have occurred since the time of original construction may materially impair the borrower's ability to effect such reconstruction or major repairs or may materially increase the cost thereof.

There is no assurance that borrowers have maintained or will maintain the insurance required under the mortgage loan documents or that such insurance will be adequate. In addition, since the mortgage loans generally do not require maintenance of terrorism insurance, we cannot assure you that any property will be covered by terrorism insurance. Therefore, damage to a mortgaged property caused by acts of terror may not be covered by insurance and result in substantial losses to us.

We may incur losses when a borrower defaults on a loan and the underlying collateral value is less than the amount due.

If a borrower defaults on a non-recourse loan, we will only have recourse to the real estate-related assets collateralizing the loan. If the underlying collateral value is less than the loan amount, we will suffer a loss. Conversely, some of our loans may be unsecured or are secured only by equity interests in the borrowing entities. These loans are subject to the risk that other lenders in the capital stack may be directly secured by the real estate assets of the borrower or may otherwise have a superior right to repayment. Upon a default, those collateralized lenders would have priority over us with respect to the proceeds of a sale of the underlying real estate. In cases described above, we may lack control over the underlying asset collateralizing our loan or the underlying assets of the borrower before a default, and, as a result, the value of the collateral may be reduced by acts or omissions by owners or managers of the assets. In addition, the value of the underlying real estate may be adversely affected by some or all of the risks referenced above with respect to our owned real estate.

Some of our loans may be backed by individual or corporate guarantees from borrowers or their affiliates that are not secured. If the guarantees are not fully or partially secured, we typically rely on financial covenants from borrowers and guarantors that are designed to require the borrower or guarantor to maintain certain levels of creditworthiness. Where we Upon a borrower bankruptcy, we may not have full recourse to the assets of the borrower to satisfy our loan. In addition, certain of our loans are subordinate to other debt of certain borrowers. If a borrower defaults on our loan or on debt senior to our loan, or upon a borrower bankruptcy, our loan will be satisfied only after the senior debt receives payment. Where debt senior to our loan exists, the presence of intercreditor arrangements may limit our ability to amend our loan documents, assign our loans, accept prepayments, exercise our remedies (through "standstill" periods) and control decisions made in bankruptcy proceedings. Bankruptcy and borrower litigation can significantly increase collection costs and the time needed for us to acquire title to the underlying collateral (if applicable), during which time the collateral and/or a borrower's financial condition may decline in value, causing us to suffer additional losses.

If the value of collateral underlying a loan declines or interest rates increase during the term of a loan, a borrower may not be able to obtain the necessary funds to repay our loan at maturity through refinancing because the underlying property revenue cannot satisfy the debt service coverage requirements necessary to obtain new financing. If a borrower is unable to repay our loan at maturity, we could suffer additional loss that may adversely impact our financial performance.

Our assets may become non-performing and sub-performing assets in the future, which are subject to increased risks relative to performing loans.

Our assets may in the near or the long term become non-performing and sub-performing assets, which are subject to increased risks relative to performing assets. Loans may become non-performing or sub-performing for a variety of reasons, such as the underlying property being too highly leveraged, decreasing income generated from the underlying property, or the financial distress of the borrower, in each case, that results in the borrower being unable to meet its debt service and/or repayment obligations. Such non-performing or sub-performing assets may require a substantial amount do not have recourse to specific collateral pledged to satisfy such guarantees or recourse loans, we will only have recourse as an unsecured creditor to the general assets of the borrower or guarantor, some or all of which may be pledged as collateral for other lenders.

There can be no assurance that a borrower or guarantor will comply with its financial covenants, or that sufficient assets will be available to pay amounts owed to us under our loans and guarantees. As a result of these factors, we may suffer additional losses that could have a material adverse effect on our financial performance.

of workout negotiations and/or restructuring, which may involve substantial cost and divert the attention of our management from other activities and entail, among other things, a substantial reduction in interest rate, the capitalization of interest payments and a substantial write-down of the principal of the loan. Even if a restructuring were successfully accomplished, the borrower may not be able or willing to maintain the restructured payments or refinance the restructured mortgage upon maturity.

From time to time we find it necessary or desirable to foreclose on some, if not many, of the loans we acquire, and the foreclosure process may be lengthy and expensive. Borrowers may resist foreclosure actions by asserting numerous claims, counterclaims and defenses to payment against us (such as lender liability claims and defenses) even when such assertions may have no basis in fact or law, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower’s position. In some states, foreclosure actions can take several years or more to litigate. At any time prior to or during the foreclosure proceedings, the borrower may file for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the resolution of our claims. Foreclosure may create a negative public perception of the related property, resulting in a diminution of its value. Even if we are successful in foreclosing on a loan, the liquidation proceeds upon sale of the underlying real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Furthermore, any costs or delays involved in the foreclosure of a loan or a liquidation of the underlying property will further reduce the proceeds and thus increase our loss. Any such reductions could materially and adversely affect the value of the commercial loans in which we invest.

Whether or not we have participated in the negotiation of the terms of a loan, there can be no assurance as to the adequacy of the protection of the terms of the loan, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, claims may be asserted that might interfere with enforcement of our rights. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of that real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Any costs or delays involved in the effectuation of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and increase our loss.

We may experience losses if the creditworthiness of our tenants deteriorates and they are unable to meet their lease obligations.

We own properties leased to tenants of our real estate assets and receive rents from tenants during the contracted term of such leases. A tenant's ability to pay rent is determined by its creditworthiness, among other factors. If a tenant's credit deteriorates, the tenant may default on its obligations under our lease and may also become bankrupt. The bankruptcy or insolvency of our tenants or other failure to pay is likely to adversely affect the income produced by our real estate assets. If a tenant defaults, we may experience delays and incur substantial costs in enforcing our rights as landlord. If a tenant files for bankruptcy, we may not be able to evict the tenant solely because of such bankruptcy or failure to pay. A court, however, may authorize a tenant to reject and terminate its lease with us. In such a case, our claim against the tenant for unpaid, future rent would be subject to a statutory cap that might be substantially less than the remaining rent owed under the lease. In addition, certain amounts paid to us within 90 days prior to the tenant's bankruptcy filing could be required to be returned to the tenant's bankruptcy estate. In any event, it is highly unlikely that a bankrupt or insolvent tenant would pay in full amounts it owes us under a lease that it intends to reject. In other circumstances, where a tenant's financial condition has become impaired, we may agree to partially or wholly terminate the lease in advance of the termination date in consideration for a lease termination fee that is likely less than the total contractual rental amount. Without regard to the manner in which the lease termination occurs, we are likely to incur additional costs in the form of tenant improvements and leasing commissions in our efforts to lease the space to a new tenant. In any of the foregoing circumstances, our financial performance could be materially adversely affected.

Lease expirations, lease defaults and lease terminations may adversely affect our revenue.

Lease expirations and lease terminations may result in reduced revenues if the lease payments received from

Whole loan mortgages are also subject to "special hazard" risk (property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies), and to bankruptcy risk (reduction in a borrower's mortgage debt by a bankruptcy court). In addition, claims may be assessed against us on account of our position as mortgage holder or property owner, including responsibility for tax payments, environmental hazards and other liabilities, which could have a material adverse effect on our results of operations, financial condition and our ability to make distributions to our stockholders.

replacement tenants are less than the lease payments received from the expiring or terminating tenants. In addition, lease defaults or lease terminations by one or more significant tenants or the failure of tenants under expiring leases to elect to renew their leases, could cause us to experience long periods of vacancy with no revenue from a facility and to incur substantial capital expenditures and/or lease concessions to obtain replacement tenants.

The real estate investments we expect to acquire will be illiquid.

Because real estate investments are relatively illiquid, our ability to adjust the portfolio promptly in response to economic or other conditions will be limited. Certain significant expenditures generally do not change in response to economic or other conditions, including: (i) debt service (if any), (ii) real estate taxes, and (iii) operating and maintenance costs. This combination of variable revenue and relatively fixed expenditures may result, under certain market conditions, in reduced earnings and could have an adverse effect on our financial condition.

We may not control the special servicing of the mortgage loans included in the commercial mortgage-backed securities in which we invest and, in such cases, the special servicer may take actions that could adversely affect our interests.

With respect to the commercial mortgage-backed securities in which we may invest, overall control over the special servicing of the related underlying mortgage loans will be held by a “directing certificate holder” or a “controlling class representative,” which is appointed by the holders of the most subordinate class of commercial mortgage-backed securities in such series. To the extent that we acquire classes of existing series of commercial mortgage-backed securities originally rated AAA, we will not have the right to appoint the directing certificate holder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificate holder, take actions with respect to the specially serviced mortgage loans that could adversely affect our interests.

We may be required to repurchase mortgage loans or indemnify investors if we breach representations and warranties, which could have a negative impact on our earnings.

When we sell or securitize loans, we will be required to

We and our third party service providers’ and servicers’ due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses.

Before making an asset acquisition, we will assess the strengths and weaknesses of the borrower, originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to it, including our third party service providers and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful.

When we foreclose on an asset, we may come to own and operate the property securing the loan, which would expose us to the risks inherent in that activity.

When we foreclose on an asset, we may take title to the property securing that asset, and if we do not or cannot sell the property, we would then come to own and operate it as “real estate owned.” Owning and operating real property involves risks that are different (and in many ways more significant) than the risks faced in owning an asset secured by that property. In addition, we may end up owning a property that we would not otherwise have decided to acquire directly at the price of our original investment or at all. Further, some of the property underlying the assets we are acquiring are of a different type or class than property we have had experience owning directly, including properties such as hotels. Accordingly, we may not manage these properties as well as they might be managed by another owner, and our returns to investors could suffer. If we foreclose on and come to own property, our financial performance and returns to investors could suffer.

make customary representations and warranties about such loans to the loan purchaser. Our commercial mortgage loan sale agreements will require us to repurchase or substitute loans in the event we breach a representation or warranty given to the loan purchaser. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. Likewise, we may be required to repurchase or substitute loans if we breach a representation or warranty in connection with our securitizations. The remedies available to a purchaser of mortgage loans are generally broader than those available to us against the originating broker or correspondent. Further, if a purchaser enforces its remedies against us, we may not be able to enforce the remedies we have against the sellers. The repurchased loans typically can only be financed at a steep discount to their repurchase price, if at all. They are also typically sold at a significant discount to the unpaid principal balance. Significant repurchase activity could adversely affect our cash flow, results of operations, financial condition and business prospects.

Financial covenants could adversely affect our ability to conduct our business.

The mortgages on our properties generally contain customary negative covenants that limit our ability to further mortgage the properties, to enter into material leases or other agreements or materially modify existing leases or other agreements without lender consent, to access cash flow in certain circumstances, and to discontinue insurance coverage, among other things. These restrictions could adversely affect operations, and our ability to pay debt obligations. In addition, in some instances guaranties given as further security for these mortgage loans contain affirmative covenants to maintain a minimum net worth and liquidity.

Joint venture investments could be adversely affected by our lack of sole decision-making authority and reliance upon a co-venturer's financial condition.

We co-invest with third parties through joint ventures. Although we generally retain control and decision-making authority in a joint venture relationship, in some circumstances (such as major decisions) we may not be permitted to exercise sole decision-making authority regarding such joint venture or the subject property. Investments in joint ventures may involve risks not present were a third party not involved, including the possibility that co-venturers might become bankrupt or otherwise fail to fund their share of required capital contributions. Additionally, our co-venturers might at any time have economic or other business interests or goals which are inconsistent with our business interests or goals, and we may in certain circumstances be liable for the actions of our co-venturers. Consequently, actions by any such co-venturer might result in subjecting properties owned by the joint venture to additional risk, although these risks are mitigated by transaction structure and the terms and conditions of agreements governing the relationship.

Risks Related to Our Relationship with Our Manager

Because the Manager is owned by members of our management, the management agreement was developed by related parties. Although our independent directors, who were responsible for protecting our and our stockholders’ interests with regard to the management agreement, had the benefit of external financial and legal advisors, they did not have the benefit of arm’s-length advice from our executive officers. The terms of the management agreement, including fees payable, may not reflect the terms we may have received if it was negotiated with an unrelated third party. In addition, particularly as a result of our relationship with the principal owners and employees of the Manager, our directors may choose not to enforce, or to enforce less vigorously, our rights under the management agreement because of our desire to maintain our ongoing relationship with our Manager.

There may be conflicts of interest between us and our executive officers.

The Manager is owned by members of our management. The owners of the Manager will be entitled to receive any profit from the management fee we pay to our Manager either in the form of distributions by our Manager or increased value of their ownership interests in the Manager. This may cause our management to have interests that conflict with our interests and those of our stockholders.

We are dependent upon the Manager who provides services to us through the management agreement and we may not find suitable replacements for our Manager if the management agreement is terminated or the Manager’s key personnel are no longer available to us.

The Manager is responsible for making all of our investment decisions. We believe that the successful implementation of our investment and financing strategies depend upon the experience of certain of the Manager’s officers and employees. None of these individuals’ continued service is guaranteed. If the management agreement is terminated or these individuals leave the Manager, the Manager or we may

The management agreement was not negotiated on an arm's length basis and the terms, including fees payable, may not be as favorable to us as if it were negotiated with an unaffiliated third party.

be unable to replace them with persons with appropriate experience, or at all, and we may not be able to execute our business plan.

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The management fee is payable regardless of our performance.

The Manager receives a management fee from us that is based on a percentage of our stockholders' equity, regardless of the performance of our investment portfolio (except to the extent that performance affects our stockholders' equity). For example, we pay our Manager a management fee for a specific period even if we experienced a net loss during the same period. The Manager's entitlement to substantial nonperformance-based compensation may reduce its incentive to provide attractive risk-adjusted returns for our investment portfolio. This in turn could limit our ability to make distributions to our stockholders and the market price of our common stock.

The fee structure of the management agreement may limit the Manager's ability to retain access to its key personnel.

The management agreement does not provide the Manager with an incentive management fee that would pay the Manager additional compensation as a result of meeting or exceeding performance targets. Some of our externally managed competitors pay their managers an incentive management fee, which could enable the manager to provide additional compensation to its key personnel. Thus, the lack of an incentive fee in the management agreement may limit the ability of the Manager to provide key personnel with additional compensation for strong performance, which could adversely affect the Manager's ability to retain these key personnel. If the Manager were not able to retain any of the key personnel that will be providing services to the Manager, it would have to find replacement personnel to provide those services. Those replacement key personnel may not be able to produce the same operating results as the current key personnel.

Conflicts of interest could arise in connection with our executive officers' fiduciary duties.

We believe that since 1997 we have qualified for taxation as a REIT for federal income tax purposes under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and Treasury Regulations promulgated thereunder (or the Code). We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service (IRS) might make changes to the tax laws and regulations, and the courts might issue new rulings that make it more difficult or impossible for us to remain qualified as a REIT.

If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and would therefore have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our equity. In addition, the tax law would no longer require us to make distributions to our stockholders.

A REIT that fails the quarterly asset tests for one or more quarters will not lose its REIT status as a result of such failure if either (i) the failure is regarded as a de minimis failure under standards set out in the Code, or (ii) the failure is greater than a de minimis failure but is

Our current executive officers are members or employees of the Manager while continuing to be executive officers of Annaly. Our executive officers, by virtue of their positions, have fiduciary duties to our company and our stockholders. The duties of our executive officers to us and our stockholders may come into conflict with the interests of such officers in their capacities as members or employees of the Manager.

Risks Related to Our Taxation as a REIT

Our failure to qualify as a REIT would have adverse tax consequences.

attributable to reasonable cause and not willful neglect. In the case of a greater than de minimis failure, however, the REIT must pay a tax and must remedy the failure within 6 months of the close of the quarter in which the failure was identified. In addition, the Code provides relief for failures of other tests imposed as a condition of REIT qualification, as long as the failures are attributable to reasonable cause and not willful neglect. A REIT would be required to pay a penalty of $50,000, however, in the case of each failure.

We have certain distribution requirements, which could adversely affect our ability to execute our business plan.

As a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). The required distribution limits the amount we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement.

To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a non-deductible 4% excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws. We intend to make distributions to our stockholders to comply with the REIT qualification requirements of the Code.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, if we purchase agency securities at a discount, we are generally required to accrete the discount into taxable income prior to receiving the cash proceeds of the accreted discount at maturity. If we do not have other funds available in these situations we could be required to borrow funds on unfavorable terms, sell investments at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the REIT distribution requirement and to avoid corporate income tax and the 4% excise tax in a particular year. These scenarios could increase our costs or reduce our stockholders' equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of our common stock and will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of any class or series of our preferred stock. Our board of directors, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons who would not be treated as “individuals” for purposes of the federal tax laws if it is satisfied, based upon information required to be provided by the party seeking the waiver and upon an opinion of counsel satisfactory to the board of directors, that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for federal income tax purposes.

The ownership limit may have the effect of delaying, deferring or preventing a change in control and, therefore, could adversely affect our stockholders’ ability to realize a premium over the then-prevailing market price for our common stock in connection with a change in control.

A REIT cannot invest more than 25% of its total assets in the stock or securities of one or more taxable REIT subsidiaries; therefore, our taxable subsidiaries cannot constitute more than 25% of our total assets.

A taxable REIT subsidiary (or TRS) is a corporation, other than a REIT or a qualified REIT subsidiary, in which a REIT owns stock and which elects TRS status. The term also includes a corporate subsidiary in which the TRS owns more than a 35% interest. A REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries. A TRS may earn income that would not be qualifying income if it was earned directly by the parent REIT. Overall, at the close of any calendar quarter, no more than 25% of the value of a REIT’s assets may consist of stock or securities of one or more taxable REIT subsidiaries.

The stock and securities of our taxable REIT

Limits on ownership of our common stock could have adverse consequences to you and could limit your opportunity to receive a premium on our stock.

To maintain our qualification as a REIT for federal income tax purposes, not more than 50% in value of the outstanding shares of our capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal tax laws to include certain entities). Primarily to facilitate maintenance of our qualification as a REIT for federal income tax purposes, our charter prohibits ownership, directly or by the attribution

subsidiaries are expected to represent less than 25% of the value of our total assets. Furthermore, we intend to monitor the value of our investments in the stock and securities of our taxable REIT subsidiaries to ensure compliance with the above-described 25% limitation. We cannot assure you, however, that we will always be able to comply with the 25% limitation so as to maintain REIT status.

Taxable REIT subsidiaries are subject to tax at the regular corporate rates, are not required to distribute dividends, and the amount of dividends a TRS can pay to its parent REIT may be limited by REIT gross income tests.

A TRS must pay income tax at regular corporate rates on any income that it earns. Our taxable REIT subsidiaries will pay corporate income tax on their taxable income, and their after-tax net income will be available for distribution to us. Such income, however, is not required to be distributed.

Moreover, the annual gross income tests that must be satisfied to ensure REIT qualification may limit the amount of dividends that we can receive from our taxable REIT subsidiaries and still maintain our REIT status. Generally, not more than 25% of our gross income can be derived from non-real estate related sources, such as dividends from a TRS. If, for any taxable year, the dividends we received from our taxable REIT subsidiaries, when added to our other items of non-real estate related income, represented more than 25% of our total gross income for the year, we could be denied REIT status, unless we were able to demonstrate, among other things, that our failure of the gross income test was due to reasonable cause and not willful neglect.

The limitations imposed by the REIT gross income tests may impede our ability to distribute assets from our taxable REIT subsidiaries to us in the form of dividends. Certain asset transfers may, therefore, have to be structured as purchase and sale transactions upon which our taxable REIT subsidiaries recognize a taxable gain.

If interest accrues on indebtedness owed by a TRS to its parent REIT at a rate in excess of a commercially reasonable rate, or if transactions between a REIT and a TRS are entered into on other than arm’s-length terms, the REIT may be subject to a penalty tax.

If interest accrues on an indebtedness owed by a TRS to that we do not become subject to these taxes, there is no assurance that we will be successful. We may not be able to avoid application of these taxes.

We may in the future choose to pay dividends in our own stock, in which case you may be required to pay income taxes in excess of the cash dividends you receive.

We may in the future distribute taxable dividends that are payable in cash and shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, stockholders may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect to all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

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

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification its parent REIT at a rate in excess of a commercially reasonable rate, the REIT is subject to tax at a rate of 100% on the excess of (i) interest payments made by a TRS to its parent REIT over (ii) the amount of interest that would have been payable had interest accrued on the indebtedness at a commercially reasonable rate. A tax at a rate of 100% is also imposed on any transaction between a TRS and its parent REIT to the extent the transaction gives rise to deductions to the TRS that are in excess of the deductions that would have been allowable had the transaction been entered into on arm's-length terms. While we will scrutinize all of our transactions with our taxable REIT subsidiaries in an effort to ensure requirements, prevent the recognition of certain types of non-cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through our TRSs or other subsidiary corporations that will be subject to corporate level income tax at regular rates.

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

To remain qualified as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To remain qualified as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets. The remainder of our investment in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our investment portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

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

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

The failure of a mezzanine loan or similar debt to qualify as a real estate asset could adversely affect our ability to qualify as a REIT.

We invest in mezzanine loans and similar debt, for which the IRS has provided a safe harbor but not rules of substantive law. Pursuant to the safe harbor, if a mezzanine loan meets certain requirements, it will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the REIT 75% income test. We may acquire mezzanine loans or similar debt that do not meet all of the requirements of this safe harbor. In the event we own a mezzanine loan or similar debt that does not meet the safe harbor, the IRS could challenge such loan's treatment as a real estate asset for purposes

Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.

To remain qualified as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as dealer property or inventory.

of the REIT asset and income tests and, if such a challenge were sustained, we could fail to qualify as a REIT.

Qualifying as a REIT involves highly technical and complex provisions of the Code.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT depends on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the REIT qualification requirements depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for federal income tax purposes.

The 100% tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of structuring CMOs, which would be treated as prohibited transactions for federal income tax purposes.

The term "prohibited transaction" generally includes a sale or other disposition of property (including agency securities, but other than foreclosure property, as discussed below) that is held primarily for sale to customers in the ordinary course of a trade or business by us or by a borrower that has issued a shared appreciation mortgage or similar debt instrument to us. We could be subject to this tax if we were to dispose of or structure CMOs in a manner that was treated as a prohibited transaction for federal income tax purposes.

We intend to conduct our operations at the REIT level so that no asset that we own (or are treated as owning) will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having been in the ordinary course of our business. As a result, we may choose not to engage in certain transactions at the REIT level, and may limit the structures we utilize for our CMO transactions, even though the sales or structures might otherwise be beneficial to us. In addition, whether property is held

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

The present federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the federal income tax treatment of an investment in us. The federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. Revisions in federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

Uncertainty exists with respect to the treatment of our TBAs for purposes of the REIT asset and income tests.

We purchase and sell Agency mortgage-backed securities through TBAs and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise, and may continue to do so in the future. While there is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test, we treat our TBAs as qualifying assets for purposes of the REIT asset tests, and we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of K&L Gates LLP substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of the underlying agency securities, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of the underlying agency "primarily for sale to customers in the ordinary course of a trade or business" depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We intend to structure our activities to avoid prohibited transaction characterization.

securities. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of K&L Gates LLP is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets or income are not qualifying assets or income. If the IRS were to successfully challenge the opinion of K&L Gates LLP, we could be subject to a penalty tax or we could fail to remain qualified as a REIT if a sufficient portion of our assets consists of TBAs or a sufficient portion of our income consists of income or gains from the disposition of TBAs.

Dividends payable by REITs generally do not qualify for the reduced tax rates on dividend income from regular corporations.

Qualified dividend income payable to U.S. stockholders that are individuals, trusts and estates is subject to the reduced maximum tax rate applicable to capital gains. Dividends payable by REITs, however, generally are not eligible for the reduced rates. The more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our common stock. Tax rates could be changed in future legislation.

Risks of Ownership of Our Common Stock

The market price and trading volume of our shares of common stock may be volatile and issuances of large amounts of shares of our common stock could cause the market price of our common stock to decline.

If we issue a significant number of shares of common stock or securities convertible into common stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock.

The market price of our shares of common stock may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our shares of common stock may fluctuate and cause significant price variations to occur. We cannot assure you that the market price of our shares of common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our shares of common stock include those set forth under “Special Note Regarding Forward-Looking Statements” as well as:

an inability to meet or exceed securities analysts' estimates or expectations;
increases in market interest rates;
hedging or arbitrage trading activity in our shares of common stock;
capital commitments;
changes in market valuations of similar companies;
adverse market reaction to any increased indebtedness we incur in the future;
additions or departures of management personnel;
actions by institutional stockholders;
speculation in the press or investment community;
changes in our distribution policy;
general market and economic conditions; and
future sales of our shares of common stock or securities convertible into, or exchangeable or exercisable for, our shares of common stock.

Holders of our shares of common stock will be subject to the risk of volatile market prices and wide fluctuations in the market price of our shares of common stock. These factors may cause the market price of our shares of common stock to decline, regardless of our financial condition, results of operations, business or prospects. It is impossible to assure you that the market prices of our shares of common stock will not fall in the future.

There may be future sales or other dilution of our equity, which may adversely affect the market price of our common stock.

Under our charter, we have 2,000,000,000 authorized shares of capital stock, par value of $0.01 per share. Sales of a substantial number of shares of our common stock or other equity-related securities in the public market, or any hedging or arbitrage trading activity that may develop involving our common stock, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities. We cannot predict the effect that future sales of our common stock or other equity-related securities would have on the market actual or anticipated variations in our quarterly operating results or business prospects;

changes in our earnings estimates or publication of research reports about us or the real estate industry;

price of our common stock.

Our charter does not permit ownership of over 9.8% of our common or preferred stock and attempts to acquire our common or preferred stock in excess of the 9.8% limit are void without prior approval from our board of directors.

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the outstanding shares of our preferred stock. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the board of directors shall be void and will result in the shares being transferred by operation of law to a charitable trust.

Provisions contained in Maryland law that are reflected in our charter and bylaws may have an anti-takeover effects, potentially preventing investors from receiving a "control premium" for their shares.

Provisions contained in our charter and bylaws, as well as Maryland corporate law, may have anti-takeover effects that delay, defer or prevent a takeover attempt, which may prevent stockholders from receiving a "control premium" for their shares. For example, these provisions may defer or prevent tender offers for our common stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium for their common stock over then-prevailing market prices. These provisions include the following:

Ownership limit. The ownership limit in our charter limits related investors including, among other things, any voting group, from acquiring over 9.8% of our common stock or more than 9.8% of our preferred stock without the consent of our board of directors.

Preferred Stock. Our charter authorizes our board of

Maryland control share acquisition statute. Maryland law limits the voting rights of "control shares" of a corporation in the event of a "control share acquisition."

The repurchase right in our Convertible Senior Notes triggered by a fundamental change could discourage a potential acquirer.

If we undergo certain fundamental changes, such as the acquisition of 50% of the voting power of all shares of our common equity entitled to vote generally in the election of directors, holders of our Convertible Senior Notes may require us to repurchase all or a portion of their notes at a price equal to 100% of the principal amount of the notes to be purchased plus any accrued and unpaid interest up to, but excluding, the repurchase date. We will pay for all notes so repurchased with shares of our common stock using a price per share equal to the average daily volume-weighted average price of our common stock for the 20 consecutive trading days ending on the trading day immediately prior to the occurrence of the fundamental change. The issuance of these shares of common stock upon certain fundamental changes could discourage a potential acquirer.

Broad market fluctuations could negatively impact the market price of our shares of common stock.

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performance. These broad market fluctuations could reduce the market price of our shares of common stock. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could lead to a material decline in the market price of our shares of common stock.

We have not established a minimum dividend payment level.

directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval.

Maryland business combination statute. Maryland law restricts the ability of holders of more than 10% of the voting power of a corporation’s shares to engage in a business combination with the corporation.

We intend to pay quarterly dividends and to make distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year (subject to certain adjustments) is distributed. This enables us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described in this section. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time.

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

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income that can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of taxable income.

Regulatory Risks

Loss of Investment Company Act exemption would adversely affect us.

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended (or Investment Company Act). If we fail to qualify for this exemption, our ability to use leverage would be substantially reduced, and we would be unable to conduct our business as we currently conduct it.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) as interpreted by the staff of the SEC, requires us to invest at least 55% of our assets in “mortgages and other liens on and interest in real estate” (or Qualifying Real Estate Assets) and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act.

We rely on an interpretation that “whole pool certificates”

On August 31, 2011, the SEC issued a concept release titled “Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments” (SEC Release No. IC-29778). Under the concept release, the SEC is reviewing interpretive issues related to the Section 3(c)(5)(C) exemption. Among other things, the SEC requested comments on whether it should revisit whether Agency Whole Pool Certificates may be treated as interests in real estate (and presumably Qualifying Real Estate Assets) and whether companies, such as us, whose primary business consists of investing in Agency Whole Pool Certificates are the type of entities that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C). The potential outcomes of the SEC’s actions are unclear as is the SEC’s timetable for its review and actions.

If the SEC determines that any of these securities are not Qualifying Real Estate Assets or real estate related assets, adopts a contrary interpretation with respect to Agency Whole Pool Certificates or otherwise believes we do not satisfy the exemption under Section 3(c)(5)(C), we could be required to restructure our activities or sell certain of our assets. The net effect of these factors will be to lower our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption.

Compliance with proposed and recently enacted changes in securities laws and regulations increases our costs.

The Dodd-Frank Act contains many regulatory changes and calls for future rulemaking that may affect our business, including, but not limited to resolutions involving derivatives, risk-retention in securitizations and short-term financings. We are evaluating, and will continue to evaluate the potential impact of regulatory change under the Dodd-Frank Act.

that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (or Agency Whole Pool Certificates) are Qualifying Real Estate Assets under Section 3(c)(5)(C). This interpretation was promulgated by the SEC staff in a no-action letter over 30 years ago, was reaffirmed by the SEC in 1992 and has been commonly relied upon by mortgage REITs.

Changes in laws or regulations governing our operations or our failure to comply with those laws or regulations may adversely affect our business.

We are subject to regulation by laws at the local, state and federal level, including securities and tax laws and financial accounting and reporting standards. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any change in these laws or regulations or the failure to comply with these laws or regulations could have a material adverse impact on our business. Certain of these laws and regulations pertain specifically to REITs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive and administrative office is located at 1211 Avenue of the Americas New York, New York 10036, telephone 212-696-0100. This office is leased under a non-cancelable lease expiring September 30, 2025.

For a description of the commercial real estate properties we own as part of our investment portfolio, refer to section titled "Schedule III – Real Estate and Accumulated Depreciation" of Item 15 "Exhibits, Financial Statement Schedules."

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on our consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading publicly on October 8, 1997 and is traded on the New York Stock Exchange under the trading symbol "NLY." As of February 20, 2015, we had 947,675,799 shares of common stock issued and outstanding which were held by approximately 432,000 beneficial holders.

The following table sets forth, for the periods indicated, the high, low, and closing prices per share of our common stock as reported on the New York Stock Exchange composite tape and the cash dividends declared per share of our common stock.

	2014				2013			
	High	Low	Close	Common Dividends Declared Per Share	High	Low	Close	Common Dividends Declared Per Share
First quarter	$11.51	$9.92	$10.97	$0.30	$16.18	$14.12	$15.89	$0.45
Second quarter	$11.87	$10.78	$11.43	$0.30	$16.00	$12.16	$12.57	$0.40
Third quarter	$11.95	$10.66	$10.68	$0.30	$12.69	$10.63	$11.58	$0.35
Fourth quarter	$11.65	$10.68	$10.81	$0.30	$12.22	$9.66	$9.97	$0.30

On February 20, 2015, the last reported sale price of our common stock on the New York Stock Exchange was $10.72 per share.

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors." All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of issuance of our preferred stock through December 31, 2014, we have paid full cumulative dividends on our preferred stock.

Share Performance Graph

The following graph and table set forth certain information comparing the yearly percentage change in cumulative total return on our common stock to the cumulative total return of the Standard & Poor's Composite 500 stock Index or S&P 500 Index, and the Bloomberg REIT Mortgage Index, or BBG REIT index, an industry index of mortgage REITs. The comparison is for the period from December 31, 2009 to December 31, 2014 and assumes the reinvestment of dividends. The graph and table assume that $100 was invested in our common stock and the two other indices on December 31, 2009. Upon written request we will provide stockholders with a list of the REITs included in the BBG REIT Index.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Annaly Capital Management, Inc.	100	119	121	122	107	119
S&P 500 Index	100	115	117	135	176	198
BBG Reit Index	100	123	121	139	137	154

The information in the share performance graph and table has been obtained from sources believed to be reliable, but neither its accuracy nor its completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

Equity Compensation Plan Information

On May 27, 2010, at our 2010 Annual Meeting of Stockholders, our stockholders approved the 2010 Equity Incentive Plan. The 2010 Equity Incentive Plan authorizes the Compensation Committee of the board of directors to grant options, stock appreciation rights, dividend equivalent rights, or other share-based awards, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the 2010 Equity Incentive Plan. For a description of our 2010 Equity Incentive Plan, see Notes to Consolidated Financial Statements.

We had previously adopted a long term stock incentive plan for executive officers, key employees and nonemployee directors (the Incentive Plan). Since the adoption of the 2010 Equity Incentive Plan, no further awards will be made under the Incentive Plan, although existing awards will remain effective. All stock options issued under the 2010 Equity Incentive Plan and Incentive Plan (the Incentive Plans) were issued at the current market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. The grant date fair value is calculated using the Black-Scholes option valuation model. For a description of our Incentive Plan, see Notes to Consolidated Financial Statements.

The following table provides information as of December 31, 2014 concerning shares of our common stock authorized for issuance under the Incentive Plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights (dollars in thousands)	Number of securities remaining available for future issuance under the Incentive Plans (excluding previously issued)
Equity compensation plans approved by security holders	2,259,335	15.35	28,156,221
Equity compensation plans not approved by security holders	-	-	-
Total	2,259,335	15.35	28,156,221

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 6. Selected Financial Data

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data should be read in conjunction with the more detailed information contained in the Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
Statement of Operations Data:	2014	2013	2012	2011	2010
	(dollars in thousands, except per share data)				
Interest income	$ 2,632,647	$ 2,918,562	$ 3,259,145	$ 3,579,618	$ 2,683,134
Interest expense	512,659	624,714	667,172	480,326	428,225
Net interest income	2,119,988	2,293,848	2,591,973	3,099,292	2,254,909
Other income (loss)	(2,747,604)	1,676,144	(584,602)	(2,459,576)	(783,293)
General and administrative expenses	209,338	232,081	235,559	237,344	171,847
Income (loss) before income taxes and income from equity method investment in affiliate	(836,954)	3,737,911	1,771,812	402,372	1,299,769
Income (loss) from equity method investment in affiliate	-	-	-	1,140	2,945
Income taxes	5,325	8,213	35,912	59,051	35,434
Net income (loss)	(842,279)	3,729,698	1,735,900	344,461	1,267,280
Net income (loss) attributable to noncontrolling interest	(196)	-	-	-	-
Net income (loss) attributable to Annaly	(842,083)	3,729,698	1,735,900	344,461	1,267,280
Dividends on preferred stock	71,968	71,968	39,530	16,854	18,033
Net income (loss) available (related) to common	$ (914,051)	$ 3,657,730	$ 1,696,370	$ 327,607	$ 1,249,247

stockholders					
Net income (loss) per share available (related) to common stockholders:					
Basic	$ (0.96)	$ 3.86	$ 1.74	$ 0.37	$ 2.12
Diluted	$ (0.96)	$ 3.74	$ 1.71	$ 0.37	$ 2.04
Weighted average number of common shares outstanding:					
Basic	947,539,294	947,337,915	972,902,459	874,212,039	588,192,659
Diluted	947,539,294	995,557,026	1,005,755,057	874,518,938	625,307,174
Other Financial Data:					
Total assets	$ 88,355,367	$ 81,922,460	$ 133,452,295	$ 109,630,002	$ 83,026,590
6.00% Series B Cumulative Convertible Preferred Stock	$ -	$ -	$ -	$ 32,272	$ 40,032
Total equity	$ 13,333,781	$ 12,405,055	$ 15,924,444	$ 15,760,642	$ 9,864,900
Dividends declared per common share	$ 1.20	$ 1.50	$ 2.05	$ 2.44	$ 2.65

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Note Regarding Forward-Looking Statements

Certain statements contained in this annual report, and certain statements contained in our future filings with the Securities and Exchange Commission (the SEC or the Commission), in our press releases or in our other public or stockholder communications may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, which are based on various assumptions, (some of which are beyond our control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms, or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates, changes in the yield curve, changes in prepayment rates, the availability of mortgage-backed securities and other securities for purchase, the availability of financing, and, if available, the terms of any financing, changes in the market value of our assets, changes in business conditions and the general economy, our ability to grow the commercial mortgage business, credit risks related to our investments in commercial real estate assets and corporate debt, our ability to consummate any contemplated investment opportunities and other corporate transactions, changes in governmental regulations affecting our business, our ability to maintain our classification as a real estate investment trust (or REIT) for federal income tax purposes, our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (or Investment Company Act), and risks associated with the business of our subsidiaries, including the investment advisory businesses of our subsidiary, and risks associated with the broker dealer business of our subsidiary. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see the information under the caption "Risk Factors" contained in this Form 10-K. We do not undertake and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

All references to "Annaly","we," "us," or "our" mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. Refer to the section titled "Glossary of Terms" located at the end of this Item 7 for definitions of commonly used terms in this annual report on Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 7. Management's Discussion and Analysis

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Overview

We are a leading mortgage REIT that is externally managed by Annaly Management Company LLC (or Manager). Our common stock is listed on the New York Stock Exchange under the symbol "NLY." Since our founding in 1997, we have strived to generate net income for distribution to our stockholders through the prudent selection and management of our investments. We own a portfolio of real estate related investments. We use our capital coupled with borrowed funds to invest in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities. For a full discussion of our business, refer to the section titled "Business Overview" of Item 1 "Business."

Business Environment

We maintained the size of our Agency mortgage-backed securities portfolio in the fourth quarter of 2014 and remain cautious as the Federal Reserve (or Fed) ceased adding to their Agency mortgage backed securities portfolio in October of this year. The Fed has concluded the third round of their asset purchasing program known as Quantitative Easing 3 (QE3), and increases in the federal funds target rate are expected to begin in 2015. Furthermore, the recent decline in longer term interest rates has increased mortgage prepayment risk which may adversely impact MBS cash flows.

Economic Environment

Economic growth, as measured by real gross domestic product (or GDP), recovered from a seasonally-adjusted annualized decline of 2.1% in the first quarter of 2014 to subsequently grow 4.6% and 5.0% in the second and third quarters of 2014, respectively, according to the Bureau of Economic Analysis. The year-over-year growth rate of 2.7% was slightly below the 3.1% growth rate in 2013. The components were mixed but generally positive, with consumer spending and private investment growing at approximately the same pace as 2013. The persistent fall in oil prices as well as continued employment gains through the fourth quarter of 2014 This is only slightly above the Fed's own estimate of the mandate-consistent unemployment rate, which was placed at 5.2-5.5% as of December 17, 2014. However, labor market slack remains in long-term unemployment, the part-time employment share and those out of the labor force who desire a job, all of which remain elevated relative to long-term averages. Inflation remained below the Fed's 2% target for the entirety of the year, as measured by the Personal Consumer Expenditure Chain Price Index (or PCE), and weakened in the fourth quarter of 2014 as oil prices suffered sharp declines. The headline PCE measure fell to 0.8% year-over-year in December 2014, down from December 2013 and 1.6% in June 2014, and is expected to fall further as the decline in energy prices take effect. The more stable core PCE measure, which excludes food and energy prices, also remained below target at 1.3% year-over-year in December 2014, unchanged from December 2013. The Federal Open Market Committee (FOMC or the Committee) has noted that "inflation persistently below its 2% objective could pose risks to economic performance," and believes the current level of inflation below target is due to "transitory effects of lower energy prices and other factors" and expects inflation to rise gradually toward 2%.

The FOMC has aimed to support its dual mandate through both keeping its target rate at the zero lower bound and conducting open market operations, or Quantitative Easing (or QE). QE3 was announced on September 13, 2012 as the FOMC statement indicated they would begin making monthly purchases of Agency mortgage-backed securities at the initial pace of $40 billion. In addition, the FOMC announced that it would maintain its existing accommodative policy of reinvesting principal payments from its holdings of Agency mortgage-backed securities purchases into new Agency mortgage-backed securities as part of its stimulus. Two meetings later, on December 12, 2012, the FOMC announced it would also begin purchasing longer-term Treasury securities at a monthly pace of $45 billion. This program was open-ended in nature, stating as its intent "to support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate." To further provides optimism for U.S. growth in the coming quarters.

The Fed currently conducts monetary policy with a dual mandate: full employment and price stability. The employment situation improved vastly in 2014, with average monthly employment gains of 260,000 through December 2014 compared to 199,000 per month in 2013, according to the Bureau of Labor Statistics. The unemployment rate continued to decline, down to 5.6% in December 2014 compared to 6.7% in December 2013.

enhance their accommodative policy, at their December 12, 2012, meeting, the FOMC gave "forward guidance" on their future policy rate increases as follows: "the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens."

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At their December 17-18, 2013 meeting, the FOMC decided to reduce monthly purchases of U.S. Treasury bonds and Agency mortgage-backed securities by $5 billion each, therefore purchasing $40 billion in U.S. Treasuries and $35 billion in Agency mortgage-backed securities per month beginning in January 2014. The Fed kept this "taper" in place throughout the year, reducing monthly purchases by a total of $10 billion during each meeting in 2014, eventually ending their program by reducing purchases by the final combined $15 billion at their October 28-29, 2014 meeting. Simultaneous to the release of their September 17, 2014 statement, the FOMC released their "policy normalization principles and plans," in which they stated their intention to reduce their security holdings primarily by ceasing reinvestments only after their first rate hike and that they currently do not anticipate selling agency mortgage-backed securities as part of their normalization process.

Markets had muted reactions to the gradual lessening of stimulus, with financial conditions remaining more accommodative than normal (as measured by the Bloomberg Financial Conditions Index). Longer-term rates declined throughout the year, largely driven by declining market-based inflation expectations and inflation risk premium, in large part owing to significant declines in oil prices. The mortgage basis, or spread between the 30-year Agency mortgage-backed security current coupon and 10-year U.S. Treasury, remained stable throughout the year amidst muted volatility.

The following table summarizes interest rates as of each date presented:

	As of December 31,					
	2014		2013		2012	
30-Year mortgage current coupon	2.83	%	3.61	%	2.23	%
Mortgage basis		66 bps		58 bps		47 bps
10-Year U.S. Treasury rate	2.17	%	3.03	%	1.76	%
LIBOR:						
1-Month	0.17	%	0.17	%	0.21	%
6-Month	0.36	%	0.35	%	0.51	%

Financial Regulatory Reform

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

Results of Operations

The results of our operations are affected by various factors, many of which are beyond our control. Certain of such risks and uncertainties are described herein (see "Special Note Regarding Forward-Looking Statements") and in Part I, Item 1A. "Risk factors".

Net Income (Loss) Summary

The following table presents summarized financial information related to our results of operations as of and for the years ended December 31, 2014, 2013 and 2012.

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	As of and for the Years Ended December 31,		
	2014	2013	2012
	(dollars in thousands, except per share data)		
Interest income	$ 2,632,647	$ 2,918,562	$ 3,259,145
Interest expense	512,659	624,714	667,172
Net interest income	2,119,988	2,293,848	2,591,973
Other income (loss)	(2,747,604)	1,676,144	(584,602)
General and administrative expenses	209,338	232,081	235,559
Income (loss) before income taxes	(836,954)	3,737,911	1,771,812
Income taxes	5,325	8,213	35,912
Net income (loss)	(842,279)	3,729,698	1,735,900
Net income (loss) attributable to noncontrolling interest	(196)	-	-
Net income (loss) attributable to Annaly	(842,083)	3,729,698	1,735,900
Dividends on preferred stock	71,968	71,968	39,530
Net income (loss) available (related) to common stockholders	$ (914,051)	$ 3,657,730	$ 1,696,370
Net income (loss) per share available (related) to common stockholders:			
Basic	$ (0.96)	$ 3.86	$ 1.74
Diluted	$ (0.96)	$ 3.74	$ 1.71
Weighted average number of common shares outstanding:			
Basic	947,539,294	947,337,915	972,902,459
Diluted	947,539,294	995,557,026	1,005,755,057
Non-GAAP financial measures (1):			
Economic interest expense	$ 1,338,019	$ 1,533,008	$ 1,560,941
Economic net interest income	$ 1,294,628	$ 1,385,554	$ 1,698,204
Core earnings	$ 1,147,739	$ 1,222,959	$ 1,537,732
Core earnings per average basic common share	$ 1.14	$ 1.21	$ 1.54
Other information:			
Asset portfolio at period-end	$ 84,828,267	$ 75,120,622	$ 127,036,719
Average total assets	$ 85,446,307	$ 107,355,670	$ 126,649,002
Average equity	$ 12,972,683	$ 13,968,979	$ 16,206,642
Leverage at period-end (2)	5.4:1	5.0:1	6.5:1
Capital ratio	15.1 %	15.1 %	11.9 %
Net interest margin	1.52 %	1.31 %	1.45 %
Net interest spread	1.21 %	1.09 %	1.27 %
Return on average total assets	(0.99 %)	3.47 %	1.37 %
Return on average equity	(6.49 %)	26.70 %	10.71 %
Constant prepayment rate	8 %	14 %	20 %
Common stock book value per share	$ 13.10	$ 12.13	$ 15.85

(1) See "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP measures to their corresponding GAAP amounts.

(2) Includes repurchase agreements, Convertible Senior Notes and non-recourse securitized debt, loan participation and mortgages payable.

This Management Discussion and Analysis section contains analysis and discussion of non-GAAP measurements. See "Non-GAAP Financial Measures" for further information.

2014 Compared with 2013

GAAP

Net income (loss) was ($842.3) million, which includes ($0.2) million attributable to a noncontrolling interest, or ($0.96) per average basic common share, for the year ended December 31, 2014 compared to $3.7 billion, or $3.86 per average basic common share, for the same period in 2013. We attribute the majority of the change in net income (loss) to the change in unrealized gains (losses) on interest rate swaps which resulted in a loss of $948.8 million for the year ended December 31, 2014 compared to a gain of $2.0 billion for the same period in 2013. The change in the fair value of interest rate swaps was primarily attributable to the downward trend in interest rates experienced during the year ended December 31, 2014 compared to the rise in interest rates experienced during the same period in 2013. The change in unrealized gains (losses) on interest rate swaps were partially offset by the reversal of unrealized losses in connection with interest rate swap positions that were terminated in 2014, which resulted in a $677.5 million increase in realized losses on the termination of interest rate swaps for the year ended December 31, 2014 compared to the same period in 2013.

Non-GAAP

Core earnings were $1.1 billion, or $1.14 per average basic common share, for the year ended December 31, 2014, a decrease of $75.2 million compared to $1.2 billion, or $1.21 per average basic common share, for the same period in 2013. We attribute the majority of the change to a decline in interest income of $285.9 million, primarily attributable to a decline in average Interest Earning Assets, partially offset by lower amortization expense and a decline in economic interest expense of $195.0 million, primarily attributable to a decline in average Interest Bearing Liabilities and swap notional amounts, for the year ended December 31, 2014 compared to the same period in 2013.

2013 Compared with 2012

GAAP
Net income (loss) increased $2.0 billion to $3.7 billion, or $3.86 per average basic common share for the year ended December 31, 2013, compared to $1.7 billion, or $1.74 per average basic common share, for the year ended December 31, 2012. We attribute the majority of the increase to the change in unrealized gains (losses) on interest rate swaps, which resulted in a gain of $2.0 billion for the year ended December 31, 2013 compared to a loss of $32.2 million for the same period in 2012. The change in the fair value of interest rate swaps was primarily attributable to the rise in interest rates experienced during the year ended December 31, 2013.

Non-GAAP
Core earnings were $1.2 billion, or $1.21 per average basic common share, for the year ended December 31, 2013, a decrease of $314.8 million compared to $1.5 billion, or $1.54 per average basic common share, for the same period in 2012. We attribute the majority of the decrease to a decline in economic net interest income of $312.7 million from 2012, primarily attributable to a decline in average Interest Earning Assets.

Non-GAAP Financial Measures

The non-GAAP measurements include the following:

- core earnings;
- core earnings per average basic common share;
- economic interest expense; and
- economic net interest income.

Core earnings represents a non-GAAP measure and is defined as net income (loss) excluding gains or losses on disposals of investments and termination of interest rate swaps, unrealized gains or losses on interest rate swaps and Agency interest-only mortgage-backed securities, net gains and losses on trading assets, impairment losses, GAAP net income (loss) attributable to noncontrolling interest and certain other non-recurring gains or losses.

We believe that core earnings, core earnings per average basic common share, economic interest expense and economic net interest income provide meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The non-GAAP measures help us to evaluate our financial position and performance without the effects of certain transactions and GAAP adjustments that are not necessarily indicative of our current investment portfolio and operations.

Our presentation of non-GAAP financial measures has important limitations. Other market participants may calculate core earnings, core earnings per average basic common share, economic interest expense and economic net interest income differently than we calculate them, making comparative analysis difficult.

Although we believe that the calculation of non-GAAP financial measures described above helps evaluate and measure our financial position and performance without the effects of certain transactions, it is of limited usefulness as an analytical tool. Therefore, the non-GAAP financial measures should not be viewed in isolation and are not a substitute for net income (loss), net income (loss) per basic share available (related) to common stockholders, interest expense and net interest income computed in accordance with GAAP.

Core Earnings

The following table provides GAAP measures of net income (loss) and net income (loss) per basic share available to common stockholders for the years ended December 31, 2014, 2013 and 2012 and details with respect to reconciling the aforementioned line items on a non-GAAP basis:

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	For the Years Ended December 31,		
	2014	2013	2012
	(dollars in thousands, except per share data)		
GAAP net income (loss)	$ (842,279)	$ 3,729,698	$ 1,735,900
Adjustments:			
Realized (gains) losses on termination of interest rate swaps	779,333	101,862	2,385
Unrealized (gains) losses on interest rate swaps	948,755	(2,002,200)	32,219
Net (gains) losses on disposal of investments	(93,716)	(403,045)	(432,139)
Net loss on extinguishment of 4% Convertible Senior Notes	-	-	162,340
Net (gains) losses on trading assets	245,495	(1,509)	(22,910)
Net unrealized (gains) losses on interest-only Agency mortgage-backed securities	86,172	(244,730)	59,937
Impairment of goodwill	-	23,987	-
Loss on previously held equity interest in CreXus	-	18,896	-
Other non-recurring expense (1)	23,783	-	-
GAAP net income (loss) attributable to noncontrolling interest	196	-	-
Core earnings	$ 1,147,739	$ 1,222,959	$ 1,537,732
GAAP net income (loss) per average basic common share	$ (0.96)	$ 3.86	$ 1.74
Core earnings per average basic common share	$ 1.14	$ 1.21	$ 1.54

(1) Represents a one-time payment made by FIDAC to Chimera Investment Corp. (Chimera) to resolve issues raised in derivative demand letters sent to Chimera's board of directors. This amount is included as a component of Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

Economic Interest Expense and Economic Net Interest Income

We believe the economic value of our investment strategy is depicted by the economic net interest income we earn. We calculate economic net interest income by determining our GAAP net interest income and reducing it by realized losses on interest rate swaps, which represents interest expense on interest rate swaps. Our economic interest expense, which is composed of interest expense on our Interest Bearing Liabilities plus interest expense on interest rate swaps, reflects total contractual interest payments.

The following table provides GAAP measures of interest expense and net interest income and details with respect to reconciling the aforementioned line items on a non-GAAP basis for each respective period:

	GAAP Interest Expense	Add: Realized Losses on	Economic Interest Expense	GAAP Net Interest Income	Less: Realized Losses on	Economic Net

		Interest Rate Swaps (1)			Interest Rate Swaps (1)	Interest Income
For the Years Ended:			(dollars in thousands)			
December 31, 2014	$512,659	$825,360	$1,338,019	$2,119,988	$825,360	$1,294,628
December 31, 2013	$624,714	$908,294	$1,533,008	$2,293,848	$908,294	$1,385,554
December 31, 2012	$667,172	$893,769	$1,560,941	$2,591,973	$893,769	$1,698,204

(1) Interest expense related to our interest rate swaps is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss).

Interest Income and Average Yield on Interest Earning Assets

Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Agency mortgage-backed securities portfolio increase, related purchase premium amortization increases, thereby reducing the yield on such assets. The following table presents the weighted average experienced CPR on our Agency mortgage-backed securities portfolio for the periods presented.

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Years Ended	CPR
December 21, 2014	8%
December 31, 2013	14%
December 31, 2012	20%

We had average Interest Earning Assets of $85.2 billion, $105.4 billion and $117.3 billion, and the average yield on Interest Earning Assets was 3.09%, 2.77%, and 2.78% for the years ended December 31, 2014, 2013 and 2012, respectively.

2014 Compared with 2013

Interest income was $2.6 billion for the year ended December 31, 2014, a decrease of $0.3 billion compared to $2.9 billion for the same period in 2013. The decline was primarily due to a $20.2 billion decrease in average Interest Earning Assets, partially offset by lower amortization on our Investment Securities resulting from lower prepayment speeds, for the year ended December 31, 2014 compared to the same period in 2013.

2013 Compared with 2012

Interest income was $2.9 billion for the year ended December 31, 2013, a decrease of $0.4 billion compared to $3.3 billion for the same period in 2012. The decline was primarily due to an $11.9 billion decrease in average Interest Earning Assets, partially offset by lower amortization on our Investment Securities resulting from lower prepayment speeds, for the year ended December 31, 2013 compared to the same period in 2012.

Economic Interest Expense and the Average Cost of Interest Bearing Liabilities

Our largest expense is the average cost of Interest Bearing Liabilities and interest expense on interest rate swaps, which is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss). The table below shows our average Interest Bearing Liabilities and average cost of Interest Bearing Liabilities as compared to average one-month and average six month LIBOR and economic interest expense for the periods presented.

Cost of Funds on Average Interest Bearing Liabilities

For the Years Ended:	Average Interest Bearing Liabilities	Interest Bearing Liabilities at Period End	Economic Interest Expense(1)	Average Cost of Interest Bearing Liabilities	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average One-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average Six-Month LIBOR
	(dollars in thousands)								
December 31, 2014	$70,983,100	$72,481,614	$1,338,019	1.88 %	0.16 %	0.33 %	(0.17 %)	1.72 %	1.55 %
December 31, 2013	$91,182,731	$67,066,390	$1,533,008	1.68 %	0.19 %	0.41 %	(0.22 %)	1.49 %	1.27 %

December 31, 2012	$103,362,717	$105,914,990	$1,560,941	1.51 %	0.24 %	0.69 %	(0.45 %)	1.27 %	0.82 %

(1) Economic interest expense includes interest expense on interest rate swaps.

2014 Compared with 2013

Economic interest expense, including interest expense on interest rate swaps, for the year ended December 31, 2014 decreased by $195.0 million when compared to the year ended December 31, 2013, primarily due to the $20.2 billion decline in average Interest Bearing Liabilities and lower swap interest expense on lower average notional balances for the year ended December 31, 2014 compared to the same period in 2013, partially offset by a 20 basis point increase in cost of Interest Bearing Liabilities.

2013 Compared with 2012

Economic interest expense, including interest expense on interest rate swaps, for the year ended December 31, 2013 decreased by $27.9 million when compared to the year ended December 31, 2012, primarily due to the $12.2 billion decline in average Interest Bearing Liabilities for the year ended December 31, 2013 compared to the same period in 2012, partially offset by a 17 basis point increase in the cost of Interest Bearing Liabilities, largely attributable to increased swap expense.

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We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number should be expected to differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the amount of mortgage-backed securities we have committed to purchase, we may retain the principal and interest we receive in the prior month, or we may use it to pay down our borrowings. Moreover, we use interest rate swaps, swaptions and other derivative instruments to hedge our portfolio and as we pledge or receive collateral under these agreements, our borrowings on any given day may be increased or decreased. Our average borrowings during a quarter will differ from period end borrowings as we implement our portfolio management strategies and risk management strategies over changing market conditions by increasing or decreasing leverage. Additionally, these numbers will differ during periods when we conduct capital raises, as in certain instances we may purchase additional assets and increase leverage with the expectation of a successful capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage.

As of December 31, 2014 and 2013, 98% and 99%, respectively, of our debt consisted of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our Consolidated Statements of Financial Condition as Repurchase Agreements. All of our Agency mortgage-backed securities and debentures are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet. As of December 31, 2014, the term to maturity of our repurchase agreements ranged from one day to five years. Additionally, we have entered into borrowings giving the counterparty the right to call the balance prior to maturity. At December 31, 2014 and 2013, the weighted average cost of funds for all of our borrowings was 1.65% and 2.37%, respectively, including the effect of the interest rate swaps, 4% Convertible Senior Notes due 2015 and 5% Convertible Senior Notes due 2015 (collectively, the Convertible Senior Notes) and securitized debt of consolidated VIE, and the weighted average days to maturity was 142 days and 208 days, respectively.

Economic Net Interest Income

The table below shows our average Interest Earning Assets, total interest income, average yield on Interest Earning Assets, average Interest Bearing Liabilities, economic interest expense, average cost of Interest Bearing Liabilities, economic net interest income, net interest spread and net interest margin for the periods presented.

Economic Net Interest Income

	Average Interest Earning Assets(1)	Total Interest Income	Average Yield on Interest	Average Interest Bearing Liabilities	Economic Interest Expense(2)	Average Cost of Interest	Economic Net Interest Income(3)	Net Interest Spread	Net Interest Margin

			Earning Assets			Bearing Liabilities			
For the Years Ended:				(dollars in thousands)					
December 31, 2014	$85,170,734	$2,632,647	3.09%	$70,983,100	$1,338,019	1.88%	$1,294,628	1.21%	1.52%
December 31, 2013	$105,375,229	$2,918,562	2.77%	$91,182,731	$1,533,008	1.68%	$1,385,554	1.09%	1.31%
December 31, 2012	$117,274,876	$3,259,145	2.78%	$103,362,717	$1,560,941	1.51%	$1,698,204	1.27%	1.45%

(1) Does not reflect unrealized gains/(losses) or premium/(discount).

(2) Economic interest expense includes interest expense on interest rate swaps.

(3) Economic net interest income includes interest expense on interest rate swaps.

2014 Compared with 2013

Economic net interest income totaled $1.3 billion for the year ended December 31, 2014, a decrease of $90.9 million compared to the same period in 2013. We attribute the majority of the change to a decline in interest income, primarily attributable to a decline in average Interest Earning Assets $20.2 billion, partially offset by a lower amortization expense, which reflects lower estimated prepayment speeds on our Agency mortgage-backed securities portfolio, and a decline in economic interest expense, primarily attributable to a decline in average Interest Bearing Liabilities of $20.2 billion and lower swap interest expense on lower average notional balances, for the year ended December 31, 2014 compared to the same period in 2013.

2013 Compared with 2012

Economic net interest income totaled $1.4 billion for the year ended December 31, 2013, a decrease of $312.6 million compared to the same period in 2012. The decline was primarily due to a lower net interest rate spread for the year ended December 31, 2013 compared to the same period in 2012. Our average Interest Earning Assets decreased by $11.9 billion during the year ended December 31, 2013 compared to the same period in 2012

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Other Income (Loss)

Other income (loss) is largely comprised of net gains (losses) on interest rate swaps, investment advisory income, net gains (losses) on disposal of investments, dividend income from affiliates, net gains (losses) on trading assets, net unrealized gains (losses) on interest-only Agency mortgage-backed securities and other income (loss). These components of other income (loss) for the years ended December 31, 2014, 2013 and 2012 were as follows:

	For the Years Ended December 31,		
	2014	2013	2012
		(dollars in thousands)	
Net gains (losses) on interest rate swaps (1)	$ (2,553,448)	$ 992,044	$ (928,373)
Investment advisory income	31,343	43,643	82,138
Net gains (losses) on disposal of investments	93,716	403,045	432,139
Dividend income from affiliates	25,189	18,575	28,336
Net gains (losses) on trading assets	(245,495)	1,509	22,910
Net unrealized gains (losses) on interest-only Agency mortgage-backed securities	(86,172)	244,730	(59,937)
Other income (loss)	(12,737)	15,481	525

(1) Includes realized gains (losses) on interest rate swaps, realized gains (losses) on termination of interest rate swaps and unrealized gains (losses) on interest rate swaps

2014 Compared with 2013

The aggregate net gains (losses) on interest rate swaps were ($2.6) billion for the year ended December 31, 2014 compared to $992.0 million for the same period in 2013. The change was primarily attributable to changes in unrealized gains (losses) reflecting the downward trend in interest rates during the year ended December 31, 2014 compared to rising interest rates for the same period in 2013. The changes in unrealized gains (losses) were partially offset by the reversal of unrealized losses in connection with interest rate swap positions that were terminated in 2014, which resulted in higher realized losses on termination of interest rate swaps during the year ended December 31, 2014 compared to the same period in 2013.

Investment advisory income decreased $12.3 million to $31.3 million for the year ended December 31, 2014, sheet as part of our asset/liability management strategy.

Dividend income from affiliates increased $6.6 million to $25.2 million for the year ended December 31, 2014, due to a $9.0 million special dividend from our investment in Chimera recognized during the first quarter of 2014, partially offset by CreXus Investment Corp. (or CreXus) declaring a dividend during the first quarter of 2013 but not during the same period in 2014 as a result of its acquisition. Chimera is and CreXus was managed by our wholly-owned subsidiary FIDAC.

Net gains (losses) on trading assets was ($245.5) million for the year ended December 31, 2014 compared to $1.5 million for the same period in 2013. The change was primarily attributable to higher net losses from interest rate swaptions.

primarily due to lower advisory fees from affiliates and the sale of Merganser Capital Management, Inc. (or Merganser) , a registered investment advisor specializing in managing fixed income securities, to a third party in October 2013.

For the year ended December 31, 2014, we disposed of Investment Securities with a carrying value of $22.5 billion for an aggregate net gain of $94.5 million. We may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance

Net unrealized gains (losses) on interest-only Agency mortgage-backed securities was ($86.2) million for the year ended December 31, 2014 compared to $244.7 million for the same period in 2013. The change was primarily attributable to the downward trend in interest rates experienced in 2014 compared to rising interest rates in 2013.

Other income (loss) was ($12.7) million for the year ended December 31, 2014 compared to $15.5 million for the same period in 2013. The change was primarily attributable to a one-time payment made in 2014 by FIDAC to Chimera to resolve issues raised in derivative demand letters sent to Chimera’s board of directors.

2013 Compared with 2012

The aggregate net gains (losses) on interest rate swaps were $992.0 million for the years ended December 31, 2013 compared to ($928.4) million for the same period in 2012. The change was primarily attributable to the rise in interest rates experienced in 2013.

Investment advisory income decreased $38.5 million to $43.6 million for the year ended December 31, 2013, primarily due to lower advisory fees from affiliates.

For the year ended December 31, 2013, we disposed of Investment Securities with a carrying value of $56.8 billion for an aggregate net gain of $424.1 million.

Dividend income from affiliates decreased $9.8 million to $18.6 million for the year ended December 31, 2013, primarily due to CreXus declaring a dividend for only the first quarter of 2013 as a result of its acquisition.

Net unrealized gains (losses) on interest-only Agency mortgage-backed securities was $244.7 million for the year ended December 31, 2013 compared to ($59.9) million for the same period in 2012. The change was primarily attributable to rising interest rates experienced in 2013.

General and Administrative Expenses

General and administrative (or G&A) expenses consists of compensation expense, the management fee and other expenses.

The table below shows our total G&A expenses as compared to average total assets and average equity for the periods presented.

G&A Expenses and Operating Expense Ratios

For the Years Ended:	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
		(dollars in thousands)	
December 31, 2014	$ 209,338	0.24 %	1.61 %
December 31, 2013	$ 232,081	0.22 %	1.66 %
December 31, 2012	$ 235,559	0.19 %	1.45 %

2014 Compared with 2013

G&A expenses decreased $22.7 million to $209.3 million for the year ended December 31, 2014 compared to the same period in 2013. The decline was attributable to a lower management fee and a decline in other general and administrative expenses, primarily brokerage expenses, in 2014.

2013 Compared with 2012

G&A expenses decreased $3.5 million to $232.1 million for the year ended December 31, 2013 compared to the

Unrealized Gains and Losses

With our available-for-sale accounting treatment on our Agency mortgage-backed securities which represent the largest portion of assets on balance sheet, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders' equity under Accumulated Other Comprehensive Income (Loss). As a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used amortized cost accounting. As a result, same period in 2012. The decrease was primarily due to the result of the pro forma adjustment to the management fee which resulted in lower compensation expenses in 2013, partially offset by an increase in other general and administrative expenses which included $7.3 million related to our acquisition of CreXus in 2013.

comparisons with companies that use amortized cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows cumulative unrealized gains and losses on our available-for-sale investments reflected in the Consolidated Statements of Financial Condition.

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Unrealized Gains and Losses

	As of December 31, 2014	As of December 31, 2013
	(dollars in thousands)	
Unrealized gain	$ 950,072	$ 600,034
Unrealized loss	(745,189)	(3,348,967)
Net unrealized gain (loss)	$ 204,883	$ (2,748,933)

Unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on our potential earnings and dividends: positive changes will increase our equity base and allow us to increase our borrowing capacity while negative changes tend to reduce borrowing capacity under our investment policy. A very large negative change in the net fair value of our available-for-sale investment securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

The fair value of these securities being below amortized cost for the year ended December 31, 2014 is solely due to market conditions and not the quality of the assets. The investments are not considered to be other-than-temporarily impaired because we currently have the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal amount of the securities by the respective issuing government agency.

Net Income (Loss) and Return on Average Equity

We recorded a net loss of $842.3 million, which includes a $0.2 million net loss attributable to a noncontrolling interest, for the year ended December 31, 2014 and net income of $3.7 billion and $1.7 billion for the years ended December 31, 2013 and 2012, respectively. Our return (loss) on average equity was (6.49%), 26.70% and 10.71% for the years ended December 31, 2014, 2013 and 2012, respectively.

The table below shows the components of our return on average equity for the periods presented.

Components of Return on Average Equity

	Economic Net Interest Income/ Average Equity(1)	Net Investment Advisory and Service Fees/Average Equity	Realized and Unrealized Gains and Losses/Average Equity	Other Income (Loss)/Average Equity(2)	G&A Expenses/ Average Equity	Income Taxes/ Average Equity	Return on Average Equity
For the Years Ended:							
December 31, 2014	9.98 %	0.24 %	(15.16 %)	0.10 %	(0.24 %)	(0.04 %)	(6.49 %)
December 31, 2013	9.92 %	0.31 %	18.25 %	(0.06 %)	(1.66 %)	(0.06 %)	26.70 %

December 31, 2012	10.48 %	0.51 %	1.22 %	0.17 %	(1.45 %)	(0.22 %)	10.71 %

(1) Economic net interest income includes interest expense on interest rate swaps.

(2) Other income (loss) includes dividend income from affiliates, impairment of goodwill, loss on previously held equity interest in CreXus and other income (loss).

Financial Condition

Total assets were $88.4 billion and $81.9 billion as of December 31, 2014 and 2013, respectively. The change was primarily due to an $11.2 billion increase in Agency mortgage-backed securities partially offset by a $1.6 billion decrease in Agency debentures.

Investment Securities

Substantially all of our Agency mortgage-backed securities at December 31, 2014 and 2013 were backed by single-family mortgage loans. Substantially all of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. We carry all of our Agency mortgage-backed securities at fair value on the Consolidated Statements of Financial Condition.

We accrete discount balances as an increase to interest income over the expected life of the related Interest Earning Assets and we amortize premium balances as a decrease to interest income over the expected life of the related Interest Earning Assets. At December 31, 2014, and 2013 we had on our Consolidated Statements of Financial Condition a total of $19.6 million and $25.7 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Investment Securities acquired at a price below principal value) and a total of $5.4 billion and $4.6 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current amortized cost of our Investment Securities acquired at a price above principal value).

We received mortgage principal repayments of $8.3 billion and $21.7 billion for the years ended December 31, 2014 and 2013, respectively. The weighted average experienced prepayment speed for the years ended December 31, 2014 and 2013 was 8% and 14%, respectively. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Agency mortgage-backed securities and Agency debentures and interest-only securities, as of the dates presented. The index level for adjustable-rate Agency mortgage-backed securities and Agency debentures is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

	December 31, 2014	December 31, 2013
	(dollars in thousands)	
Agency Mortgage-Backed Securities and Agency Debentures:		
Principal Amount	$ 77,391,804	$ 71,430,069
Net Premium	4,118,679	3,558,168
Amortized Cost	81,510,483	74,988,237
Amortized Cost/Principal Amount	105.32 %	104.98 %
Carrying Value	81,711,172	72,238,708
Carrying Value / Principal Amount	105.58 %	101.13 %
Weighted Average Coupon Rate	3.69 %	3.62 %
Weighted Average Yield	2.81 %	2.89 %
Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures:		
Principal Amount	$ 3,870,609	$ 6,719,599
Weighted Average Coupon Rate	2.82 %	2.81 %
Weighted Average Yield	2.73 %	2.80 %
Weighted Average Term to Next Adjustment	35 Months	33 Months
Weighted Average Lifetime Cap	7.95 %	6.44 %

Principal Amount at Period End as % of Total Investment Securities		5.00	%		9.41	%
Fixed-Rate Agency Mortgage-Backed Securities and Agency Debentures:						
Principal Amount	$	73,521,195		$	64,710,470	
Weighted Average Coupon Rate		3.73	%		3.71	%
Weighted Average Yield		2.82	%		2.90	%
Principal Amount at Period End as % of Total Investment Securities		95.00	%		90.59	%
Agency Interest-Only Mortgage-Backed Securities:						
Notional Amount	$	8,008,538		$	7,374,675	
Net Premium		1,230,471			1,041,990	
Amortized Cost		1,230,471			1,041,990	
Amortized Cost/Notional Amount		15.36	%		14.13	%
Carrying Value		1,222,434			1,120,126	
Carrying Value/Notional Amount		15.26	%		15.19	%
Weighted Average Coupon Rate		4.00	%		3.82	%
Weighted Average Yield		7.29	%		9.00	%

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At December 31, 2014 and 2013, we held Agency mortgage-backed securities and Agency debentures, excluding interest-only securities, with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures by Index December 31, 2014

	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indices(1)
Weighted average term to next adjustment	4 mo.	50 mo.	1 mo.	1 mo.	12 mo.	22 mo.
Weighted average annual period cap	1.75%	2.00%	-	-	2.00%	-
Weighted average lifetime cap at September 30, 2014	11.28%	9.58%	9.15%	10.71%	10.72%	4.28%
Investment principal value as percentage of Investment Securities at December 31, 2014	0.19%	2.73%	0.13%	0.18%	0.12%	1.65%

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures by Index December 31, 2013

	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indices(1)
Weighted average term to next adjustment	4 mo.	40 mo.	1 mo.	1 mo.	18 mo.	34 mo.
Weighted average annual period cap	1.78%	2.00%	-	-	2.00%	-
Weighted average lifetime cap at December 31, 2013	11.20%	9.81%	7.36%	10.80%	10.74%	2.36%
Investment principal value as percentage of Investment Securities at December 31, 2013	0.40%	4.04%	0.28%	0.23%	0.18%	4.28%

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, Convertible Senior Notes, interest expense on repurchase agreements and Convertible Senior Notes, securitized debt of consolidated VIE, mortgages payable, participation sold, the non-cancelable office leases and employment agreements as of December 31, 2014. The table does not include the effect of net interest rate payments on our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate. As of December 31, 2014, the interest rate swaps had a net negative fair value of $1.5 billion.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
			(dollars in thousands)		
Repurchase agreements	$ 60,562,124	$ 10,699,802	$ 100,000	$ -	$ 71,361,926
Interest expense on repurchase agreements(1)	231,706	178,285	3,863	-	413,854
Convertible Senior Notes (principal)	857,541	-	-	-	857,541
Interest expense on Convertible Senior Notes	14,600	-	-	-	14,600
Securitized debt of consolidated VIE (principal)	153,954	106,746	-	-	260,700
Mortgages payable (principal)	334	18,772	23,375	103,950	146,431
Participation sold (principal)	296	13,138	-	-	13,434
Long-term operating lease obligations	888	7,169	7,129	22,291	37,477
Total	$ 61,821,443	$ 11,023,912	$ 134,367	$ 126,241	$ 73,105,963