ANNALY CAPITAL MANAGEMENT INC
Form 10-Q
August 04, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2017

OR

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

FOR THE TRANSITION PERIOD FROM _______________ TO _________________

COMMISSION FILE NUMBER: 1-13447

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

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

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

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

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at July 31, 2017
Common Stock, $.01 par value	1,088,037,669

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

PART I - FINANCIAL INFORMATION

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2017 [(1)] (Unaudited)	December 31, 2016 [(2)]
ASSETS		
Cash and cash equivalents (including cash pledged as collateral of $590,082 and $1,428,475, respectively) [(3)]	$700,692	$1,539,746
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of $67,214,815 and $70,796,872, respectively)	73,963,998	75,589,873
Credit risk transfer securities (including pledged assets of $517,598 and $608,707, respectively)	605,826	724,722
Non-Agency mortgage-backed securities (including pledged assets of $1,036,362 and $1,064,603, respectively) [(4)]	1,234,053	1,401,307
Residential mortgage loans (including pledged assets of $679,435 and $314,746, respectively) [(5)]	779,685	342,289
Mortgage servicing rights (including pledged assets of $3,408 and $5,464, respectively)	605,653	652,216
Commercial real estate debt investments (including pledged assets of $3,972,560 and $4,321,739, respectively) [(6)]	3,972,560	4,321,739
Commercial real estate debt and preferred equity, held for investment (including pledged assets of $532,724 and $506,997, respectively)	928,181	970,505
Commercial loans held for sale, net	-	114,425
Investments in commercial real estate	474,510	474,567
Corporate debt (including pledged assets of $437,794 and $592,871, respectively)	773,957	773,274
Interest rate swaps, at fair value	10,472	68,194
Other derivatives, at fair value	154,004	171,266
Receivable for investments sold	9,784	51,461
Accrued interest and dividends receivable	263,217	270,400
Other assets	399,456	333,063
Goodwill	71,815	71,815
Intangible assets, net	28,715	34,184
Total assets	$84,976,578	$87,905,046
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Liabilities:		
Repurchase agreements	$62,497,400	$65,215,810
Other secured financing	3,785,543	3,884,708
Securitized debt of consolidated VIEs [(7)]	3,438,675	3,655,802
Participation sold	-	12,869
Mortgages payable	311,810	311,636

Interest rate swaps, at fair value	614,589	1,443,765
Other derivatives, at fair value	99,380	86,437
Dividends payable	305,709	305,674
Payable for investments purchased	1,043,379	65,041
Accrued interest payable	185,720	163,013
Accounts payable and other liabilities	84,948	184,319
Total liabilities	72,367,153	75,329,074
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
7.625% Series C Cumulative Redeemable Preferred Stock: 12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock: 11,500,000 authorized, issued and outstanding	287,500	287,500
Common stock, par value $0.01 per share, 1,945,437,500 authorized, 1,019,027,880 and 1,018,913,249 issued and outstanding, respectively	10,190	10,189
Additional paid-in capital	15,581,760	15,579,342
Accumulated other comprehensive income (loss)	(850,767)	(1,085,893)
Accumulated deficit	(3,339,228)	(3,136,017)
Total stockholders' equity	12,602,514	12,568,180
Noncontrolling interest	6,911	7,792
Total equity	12,609,425	12,575,972
Total liabilities and equity	$84,976,578	$87,905,046

(1) As a result of a change to a clearing organization's rulebook effective January 3, 2017, beginning with the first quarter 2017 and in subsequent periods the Company is presenting the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. The variation margin was previously reported under cash and cash equivalents and is currently reported as a reduction to interest rate swaps, at fair value. Balances reported prior to the effective date balances will not be adjusted.

(2) Derived from the audited consolidated financial statements at December 31, 2016.

(3) Includes cash of consolidated VIEs of $37.9 million and $23.2 million at June 30, 2017 and December 31, 2016, respectively.

(4) Includes $78.9 million and $88.6 million at June 30, 2017 and December 31, 2016, respectively, of non-Agency mortgage-backed securities in a consolidated VIE pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

(5) Includes securitized residential mortgage loans of a consolidated VIE carried at fair value of $150.9 million and $165.9 million at June 30, 2017 and December 31, 2016, respectively.

(6) Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $3.7 billion and $3.9 billion at June 30, 2017 and December 31, 2016, respectively.

(7) Includes securitized debt of consolidated VIEs carried at fair value of $3.4 billion and $3.7 billion at June 30, 2017 and December 31, 2016, respectively.

See notes to consolidated financial statements.

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

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

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Net interest income:				
Interest income	$537,426	$457,118	$1,125,153	$845,261
Interest expense	222,281	152,755	420,706	300,202
Net interest income	315,145	304,363	704,447	545,059
Realized and unrealized gains (losses):				
Realized gains (losses) on interest rate swaps[1]	(96,470)	(130,762)	(200,626)	(278,237)
Realized gains (losses) on termination of interest rate swaps	(58)	(60,064)	(58)	(60,064)
Unrealized gains (losses) on interest rate swaps	(177,567)	(373,220)	(28,383)	(1,404,940)
Subtotal	(274,095)	(564,046)	(229,067)	(1,743,241)
Net gains (losses) on disposal of investments	(5,516)	12,535	(281)	10,860
Net gains (losses) on trading assets	(14,423)	81,880	(14,104)	207,069
Net unrealized gains (losses) on investments measured at fair value through earnings	16,240	(54,154)	39,923	(54,026)
Subtotal	(3,699)	40,261	25,538	163,903
Total realized and unrealized gains (losses)	(277,794)	(523,785)	(203,529)	(1,579,338)
Other income (loss):				
Other income (loss)	30,865	(9,930)	62,511	(16,045)
Total other income (loss)	30,865	(9,930)	62,511	(16,045)
General and administrative expenses:				
Compensation and management fee	38,938	36,048	78,200	73,045
Other general and administrative expenses	15,085	13,173	29,651	24,121
Total general and administrative expenses	54,023	49,221	107,851	97,166
Income (loss) before income taxes	14,193	(278,573)	455,578	(1,147,490)
Income taxes	(329)	(76)	648	(913)
Net income (loss)	14,522	(278,497)	454,930	(1,146,577)
Net income (loss) attributable to noncontrolling interest	(102)	(385)	(205)	(547)
Net income (loss) attributable to Annaly	14,624	(278,112)	455,135	(1,146,030)

Dividends on preferred stock	23,473	17,992	46,946	35,984
Net income (loss) available (related) to common stockholders	$(8,849)	$(296,104)	$408,189	$(1,182,014)
Net income (loss) per share available (related) to common stockholders:				
Basic	$(0.01)	$(0.32)	$0.40	$(1.28)
Diluted	$(0.01)	$(0.32)	$0.40	$(1.28)
Weighted average number of common shares outstanding:				
Basic	1,019,000,817	924,887,316	1,018,971,942	925,850,452
Diluted	1,019,000,817	924,887,316	1,019,357,697	925,850,452
Dividends declared per share of common stock	$0.30	$0.30	$0.60	$0.60
Net income (loss)	$14,522	$(278,497)	$454,930	$(1,146,577)
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	261,964	483,930	202,349	1,501,637
Reclassification adjustment for net (gains) losses included in net income (loss)	13,360	(7,250)	32,777	(6,995)
Other comprehensive income (loss)	275,324	476,680	235,126	1,494,642
Comprehensive income (loss)	$289,846	$198,183	$690,056	$348,065
Comprehensive income (loss) attributable to noncontrolling interest	(102)	(385)	(205)	(547)
Comprehensive income (loss) attributable to Annaly	289,948	198,568	690,261	348,612
Dividends on preferred stock	23,473	17,992	46,946	35,984
Comprehensive income (loss) attributable to common stockholders	$266,475	$180,576	$643,315	$312,628

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

See notes to consolidated financial statements.

2

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2017 and 2016
(dollars in thousands, except per share data)
(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	7.625% Series E Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockho equity
BALANCE, December 31, 2015	$177,088	$290,514	$445,457	$-	$9,359	$14,675,768	$(377,596)	$(3,324,616)	$11,89
Net income (loss) attributable to Annaly	-	-	-	-	-	-	-	(1,146,030)	(1,146
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	-	1,501,637	-	1,501,
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	-	(6,995)	-	(6,995
Stock compensation expense	-	-	-	-	-	1,084	-	-	1,084
Net proceeds from direct purchase and dividend reinvestment	-	-	-	-	1	1,175	-	-	1,176
Buyback of common stock	-	-	-	-	(111)	(102,601)	-	-	(102,7
Equity contributions from (distributions to)	-	-	-	-	-	-	-	-	-

noncontrolling interest									
Preferred Series A dividends, declared $0.984 per share	-	-	-	-	-	-	-	(7,296)	(7,296
Preferred Series C dividends, declared $0.953 per share	-	-	-	-	-	-	-	(11,438)	(11,43
Preferred Series D dividends, declared $0.938 per share	-	-	-	-	-	-	-	(17,250)	(17,25
Common dividends declared, $0.60 per share	-	-	-	-	-	-	-	(554,935)	(554,9
BALANCE, June 30, 2016	$177,088	$290,514	$445,457	$-	$9,249	$14,575,426	$1,117,046	$(5,061,565)	$11,55
BALANCE, December 31, 2016	$177,088	$290,514	$445,457	$287,500	$10,189	$15,579,342	$(1,085,893)	$(3,136,017)	$12,56
Net income (loss) attributable to Annaly	-	-	-	-	-	-	-	455,135	455,13
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	-	202,349	-	202,34
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	-	32,777	-	32,77
Stock compensation expense	-	-	-	-	-	1,149	-	-	1,149
Net proceeds from direct purchase and dividend reinvestment	-	-	-	-	1	1,269	-	-	1,270
Equity contributions from (distributions to)	-	-	-	-	-	-	-	-	-

noncontrolling interest									
Preferred Series A dividends, declared $0.984 per share	-	-	-	-	-	-	-	(7,296)	(7,296
Preferred Series C dividends, declared $0.953 per share	-	-	-	-	-	-	-	(11,438)	(11,43
Preferred Series D dividends, declared $0.938 per share	-	-	-	-	-	-	-	(17,250)	(17,25
Preferred Series E dividends, declared $0.953 per share	-	-	-	-	-	-	-	(10,962)	(10,96
Common dividends declared, $0.60 per share	-	-	-	-	-	-	-	(611,400)	(611,4
BALANCE, June 30, 2017	$177,088	$290,514	$445,457	$287,500	$10,190	$15,581,760	$(850,767)	$(3,339,228)	$12,60

See notes to consolidated financial statements.

3

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

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

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income (loss)	$454,930	$(1,146,577)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Residential Investment Securities premiums and discounts, net	454,718	621,146
Amortization of Residential Mortgage Loans premiums and discounts, net	624	-
Amortization of securitized debt premiums and discounts, net	(20)	-
Amortization of commercial real estate investment premiums and discounts, net	(3,116)	(1,552)
Amortization of intangibles	4,531	7,621
Amortization of deferred financing costs	809	1,019
Amortization of net origination fees and costs, net	(2,195)	(2,868)
Depreciation expense	9,166	10,684
Net (gains) losses on sale of commercial real estate	(5,050)	(821)
Net (gains) losses on sale of commercial loans held for sale	3	67
Net (gains) losses on sale of commercial real estate debt investments	-	165
Net (gains) losses on sales of Residential Investment Securities	4,014	(10,271)
Net (gains) losses on sales of residential mortgage loans	1,314	-
Stock compensation expense	1,149	1,084
Unrealized (gains) losses on interest rate swaps	28,383	1,404,940
Net unrealized (gains) losses on investments measured at fair value through earnings	(39,923)	54,026
Equity in net income from unconsolidated joint ventures	1,192	4,417
Distributions of cumulative earnings from unconsolidated joint venture	459	-
Net (gains) losses on trading assets	14,104	(207,069)
Proceeds from sale of commercial loans held for sale	114,422	114,358
Payments on purchase of residential mortgage loans	(49,599)	-
Proceeds from repayments from residential mortgage loans	42,894	-
Payment on purchase of corporate debt held for sale	(19,494)	-
Proceeds from sale of corporate debt held for sale	19,605	-
Proceeds from repurchase agreements of RCap	1,513,657,385	1,076,600,000
Payments on repurchase agreements of RCap	(1,513,832,385)	(1,075,750,000)
Proceeds from reverse repurchase agreements of RCap	38,955,000	29,700,000
Payments on reverse repurchase agreements of RCap	(38,955,000)	(29,700,000)
Net payments on derivatives	(797,580)	196,016
Net change in:		
Due to / from brokers	(16)	(5)
Other assets	(65,037)	(65,653)
Accrued interest and dividends receivable	8,475	3,202
Accrued interest payable	22,707	7,592

Accounts payable and other liabilities	(88,818)	24,331
Net cash provided by (used in) operating activities	$(62,349)	$1,865,852
Cash flows from investing activities:		
Payments on purchases of Residential Investment Securities	(7,682,326)	(7,088,346)
Proceeds from sales of Residential Investment Securities	4,629,227	4,008,291
Principal payments on Residential Investment Securities	5,846,683	4,615,505
Purchase of MSRs	(10,000)	-
Payments on purchases of corporate debt	(252,452)	(245,447)
Principal payments on corporate debt	254,318	65,804
Purchases of commercial real estate debt investments	(38,410)	(76,862)
Purchase of securitized loans at fair value	-	(1,489,268)
Origination of commercial real estate investments, net	(110,026)	(189,020)
Proceeds from sale of commercial real estate investments	11,960	12,750
Principal payments on commercial real estate debt investments	163,914	61,601
Principal payments on securitized loans at fair value	271,054	52,407
Principal payments on commercial real estate investments	154,531	402,459
Purchase of investments in real estate	(1,132)	(1,187)
Investment in unconsolidated joint venture	(19,433)	(559)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	4,227	2,117
Payments on purchase of residential mortgage loans held for investment	(512,146)	-
Proceeds from repayments from residential mortgage loans held for investment	85,643	-
Purchase of equity securities	(2,104)	(88,062)
Proceeds from sales of equity securities	-	16,112
Net cash provided by (used in) investing activities	$2,793,528	$58,295

Statements continued on following page.

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

Cash flows from financing activities:		
Proceeds from repurchase agreements	99,863,445	85,723,588
Principal payments on repurchase agreements	(102,406,855)	(88,936,063)
Proceeds from other secured financing	6,801	2,146,084
Payments on other secured financing	(106,038)	(402,806)
Proceeds from issuance of securitized debt	-	1,381,640
Principal repayments on securitized debt	(255,927)	(163,472)
Payment of deferred financing cost	(1,079)	(3,076)
Net proceeds from direct purchases and dividend reinvestments	1,270	1,176
Principal payments on participation sold	(12,827)	(153)
Principal payments on mortgages payable	(36)	(7,399)
Distributions to noncontrolling interests	(676)	(743)
Net payment on share repurchase	-	(102,712)
Dividends paid	(658,311)	(594,219)
Net cash provided by (used in) financing activities	$(3,570,233)	$(958,155)
Net (decrease) increase in cash and cash equivalents	$(839,054)	$965,992
Cash and cash equivalents, beginning of period	1,539,746	1,769,258
Cash and cash equivalents, end of period	$700,692	$2,735,250
Supplemental disclosure of cash flow information:		
Interest received	$1,582,650	$1,456,076
Dividends received	$2,511	$-
Interest paid (excluding interest paid on interest rate swaps)	$454,110	$282,146
Net interest paid on interest rate swaps	$195,973	$281,120
Taxes paid	$1,336	$591
Noncash investing activities:		
Receivable for investments sold	$9,784	$697,943
Payable for investments purchased	$1,043,379	$746,090
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	$235,126	$1,494,642
Noncash financing activities:		
Dividends declared, not yet paid	$305,709	$277,479

See notes to consolidated financial statements.

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

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

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1. DESCRIPTION OF BUSINESS

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

- Agency invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
- Residential Credit invests primarily in non-Agency mortgage-backed assets within securitized products and residential mortgage loan markets.
- Commercial Real Estate originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
- Middle Market Lending provides customized debt financing to middle market businesses.

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

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").
The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company's most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2016 has been derived from audited consolidated financial statements included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2016.
In the opinion of management, all normal, recurring adjustments have been included for a fair presentation of this interim financial information. Interim period operating results may not be indicative of the operating results for a full year.

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

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

6

most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

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

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

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash deposited with clearing organizations is carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. As a result of a change to a clearing organization's rulebook effective January 3, 2017, beginning with the first quarter 2017 and in subsequent periods the Company is presenting the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. The variation margin was previously reported under cash and cash equivalents. As of June 30, 2017, $799.8 million of variation margin was reported as a reduction to interest rate swaps, at fair value. RCap Securities, Inc. (or RCap) is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled approximately $590.1 million and $1.4 billion at June 30, 2017 and December 31, 2016, respectively.

Fair Value Measurements – The Company reports various financial instruments at fair value. A complete discussion of the methodology utilized by the Company to estimate the fair value of certain financial instruments is included in these Notes to Consolidated Financial Statements.
Revenue Recognition – The revenue recognition policy by asset class is discussed below.

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

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

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

The Company elected the fair value option for interest-only mortgage-backed securities, non-Agency mortgage-backed securities and certain CRT securities as this election simplifies the accounting. Interest-only securities and inverse interest-only securities are collectively referred to as "interest-only securities." These interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific mortgage-backed securities. Interest-only mortgage-backed securities, non-Agency mortgage-backed securities and certain CRT securities are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on investments measured at fair value through earnings in the Company's Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.

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

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

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

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

	Interest Income Methodology
Agency	
Fixed-rate pass-through[1]	Effective yield[3]
Adjustable-rate pass-through[1]	Effective yield[3]
Collateralized Mortgage Obligation ("CMO")[1]	Effective yield[3]
Debentures[1]	Contractual Cash Flows
Interest-only[2]	Prospective
Residential Credit	
CRT[2]	Prospective
Legacy [2]	Prospective
NPL/RPL [2]	Prospective
New issue [2]	Prospective
New issue interest-only [2]	Prospective

(1) Changes in fair value are recognized in Other comprehensive income (loss) on the accompanying Consolidated Statements of Comprehensive Income (Loss).
(2) Changes in fair value are recognized in Net unrealized gains (losses) on investments measured at fair value through earnings on the accompanying Consolidated Statements of Comprehensive Income (Loss).
(3) Effective yield is recalculated for differences between estimated and actual prepayments and the amortized cost is adjusted as if the new effective yield had been applied since inception.

Residential Mortgage Loans – The Company's residential mortgage loans are primarily comprised of new origination, performing adjustable-rate and fixed-rate whole loans acquired in connection with the Company's acquisition of Hatteras Financial Corp. ("Hatteras" and such acquisition, the "Hatteras Acquisition") and through subsequent purchases. Additionally, in connection with the Hatteras Acquisition, the Company consolidates a collateralized financing entity that securitized prime adjustable-rate jumbo residential mortgage loans. The Company made elections to account for the investments in residential mortgage loans held in its portfolio and in the securitization trust at fair value as these elections simplify the accounting. Residential mortgage loans are recognized at fair value on the accompanying Consolidated Statements of Financial Condition. Changes in the estimated fair value are presented in Net unrealized gains (losses) on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

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

There was no real estate acquired in settlement of residential mortgage loans as of June 30, 2017 or December 31, 2016. The Company would be considered to have received physical possession of residential real estate property collateralizing a residential mortgage loan, so that the loan is derecognized and the real estate property would be recognized, if either (i) the Company obtains legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveys all interest in the residential real estate property to the Company to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

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

Equity Securities – The Company may invest in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with unrealized gains and losses reported as a component of Other comprehensive income (loss). Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets. Dividends are recorded in earnings based on the declaration date. Equity securities that do not have readily determinable fair values, do not result in consolidation of the investee and are not required to be accounted for under the equity method are carried at cost. Dividends from cost method equity securities are recognized as income when received to the extent they are distributed from net accumulated earnings.

Derivative Instruments – The Company may use a variety of derivative instruments to economically hedge some of its exposure to market risks, including interest rate and prepayment risk. These instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps (“swaptions”), TBA securities without intent to accept delivery (“TBA derivatives”), options on TBA securities (“MBS options”), U.S. Treasury and Eurodollar futures contracts and certain forward purchase commitments. The Company may also enter into other types of mortgage derivatives such as interest-only securities, credit derivatives referencing the commercial mortgage-backed securities index and synthetic total return swaps. Derivatives are accounted for in accordance with the Financial Accounting Standards

Board (“FASB”) Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). None of the Company’s derivative transactions have been designated as hedging instruments for accounting purposes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Income Taxes – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not be subject to federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including RCap and certain subsidiaries of Annaly Commercial Real Estate Group, Inc. and Hatteras, have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries (“TRSs”). As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.
The provisions of ASC 740, Income Taxes (“ASC 740”), clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of June 30, 2017 and December 31, 2016.

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

Commercial Real Estate Investments

Commercial Real Estate Debt Investments – The Company’s commercial real estate debt investments are comprised of commercial mortgage-backed securities and loans held by consolidated collateralized financing entities. Commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss). Management evaluates commercial mortgage-backed securities for other-than-temporary impairment at least quarterly. See the “Commercial Real Estate Investments” Note for additional information regarding the consolidated collateralized financing entities.
Commercial Real Estate Loans and Preferred Equity Interests (collectively referred to as “CRE Debt and Preferred Equity Investments”) – The Company's commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. The Company designates loans as held for investment if it has the intent and ability to hold the loans until maturity or payoff. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Commercial real estate loans that are designated as held for investment and are originated or purchased by the Company are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less an allowance for loan losses if necessary. Origination fees and costs, premiums or discounts are amortized into interest income over the life of the loan.
If the Company intends to sell or securitize the loans and the securitization vehicle is not expected to be consolidated, they are classified as held for sale. Commercial real estate loans that are designated as held for sale are carried at the lower of amortized cost or fair value and recorded as Commercial loans held for sale, net in the accompanying Consolidated Statements of Financial Condition. Any origination fees and costs or purchase premiums or discounts are deferred and recognized upon sale. The Company determines the fair value of commercial real estate loans held for sale on an individual loan basis.
Preferred equity interests are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. See the “Commercial Real Estate Investments” Note for additional information.
Investments in Commercial Real Estate – Investments in commercial real estate are carried at historical cost less accumulated depreciation. Historical cost includes all costs necessary to bring the asset to the condition and location

necessary for its intended use, including financing during the construction period. Costs directly related to acquisitions deemed to be business combinations are expensed. Ordinary repairs and maintenance which are not reimbursed by tenants are expensed as incurred. Major replacements and improvements that extend the useful life of the asset are capitalized and depreciated over their useful life.

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

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

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

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

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

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

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

The Company's real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property's value is considered impaired if the Company's estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.
Revenue Recognition – Commercial Real Estate Investments - Interest income is accrued based on the outstanding principal amount of CRE Debt and Preferred Equity Investments and their contractual terms. Origination fees and costs, premiums or discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the lives of the CRE Debt and Preferred Equity Investments using the interest method.

Corporate Debt
Corporate Loans – The Company’s investments in corporate debt that are loans are designated as held for investment when the Company has the intent and ability to hold the investment until maturity or payoff. These investments are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the interest method. These investments typically take the form of senior secured loans primarily in first lien and second lien loans. The Company’s senior secured loans generally have stated maturities of three to eight years. In connection with these

senior secured loans the Company receives a security interest in certain of the assets of the borrower and such assets support repayment of such loans. Senior secured loans are generally exposed to the least amount of credit risk given their seniority to scheduled principal and interest and priority of security in the assets of the borrower. To date, the significant majority of the Company's investments in corporate debt have been funded term loans versus bonds.

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

Impairment of Securities and Loans

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

When the fair value of an available-for-sale security is less than its amortized cost the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of Other comprehensive income (loss). If the fair value is less than the cost of a held-to-maturity security, the Company performs an analysis to determine whether it expects to recover the entire cost basis of the security. There was no other-than-temporary impairment recognized for the three months ended June 30, 2017 and 2016.

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

The Company may be exposed to various levels of credit risk depending on the nature of its investments and credit enhancements, if any, supporting its assets. The Company’s core investment process includes procedures related to the initial approval and periodic monitoring of credit risk and other risks associated with each investment. The Company’s investment underwriting procedures include evaluation of the underlying borrowers’ ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics upon either the origination or the acquisition of a new investment but generally does not update the loan-to-value metrics in the course of quarterly surveillance.

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

In connection with the quarterly surveillance review process, the Company’s CRE Debt and Preferred Equity Investments are assigned an internal risk rating. The loan risk ratings reflect guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The initial internal risk ratings (“Initial Ratings”) are based on loan-to-values and the net operating income debt yields of the underlying collateral of the Company’s CRE

Debt and Preferred Equity Investments and based upon leverage and cash flow coverages of the borrowers' debt and operating obligations. The final internal risk ratings are influenced by other quantitative and qualitative factors that can result in an adjustment to the Initial Ratings, subject to review and approval by the respective committee. The internal risk rating categories include "Performing", "Performing - Closely Monitored", "Performing - Special Mention", "Substandard", "Doubtful" or "Loss". Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans exhibit potential weakness that deserves management's close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible.

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

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

The Company did not have any impaired loans, nonaccrual loans, or loans in default as all of the loans were performing as of June 30, 2017 and December 31, 2016. There were no allowances for loan losses as of June 30, 2017 and December 31, 2016.

Broker Dealer Activities

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

Recent Accounting Pronouncements

The Company considers the applicability and impact of all Accounting Standards Updates ("ASUs"). ASUs not listed below were determined to be either not applicable, are not expected to have a significant impact on our consolidated financial statements when adopted, or did not have a significant impact on our consolidated financial statements upon adoption.

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

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
ASU 2017-05 Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets	This update clarifies that a financial asset is within the scope of Subtopic 610-20 if it meets the definition of an in-substance nonfinancial asset, including nonfinancial assets transferred within a legal entity to a counterparty. The ASU requires the Company to derecognize a distinct nonfinancial asset or in-substance nonfinancial asset in a partial sale transaction when it ceases to have a controlling financial interest in a legal entity that holds the asset or transfers control of the asset, with any noncontrolling interest retained recognized at fair value. Transfers of ownership interest in a consolidated subsidiary with controlling financial interest retained are accounted for as equity transactions.	January 1, 2018 (early adoption permitted).	The Company is evaluating the expected impact of this ASU.
ASU 2017-01 Business Combinations (Topic 805) Clarifying the Definition of a Business	This update provides a screen to determine and a framework to evaluate when a set of assets and activities is a business.	January 1, 2018 (early adoption permitted)	The amendments are expected to result in fewer transactions being accounted for as business combinations.
ASU 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	This ASU updates the existing incurred loss model to a current expected credit loss ("CECL") model for financial assets and net investments in leases that are not accounted for at fair value through earnings. The amendments affect loans, held-to-maturity debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures and any other financial assets not excluded from the scope. There are also limited amendments to the impairment model for available-for-sale debt securities.	January 1, 2020 (early adoption permitted)	The Company currently plans to adopt the new standard on its effective date and has developed an implementation plan, which it has begun executing. While the Company is continuing to assess the impact the ASU will have on the consolidated financial statements, the measurement of expected credit losses under the CECL model will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts of the financial assets in scope of the model. Further, based on the amended guidance for available-for-sale debt

securities, the Company:

- will be required to use an allowance approach to recognize credit impairment, with the allowance to be limited to the amount by which the security's fair value is less than its amortized cost basis;
- may not consider the length of time fair value has been below amortized cost, and
- may not consider recoveries of fair value after the balance sheet date when assessing whether a credit loss exists.

15

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

4. ACQUISITION OF HATTERAS

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

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

The following table summarizes the aggregate consideration and fair value of the assets acquired and liabilities assumed recognized at the acquisition date:

	July 12, 2016 (dollars in thousands)
Consideration Transferred:	
Cash	$521,082
Common equity	997,707
Preferred shares:	
Exchange of Hatteras preferred stock for Annaly preferred stock	278,252
Preferred stock fair value adjustment	9,248
Preferred shares	287,500

Total consideration	$1,806,289
Net Assets:	
Cash	$562,780
Agency mortgage-backed securities, at fair value	10,863,070
Credit risk transfer securities, at fair value	116,770
Residential mortgage loans	360,447
Mortgage servicing rights	355,820
Other derivatives, at fair value	8,677
Principal receivable	438,005
Accrued interest and dividend receivable	83,814
Other assets	57,250
Total assets acquired	$12,846,633
Repurchase agreements	$10,422,757
Other secured financing	35,769
Securitized debt of consolidated VIEs	54,135
Other derivatives, at fair value	349,922
Dividends payable	670
Payable for investments purchased	2,643
Accrued interest payable	4,833
Accounts payable and other liabilities	97,039
Total liabilities assumed	10,967,768
Net assets acquired	$1,878,865
Bargain purchase gain	$72,576

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

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

5. RESIDENTIAL INVESTMENT SECURITIES

The following tables present the Company's Residential Investment Securities portfolio that was carried at fair value as of June 30, 2017 and December 31, 2016:

	June 30, 2017						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains(1)	Unrealized Losses(1)	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$61,627,012	$3,671,722	$(1,416)	$65,297,318	$220,370	$(1,045,902)	$64,471,787
Adjustable-rate pass-through	8,092,902	307,181	(2,939)	8,397,144	26,753	(55,019)	8,368,878
Interest-only	7,051,876	1,305,067	-	1,305,067	3,351	(185,085)	1,123,333
Total Agency investments	$76,771,790	$5,283,970	$(4,355)	$74,999,529	$250,474	$(1,286,006)	$73,963,998
Residential Credit							
CRT	$550,302	$15,364	$(5,915)	$559,751	$46,077	$(2)	$605,826
Alt-A	215,364	1,255	(34,464)	182,155	11,475	(149)	193,481
Prime	198,358	264	(26,268)	172,355	16,497	-	188,852
Subprime	630,337	1,560	(80,889)	551,008	43,683	(65)	594,627
NPL/RPL	128,766	168	(92)	128,841	815	(36)	129,620
Prime Jumbo (>= 2010 Vintage)	110,465	675	-	111,140	1,356	-	112,496
Prime Jumbo (>= 2010 Vintage) Interest-Only	793,031	12,832	-	12,832	2,145	-	14,977
Total residential credit investments	$2,626,623	$32,118	$(147,628)	$1,718,082	$122,048	$(252)	$1,839,879
Total Residential Investment Securities	$79,398,413	$5,316,088	$(151,983)	$76,717,611	$372,522	$(1,286,258)	$75,803,877

	December 31, 2016						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains(1)	Unrealized Losses(1)	Estimated Fair Value
Agency	(dollars in thousands)						
Fixed-rate pass-through	$60,759,317	$3,633,354	$(1,956)	$64,390,715	$228,430	$(1,307,771)	$63,311,373
Adjustable-rate pass-through	10,653,109	391,267	(4,081)	11,040,295	47,250	(53,795)	11,033,751
Interest-only	8,133,805	1,436,192	-	1,436,192	4,225	(195,668)	1,244,749
Total Agency investments	$79,546,231	$5,460,813	$(6,037)	$76,867,202	$279,905	$(1,557,234)	$75,589,873
Residential Credit							

CRT	$690,491	$11,113	$(10,907)	$690,697	$34,046	$(21)	$724,722
Alt-A	173,108	1,068	(23,039)	151,137	3,721	(685)	154,173
Prime	248,176	287	(35,068)	213,395	7,050	(253)	220,192
Subprime	697,983	380	(96,331)	602,032	12,578	(1,061)	613,549
NPL/RPL	269,802	670	(209)	270,263	1,004	(429)	270,838
Prime Jumbo (>= 2010 Vintage)	129,453	852	(345)	129,960	267	(308)	129,919
Prime Jumbo (>= 2010 Vintage) Interest-Only	863,370	15,129	-	15,129	-	(2,493)	12,636
Total residential credit investments	$3,072,383	$29,499	$(165,899)	$2,072,613	$58,666	$(5,250)	$2,126,029
Total Residential Investment Securities	$82,618,614	$5,490,312	$(171,936)	$78,939,815	$338,571	$(1,562,484)	$77,715,902

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

The following table presents the Company's Agency mortgage-backed securities portfolio by issuing Agency concentration as of June 30, 2017 and December 31, 2016:

Investment Type	June 30, 2017	December 31, 2016
	(dollars in thousands)	
Fannie Mae	$51,216,573	$51,658,391
Freddie Mac	22,680,257	23,858,110
Ginnie Mae	67,168	73,372
Total	$73,963,998	$75,589,873

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

17

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

The following table summarizes the Company's available-for-sale Residential Investment Securities as of June 30, 2017 and December 31, 2016, according to their estimated weighted average life classifications:

Weighted Average Life	June 30, 2017 Estimated Fair Value	June 30, 2017 Amortized Cost	December 31, 2016 Estimated Fair Value	December 31, 2016 Amortized Cost
	(dollars in thousands)			
Less than one year	$158,935	$159,970	$63,510	$61,775
Greater than one year through five years	17,006,028	16,987,965	12,626,932	12,666,394
Greater than five years through ten years	58,139,230	59,089,002	56,785,601	57,738,588
Greater than ten years	499,684	480,674	8,239,859	8,473,058
Total	$75,803,877	$76,717,611	$77,715,902	$78,939,815

The weighted average lives of the Agency mortgage-backed securities at June 30, 2017 and December 31, 2016 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than projected.
The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities and debentures, accounted for as available-for-sale, by length of time that such securities have been in a continuous unrealized loss position at June 30, 2017 and December 31, 2016.

	June 30, 2017 Estimated Fair Value[(1)]	June 30, 2017 Gross Unrealized Losses[(1)]	June 30, 2017 Number of Securities[(1)]	December 31, 2016 Estimated Fair Value[(1)]	December 31, 2016 Gross Unrealized Losses[(1)]	December 31, 2016 Number of Securities[(1)]
	(dollars in thousands)					
Less than 12 Months	$50,551,597	$(871,480)	1,432	$52,465,045	$(1,094,957)	1,368
12 Months or More	5,823,250	(229,441)	55	6,277,814	(266,609)	54
Total	$56,374,847	$(1,100,921)	1,487	$58,742,859	$(1,361,566)	1,422

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

The decline in value of these securities is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, the Company is guaranteed payment of the principal amount of the securities by the respective issuing government agency.
During the three and six months ended June 30, 2017, the Company disposed of $2.5 billion and $4.6 billion of Residential Investment Securities, resulting in a net realized loss of $5.2 million and $4.0 million, respectively.

During the three and six months ended June 30, 2016, the Company disposed of $1.8 billion and $5.2 billion of Residential Investment Securities, resulting in a net realized gain of $11.9 million and $10.3 million, respectively.

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

6. RESIDENTIAL MORTGAGE LOANS

The table below presents the fair value and the unpaid principal balance of the residential mortgage loan portfolio as of June 30, 2017 and December 31, 2016:

	June 30, 2017	December 31, 2016
	(dollars in thousands)	
Fair value	$779,685	$342,289
Unpaid principal balance	$763,850	$338,323

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

	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2017
	(dollars in thousands)	
Net gains (losses) on disposal of investments	$(321)	$(1,314)
Net unrealized gains (losses) on investments measured at fair value through earnings	5,310	6,125
Net interest income	7,120	10,709
Total included in net income (loss)	$12,109	$15,520

The change in the fair value of the residential mortgage loans can be attributed to changes in interest rates. None of the change in the fair value of the residential mortgage loans was attributable to changes in credit risk based on current delinquencies.

The following table provides the geographic concentrations based on the unpaid principal balances as of June 30, 2017 and December 31, 2016, for the residential mortgage loans, including loans held in a securitization trust:

Geographic Concentrations of Residential Mortgage Loans			
June 30, 2017		December 31, 2016	
Property Location	% of Balance	Property Location	% of Balance
California	57.9 %	California	46.3 %
New York	7.2 %	Texas	9.6 %
Texas	5.0 %	Illinois	5.7 %
All other (none individually greater than 5%)	29.9 %	Florida	5.2 %
		Washington	5.1 %
		All other (none individually greater than 5%)	28.1 %
Total	100.0%	Total	100.0%

The table below provides additional data on the Company's residential mortgage loans, including loans held in a securitization trust, at June 30, 2017 and December 31, 2016:

	June 30, 2017		December 31, 2016	
	Portfolio Range	Portfolio Weighted Average	Portfolio Range	Portfolio Weighted Average
	(dollars in thousands)		(dollars in thousands)	
Unpaid principal balance	$20 - $3,686	$709	$22 - $1,905	$691
Interest rate	2.50% - 6.88%	4.35%	2.50% - 6.75%	3.72%
Maturity	8/1/2029 - 6/1/2047	10/20/2045	4/8/2044 - 11/1/2046	8/20/2045
FICO score at loan origination	620 - 823	753	665 - 814	761
Loan-to-value ratio at loan origination	20% - 90%	68%	24% - 90%	71%

As of June 30, 2017 and December 31, 2016, approximately 80% and 85%, respectively, of the carrying value of the Company’s residential mortgage loans, including loans held in a securitization trust, were adjustable-rate.

7. MORTGAGE SERVICING RIGHTS

In connection with the Hatteras Acquisition, the Company acquired an MSR portfolio and began investing in MSRs through a Hatteras wholly-owned subsidiary. The Company elected to carry all investments in MSRs at fair value.

The following table presents activity related to MSRs for the three and six months ended June 30, 2017:

	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2017
	(dollars in thousands)	
Fair value, beginning of period	$632,166	$652,216
Purchases [1]	(210)	3
Change in fair value due to:		
Changes in valuation inputs or assumptions [2]	(9,205)	(15,438)
Other changes, including realization of expected cash flows	(17,098)	(31,128)
Fair value, end of period	$605,653	$605,653

(1) Includes adjustments to original purchase price from early payoffs, defaults, or loans that were delivered but were deemed to not be acceptable.
(2) Principally represent changes in discount rates and prepayment speed inputs used in valuation model, primarily due to changes in interest rates.

For the three and six months ended June 30, 2017, the Company recognized $33.3 million and $67.8 million, respectively, of net servicing income from MSRs in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

8. COMMERCIAL REAL ESTATE INVESTMENTS

On December 11, 2015, the Company originated a $335.0 million recapitalization financing with respect to eight class A/B office properties in Orange County California. The company previously classified the senior mortgage loan as held for sale. During the six months ended June 30, 2017, the Company sold the remaining balance of $115.0 million ($114.4 million,
net of origination fees) of the senior loan to unrelated third parties at carrying value. Accordingly, no gain or loss was recorded in connection with these sales.

At June 30, 2017 and December 31, 2016, commercial real estate debt investments held for investment were comprised of the following:

CRE Debt and Preferred Equity Investments

June 30, 2017			December 31, 2016		
Outstanding	Carrying	Percentage	Outstanding	Carrying	Percentage

	Principal	Value[1]	of Loan Portfolio[2]		Principal	Value[1]	of Loan Portfolio[2]	
	(dollars in thousands)							
Senior mortgages	$528,659	$526,535	56.7	%	$512,322	$510,071	52.6	%
Mezzanine loans	393,810	392,670	42.3	%	453,693	451,467	46.5	%
Preferred equity	9,000	8,976	1.0	%	9,000	8,967	0.9	%
Total [3]	$931,469	$928,181	100.0	%	$975,015	$970,505	100.0	%

[1] Carrying value includes unamortized origination fees of $3.3 million and $4.5 million as of June 30, 2017 and December 31, 2016, respectively.
[2] Based on outstanding principal.
[3] Excludes Loans held for sale, net.

20

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

	June 30, 2017			
	Senior Mortgages	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)			
Beginning balance	$510,071	$451,467	$ 8,967	$970,505
Originations & advances (principal)	74,945	36,039	-	110,984
Principal payments	(58,608)	(95,923)	-	(154,531)
Amortization & accretion of (premium) discounts	(44)	30	-	(14)
Net (increase) decrease in origination fees	(741)	(217)	-	(958)
Amortization of net origination fees	912	1,274	9	2,195
Net carrying value	$526,535	$392,670	$ 8,976	$928,181

	December 31, 2016				
	Senior Mortgages	Senior Securitized Mortgages(1)	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	$385,838	$ 262,703	$578,503	$121,773	$1,348,817
Originations & advances (principal)	211,318	-	62,390	-	273,708
Principal payments	(86,310)	(263,072)	(191,291)	(113,444)	(654,117)
Amortization & accretion of (premium) discounts	(136)	-	(178)	-	(314)
Net (increase) decrease in origination fees	(2,086)	-	(472)	-	(2,558)
Amortization of net origination fees	1,447	369	2,515	638	4,969
Net carrying value (2)	$510,071	$ -	$451,467	$8,967	$970,505

(1) Assets of consolidated VIE.
(2) Excludes Loans held for sale, net.

Internal CRE Debt and Preferred Equity Investment Ratings

The Company's internal loan risk ratings are based on the guidance provided by the Office of the Comptroller of the Currency for commercial real estate lending. The Company's internal risk rating categories include "Performing", "Performing - Closely Monitored", "Performing - Special Mention", "Substandard", "Doubtful" or "Loss". Performing loans meet all present contractual obligations. Performing - Closely Monitored loans meet all present contractual obligations, but are transitional or could be exhibiting some weakness in both leverage and liquidity. Performing - Special Mention loans meet all present contractual obligations,
but exhibit potential weakness that deserves management's close attention and if uncorrected, may result in deterioration of repayment prospects. Substandard loans are inadequately protected by sound worth and paying capacity of the obligor or of the collateral pledged with a distinct possibility that loss will be sustained if some of the deficiencies are not corrected. Doubtful loans are Substandard loans whereby collection of all contractual principal and interest is highly questionable or improbable. Loss loans are considered uncollectible. The Company did not have any impaired loans, nonaccrual loans, or loans in default in the commercial loans portfolio as all of the loans were performing as of June 30, 2017 and December 31, 2016. Accordingly, no allowance for loan losses was deemed necessary as of June 30, 2017 and December 31, 2016.

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

	June 30, 2017		Internal Ratings						
Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard	Doubtful	Loss	Total
	(dollars in thousands)								
Senior mortgages	$528,659	56.7 %	$175,394	$249,075	$104,190	$ -	$ -	$ -	$528,659
Mezzanine loans	393,810	42.3 %	195,435	179,188	19,187	-	-	-	393,810
Preferred equity	9,000	1.0 %	-	-	9,000	-	-	-	9,000
	$931,469	100.0 %	$370,829	$428,263	$132,377	$ -	$ -	$ -	$931,469

	December 31, 2016		Internal Ratings						
Investment Type	Outstanding Principal [(1)]	Percentage of CRE Debt and Preferred Equity Portfolio	Performing	Performing - Closely Monitored	Performing - Special Mention	Substandard	Doubtful	Loss	Total
	(dollars in thousands)								
Senior mortgages	$512,322	52.6 %	$144,434	$243,448	$124,440	$ -	$ -	$ -	$512,322
Mezzanine loans	453,693	46.5 %	254,337	170,039	29,317	-	-	-	453,693
Preferred equity	9,000	0.9 %	-	-	9,000	-	-	-	9,000
	$975,015	100.0 %	$398,771	$413,487	$162,757	$ -	$ -	$ -	$975,015

(1) Excludes Loans held for sale, net.

As of June 30, 2017 and December 31, 2016, approximately 84% and 77%, respectively, of the carrying value of the Company's CRE Debt and Preferred Equity Investments, excluding commercial loans held for sale, were adjustable-rate.

Investments in Commercial Real Estate

There were no acquisitions of commercial real estate holdings during the three and six months ended June 30, 2017. The Company sold one of its wholly-owned triple net leased properties during the six months ended June 30, 2017 for $12.0 million and recognized a gain on sale of $5.1 million.
The weighted average amortization period for intangible assets and liabilities as of June 30, 2017 is 4.1 years. Above market leases and leasehold intangible assets are included in Intangible assets, net and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition.

	June 30, 2017	December 31, 2016
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	$111,012	$112,675
Buildings and improvements	330,837	335,945
Subtotal	441,849	448,620
Less: accumulated depreciation	(41,062)	(34,221)
Total real estate held for investment, at amortized cost, net	400,787	414,399
Equity in unconsolidated joint ventures	73,723	60,168
Investments in commercial real estate, net	$474,510	$474,567

Depreciation expense was $3.9 million and $7.8 million for the three and six months ended June 30, 2017, respectively. Depreciation expense was $6.1 million and $10.7 million for the three and six months ended June 30, 2016, respectively. Depreciation expense is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

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

Rental Income

The minimum rental amounts due under leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the tenants reimburse us for certain operating costs. Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at June 30, 2017 for consolidated investments in real estate are as follows:

	June 30, 2017 (dollars in thousands)
2017 (remaining)	$ 15,511
2018	28,240
2019	24,446
2020	19,749
2021	15,566
Later years	28,649
	$ 132,161

Mortgage loans payable as of June 30, 2017 and December 31, 2016, were as follows:

June 30, 2017

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$286,186	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,278	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,017	11,025	3.58%	Fixed	6/6/2019	First liens
Nevada (1)	2,329	2,329	L+200	Floating	9/29/2017	First liens
	$311,810	$314,829				

(1) The mortgage agreement contained an interest rate swap with an expiration date of March 29, 2017. Effective on March 29, 2017, the interest rate swap expired and the Company extended the maturity date of the mortgage debt to September 29, 2017.

December 31, 2016

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures	$285,993	$289,125	4.03% - 4.61%	Fixed	2024 and 2025	First liens
Tennessee	12,261	12,350	4.01%	Fixed	9/6/2019	First liens
Virginia	11,015	11,025	3.58%	Fixed	6/6/2019	First liens
Nevada	2,367	2,365	L+200	Floating (1)	3/29/2017	First liens

$311,636	$314,865

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

The following table details future mortgage loan principal payments as of June 30, 2017:

	Mortgage Loan Principal Payments (dollars in thousands)
2017 (remaining)	$ 2,329
2018	-
2019	23,375
2020	-
2021	-
Later years	289,125
	$ 314,829

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

9. CORPORATE DEBT

The Company invests in corporate loans and corporate debt securities through Annaly Middle Market Lending LLC. The industry and rate sensitivity dispersion of the portfolio as of June 30, 2017 and December 31, 2016 are as follows:

	Industry Dispersion					
	June 30, 2017			December 31, 2016		
	Fixed Rate	Floating Rate	Total	Fixed Rate	Floating Rate	Total
	(dollars in thousands)					
Aircraft and Parts	$-	$34,892	$34,892	$-	$32,067	$32,067
Commercial Fishing	-	38,828	38,828	-	40,600	40,600
Computer Programming, Data Processing & Other Computer Related Services	-	132,323	132,323	-	146,547	146,547
Drugs	-	33,642	33,642	-	34,042	34,042
Groceries and Related Products	-	14,838	14,838	-	14,856	14,856
Grocery Stores	-	23,618	23,618	-	23,761	23,761
Home Health Care Services	-	24,033	24,033	-	39,205	39,205
Insurance Agents, Brokers and services	4,414	72,973	77,387	4,391	73,267	77,658
Management and Public Relations Services	-	94,481	94,481	-	16,493	16,493
Medical and Dental Laboratories	-	26,039	26,039	-	17,292	17,292
Miscellaneous Business Services	-	19,797	19,797	84,486	-	84,486
Miscellaneous Equipment Rental and Leasing	-	19,630	19,630	-	-	-
Miscellaneous Health and Allied Services, not elsewhere classified	-	25,241	25,241	-	9,791	9,791
Miscellaneous Nonmetallic Minerals, except Fuels	-	24,674	24,674	-	24,688	24,688
Miscellaneous Plastic Products	-	9,914	9,914	-	27,036	27,036
Motor Vehicles and Motor Vehicle Parts and Supplies	-	12,259	12,259	-	12,319	12,319
Offices and Clinics of Doctors of Medicine	-	48,274	48,274	-	83,386	83,386
Offices and Clinics of Health Practitioners, not elsewhere classified	-	7,444	7,444	-	-	-
Personnel Supply Services	-	-	-	-	36,921	36,921
Public Warehousing and Storage	-	37,121	37,121	-	-	-
Research, Development and Testing Services	-	17,717	17,717	-	17,744	17,744
Schools and Educational Services, not elsewhere classified	-	20,890	20,890	-	20,979	20,979
Surgical, Medical, and Dental Instruments and Supplies	-	13,041	13,041	-	13,403	13,403
Telephone Communications	-	17,874	17,874	-	-	-
Total	$4,414	$769,543	$773,957	$88,877	$684,397	$773,274

The table below reflects the Company's aggregate positions by their respective place in the capital structure of the borrowers as of June 30, 2017 and December 31, 2016.

	June 30, 2017	December 31, 2016
	(dollars in thousands)	

First lien loans	$496,953	$505,956
Second lien loans	272,590	178,441
Second lien notes	-	84,486
Subordinated notes	4,414	4,391
Total	$773,957	$773,274

10. VARIABLE INTEREST ENTITIES

In February 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KLSF (“FREMF 2015-KLSF”) for $102.1 million. The underlying portfolio is a pool of 11 floating rate multifamily mortgage loans with a cut-off principal balance of $1.4 billion at settlement. The Company was required to consolidate the FREMF 2015-KLSF Trust’s
assets and liabilities of $1.3 billion and $1.2 billion, respectively, at June 30, 2017.

In April 2015, the Company purchased the junior-most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KF07 (“FREMF 2015-KF07”) for $89.4 million. The underlying portfolio is a pool of 40 floating rate multifamily mortgage loans with a cut-off principal balance of $1.2 billion at settlement. The Company was required to consolidate the FREMF 2015-KF07 Trust’s assets and liabilities of $0.8 billion and $0.8 billion, respectively, at June 30, 2017.

In February 2016, the Company purchased the junior- most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2016-KLH1 ("FREMF 2016-KLH1") for $107.6 million, net of a $4.4 million discount to face value of $112.0 million. The underlying portfolio is a pool of 28 floating rate multifamily mortgage loans with a cut-off principal balance of $1.5 billion at settlement. The Company was required to consolidate the FREMF 2016-KLH1 Trust's assets and liabilities of $1.5 billion and $1.4 billion, respectively, at June 30, 2017. FREMF 2015-KLSF, FREMF 2015-KF07 and FREMF 2016-KLH1 are collectively referred to herein as the FREMF Trusts.

The FREMF Trusts are structured as pass-through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The FREMF Trusts are VIEs and the Company is considered to be the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership of the Class C Certificates and its current designation as the directing certificate holder. The Company's exposure to the obligations of the VIEs is generally limited to the Company's investment in the FREMF Trusts of $267.2 million at June 30, 2017. Assets of the FREMF Trusts may only be used to settle obligations of the FREMF Trusts. Creditors of the FREMF Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the FREMF Trusts. No gain or loss was recognized upon initial consolidation of the FREMF Trusts, but $0.8 million of related costs were expensed. The FREMF Trusts' assets are included in Commercial real estate debt investments and the FREMF Trusts' liabilities are included in Securitized debt of consolidated VIEs in the accompanying Consolidated Statements of Financial Condition.

Upon consolidation, the Company elected the fair value option for the financial assets and liabilities of the FREMF Trusts in order to avoid an accounting mismatch, and to more faithfully represent the economics of its interest in the entities. The fair value option requires that changes in fair value be reflected in the Company's Consolidated Statements of Comprehensive Income (Loss). The Company applies the practical expedient fair value measurement under ASU 2014-13, whereby the Company determines whether the fair value of the financial assets or financial liabilities is more observable as a basis for measuring the less observable financial instruments. The Company has determined that the fair value of the financial liabilities of the FREMF Trusts are more observable, since the prices for these liabilities are primarily available from third-party pricing services utilized for multifamily mortgage-backed securities, while the individual assets of the trusts are inherently less capable of precise measurement given their illiquid nature and the limitations on available information related to these assets. Given that the Company's methodology for valuing the financial assets of the FREMF Trusts are an aggregate fair value derived from the fair value of the financial liabilities, the Company has determined that the fair value of each of the financial assets in their entirety should be classified in Level 2 of the fair value measurement hierarchy.

The FREMF Trusts mortgage loans had an unpaid principal balance of $3.6 billion at June 30, 2017. As of June 30, 2017, there are no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities as of June 30, 2017 based upon the Company's process of monitoring events of default on the underlying mortgage loans.

The Company consolidates a residential mortgage trust that issued residential mortgage-backed securities that are collateralized by residential mortgage loans that had been transferred to the trust by one of the Company's subsidiaries. The Company owns most of the mortgage-backed securities issued by this VIE, including the subordinate securities, and a subsidiary of the Company continues to be the servicer. As such, the Company is deemed to be the primary beneficiary of the residential mortgage trust and consolidates the entity. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has elected not to apply the practical expedient under ASU 2014-13 as prices of both the financial liabilities and financial assets of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt was $147.9 million as of June 30, 2017.

In June 2016, a consolidated subsidiary of the Company (the "Borrower") entered into a $300.0 million credit facility with a third party financial institution. The Borrower was determined to be a VIE and the Company was determined to be the primary beneficiary due to its role as collateral manager and because it holds a variable interest in the entity that could be potentially significant to the entity. The Company has transferred corporate loans with a carrying amount of $437.8 million at June 30, 2107 that are pledged as collateral for the credit facility. The transfers did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation. As of June 30, 2017, the Borrower had an intercompany receivable of $189.6 million, which eliminates upon consolidation and an Other secured financing of $189.6 million to the third party financial institution.

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

The Company's exposure to the obligations of its VIEs is generally limited to the Company's investment in the VIEs of $1.1 billion at June 30, 2017. Assets of the VIEs may only be used to settle obligations of the VIEs. Creditors of the VIEs have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the VIEs. No gain or loss was recognized upon initial consolidation of the VIEs. Interest income and expense are recognized using the effective interest method.

The statements of financial condition of the Company's VIEs that are reflected in the Company's Consolidated Statements of Financial Condition at June 30, 2017 and December 31, 2016 are as follows:

	June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trust	MSR Silos
	(dollars in thousands)		
Assets			
Cash and cash equivalents	$-	$-	$37,901
Commercial real estate debt investments	3,664,092	-	-
Residential mortgages loans	-	150,859	13,979
Mortgage servicing rights	-	-	605,653
Accrued interest receivable	9,661	754	-
Other assets	-	-	32,721
Total assets	$3,673,753	$151,613	$690,254
Liabilities			
Securitized debt (non-recourse) at fair value	$3,396,885	$41,790	$-
Other secured financing	-	-	7,659
Other derivatives, at fair value	-	-	11
Accrued interest payable	4,588	95	-
Accounts payable and other liabilities	-	71	4,017
Total liabilities	$3,401,473	$41,956	$11,687

	December 31, 2016		
	FREMF Trusts	Residential Mortgage Loan Trust	MSR Silos
	(dollars in thousands)		

Assets			
Cash and cash equivalents	$-	$-	$23,198
Commercial real estate debt investments	3,890,807	-	-
Residential mortgages loans	-	165,869	8,309
Mortgage servicing rights	-	-	652,216
Accrued interest receivable	8,690	836	-
Other derivatives, at fair value	-	-	9
Other assets	138	-	35,540
Total assets	$3,899,635	$166,705	$719,272
Liabilities			
Securitized debt (non-recourse) at fair value	$3,609,164	$46,638	$-
Other secured financing	-	-	3,825
Other derivatives, at fair value	-	-	9
Accrued interest payable	4,350	107	-
Accounts payable and other liabilities	-	662	14,007
Total liabilities	$3,613,514	$47,407	$17,841

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

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

	For the Three Months Ended June 30, 2017		
	FREMF Trusts	Residential Mortgage Loan Trust	MSR Silos
	(dollars in thousands)		
Net interest income:			
Interest income	$24,948	$ 1,171	$491
Interest expense	11,679	298	57
Net interest income	13,269	873	434
Realized gain (loss) on disposal of investments	-	(121)	24
Unrealized gain (loss) on investments at fair value [1]	4,387	720	(26,848)
Other income (loss)	(6,224)	(94)	33,338
General and administration expenses	1	17	838
Net income (loss)	$11,431	$ 1,361	$6,110

[1] Included in Net unrealized gains (losses) on investments measured at fair value through earnings.

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

[1] Included in Net unrealized gains (losses) on investments measured at fair value through earnings.

The geographic concentrations of credit risk exceeding 5% of the total loan unpaid principal balances related to the Company's VIEs as of June 30, 2017 are as follows:

FREMF Trusts	Residential Mortgage Loan Trust
Property Location	