

ANNALY CAPITAL MANAGEMENT INC  
Form 10-K  
February 15, 2019  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2018

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.

(Exact Name of Registrant as Specified in its Charter)

MARYLAND

(State or other jurisdiction of incorporation or organization) 22-3479661 (IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS

NEW YORK, NEW YORK

(Address of principal executive offices)

(212) 696-0100

(Registrant's telephone number, including area code)

10036

(Zip Code)

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

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, par value \$0.01 per share

New York Stock Exchange

7.625% Series C Cumulative Redeemable Preferred Stock

New York Stock Exchange

7.50% Series D Cumulative Redeemable Preferred Stock

New York Stock Exchange

6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock

New York Stock Exchange

6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock

New York Stock Exchange

8.125% Series H Cumulative Redeemable Preferred Stock

New York Stock Exchange

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions 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 Act). Yes No

At June 30, 2018, the aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$11.9 billion, based on the closing sales price of the registrant's common stock on such date as reported on the New York Stock Exchange.

The number of shares of the registrant's Common Stock outstanding on January 31, 2019 was 1,400,060,337.

#### DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2018. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC.  
 2018 FORM 10-K ANNUAL REPORT  
 TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>Item 1.</u> <u>Business</u>	<u>1</u>
<u>Item 1A.</u> <u>Risk Factors</u>	<u>11</u>
<u>Item 1B.</u> <u>Unresolved Staff Comments</u>	<u>42</u>
<u>Item 2.</u> <u>Properties</u>	<u>42</u>
<u>Item 3.</u> <u>Legal Proceedings</u>	<u>43</u>
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	<u>43</u>
<u>PART II</u>	
<u>Item 5.</u> <u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>44</u>
<u>Item 6.</u> <u>Selected Financial Data</u>	<u>46</u>
<u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>47</u>
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>87</u>
<u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>	<u>87</u>
<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>87</u>
<u>Item 9A.</u> <u>Controls and Procedures</u>	<u>87</u>
<u>Item 9B.</u> <u>Other Information</u>	<u>91</u>
<u>PART III</u>	
<u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</u>	<u>92</u>
<u>Item 11.</u> <u>Executive Compensation</u>	<u>92</u>
<u>Item 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>92</u>
<u>Item 13.</u> <u>Certain Relationships and Related Transactions and Director Independence</u>	<u>93</u>
<u>Item 14.</u> <u>Principal Accounting Fees and Services</u>	<u>93</u>
<u>PART IV</u>	
<u>Item 15.</u> <u>Exhibits, Financial Statement Schedules</u>	<u>94</u>
<u>Exhibit Index</u>	<u>94</u>
<u>Item 16.</u> <u>Form 10-K Summary</u>	<u>97</u>
<u>Financial Statements</u>	<u>98</u>
<u>Signatures</u>	<u>II-1</u>

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

PART I

ITEM 1. BUSINESS

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

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

The following description of our business should be read in conjunction with the Consolidated Financial Statements and the related Notes thereto, and the information set forth under the heading “Special Note Regarding Forward-Looking Statements” in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

INDEX TO ITEM 1. BUSINESS

	Page
<u>Business Overview</u>	<u>2</u>
Acquisition of MTGE Investment Corp.	2
<u>Investment Groups</u>	<u>2</u>
<u>Investment Strategy and Capital Allocation Policy</u>	<u>2</u>
<u>Our Portfolio and Capital Allocation</u>	<u>3</u>
<u>Risk Appetite Statement</u>	<u>3</u>
<u>Target Assets</u>	<u>3</u>
<u>Capital Structure and Financing</u>	<u>4</u>
<u>Operating Platform</u>	<u>5</u>
<u>Risk Management</u>	<u>6</u>
<u>Management Agreement</u>	<u>6</u>
<u>Executive Officers</u>	<u>7</u>
<u>Employees</u>	<u>7</u>
<u>Regulatory Requirements</u>	<u>8</u>
<u>Competition</u>	<u>8</u>
<u>Corporate Governance</u>	<u>8</u>
<u>Distributions</u>	<u>9</u>
<u>Available Information</u>	<u>10</u>

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

Business Overview

We are a leading diversified capital manager that invests in and finances residential and commercial assets. Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments and continuous management of our portfolio. We are a Maryland corporation founded in 1997 that has elected to be taxed as a real estate investment trust (“REIT”). We are externally managed by Annaly Management Company LLC (“Manager”). Our common stock is listed on the New York Stock Exchange under the symbol “NLY.”

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

Acquisition of MTGE Investment Corp.

As previously disclosed in our filings with the Securities Exchange Commission (“SEC”), the acquisition of MTGE Investment Corp. (“MTGE” and such acquisition, the “MTGE Acquisition”), an externally managed hybrid mortgage REIT, closed on September 7, 2018 for an aggregate consideration to MTGE common stockholders of \$906.2 million, consisting of \$455.9 million in equity consideration and \$450.3 million in cash consideration. Annaly issued 43.6 million common shares as part of the consideration for the MTGE Acquisition.

Refer to the note titled “Acquisition of MTGE Investment Corp.” located in Item 15. “Exhibits, Financial Statement Schedules” for additional details.

Investment Groups

Our investment groups are comprised of the following:

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

We have made significant investments in our business as part of the diversification of our investment strategy. Our operating platform has expanded in support of our diversification strategy, and has included investments in systems, infrastructure and personnel. Our operating platform supports our investments in Agency assets as well as residential credit assets, commercial real estate, residential mortgage loans, mortgage servicing rights (“MSRs”), and corporate loans. The diversity of our investment alternatives provides us the flexibility to adapt to changes in market conditions and to take advantage of potential resulting opportunities.

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

Investment Strategy and Capital Allocation Policy

We seek to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments and continuous management of our portfolio. Under our capital allocation policy, subject to oversight by our board of directors (“Board”), we may allocate our investments within our target asset classes as we determine to be appropriate from time to time.

Our Board may adopt changes to our capital allocation policy and targeted assets at its discretion.

The nature of our assets and our operations are intended to meet our REIT qualification requirements and our exemption from registration as an investment company under the Investment Company Act of 1940, as amended (“Investment Company Act”).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

Our Portfolio and Capital Allocation

Our portfolio composition and capital allocation at December 31, 2018 and 2017 were as follows:

Investment Group	December 31, 2018		December 31, 2017	
	Percentage of Portfolio	Capital Allocation <sup>(1)</sup>	Percentage of Portfolio	Capital Allocation <sup>(1)</sup>
Residential				
Annaly Agency Group <sup>(2)</sup>	89%	72%	91%	76%
Annaly Residential Credit Group <sup>(3)</sup>	4%	10%	3%	11%
Commercial				
Annaly Commercial Real Estate Group <sup>(3)</sup>	5%	7%	5%	8%
Annaly Middle Market Lending Group	2%	11%	1%	5%

<sup>(1)</sup> Capital allocation represents the percentage of equity allocated to each category.

<sup>(2)</sup> Includes MSRs.

<sup>(3)</sup> Includes assets transferred or pledged to securitization vehicles.

Risk Appetite

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

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

Risk Parameter	Description
Portfolio composition	We will maintain a portfolio comprised of target assets approved by our Board and in accordance with our capital allocation policy.
Leverage	We generally expect to maintain an economic leverage ratio no greater than 10:1.
Liquidity risk	We will seek to maintain an unencumbered asset portfolio sufficient to meet our liquidity needs even under adverse market conditions.
Interest rate risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements utilizing derivative instruments targeting both income generation and capital preservation.
Credit risk	We will seek to manage credit risk by making investments which conform within our specific investment policy parameters and optimize risk-adjusted returns.
Capital preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

Our Board has reviewed and approved the investment and operating policies and strategies that support our risk appetite statement established by our Manager and set forth in this Form 10-K. Our Board has the power to modify or waive these policies and strategies to the extent that our Board, in its discretion, determines that the modification or waiver is in the best interests of our stockholders. Among other factors, market developments which affect our policies and strategies or which change our assessment of the market may cause our Board to revise our policies and strategies.

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

opportunities.

Target Assets

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

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

- The liquidity of the asset;

- The ability to pledge the asset to secure collateralized borrowings;

3

---



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

- When applicable, the credit of the underlying borrower;
- The costs of financing, hedging and managing the asset;

- The impact of the asset to our REIT compliance and our exemption from registration under the Investment Company Act; and
- The capital requirements associated with the purchase and financing of the asset.

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

Investment Group	Targeted Asset Class	Description
	Agency mortgage-backed securities	Agency pass-through certificates issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae. Other Agency MBS include collateralized mortgage obligations (“CMOs”), interest-only securities and inverse floaters
Annaly Agency Group	To-be-announced forward contracts (“TBAs”)	Forward contracts for Agency pass-through certificates
	Agency commercial mortgage-backed securities	Pass-through certificates collateralized by commercial mortgages guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae
	Mortgage Servicing Rights (“MSRs”)	Rights to service a pool of residential loans in exchange for a portion of the interest payments made on the loans
	Residential mortgage loans	Residential mortgage loans that are not guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae
Annaly Residential Credit Group	Residential mortgage-backed securities	Securities collateralized by pools of residential loans that are not guaranteed by one of the Agencies
	Agency or private label credit risk transfer securities (“CRT”)	Risk sharing transactions issued by Freddie Mac and Fannie Mae and similarly structured transactions arranged by third party market participants, designed to synthetically transfer mortgage credit risk to private investors
	Commercial mortgage loans	Loans collateralized by commercial real estate properties
Annaly Commercial Real Estate Group	Commercial mortgage-backed securities	Securities collateralized by pools of commercial mortgage loans
	Mezzanine loans	Loans collateralized by commercial real estate properties subordinate to first mortgage loans
	Real property	Commercial real estate properties that generate current cash flow
Annaly Middle Market Lending Group	First lien middle market loans	Senior secured loans made to middle market companies that are the first to be repaid in the event of a borrower default
	Second lien middle market loans	Senior secured loans to middle market companies that have a junior claim on collateral to those of first lien loans

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

Capital Structure and Financing

Our capital structure is designed to offer an efficient complement of funding sources to generate positive risk-adjusted returns for our stockholders while maintaining appropriate liquidity to support our business and meet our financial obligations under periods of market stress. To maintain our desired capital profile, we utilize a mix of debt and equity funding. Debt funding may include the use of repurchase agreements, Federal Home Loan Bank (“FHLB”) advances, loans, securitizations, participation sold, lines of credit, asset backed lending facilities, corporate bond issuance, convertible bonds, mortgages payable or other liabilities. Equity capital primarily consists of common and preferred stock.

We finance our Agency mortgage-backed securities and residential credit investments primarily with repurchase agreements. We also finance certain commercial real estate investments with repurchase agreements. We seek to diversify our exposure and limit concentrations by entering into repurchase agreements with multiple counterparties. We enter into repurchase agreements with national broker-dealers, commercial banks and other lenders that typically offer this type of financing. We enter into collateralized borrowings with financial institutions meeting internal credit standards and we monitor the financial condition of these institutions on a regular basis. At December 31, 2018, we had \$81.1 billion of repurchase agreements outstanding.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

Additionally, our wholly-owned subsidiary, Arcola Securities, Inc. (“Arcola”), provides direct access to bilateral and triparty funding as a FINRA member broker-dealer. As an eligible institution, Arcola also raises funds through the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation (“FICC”), with FICC acting as the central counterparty. Since its inception in 2008, Arcola has provided us greater depth and diversity of repurchase agreement funding while also limiting our counterparty exposure.

To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements. At December 31, 2018, the weighted average days to maturity was 77 days.

We maintain access to FHLB funding through our captive insurance subsidiary Truman Insurance Company LLC (“Truman”). We finance eligible Agency, residential and commercial investments through the FHLB. While a January 2016 Federal Housing Finance Agency (“FHFA”) ruling requires captive insurance companies to terminate their FHLB membership, given the length of its membership, Truman has been granted a five year sunset provision whereby its membership is scheduled to expire in February 2021. We believe our business objectives align well with the mission of the FHLB System. While there can be no assurances that such steps will be taken, we believe it would be appropriate for there to be legislative action to permit Truman and similar captive insurance subsidiaries to retain their membership status beyond the current sunset period.

We utilize diverse funding sources to finance our commercial investments. In addition to FHLB funding, we may utilize bilateral borrowing facilities, securitization funding and, in the case of equity investments in commercial real estate, mortgage financing.

We utilize leverage to enhance the risk-adjusted returns generated for our stockholders. We generally expect to maintain an economic leverage ratio of no greater than 10:1. This ratio varies from time to time based upon various factors, including our management’s opinion of the level of risk of our assets and liabilities, our mix of assets, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and, lastly, our assessment of domestic and international market conditions. Since the financial crisis beginning in 2007, we have maintained an economic leverage ratio below 8:1, which is generally lower than our leverage ratio had been prior to 2007. For purposes of calculating this ratio, our economic leverage ratio is equal to the sum of Recourse Debt, TBA derivative and CMBX notional outstanding and net forward purchases (sales) of investments divided by total equity.

Our target economic leverage ratio is determined under our capital management policy. Should our actual economic leverage ratio increase above the target level, we will consider appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

The following table presents our leverage, economic leverage and capital ratios as of the periods presented.

	December 31, 2018	December 31, 2017
Leverage ratio	6.3:1	5.7:1
Economic leverage ratio	7.0:1	6.6:1
Capital ratio	12.1%	12.9%

#### Operating Platform

We maintain a flexible and scalable operating platform to support the management and maintenance of our diverse asset portfolio. We have invested in our infrastructure to enhance resiliency, efficiency, cybersecurity, and leveragability while also ensuring coverage of our target assets. Our information technology applications span the portfolio life-cycle including pre-trade analysis, trade execution and capture, trade settlement and financing, monitoring, and financial accounting and reporting.

Technology applications also support our control functions including risk, compliance, middle- and back-office functions. We have added breadth to our operating platform to accommodate diverse asset classes and drive automation-based efficiencies. Our business operations include a centralized collateral management function that permits in-house settlement and self-clearing, thereby creating greater control and management of our collateral.

Through technology, we have also incorporated exception based processing, critical data assurance and paperless workflows. Our infrastructure investment has driven operating efficiencies while expanding the platform. Routine disaster recovery and penetration testing enhances our systems resiliency, security and recovery of critical systems throughout the computing estate.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

Risk Management

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

Management Agreement

We have entered into a management agreement with the Manager pursuant to which our management is conducted by the Manager through the authority delegated to it in the Management Agreement and pursuant to the policies established by our Board (the “Externalization”). The Management Agreement was effective as of July 1, 2013 and was amended on November 5, 2014 and amended and restated on April 12, 2016 and August 1, 2018 (the management agreement, as amended and restated, is referred to as the “Management Agreement”).

The Management Agreement’s current term ends on December 31, 2019 and will automatically renew for successive two-year terms unless at least two-thirds of our independent directors or the holders of a majority of our outstanding shares of common stock elect to terminate the agreement in their sole discretion and for any or no reason. At any time during the term or any renewal term we may deliver to the Manager written notice of our intention to terminate the Management Agreement upon 365 days notice (such notice, a “Termination Notice”). During any period between the date we deliver a Termination Notice (the “Notice Delivery Date”) and the date designated by us as the date on which the Manager shall cease to provide management services (the “Termination Date”), the Manager shall continue to perform its duties and obligations under the Management Agreement and cooperate with us to execute an orderly transition to a new manager. If we elect to terminate the Management Agreement, we may elect to accelerate the Termination Date to a date that is between seven and 90 days after the Notice Delivery Date. If we do not elect to do so, then the Manager may elect to accelerate the Termination Date to the date that is 90 days after the Notice Delivery Date. If the Termination Date is accelerated (such date, the “Accelerated Termination Date”) by either us or the Manager, we shall pay the Manager an acceleration fee (the “Acceleration Fee”) in an amount equal to the average annual management fee earned by the Manager during the 24-month period immediately preceding such Accelerated Termination Date multiplied by a fraction with a numerator of 365 minus the number of days from the Notice Delivery Date to the Accelerated Termination Date, and a denominator of 365. The Management Agreement also provides that the Manager may terminate the Management Agreement by providing to us prior written notice of its intention to terminate the Management Agreement no less than 365 days prior to the date designated by the Manager on which the Manager would cease to provide services or such earlier date as determined by us in our sole discretion. Under the Management Agreement, the Manager, subject to the supervision and direction of our Board, is responsible for (i) the selection, purchase and sale of assets for our investment portfolio; (ii) recommending alternative forms of capital raising; (iii) supervising our financing and hedging activities; and (iv) day to day management functions. The Manager also performs such other supervisory and management services and activities relating to our assets and operations as may be appropriate. In exchange for the management services, we pay the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of our stockholders’ equity (as defined in the Management Agreement), and the Manager is responsible for providing personnel to manage us and paying all compensation and benefit expenses associated with such personnel. We do not pay the Manager any incentive fees. In addition to the management fee, in August 2018, the Company began reimbursing the Manager for the cost of certain legal, tax, accounting and other support and advisory services provided by employees of the Manager to the Company. Such reimbursements are permitted pursuant to the terms of the Management Agreement provided the related costs are no greater than those that would be payable to comparable third party providers.

The Management Agreement provides that during the term of the Management Agreement and, in the event of termination of this Agreement by the Manager without cause, for a period of one year following such termination, the

Manager will not, without our prior written consent, manage, operate, join, control, participate in, or advise any person other than us without the prior written consent of the Risk Committee of the Board.

The Management Agreement may be amended or modified by agreement between us and the Manager.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

## Executive Officers

Our executive officers are provided and compensated by our Manager. We do not employ or compensate our executive officers. The following table sets forth certain information as of January 31, 2019 concerning our executive officers:

Name	Age	Title
Kevin G. Keyes	51	Chairman, Chief Executive Officer and President
Glenn A. Votek	60	Chief Financial Officer
David L. Finkelstein	46	Chief Investment Officer
Timothy P. Coffey	45	Chief Credit Officer
Anthony C. Green	44	Chief Corporate Officer, Chief Legal Officer and Secretary

Kevin G. Keyes serves as Annaly's Chairman, Chief Executive Officer and President. Mr. Keyes has served as Chairman since January 2018, Chief Executive Officer since September 2015 and President since October 2012. Previously, Mr. Keyes served as Chief Strategy Officer and Head of Capital Markets of Annaly from September 2010 until October 2012. Prior to joining Annaly as a Managing Director in 2009, Mr. Keyes worked for 20 years in senior Investment Banking and Capital Markets roles. From 2005 - 2009, Mr. Keyes served in senior management and business origination roles in the Global Capital Markets and Banking Group at Bank of America Merrill Lynch. Prior to that, from 1997 - 2005 he worked at Credit Suisse First Boston in various Capital Markets Origination roles, and from 1990 - 1997 at Morgan Stanley Dean Witter in the Mergers and Acquisitions Group and Real Estate Investment Banking Group. Mr. Keyes is a member of the University of Notre Dame's Campaign Cabinet, the President's Circle, the Student-Athlete Advisory Council and the Jesse Harper Council, as part of the Rockne Athletics Fund. He is a member of the Wall Street Journal's CEO Council and serves on the Board of Directors of the Rock and Roll Forever Foundation. Mr. Keyes holds a B.A. in Economics and a B.S. in Business Administration (ALPA Program) from the University of Notre Dame.

Glenn A. Votek has served as Chief Financial Officer of Annaly since August 2013. Mr. Votek also served as Chief Financial Officer of Fixed Income Discount Advisory Company ("FIDAC"), a former wholly-owned subsidiary of the Company, from August 2013 until October 2015. Mr. Votek joined Annaly in May 2013 from CIT Group where he had been an Executive Vice President and Treasurer since 1999 and President of Consumer Finance since 2012. Prior to that, Mr. Votek worked at AT&T and its finance subsidiary from 1986 until 1999 in various financial management roles. Mr. Votek has a B.S. in Finance and Economics from the University of Arizona/Kean College and a M.B.A. in Finance from Rutgers University.

David L. Finkelstein has served as Chief Investment Officer of Annaly since November 2016. Mr. Finkelstein previously served as Annaly's Chief Investment Officer, Agency and RMBS beginning in February 2015 and as Annaly's Head of Agency Trading beginning in August 2013. Prior to joining Annaly in 2013, Mr. Finkelstein served for four years as an Officer in the Markets Group of the Federal Reserve Bank of New York where he was the primary strategist and policy advisor for the MBS purchase program. Mr. Finkelstein has over 20 years of experience in fixed income investment. Prior to the Federal Reserve Bank of New York, Mr. Finkelstein held Agency MBS trading positions at Salomon Smith Barney, Citigroup Inc. and Barclays PLC. Mr. Finkelstein received his B.A. in Business Administration from the University of Washington and his M.B.A. from the University of Chicago, Booth School of Business. Mr. Finkelstein also holds the Chartered Financial Analyst® designation.

Timothy P. Coffey has served as Chief Credit Officer of Annaly since January 2016. Mr. Coffey served as Annaly's Head of Middle Market Lending from 2010 until January 2016. Mr. Coffey has over 20 years of experience in leveraged finance and has held a variety of origination, execution, structuring and distribution positions. Prior to joining Annaly in 2010, Mr. Coffey served as Managing Director and Head of Debt Capital Markets in the Leverage Finance Group at Bank of Ireland. Prior to that, Mr. Coffey held positions at Scotia Capital, the holding company of Saul Steinberg's Reliance Group Holdings, and SC Johnson International. Mr. Coffey received his B.A. in Finance from Marquette University.

Anthony C. Green has served as Chief Corporate Officer of Annaly since January 2019 and as Chief Legal Officer and Secretary of Annaly since March 2017. Mr. Green previously served as Annaly's Deputy General Counsel from 2009 until February 2017. Prior to joining Annaly, Mr. Green was a partner in the Corporate, Securities, Mergers & Acquisitions Group at the law firm K&L Gates LLP. Mr. Green has over 18 years of experience in corporate and securities law. Mr. Green holds a B.A. in Economics and Political Science from the University of Pennsylvania and a J.D. and LL.M. in International and Comparative Law from Cornell Law School.

#### Employees

Effective July 1, 2013, all of Annaly's employees were terminated by us and were hired by the Manager. However, a limited number of employees of our subsidiaries remain as employees of our subsidiaries for regulatory or corporate efficiency reasons.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

At December 31, 2018, our subsidiaries had 8 employees and the Manager had 162 employees. For information about the management fee, see the discussion in the “Management Agreement” section.

**Regulatory Requirements**

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

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

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

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

**Competition**

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

**Corporate Governance**

We strive to conduct our business in accordance with the highest ethical standards and in compliance with applicable governmental laws, rules and regulations. In 2018, our Board made a number of significant corporate governance enhancements further aligning the Company’s interests with those of our stockholders. These enhancements included the amendment of the Company’s bylaws to declassify our Board over a three-year period beginning with the Company’s annual meeting of stockholders in 2019, with all directors standing for annual election by the Company’s annual meeting of stockholders in 2021. Our Board also adopted an enhanced director refreshment policy, which provides that an independent director may not stand for re-election at the next annual meeting of stockholders taking place at the end of his or her term following the earlier of his or her: (i) 12<sup>th</sup> anniversary of service on our Board or (ii) 73<sup>rd</sup> birthday. Other notable governance practices and policies include:

• Our Board is composed of a majority of independent directors, and our Audit, Compensation and Nominating/Corporate Governance Committees are composed exclusively of independent directors.

Our independent directors annually select an independent director to serve as lead independent director, although the lead independent director is generally expected to serve more than one year.

• We have adopted a Code of Business Conduct and Ethics, which sets forth the basic principles and guidelines for resolving various legal and ethical

questions that may arise in the workplace and in the conduct of our business. This code is applicable to our directors, officers and employees as well as those of our Manager and subsidiaries.

• We have adopted Corporate Governance Guidelines which, in conjunction with the charters of our Board committees, provide the framework for the governance of our company.

• We have procedures by which any of our employees, including employees of our Manager as well as those of our subsidiaries, officers or directors may raise concerns

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

confidentially about our company's conduct, accounting, internal controls or auditing matters with the lead independent director, the independent directors, or the chair of the Audit Committee or through our company's whistleblower phone hotline or e-mail inbox.

We have an Insider Trading Policy that prohibits our directors, officers and employees, including employees of our Manager, as well as those of our subsidiaries from buying or selling our securities on the basis of material nonpublic information and prohibits communicating material nonpublic information about our company to others. Our Insider Trading Policy prohibits our officers

and employees, from (1) pledging our stock as collateral for a loan or (2) engaging in any hedging transactions with respect to our equity securities held by them.

Our Board has instituted expansive employee stock ownership guidelines, pursuant to which more than 40% of our employees, including employees of our Manager, as well as those of our subsidiaries, are asked to purchase predetermined amounts of Company common stock in the open market.

#### Distributions

In accordance with the requirements for maintaining REIT status, we intend to distribute to stockholders aggregate dividends equaling at least 90% of our REIT taxable income (determined without regard to the deduction of dividends paid and by excluding any net capital gain) for each taxable year and will endeavor to distribute at least 100% of our REIT taxable income so as not to be subject to tax. Distributions of economic profits from our enterprise could be classified as return of capital due to differences between book and tax accounting rules. We may make additional returns of capital when the potential risk-adjusted returns from new investments fail to exceed our cost of capital. Subject to the limitations of applicable securities and state corporation laws, we can return capital by making purchases of our own capital stock or through payment of dividends.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
ITEM 1. BUSINESS

Available Information

Our website is [www.annaly.com](http://www.annaly.com). We make available on this website under “Investors - SEC Filings,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the “Securities Exchange Act”).

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

Our Investor Relations Department can be contacted at:

Annaly Capital Management, Inc.

1211 Avenue of the Americas

New York, New York 10036

Attn: Investor Relations

Telephone: 888-8ANNALY

E-mail: [investor@annaly.com](mailto:investor@annaly.com)

The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at [www.sec.gov](http://www.sec.gov).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

ITEM 1A. RISK FACTORS

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

INDEX TO ITEM 1A. RISK FACTORS

	Page
<u>Risks Related to Our Investing, Portfolio Management and Financing Activities</u>	<u>11</u>
<u>Risks Related to Our Credit Assets</u>	<u>22</u>
<u>Risks Related To Commercial Real Estate Debt, Preferred Equity Investments, Net Lease Real Estate Assets and Other Equity Ownership of Real Estate Assets</u>	<u>26</u>
<u>Risks Related to Our Residential Credit Business</u>	<u>30</u>
<u>Risks Related to Our Relationship with Our Manager</u>	<u>33</u>
<u>Risks Related to Our Taxation as a REIT</u>	<u>34</u>
<u>Risks of Ownership of Our Common Stock</u>	<u>40</u>
<u>Regulatory Risks</u>	<u>42</u>

Risks Related to Our Investing, Portfolio Management and Financing Activities

We may change our policies without stockholder approval.

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

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

To date, a significant portion of our total assets have consisted of Agency mortgage-backed securities which carry an implied or actual “AAA” rating. Nevertheless, pursuant to the ongoing diversification of our assets, we also acquire assets of lower credit quality.

While we remain committed to the Agency market and have grown our Agency assets, given the current environment, we believe it is prudent to diversify a portion of our investment portfolio. For example, during 2018 we also focused on growth in our three credit businesses, and expect that trend to continue during 2019. We invest in a range of targeted asset classes and continue to explore new business strategies and assets and expect to continue to do so in the future.

Additionally, we may enter into or engage in various types of securitizations, transactions, services and other operating businesses that are different than the types into which we have traditionally entered or engaged.

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



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

Because of our leverage, we may incur substantial losses if our borrowing costs increase. The reasons our borrowing costs may increase include, but are not limited to, the following:

- short-term interest rates increase;
- the market value of our investments decreases;
- the “haircut” applied to our assets under the repurchase agreements or other secured financing arrangements we are party to increases;

- interest rate volatility increases; or
- the availability of financing in the market decreases.

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

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

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

We may exceed our target leverage ratios.

We generally expect to maintain an economic leverage ratio of less than 10:1. However, we are not required to stay below this economic leverage ratio. We may exceed this ratio by incurring additional debt without increasing the amount of equity we have. For example, if we increase the amount of borrowings under our master repurchase agreements with our existing or new counterparties or the market value of our portfolio declines, our economic leverage ratio would increase. If we increase our economic leverage ratio, the adverse impact on our financial condition and results of operations from the types of risks associated with the use of leverage would likely be more severe.

We may not be able to achieve our optimal leverage.

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

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

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

One or more of our lenders could be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. Furthermore, if any of our potential lenders or existing lenders is

unwilling or unable to provide us with financing or if we are not able to renew or replace maturing borrowings, we could be forced to sell our assets at an inopportune time when prices are depressed. Our business, results of operations and financial condition may be materially adversely affected by disruptions in the financial markets. We cannot assure you, under such extreme conditions, that these markets will remain an efficient source of long-term financing for our assets. If our strategy is not viable, we will have to find alternative forms of financing for our assets, which may not be available. Further, as a REIT, we are required to distribute annually at least 90% of our REIT taxable income (subject to certain adjustments) to our stockholders and are, therefore, not able to retain significant amounts of our earnings for new investments. We cannot assure you that any, or sufficient, funding or capital will be available to us in the future on terms that are acceptable to us. If we cannot obtain sufficient funding on acceptable terms, there may be a negative impact on the market price of our common stock and our ability to make distributions to our stockholders. Moreover,



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

our ability to grow will be dependent on our ability to procure additional funding. To the extent we are not able to raise additional funds through the issuance of additional equity or borrowings, our growth will be constrained.

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

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

Risk management policies and procedures may not adequately identify all risks to our businesses.

We have established and maintain risk management policies and procedures designed to support our risk framework, and to identify, measure, monitor and control financial risks. Risks include market risk (interest rate, spread and prepayment), liquidity risk, credit risk and operational risk. These policies and procedures may not sufficiently identify the full range of risks that we are or may become exposed to. Any changes to business activities, including expansion of traded or illiquid products, may result in our being exposed to different risks or an increase in certain risks. Any failure to identify and mitigate financial risks could result in an adverse impact to our financial condition, business or results of operations. Additionally, as regulations and markets in which we operate continue to evolve, our risk management policies and procedures may not always keep sufficient pace with those changes.

An increase or decrease in prepayment rates may adversely affect our profitability.

The mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on the underlying mortgage loans. We often purchase mortgage-backed securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these mortgage-backed securities. In accordance with U.S. generally accepted accounting principles (“GAAP”), we amortize the premiums on our mortgage-backed securities over the expected life of the related mortgage-backed securities. If the mortgage loans securing these mortgage-backed securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis that may adversely affect our profitability.

Defaults on mortgage loans underlying Agency mortgage-backed securities typically have the same effect as prepayments because of the underlying Agency guarantee.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans. While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

Conversely, a decline in prepayment rates on our investments will reduce the amount of principal we receive and therefore reduce the amount of cash we otherwise could have reinvested in higher yielding assets at that time, which could negatively impact our future operating results.

We are subject to reinvestment risk.

We also are subject to reinvestment risk as a result of changes in interest rates. Declines in interest rates are generally accompanied by increased prepayments of mortgage loans, which in turn results in a prepayment of the related mortgage-backed securities. An increase in prepayments could result in the reinvestment of the proceeds we receive from such prepayments into lower yielding assets.

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

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

Significant adverse changes in financial market conditions can result in a deleveraging of the global financial system and the forced sale of large quantities of mortgage-related and other financial assets. Concerns over economic recession, geopolitical issues including events such as the United Kingdom's decision to exit from the European Union, (commonly referred to as "Brexit"), unemployment, the availability and cost of financing, the mortgage market and a declining real estate market or prolonged government shutdown may contribute to increased volatility and diminished expectations for the economy and markets.

For example, as a result of the financial market conditions beginning in the summer of 2007 and through the subsequent credit and housing crisis, many traditional mortgage investors suffered severe losses in their residential mortgage portfolios and several major market participants failed or were impaired, resulting in a significant contraction in market liquidity for mortgage-related assets. This illiquidity negatively affected both the terms and availability of financing for all mortgage-related assets.

Further increased volatility and deterioration in the markets for mortgages and mortgage-related assets as well as the broader financial markets may adversely affect the performance and market value of our Agency mortgage-backed securities. If these conditions exist, institutions from which we seek financing for our investments may tighten their lending standards or become insolvent, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability and financial condition may be adversely affected if we are unable to obtain cost-effective financing for our investments.

Competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these assets.

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

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

We generally earn money based upon the spread between the interest payments we earn on our interest earning assets and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our interest earning assets, our profitability may be adversely affected. A significant portion of our assets are longer-term, fixed-rate interest earning assets, and a significant portion of our borrowings are shorter-term, floating-rate borrowings. Periods of rising interest rates or a relatively flat or inverted yield curve could decrease or eliminate the spread between the interest payments we earn on our interest earning assets and the interest

payments we must make on our borrowings.

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

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

• **LIBOR.** The rate banks charge each other for short-term Eurodollar loans.

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

• **Secured Overnight Financing Rate.** A measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities, as published by the Federal Reserve Bank of New York.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

These indices generally reflect short-term interest rates. The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate interest earning assets, which are also typically subject to periodic and lifetime interest rate caps. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate interest earning assets.

Changes in banks' inter-bank lending rate reporting practices or the method pursuant to which LIBOR is determined may adversely affect the value of the financial obligations to be held or issued by us that are linked to LIBOR. LIBOR and other indices which are deemed "benchmarks" are the subject of recent national, international, and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause such benchmarks to perform differently than in the past, or have other consequences which cannot be predicted. In particular, regulators and law enforcement agencies in the U.K. and elsewhere conducted criminal and civil investigations into whether the banks that contributed information to the British Bankers' Association ("BBA") in connection with the daily calculation of LIBOR may have been under-reporting or otherwise manipulating or attempting to manipulate LIBOR. A number of BBA member banks have entered into settlements with their regulators and law enforcement agencies with respect to this alleged manipulation of LIBOR. LIBOR is calculated by reference to a market for interbank lending that continues to shrink, as its based on increasingly fewer actual transactions. This increases the subjectivity of the LIBOR calculation process and increases the risk of manipulation. Actions by the regulators or law enforcement agencies, as well as ICE Benchmark Administration (the current administrator of LIBOR), may result in changes to the manner in which LIBOR is determined or the establishment of alternative reference rates. For example, on July 27, 2017, the U.K. Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021.

It is likely that, over time, U.S. Dollar LIBOR will be replaced by the Secured Overnight Financing Rate ("SOFR") published by the Federal Reserve Bank of New York. However, the manner and timing of this shift is currently unknown. SOFR is an overnight rate instead of a term rate, making SOFR an inexact replacement for LIBOR. There is currently no perfect way to create robust, forward-looking, SOFR term rates. Market participants are still considering how various types of financial instruments and securitization vehicles should react to a discontinuation of LIBOR. It is possible that not all of our assets and liabilities will transition away from LIBOR at the same time, and it is possible that not all of our assets and liabilities will transition to the same alternative reference rate, in each case increasing the difficulty of hedging. Switching existing financial instruments and hedging transactions from LIBOR to SOFR requires calculations of a spread. Industry organizations are attempting to structure the spread calculation in a manner that minimizes the possibility of value transfer between counterparties, borrowers, and lenders by virtue of the transition, but there is no assurance that the calculated spread will be fair and accurate or that all asset types and all types of securitization vehicles will use the same spread. We and other market participants have less experience understanding and modeling SOFR-based assets and liabilities than LIBOR-based assets and liabilities, increasing the difficulty of investing, hedging, and risk management. The process of transition involves operational risks. It is also possible that no transition will occur for many financial instruments, meaning that those instruments would continue to be subject to the weaknesses of the LIBOR calculation process. At this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be implemented. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the market for or value of any securities on which the interest or dividend is determined by reference to LIBOR, loans, derivatives and other financial obligations or on our overall financial condition or results of operations. More generally, any of the above changes or any other consequential changes to LIBOR or any other "benchmark" as a result of international, national or other proposals for reform or other initiatives or investigations, or any further uncertainty in relation to the timing and manner of implementation of such changes, could have a material

adverse effect on the value of and return on any securities based on or linked to a “benchmark.”

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

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

The soundness of other financial institutions could adversely affect us.

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

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

Our policies permit us to enter into interest rate swaps, caps and floors, interest rate swaptions, U.S. Treasury futures and other derivative transactions to help us mitigate our interest rate and prepayment risks described above subject to maintaining our qualification as a REIT and our 40 Act exemption. We have used interest rate swaps and options to enter into interest rate swaps (commonly referred to as interest rate swaptions) to provide a level of protection against interest rate risks. We may also purchase or sell TBAs on Agency mortgage-backed securities, purchase or write put or call options on TBAs and invest in other types of mortgage derivatives, such as interest-only securities. No hedging strategy can protect us completely. Entering into interest rate hedging may fail to protect or could adversely affect us because, among other things: interest rate hedging can be expensive, particularly during periods of volatile interest rates; available hedges may not correspond directly with the risk for which protection is sought; and the duration of the hedge may not match the duration of the related asset or liability. The expected transition from LIBOR to alternative reference rates adds additional complication to our hedging strategies.

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

The Dodd-Frank Act, and regulations under it, have caused significant changes to the structure of the market for interest rate swaps and swaptions. These new structures change, but do not eliminate, the risks we face in our hedging activities.

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

Most swaps must be cleared through a DCO. Most swaps must be or are traded on a Swap Execution Facility. We bear additional fees for use of the DCO. We also bear fees for use of the Swap Execution Facility. We continue to bear risk of trade errors. Because the standardized swaps available on Swap Execution Facilities and cleared through DCOs are

not as customizable as the swaps available before the implementation of Dodd-Frank Act, we may bear additional basis risk from hedge positions that do not exactly reflect the interest rate risk on the asset being hedged.

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

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



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

It is possible that new regulations could be issued governing the derivatives market, or that additional types of derivatives switch to being executed on Swap Execution Facilities or cleared on a DCO. Ongoing regulatory change in this area could increase costs, increase risks, and adversely affect our business and results of operations.

It may be uneconomical to "roll" our TBA dollar roll transactions or we may be unable to meet margin calls on our TBA contracts, which could negatively affect our financial condition and results of operations.

From time to time, we enter into TBAs as an alternate means of investing in and financing Agency mortgage-backed securities. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency mortgage-backed security with a specified issuer, term and coupon. A TBA dollar roll represents a transaction where TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the "drop". The drop is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, that would be foregone as a result of settling the contract in the later month rather than in the earlier month. The drop between the current settlement month price and the forward settlement month price occurs because in the TBA dollar roll market, the party providing the implied financing is the party that would retain all principal and interest payments accrued during the financing period. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost. Consequently, dollar roll transactions and such forward purchases of Agency securities represent a form of off-balance sheet financing and increase our "at risk" leverage.

The economic return of a TBA dollar roll generally equates to interest income on a generic TBA-eligible security less an implied financing cost, and there may be situations in which the implied financing cost exceeds the interest income, resulting in a negative carry on the position. If we roll our TBA dollar roll positions when they have a negative carry, the positions would decrease net income and amounts available for distributions to shareholders.

There may be situations in which we are unable or unwilling to roll our TBA dollar roll positions. The TBA transaction could have a negative carry or otherwise be uneconomical, we may be unable to find counterparties with whom to trade in sufficient volume, or we may be required to collateralize the TBA positions in a way that is uneconomical. Because TBA dollar rolls represent implied financing, an inability or unwillingness to roll has effects similar to any other loss of financing. If we do not roll our TBA positions prior to the settlement date, we would have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. Counterparties may also make margin calls as the value of a generic TBA-eligible security (and therefore the value of the TBA contract) declines. Margin calls on TBA positions or failure to roll TBA positions could have the effects described in the liquidity risks described above.

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

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

Some of the risks of relying on analytical models and third-party data are particular to analyzing tranches from securitizations, such as commercial or residential mortgage-backed securities. These risks include, but are not limited to, the following: (i) collateral

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral or bond historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (e.g., different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); or (iv) collateral or bond information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

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

Many of the models we use include LIBOR as an input. The expected transition away from LIBOR may require changes to models, may change the underlying economic relationships being modeled, and may require the models to be run with less historical data than is currently available for LIBOR.

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

Accounting rules related to certain of our transactions are highly complex and involve significant judgment and assumptions, and changes in accounting treatment may adversely affect our profitability and impact our financial results. Additionally, our application of GAAP may produce financial results that fluctuate from one period to another. Accounting rules for valuations of investments, mortgage loan sales and securitizations, investment consolidations, acquisitions of real estate and other aspects of our operations are highly complex and involve significant judgment and assumptions. These complexities could lead to a delay in preparation of financial information and the delivery of this information to our stockholders. Changes in accounting interpretations or assumptions could impact our financial statements and our ability to prepare our financial statements in a timely fashion. Our inability to prepare our financial statements in a timely fashion in the future would likely adversely affect our share price significantly. The fair value at which our assets may be recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset was recorded. Accordingly, the value of our common shares could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time. We have made certain accounting elections which may result in volatility in our periodic net income, as computed in accordance with GAAP. For example, changes in fair value of certain instruments are reflected in GAAP net income (loss) while others are reflected in Other comprehensive income (loss).

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

Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, including mortgage-backed securities trading activities. A disruption or breach could also lead to unauthorized access to and release, misuse, loss or destruction of our confidential information or personal or confidential information of our employees or third parties, which could lead to regulatory fines, costs of remediating the breach, reputational harm, financial losses, litigation and increased difficulty doing business with third parties that rely on us to meet their own data protection requirements. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective systems experience failure, interruption, cyber-attacks, or security breaches. We may face increased costs as we continue to evolve our cyber defenses in order to contend with changing risks. These costs and losses associated with these risks are difficult to predict and quantify, but could have a significant adverse effect on our operating results. Additionally,

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

the legal and regulatory environment surrounding information privacy and security in the U.S. and international jurisdictions is constantly evolving.

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

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

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

While we would intend to retain the non-investment grade tranches of securitizations and, therefore, still have exposure to any assets included in such securitizations, our inability to enter into such securitizations would increase our overall exposure to risks associated with direct ownership of such assets, including the risk of default. Our inability to refinance any short-term facilities would also increase our risk because borrowings thereunder would likely be recourse to us as an entity. If we are unable to obtain and renew short-term facilities or to consummate securitizations to finance our assets on a long-term basis, we may be required to seek other forms of potentially less attractive financing or to liquidate assets at an inopportune time or price. To the extent that we are unable to obtain financing for our assets, to the extent that we retain such assets in our portfolio, our returns on investment and earnings will be negatively impacted.

Securitizations expose us to additional risks.

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

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

If or when we obtain debt financing, lenders (especially in the case of credit facilities) may impose restrictions on us that would affect our ability to incur additional debt, make certain allocations or acquisitions, reduce liquidity below certain levels, make distributions to our stockholders, or redeem debt or equity securities, and may impact our flexibility to determine our operating policies and strategies. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. A default and resulting repayment acceleration could significantly reduce our liquidity, which could require us to sell our assets to repay amounts due and outstanding. This could also significantly harm our business, financial condition, results of operations and ability

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

to make distributions, which could cause our share price to decline. A default could also significantly limit our financing alternatives such that we would be unable to pursue our leverage strategy, which could adversely affect our returns.

Final rules issued by the FHFA relating to captive insurance company membership in the FHLB System prohibit us from taking new advances or renewing existing advances that mature beyond February 19, 2021.

On January 12, 2016, the FHFA issued final rules (“FHFA Final Rules”) providing that captive insurance companies will no longer be eligible for membership in the FHLB System. Because our wholly-owned subsidiary Truman was admitted as a member of the FHLB of Des Moines (“FHLB Des Moines”) prior to September 2014, it is eligible under the FHFA Final Rules to remain as a member of the FHLB Des Moines through February 19, 2021. In addition, under the FHFA Final Rules, the FHLB Des Moines is permitted to allow advances that were outstanding prior to February 19, 2016 to remain outstanding until scheduled maturity, however we are not permitted to increase our existing FHLB advances. It is possible for Congress or the FHFA to change the FHFA Final Rules, but there is no assurance that they will do so. We may be forced to find alternative financing for assets currently financed with FHLB Des Moines, which could result in increased financing cost; a decreased weighted average duration of liabilities; and an increase in risks described above related to securitizations, credit facilities, and other types of borrowings. Some of the assets in which we currently invest may become uneconomical if financing from FHLB Des Moines is no longer available, and we may choose to exit certain investment strategies. Many of the assets currently financed with FHLB Des Moines are expected to remain outstanding past the date on which advances are no longer available.

We may enter into new lines of business, acquire other companies or engage in other strategic initiatives, each of which may result in additional risks and uncertainties in our businesses.

We may pursue growth through acquisitions of other companies or other strategic initiatives. To the extent we pursue strategic investments or acquisitions, undertake other strategic initiatives or consider new lines of business, we will face numerous risks and uncertainties, including risks associated with:

- the availability of suitable opportunities;
- the level of competition from other companies that may have greater financial resources;
- our ability to assess the value, strengths, weaknesses, liabilities and potential profitability of potential acquisition opportunities accurately and negotiate acceptable terms for those opportunities;
- the required investment of capital and other resources;
- the lack of availability of financing and, if available, the terms of any financings;
- the possibility that we have insufficient expertise to engage in such activities profitably or without incurring inappropriate amounts of risk;
- the diversion of management’s attention from our core businesses;
- the potential loss of key personnel of an acquired business;
  
- assumption of liabilities in any acquired business;
- the disruption of our ongoing businesses;
- the increasing demands on or issues related to the combining or integrating operational and management systems and controls;
- compliance with additional regulatory requirements;
- costs associated with integrating and overseeing the operations of the new businesses;
- failure to realize the full benefits of an acquisition, including expected synergies, cost savings, or sales or growth opportunities, within the anticipated timeframe or at all; and
- post-acquisition deterioration in an acquired business that could result in lower or negative earnings contribution and/or goodwill impairment charges.

Entry into certain lines of business may subject us to new laws and regulations with which we are not familiar, or from which we are currently exempt, and may lead to increased litigation and regulatory risk. Our strategy to increase investments in a line of business, such as our middle market lending, residential credit or commercial real estate business, may lead to additional risks and uncertainties. In addition, if a new or acquired business generates insufficient revenues or if we are unable to efficiently manage our expanded operations, our results of operations will be adversely affected. Our strategic initiatives may include joint ventures, in which case we will be subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to systems, controls and personnel that are not under our control.

We are subject to risks and liabilities in connection with sponsoring, investing in and managing new funds and other investment accounts, including potential regulatory risks.

We have, and may in the future, sponsor, manage and serve as general partner and/or manager of new funds or investment accounts, such as collateralized loan obligations (“CLO”). Such sponsorship and management of, and investment in, such funds and accounts



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

may involve risks not otherwise present with a direct investment in such funds, and accounts' target investments, including, for example:

- the possibility that investors in the funds/accounts might become bankrupt or otherwise be unable to meet their capital commitment obligations;
- that operating and/or management agreements of a fund/account may restrict our ability to transfer or liquidate our interest when we desire or on advantageous terms;
- that our relationships with the investors will be generally contractual in nature and may be terminated or dissolved under the terms of the agreements, or we may be removed as general partner and manager (with or without cause), and in

such event, we may not continue to manage or invest in the applicable fund/account;

that disputes between us and the investors may result in litigation or arbitration that would increase our expenses and prevent our officers and directors from focusing their time and effort on our business and result in subjecting the investments owned by the applicable fund/account to additional risk; and

• that we may incur liability for obligations of a fund/account by reason of being its general partner or manager.

Further, in relation to our operations, we have subsidiaries that are registered with the SEC as investment advisers under the Investment Advisers Act. As a result, we are subject to the anti-fraud provisions of the Investment Advisers Act and to fiduciary duties derived from these provisions that apply to our relationships with our managed companies. These provisions and duties impose restrictions and obligations on us with respect to our dealings with our funds' investors and our investments, including, for example, restrictions on agency, cross and principal transactions. We or our registered investment adviser subsidiaries will be subject to periodic SEC examinations and other requirements under the Investment Advisers Act and related regulations primarily intended to benefit advisory clients. These additional requirements relate to, among other things, maintaining an effective and comprehensive compliance program, recordkeeping and reporting requirements and disclosure requirements. The Investment Advisers Act generally grants the SEC broad administrative powers, including the power to limit or restrict an investment adviser from conducting advisory activities in the event it fails to comply with federal securities laws. Additional sanctions that may be imposed for failure to comply with applicable requirements under the Investment Advisers Act include the prohibition of individuals from associating with an investment adviser, the revocation of registrations and other censures and fines.

Investments in MSR's may expose us to additional risks.

Our investments in MSR's may subject us to certain additional risks, including the following:

Investments in MSR's are highly illiquid and subject to numerous restrictions on transfer and, as a result, there is risk that we would be unable to locate a willing buyer or get required approval to sell MSR's in the future should we desire to do so.

• Our rights to the excess servicing spread are subordinate to the interests of Fannie Mae, Freddie Mac and Ginnie Mae, and are subject to extinguishment. Fannie Mae and Freddie Mac each

require approval of the sale of excess servicing spreads pertaining to their respective MSR's. We have entered into acknowledgment agreements or subordination of interest agreements with them, which acknowledge our subordinated rights.

• Changes in minimum servicing compensation for agency loans could occur at any time and could negatively impact the value of the income derived from MSR's.

If we are not able to successfully manage these and other risks related to investing in MSRs, it may adversely affect our business, results of operations and financial condition.

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

The Federal Reserve owns approximately \$1.6 trillion of Agency mortgage-backed securities as of December 31, 2018. Starting in October 2017, the Federal Reserve has begun to phase out its policy of reinvesting principal payments from its holdings of Agency mortgage-backed securities into new Agency mortgage-backed securities purchases, therefore causing a decline in Federal Reserve security holdings over time. While it is very difficult to predict the impact of the Federal Reserve portfolio runoff on the prices and liquidity of Agency mortgage-backed securities, returns on Agency mortgage-backed securities may be adversely affected as private investors seek higher yields to purchase larger amounts of Agency mortgage-backed securities.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of Agency mortgage-backed securities. The interest and principal payments we expect to receive on the Agency mortgage-backed securities in which we invest are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Principal and interest payments on Ginnie Mae certificates are directly guaranteed by the U.S. government. Principal and interest payments relating to the securities issued by Fannie Mae and Freddie Mac are only guaranteed by each respective Agency.

In September 2008, Fannie Mae and Freddie Mac were placed into the conservatorship of the FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity in an effort to ensure their financial stability. In December 2017, FHFA and the U.S. Treasury Department announced that Fannie Mae and Freddie Mac will each be allowed to retain \$3.0 billion in capital reserve in order to cover ordinary income fluctuations.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac in the U.S. housing finance market should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency mortgage-backed security and could have broad adverse market implications. If Fannie Mae or Freddie Mac was eliminated, or their structures were to change in a material manner that is not compatible with our business model, we would not be able to acquire Agency mortgage-backed securities from these entities, which could adversely affect our business operations.

The implementation of the Single Security Initiative may adversely affect our results and financial condition. The Single Security Initiative is a joint initiative of Fannie Mae and Freddie Mac (the Enterprises), under the direction of the Federal Housing Finance Agency (FHFA), the Enterprises' regulator and conservator, to develop a common mortgage-backed security (MBS) that will be issued by the Enterprises. The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac includes the goal of developing a common MBS. The Single Security would finance the same types of fixed-rate mortgages that currently back agency MBS eligible for delivery into the TBA market. The GSEs expect to complete the Single Security initiative and issue the first Single Security in the second quarter of 2019 with the impact on forward trading in the TBA market to commence in the first quarter of 2019. Our primary investments are Agency mortgage-backed securities. We may be adversely impacted by the Single Security Initiative in ways including, but not limited to:

- The Single Security Initiative may introduce uncertainty and/or negative impacts to the Agency mortgage-backed market which reduce our liquidity, affect asset values or increase our financing costs.
- Our operational preparations may be insufficient, resulting in operational impacts or missed opportunities.

Opting to convert legacy Freddie Mac positions to the Uniform Mortgage-Backed Securities (UMBS) will increase the number of delay days between factor changes and payment which could negatively impact liquidity.

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

In addition to the increased pressure upon residential mortgage loan investors and servicers to engage in loss mitigation activities, the U.S. Government has encouraged the refinancing of certain loans, and this action may affect prepayment rates for mortgage loans. To the extent these and other economic stabilization or stimulus efforts are

successful in increasing prepayment speeds for residential mortgage loans, such efforts could potentially have a negative impact on our income and operating results, particularly in connection with loans or Agency mortgage-backed securities purchased at a premium, interest-only securities or MSRs.

#### Risks Related To Our Credit Assets

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

We invest in securities in the credit risk transfer (“CRT”) sector. The CRT sector is comprised of the risk sharing transactions issued by Fannie Mae (“CAS”) and Freddie Mac (“STACR”), and similarly structured transactions arranged by third party market

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

participants. The securities issued in the CRT sector are designed to synthetically transfer mortgage credit risk from Fannie Mae and Freddie Mac to private investors. The holder of the securities in the CRT sector has the risk that the borrowers may default on their obligations to make full and timely payments of principal and interest. Investments in securities in the CRT sector could cause us to incur losses of income from, and/or losses in market value relating to, these assets if there are defaults of principal and/or interest on the pool of mortgages referenced in the transaction. The holder of the CRT may also bear the risk of the default of the issuer of the security.

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

Our non-Agency mortgage-backed securities, mortgage loans, and mortgage loans for which we own the servicing rights, along with our commercial real estate debt, preferred equity, and real estate assets may be susceptible to economic slowdowns or recessions, which could lead to financial losses in our assets and a decrease in revenues, net income and asset values.

Owners of Agency mortgage-backed securities are protected from the risk of default on the underlying mortgages by guarantees from Fannie Mae, Freddie Mac or, in the case of the Ginnie Mae, the U.S. Government. However, we also acquire CRTs, non-Agency mortgage-backed securities and residential loans, which are backed by residential real property but, in contrast to Agency mortgage-backed securities, the principal and interest payments are not guaranteed by GSEs or the U.S. Government. Our CRT, non-Agency mortgage-backed securities and residential loan investments are therefore particularly sensitive to recessions and declining real estate values.

In the event of a default on one of our commercial mortgage loans or other commercial real estate debt or residential mortgage loans that we hold in our portfolio or a mortgage loan underlying CRT or non-Agency mortgage-backed securities in our portfolio, we bear the risk of loss as a result of the potential deficiency between the value of the collateral and the debt owed, as well as the costs and delays of foreclosure or other remedies, and the costs of maintaining and ultimately selling a property after foreclosure. Delinquencies and defaults on mortgage loans for which we own the servicing rights will adversely affect the amount of servicing fee income we receive and may result in increased servicing costs and operational risks due to the increased complexity of servicing delinquent and defaulted mortgage loans.

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

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

Other regional factors – e.g., earthquakes, floods, forest fires, hurricanes or changes in governmental rules or fiscal policies – also may adversely affect the mortgaged properties. Assets in certain regional areas may be more susceptible to certain hazards (such as earthquakes, widespread fires, floods or hurricanes) than properties in other parts of the country and collateral properties located in coastal states may be more susceptible to hurricanes than properties in other parts of the country. As a result, areas affected by such events often experience disruptions in travel, transportation and tourism, loss of jobs and an overall decrease in consumer activity, and often a decline in real

estate-related investments. There can be no assurance that the economies in such impacted areas will recover sufficiently to support income producing real estate at pre-event levels or that the costs of the related clean-up will not have a material adverse effect on the local or national economy.

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

Commercial and residential real estate assets may suffer casualty losses due to risks (including acts of terrorism) that are not covered by insurance or for which insurance coverage requirements have been contractually limited by the related loan documents. Moreover, if reconstruction or major repairs are required following a casualty, changes in laws that have occurred since the time of original construction may materially impair the borrower's ability to effect such reconstruction or major repairs or may materially increase the cost thereof.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

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

Some of our loans may be backed or supported by individual or corporate guarantees from borrowers or their affiliates that are not secured. If the guarantees are not fully or partially secured, we typically rely on financial covenants from borrowers and guarantors that are designed to require the borrower or guarantor to maintain certain levels of creditworthiness. Where we do not have recourse to specific collateral pledged to satisfy such guarantees or recourse loans, we will only have recourse as an unsecured creditor to the general assets of the borrower or guarantor, some or all of which may be pledged as collateral for other lenders. There can be no assurance that a borrower or guarantor will comply with its financial covenants, or that sufficient assets will be available to pay amounts owed to us under our loans and guarantees. As a result of these factors, we may suffer additional losses that could have a material adverse effect on our financial performance.

Upon a borrower bankruptcy, we may not have full recourse to the assets of the borrower to satisfy our loan. In addition, certain of our loans are subordinate to other debt. If a borrower defaults on our loan or on debt senior to our loan, or upon a borrower bankruptcy, our loan will be satisfied only after the senior debt holder receives payment. Where debt senior to our loan exists, the presence of intercreditor arrangements may limit our ability to amend our loan documents, assign our loans, accept prepayments, exercise our remedies (through “standstill” periods) and control decisions made in bankruptcy proceedings. Bankruptcy and borrower litigation can significantly increase collection costs and the time needed for us to acquire title to the underlying collateral (if applicable), during which time the collateral and/or a borrower’s financial condition may decline in value, causing us to suffer additional losses. If the value of collateral underlying a loan declines or interest rates increase during the term of a loan, a borrower may not be able to obtain the necessary funds to repay our loan at maturity through refinancing because the underlying property revenue cannot satisfy the debt service coverage requirements necessary to obtain new financing. If a borrower is unable to repay our loan at maturity, we could suffer additional loss that may adversely impact our financial performance.

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

Our assets may in the near or the long term become non-performing or sub-performing assets, which are subject to increased risks relative to performing assets. Commercial loans and residential mortgage loans may become non-performing or sub-performing for a variety of reasons that result in the borrower being unable to meet its debt service and/or repayment obligations, such as the underlying property being too highly leveraged, the financial

distress of the borrower, or in the case of a commercial loan, decreasing income generated from the underlying property. Such non-performing or sub-performing assets may require a substantial amount of workout negotiations and/or restructuring, which may involve substantial cost and divert the attention of our management from other activities and may entail, among other things, a substantial reduction in interest rate, the capitalization of interest payments and a substantial write-down of the principal of the loan. Even if a restructuring were successfully accomplished, the borrower may not be able or willing to maintain the restructured payments or refinance the restructured loan upon maturity.

From time to time we may find it necessary or desirable to foreclose on loans we acquire or originate, and the foreclosure process may be lengthy and expensive. Borrowers may resist foreclosure actions by asserting numerous claims, counterclaims and defenses to payment against us (such as lender liability claims and defenses) even when such assertions may have no basis in fact or law, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower's position. In some states, foreclosure actions can take several years or more to litigate. At any time prior to or during the foreclosure proceedings, the borrower may file for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the resolution of our claims. Foreclosure may create a negative public perception of the related property,



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

resulting in a diminution of its value. Even if we are successful in foreclosing on a loan, the liquidation proceeds upon sale of the underlying real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Furthermore, any costs or delays involved in the foreclosure of a loan or a liquidation of the underlying property will further reduce the proceeds and thus increase our loss. Any such reductions could materially and adversely affect the value of the commercial loans in which we invest.

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

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

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

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

Our and our third party service providers’ and servicers’ due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses. Before acquiring a commercial or residential real estate debt asset, we will assess the strengths and weaknesses of the borrower, originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to us, including our third party service providers and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful.

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

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

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

The commercial mortgages on our equity properties generally contain customary negative covenants that limit our ability to further mortgage the properties, to enter into material leases or other agreements or materially modify existing leases or other agreements without lender consent, to access cash flow in certain circumstances, and to discontinue insurance coverage, among other things. With respect to the long-term, fixed rate mortgage loans secured by certain of our healthcare properties and insured by the U.S. Department of Housing and Urban Development (“HUD”), the approval of HUD is also required for certain actions. These restrictions could adversely affect operations, and our ability to pay debt obligations. In addition, in some instances guaranties given by Annaly entities as further security for these mortgage loans contain affirmative covenants to maintain a minimum net worth and liquidity.

Proposals to acquire mortgage loans by eminent domain may adversely affect the value of our assets. Local governments have taken steps to consider how the power of eminent domain could be used to acquire residential mortgage loans and there can be no certainty whether any mortgage loans sought to be purchased will be mortgage loans held in securitization trusts and what purchase price would be paid for any such mortgage loans. Any such actions could have a material adverse effect on the market value of our mortgage-backed securities, mortgage loans and MSR. There is also no certainty as to whether any such action without the consent of investors would face legal challenge, and, if so, the outcome of any such challenge.

Our investments in corporate loans and debt securities for middle market companies carry risks. We invest a percentage of our assets directly in the ownership of corporate loans and debt securities for middle market companies, and we expect our investments in this space to grow in 2019. Non-investment grade or unrated loans to middle market businesses may carry more inherent risks than loans to larger, investment grade publicly traded entities. These middle market companies generally have less access to public capital markets, and generally have higher financing costs. Such companies, particularly in an economic slowdown or recession, may be in a weaker financial position, may need more capital to expand or compete, and may be unable to obtain financing from their respective private capital providers, public capital markets or from traditional sources, such as commercial banks. In an economic downturn, middle market loan obligors, which may be highly leveraged, may be unable to meet their debt service requirements. Middle market businesses may have narrower product lines, be more vulnerable to exogenous events and maintain smaller market shares than large businesses. Therefore, they may be more vulnerable to competitors’ actions and market conditions, as well as general economic downturns. Middle market businesses may have more difficulties implementing enterprise resource plans and may face greater challenges integrating acquisitions than large businesses. These businesses may also experience variations in operating results. The success of a middle market company may depend on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons may have a material adverse impact on such middle market company and its ability to repay its obligations. A deterioration in the value of our investments in corporate loans and debt securities for middle market companies could have an adverse impact on our results of operations.

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

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

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

- acts of God, including earthquakes, hurricanes, floods and other natural disasters, which may result in uninsured losses;
- acts of war or terrorism, including the consequences of terrorist attacks;
- adverse changes in national and local economic and market conditions;

- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the potential for uninsured or under-insured property losses; and
- environmental conditions of the real estate.

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

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

• declines in regional or local real estate values;

• declines in regional or local rental or occupancy rates;

• increases in interest rates, real estate tax rates and other operating expenses;

• tenant mix;

• success of tenant businesses and the tenant's ability to meet their lease obligations;

• property management decisions;

• property location, condition and design;

• competition from comparable types of properties;

• changes in laws that increase operating expenses or limit rents that may be charged;

• costs of remediation and liabilities associated with environmental conditions;

• the potential for uninsured or underinsured property losses;

• changes in governmental laws and regulations, including fiscal policies, zoning ordinances and environmental legislation and the related costs of compliance;

• acts of God, terrorist attacks, social unrest and civil disturbances;

• litigation and condemnation proceedings regarding the properties; and

• bankruptcy proceedings.

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

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

In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by the holder of a mezzanine loan or B-Note, if any, then by the "first loss" subordinated security holder generally, the "B-Piece" buyer, and then by the holder of a higher-rated security. In the event of default and the exhaustion of any equity support, mezzanine loans or B-Notes, and any classes of securities junior to those that we acquire, we may not be able to recover all of our capital in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently

decline, less collateral is available to satisfy interest and principal payments due on the related mortgage-backed securities. The prices of lower credit quality mortgage-backed securities are generally less sensitive to interest rate changes than more highly rated mortgage-backed securities, but more sensitive to adverse economic downturns or individual issuer developments. The projection of an economic downturn, for example, could cause a decline in the price of lower credit quality mortgage-backed securities because the ability of obligors of mortgages underlying mortgage-backed securities to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal and interest on these securities.

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

27

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

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

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

- the availability of, and competition for, credit for commercial real estate projects, which fluctuate over time;
- the prevailing interest rates;
- the net operating income generated by the related mortgaged properties;
- the fair market value of the related mortgaged properties;
- the borrower's equity in the related mortgaged properties;
- significant tenant rollover at the related mortgaged properties;
- the borrower's financial condition;
- the operating history and occupancy level of the related mortgaged properties;

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

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

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

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

The mezzanine loan assets and other subordinate debt positions that we originate and acquire involve greater risks of loss than senior loans.

We originate and acquire mezzanine loans, which take the form of subordinated loans secured by a pledge of the ownership interests by the entity that owns the interest in the entity owning the real property. We also make commercial real estate preferred equity investments, which, unlike mezzanine loans, are generally not secured by a pledge of equity interests and may be less liquid investments. Although as a holder of preferred equity we may protect our position with covenants that limit the activities of the entity in which we hold an interest and protect our equity by obtaining a contractual right to control the underlying property or force a sale after an event of default, should such a default occur, we would only be able to proceed against the entity in which we hold an interest, and not the real property owned by such entity and ultimately underlying the investment. These types of subordinate debt assets involve a higher degree of risk than senior mortgage lending secured by income-producing real property, because the loan may become unsecured or unrecoverable as a result of foreclosure by the senior lender on its mortgage or the exercise of remedies by a lender holding a mezzanine loan that is senior to our subordinate debt. In the event of a bankruptcy of the entity providing the pledge of ownership interests as security for a mezzanine loan, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan, preferred equity investment, or debt senior to our loan, or in the event of a borrower bankruptcy, our subordinate debt will be satisfied only after the senior debt. As a result, we may not recover some or all of our initial investment. In addition, mezzanine loans and preferred equity investments may have higher loan-to-value ratios than conventional mortgage loans, resulting in the borrower having less equity in the property and increasing the risk of loss of principal. Further, any subordinate debt investment



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

may give rise to sudden liquidity needs in order for us to protect our position. Significant losses related to our mezzanine loans and/or preferred equity positions would result in operating losses for us and may limit our ability to make distributions to our stockholders.

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

Construction loans involve an increased risk of loss.

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

If we do not have an adequate completion guarantee, risks of cost overruns and non-completion of renovation of the properties underlying rehabilitation loans may result in significant losses. The renovation, refurbishment or expansion of a mortgaged property by a borrower involves risks of cost overruns and non-completion. Estimates of the costs of improvements to bring an acquired property up to standards established for the market position intended for that property may prove inaccurate. Other risks may include rehabilitation costs exceeding original estimates, possibly making a project uneconomical, environmental risks and rehabilitation and subsequent leasing of the property not being completed on schedule. If such renovation is not completed in a timely manner, or if it costs more than expected, the borrower may experience a prolonged impairment of net operating income and may not be able to make payments on our investment, which could result in significant losses.

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

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

With respect to a deterioration affecting an operating tenant of one or more of our healthcare properties, there can be no assurance that we would be able to identify suitable replacement tenants or enter into leases with new tenants on terms as favorable to us as the current leases or that we would be able to lease those properties at all. Our ability to reposition our properties with a suitable replacement tenant or operator could be significantly delayed or limited by state licensing, receivership or other laws, as well as by the Medicare and Medicaid change-of-ownership rules, and we could incur substantial additional expenses in connection with any licensing, receivership or change-of-ownership proceedings. Our ability to locate and attract suitable replacement tenants also could be impaired by the specialized healthcare uses or contractual restrictions on use of the properties, and we may be forced to spend substantial amounts to adapt the properties to other uses. If we are not successful in identifying suitable replacements on a timely basis we may be required to fund certain expenses and obligations (e.g., real estate taxes, debt costs and maintenance expenses) to preserve the value of, and avoid the imposition of liens on, our properties while they are being repositioned. In

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

addition, we may incur certain obligations and liabilities, including obligations to indemnify the replacement tenant or operator, which could adversely affect our business, results of operations and financial condition.

In any of the foregoing circumstances, our financial performance could be materially adversely affected.

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

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

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

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

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

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

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

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

Consequently, actions by any such co-venturer might result in subjecting properties owned by the joint venture to additional risk, although these risks are mitigated by transaction structure and the terms and conditions of agreements governing the relationship.

#### Risks Related To Our Residential Credit Business

Our investments in non-Agency mortgage-backed securities (including re-performing loans (“RPL”) / non-performing loans (“NPL”) which we have acquired in recent periods) or other investment assets of lower credit quality, including our investments in seasoned re-performing and non-performing residential whole loans, involve credit risk, which

could materially adversely affect our results of operations.

Our current investment strategy includes seeking growth in our residential credit business. The holder of a mortgage or mortgage-backed securities assumes the risk that the related borrowers may default on their obligations to make full and timely payments of principal and interest. Under our investment policy, we have the ability to acquire non-Agency mortgage-backed securities, residential whole loans and other investment assets of lower credit quality. In general, non-Agency mortgage-backed securities carry greater investment risk than Agency mortgage-backed securities because they are not guaranteed as to principal or interest

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

by the U.S. Government, any federal agency or any federally chartered corporation. Non-investment grade, non-Agency securities tend to be less liquid, may have a higher risk of default and may be more difficult to value than investment grade bonds. Higher-than-expected rates of default and/or higher-than-expected loss severities on the mortgages underlying our non-Agency mortgage-backed securities or on our residential whole loan investments may adversely affect the value of those assets. Accordingly, defaults in the payment of principal and/or interest on our non-Agency mortgage-backed securities, residential whole loan investments and other investment assets of less-than-high credit quality would likely result in our incurring losses of income from, and/or losses in market value relating to, these assets.

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

We have certain investments in non-Agency mortgage-backed securities backed by collateral pools containing mortgage loans that were originated under underwriting standards that were less strict than those used in underwriting “prime mortgage loans.” These lower standards permitted mortgage loans, often with LTV ratios in excess of 80%, to be made to borrowers having impaired credit histories, lower credit scores, higher debt-to-income ratios and/or unverified income. Difficult economic conditions, including increased interest rates and lower home prices, can result in Alt A and subprime mortgage loans having increased rates of delinquency, foreclosure, bankruptcy and loss (including such as during the credit crisis of 2007-2008 and the housing crisis that followed), and are likely to otherwise experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of higher delinquency rates and losses associated with Alt A and subprime mortgage loans, the performance of our non-Agency mortgage-backed securities that are backed by these types of loans could be correspondingly adversely affected, which could materially adversely impact our results of operations, financial condition and business.

Our investments may include subordinated tranches of non-Agency mortgage-backed securities, which are subordinate in right of payment to more senior securities.

Our investments may include subordinated tranches of non-Agency mortgage-backed securities, which are subordinated classes of securities in a structure of securities collateralized by a pool of mortgage loans and, accordingly, are the first or among the first to bear the loss upon a restructuring or liquidation of the underlying collateral and the last to receive payment of interest and principal. Additionally, estimated fair values of these subordinated interests tend to be more sensitive to changes in economic conditions than more senior securities. As a result, such subordinated interests generally are not actively traded and may not be liquid investments.

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

When selling mortgage loans, sellers typically make customary representations and warranties about such loans. Residential mortgage loan purchase agreements may entitle the purchaser of the loans to seek indemnity or demand repurchase or substitution of the loans in the event the seller of the loans breaches a representation or warranty given to the purchaser. There can be no assurance that a mortgage loan purchase agreement will contain appropriate representations and warranties, that we or the trust that purchases the mortgage loans would be able to enforce a contractual right to repurchase or substitution, or that the seller of the loans will remain solvent or otherwise be able to honor its obligations under its mortgage loan purchase agreements. The inability to obtain or enforce an indemnity or require repurchase of a significant number of loans could adversely affect our results of operations, financial condition and business.

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

We may acquire residential whole loans that we purchase together with the related MSR's. We rely on unaffiliated servicing companies to service and manage the mortgages underlying our Non-Agency mortgage-backed securities and our residential whole loans. If a servicer is not vigilant in seeing that borrowers make their required monthly payments, borrowers may be less likely to make these payments, resulting in a higher frequency of default. If a servicer takes longer to liquidate non-performing mortgages, our losses related to those loans may be higher than originally anticipated.

Any failure by servicers to service these mortgages and related real estate owned ("REO") properties could negatively impact the value of these investments and our financial performance. In addition, while we have contracted, and will continue to contract, with unaffiliated servicing companies to carry out the actual servicing of the loans (including all direct interface with the borrowers), we are nevertheless ultimately responsible, vis-à-vis the borrowers and state and federal regulators, for ensuring that the loans are serviced in accordance with the terms of the related notes and mortgages and applicable law and regulation. In light of the current

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

regulatory environment, such exposure could be significant even though we might have contractual claims against our servicers for any failure to service the loans to the required standard.

When a residential whole loan we own is foreclosed upon, title to the underlying property would be taken by one of our subsidiaries. The foreclosure process, especially in judicial foreclosure states such as New York, Florida and New Jersey can be lengthy and expensive, and the delays and costs involved in completing a foreclosure, and then liquidating the property through sale, may materially increase any related loss. Finally, at such time as title is taken to a foreclosed property, it may require more extensive rehabilitation than we estimated at acquisition or a previously unknown environmental liability may be discovered that would require expensive and time-consuming remediation.

Challenges to the MERS® System could materially and adversely affect our business, results of operations and financial condition.

MERSCORP, Inc. is a privately held company that maintains an electronic registry, referred to as the MERS System, that tracks ownership of residential mortgage loans in the U.S., as well as the identity of the associated servicer and subservicer. Mortgage Electronic Registration Systems, Inc., or MERS, a wholly-owned subsidiary of MERSCORP, Inc., can serve as a nominee for the owner of a mortgage loan and in that role initiate foreclosures and/or become the mortgagee of record for the loan in local land records. We, or other parties with whom we contract to do business or from whom we acquire assets, may choose to use MERS as a nominee. The MERS System is widely used by participants throughout the mortgage finance industry.

Over the last several years, there have been legal challenges disputing MERS's legal standing to initiate foreclosures and/or act as nominee in local land records.

It is possible that these challenges could negatively affect MERS's ability to serve as the mortgagee of record in some jurisdictions. In addition, where MERS is the mortgagee of record, it must execute assignments of mortgages, affidavits and other legal documents in connection with foreclosure proceedings. As a result, investigations by governmental authorities and others into a servicer's possible foreclosure process deficiencies may impact MERS. Failures by MERS to apply prudent and effective process controls and to comply with legal and other requirements in the foreclosure process could pose operational, reputational and legal risks that may materially and adversely affect our business, results of operations and financial condition.

With respect to mortgage loans we own, or which we have purchased and subsequently sold, we may be subject to liability for potential violations of truth-in-lending or other similar consumer protection laws and regulations, which could adversely impact our business and financial results.

Federal consumer protection laws and regulations regulate residential mortgage loan underwriting and originators' lending processes, standards, and disclosures to borrowers. These laws and regulations include, among others, the Consumer Financial Protection Bureau's "ability-to-repay" and "qualified mortgage" regulations. In addition, there are various other federal, state, and local laws and regulations that are intended to discourage predatory lending practices by residential mortgage loan originators. For example, the federal Home Ownership and Equity Protection Act of 1994 ("HOEPA") which was expanded under the Dodd Frank Act, prohibits inclusion of certain provisions in residential mortgage loans that have mortgage rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. Some states have enacted, or may enact, similar laws or regulations, which in some cases may impose restrictions and requirements greater than those in place under federal laws and regulations. In addition, under the anti-predatory lending laws of some states, the origination of certain residential mortgage loans, including loans that are classified as "high cost" loans under applicable law, must satisfy a net tangible benefits test with respect to the borrower. This test, as well as certain standards set forth in the "ability-to-repay" and "qualified mortgage" regulations, may be highly subjective and open to interpretation. As a result, a court may determine that a residential mortgage loan did not meet the applicable standard or test even if the originator reasonably believed such standard or test had been satisfied. Failure of residential mortgage loan originators or servicers to comply with federal consumer protection laws and regulations could subject us, as an assignee or

purchaser of these loans (or as an investor in securities backed by these loans), to monetary penalties and defenses to foreclosure, including by recoupment or setoff of damages and costs, which for some violations included the sum of all finance charges and fees paid by the consumer, and could result in rescission of the affected residential mortgage loans, which could adversely impact our business and financial results.

We may not be able to obtain or maintain the governmental licenses required to operate our Residential Credit business and we may fail to comply with various state and federal laws and regulations applicable to our business of acquiring residential mortgage loans and servicing rights.

While we are not required to obtain licenses to purchase mortgage-backed securities, the purchase of residential mortgage loans and certain business purpose mortgage loans in the secondary market may, in some circumstances, require us to maintain various



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

state licenses. Acquiring the right to service residential mortgage loans and certain business purpose mortgage loans may also, in some circumstances, require us to maintain various state licenses even though we currently do not expect to directly engage in loan servicing ourselves. As a result, we could be delayed in conducting certain business if we were first required to obtain a state license. We cannot assure you that we will be able to obtain all of the licenses we need or that we would not experience significant delays in obtaining these licenses. Furthermore, once licenses are issued we are required to comply with various information reporting and other regulatory requirements to maintain those licenses, and there is no assurance that we will be able to satisfy those requirements or other regulatory requirements applicable to our business of acquiring mortgage loans on an ongoing basis. Our failure to obtain or maintain required licenses or our failure to comply with regulatory requirements that are applicable to our business of acquiring mortgage loans may restrict our residential credit business and investment options and could harm our business and expose us to penalties or other claims.

Risks Related to Our Relationship with Our Manager

The management agreement was negotiated between related parties and the terms, including fees payable, may not be as favorable to us as if it were negotiated with an unaffiliated third party.

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

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

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

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

The Manager is responsible for making all of our investment decisions. We believe that the successful implementation of our investment and financing strategies depend upon the experience of certain of the Manager's officers and employees. None of these individuals' continued service is guaranteed. If the management agreement is terminated or these individuals leave the Manager, the Manager or we may be unable to replace them with persons with appropriate experience, or at all, and we may not be able to execute our business plan.

The management fee is payable regardless of our performance.

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

The fee structure of the management agreement may limit the Manager's ability to retain access to its key personnel. The management agreement does not provide the Manager with an incentive management fee that would pay the Manager additional compensation as a result of meeting or exceeding performance targets. Some of our externally managed competitors pay their managers an incentive management fee, which could enable the manager to provide additional compensation to its key personnel. Thus, the lack of an incentive fee in the management agreement may limit the ability of the Manager to provide key personnel with additional compensation for strong performance, which could adversely affect the Manager's ability to retain these key

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

personnel. If the Manager were not able to retain any of the key personnel that will be providing services to the Manager, it would have to find replacement personnel to provide those services. Those replacement key personnel may not be able to produce the same operating results as the current key personnel.

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

Our current executive officers are members or employees of the Manager while continuing to be executive officers of Annaly. Our executive officers, by virtue of their positions, have fiduciary duties to our company and our stockholders. The duties of our executive officers to us and our stockholders may come into conflict with the interests of such officers in their capacities as members or employees of the Manager. If the Manager were to manage any additional entities, our executive officers could face conflicts of interest in allocating their time among us and such additional entities.

Risks Related to Our Taxation as a REIT

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

We believe that since 1997 we have qualified for taxation as a REIT for federal income tax purposes under Sections 856 through 860 of the Code. We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. Additionally, our ability to satisfy the REIT asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to precise determination, and for which we will not obtain independent appraisals. The proper classification of an instrument as debt or equity for U.S. federal income tax purposes may be uncertain in some circumstances, which could affect the application of the REIT asset requirements. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service ("IRS") might make changes to the tax laws and regulations, and the courts might issue new rulings that make it more difficult or impossible for us to remain qualified as a REIT.

We also indirectly own interests in entities that have elected to be taxed as REITs under the U.S. federal income tax laws, or "Subsidiary REITs." Subsidiary REITs are subject to the various REIT qualification requirements that are applicable to us. If any Subsidiary REIT were to fail to qualify as a REIT, then (i) that Subsidiary REIT would become subject to regular U.S. federal, state, and local corporate income tax, (ii) our interest in such Subsidiary REIT would cease to be a qualifying asset for purposes of the REIT asset tests, and (iii) it is possible that we would fail certain of the REIT asset tests, in which event we also would fail to qualify as a REIT unless we could avail ourselves of certain relief provisions. While we believe that the Subsidiary REITs have qualified as REITs under the Code, we have joined each Subsidiary REIT in filing "protective" TRS elections under Section 856(l) of the Code. We cannot assure you that such "protective" TRS elections would be effective to avoid adverse consequences to us. Moreover, even if the "protective" elections were to be effective, the Subsidiary REITs would be subject to regular corporate income tax, and we cannot assure you that we would not fail to satisfy the requirement that not more than 20% of the value of our total assets may be represented by the securities of one or more TRSs. If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and would therefore have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our equity. In addition, the tax law would no longer require us to make distributions to our stockholders.

A REIT that fails the quarterly asset tests for one or more quarters will not lose its REIT status as a result of such failure if either (i) the failure is regarded as a de minimis failure under standards set out in the Code, or (ii) the failure is greater than a de minimis failure but is attributable to reasonable cause and not willful neglect. In the case of a greater than de minimis failure, however, the REIT must pay a tax and must remedy the failure within 6 months of the close of the quarter in which the failure was identified. In addition, the Code provides relief for failures of other tests imposed as a condition of REIT qualification, as long as the failures are attributable to reasonable cause and not willful neglect. A REIT would be required to pay a penalty of \$50,000, however, in the case of each failure.

We have certain distribution requirements, which could adversely affect our ability to execute our business plan. As a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). The required distribution limits the amount we have available for other business

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement.

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

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

Conversely, from time to time, we may generate taxable income less than our income for financial reporting purposes due to GAAP and tax accounting differences or, as mentioned above, the timing between the recognition of taxable income and the actual receipt of cash. In such circumstances we may make distributions according to our business plan that are within our wherewithal from an economic or cash management perspective, but that are labeled as return of capital for tax reporting purposes as they are in excess of taxable income in that period.

Distributions to tax-exempt investors may be classified as unrelated business taxable income.

Neither ordinary nor capital gain distributions with respect to our common stock nor gain from the sale of our common stock are anticipated to constitute unrelated business taxable income to a tax-exempt investor. However, there are certain exceptions to this rule. In particular:

part of the income and gain recognized by certain qualified employee pension trusts with respect to our common stock may be treated as unrelated business taxable income if shares of our common stock are predominantly held by qualified employee pension trusts, and we are required to rely on a special look-through rule for purposes of meeting one of the REIT ownership tests, and we are not operated in a manner to avoid treatment of such income or gain as unrelated business taxable income;

part of the income and gain recognized by a tax-exempt investor with respect to our common stock would constitute unrelated business taxable income if the investor incurs debt in order to acquire the common stock;

part or all of the income or gain recognized with respect to our common stock by social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal services plans which are exempt from federal income taxation under the Code may be treated as unrelated business taxable income;

to the extent that we (or a part of us, or a disregarded subsidiary of ours) are a "taxable mortgage pool," or if we hold residual interests in a real estate mortgage investment conduit or a CLO;

a portion of the distributions paid to a tax-exempt stockholder that is allocable to excess inclusion income may be treated as unrelated business taxable income.

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

We may in the future distribute taxable dividends that are payable in cash or shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, stockholders may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore,

35

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

with respect to certain non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect to all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

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

To maintain our qualification as a REIT for federal income tax purposes, not more than 50% in value of the outstanding shares of our capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal tax laws to include certain entities). Primarily to facilitate maintenance of our qualification as a REIT for federal income tax purposes, our charter prohibits ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of any class of our capital. Our Board, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons who would not be treated as “individuals” if it is satisfied that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for federal income tax purposes.

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

A REIT cannot invest more than 20% of its total assets in the stock or securities of one or more taxable REIT subsidiaries (“TRSs”); therefore, our TRSs cannot constitute more than 20% of our total assets.

A TRS is a corporation, other than a REIT or a qualified REIT subsidiary, in which a REIT owns stock and with which we jointly elect TRS status. The term also includes a corporate subsidiary in which the TRS owns more than a 35% interest.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if it was earned directly by the parent REIT. Overall, at the close of any calendar quarter, no more than 20% of the value of a REIT’s assets may consist of stock or securities of one or more TRSs.

The stock and securities of our TRSs are expected to represent less than 20% of the value of our total assets. Furthermore, we intend to monitor the value of our investments in the stock and securities of our TRSs to ensure compliance with the above-described limitation. We cannot assure you, however, that we will always be able to comply with the limitation so as to maintain REIT status.

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

A TRS must pay income tax at regular corporate rates on any income that it earns. In certain circumstances, the ability of our TRSs to deduct interest expenses for federal income tax may be limited. Such income, however, is not required to be distributed. Our TRSs will pay corporate income tax on their taxable income, and their after-tax net income will be available for distribution to us.

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

The limitations imposed by the REIT gross income tests may impede our ability to distribute assets from our TRSs to us in the form of dividends. Certain asset transfers may, therefore, have to be structured as purchase and sale

transactions upon which our TRSs recognize a taxable gain.

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

36

---



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

If interest accrues on an indebtedness owed by a TRS to its parent REIT at a rate in excess of a commercially reasonable rate, the REIT is subject to tax at a rate of 100% on the excess of (i) interest payments made by a TRS to its parent REIT over (ii) the amount of interest that would have been payable had interest accrued on the indebtedness at a commercially reasonable rate. A tax at a rate of 100% is also imposed on any transaction between a TRS and its parent REIT to the extent the transaction gives rise to deductions to the TRS that are in excess of the deductions that would have been allowable had the transaction been entered into on arm's-length terms. While we will scrutinize all of our transactions with our TRSs in an effort to ensure that we do not become subject to these taxes, there is no assurance that we will be successful. We may not be able to avoid application of these taxes.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow. Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through our TRSs or other subsidiary corporations that will be subject to corporate level income tax at regular rates.

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

Complying with REIT requirements may force us to liquidate otherwise attractive investments. To remain qualified as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, U.S. Government securities and qualified real estate assets. The remainder of our investment in securities (other than U.S. Government securities, qualified real estate assets and securities issued by a TRS) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than U.S. Government securities, qualified real estate assets and securities issued by a TRS) can consist of the securities of any one issuer, no more than 20% of the value of our total assets can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our investment portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

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

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

We enter into certain financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the assets that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the assets to the

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we could fail to remain qualified as a REIT.

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

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

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

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

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

The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of structuring CMOs.

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

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

We intend to conduct our operations at the REIT level so that no asset that we own (or are treated as owning) will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having

been in the ordinary course of our business. As a result, we may choose not to engage in certain transactions at the REIT level, and may limit the structures we utilize for our CMO transactions, even though the sales or structures might otherwise be beneficial to us. In addition, whether property is held “primarily for sale to customers in the ordinary course of a trade or business” depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We intend to structure our activities to avoid the prohibited transaction tax.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

Certain financing activities may subject us to U.S. federal income tax and could have negative tax consequences for our stockholders.

We may enter into securitization transactions and other financing transactions that could result in us, or a portion of our assets, being treated as a taxable mortgage pool for U.S. federal income tax purposes. If we enter into such a transaction in the future, we could be taxable at the highest corporate income tax rate on a portion of the income arising from a taxable mortgage pool, referred to as "excess inclusion income," that is allocable to the percentage of our shares held in record name by disqualified organizations (generally tax-exempt entities that are exempt from the tax on unrelated business taxable income, such as state pension plans and charitable remainder trusts and government entities). In that case, we could reduce distributions to such stockholders by the amount of tax paid by us that is attributable to such stockholder's ownership.

If we were to realize excess inclusion income, IRS guidance indicates that the excess inclusion income would be allocated among our stockholders in proportion to the dividends paid. Excess inclusion income cannot be offset by losses of a stockholder. If the stockholder is a tax-exempt entity and not a disqualified organization, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Code. If the stockholder is a foreign person, it would be subject to U.S. federal income tax at the maximum tax rate and withholding will be required on this income without reduction or exemption pursuant to any otherwise applicable income tax treaty.

The lease of qualified healthcare properties to a TRS is subject to special requirements.

We lease certain qualified healthcare properties we acquired from MTGE to a TRS, which hires a manager to manage the healthcare operations at these properties. The lease revenues from this structure are treated as rents from real property if (1) they are paid pursuant to an arms-length lease of a qualified healthcare property with a TRS and (2) the manager qualifies as an "eligible independent contractor," as defined in the Code. If any of these conditions are not satisfied, then the rents may not be treated as revenues from real property.

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

We purchase and sell Agency mortgage-backed securities through TBAs and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise, and may continue to do so in the future. While there is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test, we treat our TBAs as qualifying assets for purposes of the REIT asset tests, and we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of counsel substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of real estate assets, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of an interest in mortgages on real property. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of counsel is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets or income are not qualifying assets or income. If the IRS were to successfully challenge the opinion of counsel, we could be subject to a penalty tax or we could fail to remain qualified as a REIT if a sufficient portion of our assets consists of TBAs or a sufficient portion of our income consists of income or gains from the disposition of TBAs.

Dividends payable by REITs generally receive different tax treatment than dividend income from regular corporations.

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

legislation.

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

The present federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the federal income tax treatment of an investment in us. The federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. The recently enacted tax law informally known as the Tax Cuts and Jobs Act (the “TCJA”) significantly changes the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. Technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming. Additional future revisions in federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

Risks of Ownership of Our Common Stock

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

If we issue a significant number of shares of common stock or securities convertible into common stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock. During 2018, we issued 154.2 million shares of common stock, which includes 86.3 million shares of common stock issued in connection with a public offering, 43.6 million shares of common stock issued in connection with the MTGE Acquisition and 24.0 million shares of common stock issued under our at-the-market sales program, and 19.2 million shares of preferred stock, including 2.2 million shares of preferred stock issued in connection with the MTGE Acquisition, which could become convertible into common stock under limited circumstances related to a change of control of the Company.

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

- actual or anticipated variations in our quarterly operating results or business prospects;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- an inability to meet or exceed securities analysts’ estimates or expectations;
- increases in market interest rates;
- hedging or arbitrage trading activity in our shares of common stock;
- capital commitments;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;

- additions or departures of management personnel;
- actions by institutional stockholders or activist investors;
- speculation in the press or investment community;
- changes in our distribution policy;
- government action or regulation;
- general market and economic conditions; and

future sales of our shares of common stock or securities convertible into, or exchangeable or exercisable for, our shares of common stock.

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

Under our charter, we have 2,000,000,000 authorized shares of capital stock, par value of \$0.01 per share. Sales of a substantial number of shares of our common stock or other equity-related securities in the public market, or any hedging or arbitrage trading activity that may develop involving our common stock, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1A. Risk Factors

Our charter does not permit ownership of over 9.8% of our common or preferred stock and attempts to acquire our common or preferred stock in excess of the 9.8% limit are void without prior approval from our Board. For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the total number or value of any class of our outstanding common or preferred stock. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board shall be void and will result in the shares being transferred by operation of law to a charitable trust.

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

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

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

**Preferred Stock.** Our charter authorizes our board of directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval.

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

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

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

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

We have not established a minimum dividend payment level and cannot assure stockholders of our ability to pay dividends in the future.

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

maintenance of our REIT status and such other factors as our Board may deem relevant from time to time.

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

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income that can lead to significant variances in the amount and timing of when income

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 1A. Risk Factors

and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of taxable income.

#### Regulatory Risks

Loss of Investment Company Act exemption from registration would adversely affect us.

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act. If we were to become subject to the Investment Company Act, our ability to use leverage would be substantially reduced, and we would be unable to conduct our business as we currently conduct it.

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

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

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

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

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

We are subject to regulation by laws at the local, state and federal level, including securities and tax laws and financial accounting and reporting standards. These laws and regulations, as well as their interpretation, may be changed from time to time.

Accordingly, any change in these laws or regulations or the failure to comply with these laws or regulations could have a material adverse impact on our business. Certain of these laws and regulations pertain specifically to REITs.

### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

### ITEM 2. PROPERTIES

Our executive and administrative office is located at 1211 Avenue of the Americas New York, New York 10036, telephone 212-696-0100. This office is leased under a non-cancelable lease expiring September 30, 2025. For a description of the commercial real estate properties we own as part of our investment portfolio, refer to the section titled “Schedule III – Real Estate and Accumulated Depreciation” of Item 15. “Exhibits, Financial Statement Schedules.”

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. At December 31, 2018, we were not party to any pending material legal proceedings.

ITEM 4. MINE SAFETY DISCLOSURES

None.

43

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

## PART II

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

Our common stock began trading publicly on October 8, 1997 and is traded on the New York Stock Exchange under the trading symbol "NLY." As of January 31, 2019, we had 1,400,060,337 shares of common stock issued and outstanding which were held by approximately 395,000 beneficial holders. The equity compensation plan information called for by Item 201(d) of Regulation S-K is set forth in Item 12 of Part III of this Form 10-K under the heading "Equity Compensation Plan Information."

## Dividends

The following table sets forth, for the periods indicated, the cash dividends declared per share of our common stock.

	Common Dividends Declared Per Share	
	2018	2017
First quarter	\$0.30	\$0.30
Second quarter	\$0.30	\$0.30
Third quarter	\$0.30	\$0.30
Fourth quarter	\$0.30	\$0.30

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments) consistent with the distribution requirements applicable to REITs. This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by factors beyond our control. In addition, unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on dividends. All distributions will be made at the discretion of our Board and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time. See also Item 1A. "Risk Factors." No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of issuance of our preferred stock through December 31, 2018, we have paid full cumulative dividends on our preferred stock.

## Share Performance Graph

The following graph and table set forth certain information comparing the yearly percentage change in cumulative total return on our common stock to the cumulative total return of the Standard & Poor's Composite 500 stock Index or S&P 500 Index, and the Bloomberg Mortgage REIT Index, or BBG REIT index, an industry index of mortgage REITs. The comparison is for the five-year period ended December 31, 2018 and assumes the reinvestment of dividends. The graph and table assume that \$100 was invested in our common stock and the two other indices on the last trading day of the initial year shown in the graph. Upon written request we will provide stockholders with a list of the REITs included in the BBG REIT Index.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

## Five-Year Share Performance

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Annaly Capital Management, Inc.	100	121	118	141	186	172
S&P 500 Index	100	114	115	129	157	150
BBG REIT Index	100	119	108	132	158	154

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

The above performance graph and related information shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 (the "Securities Exchange Act") or to the liabilities of Section 18 of the Securities Exchange Act, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act, except to the extent that we specifically incorporate it by reference into such a filing.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 6. Selected Financial Data

## ITEM 6. SELECTED FINANCIAL DATA

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

## SELECTED FINANCIAL DATA

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
Statement of comprehensive income data	(dollars in thousands, except per share data)				
Interest income	\$3,332,563	\$2,493,126	\$2,210,951	\$2,170,697	\$2,632,398
Interest expense	1,897,860	1,008,354	657,752	471,596	512,659
Net interest income	1,434,703	1,484,772	1,553,199	1,699,101	2,119,739
Realized and unrealized gains (losses)	(1,162,984 )	199,493	84,204	(1,021,351 )	(2,791,399 )
Other income (loss)	109,927	115,857	44,144	(13,717 )	44,044
Less: Total general and administrative expenses	329,873	224,124	250,356	200,240	209,338
Income (loss) before income taxes	51,773	1,575,998	1,431,191	463,793	(836,954 )
Less: Income taxes	(2,375 )	6,982	(1,595 )	(1,954 )	5,325
Net income (loss)	54,148	1,569,016	1,432,786	465,747	(842,279 )
Less: Net income (loss) attributable to noncontrolling interests	(260 )	(588 )	(970 )	(809 )	(196 )
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756	466,556	(842,083 )
Dividends on preferred stock	129,312	109,635	82,260	71,968	71,968
Net income (loss) available (related) to common stockholders	\$(74,904 )	\$1,459,969	\$1,351,496	\$394,588	\$(914,051 )
Net income (loss) per share available (related) to common stockholders					
Basic	\$(0.06 )	\$1.37	\$1.39	\$0.42	\$(0.96 )
Diluted	\$(0.06 )	\$1.37	\$1.39	\$0.42	\$(0.96 )
Weighted average number of common shares outstanding					
Basic	1,209,601,809	1,065,923,652	969,787,583	947,062,099	947,539,294
Diluted	1,209,601,809	1,066,351,616	970,102,353	947,276,742	947,539,294
Other financial data					
Total assets	\$105,787,527	\$101,760,050	\$87,905,046	\$75,190,893	\$88,355,367
Total equity	\$14,117,801	\$14,871,573	\$12,575,972	\$11,905,922	\$13,333,781
Dividends declared per common share	\$1.20	\$1.20	\$1.20	\$1.20	\$1.20



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

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

Special Note Regarding Forward-Looking Statements

Certain statements contained in this annual report, and certain statements contained in our future filings with the Securities and Exchange Commission (the "SEC" or the "Commission"), in our press releases or in our other public or stockholder communications contain or incorporate by reference certain forward-looking statements which are based on various assumptions (some of which are beyond our control) and may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates; changes in the yield curve; changes in prepayment rates; the availability of mortgage-backed securities and other securities for purchase; the availability of financing and, if available, the terms of any financing; changes in the market value of our assets; changes in business conditions and the general economy; our ability to grow our commercial business; our ability to grow our residential credit business; our ability to grow our middle market lending business; credit risks related to our investments in credit risk transfer securities, residential mortgage-backed securities and related residential mortgage credit assets, commercial real estate assets and corporate debt; risks related to investments in MSRs; our ability to consummate any contemplated investment opportunities; changes in government regulations or policy affecting our business; our ability to maintain our qualification as a REIT for U.S. federal income tax purposes; and our ability to maintain our exemption from registration under the Investment Company Act. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in this Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q or Current Reports on Form 8-K. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

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

	Page
<u>Overview</u>	<u>49</u>
Acquisition of MTGE Investment Corp.	<u>49</u>
<u>Business Environment</u>	<u>49</u>
<u>Economic Environment</u>	<u>49</u>
<u>Results of Operations</u>	<u>51</u>
<u>Net Income (Loss) Summary</u>	<u>51</u>
<u>Non-GAAP Financial Measures</u>	<u>51</u>
Core earnings and core earnings (excluding PAA), core earnings attributable to common stockholders and core earnings attributable to common stockholders (excluding PAA), core earnings and core earnings (excluding PAA) per average common share and annualized core return on average equity (excluding PAA)	<u>52</u>
<u>Premium amortization expense</u>	<u>54</u>
Interest income (excluding PAA), economic interest expense and economic net interest income (excluding PAA)	<u>55</u>
<u>Experienced and Projected Long-term CPR</u>	<u>56</u>
Average Yield on Interest Earning Assets (excluding PAA), Net Interest Spread (excluding PAA) and Net Interest Margin (excluding PAA)	<u>56</u>
<u>Economic Interest Expense and Average Cost of Interest Bearing Liabilities</u>	<u>57</u>
<u>Realized and Unrealized Gains (Losses)</u>	<u>58</u>
<u>Other Income (Loss)</u>	<u>59</u>
<u>General and Administrative Expenses</u>	<u>59</u>
<u>Unrealized Gains and Losses</u> - Available-for-Sale Investments	<u>60</u>
<u>Return on Average Equity</u>	<u>60</u>
<u>Financial Condition</u>	<u>61</u>
<u>Residential Securities</u>	<u>61</u>
<u>Contractual Obligations</u>	<u>64</u>
<u>Off-Balance Sheet Arrangements</u>	<u>64</u>
<u>Capital Management</u>	<u>65</u>
<u>Stockholders' Equity</u>	<u>65</u>
<u>Capital Stock</u>	<u>66</u>
<u>Leverage and Capital</u>	<u>66</u>
<u>Risk Management</u>	<u>66</u>
<u>Risk Appetite</u>	<u>66</u>
<u>Governance</u>	<u>67</u>
<u>Description of Risks</u>	<u>68</u>
Capital, Liquidity and Funding Risk Management	<u>68</u>
<u>Funding</u>	<u>69</u>
<u>Excess Liquidity</u>	<u>70</u>
<u>Maturity Profile</u>	<u>71</u>
<u>Stress Testing</u>	<u>73</u>
<u>Liquidity Management Policies</u>	<u>73</u>
<u>Investment/Market Risk Management</u>	<u>73</u>
<u>Credit Risk Management</u>	<u>74</u>
<u>Counterparty Risk Management</u>	<u>75</u>
<u>Operational Risk Management</u>	<u>75</u>
<u>Compliance, Regulatory and Legal Risk Management</u>	<u>76</u>

<u>Critical Accounting Policies and Estimates</u>	<u>76</u>
<u>Valuation of Financial Instruments</u>	<u>76</u>
<u>Residential Securities</u>	<u>76</u>
<u>Residential Mortgage Loans</u>	<u>76</u>
<u>Commercial Real Estate Investments</u>	<u>77</u>
<u>Interest Rate Swaps</u>	<u>77</u>
<u>Revenue Recognition</u>	<u>77</u>
<u>Consolidation of Variable Interest Entities</u>	<u>77</u>
<u>Use of Estimates</u>	<u>78</u>
<u>Glossary of Terms</u>	<u>79</u>

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Overview

We are a leading diversified capital manager that invests in and finances residential and commercial assets. Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments and continuous management of our portfolio. We are a Maryland corporation that has elected to be taxed as a REIT. We are externally managed by Annaly Management Company LLC ("Manager"). Our common stock is listed on the New York Stock Exchange under the symbol "NLY."

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

For a full discussion of our business, refer to the section titled "Business Overview" of Part I, Item 1. "Business."

Acquisition of MTGE Investment Corp.

As previously disclosed in our filings with the SEC, on September 7, 2018, Mountain Merger Sub Corporation, a wholly-owned subsidiary of the Company, completed its acquisition of MTGE Investment Corp. ("MTGE"), an externally managed hybrid mortgage REIT, for aggregate consideration to MTGE common shareholders of \$906.2 million, consisting of \$455.9 million in equity consideration and \$450.3 million in cash consideration (the "MTGE Acquisition"). We issued 43.6 million shares of common stock as part of the consideration for the MTGE Acquisition. In addition, as part of the MTGE Acquisition, each share of MTGE 8.125% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share (each, a "MTGE Preferred Share"), that was outstanding immediately prior to the completion of the MTGE Acquisition was converted into one share of a newly-designated series of our preferred stock, par value \$0.01 per share, which we classified and designated as Series H Preferred Stock, and which has rights, preferences, privileges and voting powers substantially the same as a MTGE Preferred Share.

We believe that MTGE's portfolio is complementary to our pre-acquisition portfolio, that the combined capital base supports continued growth of our businesses and that the acquisition creates efficiency and growth opportunities. The MTGE Acquisition was accounted for as an asset acquisition in accordance with U.S. GAAP. In connection with the MTGE Acquisition, transaction costs of \$58.3 million were expensed as they were incurred and included in Other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss) during the year ended December 31, 2018. Similarly, the excess consideration of \$44.5 million over the fair value of the assets acquired was recognized within Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss) on the closing date of the acquisition in September 2018.

For additional details regarding the terms and conditions of the MTGE Acquisition and related matters, please refer to the "Acquisition of MTGE Investment Corp." Note in Part I, Item 1 and our other filings with the SEC that were made in connection with the MTGE Acquisition.

Business Environment

The year ended December 31, 2018 was marked by the continued expansion of the United States economy, as underlying fundamentals, particularly for the consumer and government sectors, remained sound. Interest rates continued to rise for much of the year in large part driven by the Federal Reserve's ("Fed") four hikes to the Federal Funds Target Rate. Meanwhile, Agency mortgage-backed security spreads widened over the course of the year as robust supply and the Federal Reserve balance sheet runoff weighed on the sector. Credit sector spreads were modestly wider on growing concerns of an economic slowdown in coming years. This broader macro-economic environment that included notable bouts of volatility, primarily in the first and fourth quarter of 2018, lead us to maintain an active hedging strategy. Over the course of 2018, our net portfolio additions tilted modestly towards credit assets. Despite our interest in adding credit assets to achieve greater portfolio diversification, we continue to view the broader credit sector as fully valued. Consequently, we remain highly selective in the evaluation of investment opportunities. Within Agency MBS, persistently higher interest rates provided a catalyst to rotate a portion of the portfolio into higher coupon MBS, which contributed to the higher asset yield on our portfolio relative to the prior year.

#### Economic Environment

The pace of economic growth remained strong in 2018, coming in above estimated potential growth. Measured by real gross domestic product (“GDP”), activity increased by an annualized 3.2% rate through the third quarter of 2018, an increase from the 2.5% growth rate in 2017. The increase was largely driven by increased government expenditures, growing by 2.2% through the first three quarters of 2018 compared to 0.1% in 2017. Personal consumption, aided by improvement in the labor markets, grew by an annualized rate of 2.6% over the first three quarters, similar to the 2.7% experienced in 2017. Business investment benefited

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

from the tailwind of the 2017 tax reform and higher oil prices, rising at an annualized rate of 7.5% through September 30, 2018, compared to 6.3% in 2017. Meanwhile, residential investment slowed meaningfully subsequent to higher mortgage rates, falling by an annualized 2.8% through three quarters after increasing by 3.8% in 2017. Net exports were similarly a headwind on growth, with the trade balance widening to a \$950 billion as of the quarter ended September 30, 2018, as compared to a \$900 billion in the quarter ended December 31, 2017.

The Fed currently conducts monetary policy with a dual mandate: full employment and price stability. The unemployment rate fell from 4.1% to 3.9% over the year, remaining below the Fed's estimate of the long-run unemployment rate of 4.4%, according to the Bureau of Labor Statistics and Federal Reserve Board. The economy added 223,000 jobs per month in 2018, up from 179,000 jobs added per month in 2017, with gains seen across a broad number of industries. Wage growth, as measured by the year-over-year change in private sector Average Hourly Earnings, finally broke to the upside, reaching a post-crisis high of 3.3% in December 2018 compared to 2.7% in December 2017. The outlook has dimmed somewhat for 2019. In their latest forecast, the Fed projected a modest dip to 3.5% unemployment in 2019 before rising moderately in later years as the economy slows.

Inflation remained near the Fed's 2% target throughout 2018 as measured by the year-over-year changes in the Personal Consumer Expenditure Chain Price Index ("PCE"). The headline PCE measure increased by 1.8% year-over-year in November 2018, roughly unchanged from December 2017. The more stable core PCE measure, which excludes volatile food and energy prices, remained close to the Fed's 2.0% target after weakness in the first three months of the year, with the most recent reading of 1.9% year-over-year in November 2018. The Fed expects the core and headline PCE measures to remain at or close to their 2% target over the foreseeable future.

Throughout 2018 the Federal Open Market Committee ("FOMC") continued to remove support for the economy by raising its target for the federal funds rate. In assessing realized and expected progress towards its objectives, the FOMC raised the Federal Funds Target Rate four times, at every other meeting throughout the year to coincide with the meetings that included a press conference. Each increase was 25 basis points, bringing the target range from 1.25-1.50% in January 2018 to 2.25-2.50% at year-end. Continued strong economic growth, labor market improvement and inflation near target led the FOMC to keep its economic outlook optimistic, with the target range nearing the range of estimates for the long-run federal funds rate. In spite of this strong realized growth, the FOMC noted increased risks to their outlook, reducing their median forecast for 2019 rate hikes from three to two at their December 2018 meeting. This downgrade was primarily due to worsening foreign growth while also allowing the FOMC to analyze the impact of previous rate increases and recent increased market volatility. Meanwhile, balance sheet runoff continued in a programmatic way according to the implemented guidelines released on May 24, 2017. The Fed gradually reduced the size of its portfolio of U.S. Treasury and Agency mortgage-backed securities holdings with runoff reaching the ultimate cap of \$30 billion for U.S. Treasury securities and \$20 billion for Agency mortgage-backed securities in October 2018.

During the year ended December 31, 2018, the 10-year U.S. Treasury rate initially sold off to a seven-year high yield of 3.24% on November 8, 2018, before rallying to 2.68% by year-end. The strong economic growth seen throughout the year contributed to the initial move, while foreign growth fears and a dimming domestic economic outlook led to risk-off sentiment in the final months of the year. Estimates of term premium, or the compensation required for purchasing longer-dated U.S. Treasury maturities, remained at very low levels throughout the year, suggesting consistent demand for duration. The mortgage basis, or the spread between the 30-year Agency mortgage-backed security coupon and 10-year U.S. Treasury rate, rose steadily throughout the year, likely due to a combination of increased volatility and Fed balance sheet runoff.

The following table below presents interest rates and spreads at each date presented:

	As of December 31,		
	2018	2017	2016
30-Year mortgage current coupon	3.50%	3.00%	3.13%
Mortgage basis	82 bps	59 bps	68 bps
10-Year U.S. Treasury rate	2.68%	2.41%	2.44%
LIBOR			

1-Month	2.50%	1.56%	0.77%
6-Month	2.88%	1.84%	1.32%

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## Results of Operations

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

This Management Discussion and Analysis section contains analysis and discussion of financial results computed in accordance with U.S. generally accepted accounting principles ("GAAP") and non-GAAP measurements. To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide non-GAAP financial measures to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers.

Please refer to the "Non-GAAP Financial Measures" section for additional information.

## Net Income (Loss) Summary

The following table presents financial information related to our results of operations as of and for the years ended December 31, 2018, 2017 and 2016.

	As of and for the Years Ended December 31,			
	2018	2017	2016	
	(dollars in thousands, except per share data)			
Interest income	\$3,332,563	\$2,493,126	\$2,210,951	
Interest expense	1,897,860	1,008,354	657,752	
Net interest income	1,434,703	1,484,772	1,553,199	
Realized and unrealized gains (losses)	(1,162,984 )	199,493	84,204	
Other income (loss)	109,927	115,857	44,144	
Less: General and administrative expenses	329,873	224,124	250,356	
Income (loss) before income taxes	51,773	1,575,998	1,431,191	
Income taxes	(2,375 )	6,982	(1,595 )	
Net income (loss)	54,148	1,569,016	1,432,786	
Less: Net income (loss) attributable to noncontrolling interests	(260 )	(588 )	(970 )	
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756	
Less: Dividends on preferred stock	129,312	109,635	82,260	
Net income (loss) available (related) to common stockholders	\$(74,904 )	\$1,459,969	\$1,351,496	
Net income (loss) per share available (related) to common stockholders				
Basic	\$(0.06 )	\$1.37	\$1.39	
Diluted	\$(0.06 )	\$1.37	\$1.39	
Weighted average number of common shares outstanding				
Basic	1,209,601,809	1,065,923,652	969,787,583	
Diluted	1,209,601,809	1,066,351,616	970,102,353	
Other information				
Asset portfolio at period-end	\$102,340,249	\$99,935,666	\$85,364,917	
Average total assets	\$102,544,922	\$91,374,962	\$81,033,136	
Average equity	\$14,332,404	\$13,371,907	\$12,192,715	
Leverage at period-end <sup>(1)</sup>	6.3:1	5.7:1	5.8:1	
Economic leverage at period-end <sup>(2)</sup>	7.0:1	6.6:1	6.4:1	
Capital ratio <sup>(3)</sup>	12.1	% 12.9	% 13.1	%
Annualized return on average total assets	0.05	% 1.72	% 1.77	%
Annualized return on average equity	0.38	% 11.73	% 11.75	%
Annualized core return on average equity (excluding PAA) <sup>(4)</sup>	10.99	% 10.54	% 9.96	%



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Net interest margin <sup>(5)</sup>	1.57	% 1.38	% 1.48	%
Net interest margin (excluding PAA) <sup>(4)</sup>	1.52	% 1.51	% 1.50	%
Average yield on interest earning assets	3.23	% 2.78	% 2.81	%
Average yield on interest earning assets (excluding PAA) <sup>(4)</sup>	3.17	% 2.94	% 2.83	%
Average cost of interest bearing liabilities <sup>(6)</sup>	2.04	% 1.75	% 1.62	%
Net interest spread	1.19	% 1.03	% 1.19	%
Net interest spread (excluding PAA) <sup>(4)</sup>	1.13	% 1.19	% 1.21	%
Constant prepayment rate	9.3	% 10.6	% 13.3	%
Long-term constant prepayment rate	10.1	% 10.4	% 10.1	%
Common stock book value per share	\$9.39	\$11.34	\$11.16	
Interest income (excluding PAA) <sup>(4)</sup>	\$3,270,542	\$2,634,962	\$2,229,892	
Economic interest expense <sup>(4)</sup> <sup>(6)</sup>	\$1,797,307	\$1,334,093	\$1,085,118	
Economic net interest income (excluding PAA) <sup>(4)</sup>	\$1,473,235	\$1,300,869	\$1,144,774	
Core earnings <sup>(4)</sup>	\$1,636,941	\$1,267,160	\$1,194,884	
Premium amortization adjustment cost (benefit)	\$(62,021)	) \$141,836	\$18,941	
Core earnings (excluding PAA) <sup>(4)</sup>	\$1,574,920	\$1,408,996	\$1,213,825	
Core earnings per common share <sup>(4)</sup>	\$1.25	\$1.09	\$1.15	
PAA cost (benefit) per common share <sup>(4)</sup>	\$(0.05)	) \$0.13	\$0.02	
Core earnings (excluding PAA) per common share <sup>(4)</sup>	\$1.20	\$1.22	\$1.17	

Debt consists of repurchase agreements, other secured financing, debt issued by securitization vehicles and (1) mortgages payable. Debt issued by securitization vehicles, certain credit facilities (included within other secured financing), and mortgages payable are non-recourse to us.

(2) Computed as the sum of Recourse Debt, TBA derivative and CMBX notional outstanding and net forward purchases (sales) of investments divided by total equity.

(3) Calculated as total stockholders' equity divided by total assets inclusive of outstanding market value of TBA positions and exclusive of consolidated VIEs.

(4) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

(5) Represents the sum of our interest income plus TBA dollar roll income and CMBX coupon income less interest expense and the net interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average outstanding TBA contract and CMBX balances.

Average cost on interest bearing liabilities represents annualized economic interest expense divided by average interest bearing liabilities. Average interest bearing liabilities reflects the average amortized cost during the period.

(6) Economic interest expense is comprised of GAAP interest expense and the net interest component of interest rate swaps. Prior to the quarter ended March 31, 2018, this metric included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the quarter ended March 31, 2018, as a result of changes to the Company's hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

2018 Compared with 2017

GAAP

Net income (loss) was \$54.1 million, which includes (\$0.3) million attributable to noncontrolling interests, or (\$0.06) per average basic common share, for the year ended December 31, 2018 compared to \$1.6 billion, which includes (\$0.6) million attributable to noncontrolling interests, or \$1.37 per average basic common share, for the same period in 2017. We attribute the majority of the change in net income (loss) to the increase in net losses on disposal of investments and the unfavorable change in net gains (losses) on other derivatives, partially offset by the favorable change in the net interest component of interest rate swaps. Net losses on disposal of investments was (\$1.1) billion for the year ended December 31, 2018 compared to (\$3.9) million for the same period in 2017. Net losses on other derivatives was (\$403.0) million for the year ended December 31, 2018 compared to net gains of \$261.4 million for the same period in 2017. The net interest component of interest rate swaps was \$100.6 million for the year ended December 31, 2018 compared with (\$371.1) million for the same period in 2017. Refer to the section titled "Realized and Unrealized Gains (Losses)" located within this Item 7 for additional information related to these changes.

#### Non-GAAP

Core earnings (excluding premium amortization adjustment (“PAA”)) were \$1.6 billion, or \$1.20 per average common share, for the year ended December 31, 2018, compared to \$1.4 billion, or \$1.22 per average common share, for the same period in 2017. Core earnings (excluding PAA) increased during the year ended December 31, 2018 compared to the same period in 2017 primarily due to higher coupon income earned resulting from an increase in average Interest Earning Assets and favorable changes in the net interest component of interest rate swaps, partially offset by an increase in interest expense from higher borrowing rates and an increase in average Interest Bearing Liabilities.

#### 2017 Compared with 2016

##### GAAP

Net income (loss) was \$1.6 billion, which includes (\$0.6) million attributable to noncontrolling interests, or \$1.37 per average basic common share, for the year ended December 31, 2017 compared to \$1.4 billion, which includes (\$1.0) million attributable to noncontrolling interests, or \$1.39 per average basic common share, for the same period in 2016. We attribute the majority of the change in net income (loss) to an increase in unrealized gains on interest rate swaps and the lower net interest component of interest rate swaps, partially offset by the change in net unrealized gains (losses) on instruments measured at fair value through earnings and lower net interest income during the year ended December 31, 2017 compared to the same period in 2016. Unrealized gains on interest rate swaps were \$512.9 million for the year ended December 31, 2017 compared with \$282.2 million for the same period in 2016, reflecting a rise in forward interest rates during the year ended December 31, 2017 compared to lower forward rates during the same period in 2016. The net interest component of interest rate swaps decreased \$135.6 million to (\$371.1) million for the year ended December 31, 2017 reflecting lower net rates during the year ended December 31, 2017 compared to the same period in 2016. Net unrealized gains (losses) on instruments measured at fair value through earnings were (\$39.7) million for the year ended December 31, 2017 compared to \$86.4 million for the same period in 2016. The change was primarily due to unfavorable changes in unrealized gains (losses) on MSRs, partially offset by higher unrealized gains on non-Agency mortgage-backed securities and lower unrealized losses on Agency interest-only investments. Net interest income decreased \$68.4 million to \$1.5 billion for the year ended December 31, 2017, primarily due to higher cost of funds largely attributable to higher rates and higher average balances on repurchase agreements, partially offset by higher coupon income earned from an increase in average Interest Earning Assets for the year ended December 31, 2017 compared to the same period in 2016.

##### Non-GAAP

Core earnings (excluding premium amortization adjustment (“PAA”)) were \$1.4 billion, or \$1.22 per average basic common share, for the year ended December 31, 2017, compared to \$1.2 billion, or \$1.17 per average basic common share, for the same period in 2016. Core earnings increased during the year ended December 31, 2017 compared to the same period in 2016 primarily due to higher coupon income earned resulting from an increase in average Interest Earning Assets and the lower net interest component of interest rate swaps, partially offset by an increase in interest expense from higher rates and an increase in average Interest Bearing Liabilities.

#### Non-GAAP Financial Measures

Beginning with the quarter ended September 30, 2018, we updated our calculation of core earnings and related metrics to reflect changes to our portfolio composition and operations, including the acquisition of MTGE in September 2018. Compared to prior periods, the revised definition of core earnings includes coupon income (expense) on CMBX positions (reported in Net gains (losses) on other derivatives) and excludes depreciation and amortization expense on real estate and related intangibles (reported

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

in Other income (loss)), non-core income (loss) allocated to equity method investments (reported in Other income (loss)) and the income tax effect of non-core income (loss) (reported in Income taxes). Prior period results have not been adjusted to conform to the revised calculation as the impact in each of those periods is not material.

To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide the following non-GAAP financial measures.

• core earnings and core earnings (excluding PAA);

• core earnings attributable to common stockholders and core earnings attributable to common stockholders (excluding PAA);

• core earnings and core earnings (excluding PAA) per average common share;

• annualized core return on average equity (excluding PAA);

• interest income (excluding PAA);

• economic interest expense;

• economic net interest income (excluding PAA);

• average yield on Interest Earning Assets (excluding PAA);

• net interest margin (excluding PAA); and

• net interest spread (excluding PAA).

These measures should not be considered a substitute for, or superior to, financial measures computed in accordance with GAAP. While intended to offer a fuller understanding of our results and operations, non-GAAP financial measures also have limitations. For example, we may calculate our non-GAAP metrics, such as core earnings, or the PAA, differently than our peers making comparative analysis difficult. Additionally, in the case of non-GAAP measures that exclude the PAA, the amount of amortization expense excluding the PAA is not necessarily representative of the amount of future periodic amortization nor is it indicative of the term over which we will amortize the remaining unamortized premium. Changes to actual and estimated prepayments will impact the timing and amount of premium amortization and, as such, both GAAP and non-GAAP results.

These non-GAAP measures provide additional detail to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers. Additional information pertaining to our use of these non-GAAP financial measures, including discussion of how each such measure may be useful to investors, and reconciliations to their most directly comparable GAAP results are provided below.

Core earnings and core earnings (excluding PAA), core earnings attributable to common stockholders and core earnings attributable to common stockholders (excluding PAA), core earnings and core earnings (excluding PAA) per average common share and annualized core return on average equity (excluding PAA)

Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments and continuous management of our portfolio. We generate net income by earning a net interest spread on our investment portfolio, which is a function of interest income from our investment portfolio less financing, hedging and operating costs. Core earnings, which is defined as the sum of (a) economic net interest income, (b) TBA dollar roll income and CMBX coupon income, (c) realized amortization of MSRs, (d) other income (loss) (excluding depreciation and amortization expense on real estate and related intangibles, non-core income allocated to equity method investments and other non-core components of other income (loss)), (e) general and administrative expenses (excluding transaction expenses and non-recurring items) and (f) income taxes (excluding the income tax effect of non-core income (loss) items), and core earnings (excluding PAA), which is defined as core earnings excluding the premium amortization adjustment representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities, are used by management and, we believe, used by analysts and investors to measure our progress in achieving our principal business objective.

We seek to fulfill our principal business objective through a variety of factors including portfolio construction, the degree of market risk exposure and related hedge profile, and the use and forms of leverage, all while operating within the parameters of our capital allocation policy and risk governance framework.

We believe these non-GAAP measures provide management and investors with additional details regarding our underlying operating results and investment portfolio trends by (i) making adjustments to account for the disparate reporting of changes in fair value where certain instruments are reflected in GAAP net income (loss) while others are reflected in other comprehensive income (loss), and (ii) by excluding certain unrealized, non-cash or episodic components of GAAP net income (loss) in order to provide additional transparency into the operating performance of our portfolio. Annualized core return on average equity (excluding PAA), which is calculated by dividing core earnings (excluding PAA) over average stockholders' equity, provides investors with additional detail on the core earnings generated by our invested equity capital.

The following table presents a reconciliation of GAAP financial results to non-GAAP core earnings for the periods presented:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

	For the Years Ended December 31,		
	2018	2017	2016
	(dollars in thousands, except per share data)		
GAAP net income (loss)	\$54,148	\$1,569,016	\$1,432,786
Net income (loss) attributable to noncontrolling interests	(260 )	(588 )	(970 )
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756
Adjustments to exclude reported realized and unrealized (gains) losses			
Realized (gains) losses on termination or maturity of interest rate swaps	(1,409 )	160,133	113,941
Unrealized (gains) losses on interest rate swaps	(424,081 )	(512,918 )	(282,190 )
Net (gains) losses on disposal of investments	1,124,448	3,938	(33,089 )
Net (gains) losses on other derivatives	403,001	(261,438 )	(230,580 )
Net unrealized (gains) losses on instruments measured at fair value through earnings	158,082	39,684	(86,391 )
Loan loss provision	3,496	—	—
Bargain purchase gain	—	—	(72,576 )
Adjustments to exclude components of other (income) loss			
Depreciation and amortization expense related to commercial real estate <sup>(1)</sup>	20,278	—	—
Non-core (income) loss allocated to equity method investments <sup>(2)</sup>	(12,665 )	—	—
Non-core other (income) loss <sup>(3)</sup>	44,525	—	—
Adjustments to exclude components of general and administrative expenses and income taxes			
Transaction expenses and non-recurring items <sup>(4)</sup>	65,416	—	48,887
Income tax effect of non-core income (loss) items	4,220	—	—
Adjustments to add back components of realized and unrealized (gains) losses			
TBA dollar roll income and CMBX coupon income <sup>(5)</sup>	276,986	334,824	351,778
MSR amortization <sup>(6)</sup>	(79,764 )	(66,667 )	(48,652 )
Core earnings <sup>(7)</sup>	1,636,941	1,267,160	1,194,884
Less			
Premium amortization adjustment cost (benefit)	(62,021 )	141,836	18,941
Core earnings (excluding PAA) <sup>(7)</sup>	\$1,574,920	\$1,408,996	\$1,213,825
Dividends on preferred stock	129,312	109,635	82,260
Core earnings attributable to common stockholders <sup>(7)</sup>	\$1,507,629	\$1,157,525	\$1,112,624
Core earnings attributable to common stockholders (excluding PAA) <sup>(7)</sup>	\$1,445,608	\$1,299,361	\$1,131,565
GAAP net income (loss) per average common share	\$(0.06 )	\$1.37	\$1.39
Core earnings per average common share <sup>(7)</sup>	\$1.25	\$1.09	\$1.15
Core earnings (excluding PAA) per average common share <sup>(7)</sup>	\$1.20	\$1.22	\$1.17
GAAP return (loss) on average equity	0.38	% 11.73	% 11.75
Core return on average equity (excluding PAA) <sup>(7)</sup>	10.99	% 10.54	% 9.96

<sup>(1)</sup> Includes depreciation and amortization expense related to equity method investments.

Beginning with the quarter ended September 30, 2018, we exclude non-core (income) loss allocated to equity

<sup>(2)</sup> method investments, which represents unrealized (gains) losses allocated to equity interests in a portfolio of MSR and a realized gain on sale within an unconsolidated joint venture, which are components of Other income (loss).

<sup>(3)</sup> Represents the amount of consideration paid for the acquisition of MTGE in excess of the fair value of net assets acquired. This amount is primarily attributable to a decline in portfolio valuation between the pricing and closing dates of the transaction and is consistent with changes in market values observed for similar instruments over the

same period.

Represents costs incurred in connection with the MTGE transaction and securitizations of residential whole loans  
(4) for the year ended December 31, 2018. Represents costs incurred in connection with the acquisition of Hatteras Financial Corp. for the year ended December 31, 2016.

TBA dollar roll income and CMBX coupon income each represent a component of Net gains (losses) on other  
(5) derivatives. CMBX coupon income totaled \$2.3 million for the year ended December 31, 2018. There were no adjustments for CMBX coupon income prior to the quarter ended September 30, 2018.

MSR amortization represents the portion of changes in fair value that is attributable to the realization of estimated  
(6) cash flows on the Company's MSR portfolio and is reported as a component of Net unrealized gains (losses) on instruments measured at fair value.

(7) Represents a non-GAAP financial measure.

From time to time, we enter into TBA forward contracts as an alternate means of investing in and financing Agency mortgage-backed securities. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency mortgage-backed security with a specified issuer, term and coupon. A TBA dollar roll represents a transaction where TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the "drop". The drop is a reflection of

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management’s Discussion and Analysis

the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, that would be foregone as a result of settling the contract in the later month rather than in the earlier month. The drop between the current settlement month price and the forward settlement month price occurs because in the TBA dollar roll market, the party providing the financing is the party that would retain all principal and interest payments accrued during the financing period. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost.

TBA dollar roll transactions are accounted for under GAAP as a series of derivatives transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities. We record TBA derivatives at fair value on our Consolidated Statements of Financial Condition and recognize periodic changes in fair value as Net gains (losses) on other derivatives in our Consolidated Statements of Comprehensive Income (Loss), which includes both unrealized and realized gains and losses on derivatives (excluding interest rate swaps). TBA dollar roll income is calculated as the difference in price between two TBA contracts with the same terms but different settlement dates multiplied by the notional amount of the TBA contract. Although accounted for as derivatives, TBA dollar rolls capture the economic equivalent of net interest income, or carry, on the underlying Agency mortgage-backed security (interest income less an implied cost of financing). TBA dollar roll income is reported as a component of Net gains (losses) on other derivatives in the Consolidated Statements of Comprehensive Income (Loss).

The CMBX index is a synthetic tradable index referencing a basket of 25 commercial mortgage-backed securities of a particular rating and vintage. The CMBX index allows investors to take a long position (referred to as selling protection) or short position (referred to as purchasing protection) on the respective basket of commercial mortgage-backed securities and is structured as a “pay-as-you-go” contract whereby the protection seller receives and the protection buyer pays a standardized running coupon on the contracted notional amount. Additionally, the protection seller is obligated to pay to the protection buyer the amount of principal losses and/or coupon shortfalls on the underlying commercial mortgage-backed securities as they occur. We report income (expense) on CMBX positions in Net gains (losses) on other derivatives in the Consolidated Statements of Comprehensive Income (Loss). The coupon payments received or paid on CMBX positions is equivalent to interest income (expense) and therefore included in core earnings.

#### Premium Amortization Expense

In accordance with GAAP, we amortize or accrete premiums or discounts into interest income for our Agency mortgage-backed securities, excluding interest-only securities, taking into account estimates of future principal prepayments in the calculation of the effective yield. We recalculate 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. 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. Our GAAP metrics include the unadjusted impact of amortization and accretion associated with this method. Certain of our non-GAAP metrics exclude the effect of the PAA, which quantifies the component of premium amortization representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term CPR.

The following table illustrates the impact of the PAA on premium amortization expense for our Residential Securities portfolio for the periods presented:

For the Years Ended December		
31,		
2018	2017	2016

	(dollars in thousands)		
Premium amortization expense	\$705,926	\$879,305	\$814,575
Less: PAA cost (benefit)	(62,021 )	141,836	18,941
Premium amortization expense (excluding PAA)	\$767,947	\$737,469	\$795,634



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

	For the Years Ended		
	December 31,		
	2018	2017	2016
	(per average common share)		
Premium amortization expense	\$0.58	\$0.82	\$0.84
Less: PAA cost (benefit)	(0.05 )	0.13	0.02
Premium amortization expense (excluding PAA)	\$0.63	\$0.69	\$0.82

Interest income (excluding PAA), economic interest expense and economic net interest income (excluding PAA) Interest income (excluding PAA) represents interest income excluding the effect of the premium amortization adjustment, and serves as the basis for deriving average yield on Interest Earning Assets (excluding PAA), net interest spread (excluding PAA) and net interest margin (excluding PAA), which are discussed below. We believe this measure provides management and investors with additional detail to enhance their understanding of our operating results and trends by excluding the component of premium amortization expense representing the cumulative effect of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities (other than interest-only securities), which can obscure underlying trends in the performance of the portfolio.

Economic interest expense is comprised of GAAP interest expense and the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps. We use interest rate swaps to manage our exposure to changing interest rates on repurchase agreements by economically hedging cash flows associated with these borrowings. Accordingly, adding the net interest component of interest rate swaps to interest expense, as computed in accordance with GAAP, reflects the total contractual interest expense and thus, provides investors with additional information about the cost of our financing strategy.

Similarly, economic net interest income (excluding PAA), as computed below, provides investors with additional information to enhance their understanding of the net economics of our primary business operations.

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

## Interest Income (excluding PAA)

	GAAP Interest Income	PAA Cost (Benefit)	Interest Income (excluding PAA)
For the years ended (dollars in thousands)			
December 31, 2018	\$3,332,563	\$(62,021 )	\$3,270,542
December 31, 2017	\$2,493,126	\$141,836	\$2,634,962
December 31, 2016	\$2,210,951	\$18,941	\$2,229,892

## Economic Interest Expense and Economic Net Interest Income (excluding PAA)

GAAP Interest Expense	Add: Net Interest Component of Interest Rate Swaps (1)	Economic Interest Expense	GAAP Net Interest Income	Less: Net Interest Component of Interest Rate Swaps (1)	Economic Net Interest Income	Add: PAA Cost (Benefit)	Economic Net Interest Income (excluding PAA)
(dollars in thousands)							

For the years  
ended

December 31, 2018	\$1,897,860	\$(100,553 )	\$1,797,307	\$1,434,703	\$(100,553 )	\$1,535,256	\$(62,021 )	\$1,473,235
December 31, 2017	\$1,008,354	\$325,739	\$1,334,093	\$1,484,772	\$325,739	\$1,159,033	\$141,836	\$1,300,869
December 31, 2016	\$657,752	\$427,366	\$1,085,118	\$1,553,199	\$427,366	\$1,125,833	\$18,941	\$1,144,774

(1) Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## Experienced and Projected Long-Term CPR

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

	Experienced CPR <sup>(1)</sup>	Long-term CPR <sup>(2)</sup>
December 31, 2018	9.3%	10.1%
December 31, 2017	10.6%	10.4%
December 31, 2016	13.3%	10.1%

<sup>(1)</sup> For the years ended December 31, 2018, 2017 and 2016, respectively.

<sup>(2)</sup> At December 31, 2018, 2017 and 2016, respectively.

## Average Yield on Interest Earning Assets (excluding PAA), Net Interest Spread (excluding PAA) and Net Interest Margin (excluding PAA)

Net interest spread (excluding PAA), which is the difference between the average yield on interest earning assets (excluding PAA) and the average cost of interest bearing liabilities, and net interest margin (excluding PAA), which is calculated as the sum of interest income (excluding PAA) plus TBA dollar roll income and CMBX coupon income less interest expense and the net interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average TBA contract and CMBX balances, provide management with additional measures of our profitability that management relies upon in monitoring the performance of the business.

Disclosure of these measures, which are presented below, provides investors with additional detail regarding how management evaluates our performance.

## Net Interest Spread (excluding PAA)

	Average Interest Earning Assets <sup>(1)</sup>	Interest Income (excluding PAA) <sup>(2)</sup>	Average Yield on Interest Earning Assets (excluding PAA) <sup>(2)</sup>	Average Interest Bearing Liabilities	Economic Interest Expense <sup>(2)(3)</sup>	Average Cost of Interest Bearing Liabilities <sup>(3)</sup>	Economic Net Interest Income (excluding PAA) <sup>(2)</sup>	Net Interest Spread (excluding PAA) <sup>(2)</sup>
For the years ended	(dollars in thousands)							
December 31, 2018	\$103,227,574	\$3,270,542	3.17%	\$88,216,125	\$1,797,307	2.04%	\$1,473,235	1.13 %
December 31, 2017	\$89,648,025	\$2,634,962	2.94%	\$76,321,069	\$1,334,093	1.75%	\$1,300,869	1.19 %
December 31, 2016	\$78,813,547	\$2,229,892	2.83%	\$66,817,870	\$1,085,118	1.62%	\$1,144,774	1.21 %

<sup>(1)</sup> Does not reflect the unrealized gains/(losses).

<sup>(2)</sup> Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

<sup>(3)</sup> Average cost on interest bearing liabilities represents annualized economic interest expense divided by average interest bearing liabilities. Average interest bearing liabilities reflects the average amortized cost during the period. Economic interest expense is comprised of GAAP interest expense and the net interest component of interest rate swaps. Prior to the quarter ended March 31, 2018, this metric included the net interest component of interest rate

swaps used to hedge cost of funds. Beginning with the quarter ended March 31, 2018, as a result of changes to the Company's hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## Net Interest Margin (excluding PAA)

	Interest Income (excluding PAA) <sup>(1)</sup>	TBA Dollar Roll and CMBX Coupon Income <sup>(2)</sup>	Interest Expense	Net Interest Component of Interest Rate Swaps	Subtotal	Average Interest Earnings Assets	Average TBA Contract and CMBX Balances	Subtotal	Net Interest Margin (excluding PAA) <sup>(1)</sup>
For the years ended (dollars in thousands)									
December 31, 2018	\$3,270,542	276,986	(1,897,860)	100,553	\$1,750,221	\$103,227,574	12,115,869	\$115,343,443	1.52%
December 31, 2017	\$2,634,962	334,824	(1,008,354)	(371,108)	\$1,590,324	\$89,648,025	15,416,045	\$105,064,070	1.51%
December 31, 2016	\$2,229,892	351,778	(657,752)	(506,681)	\$1,417,237	\$78,813,547	15,399,142	\$94,212,689	1.50%

<sup>(1)</sup> Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

<sup>(2)</sup> TBA dollar roll income and CMBX coupon income each represent a component of Net gains (losses) on other derivatives. CMBX coupon income totaled \$1.2 million for each of the quarters ended December 31, 2018 and September 30, 2018, and \$2.3 million for the year ended December 31, 2018. There were no adjustments for CMBX coupon income prior to September 30, 2018.

## Economic Interest Expense and Average Cost of Interest Bearing Liabilities

Typically, our largest expense is the cost of Interest Bearing Liabilities and the net interest component of interest rate swaps. The table below shows our average Interest Bearing Liabilities and average cost of Interest Bearing Liabilities as compared to average one-month and average six-month LIBOR for the periods presented.

## Cost of Funds on Average Interest Bearing Liabilities

	Average Interest Bearing Liabilities	Interest Bearing Liabilities at Period End	Economic Interest Expense <sup>(1)</sup>	Average Cost of Interest Bearing Liabilities	Average One- Month LIBOR	Average Six- Month LIBOR	Average One-Month LIBOR Relative to Average Six- Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average One- Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average Six-Month LIBOR
For the years ended (dollars in thousands)									
December 31, 2018	\$88,216,125	\$88,646,247	\$1,797,307	2.04 %	2.02 %	2.49 %	(0.47 %)	0.02 %	(0.45 %)
December 31, 2017	\$76,321,069	\$84,505,642	\$1,334,093	1.75 %	1.11 %	1.48 %	(0.37 %)	0.64 %	0.27 %
December 31, 2016	\$66,817,870	\$72,769,189	\$1,085,118	1.62 %	0.50 %	1.06 %	(0.56 %)	1.12 %	0.56 %

Economic interest expense is comprised of GAAP interest expense and the net interest component of interest rate swaps. Prior to the three months ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

#### 2018 Compared with 2017

Economic interest expense increased by \$463.2 million for the year ended December 31, 2018 compared to the same period in 2017. The change in each period was primarily due to an increase in average Interest Bearing Liabilities and higher rates on repurchase agreements, partially offset by the change in the net interest component of interest rate swaps which was \$100.6 million for the year ended December 31, 2018 compared to the net interest component of interest rate swaps used to hedge cost of funds of (\$325.7) million for the same period in 2017.

#### 2017 Compared with 2016

Economic interest expense increased by \$249.0 million for the year ended December 31, 2017 compared to the same period in 2016. The change in each period was primarily due to an increase in average Interest Bearing Liabilities of \$9.5 billion and higher rates on repurchase agreements, partially offset by the change in the net interest component of interest rate swaps for the year ended December 31, 2017 compared to the same period in 2016.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number may differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

amount of mortgage-backed securities we have committed to purchase, we may retain the principal and interest we receive in the prior month, or we may use it to pay down our borrowings. Moreover, we generally use interest rate swaps, swaptions and other derivative instruments to hedge our portfolio, and as we pledge or receive collateral under these agreements, our borrowings on any given day may be increased or decreased. Our average borrowings during a quarter may differ from period end borrowings as we implement our portfolio management strategies and risk management strategies over changing market conditions by increasing or decreasing leverage. Additionally, these numbers may differ during periods when we conduct equity capital raises, as in certain instances we may purchase additional assets and increase leverage in anticipation of an equity capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage than our period end borrowings.

At December 31, 2018 and 2017, the majority of our debt represented repurchase agreements and other secured financing arrangements collateralized by a pledge of our Residential Securities, residential mortgage loans, commercial real estate investments and corporate loans. All of our Residential Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and maintain the liquidity and strength of our balance sheet.

## Realized and Unrealized Gains (Losses)

Realized and unrealized gains (losses) is comprised of net gains (losses) on interest rate swaps, net gains (losses) on disposal of investments, net gains (losses) on other derivatives and net unrealized gains (losses) on instruments measured at fair value through earnings. These components of realized and unrealized gains (losses) for the years ended December 31, 2018, 2017 and 2016 were as follows:

	For the Years Ended December 31,		
	2018	2017	2016
	(dollars in thousands)		
Net gains (losses) on interest rate swaps <sup>(1)</sup>	\$526,043	\$(18,323)	\$(338,432)
Net gains (losses) on disposal of investments	(1,124,448)	(3,938)	33,089
Net gains (losses) on other derivatives	(403,001)	261,438	230,580
Net unrealized gains (losses) on instruments measured at fair value through earnings	(158,082)	(39,684)	86,391
Loan loss provision	(3,496)	—	—
Bargain purchase gain	—	—	72,576
Total	\$(1,162,984)	\$199,493	\$84,204

<sup>(1)</sup> Includes the net interest component of interest rate swaps, realized gains (losses) on termination or maturity of interest rate swaps and unrealized gains (losses) on interest rate swaps.

## 2018 Compared with 2017

Net gains (losses) on interest rate swaps for the year ended December 31, 2018 was \$526.0 million compared to (\$18.3) million for the same period in 2017. The change was primarily attributable to the net interest component of interest rate swaps which was \$100.6 million for the year ended December 31, 2018 compared to (\$371.1) million for the same period in 2017, as our interest rate swaps shifted to a net receive position during the year ended December 31, 2018 compared to a net pay position for the same period in 2017.

Net gains (losses) on disposal of investments was (\$1.1) billion for the year ended December 31, 2018 compared with (\$3.9) million for the same period in 2017. For the year ended December 31, 2018, we disposed of Residential Securities with a carrying value of \$45.6 billion for an aggregate net loss of (\$1.1) billion. For the same period in 2017, we disposed of Residential Securities with a carrying value of \$12.9 billion for an aggregate net loss of (\$6.4) million.

Net gains (losses) on other derivatives was (\$403.0) million for the year ended December 31, 2018 compared to \$261.4 million for the same period in 2017. Net gains (losses) on TBA derivatives was (\$209.2) million for the year

ended December 31, 2018 compared to \$220.1 million for the same period in 2017. Net gains (losses) on futures contracts was (\$104.0) million for the year ended December 31, 2018 compared to \$83.2 million for the same period in 2017.

Net unrealized gains (losses) on instruments measured at fair value through earnings was (\$158.1) million for the year ended December 31, 2018 compared to (\$39.7) million for the same period in 2017, primarily due to unfavorable changes in unrealized gains (losses) on Agency interest-only investments, non-Agency mortgage-backed securities and credit risk transfer securities,



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

partially offset by favorable changes in unrealized gains (losses) on MSRs for the year ended December 31, 2018 compared to the same period in 2017.

For the year ended December 31, 2018, a loan loss provision of \$3.5 million was recorded on a commercial mortgage loan. Refer to Note 6 located within Item 15 for additional information related to this loan loss provision. No provision for loan loss was recorded for the same period in 2017.

## 2017 Compared with 2016

Net losses on interest rate swaps decreased by \$320.1 million for the year ended December 31, 2017 compared to the same period in 2016. Unrealized gains on interest rate swaps increased \$230.7 million, there was a favorable change in the net interest component of interest rate swaps of \$135.6 million and realized losses on termination of interest rate swaps increased \$46.2 million for the year ended December 31, 2017 compared to the same period in 2016.

For the year ended December 31, 2017, we disposed of Residential Investment Securities with a carrying value of \$12.9 billion for an aggregate net loss of (\$6.4) million. We may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Net gains (losses) on other derivatives was \$261.4 million for the year ended December 31, 2017 compared to \$230.6 million for the same period in 2016. The change was primarily attributable to a net gains on TBA contracts, partially offset by an unfavorable change in net gains (losses) on interest rate swaptions recognized for the year ended December 31, 2017 compared to the same period in 2016.

Net unrealized gains (losses) on instruments measured at fair value through earnings was (\$39.7) million for the year ended December 31, 2017 compared to \$86.4 million for the same period in 2016. The change was primarily attributable to unrealized gains (losses) on MSRs, partially offset by higher unrealized gains on non-agency mortgage-backed securities and lower unrealized losses on Agency interest-only investments for the year ended December 31, 2017 compared to the same period in 2016.

## Other Income (Loss)

Other income (loss) includes certain revenues and costs associated with our investments in commercial real estate, including rental income and recoveries, net servicing income on MSRs, operating costs as well as depreciation and amortization expense. We report in Other income (loss) items whose amounts, either individually or in the aggregate, would not, in the opinion of management, be meaningful to readers of the financial statements. Given the nature of certain components of this line item, balances may fluctuate from period to period.

Other income (loss) also includes the amount of consideration paid for the acquisition of MTGE Investment Corp. in excess of the fair value of net assets acquired, which was \$44.5 million for the year ended December 31, 2018.

## General and Administrative Expenses

General and administrative ("G&A") expenses consist of compensation and management fee and other expenses. The following table shows our total G&A expenses as compared to average total assets and average equity for the periods presented.

## G&amp;A Expenses and Operating Expense Ratios

	Total G&A Expenses (1)	Total G&A Expenses/Average Assets (1)	%	Total G&A Expenses/Average Equity (1)	%
For the years ended (dollars in thousands)					
December 31, 2018	\$329,873	0.32	%	2.30	%
December 31, 2017	\$224,124	0.25	%	1.68	%
December 31, 2016	\$250,356	0.31	%	2.05	%

<sup>(1)</sup>Includes \$65.4 million of transaction costs incurred in connection with the MTGE Acquisition and securitizations of residential whole loans for the year ended December 31, 2018. Excluding these transaction costs, G&A expenses as a percentage of average total assets were 0.26% and as a percentage of average equity were 1.85% for year ended December 31, 2018.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## 2018 Compared with 2017

G&A expenses increased \$105.7 million to \$329.9 million for the year ended December 31, 2018 compared to the same period in 2017. The change was largely attributable to transaction costs in connection with the MTGE Acquisition and securitizations of residential whole loans, higher compensation and management fees, reflecting an increase in adjusted stockholders' equity primarily resulting from the equity capital raised during the third quarter of 2018 and second half of 2017, and reimbursement payments made to the Manager for certain services in connection with the management and operations of Annaly which commenced during the third quarter of 2018.

## 2017 Compared with 2016

G&A expenses decreased \$26.2 million to \$224.1 million for the year ended December 31, 2017 compared to the same period in 2016. The change in the period was primarily due to the transaction costs recognized in connection with the Hatteras Acquisition of \$48.9 million in 2016, partially offset by higher compensation and management fees reflecting an increase in adjusted stockholders' equity primarily due to the equity capital raised conducted during year ended December 31, 2017.

## Unrealized Gains and Losses - Available-for-Sale Investments

With our available-for-sale accounting treatment on our Agency mortgage-backed securities, which represent the largest portion of assets on balance sheet, as well as certain commercial mortgage-backed securities, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders' equity under accumulated other comprehensive income (loss). As a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used amortized cost accounting. As a result, comparisons with companies that use amortized cost accounting for some or all of their balance sheet may not be meaningful. The table below shows cumulative unrealized gains and losses on our available-for-sale investments reflected in the Consolidated Statements of Financial Condition.

	December 31, December 31,	
	2018	2017
	(dollars in thousands)	
Unrealized gain	\$306,037	\$157,818
Unrealized loss	(2,285,902)	(1,283,838)
Net unrealized gain (loss)	\$(1,979,865)	\$(1,126,020)

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

The fair value of these securities being less than amortized cost at December 31, 2018 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 we currently have the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal and interest amounts of the securities by the respective issuing Agency.

## Return on Average Equity

Our return on average equity was 0.38%, 11.73% and 11.75% for the years ended December 31, 2018, 2017 and 2016, respectively.

The following table shows the components of our annualized return on average equity for the periods presented.  
Components of Annualized Return on Average Equity

60

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

	Economic Net Interest Income/ Average Equity <sup>(1)</sup>	Realized and Unrealized Gains and Losses/Average Equity <sup>(2)</sup>	Other Income (Loss)/Average Equity	G&A Expenses/ Average Equity	Income Taxes/ Average Equity	Return on Average Equity
For the years ended						
December 31, 2018	10.71 %	(8.81 %)	0.76 %	(2.30 %)	0.02 %	0.38 %
December 31, 2017	8.67 %	3.93 %	0.86 %	(1.68 %)	(0.05 %)	11.73 %
December 31, 2016	9.23 %	4.20 %	0.36 %	(2.05 %)	0.01 %	11.75 %

Economic net interest income includes the net interest component of interest rate swaps. Prior to the three months <sup>(1)</sup>ended March 31, 2018, economic interest expense included the net interest component of interest rate swaps used to hedge cost of funds. Beginning with the three months ended March 31, 2018, as a result of changes to our hedging portfolio, this metric reflects the net interest component of all interest rate swaps.

<sup>(2)</sup> Realized and unrealized gains and losses excludes the net interest component of interest rate swaps.

## Financial Condition

Total assets were \$105.8 billion and \$101.8 billion at December 31, 2018 and 2017, respectively. The change was primarily due to increases in residential mortgage loans of \$1.0 billion, cash and cash equivalents of \$1.0 billion, corporate debt of \$0.9 billion, reverse repurchase agreements of \$0.7 billion, and commercial real estate investments of \$0.4 billion. Our portfolio composition, net equity allocation and debt-to-net equity ratio by asset class were as follows at December 31, 2018:

Assets	Residential			Non-Agency MBS and Residential Mortgage Loans	Commercial			Total <sup>(3)</sup>
	Agency MBS and MSRs	TBAs <sup>(1)</sup>	CRTs		CRE Debt & Preferred Equity Investments <sup>(2)</sup>	Investments in CRE	Corporate Debt	
Fair value/carrying value	(dollars in thousands)							
Debt								
Repurchase agreements	79,122,838	13,803,000	373,536	721,304	898,196	—	—	81,115,8
Other secured financing	2,534,194	—	—	968,235	154,282	—	526,600	4,183,31
Debt issued by securitization vehicles	—	—	—	837,798	2,509,264	—	—	3,347,06
Net forward purchases	514,257	—	—	—	—	—	—	514,257
Mortgages payable	—	—	—	—	—	511,056	—	511,056
Net equity allocated	\$9,139,519	\$161,797	\$178,561	\$1,089,238	\$672,372	\$228,417	\$1,360,582	\$12,668,
	72	% 1	% 1	% 9	% 5	% 2	% 11	% 100

Net equity allocated (%)								
Debt/net equity ratio	9.0:1	NM	2.1:1	2.3:1	5.3:1	2.2:1	0.4:1	6.3:1

(1) Fair value/carrying value represents implied market value and repurchase agreements represent the notional value.

(2) Includes loans held for sale, net.

(3) Excludes the TBA asset, debt and equity balances.

(4) Net Equity Allocated, as disclosed in the above table, excludes non-portfolio related activity and may differ from stockholders' equity per the Consolidated Statements of Financial Condition.

(5) Represents the debt/net equity ratio as determined using amounts on the Consolidated Statements of Financial Condition.

NM Not meaningful.

#### Residential Securities

Substantially all of our Agency mortgage-backed securities at December 31, 2018 and December 31, 2017 were backed by single-family residential mortgage loans and were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. We carry all of our Agency mortgage-backed securities at fair value on the Consolidated Statements of Financial Condition.

We accrete discount balances as an increase to interest income over the expected life of the related Interest Earning Assets and we amortize premium balances as a decrease to interest income over the expected life of the related Interest Earning Assets. At December 31, 2018 and December 31, 2017 we had on our Consolidated Statements of Financial Condition a total of \$183.2 million and \$148.3 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Residential Securities acquired at a price below principal value) and a total of \$5.3 billion and

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

\$6.2 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current amortized cost of our Residential Securities acquired at a price above principal value).

The weighted average experienced prepayment speed on our Agency mortgage-backed securities portfolio for the years ended December 31, 2018 and 2017 was 9.3% and 10.6%, respectively. The weighted average projected long-term prepayment speed on our Agency mortgage-backed securities portfolio as of December 31, 2018 and 2017 was 10.1% and 10.4%, respectively.

Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The following tables present our Residential Securities that were carried at fair value at December 31, 2018 and December 31, 2017.

	December 31, 2018	December 31, 2017
	Estimated Fair Value	
	(dollars in thousands)	
Agency		
Fixed-rate pass-through	\$83,052,552	\$81,983,842
Adjustable-rate pass-through	4,937,984	6,948,906
CMO	11,221	—
Interest-only	873,889	1,085,762
Multifamily	1,838,565	493,689
Reverse mortgages	38,784	39,564
Total agency securities	\$90,752,995	\$90,551,763
Residential credit		
CRT	\$552,097	\$651,764
Alt-A	182,361	183,886
Prime	343,986	192,760
Subprime	394,621	533,880
NPL/RPL	3,438	42,988
Prime jumbo (>= 2010 vintage)	220,658	126,622
Prime jumbo (>= 2010 vintage) interest-only	16,874	17,158
Total residential credit securities	\$1,714,035	\$1,749,058
Total residential securities	\$92,467,030	\$92,300,821

The following table summarizes certain characteristics of our Residential Securities (excluding interest-only mortgage-backed securities) and interest-only mortgage-backed securities at the dates presented.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

	December 31, 2018	December 31, 2017		
Residential securities <sup>(1)</sup>	(dollars in thousands)			
Principal amount	\$89,579,223	\$87,518,155		
Net premium	3,925,803	4,682,299		
Amortized cost	93,505,026	92,200,454		
Amortized cost / principal amount	104.38	% 105.35	%	
Carrying value	91,575,882	91,197,901		
Carrying value / principal amount	102.23	% 104.20	%	
Weighted average coupon rate	3.90	% 3.69	%	
Weighted average yield	3.17	% 2.79	%	
Adjustable-rate residential securities <sup>(1)</sup>				
Principal amount	\$6,020,096	\$8,002,252		
Weighted average coupon rate	3.47	% 3.05	%	
Weighted average yield	2.87	% 2.52	%	
Weighted average term to next adjustment	19 Months	24 Months		
Weighted average lifetime cap <sup>(2)</sup>	8.04	% 8.12	%	
Principal amount at period end as % of total residential securities	6.72	% 9.14	%	
Fixed-rate residential securities <sup>(1)</sup>				
Principal amount	\$83,559,127	\$79,515,903		
Weighted average coupon rate	3.93	% 3.75	%	
Weighted average yield	3.19	% 2.82	%	
Principal amount at period end as % of total residential securities	93.28	% 90.86	%	
Interest-only residential securities				
Notional amount	\$6,867,093	\$7,793,767		
Net premium	1,192,675	1,342,048		
Amortized cost	1,192,675	1,342,048		
Amortized cost / notional amount	17.37	% 17.22	%	
Carrying value	891,148	1,102,920		
Carrying value / notional amount	12.98	% 14.15	%	
Weighted average coupon rate	3.10	% 3.61	%	
Weighted average yield	1.73	% 4.17	%	

<sup>(1)</sup> Excludes interest-only mortgage-backed securities.

<sup>(2)</sup> Excludes non-Agency mortgage-backed securities and CRT securities as this attribute is not applicable to these asset classes.

The following tables summarize certain characteristics of our Residential Credit portfolio at December 31, 2018.

Product	Total	Payment Structure		Investment Characteristics						
		Senior	Subordinate	Coupon	Credit Enhancement	60+ Delinquencies	3M VPR <sup>(1)</sup>			
(dollars in thousands)										
Agency credit risk transfer	\$524,414	\$—	\$524,414	5.78%	1.18	%	0.29	%	7.41	%
Private label credit risk transfer	27,683	—	27,683	7.70%	0.26	%	0.29	%	8.65	%
Alt-A	182,361	107,293	75,068	4.74%	11.06	%	9.59	%	10.08	%
Prime	343,986	158,351	185,635	4.71%	10.34	%	7.54	%	13.32	%
Subprime	394,621	145,384	249,237	2.84%	8.89	%	18.98	%	5.53	%
Non-performing loan securitizations	3,438	—	3,438	5.00%	59.46	%	47.86	%	6.86	%
Prime jumbo (>=2010 vintage)	220,658	186,014	34,644	3.98%	14.68	%	0.10	%	5.71	%



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Prime jumbo ( $\geq$ 2010 vintage) interest-only	16,874	16,874	—	0.44%	—	0.28	%	7.24	%
Total/weighted average	\$1,714,035	\$613,916	\$1,100,119	4.68%	7.91	%	7.93	%	11.84%

<sup>(1)</sup> Represents the 3 month voluntary prepayment rate (“VPR”).

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

Product	Bond Coupon				Estimated Fair Value
	ARM	Fixed	Floater	Interest-Only	
(dollars in thousands)					
Agency credit risk transfer	\$—	\$—	\$524,414	\$—	\$524,414
Private label credit risk transfer	—	—	27,683	—	27,683
Alt-A	44,896	112,952	24,513	—	182,361
Prime	160,736	168,137	15,113	—	343,986
Subprime	—	48,583	345,653	385	394,621
Non-performing loan securitizations	—	3,438	—	—	3,438
Prime jumbo (>=2010 vintage)	—	220,658	—	—	220,658
Prime jumbo (>=2010 vintage) interest-only	—	—	—	16,874	16,874
Total	\$205,632	\$553,768	\$937,376	\$ 17,259	\$1,714,035

## Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations at December 31, 2018. The table does not include the effect of net interest rate payments on our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate. At December 31, 2018, the interest rate swaps had a net fair value of (\$372.3) million.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
(dollars in thousands)					
Repurchase agreements	\$80,581,658	\$534,216	\$—	\$—	\$81,115,874
Interest expense on repurchase agreements <sup>(1)</sup>	468,490	20,737	—	—	489,227
Other secured financing	2,893	3,653,818	526,600	—	4,183,311
Interest expense on other secured financing <sup>(1)</sup>	126,676	150,679	24,726	—	302,081
Debt issued by securitization vehicles (principal)	—	883,500	1,218,740	1,234,641	3,336,881
Interest expense on debt issued by securitization vehicles	120,923	241,846	117,073	761,707	1,241,549
Mortgages payable (principal)	33,081	16,125	—	467,628	516,834
Interest expense on mortgages payable	20,332	38,068	37,888	160,999	257,287
Long-term operating lease obligations	3,565	7,514	7,723	6,757	25,559
Total	\$81,357,618	\$5,546,503	\$1,932,750	\$2,631,732	\$91,468,603

<sup>(1)</sup> Interest expense on repurchase agreements and other secured financing calculated based on rates at December 31, 2018.

In the coming periods, we expect to continue to finance our Residential Securities in a manner that is largely consistent with our current operations via repurchase agreements. We may use FHLB Des Moines advances, securitization structures, credit facilities, mortgages payable or other term financing structures to finance certain of our assets. During the year ended December 31, 2018, we received \$11.4 billion from principal repayments and \$33.3 billion in cash from disposal of Residential Securities. During the year ended December 31, 2017, we received \$12.0 billion from principal repayments and \$13.4 billion in cash from disposal of Residential Securities.

## Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships which would have been established for the sole purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

We have limited future funding commitments related to certain of our unconsolidated joint ventures. In addition, the Company has provided customary non-recourse carve-out and environmental guarantees (or underlying indemnities with respect thereto) with respect to mortgage loans held by subsidiaries of these unconsolidated joint ventures. We believe that the likelihood of making any payments under these guarantees is remote, and have not accrued a related liability at December 31, 2018.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management’s Discussion and Analysis

## Capital Management

Maintaining a strong balance sheet that can support the business even in times of economic stress and market volatility is of critical importance to our business strategy. A strong and robust capital position is essential to executing our investment strategy. Our capital strategy is predicated on a strong capital position, which enables us to execute our investment strategy regardless of the market environment.

Our Internal Capital Adequacy Assessment Program (“ICAAP”) framework supports capital measurement, and is integrated within the overall risk governance framework. The ICAAP framework is designed to align capital measurement with our risk appetite.

Our capital policy defines the parameters and principles supporting a comprehensive capital management practice, including processes that effectively identify, measure and monitor risks impacting capital adequacy. Our capital assessment process considers the precision in risk measures as well as the volatility of exposures and the relative activities producing risk. Parameters used in modeling economic capital must align with our risk appetite.

The major risks impacting capital are liquidity, investment/market, credit, counterparty, operational and compliance, regulatory and legal risks. For further discussion of the risks we are subject to, please see Part I, Item 1A. “Risk Factors” of this annual report on Form 10-K.

Capital requirements are based on maintaining levels above approved limits, ensuring the quality of our capital appropriately reflects our asset mix, market and funding structure. As such we use a complement of capital metrics and related threshold levels to measure and analyze our capital from a magnitude and composition perspective. Our policy is to maintain an appropriate amount of available financial resources over the aggregate economic capital requirements.

Available Financial Resources is the actual capital held to protect against the unexpected losses measured in our capital management process and may include:

- Common and preferred equity;
- Other forms of equity-like capital;

•Surplus credit reserves over expected losses; and

•Other loss absorption instruments.

In the event we fall short of our internal limits, we will consider appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

## Stockholders’ Equity

The following table provides a summary of total stockholders’ equity at December 31, 2018 and 2017:

	December 31, 2018	December 31, 2017
Stockholders’ equity	(dollars in thousands)	
7.625% Series C cumulative redeemable preferred stock	169,466	290,514
7.50% Series D cumulative redeemable preferred stock	445,457	445,457
7.625% Series E cumulative redeemable preferred stock	—	287,500
6.95% Series F fixed-to-floating rate cumulative redeemable preferred stock	696,910	696,910
6.50% Series G fixed-to-floating rate cumulative redeemable preferred stock	411,335	—
8.125% Series H cumulative redeemable preferred stock	55,000	—
Common stock	13,138	11,596
Additional paid-in capital	18,794,331	17,221,265
Accumulated other comprehensive income (loss)	(1,979,865 )	(1,126,020 )

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Accumulated deficit	(4,493,660 )	(2,961,749 )
Total stockholders' equity	\$14,112,112	\$14,865,473

65

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## Capital Stock

The following table provides activity related to our Direct Purchase and Dividend Reinvestment Program for the periods presented:

	Amount	
	Shares Issued Through Direct Purchase	Raised from Direct Dividend Reinvestment Program
For the years ended (dollars in thousands, except per share data)		
December 31, 2018	302,000	\$ 3,144
December 31, 2017	219,000	\$ 2,542
December 31, 2016	228,000	\$ 2,362

During the year ended December 31, 2018, we issued 24.0 million shares under the at-the-market sales program, for proceeds of \$251.1 million, net of commissions and fees.

During the year ended December 31, 2018, we closed the public offering of an original issuance of 75.0 million shares of common stock for proceeds of approximately \$762.8 million before deducting offering expenses. In connection with the offering, we granted the underwriters a thirty-day option to purchase up to an additional 11.3 million shares of common stock, which the underwriters exercised in full resulting in an additional \$114.4 million in proceeds before deducting offering expenses.

During the year ended December 31, 2017, we issued 140.5 million shares of common stock for proceeds of \$1.7 billion before deducting offering expenses.

Refer to the section titled "Acquisition of MTGE Investment Corp." for capital stock activity related to the MTGE Acquisition.

No options were exercised during the years ended December 31, 2018, 2017, and 2016.

## Leverage and Capital

We believe that it is prudent to maintain conservative debt-to-equity and economic leverage ratios as there may be volatility in the mortgage and credit markets. Our capital policy governs our capital and leverage position including setting limits. Based on the guidelines, we generally expect to maintain an economic leverage ratio of less than 10:1. Our actual economic leverage ratio varies from time to time based upon various factors, including our Manager's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions.

Our debt-to-equity ratio at December 31, 2018 and December 31, 2017 was 6.3:1 and 5.7:1, respectively. Our economic leverage ratio, which is computed as the sum of Recourse Debt, TBA derivative and CMBX notional outstanding and net forward purchases of investments divided by total equity, at December 31, 2018 and December 31, 2017 was 7.0:1 and 6.6:1, respectively. Our capital ratio, which represents our ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives and exclusive of debt issued by securitization vehicles), was 12.1% and 12.9% at December 31, 2018 and December 31, 2017, respectively.

## Risk Management

We are subject to a variety of risks in the ordinary conduct of our business. The effective management of these risks is of critical importance to the overall success of Annaly. The objective of our risk management framework is to identify, measure, monitor and control these risks.

Our risk management framework is intended to facilitate a holistic, enterprise wide view of risk. We have built a strong and collaborative risk management culture throughout Annaly focused on awareness which ensures the key risks are understood and managed appropriately. Each employee of our Manager is accountable for monitoring and managing risk within their area of responsibility.

#### Risk Appetite

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

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management’s Discussion and Analysis

Risk Parameter	Description
Portfolio Composition	We will maintain a portfolio comprised of target assets approved by our Board and in accordance with our capital allocation policy.
Leverage	We generally expect to maintain an economic leverage ratio no greater than 10:1.
Liquidity Risk	We will seek to maintain an unencumbered asset portfolio sufficient to meet our liquidity needs under adverse market conditions.
Interest Rate Risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements utilizing derivative instruments targeting both income and capital preservation.
Credit Risk	We will seek to manage credit risk by making investments which conform within our specific investment policy parameters and optimize risk-adjusted returns.
Capital Preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

Governance

Risk management begins with our Board, through the review and oversight of the risk management framework, and executive management, through the ongoing formulation of risk management practices and related execution in managing risk. The Board exercises its oversight of risk management primarily through the Board Risk Committee (“BRC”) and Board Audit Committee (“BAC”). The BRC is responsible for oversight of our risk governance structure, risk management and risk assessment guidelines and policies and our risk appetite. The BAC is responsible for oversight of the quality and integrity of our accounting, internal controls and financial reporting practices, including independent auditor selection, evaluation and review, and oversight of the internal audit function.

Risk assessment and risk management are the responsibility of our management. A series of management committees have oversight or decision-making responsibilities for risk management activities. Membership of these committees is reviewed regularly to ensure the appropriate personnel are engaged in the risk management process. Four primary management committees have been established to provide a comprehensive framework for risk management. The management committees responsible for our risk management include the Enterprise Risk Committee (“ERC”), Asset and Liability Committee (“ALCO”), Investment Committee and the Financial Reporting and Disclosure Committee (“FRDC”). Each of these committees reports to our management Operating Committee which is responsible for oversight and management of our operations, including oversight and approval authority over all aspects of our enterprise risk management.

Audit Services is an independent function with reporting lines to the BAC. Audit Services is responsible for performing our internal audit activities, which includes independently assessing and validating key controls within the risk management framework.

In the fourth quarter of 2018, the Company implemented an enhanced corporate compliance function, headed by a newly appointed Chief Compliance Officer, who has reporting lines to the BAC. The corporate compliance group is responsible for the oversight of the Company’s regulatory compliance.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management’s Discussion and Analysis

Description of Risks

We are subject to a variety of risks due to the business we operate. Risk categories are an important component of a robust enterprise wide risk management framework.

We have identified the following primary categories that we utilize to identify, assess, measure and monitor risk.

Risk	Description
Capital, Liquidity and Funding Risk	Risk to earnings, capital or business resulting from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.
Investment/Market Risk	Risk to earnings, capital or business resulting in the decline in value of our assets or an increase in the costs of financing caused by changes in market variables, such as interest rates, which affect the values of investment securities and other investment instruments.
Credit Risk	Risk to earnings, capital or business resulting from an obligor’s failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in lending and investing activities.
Counterparty Risk	Risk to earnings, capital or business resulting from a counterparty’s failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in funding, hedging and investing activities.
Operational Risk	Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems (including proprietary and third party models), human factors or external events.
Compliance, Regulatory and Legal Risk	Risk to earnings, capital, reputation or conduct of business arising from violations of, or nonconformance with internal and external applicable rules and regulations, losses resulting from lawsuits or adverse judgments, or from changes in the regulatory environment that may impact our business model.

Capital, Liquidity and Funding Risk Management

Our capital, liquidity and funding risk management strategy is designed to ensure the availability of sufficient resources to support our business and meet our financial obligations under both normal and adverse market and business environments. Our capital, liquidity and funding risk management practices consist of the following primary elements:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

Element	Description
Funding	Availability of diverse and stable sources of funds.
Excess Liquidity	Excess liquidity primarily in the form of unencumbered assets and cash.
Maturity Profile	Diversity and tenor of liabilities and modest use of leverage.
Stress Testing	Scenario modeling to measure the resiliency of our liquidity position.
Liquidity Management Policies	Comprehensive policies including monitoring, risk limits and an escalation protocol.

## Funding

Our primary financing sources are repurchase agreements provided through counterparty arrangements and through Arcola, other secured financing including funding from the Federal Home Loan Bank ("FHLB"), debt issued by securitization vehicles, mortgages, credit facilities, note sales and various forms of equity. We maintain excess liquidity by holding unencumbered liquid assets that could be either sold or used to collateralize additional borrowings.

We seek to conservatively manage our repurchase agreement funding position through a variety of methods including diversity, breadth and depth of counterparties and maintaining a staggered maturity profile.

Additionally, our wholly-owned subsidiary, Arcola, provides direct access to third party funding as a FINRA member broker-dealer. Arcola borrows funds through the General Collateral Finance Repo service offered by the FICC, with FICC acting as the central counterparty. Arcola also borrows funds through direct repurchase agreements.

To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements. At December 31, 2018, the weighted average days to maturity was 77 days.

Our repurchase agreements generally provide that in the event of a margin call we must provide additional securities or cash on the same business day that a margin call is made. Should prepayment speeds on the mortgages underlying our Agency and Residential mortgage-backed securities and/or market interest rates or other factors move suddenly and cause declines in the market value of assets posted as collateral, resulting margin calls may cause an adverse change in our liquidity position.

We maintain access to FHLB funding through our captive insurance subsidiary Truman. We finance eligible Agency, residential credit and commercial investments through the FHLB. A rule from the FHFA requires captive insurance companies to terminate their FHLB membership, however, given the length of its membership, Truman was granted a five year sunset provision whereby its membership will expire in February 2021. We believe our business objectives align well with the mission of the FHLB System. While there can be no assurances that such steps will be taken, we believe it would be appropriate for there to be legislative or other action to permit Truman and similar captive insurance subsidiaries to retain their membership status beyond the current sunset period.

We utilize diverse funding sources to finance our commercial investments. Aside from FHLB funding, we may utilize credit facilities, securitization funding and, in the case of investments in commercial real estate, mortgage financing and note sales.

At December 31, 2018, we had total financial assets and cash pledged against existing liabilities of \$91.8 billion. The weighted average haircut was approximately 4% on repurchase agreements. The quality and character of the Residential Securities and commercial real estate investments that we pledge as collateral under the repurchase agreements and interest rate swaps did not materially change at December 31, 2018 compared to the same period in 2017, and our counterparties did not materially alter any requirements, including required haircuts, related to the collateral we pledge under repurchase agreements and interest rate swaps during the year ended December 31, 2018. The following table presents our quarterly average and quarter-end repurchase agreement and reverse repurchase agreement balances outstanding for the periods presented:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

Quarter ended	Repurchase Agreements		Reverse Repurchase Agreements	
	Average Daily Amount Outstanding	Ending Amount Outstanding	Average Daily Amount Outstanding	Ending Amount Outstanding
(dollars in thousands)				
December 31, 2018	\$83,984,254	\$81,115,874	\$2,741,022	\$ 650,040
September 30, 2018	79,214,382	79,073,026	2,330,519	1,234,704
June 30, 2018	80,582,681	75,760,655	2,929,470	259,762
March 31, 2018	80,770,663	78,015,431	2,064,862	200,459
December 31, 2017	78,755,896	77,696,343	1,295,652	—
September 30, 2017	69,314,576	69,430,268	994,565	—
June 30, 2017	63,191,827	62,497,400	474,176	—
March 31, 2017	64,961,511	62,719,087	1,738,333	—
December 31, 2016	64,484,326	65,215,810	1,064,130	—

The following table provides information on our repurchase agreements and other secured financing by maturity date at December 31, 2018. The weighted average remaining maturity on our repurchase agreements and other secured financing was 113 days at December 31, 2018:

December 31, 2018					
	Principal Balance	Weighted Average Rate	% of Total		
(dollars in thousands)					
1 day	\$—	—	%	—	%
2 to 29 days	32,012,640	3.50	%	37.5	%
30 to 59 days	8,164,165	2.33	%	9.6	%
60 to 89 days	18,689,773	2.62	%	21.9	%
90 to 119 days	10,132,675	2.52	%	11.9	%
Over 120 days <sup>(1)</sup>	16,299,932	2.96	%	19.1	%
Total	\$85,299,185	2.97	%	100.0	%

<sup>(1)</sup> Approximately 5% of the total repurchase agreements and other secured financing had a remaining maturity over 1 year.

The table below presents our outstanding debt balances and associated weighted average rates and days to maturity at December 31, 2018:

	Principal Balance	Weighted Average Rate	As of Period End	For the Quarter	Weighted Average Days to Maturity <sup>(1)</sup>
(dollars in thousands)					
Repurchase agreements	\$81,115,874	2.97%	2.43	%	77
Other secured financing <sup>(2)</sup>	4,183,311	3.04%	2.93	%	812
Securitized debt of consolidated VIEs <sup>(3)</sup>	3,336,881	3.62%	3.76	%	3,833
Mortgages payable <sup>(3)</sup>	516,834	4.11%	4.11	%	4,734

Total indebtedness \$89,152,900

- (1) Determined based on estimated weighted-average lives of the underlying debt instruments.
- (2) Includes advances from the Federal Home Loan Bank of Des Moines of \$3.6 billion and financing under credit facilities.
- (3) Non-recourse to Annaly.

#### Excess Liquidity

Our primary source of liquidity is the availability of unencumbered assets which may be provided as collateral to support additional funding needs. We target minimum thresholds of available, unencumbered assets to maintain excess liquidity. The following table illustrates our asset portfolio available to support potential collateral obligations and funding needs.

Assets are considered encumbered if pledged as collateral against an existing liability, and therefore are no longer available to support additional funding. An asset is considered unencumbered if it has not been pledged or securitized. The following table also provides the carrying amount of our encumbered and unencumbered financial assets at December 31, 2018:

70

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

	Encumbered Assets	Unencumbered Assets	Total
Financial assets	(dollars in thousands)		
Cash and cash equivalents	\$1,581,775	\$ 153,974	\$1,735,749
Reverse repurchase agreements <sup>(1)</sup>	650,040	—	650,040
Investments, at carrying value <sup>(2)</sup>			
Agency mortgage-backed securities	85,594,336	4,684,307	90,278,643
Credit risk transfer securities	470,238	81,859	552,097
Non-agency mortgage-backed securities	982,611	179,327	1,161,938
Residential mortgage loans <sup>(3)</sup>	2,035,373	419,264	2,454,637
MSRs	3,616	554,197	557,813
Commercial real estate debt investments <sup>(3)</sup>	2,884,501	10,626	2,895,127
Commercial real estate debt and preferred equity, held for investment	1,041,331	255,472	1,296,803
Loans held for sale, net	42,184	—	42,184
Corporate debt	803,428	1,083,754	1,887,182
Other assets <sup>(4)</sup>	—	245,030	245,030
Total financial assets	\$96,089,433	\$ 7,667,810	\$ 103,757,243

<sup>(1)</sup> The collateral received in connection with reverse repurchase agreements was repledged as of December 31, 2018.

<sup>(2)</sup> The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

<sup>(3)</sup> Includes assets transferred or pledged to securitization vehicles.

<sup>(4)</sup> Includes interests in certain joint ventures and equity and debt instruments.

We maintain liquid assets in order to satisfy our current and future obligations in normal and stressed operating environments. These are held as the primary means of liquidity risk mitigation. The composition of our liquid assets is also considered and is subject to certain parameters. The composition is monitored for concentration risk and asset type. We believe the assets we consider liquid can be readily converted into cash, through liquidation or by being used as collateral in financing arrangements (including as additional collateral to support existing financial arrangements). Our balance sheet also generates liquidity on an on-going basis through mortgage principal and interest repayments and net earnings held prior to payment of dividends. The following table presents our liquid assets as a percentage of total assets at December 31, 2018:

	Carrying Value <sup>(1)</sup>
Liquid assets	(dollars in thousands)
Cash and cash equivalents	\$1,735,749
Residential securities <sup>(2)</sup>	91,992,293
Residential mortgage loans <sup>(3)</sup>	1,359,806
Commercial real estate debt investments <sup>(4)</sup>	156,758
Commercial real estate debt and preferred equity, held for investment	1,041,995
Loans held for sale, net	42,184
Corporate debt	1,346,355
Total liquid assets	\$97,675,140
Percentage of liquid assets to carrying amount of encumbered and unencumbered financial assets <sup>(3)(4)</sup>	97.75 %

Carrying value approximates the market value of assets. The assets listed in this table include \$91.8 billion of

<sup>(1)</sup> assets that have been pledged as collateral against existing liabilities at December 31, 2018. Please refer to the Encumbered and Unencumbered Assets table for related information.

<sup>(2)</sup>

The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

- (3) Excludes securitized residential mortgage loans transferred or pledged to consolidated VIEs carried at fair value of \$1.1 billion.
- (4) Excludes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of \$2.7 billion.

#### Maturity Profile

We consider the profile of our assets, liabilities and derivatives when managing both liquidity risk as well as investment/market risk employing a measurement of both the maturity gap and interest rate sensitivity gap. We determine the amount of liquid assets that are required to be held by monitoring several liquidity metrics. We utilize several modeling techniques to analyze our current and potential obligations including the expected cash flows from our assets, liabilities and derivatives. The following table illustrates the expected final maturities and cash flows of our assets, liabilities and derivatives. The table is based on a static portfolio and assumes no reinvestment of asset cash flows and no future liabilities are entered into. In assessing the maturity of our assets, liabilities and off balance sheet obligations, we use the stated maturities, or our prepayment expectations for assets and liabilities

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

that exhibit prepayment characteristics. Cash and cash equivalents are included in the 'Less than 3 Months' maturity bucket, as they are typically held for a short period of time.

With respect to each maturity bucket, our maturity gap is considered negative when the amount of maturing liabilities exceeds the amount of maturing assets. A negative gap increases our liquidity risk as we must enter into future liabilities.

Our interest rate sensitivity gap is the difference between Interest Earning Assets and Interest Bearing Liabilities maturing or re-pricing within a given time period. Unlike the calculation of maturity gap, interest rate sensitivity gap includes the effect of our interest rate swaps. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if assets and liabilities were perfectly matched in each maturity category. The amount of assets and liabilities utilized to compute our interest rate sensitivity gap was determined in accordance with the contractual terms of the assets and liabilities, except that adjustable-rate loans and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature. The effects of interest rate swaps, whereby we generally pay a fixed rate and receive a floating rate and effectively lock in our financing costs for a longer term, are also reflected in our interest rate sensitivity gap. The interest rate sensitivity of our assets and liabilities in the following table at December 31, 2018 could vary substantially based on actual prepayment experience.

	Less than 3 Months	3-12 Months	More than 1 Year to 3 Years	3 Years and Over	Total
Financial assets	(dollars in thousands)				
Cash and cash equivalents	\$ 1,735,749	\$—	\$—	\$—	\$ 1,735,749
Reverse repurchase agreements	650,040	—	—	—	650,040
Agency mortgage-backed securities (principal)	844	—	4,370,379	83,457,465	87,828,688
Credit risk transfer securities (principal)	—	—	—	542,374	542,374
Non-agency mortgage-backed securities (principal)	—	12,121	116,365	1,079,675	1,208,161
Commercial mortgage-backed securities (principal)	—	—	—	155,921	155,921
Total securities	844	12,121	4,486,744	85,235,435	89,735,144
Residential mortgage loans (principal)	—	—	—	1,347,052	1,347,052
Commercial real estate debt and preferred equity (principal)	370,788	300,199	486,471	150,453	1,307,911
Corporate debt (principal)	—	—	109,226	1,799,337	1,908,563
Total loans	370,788	300,199	595,697	3,296,842	4,563,526
Assets transferred or pledged to securitization vehicles (principal)	—	—	—	3,803,655	3,803,655
Total financial assets - maturity	2,757,421	312,320	5,082,441	92,335,932	100,488,114
Effect of utilizing reset dates <sup>(1)</sup>	7,100,673	2,941,406	(2,002,702)	(7,883,456)	
Total financial assets - interest rate sensitive	\$ 9,858,094	\$ 3,253,726	\$ 3,079,739	\$ 84,452,476	\$ 100,644,035
Financial liabilities					

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Repurchase agreements	\$58,866,578	\$21,715,080	\$534,216	\$—	\$81,115,874
Other secured financing	—	65,492	3,591,219	526,600	4,183,311
Debt issued by securitization vehicles (principal)	—	—	883,500	2,453,381	3,336,881
Total financial liabilities - maturity	58,866,578	21,780,572	5,008,935	2,979,981	88,636,066
Effect of utilizing reset dates <sup>(1)(2)</sup>	(48,566,528 )	5,044,601	9,276,308	34,245,619	
Total financial liabilities - interest rate sensitive	\$10,300,050	\$26,825,173	\$14,285,243	\$37,225,600	\$88,636,066
 Maturity gap	 \$(56,109,157)	 \$(21,468,252)	 \$73,506	 \$89,355,951	 \$11,852,048
Cumulative maturity gap	\$(56,109,157)	\$(77,577,409)	\$(77,503,903)	\$11,852,048	
 Interest rate sensitivity gap	 \$(441,956 )	 \$(23,571,447)	 \$(11,205,504)	 \$47,226,876	 \$12,007,969
Cumulative rate sensitivity gap	\$(441,956 )	\$(24,013,403)	\$(35,218,907)	\$12,007,969	

(1) Maturity gap utilizes stated maturities, or prepayment expectations for assets that exhibit prepayment characteristics, while interest rate sensitivity gap utilizes reset dates, if applicable.

(2) Includes effect of interest rate swaps.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 7. Management's Discussion and Analysis

The methodologies we employ for evaluating interest rate risk include an analysis of our interest rate "gap," measurement of the duration and convexity of our portfolio and sensitivities to interest rates and spreads.

#### Stress Testing

We utilize liquidity stress testing to ensure we have sufficient liquidity under a variety of scenarios and stresses. These stress tests assist with the management of our pool of liquid assets and influence our current and future funding plans. Our stress tests are modeled over both short term and longer time horizons. The stresses applied include market-wide and firm-specific stresses.

#### Liquidity Management Policies

We utilize a comprehensive liquidity policy structure to inform our liquidity risk management practices including monitoring and measurement, along with well-defined key limits. Both quantitative and qualitative targets are utilized to measure the ongoing stability and condition of the liquidity position, and include the level and composition of unencumbered assets, as well as both short-term and long-term sustainability of the funding composition under stress conditions.

We also monitor early warning metrics designed to measure the quality and depth of liquidity sources based upon both company-specific and market conditions. The metrics assist in assessing our liquidity conditions and are integrated into our escalation protocol, with various liquidity ratings influencing management actions with respect to contingency planning and potential related actions.

#### Investment/Market Risk Management

One of the primary risks we are subject to is investment/market risk. Changes in the level of interest rates can affect our net interest income, which is the difference between the income we earn on our Interest Earning Assets and the interest expense incurred from Interest Bearing Liabilities and derivatives. Changes in the level of interest rates and spreads can also affect the value of our securities and potential realization of gains or losses from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, swaptions, options, futures and other hedges, in order to limit the adverse effects of interest rates on our results. In the case of interest rate swaps, we may use market agreed coupon ("MAC") interest rate swaps in which we may receive or make a payment at the time of entering such interest rate swap to compensate for the off-market nature of such interest rate swap. MAC interest rate swaps offer increased liquidity and more efficient portfolio administration through compression which is the process of reducing the number of unique interest rate swap contracts and replacing them with fewer contracts containing market defined terms. Our portfolio and the value of our portfolio, including derivatives, may be adversely affected as a result of changing interest rates and spreads.

We simulate a wide variety of interest rate scenarios in evaluating our risk. Scenarios are run to capture our sensitivity to changes in interest rates, spreads and the shape of the yield curve. We also consider the assumptions affecting our analysis such as those related to prepayments. In addition to predefined interest rate scenarios, we utilize Value-at-Risk measures to estimate potential losses in the portfolio over various time horizons utilizing various confidence levels. The following tables estimate the potential changes in economic net interest income over a twelve month period and the immediate effect on our portfolio market value (inclusive of derivative instruments), should interest rates instantaneously increase or decrease by 25, 50 or 75 basis points, and the effect of portfolio market value if mortgage option-adjusted spreads instantaneously increase or decrease by 5, 15 or 25 basis points (assuming shocks are parallel and instantaneous). All changes to income and portfolio market value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at December 31, 2018. The net interest income simulations incorporate the interest expense effect of rate resets on liabilities and derivatives as well as the amortization expense and reinvestment of principal based on the prepayments on our securities, which varies based on the level of rates. The results assume no management actions in response to the rate or spread changes. The following table presents estimates at December 31, 2018. Actual results could differ materially from these estimates.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

Change in Interest Rate <sup>(1)</sup>	Projected Percentage Change in Economic Net Interest Income <sup>(2)</sup>	Estimated Percentage Change in Portfolio Value <sup>(3)</sup>	Estimated Change as a % on NAV <sup>(3)(4)</sup>
-75 Basis points	(18.6%)	—%	(0.1%)
-50 Basis points	(11.0%)	0.1%	0.9%
-25 Basis points	(4.9%)	0.1%	0.9%
Base interest rate	—	—	—
+25 Basis points	1.9%	(0.2%)	(1.8%)
+50 Basis points	3.2%	(0.6%)	(4.3%)
+75 Basis points	3.1%	(1.0%)	(7.3%)
MBS Spread Shock <sup>(1)</sup>	Estimated Change in Portfolio Market Value	Estimated Change as a % on NAV <sup>(3)(4)</sup>	
-25 Basis points	1.5%	11.5%	
-15 Basis points	0.9%	6.9%	
-5 Basis points	0.3%	2.3%	
Base interest rate	—	—	
+5 Basis points	(0.3%)	(2.3%)	
+15 Basis points	(0.9%)	(6.8%)	
+25 Basis points	(1.5%)	(11.2%)	

(1) Interest rate and MBS spread sensitivity are based on results from third party models in conjunction with inputs from our internal investment professionals. Actual results could differ materially from these estimates.

Scenarios include Residential Securities, commercial real estate investments, corporate debt, repurchase

(2) agreements, other secured financing and interest rate swaps. Economic net interest income includes the net interest component of interest rate swaps.

(3) Scenarios include Residential Securities, residential mortgage loans, MSRs and derivative instruments.

(4) NAV represents book value of equity.

## Credit Risk Management

Key risk parameters have been established to specify our credit risk appetite. We will seek to manage credit risk by making investments which conform within the firm's specific investment policy parameters and optimize risk-return attributes.

While we do not expect to encounter credit risk in our Agency investments, we face credit risk on the non-Agency mortgage-backed securities and CRT securities in our portfolio. In addition, we are also exposed to credit risk on residential mortgage loans, commercial real estate investments and corporate debt. MSR values may also be impacted if overall costs to service the underlying mortgage loans increase due to borrower performance. We are subject to risk of loss if an issuer or borrower fails to perform its contractual obligations. We have established policies and procedures for mitigating credit risk, including establishing and reviewing limits for credit exposure. We will originate or purchase commercial investments that meet our comprehensive underwriting process and credit standards and are approved by the appropriate committee. Once a commercial investment is made, our ongoing surveillance process includes regular reviews, analysis and oversight of investments by our investment personnel and appropriate committee. We review credit and other risks of loss associated with each investment. Our management monitors the overall portfolio risk and determines estimates of provision for loss. Our portfolio composition, based on balance sheet values, at December 31, 2018 and December 31, 2017 was as follows:

Category	December 31, 2018		December 31, 2017	
	%		%	
Agency mortgage-backed securities	88.8		90.6	

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Credit risk transfer securities	0.5	% 0.7	%
Non-agency mortgage-backed securities	1.1	% 1.1	%
Residential mortgage loans	2.4	% 1.4	%
Mortgage servicing rights	0.5	% 0.6	%
Commercial real estate <sup>(1)</sup> <sup>(2)</sup>	4.9	% 4.6	%
Corporate debt	1.8	% 1.0	%

<sup>(1)</sup> Includes assets transferred or pledged to securitization vehicles.

<sup>(2)</sup> Net of unamortized origination fees.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 7. Management's Discussion and Analysis

## Counterparty Risk Management

Our use of repurchase and derivative agreements and trading activities create exposure to counterparty risk relating to potential losses that could be recognized if the counterparties to these agreements fail to perform their obligations under the contracts. In the event of default by a counterparty, we could have difficulty obtaining our assets pledged as collateral. A significant portion of our investments are financed with repurchase agreements by pledging our Residential Securities and certain commercial real estate investments as collateral to the lender. The collateral we pledge generally exceeds the amount of the borrowings under each agreement. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged asset, we are at risk of losing the over-collateralization or haircut. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps and other derivatives to manage interest rate risk. Under these agreements, we pledge securities and cash as collateral or settle variation margin payments as part of a margin arrangement.

If a counterparty were to default on its obligations, we would be exposed to a loss to a derivative counterparty to the extent that the amount of our securities or cash pledged exceeded the unrealized loss on the associated derivative and we were not able to recover the excess collateral. Additionally, we would be exposed to a loss to a derivative counterparty to the extent that our unrealized gains on derivative instruments exceeded the amount of the counterparty's securities or cash pledged to us.

We monitor our exposure to counterparties across several dimensions including by type of arrangement, collateral type, counterparty type, ratings and geography.

The following table summarizes our exposure to counterparties by geography at December 31, 2018:

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure <sup>(1)</sup>
(dollars in thousands)				
North America	32	\$58,638,821	\$(142,904)	\$2,666,202
Europe	13	16,775,716	(229,347)	1,415,538
Asia (non-Japan)	1	502,072	—	29,343
Japan	4	5,199,265	—	307,529
Total	50	\$81,115,874	\$(372,251)	\$4,418,612

(1) Represents the amount of cash and/or securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrealized loss on swaps for each counterparty.

## Operational Risk Management

We are subject to operational risk in each of our business and support functions. Operational risk may arise from internal or external sources including human error, fraud, systems issues, process change, vendors, business interruptions and other external events. Model risk considers potential errors with a model's results due to uncertainty in model parameters and inappropriate methodologies used. The result of these risks may include financial loss and reputational damage. We manage operational risk through a variety of tools including policies and procedures that cover topics such as business continuity, personal conduct, cybersecurity and vendor management. Other tools include testing, including disaster recovery testing; systems controls, including access controls; training, including cybersecurity awareness training; and monitoring, which includes the use of key risk indicators. Employee level lines of defense against operational risk include proper segregation of incompatible duties, activity-level internal controls over financial reporting, the empowerment of business units to identify and mitigate operational risk sources, testing by our internal audit staff, and our overall governance framework.

We have established a Cybersecurity Committee to help mitigate cybersecurity risks. The role of the committee is to oversee cyber risk assessments, monitor applicable key risk indicators, review cybersecurity training procedures, oversee the Company's Cybersecurity Incident Response Plan and engage third parties to conduct periodic penetration testing. Our cybersecurity risk assessment includes an evaluation of cyber risk related to sensitive data held by third parties on their systems. The Cybersecurity Committee periodically reports to the ERC, the BRC and the BAC. There is no assurance that these efforts will effectively mitigate cybersecurity risk and mitigation efforts are not an assurance that no cybersecurity incidents will occur. We have purchased cybersecurity insurance, however, there is no assurance that the insurance policy will cover all cybersecurity breaches or that the policy will cover all losses.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Compliance, Regulatory and Legal Risk Management

Our business is organized as a REIT, and we plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances. Accordingly, we closely monitor our REIT status within our risk management program.

The financial services industry is highly regulated and continues to receive increasing attention from regulators, which may impact both our company as well as our business strategy. We proactively monitor the potential impact regulation may have both directly and indirectly on us. We maintain a process to actively monitor both actual and potential legal action that may affect us. Our risk management framework is designed to identify, monitor and manage these risks under the oversight of the ERC.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act, and we plan to continue to meet the requirements for this exemption from registration. The determination that we qualify for this exemption from registration depends on various factual matters and circumstances. Accordingly, in conjunction with our legal department, we closely monitor our compliance with Section 3(c)(5)(C) within our risk management program. The monitoring of this risk is also under the oversight of the ERC.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the U.S. Commodity Futures Trading Commission ("CFTC") gained jurisdiction over the regulation of interest rate swaps. The CFTC has asserted that this causes the operators of mortgage real estate investment trusts that use swaps as part of their business model to fall within the statutory definition of Commodity Pool Operator ("CPO"), and, absent relief from the Division of Swap Dealer and Intermediary Oversight or the CFTC, to register as CPOs. On December 7, 2012, as a result of numerous requests for no-action relief from the CPO registration requirement for operators of mortgage real estate investment trusts, the Division of Swap Dealer and Intermediary Oversight of the CFTC issued no-action relief entitled "No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts" that permits a CPO to receive relief by filing a claim to perfect the use of the relief. A claim submitted by a CPO will be effective upon filing, so long as the claim is materially complete. The conditions that must be met relate to initial margin and premiums requirements, net income derived annually from commodity interest positions that are not qualifying hedging transactions, marketing of interests in the mortgage real estate investment trust to the public, and identification of the entity as a mortgage real estate investment trust in its federal tax filings with the Internal Revenue Service. While we disagree with the CFTC's position that mortgage real estate investment trusts that use swaps as part of their business model fall within the statutory definition of a CPO, we have submitted a claim for the relief set forth in the no-action relief entitled "No-Action Relief from the Commodity Pool Operator Registration Requirement for Commodity Pool Operators of Certain Pooled Investment Vehicles Organized as Mortgage Real Estate Investment Trusts" and believe we meet the criteria for such relief set forth therein.

Critical Accounting Policies and Estimates

Our critical accounting policies that require us to make significant judgments or estimates are described below. For more information on these critical accounting policies and other significant accounting policies, see "Significant Accounting Policies" in the Notes to the Consolidated Financial Statements.

Valuation of Financial Instruments

Residential Securities

There is an active market for our Agency mortgage-backed securities, CRT securities and non-Agency mortgage-backed securities. Since we primarily invest in securities that can be valued using actively quoted prices for actively traded assets, there is a high degree of observable inputs and less subjectivity in measuring fair value. Internal fair values are determined using quoted prices from the TBA securities market, the Treasury curve and the underlying characteristics of the individual securities, which may include coupon, periodic and life caps, reset dates and the expected life of the security. Prepayment rates are difficult to predict and require estimation and judgment in the valuation of Agency mortgage-backed securities. All internal fair values are compared to external pricing sources

and/or dealer quotes to determine reasonableness. Additionally, securities used as collateral for repurchase agreements are priced daily by counterparties to ensure sufficient collateralization, providing additional verification of our internal pricing.

#### Residential Mortgage Loans

There is an active market for the residential whole loans in which we invest. Since we primarily invest in residential loans that can be valued using actively quoted prices for similar assets, there are observable inputs in measuring fair value. Internal fair values are determined using quoted prices for similar market transactions, the swap curve and the underlying characteristics of



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 7. Management's Discussion and Analysis

the individual loans, which may include loan term, coupon, and reset dates. Prepayment rates are difficult to predict and are a significant estimate requiring judgment in the valuation of residential whole loans. All internal fair values are compared to external pricing sources to determine reasonableness.

#### Commercial Real Estate Investments

The fair value of commercial mortgage-backed securities classified as available-for-sale is determined based upon quoted prices of similar assets in recent market transactions and requires the application of judgment due to differences in the underlying collateral. These securities must also be evaluated for other-than-temporary impairment if the fair value of the security is lower than its amortized cost. Determining whether there is an other-than-temporary impairment may require us to exercise significant judgment and make estimates to determine expected cash flows incorporating assumptions such as changes in interest rates and loss expectations. For commercial real estate loans and preferred equity investments classified as held for investment, we apply significant judgment in evaluating the need for a loss reserve. Estimated net recoverable value of the commercial real estate loans and preferred equity investments and other factors such as the fair value of any collateral, the amount and status of senior debt, the prospects of the borrower and the competitive landscape where the borrower conducts business must be considered in determining the allowance for loan losses. For commercial real estate loans held for sale, significant judgment may need to be applied in determining the fair value of the loans and whether a valuation allowance is necessary. Factors that may need to be considered to determine the fair value of a loan held for sale include the borrower's credit quality, liquidity and other market factors and the fair value of the underlying collateral.

#### Interest Rate Swaps

We use the overnight indexed swap ("OIS") curve as an input to value substantially all of our uncleared interest rate swaps. We believe using the OIS curve, which reflects the interest rate typically paid on cash collateral, enables us to most accurately determine the fair value of uncleared interest rate swaps. Consistent with market practice, we exchange collateral (also called margin) based on the fair values of our interest rate swaps. Through this margining process, we may be able to compare our recorded fair value with the fair value calculated by the counterparty or derivatives clearing organization, providing additional verification of our recorded fair value of the uncleared interest rate swaps. We value our cleared interest rate swaps using the prices provided by the derivatives clearing organization.

#### Revenue Recognition

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Residential Securities and their contractual terms. Premiums and discounts associated with the purchase of the Residential Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. We use third-party model and market information to project prepayment speeds. Our prepayment speed projections incorporate underlying loan characteristics (i.e., coupon, term, original loan size, original loan-to-value ratio, etc.) and market data, including interest rate and home price index forecasts and expert judgment. Prepayment speeds vary according to the type of investment, conditions in the financial markets and other factors and cannot be predicted with any certainty. Changes to model assumptions, including interest rates and other market data, as well as periodic revisions to the model will cause changes in the results. Adjustments are made for actual prepayment activity as it relates to calculating the effective yield. Gains or losses on sales of Residential Securities are recorded on trade date based on the specific identification method.

#### Consolidation of Variable Interest Entities

Determining whether an entity has a controlling financial interest in a VIE requires significant judgment related to assessing the purpose and design of the VIE and determination of the activities that most significantly impact its economic performance. We must also identify explicit and implicit variable interests in the entity and consider our involvement in both the design of the VIE and its ongoing activities. To determine whether consolidation of the VIE is required, we must apply judgment to assess whether we have the power to direct the most significant activities of the

VIE and whether we have either the rights to receive benefits or the obligation to absorb losses that could be potentially significant to the VIE.

77

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Use of Estimates

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Glossary of Terms

A

Adjustable-Rate Loan / Security

A loan / security on which interest rates are adjusted at regular intervals according to predetermined criteria. The adjustable interest rate is tied to an objective, published interest rate index.

Agency

Refers to a federally chartered corporation, such as the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or an agency of the U.S. Government, such as the Government National Mortgage Association.

Agency Mortgage-Backed Securities

Refers to residential mortgage-backed securities that are issued or guaranteed by an Agency.

Amortization

Liquidation of a debt through installment payments. Amortization also refers to the process of systematically reducing a recognized asset or liability (e.g., a purchase premium or discount for a debt security) with an offset to earnings.

Average Life

On a mortgage-backed security, the average time to receipt of each dollar of principal, weighted by the amount of each principal prepayment, based on prepayment assumptions.

B

Basis Point ("BP")

One hundredth of one percent, used in expressing differences in interest rates. One basis point is 0.01% of yield. For example, a bond's yield that changed from 3.00% to 3.50% would be said to have moved 50 basis points.

Benchmark

A bond or an index referencing a basket of bonds whose terms are used for comparison with other bonds of similar maturity. The global financial market typically looks to U.S. Treasury securities as benchmarks.

Beneficial Owner

One who benefits from owning a security, even if the security's title of ownership is in the name of a broker or bank.

B-Note

Subordinate mortgage notes and/or subordinate mortgage loan participations.

B-Piece

The most subordinate commercial mortgage-backed security bond class.

Board

Refers to the board of directors of Annaly.

**Bond**

The written evidence of debt, bearing a stated rate or stated rates of interest, or stating a formula for determining that rate, and maturing on a date certain, on which date and upon presentation a fixed sum of money plus interest (usually represented by interest coupons attached to the bond) is payable to the holder or owner. Bonds are long-term securities with an original maturity of greater than one year.

**Book Value Per Share**

Calculated by summing common stock, additional paid-in capital, accumulated other comprehensive income (loss) and accumulated deficit and dividing that number by the total common shares outstanding.

**Broker**

Generic name for a securities firm engaged in both buying and selling securities on behalf of customers or its own account.

**C**

**Capital Buffer**

Includes unencumbered financial assets which can be either sold or utilized as collateral to meet liquidity needs.

**Capital Ratio**

Calculated as total stockholders' equity divided by total assets inclusive of outstanding market value of TBA positions and exclusive of consolidated VIEs.

**Carry**

The amount an asset earns over its hedging and financing costs. A positive carry happens when the rate on the securities being financed is greater than the rate on the funds borrowed. A negative carry is when the rate on the funds borrowed is greater than the rate on the securities that are being financed.

**CMBX**

The CMBX index is a synthetic tradable index referencing a basket of 25 CMBS of a particular rating and vintage. The CMBX index allows investors to take a long position

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

(referred to as selling protection) or short position (referred to as purchasing protection) on the respective basket of CMBS securities and is structured as a "pay-as-you-go" contract whereby the protection seller receives and the protection buyer pays a standardized running coupon on the contracted notional amount. Additionally, the protection seller is obligated to pay to the protection buyer the amount of principal losses and/or coupon shortfalls on the underlying CMBS securities as they occur.

Collateral

Securities, cash or property pledged by a borrower or party to a derivative contract to secure payment of a loan or derivative. If the borrower fails to repay the loan or defaults under the derivative contract, the secured party may take ownership of the collateral.

Collateralized Mortgage Obligation ("CMO")

A multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans.

Commodity Futures Trading Commission ("CFTC")

An independent U.S. federal agency established by the Commodity Futures Trading Commission Act of 1974. The CFTC regulates the swaps, commodity futures and options markets. Its goals include the promotion of competitive and efficient futures markets and the protection of investors against manipulation, abusive trade practices and fraud.

Commercial Mortgage-Backed Security

Securities collateralized by a pool of mortgages on commercial real estate in which all principal and interest from the mortgages flow to certificate holders in a defined sequence or manner.

Constant Prepayment Rate ("CPR")

The percentage of outstanding mortgage loan principal that prepays in one year, based on the annualization of the Single Monthly Mortality, which reflects the outstanding mortgage loan principal that prepays in one month.

Convertible Securities

Securities which may be converted into shares of another security under stated terms, often into the issuing company's common stock.

Convexity

A measure of the change in a security's duration with respect to changes in interest rates. The more convex a security is, the more its duration will change with interest rate changes.

Core Earnings and Core Earnings Per Average Common Share

Core earnings is defined as the sum of (a) economic net interest income, (b) TBA dollar roll income and CMBX coupon income, (c) realized amortization of MSRs, (d) other income (loss) (excluding depreciation and amortization expense on real estate and related intangibles, non-core income allocated to equity method investments and other

non-core components of other income (loss)), (e) general and administrative expenses (excluding transaction expenses and non-recurring items) and (f) income taxes (excluding the income tax effect of non-core income (loss) items), and core earnings (excluding PAA) is defined as core earnings excluding the premium amortization adjustment representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities. Core earnings and core earnings (excluding PAA) per average common share is calculated by dividing core earnings or core earnings (excluding PAA) by average basic common shares for the period. As discussed in the section titled "Non-GAAP Financial Measures", these measures have been updated beginning in the third quarter ended September 30, 2018. Prior

period results will not be adjusted to conform to the revised calculation as the impact in each of those periods is not material.

#### Corporate Debt

Non-government debt instruments issued by corporations. Long-term corporate debt can be issued as bonds or loans.

#### Counterparty

One of two entities in a transaction. For example, in the bond market a counterparty can be a state or local government, a broker-dealer or a corporation.

#### Coupon

The interest rate on a bond that is used to compute the amount of interest due on a periodic basis.

#### Credit and Counterparty Risk

Risk to earnings, capital or business, resulting from an obligor's or counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. Credit and counterparty risk is present in lending, investing, funding and hedging activities.

#### Credit Derivatives

Derivative instruments that have one or more underlyings related to the credit risk of a specified entity (or group of entities) or an index that exposes the seller to potential loss from specified credit-risk related events. An example is credit derivatives referencing the commercial mortgage-backed securities index.

#### Credit Risk Transfer ("CRT") Securities

Credit Risk Transfer securities are risk sharing transactions issued by Fannie Mae and Freddie Mac and similarly structured transactions arranged by third party market participants. The securities issued in the CRT sector are designed to synthetically transfer mortgage credit risk from Fannie Mae, Freddie Mac and/or third parties to private investors.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Current Face

The current remaining monthly principal on a mortgage security. Current face is computed by multiplying the original face value of the security by the current principal balance factor.

D

Dealer

Person or organization that underwrites, trades and sells securities, e.g., a principal market-maker in securities.

Default Risk

Possibility that a bond issuer will fail to pay principal or interest when due.

Derivative

A financial product that derives its value from the price, price fluctuations and price expectations of an underlying instrument, index or reference pool (e.g. futures contracts, options, interest rate swaps, interest rate swaptions and certain to-be-announced securities).

Discount Price

When the dollar price is below face value, it is said to be selling at a discount.

Duration

The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.

E

Economic Capital

A measure of the risk a firm is subject to. It is the amount of capital a firm needs as a buffer to protect against risk. It is a probabilistic measure of potential future losses at a given confidence level over a given time horizon.

Economic Interest Expense

Non-GAAP financial measure that is comprised of GAAP interest expense and the net interest component of interest rate swaps.

Economic Leverage Ratio (Economic Debt-to-Equity Ratio)

Calculated as the sum of recourse debt, TBA derivative and CMBX notional outstanding and net forward purchases (sales) of investments divided by total equity. Recourse debt consists of repurchase agreements and other secured financing (excluding certain non-recourse credit facilities). Debt issued by securitization vehicles, certain credit facilities (included within other secured financing) and mortgages payable are non-recourse to us and are excluded from this measure.

Economic Net Interest Income

Non-GAAP financial measure that is composed of GAAP net interest income less Economic Interest Expense.

Encumbered Assets



Assets on the company's balance sheet which have been pledged as collateral against a liability.

**Eurodollar**

A U.S. dollar deposit held in Europe or elsewhere outside the United States.

**F**

**Face Amount**

The par value (i.e., principal or maturity value) of a security appearing on the face of the instrument.

**Factor**

A decimal value reflecting the proportion of the outstanding principal balance of a mortgage security, which changes over time, in relation to its original principal value.

**Fannie Mae**

Federal National Mortgage Association.

**Federal Deposit Insurance Corporation ("FDIC")**

An independent agency created by the U.S. Congress to maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships.

**Federal Funds Rate**

The interest rate charged by banks on overnight loans of their excess reserve funds to other banks.

**Federal Home Loan Banks ("FHLB")**

U.S. Government-sponsored banks that provide reliable liquidity to member financial institutions to support housing finance and community investment.

**Federal Housing Financing Agency ("FHFA")**

The FHFA is an independent regulatory agency that oversees vital components of the secondary mortgage market including Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

**Financial Industry Regulatory Authority, Inc. ("FINRA")**

FINRA is a non-governmental organization tasked with regulating all business dealings conducted between dealers, brokers and all public investors.

**Fixed-Rate Mortgage**

A mortgage featuring level monthly payments, determined at the outset, which remain constant over the life of the mortgage.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Fixed Income Clearing Corporation ("FICC")

The FICC is an agency that deals with the confirmation, settlement and delivery of fixed-income assets in the U.S. The agency ensures the systematic and efficient settlement of U.S. Government securities and mortgage-backed security transactions in the market.

Floating Rate Bond

A bond for which the interest rate is adjusted periodically according to a predetermined formula, usually linked to an index.

Floating Rate CMO

A CMO tranche which pays an adjustable rate of interest tied to a representative interest rate index such as the LIBOR, the Constant Maturity Treasury or the Cost of Funds Index.

Freddie Mac

Federal Home Loan Mortgage Corporation.

Futures Contract

A legally binding agreement to buy or sell a commodity or financial instrument in a designated future month at a price agreed upon at the initiation of the contract by the buyer and seller. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. A futures contract differs from an option in that an option gives one of the counterparties a right and the other an obligation to buy or sell, while a futures contract represents an obligation of both counterparties, one to deliver and the other to accept delivery. A futures contract is part of a class of financial instruments called derivatives.

G

GAAP

U.S. generally accepted accounting principles.

Ginnie Mae

Government National Mortgage Association.

H

Hedge

An investment made with the intention of minimizing the impact of adverse movements in interest rates or securities prices.

I

In-the-Money

Description for an option that has intrinsic value and can be sold or exercised for a profit; a call option is in-the-money when the strike price (execution price) is below the market price of the underlying security.

#### Interest Bearing Liabilities

Refers to repurchase agreements, debt issued by securitization vehicles, FHLB Des Moines advances and credit facilities. Average Interest Bearing Liabilities is based on daily balances.

#### Interest Earning Assets

Refers to Residential Securities, U.S. Treasury securities, reverse repurchase agreements, commercial real estate debt and preferred equity interests, residential mortgage loans and corporate debt. Average Interest Earning Assets is based on daily balances.

#### Interest-Only (IO) Bond

The interest portion of mortgage, Treasury or bond payments, which is separated and sold individually from the principal portion of those same payments.

#### Interest Rate Risk

The risk that an investment's value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship. As market interest rates rise, the value of current fixed income investment holdings declines. Diversifying, deleveraging and hedging techniques are utilized to mitigate this risk. Interest rate risk is a form of market risk.

#### Interest Rate Swap

A binding agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. For example, one party will pay fixed and receive a variable rate .

#### Interest Rate Swaption

Options on interest rate swaps. The buyer of a swaption has the right to enter into an interest rate swap agreement at some specified date in the future. The swaption agreement will specify whether the buyer of the swaption will be a fixed-rate receiver or a fixed-rate payer.

#### Internal Capital Adequacy Assessment Program ("ICAAP")

The ongoing assessment and measurement of risks, and the amount of capital which is necessary to hold against those risks. The objective is to ensure that a firm is appropriately capitalized relative to the risks in its business.

#### International Swaps and Derivatives Association ("ISDA") Master Agreement

Standardized contract developed by ISDA used as an umbrella under which bilateral derivatives contracts are entered into.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Inverse IO Bond

An interest-only bond whose coupon is determined by a formula expressing an inverse relationship to a benchmark rate, such as LIBOR. As the benchmark rate changes, the IO coupon adjusts in the opposite direction. When the benchmark rate is relatively low, the IO pays a relatively high coupon payment, and vice versa.

Investment/Market Risk

Risk to earnings, capital or business resulting in the decline in value of our assets caused from changes in market variables, such as interest rates, which affect the values of Residential Securities and other investment instruments.

Investment Company Act

Refers to the Investment Company Act of 1940, as amended.

L

Leverage

The use of borrowed money to increase investing power and economic returns.

Leverage Ratio (Debt-to-Equity Ratio)

Calculated as total debt to total stockholders' equity. For purposes of calculating this ratio total debt includes repurchase agreements, other secured financing, debt issued by securitization vehicles and mortgages payable. Certain credit facilities (included within other secured financing), debt issued by securitization vehicles and mortgages payable are non-recourse to us.

LIBOR (London Interbank Offered Rate)

The rate banks charge each other for short-term Eurodollar loans. LIBOR is frequently used as the base for resetting rates on floating-rate securities and the floating-rate legs of interest rate swaps.

Liquidity Risk

Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.

Long-Term CPR

The Company's projected prepayment speeds for certain Agency mortgage-backed securities using third-party model and market information. The Company's prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan-to-value ratio, etc.) and market data, including interest rate and home price index forecasts. Changes to model assumptions, including interest rates and other market data, as well as periodic revisions to the model will cause changes in the results.

Long-Term Debt

Debt which matures in more than one year.

M

Market Agreed Coupon ("MAC") Interest Rate Swap

An interest rate swap contract structure with pre-defined, market agreed terms, developed by SIFMA and ISDA with the purpose of promoting liquidity and simplified administration.

**Monetary Policy**

Action taken by the Federal Open Market Committee of the Federal Reserve System to influence the money supply or interest rates.

**Mortgage-Backed Security (“MBS”)**

A security representing a direct interest in a pool of mortgage loans. The pass-through issuer or servicer collects the payments on the loans in the pool and “passes through” the principal and interest to the security holders on a pro rata basis.

**Mortgage Loan**

A mortgage loan granted by a bank, thrift or other financial institution that is based solely on real estate as security and is not insured or guaranteed by a government agency.

**Mortgage Servicing Rights (“MSRs”)**

Contractual agreements constituting the right to service an existing mortgage where the holder receives the benefits and bears the costs and risks of servicing the mortgage.

N

**NAV**

Net asset value.

**Net Interest Income**

Represents interest income earned on our portfolio investments, less interest expense paid for borrowings.

**Net Interest Margin**

Represents the sum of the Company's interest income plus TBA dollar roll income and CMBX coupon income less interest expense and the net interest component of interest rate swaps divided by the sum of average Interest Earning Assets plus average TBA contract and CMBX balances.

**Net Interest Spread**

Calculated by taking the average yield on Interest Earning Assets minus the average cost of Interest Bearing Liabilities, which includes the net interest component of interest rate swaps.

**Non-Performing Loan (“NPL”)**

A loan that is close to defaulting or is in default.

**Notional Amount**

A stated principal amount in a derivative contract on which the contract is based.

83

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

O

Operational Risk

Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events.

Option Contract

A contract in which the buyer has the right, but not the obligation, to buy or sell an asset at a set price on or before a given date. Buyers of call options bet that a security will be worth more than the price set by the option (the strike price), plus the price they pay for the option itself. Buyers of put options bet that the security's price will drop below the price set by the option. An option is part of a class of financial instruments called derivatives, which means these financial instruments derive their value from the worth of an underlying investment.

Original Face

The face value or original principal amount of a security on its issue date.

Out-of-the-Money

Description for an option that has no intrinsic value and would be worthless if it expired today; for a call option, this situation occurs when the strike price is higher than the market price of the underlying security; for a put option, this situation occurs when the strike price is less than the market price of the underlying security.

Over-The-Counter ("OTC") Market

A securities market that is conducted by dealers throughout the country through negotiation of price rather than through the use of an auction system as represented by a stock exchange.

P

Par

Price equal to the face amount of a security; 100%.

Par Amount

The principal amount of a bond or note due at maturity. Also known as par value.

Pass-Through Security

A securitization structure where a GSE or other entity "passes" the amount collected from the borrowers every month to the investor, after deducting fees and expenses.

Pool

A collection of mortgage loans assembled by an originator or master servicer as the basis for a security. In the case of Ginnie Mae, Fannie Mae, or Freddie Mac mortgage pass-through securities, pools are identified by a number assigned by the issuing agency.

Premium

The amount by which the price of a security exceeds its principal amount. When the dollar price of a bond is above its face value, it is said to be selling at a premium.

Premium Amortization Adjustment (“PAA”)

The cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities.

Prepayment

The unscheduled partial or complete payment of the principal amount outstanding on a mortgage loan or other debt before it is due.

Prepayment Risk

The risk that falling interest rates will lead to increased prepayments of mortgage or other loans, forcing the investor to reinvest at lower prevailing rates.

Prime Rate

The indicative interest rate on loans that banks quote to their best commercial customers.

Principal and Interest

The term used to refer to regularly scheduled payments or prepayments of principal and payments of interest on a mortgage or other security.

R

Rate Reset

The adjustment of the interest rate on a floating-rate security according to a prescribed formula.

Real Estate Investment Trust (“REIT”)

A special purpose investment vehicle that provides investors with the ability to participate directly in the ownership or financing of real-estate related assets by pooling their capital to purchase and manage mortgage loans and/or income property.

Recourse Debt

Debt on which the economic borrower is obligated to repay the entire balance regardless of the value of the pledged collateral. By contrast, the economic borrower’s obligation to repay non-recourse debt is limited to the value of the pledged collateral. Recourse debt consists of repurchase agreements and other secured financing (excluding certain non-recourse credit facilities). Securitized debt, certain credit facilities (included within other secured financing) and mortgages payable are non-recourse to us and are excluded from this measure.

Reinvestment Risk

The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

Re-Performing Loan ("RPL")

A type of loan in which payments were previously delinquent by at least 90 days but have resumed.

Repurchase Agreement

The sale of securities to investors with the agreement to buy them back at a higher price after a specified time period; a form of short-term borrowing. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement.

Residential Securities

Refers to Agency mortgage-backed securities, CRT securities and non-Agency mortgage-backed securities.

Residual

In a CMO, the residual is the tranche that collects any cash flow from the collateral that remains after obligations to the other tranches have been met.

Return on Average Equity

Calculated by taking earnings divided by average stockholders' equity.

Reverse Repurchase Agreement

Refer to Repurchase Agreement. The buyer of securities effectively provides a collateralized loan to the seller.

Risk Appetite Statement

Defines the types and levels of risk we are willing to take in order to achieve our business objectives, and reflects our risk management philosophy.

S

Secondary Market

Ongoing market for bonds previously offered or sold in the primary market.

Secured Overnight Financing Rate ("SOFR")

Broad measure of the cost of borrowing cash overnight collateralized by Treasury securities and was chosen by the Alternative Reference Rate Committee as the preferred benchmark rate to replace dollar LIBOR in coming years.

Settlement Date

The date securities must be delivered and paid for to complete a transaction.

Short-Term Debt

Generally, debt which matures in one year or less. However, certain securities that mature in up to three years may be considered short-term debt.

Spread

When buying or selling a bond through a brokerage firm, investors will be charged a commission or spread, which is the difference between the market price and cost of purchase,

and sometimes a service fee. Spreads differ based on several factors including liquidity.



## T

### Target Assets

Includes Agency mortgage-backed securities, to-be-announced forward contracts, CRT securities, MSRs, non-Agency mortgage-backed securities, residential mortgage loans, commercial real estate investments, and corporate debt.

### To-Be-Announced Securities (“TBAs”)

A contract for the purchase or sale of a mortgage-backed security to be delivered at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date but does not include a specified pool number and number of pools.

### TBA Dollar Roll Income

TBA dollar roll income is defined as the difference in price between two TBA contracts with the same terms but different settlement dates. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the “drop”. TBA dollar roll income represents the equivalent of interest income on the underlying security less an implied cost of financing.

### Total Return

Investment performance measure over a stated time period which includes coupon interest, interest on interest, and any realized and unrealized gains or losses.

### Total Return Swap

A derivative instrument where one party makes payments at a predetermined rate (either fixed or variable) while receiving a return on a specific asset (generally an equity index, loan or bond) held by the counterparty.

## U

### Unencumbered Assets

Assets on our balance sheet which have not been pledged as collateral against an existing liability.

### U.S. Government-Sponsored Enterprise (“GSE”) Obligations

Obligations of Agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress, such as Fannie Mae and Freddie Mac; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis

V

Value-at-Risk ("VaR")

A statistical technique which measures the potential loss in value of an asset or portfolio over a defined period for a given confidence interval.

Variable Interest Entity ("VIE")

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.

Variation Margin

Cash or securities provided by a party to collateralize its obligations under a transaction as a result of a change in value of such transaction since the trade was executed or the last time collateral was provided.

Volatility

A statistical measure of the variance of price or yield over time. Volatility is low if the price does not change very much over a short period of time, and high if there is a greater change.

W

Warehouse Lending

A line of credit extended to a loan originator to fund mortgages extended by the loan originators to property purchasers. The loan typically lasts from the time the mortgage is originated to when the mortgage is sold into the secondary market, whether directly or through a securitization. Warehouse lending can provide liquidity to the loan origination market.

Weighted Average Coupon

The weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a security, weighted by the size of the principal loan balances.

Weighted Average Life ("WAL")

The assumed weighted average amount of time that will elapse from the date of a security's issuance until each dollar of principal is repaid to the investor. The WAL will change as the security ages and depending on the actual realized rate at which principal, scheduled and unscheduled, is paid on the loans underlying the MBS.

Y

Yield-to-Maturity

The expected rate of return of a bond if it is held to its maturity date; calculated by taking into account the current market price, stated redemption value, coupon payments and time to maturity and assuming all coupons are reinvested at the same rate; equivalent to the internal rate of return.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and qualitative disclosures about market risk are contained within the section titled “Risk Management” of Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements and the related notes, together with the Report of Independent Registered Public Accounting Firm thereon, are set forth beginning on page F-1 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed, (1) were effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in ensuring that information required to be disclosed by the Company in reports it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms.

There have been no changes in our internal controls over financial reporting that occurred during the three months ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Management’s Annual Report On Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) or 15d-15(f) under the Securities Exchange Act. Our internal control over financial reporting is a process designed by, or under the supervision of, the Company’s CEO and CFO and effected by the Company’s board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts

and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. As a result, even systems determined to be effective can provide only reasonable assurance regarding the preparation and presentation of financial statements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

87

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In making this assessment, the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission's ("COSO") Internal Control-Integrated Framework (2013). As permitted by the Securities and Exchange Commission guidelines that allow companies to exclude certain acquisitions from their assessment of internal control over financial reporting during the first year after acquisition, the scope of our evaluation excluded the internal controls of certain subsidiaries of Mountain Merger Sub Corporation (successor by merger to MTGE Investment Corp.), namely Annaly Healthcare Investments LLC (formerly Capital Healthcare Investments, LLC) and its subsidiaries, which constituted \$321.6 million and \$115.1 million of total assets and total equity, respectively, as of December 31, 2018, and \$2.1 million of net income (loss) for the year then ended. Based on the Company's management's evaluation under the framework in Internal Control—Integrated Framework (2013), the Company's management concluded that its internal control over financial reporting was effective as of December 31, 2018. The Company's independent registered public accounting firm, Ernst & Young LLP, has issued an attestation report on the Company's internal control over financial reporting, which is included herein.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of  
Annaly Capital Management, Inc. and Subsidiaries

Opinion on Internal Control over Financial Reporting

We have audited Annaly Capital Management, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Annaly Capital Management, Inc. and Subsidiaries' (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

As indicated in the accompanying Management's Annual Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of certain subsidiaries of Mountain Merger Sub Corporation (successor by merger to MTGE Investment Corp.), namely Annaly Healthcare Investments LLC (formerly Capital Healthcare Investments, LLC) and its subsidiaries, which is included in the 2018 consolidated financial statements of the Company and constituted \$321.6 million and \$115.1 million of total assets and total equity, respectively, as of December 31, 2018, and \$2.1 million of net income (loss) for the year then ended. Our audit of internal control over financial reporting of Annaly Capital Management, Inc. and Subsidiaries also did not include an evaluation of the internal control over financial reporting of certain subsidiaries of Mountain Merger Sub Corporation (successor by merger to MTGE Investment Corp.), namely Annaly Healthcare Investments LLC (formerly Capital Healthcare Investments, LLC) and its subsidiaries.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statements of financial condition of the Company as of December 31, 2018 and 2017, and the related consolidated statements of comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2018, the related notes, and financial statement schedules III and IV, and our report dated February 14, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that

transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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

/s/ Ernst & Young LLP

New York, NY

February 14, 2019



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 9B. OTHER INFORMATION

None.

91

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 as to our directors is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018. The information regarding our executive officers required by Item 10 appears in Part I of this Form 10-K. The information required by Item 10 as to our compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018.

We have adopted a Code of Business Conduct and Ethics within the meaning of Item 406(b) of Regulation S-K. This Code of Business Conduct and Ethics applies to our principal executive officer, principal financial officer and principal accounting officer. This Code of Business Conduct and Ethics is publicly available on our website at [www.annaly.com](http://www.annaly.com). We intend to satisfy the disclosure requirements regarding amendments to, or waivers from, certain provisions of this Code of Business Conduct and Ethics by posting on our website.

The information regarding certain matters pertaining to our corporate governance required by Item 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is incorporated by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2018.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity Compensation Plan Information

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

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

The following table provides information as of December 31, 2018 concerning shares of our common stock authorized for issuance under the Incentive Plans.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options,	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under the
---------------	--	--	---

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	warrants and rights		Incentive Plans (excluding securities in column 'a')
Equity compensation plans approved by security holders	209,375	\$ 13.25	29,695,575
Equity compensation plans not approved by security holders	—	—	—
Total	209,375	\$ 13.25	29,695,575

Information with respect to security ownership of certain beneficial owners and management is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2018.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

1. Financial Statements. See Index to Financial Statements below.

2. Schedules to Financial Statements. See Index to Financial Statements below

All financial statement schedules not included have been omitted because they are either inapplicable or the information required is provided in our Financial Statements and Notes thereto.

3. Exhibits. See Exhibit Index below.

EXHIBIT INDEX

Exhibit Number	Exhibit Description
2.1	<u>Agreement and Plan of Merger, by and among the Registrant, Mountain Merger Sub Corporation and MTGE Investment Corp., dated as of May 2, 2018 (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on May 3, 2018).</u>
3.1	<u>Articles of Amendment and Restatement of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed August 5, 1997).</u>
3.2	<u>Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed June 12, 2002).</u>
3.3	<u>Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed August 3, 2006).</u>
3.4	<u>Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Quarterly Report on Form 10-Q filed May 7, 2008).</u>
3.5	<u>Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed June 23, 2011).</u>
3.6	<u>Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A filed April 1, 2004).</u>
3.7	<u>Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the State Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed October 18, 2004).</u>
3.8	<u>Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on 8-K filed April 10, 2006).</u>
3.9	<u>Articles Supplementary designating the Registrant's 7.625% Series C Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed May 16, 2012).</u>
3.10	<u>Articles Supplementary designating the Registrant's 7.50% Series D Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed September 13, 2012).</u>

- 3.11 Articles Supplementary designating the Registrant's 7.625% Series E Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 (incorporated by reference to Exhibit 3.12 to the Registrant's Registration Statement on Form 8-A filed July 12, 2016).
- 3.12 Articles Supplementary reclassifying the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.13 to the Registrant's Registration Statement on Form 8-A filed July 27, 2017).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

- Articles Supplementary designating the Registrant's 6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.14 to the Registrant's Registration Statement on Form 8-A filed July 27, 2017).
- Articles Supplementary reclassifying and designating (1) 7,412,500 authorized but unissued shares of the Registrant's preferred stock, \$0.01 par value per share, without designation as to series or class, as shares of undesignated Common Stock; (2) 650,000 authorized but unissued shares of the Registrant's 7.625% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share, as shares of undesignated Common Stock; and (3) 3,400,000 authorized but unissued shares of the Registrant's 6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, \$0.01 par value per share, as shares of undesignated Common Stock. (incorporated by reference to Exhibit 3.15 of the Registrant's Quarterly Report on Form 10-Q filed November 3, 2017).
- Articles Supplementary designating Annaly's 6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.16 to the Registrant's Registration Statement on Form 8-A filed January 10, 2018).
- Articles Supplementary reclassifying and designating (i) 11,500,000 authorized but unissued shares of the Registrant's preferred stock, \$0.01 par value per share, without designation as to series or class, as shares of Registrant's undesignated common stock and (ii) 5,000,000 authorized but unissued shares of Registrant's 7.625% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share, as shares of Registrant's undesignated common stock (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q filed August 3, 2018).
- Form of Articles Supplementary designating Annaly's 8.125% Series H Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.17 to the Registrant's Registration Statement on Form 8-A filed September 7, 2018).
- Amended and Restated Bylaws of the Registrant, adopted December 13, 2018 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed December 13, 2018).
- Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed September 17, 1997).
- Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed on December 5, 2001).
- Specimen Series C Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed May 16, 2012).
- Specimen Series D Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed September 13, 2012).
- Specimen Series E Preferred Stock Certificate (incorporated by reference to Exhibit 4.7 to the Registrant's Registration Statement (Registration No. 333-211140) on Form S-4/A filed May 27, 2016).
- Specimen Series F Preferred Stock Certificate (incorporated by reference to Exhibit 4.8 to the Registrant's Registration Statement on Form 8-A filed July 27, 2017).
- Specimen Series G Preferred Stock Certificate (incorporated by reference to Exhibit 4.9 to the Registrant's Registration Statement on Form 8-A filed January 10, 2018).
- Specimen Series H Preferred Stock Certificate (incorporated by reference to Exhibit 4.10 to the Registrant's Registration Statement on Form S-4A filed May 31, 2018).
- Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed February 12, 2010).

- 4.10 Indenture, dated as of February 1, 2019, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.7 to the Registrant's Current Report on Form S-3 filed February 1, 2019).
- 4.11 Supplemental Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed February 12, 2010).
- 4.12 Second Supplemental Indenture, dated as of May 14, 2012, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed May 14, 2012).
- 10.1 Long-Term Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed August 5, 1997).\*
- 10.2 Form of Master Repurchase Agreement (incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed August 5, 1997).
- 10.3 Amended and Restated Management Agreement, by and between the Registrant and Annaly Capital Management LLC, dated as of April 12, 2016 (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q filed August 3, 2018).\*



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

<u>10.4</u>	<u>Registrant's 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed June 1, 2010).*</u>
<u>10.5</u>	<u>Registrant's Deferred Compensation Plan for Directors (incorporated by reference to Exhibit 10.5 to the Registrant's Annual Report on Form 10-K filed February 23, 2017).*</u>
<u>10.6</u>	<u>Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed March 20, 2017).</u> <u>Severance and Noncompetition Agreement, by and between the Registrant and Kevin G. Keyes, dated as of August 1, 2018 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed August 3, 2018).*</u>
<u>10.7</u>	
<u>21.1</u>	<u>Subsidiaries of Registrant.</u>
<u>23.1</u>	<u>Consent of Ernst &amp; Young LLP.</u>
<u>31.1</u>	<u>Certification of Kevin G. Keyes, Chief Executive Officer and President (Principal Executive Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>31.2</u>	<u>Certification of Glenn A. Votek, Chief Financial Officer (Principal Financial Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>32.1</u>	<u>Certification of Kevin G. Keyes, Chief Executive Officer and President (Principal Executive Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
<u>32.2</u>	<u>Certification of Glenn A. Votek, Chief Financial Officer (Principal Financial Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
Exhibit 101.INS XBRL	Instance Document †
Exhibit 101.SCH XBRL	Taxonomy Extension Schema Document †
Exhibit 101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document †
Exhibit 101.DEF XBRL	Additional Taxonomy Extension Definition Linkbase Document Created†
Exhibit 101.LAB XBRL	Taxonomy Extension Label Linkbase Document †
Exhibit 101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document †

\* Exhibit Numbers 10.1, 10.3, 10.4, 10.5 and 10.7 are management contracts or compensatory plans required to be filed as Exhibits to this Form 10-K.

† Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition at

December 31, 2018 and December 31, 2017; (ii) Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2018, 2017 and 2016; (iii) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2018, 2017 and 2016; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016; and (v) Notes to Consolidated Financial Statements. Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 16. FORM 10-K SUMMARY

None.

97

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Financial Statements	Page
Report of Independent Registered Public Accounting Firm	<u>F-1</u>

Consolidated Financial Statements as of December 31, 2018 and 2017 and for the Years Ended December 31, 2018, 2017 and 2016

<u>Consolidated Statements of Financial Condition</u>	<u>F-2</u>
---	------------

<u>Consolidated Statements of Comprehensive Income (Loss)</u>	<u>F-3</u>
---	------------

<u>Consolidated Statements of Stockholders' Equity</u>	<u>F-4</u>
--	------------

<u>Consolidated Statements of Cash Flows</u>	<u>F-5</u>
--	------------

Notes To Consolidated Financial Statements

<u>Note 1. Description of Business</u>	<u>F-6</u>
<u>Note 2. Basis of Presentation</u>	<u>F-6</u>
<u>Note 3. Significant Accounting Policies</u>	<u>F-6</u>
<u>Note 4. Financial Instruments</u>	<u>F-9</u>
<u>Note 5. Securities</u>	<u>F-9</u>
<u>Note 6. Loans</u>	<u>F-13</u>
<u>Note 7. Mortgage Servicing Rights</u>	<u>F-19</u>
<u>Note 8. Variable Interest Entities</u>	<u>F-19</u>
<u>Note 9. Real Estate</u>	<u>F-23</u>
<u>Note 10. Derivative Instruments</u>	<u>F-24</u>
<u>Note 11. Fair Value Measurements</u>	<u>F-29</u>
<u>Note 12. Goodwill and Intangible Assets</u>	<u>F-32</u>
<u>Note 13. Secured Financing</u>	<u>F-32</u>
<u>Note 14. Capital Stock</u>	<u>F-35</u>
<u>Note 15. Interest Income and Interest Expense</u>	<u>F-37</u>
<u>Note 16. Net Income (Loss) Per Common Share</u>	<u>F-39</u>
<u>Note 17. Income Taxes</u>	<u>F-39</u>
<u>Note 18. Risk Management</u>	<u>F-40</u>
<u>Note 19. Related Party Transactions</u>	<u>F-40</u>
<u>Note 20. Lease Commitments and Contingencies</u>	<u>F-41</u>
<u>Note 21. Arcola Regulatory Requirements</u>	<u>F-42</u>
<u>Note 22. Acquisition of MTGE Investment Corp.</u>	<u>F-42</u>
<u>Note 23. Summarized Quarterly Results (Unaudited)</u>	<u>F-44</u>
<u>Note 24. Subsequent Events</u>	<u>F-44</u>

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of  
Annaly Capital Management, Inc. and Subsidiaries  
Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial condition of Annaly Capital Management, Inc. and Subsidiaries (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2018, the related notes, and financial statement schedules III and IV, collectively referred to as the "consolidated financial statements". In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 14, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 2012.

New York, NY  
February 14, 2019

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

	December 31, 2018	December 31, 2017
Assets		
Cash and cash equivalents (includes pledged assets of \$1,581,775 and \$579,213, respectively) <sup>(1)</sup>	\$1,735,749	\$706,589
Securities (includes pledged assets of \$87,193,316 and \$84,752,790, respectively) <sup>(2)</sup>	92,623,788	92,563,572
Loans, net (includes pledged assets of \$2,997,051 and \$1,811,062, respectively) <sup>(3)</sup>	4,585,975	2,999,148
Mortgage servicing rights (includes pledged assets of \$3,616 and \$5,224, respectively)	557,813	580,860
Assets transferred or pledged to securitization vehicles	3,833,200	3,306,133
Real estate, net	739,473	485,953
Derivative assets	200,503	313,885
Reverse repurchase agreements	650,040	—
Receivable for unsettled trades	68,779	1,232
Interest receivable	357,365	323,526
Goodwill and intangible assets, net	100,854	95,035
Other assets	333,988	384,117
Total assets	\$105,787,527	\$101,760,050
Liabilities and stockholders' equity		
Liabilities		
Repurchase agreements	\$81,115,874	\$77,696,343
Other secured financing	4,183,311	3,837,528
Debt issued by securitization vehicles	3,347,062	2,971,771
Mortgages payable	511,056	309,686
Derivative liabilities	889,750	607,854
Payable for unsettled trades	583,036	656,581
Interest payable	570,928	253,068
Dividends payable	394,129	347,876
Other liabilities	74,580	207,770
Total liabilities	91,669,726	86,888,477
Stockholders' equity		
Preferred stock, par value \$0.01 per share, 75,950,000 and 70,700,000 authorized, 73,400,000 and 70,700,000 issued and outstanding, respectively	1,778,168	1,720,381
Common stock, par value \$0.01 per share, 1,924,050,000 and 1,929,300,000 authorized, 1,313,763,450 and 1,159,585,078 issued and outstanding, respectively	13,138	11,596
Additional paid-in capital	18,794,331	17,221,265
Accumulated other comprehensive income (loss)	(1,979,865)	(1,126,020)
Accumulated deficit	(4,493,660)	(2,961,749)
Total stockholders' equity	14,112,112	14,865,473
Noncontrolling interests	5,689	6,100
Total equity	14,117,801	14,871,573
Total liabilities and equity	\$105,787,527	\$101,760,050

(1) Includes cash of consolidated Variable Interest Entities ("VIEs") of \$30.4 million and \$42.3 million at December 31, 2018 and 2017, respectively.

(2)

Excludes \$83.6 million and \$66.3 million at December 31, 2018 and 2017, respectively, of non-Agency mortgage-backed securities and \$224.3 million and \$0 at December 31, 2018 and December 31, 2017, respectively, of commercial mortgage-backed securities in consolidated VIEs pledged as collateral and eliminated from the Company's Consolidated Statements of Financial Condition.

- (3) Includes \$97.5 million and \$19.7 million of residential mortgage loans held for sale and \$42.2 million and \$0 of commercial mortgage loans held for sale at December 31, 2018 and 2017, respectively.

See notes to consolidated financial statements.

F-2

---

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

	For The Years Ended December 31,		
	2018	2017	2016
Net interest income			
Interest income	\$3,332,563	\$2,493,126	\$2,210,951
Interest expense	1,897,860	1,008,354	657,752
Net interest income	1,434,703	1,484,772	1,553,199
Realized and unrealized gains (losses)			
Net interest component of interest rate swaps	100,553	(371,108)	(506,681)
Realized gains (losses) on termination or maturity of interest rate swaps	1,409	(160,133)	(113,941)
Unrealized gains (losses) on interest rate swaps	424,081	512,918	282,190
Subtotal	526,043	(18,323)	(338,432)
Net gains (losses) on disposal of investments	(1,124,448)	(3,938)	33,089
Net gains (losses) on other derivatives	(403,001)	261,438	230,580
Net unrealized gains (losses) on instruments measured at fair value through earnings	(158,082)	(39,684)	86,391
Loan loss provision	(3,496)	—	—
Bargain purchase gain	—	—	72,576
Subtotal	(1,689,027)	217,816	422,636
Total realized and unrealized gains (losses)	(1,162,984)	199,493	84,204
Other income (loss)	109,927	115,857	44,144
General and administrative expenses			
Compensation and management fee	179,841	164,322	151,599
Other general and administrative expenses	150,032	59,802	98,757
Total general and administrative expenses	329,873	224,124	250,356
Income (loss) before income taxes	51,773	1,575,998	1,431,191
Income taxes	(2,375)	6,982	(1,595)
Net income (loss)	54,148	1,569,016	1,432,786
Net income (loss) attributable to noncontrolling interests	(260)	(588)	(970)
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756
Dividends on preferred stock	129,312	109,635	82,260
Net income (loss) available (related) to common stockholders	\$(74,904)	\$1,459,969	\$1,351,496
Net income (loss) per share available (related) to common stockholders			
Basic	\$(0.06)	\$1.37	\$1.39
Diluted	\$(0.06)	\$1.37	\$1.39
Weighted average number of common shares outstanding			
Basic	1,209,601,809	1,065,923,652	969,787,583
Diluted	1,209,601,809	1,066,351,616	970,102,353
Other comprehensive income (loss)			
Net income (loss)	\$54,148	\$1,569,016	\$1,432,786
Unrealized gains (losses) on available-for-sale securities	(2,004,166)	(89,997)	(686,414)
Reclassification adjustment for net (gains) losses included in net income (loss)	1,150,321	49,870	(21,883)
Other comprehensive income (loss)	(853,845)	(40,127)	(708,297)
Comprehensive income (loss)	(799,697)	1,528,889	724,489
Comprehensive income (loss) attributable to noncontrolling interests	(260)	(588)	(970)



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Comprehensive income (loss) attributable to Annaly	(799,437 )	1,529,477	725,459
Dividends on preferred stock	129,312	109,635	82,260
Comprehensive income (loss) attributable to common stockholders	\$(928,749 )	\$ 1,419,842	\$643,199

See notes to consolidated financial statements.

F-3

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial StatementsANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(dollars in thousands)

	For The Years Ended December 31,		
	2018	2017	2016
Preferred stock			
Beginning of period	\$ 1,720,381	\$ 1,200,559	\$ 913,059
Issuance	411,335	696,910	—
Acquisition of subsidiary	55,000	—	287,500
Redemption	(408,548 )	(177,088 )	—
End of period	\$ 1,778,168	\$ 1,720,381	\$ 1,200,559
Common stock			
Beginning of period	\$ 11,596	\$ 10,189	\$ 9,359
Issuance	1,103	1,405	—
Buyback of common stock	—	—	(111 )
Acquisition of subsidiary	436	—	939
Direct purchase and dividend reinvestment	3	2	2
End of period	\$ 13,138	\$ 11,596	\$ 10,189
Additional paid-in capital			
Beginning of period	\$ 17,221,265	\$ 15,579,342	\$ 14,675,768
Stock compensation expense	1,961	1,406	7,047
Issuance	1,116,409	1,646,201	—
Buyback of common stock	—	—	(102,601 )
Acquisition of subsidiary	455,507	—	996,768
Redemption of preferred stock	(3,952 )	(8,224 )	—
Direct purchase and dividend reinvestment	3,141	2,540	2,360
End of period	\$ 18,794,331	\$ 17,221,265	\$ 15,579,342
Accumulated other comprehensive income (loss)			
Beginning of period	\$ (1,126,020 )	\$ (1,085,893 )	\$ (377,596 )
Unrealized gains (losses) on available-for-sale securities	(2,004,166 )	(89,997 )	(686,414 )
Reclassification adjustment for net gains (losses) included in net income (loss)	1,150,321	49,870	(21,883 )
End of period	\$ (1,979,865 )	\$ (1,126,020 )	\$ (1,085,893 )
Accumulated deficit			
Beginning of period	\$ (2,961,749 )	\$ (3,136,017 )	\$ (3,324,616 )
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756
Dividends declared on preferred stock	(129,312 )	(109,635 )	(82,260 )
Dividends and dividend equivalents declared on common stock and share-based awards	(1,457,007 )	(1,285,701 )	(1,162,897 )
End of period	\$ (4,493,660 )	\$ (2,961,749 )	\$ (3,136,017 )
Total stockholder's equity	\$ 14,112,112	\$ 14,865,473	\$ 12,568,180
Noncontrolling interests			
Beginning of period	\$ 6,100	\$ 7,792	\$ 9,948
Net income (loss) attributable to noncontrolling interests	(260 )	(588 )	(970 )
Equity contributions from (distributions to) noncontrolling interests	(151 )	(1,104 )	(1,186 )
End of period	\$ 5,689	\$ 6,100	\$ 7,792
Total equity	\$ 14,117,801	\$ 14,871,573	\$ 12,575,972

See notes to consolidated financial statements.

F-4

---

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

	For The Years Ended December 31,		
	2018	2017	2016
Cash flows from operating activities			
Net income (loss)	\$54,148	\$ 1,569,016	\$ 1,432,786
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Amortization of premiums and discounts of investments, net	692,811	872,346	807,572
Amortization of securitized debt premiums and discounts and deferred financing costs	(3,439)	(3,596)	1,633
Depreciation, amortization and other noncash expenses	72,364	27,956	41,808
Net (gains) losses on disposals of investments	1,123,969	3,938	(33,089)
Net (gains) losses on investments and derivatives	136,673	(734,672)	(599,161)
Income from unconsolidated joint ventures	2,840	2,864	4,592
Loan loss provision	3,496	—	—
Bargain purchase gain	—	—	(72,576)
Payments on purchases of loans held for sale	(227,871)	(309,473)	(99,590)
Proceeds from sales and repayments of loans held for sale	97,913	410,285	299,060
Net receipts (payments) on derivatives	480,216	(233,915)	(168,812)
Net change in			
Due to / from brokers	—	(16)	(12)
Other assets	98,104	(58,715)	(110,417)
Interest receivable	(19,563)	(52,202)	27,712
Interest payable	295,640	89,777	6,337
Other liabilities	(185,283)	48,646	43,020
Net cash provided by (used in) operating activities	2,622,018	1,632,239	1,580,863
Cash flows from investing activities			
Payments on purchases of residential securities	(44,624,006)	(40,287,765)	(25,529,322)
Proceeds from sales of residential securities	33,256,888	13,402,428	12,488,907
Principal payments on residential securities	11,365,683	12,016,190	12,470,168
Payments on purchases of MSRs	(381)	(11,493)	(174,167)
Proceeds from sales of MSRs	—	33	—
Payments on purchases of corporate debt	(1,241,818)	(693,095)	(399,713)
Principal payments on corporate debt	378,865	462,622	117,282
Originations and purchases of commercial real estate investments	(815,252)	(504,952)	(1,918,845)
Proceeds from sales of commercial real estate investments	150,059	11,960	39,530
Principal repayments on commercial real estate investments	1,504,032	1,669,900	916,998
Proceeds from reverse repurchase agreements	85,318,562	67,675,100	60,990,000
Payments on reverse repurchase agreements	(85,030,351)	(67,675,100)	(60,990,000)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	26,228	7,998	4,620
Payments on purchases of residential mortgage loans held for investment	(1,286,046)	(928,512)	(65,623)
Proceeds from repayments of residential mortgage loans held for investment	347,451	185,391	18,268
Payments on purchases of equity securities	—	(2,104)	(88,062)
Proceeds from sale of equity securities	—	—	16,112
Cash paid related to asset acquisition, net of cash acquired	(258,334)	—	41,698

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Net payment from disposal of subsidiary	—	5,451	—
Net cash provided by (used in) investing activities	(908,420 )	(14,665,948 )	(2,062,149 )
Cash flows from financing activities			
Proceeds from repurchase agreements and other secured financing	5,117,155,986	6,606,915,741	2,452,599,821
Principal payments on repurchase agreements and other secured financing	(5,116,952,446)	(6,594,482,419)	(2,452,037,156)
Proceeds from issuances of securitized debt	920,142	—	1,381,640
Principal repayments on securitized debt	(1,384,333 )	(1,022,994 )	(343,071 )
Payment of deferred financing cost	(1,072 )	(2,054 )	(3,076 )
Net proceeds from stock offerings, direct purchases and dividend reinvestments	1,532,356	2,347,058	2,362
Redemptions of preferred stock	(412,500 )	(185,312 )	—
Principal payments on participation sold	—	(12,827 )	(336 )
Principal payments on mortgages payable	(716 )	(2,365 )	(23,581 )
Net contributions (distributions) from (to) noncontrolling interests	(971 )	(1,104 )	(1,186 )
Net payments on share repurchases	—	—	(102,712 )
Dividends paid	(1,540,886 )	(1,353,172 )	(1,220,931 )
Net cash provided by (used in) financing activities	(684,438 )	12,200,552	251,774
Net (decrease) increase in cash and cash equivalents	\$1,029,160	\$ (833,157 )	\$ (229,512 )
Cash and cash equivalents including cash pledged as collateral, beginning of period	706,589	1,539,746	1,769,258
Cash and cash equivalents including cash pledged as collateral, end of period	\$1,735,749	\$ 706,589	\$ 1,539,746
Supplemental disclosure of cash flow information			
Interest received	\$3,894,478	\$ 3,447,308	\$ 2,968,161
Dividends received	\$7,564	\$ 5,238	\$ 2,520
Fees received	\$—	\$—	\$ 4,266
Interest paid (excluding interest paid on interest rate swaps)	\$1,726,887	\$ 987,958	\$ 624,784
Net interest paid on interest rate swaps	\$(1,894 )	\$ 369,660	\$ 536,674
Taxes received (paid)	\$(295 )	\$(1,502 )	\$ 934
Noncash investing activities			
Receivable for unsettled trades	\$68,779	\$ 1,232	\$ 51,461
Payable for unsettled trades	\$583,036	\$ 656,581	\$ 65,041
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	\$(853,845 )	\$(40,127 )	\$(708,297 )
Noncash financing activities			
Dividends declared, not yet paid	\$394,129	\$ 347,876	\$ 305,674
Securitized debt assumed through consolidation of VIEs	\$—	\$ 315,111	\$—
See notes to consolidated financial statements.			

F-5

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 and 2016

1. DESCRIPTION OF BUSINESS

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

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

Investment Groups	Description
Annaly Agency Group	Invests in Agency mortgage-backed securities (“MBS”) collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
Annaly Residential Credit Group	Invests primarily in non-Agency residential mortgage assets within securitized products and residential mortgage loan markets.
Annaly Commercial Real Estate Group	Originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
Annaly Middle Market Lending Group	Provides financing to private equity-backed middle market businesses across the capital structure.

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

2. BASIS OF PRESENTATION

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

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported balance sheet amounts and/or disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

3. SIGNIFICANT ACCOUNTING POLICIES

The Company’s significant accounting policies are described below or are included elsewhere in these notes to the Consolidated Financial Statements.

**Principles of Consolidation** – The consolidated financial statements include the accounts of the entities where the Company has a controlling financial interest. In order to determine whether the Company has a controlling financial interest, it first evaluates whether an entity is a voting interest entity (“VOE”) or a variable interest entity (“VIE”). 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.

Voting Interest Entities – A VOE is an entity that has sufficient equity and in which equity investors have a controlling financial interest. The Company consolidates VOEs where it has a majority of the voting equity of such VOE.

Variable Interest Entities – A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that has both (i) the power to control the activities that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

F-6

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The Company performs ongoing reassessments of whether changes in the facts and circumstances regarding the Company's involvement with a VIE causes the Company's consolidation conclusion to change. Refer to the "Variable Interest Entities" Note for further information.

**Equity Method Investments** - For entities that are not consolidated, but where the Company has significant influence over the operating or financial decisions of the entity, the Company accounts for the investment under the equity method of accounting. In accordance with 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. These investments are included in Real estate, net and Other assets with income or loss included in Other income (loss).

**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. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to the Company's interest rate swaps and other derivatives totaled \$1.6 billion and \$579.2 million at December 31, 2018 and December 31, 2017.

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

**Fair Value Measurements and the Fair Value Option** – The Company reports various investments at fair value, including certain eligible financial instruments elected to be accounted for under the fair value option ("FVO"). The Company chooses to elect the fair value option in order to simplify the accounting treatment for certain financial instruments. If an item is accounted for at fair value, including financial instruments elected under the FVO, it is presented at fair value in the Consolidated Statements of Financial Condition and any change in fair value is recorded in Net unrealized gains (losses) on instruments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss). For additional information regarding financial instruments for which the Company has elected the fair value option see the table in the "Financial Instruments" Note.

Refer to the "Fair Value Measurements" Note for a complete discussion on the methodology utilized by the Company to estimate the fair value of certain financial instruments.

**Offsetting Assets and Liabilities** - The Company elected to present all derivative instruments on a gross basis as discussed in the "Derivative Instruments" Note. Reverse repurchase and repurchase agreements are presented net in the Consolidated Statements of Financial Condition if they are subject to netting agreements and they meet the offsetting criteria. Please see below and refer to the "Secured Financing" Note for further discussion on reverse repurchase and repurchase agreements.

**Derivative Instruments** – Derivatives are accounted for in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). The changes in the estimated fair value are presented within Net gains (losses) on other derivatives with the exception of interest rate swaps which are separately presented. None of the Company's derivative transactions have been designated as hedging instruments for accounting purposes. Refer to the "Derivative Instruments" Note for further discussion.



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 ratably over the requisite service period for the entire award.

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

F-7

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

amortization adjustment in each period. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

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

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

**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. As a REIT, the Company will not incur federal income tax to the extent that it distributes its taxable income to its stockholders. The Company and certain of its direct and indirect subsidiaries 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 its taxable income. Refer to the “Income Taxes” Note for further discussion on income taxes.

**Recent Accounting Pronouncements**

The Company considers the applicability and impact of all Accounting Standards Updates (“ASUs”). ASUs not listed below were not applicable, not expected to have a significant impact on the Company’s consolidated financial statements when adopted or did not have a significant impact on the Company’s consolidated financial statements upon adoption.

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
Standards that are not yet adopted			
ASU 2016-13 Financial instruments - Credit losses (Topic 326): Measurement of credit losses on financial instruments	This ASU updates the existing incurred loss model to a current expected credit loss (“CECL”) model for financial assets and net investments in leases that are not accounted for at fair value through earnings. The amendments affect loans, held-to-maturity debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures and any other financial assets not excluded from the scope. There are also limited amendments to the impairment model for available-for-sale debt securities.	January 1, 2020 (early adoption permitted)	The Company plans to adopt the new standard on its effective date. While the Company is continuing to assess the impact the ASU will have on the consolidated financial statements, the measurement of expected credit losses under the CECL model will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts of the financial assets in scope of the model. The Company is developing an appropriate allowance methodology, assessing the impact on the consolidated financial statements and determining appropriate internal controls and financial statement disclosures. Further, based on the amended guidance for available-for-sale debt securities, the Company: <ul style="list-style-type: none"> <li>• 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</li> </ul>

- basis;
- may not consider the length of time fair value has been below amortized cost, and
  - may not consider recoveries of fair value after the balance sheet date when assessing whether a credit loss exists.

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
Standards that were adopted ASU 2017-01 Business combinations (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	The amendments are expected to result in fewer transactions being accounted for as business combinations.
ASU 2016-15 Statement of cash flows (Topic 230): Classification of certain cash receipts and cash payments	This update provides specific guidance on certain cash flow classification issues, including classification of cash receipts and payments that have aspects of more than one class of cash flows. If cash flows cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the predominant source or use of cash flows.	January 1, 2018	As a result of adopting this standard, the Company reclassified its cash flows on reverse repurchase and repurchase agreements entered into by Arcola Securities, Inc. from operating activities to investing and financing activities, respectively, in the Consolidated Statements of Cash Flows. The Company applied the retrospective transition method, which resulted in reclassification of comparative periods.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 4. FINANCIAL INSTRUMENTS

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

Financial Instruments <sup>(1)</sup>

Balance Sheet Line Item	Type / Form	Measurement Basis	December 31, 2018	December 31, 2017
	Assets	(dollars in thousands)		
Securities	Agency mortgage-backed securities <sup>(2)</sup>	Fair value, with unrealized gains (losses) through other comprehensive income	\$89,840,322	\$89,426,437
Securities	Agency mortgage-backed securities <sup>(3)</sup>	Fair value, with unrealized gains (losses) through earnings	912,673	1,125,326
Securities	Credit risk transfer securities	Fair value, with unrealized gains (losses) through earnings	552,097	651,764
Securities	Non-agency mortgage-backed securities	Fair value, with unrealized gains (losses) through earnings	1,161,938	1,097,294
Securities	Commercial real estate debt investments - CMBS	Fair value, with unrealized gains (losses) through other comprehensive income	138,242	244,636
Securities	Commercial real estate debt investments - Conduit CMBS	Fair value, with unrealized gains (losses) through earnings	18,516	18,115
Total securities			92,623,788	92,563,572
Loans, net	Residential mortgage loans	Fair value, with unrealized gains (losses) through earnings	1,359,806	958,546
Loans, net	Commercial real estate debt and preferred equity, held for investment	Amortized cost	1,296,803	1,029,327
Loans, net	Commercial loans held for sale, net	Lower of amortized cost or fair value	42,184	—
Loans, net	Corporate debt	Amortized cost	1,887,182	1,011,275
Total loans, net			4,585,975	2,999,148
Assets transferred or pledged to securitization vehicles	Residential mortgage loans	Fair value, with unrealized gains (losses) through earnings	1,094,831	479,776
Assets transferred or pledged to securitization vehicles	Commercial mortgage loans	Fair value, with unrealized gains (losses) through earnings	2,738,369	2,826,357
Total assets transferred or pledged to securitization vehicles			3,833,200	3,306,133
Reverse repurchase agreements	Reverse repurchase agreements	Amortized cost	650,040	—
	Liabilities			
Repurchase agreements	Repurchase agreements	Amortized cost	81,115,874	77,696,343
Other secured financing	Loans	Amortized cost	4,183,311	3,837,528
	Securities		3,347,062	2,971,771

Debt issued by securitization vehicles		Fair value, with unrealized gains (losses) through earnings		
Mortgages payable	Loans	Amortized cost	511,056	309,686

(1) Receivable for unsettled trades, Interest receivable, Dividends payable, Payable for unsettled trades and Interest payable are accounted for at cost.

(2) Includes Agency pass-through, CMO and multifamily securities.

(3) Includes interest-only securities and reverse mortgages.

## 5. SECURITIES

The Company's investments in securities include agency, credit risk transfer, non-agency and commercial mortgage-backed securities. All of the debt securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, with changes in fair value recognized in other comprehensive income, unless the fair value option is elected in which case changes in fair value are recognized in Net unrealized gains (losses) on instruments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

Transactions for securities are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Gains and losses on disposals of securities are recorded on trade date based on the specific identification method.

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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). When the fair value of a held-to-maturity security is less than the cost, 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 years ended December 31, 2018, 2017 and 2016.

**Agency Mortgage-Backed Securities** - The Company invests in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of residential or multifamily mortgage loans and certificates. Many of the underlying loans and certificates are 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”).

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”). TBA securities without intent to accept delivery (“TBA derivatives”), are accounted for as derivatives as discussed in the “Derivative Instruments” Note.

**Credit Risk Transfer 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.

**Non-Agency Mortgage-Backed Securities**- The Company invests in non-Agency mortgage-backed securities such as those issued in non-performing loan (“NPL”) and re-performing loan (“RPL”) securitizations.

**Commercial Mortgage-Backed Securities (“Commercial Securities”)** - Certain commercial mortgage-backed securities are classified as available-for-sale and reported at fair value with unrealized gains and losses reported as a component of Other comprehensive income (loss). Management evaluates such Commercial Securities for other-than-temporary impairment at least quarterly. The Company elected the fair value option on certain Commercial Securities, including conduit commercial mortgage-backed securities, to simplify the accounting where the unrealized gains and losses on these financial instruments are recorded through earnings.

Agency mortgage-backed securities, non-Agency mortgage-backed securities and CRT securities are referred to herein as “Residential Securities.” Although the Company generally intends to hold most of its Residential Securities until maturity, it may, from time to time, sell any of its Residential Securities as part of the overall management of its portfolio.

The following represents a rollforward of the activity for the Company’s securities:

December 31, 2018

	Residential Securities	Commercial Securities	Total
	(dollars in thousands)		
Beginning balance January 1	\$92,300,821	\$ 262,751	\$92,563,572
Purchases	58,857,206	73,261	58,930,467
Sales	(45,628,102 )	(56,555 )	(45,684,657 )
Principal paydowns	(11,364,599 )	(122,659 )	(11,487,258 )
Amortization / accretion	(705,928 )	675	(705,253 )
Fair value adjustment	(992,368 )	(715 )	(993,083 )
Ending balance December 31	\$92,467,030	\$ 156,758	\$92,623,788



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Financial Statements

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

Agency	December 31, 2018						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(dollars in thousands)						
Fixed-rate pass-through	\$81,144,650	\$3,810,808	\$(36,987)	\$84,918,471	\$264,443	\$(2,130,362)	\$83,052,552
Adjustable-rate pass-through CMO	4,835,983	247,981	(1,337)	5,082,627	7,127	(151,770)	4,937,984
Interest-only	11,113	53	—	11,166	55	—	11,221
Multifamily	6,007,008	1,179,855	—	1,179,855	1,446	(307,412)	873,889
Reverse mortgages	1,802,292	12,329	(5,332)	1,809,289	32,753	(3,477)	1,838,565
Total agency securities	34,650	4,175	—	38,825	69	(110)	38,784
Residential credit	\$93,835,696	\$5,255,201	\$(43,656)	\$93,040,233	\$305,893	\$(2,593,131)	\$90,752,995
CRT	\$542,374	\$28,444	\$(15,466)	\$555,352	\$7,879	\$(11,134)	\$552,097
Alt-A	202,889	349	(31,238)	172,000	10,559	(198)	182,361
Prime	353,108	2,040	(23,153)	331,995	12,821	(830)	343,986
Subprime	423,166	1,776	(65,005)	359,937	35,278	(594)	394,621
NPL/RPL	3,431	—	(30)	3,401	37	—	3,438
Prime jumbo (>=2010 vintage)	225,567	1,087	(4,691)	221,963	1,439	(2,744)	220,658
Prime jumbo (>=2010 vintage) Interest-only	860,085	12,820	—	12,820	4,054	—	16,874
Total residential credit securities	\$2,610,620	\$46,516	\$(139,583)	\$1,657,468	\$72,067	\$(15,500)	\$1,714,035
Total residential securities	\$96,446,316	\$5,301,717	\$(183,239)	\$94,697,701	\$377,960	\$(2,608,631)	\$92,467,030
Commercial							
Commercial securities	\$155,921	9,778	\$(9,740)	\$155,959	\$1,659	\$(860)	\$156,758
Total securities	\$96,602,237	\$5,311,495	\$(192,979)	\$94,853,660	\$379,619	\$(2,609,491)	\$92,623,788
	December 31, 2017						
	Principal / Notional	Remaining Premium	Remaining Discount	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(dollars in thousands)						
Fixed-rate pass-through	\$78,509,335	\$4,514,815	\$(1,750)	\$83,022,400	\$140,115	\$(1,178,673)	\$81,983,842
Adjustable-rate pass-through	6,760,991	277,212	(1,952)	7,036,251	15,776	(103,121)	6,948,906
Interest-only	6,804,715	1,326,761	—	1,326,761	1,863	(242,862)	1,085,762
Multifamily	490,753	5,038	(341)	495,450	84	(1,845)	493,689
Reverse mortgages	35,000	4,527	—	39,527	37	—	39,564
Total agency investments	\$92,600,794	\$6,128,353	\$(4,043)	\$91,920,389	\$157,875	\$(1,526,501)	\$90,551,763
Residential credit							
CRT	\$593,027	\$25,463	\$(3,456)	\$615,034	\$36,730	\$—	\$651,764
Alt-A	204,213	499	(34,000)	170,712	13,976	(802)	183,886
Prime	197,756	358	(24,158)	173,956	18,804	—	192,760
Subprime	554,470	2,037	(78,561)	477,946	56,024	(90)	533,880
NPL/RPL	42,585	14	(117)	42,482	506	—	42,988



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Prime jumbo (>=2010 vintage)	130,025	627	(3,956 )	126,696	1,038	(1,112 )	126,622
Prime jumbo (>=2010 vintage) Interest-only	989,052	15,287	—	15,287	1,871	—	17,158
Total residential credit securities	\$2,711,128	\$44,285	\$(144,248)	\$1,622,113	\$128,949	\$(2,004 )	\$1,749,058
Total residential securities	\$95,311,922	\$6,172,638	\$(148,291)	\$93,542,502	\$286,824	\$(1,528,505)	\$92,300,821
Commercial							
Commercial securities	\$270,288	\$680	\$(9,731 )	\$261,237	\$1,843	\$(329 )	\$262,751
Total securities	\$95,582,210	\$6,173,318	\$(158,022)	\$93,803,739	\$288,667	\$(1,528,834)	\$92,563,572

F-11

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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

	December 31, 2018	December 31, 2017
Investment Type (dollars in thousands)		
Fannie Mae	\$60,270,432	\$63,361,415
Freddie Mac	30,397,556	27,091,978
Ginnie Mae	85,007	98,370
Total	\$90,752,995	\$90,551,763

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

The following table summarizes the Company's Residential Securities at December 31, 2018 and 2017, according to their estimated weighted average life classifications:

	December 31, 2018		December 31, 2017	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
Estimated weighted average life (dollars in thousands)				
Less than one year	\$13,447	\$13,670	\$471,977	\$476,538
Greater than one year through five years	11,710,172	11,928,973	13,838,890	13,925,749
Greater than five years through ten years	80,202,479	82,218,464	77,273,833	78,431,852
Greater than ten years	540,932	536,594	716,121	708,363
Total	\$92,467,030	\$94,697,701	\$92,300,821	\$93,542,502

The estimated weighted average lives of the Residential Securities at December 31, 2018 and 2017 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Residential Securities could be longer or shorter than projected.

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

	December 31, 2018			December 31, 2017		
	Estimated Fair Value (1)	Gross Unrealized Losses (1)	Number of Securities (1)	Estimated Fair Value (1)	Gross Unrealized Losses (1)	Number of Securities (1)
	(dollars in thousands)					
Less than 12 months	\$22,418,036	\$(432,352)	713	\$39,878,158	\$(272,234)	1,114
12 Months or more	43,134,843	(1,853,257)	1,476	39,491,238	(1,011,405)	911
Total	\$65,552,879	\$(2,285,609)	2,189	\$79,369,396	\$(1,283,639)	2,025

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

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

During the year ended December 31, 2018, the Company disposed of \$45.6 billion of Residential Securities, resulting in a net realized loss of (\$1.1) billion. During the year ended December 31, 2017, the Company disposed of \$12.9 billion of Residential Securities, resulting in a net realized loss of (\$6.4) million. During the year ended December 31, 2016, the Company disposed of \$12.3 billion of Residential Securities, resulting in a net realized gain of \$31.0 million.

F-12

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 6. LOANS

The Company invests in residential, commercial and corporate loans. Loans are classified as either held for investment or held for sale. Loans are also eligible to be accounted for under the fair value option. Excluding loans transferred or pledged to securitization vehicles, as of December 31, 2018, the Company reported \$1.4 billion of loans for which the fair value option was elected. If loans are held for investment and the fair value option has not been elected, they are accounted for at amortized cost less impairment. If loans are held for sale and the fair value option was not elected, they are accounted for at the lower of cost or fair value.

Loans can be classified as held for investment if the Company has the intent and ability to hold the loan for the foreseeable future or to maturity or payoff. If the Company has the intent and ability to sell loans, they are classified as held for sale.

**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.

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

The Company may be exposed to various levels of credit risk depending on the nature of its investments and credit enhancements, if any, supporting its assets. The Company’s core investment process includes procedures related to the initial approval and periodic monitoring of credit risk and other risks associated with each investment. The Company’s investment underwriting procedures include evaluation of the underlying borrowers’ ability to manage and operate their respective properties or companies. Management reviews loan-to-value metrics at origination or acquisition of a new investment and if events occur that trigger re-evaluation by management.

Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to, net operating income (“NOI”), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company’s CRE Debt and Preferred Equity Investments, and may consider other factors management deems important.

Management also reviews market pricing to determine each borrower’s ability to refinance their respective assets at the maturity of each loan, economic trends (both macro and those affecting the property specifically), and the supply and demand of competing projects in the sub-market in which each subject property is located. Management monitors the financial condition and operating results of its borrowers and continually assesses the future outlook of the borrower’s

financial performance in light of industry developments, management changes and company-specific considerations. The Company'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.

F-13

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

As of and for the year ended December 31, 2018, the Company recorded a loan loss provision of \$3.5 million on a mezzanine loan secured by 100% of the equity interests in the owner of an office park in suburban Houston, Texas. There was no provision for loan loss recorded as of and for the year ended December 31, 2017.

The following table presents the activity of the Company's loan investments, including loans held for sale, for the year ended December 31, 2018:

	Residential	Commercial	Corporate	Total
	(dollars in thousands)			
Beginning balance January 1, 2018	\$958,546	\$1,029,327	\$1,011,275	\$2,999,148
Purchases	1,816,353	663,683	1,314,445	3,794,481
Sales and transfers <sup>(1)</sup>	(1,227,769 )	—	(72,610 )	(1,300,379 )
Principal Payments	(186,878 )	(353,740 )	(378,865 )	(919,483 )
Change in fair value	2,186	—	—	2,186
Amortization / accretion	(2,632 )	3,213	12,937	13,518
Change in loan loss allowance	—	(3,496 )	—	(3,496 )
Ending balance December 31, 2018	\$1,359,806	\$1,338,987	\$1,887,182	\$4,585,975

<sup>(1)</sup> Includes securitizations, syndications and transfers.

The carrying value of the Company's commercial loans held for sale was \$42.2 million and \$0 at December 31, 2018 and December 31, 2017, respectively.

#### Residential

The Company's residential mortgage loans are primarily comprised of performing adjustable-rate and fixed-rate whole loans. Additionally, the Company consolidates a collateralized financing entity that securitized prime adjustable-rate jumbo residential mortgage loans. The Company also consolidates securitization trusts in which it had purchased subordinated securities because it also has certain powers and rights to direct the activities of such trusts. Please refer to the "Variable Interest Entities" Note for further information related to the Company's consolidated Residential Mortgage Loan Trusts.

The following table presents the fair value and the unpaid principal balances of the residential mortgage loan portfolio, including loans transferred or pledged to securitization vehicles, at December 31, 2018 and 2017:

	December 31, 2018	December 31, 2017
	(dollars in thousands)	
Fair value	\$2,454,637	\$1,438,322
Unpaid principal balance	\$2,425,657	\$1,419,807

The following table provides information regarding the line items and amounts recognized in the Consolidated Statements of Comprehensive Income (Loss) for December 31, 2018 and 2017 for these investments:

	For the Years Ended	
	December 31, 2018	December 31, 2017
	(dollars in thousands)	
Interest income	\$83,259	\$28,817
Net gains (losses) on disposal of investments	(12,934 )	(4,704 )
Net unrealized gains (losses) on instruments measured at fair value through earnings	1,102	8,468
Total included in net income (loss)	\$71,427	\$32,581



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The following table provides the geographic concentrations based on the unpaid principal balances at December 31, 2018 and 2017 for the residential mortgage loans, including loans transferred or pledged to securitization vehicles:

Geographic Concentrations of Residential Mortgage Loans

December 31, 2018		December 31, 2017	
Property location	% of Balance	Property location	% of Balance
California	53.7%	California	49.8%
Florida	7.1%	Florida	9.3%
New York	6.6%	New York	7.1%
All other (none individually greater than 5%)	32.6%	All other (none individually greater than 5%)	33.8%
Total	100.0%	Total	100.0%

The following table provides additional data on the Company's residential mortgage loans, including loans transferred or pledged to securitization vehicles, at December 31, 2018 and 2017:

	December 31, 2018		December 31, 2017	
	Portfolio Range	Portfolio Weighted Average	Portfolio Range	Portfolio Weighted Average
	(dollars in thousands)			
Unpaid principal balance	\$0 - \$3,500	\$457	\$1 - \$3,663	\$514
Interest rate	2.00% - 7.75%	4.72%	1.63% - 7.50%	4.25%
Maturity	1/1/2028 - 11/1/2058	1/11/2046	1/1/2028 - 5/1/2057	2/1/2043
FICO score at loan origination	505 - 823	752	468 - 823	748
Loan-to-value ratio at loan origination	8% - 111%	68%	11% - 100%	68%

At December 31, 2018 and 2017, approximately 47% and 78%, respectively, of the carrying value of the Company's residential mortgage loans, including loans transferred or pledged to securitization vehicles, were adjustable-rate.

Commercial

The Company's commercial real estate loans are comprised of adjustable-rate and fixed-rate loans. The Company designates loans as held for investment if it has the intent and ability to hold the loans until maturity or payoff. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Commercial real estate loans that are designated as held for investment and are originated or purchased by the Company are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less an allowance for losses, if necessary. Origination fees and costs, premiums or discounts are amortized into interest income over the life of the loan.

If the Company intends to sell or securitize the loans and the securitization vehicle is not expected to be consolidated, the loans 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 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. At December 31, 2018, and 2017, approximately 88% and 86%, respectively, of the carrying value of the Company's CRE Debt and Preferred Equity Investments, excluding commercial loans held for sale, were adjustable-rate.



During the year ended December 31, 2017, the Company sold \$115.0 million (\$114.4 million, net of origination fees) of a commercial mortgage loan held for sale to unrelated third parties at carrying value. Accordingly, no gain or loss was recorded in connection with the sale.

F-15

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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

	December 31, 2018		December 31, 2017			
	Outstanding Principal	Carrying Value <sup>(1)</sup>	Percentage of Loan Portfolio <sup>(2)</sup>	Outstanding Principal	Carrying Value <sup>(1)</sup>	Percentage of Loan Portfolio <sup>(2)</sup>
	(dollars in thousands)					
Senior mortgages	\$988,248	\$981,202	75.6 %	\$629,143	\$625,900	60.9 %
Mezzanine loans	319,663	315,601	24.4 %	395,015	394,442	38.2 %
Preferred equity	—	—	— %	9,000	8,985	0.9 %
Total	\$1,307,911	\$1,296,803	100.0 %	\$1,033,158	\$1,029,327	100.0 %

<sup>(1)</sup> Carrying value includes unamortized origination fees of \$7.6 million and \$3.8 million at December 31, 2018 and 2017, respectively.

<sup>(2)</sup> Based on outstanding principal.

The following tables represent a rollforward of the activity for the Company's commercial real estate investments held for investment at December 31, 2018 and 2017:

## December 31, 2018

	Senior Mortgages	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)			
Net carrying value (January 1, 2018)	\$625,900	\$394,442	\$8,985	\$1,029,327
Originations & advances (principal)	575,953	52,224	—	628,177
Principal payments	(216,849 )	(127,575 )	(9,000 )	(353,424 )
Net (increase) decrease in origination fees	(6,624 )	(370 )	—	(6,994 )
Amortization of net origination fees	2,822	376	15	3,213
Allowance for loan losses	—	(3,496 )	—	(3,496 )
Net carrying value (December 31, 2018)	\$981,202	\$315,601	\$—	\$1,296,803

## December 31, 2017

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The following table provides the internal loan risk ratings of commercial real estate investments held for investment as of December 31, 2018 and 2017.

December 31, 2018

Investment Type	Outstanding Principal <sup>(1)</sup>	Percentage of CRE Debt and Preferred Equity Portfolio	Internal Ratings					Loss	Total
			Performing	Performing Closely Monitored	Performing - Special Mention	Substandard <sup>(2)</sup>	Doubtful <sup>(3)</sup>		
(dollars in thousands)									
Senior mortgages	\$988,248	75.6 %	\$653,066	\$215,792	\$55,000	\$64,390	\$—	\$—	-\$988,248
Mezzanine loans	319,663	24.4 %	140,776	38,884	96,400	36,603	7,000	—	319,663
Total	\$1,307,911	100.0 %	\$793,842	\$254,676	\$151,400	\$100,993	\$7,000	—	\$1,307,911

December 31, 2017

Investment Type	Outstanding Principal <sup>(1)</sup>	Percentage of CRE Debt and Preferred Equity Portfolio	Internal Ratings					Loss	Total
			Performing	Performing Closely Monitored	Performing - Special Mention	Substandard <sup>(2)</sup>	Doubtful		
(dollars in thousands)									
Senior mortgages	\$629,143	60.9 %	\$409,878	\$115,075	\$36,800	\$67,390	\$—	—	-\$629,143
Mezzanine loans	395,015	38.2 %	206,169	66,498	122,348	—	—	—	395,015
Preferred equity	9,000	0.9 %	—	—	9,000	—	—	—	9,000
Total	\$1,033,158	100.0 %	\$616,047	\$181,573	\$168,148	\$67,390	\$—	—	-\$1,033,158

<sup>(1)</sup> Excludes Loans held for sale, net.

<sup>(2)</sup> The Company rated two loans as Substandard as of December 31, 2018. The Company evaluated whether an impairment exists and determined in each case that, based on quantitative and qualitative factors, the Company expects repayment of contractual amounts due.

<sup>(3)</sup> The Company rated one loan as Doubtful as of December 31, 2018. The Company evaluated impairment considerations and recognized a loan loss allowance of \$3.5 million as of and for the year ended December 31, 2018.

#### Corporate Debt

The Company's investments in corporate loans are designated as held for investment when the Company has the intent and ability to hold the investment until maturity or payoff. These investments are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the effective interest method. These investments typically take the form of senior secured loans primarily in first or second lien positions. The Company's senior secured loans generally have stated maturities of five to seven years. In connection with these senior secured loans the Company receives a security interest in certain assets of the borrower and such assets support repayment of such loans. Senior secured loans are generally exposed to less credit risk than more junior loans given their seniority to scheduled principal and interest and priority of security in the assets of the borrower.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The Company invests in corporate loans through its Annaly Middle Market Lending Group. The industry and rate attributes of the portfolio at December 31, 2018 and 2017 are as follows:

	Industry Dispersion		December 31, 2017	
	December 31, 2018	Total	December 31, 2017	Total
	Fixed	Floating	Fixed	Floating
	Rate	Rate	Rate	Rate
	(dollars in thousands)			
Aircraft and parts	\$41,342	\$41,342	\$34,814	\$34,814
Arrangement of transportation of freight & cargo	21,632	21,632	—	—
Coating, engraving and allied services	57,223	57,223	64,034	64,034
Computer programming, data processing & other computer related services	242,185	242,185	209,624	209,624
Drugs	35,882	35,882	38,708	38,708
Electrical work	41,760	41,760	—	—
Electronic components & accessories	24,059	24,059	23,916	23,916
Engineering, architectural & surveying	80,748	80,748	—	—
Groceries and related products	—	—	14,794	14,794
Grocery stores	23,431	23,431	23,531	23,531
Home health care services	—	—	23,779	23,779
Insurance agents, brokers and services	48,942	48,942	28,872	28,872
Mailing, reproduction, commercial art and photography, and stenographic	14,843	14,843	—	—
Management and public relations services	487,046	487,046	94,871	94,871
Medical and dental laboratories	26,858	26,858	26,956	26,956
Metal cans & shipping containers	118,248	118,248	—	—
Miscellaneous business services	19,622	19,622	19,723	19,723
Miscellaneous equipment rental and leasing	49,552	49,552	49,129	49,129
Miscellaneous health and allied services, not elsewhere classified	56,003	56,003	25,963	25,963
Miscellaneous nonmetallic minerals, except fuels	—	—	25,992	25,992
Miscellaneous plastic products	9,953	9,953	9,879	9,879
Motor vehicles and motor vehicle equipment	16,563	16,563	—	—
Motor vehicles and motor vehicle parts and supplies	29,046	29,046	12,212	12,212
Nonferrous foundries (castings)	12,948	12,948	—	—
Offices and clinics of doctors of medicine	97,877	97,877	60,000	60,000
Offices of clinics and other health practitioners	21,100	21,100	18,979	18,979
Public warehousing and storage	84,278	84,278	48,890	48,890
Research, development and testing services	33,381	33,381	33,155	33,155
Schools and educational services, not elsewhere classified	19,805	19,805	20,625	20,625
Services allied with the exchange of securities	14,877	14,877	13,960	13,960
Surgical, medical, and dental instruments and supplies	96,607	96,607	29,687	29,687
Telephone communications	61,371	61,371	59,182	59,182
Total	\$1,887,182	\$1,887,182	\$1,011,275	\$1,011,275

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

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

December 31, 2018      December 31, 2017  
(dollars in thousands)

First lien loans	\$ 1,346,356	\$ 582,724
Second lien loans	540,826	428,551
Total	\$ 1,887,182	\$ 1,011,275

F-18

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 7. MORTGAGE SERVICING RIGHTS

The Company owns variable interests in an entity that invests in MSR, refer to the “Variable Interest Entities” Note for a detailed discussion on this topic.

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

The following table presents activity related to MSRs for the years ended December 31, 2018 and 2017:

	December 31, 2018	December 31, 2017
	(dollars in thousands)	
Fair value, beginning of period	\$580,860	\$ 652,216
Sales	—	(33 )
Other <sup>(1)</sup>	(4 )	(27 )
Change in fair value due to		
Changes in valuation inputs or assumptions <sup>(2)</sup>	56,721	(4,629 )
Other changes, including realization of expected cash flows	(79,764 )	(66,667 )
Fair value, end of period	\$557,813	\$ 580,860

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

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

For the years ended December 31, 2018 and 2017, the Company recognized \$112.7 million and \$129.4 million of net servicing income from MSRs in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

## 8. VARIABLE INTEREST ENTITIES

The Company has investments in Freddie Mac securitizations (“FREMF Trusts”) which 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 FREMF Trusts are included in the “Commercial Trusts” in the tables below.

The Company purchased approximately \$94 million of a subordinated tranche in a securitization trust in 2018. As the directing holder, the Company can remove the special servicer with or without cause as well as direct activities that are considered to be most significant to the economic performance of the trust. As such, the Company was determined to be the primary beneficiary and consolidates the trust. The trust is included in “Commercial Trusts” in the tables below.

Upon consolidation, the Company elected the fair value option for the financial assets and liabilities of the Commercial Trusts in order to avoid an accounting mismatch, and to represent more faithfully the economics of its interest in the entities. The fair value option requires that changes in fair value be reflected in the Company's Consolidated Statements of Comprehensive Income (Loss). The Company applied the practical expedient under ASU 2014-07, whereby the Company determines whether the fair value of the financial assets or financial liabilities is more observable as a basis for measuring the less observable financial instruments. The Company has determined that the fair value of the financial liabilities of the Commercial 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 Commercial Trusts are an aggregate fair value derived from the fair value of the financial liabilities, the Company

F-19

---



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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 Commercial Trusts mortgage loans had an aggregate unpaid principal balance of \$2.7 billion at December 31, 2018. At December 31, 2018, there were no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities at December 31, 2018 based upon the Company's process of monitoring events of default on the underlying mortgage loans. The Company consolidates a securitization trust, which is included in "Residential Trusts" in the tables below, 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 the subordinate securities, and a subsidiary of the Company continues to be the master servicer. As such, the Company is deemed to be the primary beneficiary of the residential mortgage trust and consolidates the entity. The Company has elected the fair value option for the financial assets and liabilities of this VIE, but has not elected to apply the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The contractual principal amount of the residential mortgage trust's debt held by third parties was \$72.1 million at December 31, 2018.

In March 2018, the Company closed OBX 2018-01, with a face value of \$327.5 million. In July 2018, the Company closed OBX 2018-EXP1 with a face value of 383.4 million. In October 2018, the Company closed OBX 2018-EXP2 with a face value of \$384.0 million. The OBX 2018-01 Trust, the OBX 2018-EXP1 Trust and the OBX 2018-EXP2 Trust are referred to collectively as the "OBX Trusts". These securitizations represent financing transactions which provide non-recourse financing to the Company that are collateralized by residential mortgage loans purchased by the Company. As of December 31, 2018, a total of \$766.5 million of bonds were issued to third parties and the Company retained \$221.3 million of mortgage-backed securities, which are eliminated in consolidation. The Company is deemed to be the primary beneficiary and consolidates the OBX Trusts because it has power to direct the activities that most significantly impact the OBX Trusts' performance and holds a variable interest that could be potentially significant to these VIEs. The Company has elected the fair value option for the financial assets and liabilities of these VIEs, but has not elected the practical expedient under ASU 2014-13 as prices of both the financial assets and financial liabilities of the residential mortgage trust are available from third-party pricing services. The Company incurred approximately \$5.4 million of costs in connection with these securitizations that were expensed as incurred during the year ended December 31, 2018. The contractual principal amount of the OBX Trusts' debt held by third parties was \$769.0 million at December 31, 2018.

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

In June 2016, a consolidated subsidiary of the Company entered into a credit facility with a third party financial institution. As of December 31, 2018, the borrowing limit on this facility was \$400.0 million. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as collateral manager and because it holds a variable interest in the entity that could potentially be significant to the entity. The Company has pledged as collateral for this facility corporate loans with a carrying amount of \$568.7 million at December 31, 2018. The transfers did not qualify for sale accounting and are reflected as an intercompany secured borrowing that is eliminated upon consolidation. At December 31, 2018, the subsidiary had an intercompany receivable of \$376.6 million, which eliminates upon consolidation and an Other secured financing of \$376.6 million to the third party financial institution.

In July 2017, a consolidated subsidiary of the Company entered into a \$150.0 million credit facility with a third party financial institution. The subsidiary was deemed to be a VIE and the Company was determined to be the primary beneficiary due to its role as servicer and because it holds a variable interest in the entity that could potentially be significant to the entity. The Company has transferred corporate loans to the subsidiary with a carrying amount of \$234.8 million at December 31, 2018, which continue to be reflected in the Company's Consolidated Statements of Financial Condition in Loans. At December 31, 2018, the subsidiary had an Other secured financing of \$150.0 million

to the third party financial institution.

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

The Company’s exposure to the obligations of its VIEs is generally limited to the Company’s investment in the VIEs of \$1.8 billion at December 31, 2018. Assets of the VIEs may only be used to settle obligations of the VIEs. Creditors of the VIEs have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of

F-20

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Financial Statements

financial support to the VIEs. No gains or losses were recognized upon consolidation of existing VIEs. Interest income and expense are recognized using the effective interest method.

The statements of financial condition of the Company's VIEs, excluding the credit facility VIEs and OBX Trusts as the transfers of residential mortgage loans did not meet the criteria to be accounted for as sales, that are reflected in the Company's Consolidated Statements of Financial Condition at December 31, 2018 and 2017 are as follows:

December 31, 2018

	Commercial Trusts	Residential Trusts	MSR Silo
(dollars in thousands)			
Assets			
Cash and cash equivalents	\$—	\$—	\$30,444
Loans	—	—	97,464
Assets transferred or pledged to securitization vehicles	2,738,369	105,003	—
Mortgage servicing rights	—	—	557,813
Interest receivable	11,451	539	—
Other assets	—	4	28,756
Total assets	\$2,749,820	\$105,546	\$714,477
Liabilities			
Debt issued by securitization vehicles (non-recourse)	\$2,509,264	\$71,324	\$—
Other secured financing	—	—	68,385
Interest payable	4,594	238	—
Other liabilities	—	—	1,975
Total liabilities	\$2,513,858	\$71,562	\$70,360

December 31, 2017

	Commercial Trusts	Residential Trusts	MSR Silo
(dollars in thousands)			
Assets			
Cash and cash equivalents	\$—	\$—	\$42,293
Loans	—	—	19,667
Assets transferred or pledged to securitization vehicles	2,826,357	478,811	—
Mortgage servicing rights	—	—	580,860
Interest receivable	10,339	1,599	—
Derivative assets	—	—	1
Other assets	—	1,418	32,354
Total assets	\$2,836,696	\$481,828	\$675,175
Liabilities			
Debt issued by securitization vehicles (non-recourse)	\$2,620,952	\$350,819	\$—
Other secured financing	—	—	10,496
Interest payable	4,554	931	—
Other liabilities	—	112	4,856
Total liabilities	\$2,625,506	\$351,862	\$15,352



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The geographic concentrations of credit risk exceeding 5% of the total loan unpaid principal balances related to the Company's VIEs, excluding the credit facility VIEs and OBX Trusts, at December 31, 2018 are as follows:

Securitized Loans at Fair Value Geographic Concentration of Credit Risk

Commercial Trusts			Residential Trusts		
Property Location	Principal Balance	% of Balance	Property Location	Principal Balance	% of Balance
(dollars in thousands)					
Maryland	\$408,671	15.0 %	California	\$46,574	44.4 %
California	360,279	13.2 %	Texas	13,888	13.2 %
Virginia	336,799	12.4 %	Washington	7,512	7.2 %
Texas	306,590	11.3 %	Illinois	7,239	6.9 %
Pennsylvania	281,084	10.3 %	Florida	5,382	5.1 %
New York	280,552	10.3 %	Other <sup>(1)</sup>	24,325	23.2 %
Massachusetts	179,202	6.6 %			
Other <sup>(1)</sup>	571,873	20.9 %			
Total	\$2,725,050	100.0 %		\$104,920	100.0 %

<sup>(1)</sup> No individual state greater than 5%.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 9. REAL ESTATE

Real estate investments 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.

Real estate investments are depreciated using the straight-line method over the estimated useful lives of the assets, summarized as follows:

Category	Term
Building and building improvements	1 - 44 years
Furniture and fixtures	1 - 4 years

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

Real estate investments, 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.

The Company acquired real estate holdings in connection with the MTGE Acquisition during the year ended December 31, 2018; refer to the "Acquisition of MTGE Investment Corp." Note for additional information. There were no acquisitions of new real estate holdings during the year ended December 31, 2017. The company sold one of its wholly-owned triple net leased properties during the year ended December 31, 2017 for \$12.0 million and recognized a gain on sale of \$5.1 million.

The weighted average amortization period for intangible assets and liabilities at December 31, 2018 is 4.9 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.

	December 31, 2018	December 31, 2017
Real estate, net	(dollars in thousands)	
Land	\$ 128,742	\$ 111,012
Buildings and improvements	581,320	330,959
Furniture, fixtures and equipment	11,602	—
Subtotal	721,664	441,971
Less: accumulated depreciation	(67,026)	(48,920)
Total real estate held for investment, at amortized cost, net	654,638	393,051

Equity in unconsolidated joint ventures	84,835	92,902
Total real estate, net	\$739,473	\$ 485,953

Depreciation expense was \$18.1 million and \$15.8 million for the years ended December 31, 2018 and 2017, respectively and is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

F-23

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
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 the Company for certain operating costs. Rental income is included in Other income (loss) in the Company's Consolidated Statements of Comprehensive Income (Loss).

Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at December 31, 2018 for consolidated investments in real estate are as follows:

December 31, 2018

(dollars in  
thousands)

2019	\$49,950
2020	46,290
2021	43,050
2022	39,327
2023	36,624
Later years	208,706
Total	\$423,947

10. DERIVATIVE INSTRUMENTS

Derivative instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps ("swaptions"), 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.

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

Derivatives are accounted for in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). The changes in the estimated fair value are presented within Net gains (losses) on other derivatives with the exception of interest rate swaps which are separately presented. None of the Company's derivative transactions have been designated as hedging instruments for accounting purposes.



The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. In accordance with a clearing organization's rulebook, the Company presents the fair value of centrally cleared interest rate swaps net of variation margin pledged under such transactions. At December 31, 2018, \$496.2 million of variation margin was reported as a reduction to interest rate swaps, at fair value.

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

F-24

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

using the DCO's market values. MAC interest rate swaps are also centrally cleared and fair valued using internal pricing models and compared to the DCO's market value.

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

The fair value of swaptions is estimated using internal pricing models and compared to the counterparty market value. TBA Dollar Rolls – TBA dollar roll transactions are accounted for as a series of derivative transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities.

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

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

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

Credit Derivatives – The Company may enter into credit derivatives referencing the commercial mortgage-backed securities index, such as the CMBX index, and synthetic total return swaps. Refer to the section titled “Glossary of Terms” located in Part II, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for additional information related to the CMBX index.

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

Derivatives Instruments	December 31, 2018	December 31, 2017
Assets	(dollars in thousands)	
Interest rate swaps	\$48,114	\$ 30,272
Interest rate swaptions	7,216	36,150
TBA derivatives	141,688	29,067
Futures contracts	—	218,361
Purchase commitments	844	35
Credit derivatives <sup>(1)</sup>	2,641	—
	\$200,503	\$ 313,885
Liabilities		
Interest rate swaps	\$420,365	\$ 569,129
TBA derivatives	—	21,776
Futures contracts	462,309	12,285
Purchase commitments	33	157
Credit derivatives <sup>(1)</sup>	7,043	4,507

\$889,750 \$ 607,854

The notional amount of the credit derivatives in which the Company purchased protection was \$30.0 million at December 31, 2018. The maximum potential amount of future payments is the notional amount of credit derivatives in which the Company sold protection of \$451.0 million and \$125.0 million at December 31, 2018 and December 31, 2017, respectively, plus any coupon shortfalls on the underlying tranche. The credit derivative tranches referencing the basket of bonds had a range of ratings between AAA and BBB-.

F-25

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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

December 31, 2018

Maturity	Current Notional <sup>(1)</sup>	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Years to Maturity
(dollars in thousands)				
0 - 3 years	\$31,900,200	1.84 %	2.73 %	1.21
3 - 6 years	16,603,200	2.29 %	2.70 %	4.30
6 - 10 years	18,060,900	2.57 %	2.56 %	8.62
Greater than 10 years	3,901,400	3.63 %	2.59 %	17.33
Total / Weighted average	\$70,465,700	2.17 %	2.68 %	4.26

December 31, 2017

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

<sup>(1)</sup> There were no forward starting swaps at December 31, 2018. Notional amount includes \$8.1 billion forward starting pay fixed swaps at December 31, 2017.

<sup>(2)</sup> Excludes forward starting swaps.

<sup>(3)</sup> Weighted average fixed rate on forward starting pay fixed swaps was 1.86% at December 31, 2017.

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

December 31, 2018

Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
(dollars in thousands)				
Long \$4,075,000	3.30%	3M LIBOR	10.08	3.06

December 31, 2017

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



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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

December 31, 2018

Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	\$ 13,803,000	\$ 13,823,109	\$ 13,964,797	\$ 141,688

December 31, 2017

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

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

December 31, 2018

	Notional - Long Positions	Notional - Short Positions	Weighted Average Years to Maturity
(dollars in thousands)			
U.S. Treasury futures - 2 year	\$ —	—\$(1,166,000 )	1.97
U.S. Treasury futures - 5 year	—	(6,359,400 )	4.39
U.S. Treasury futures - 10 year and greater	—	(11,152,600 )	7.10
Total	\$ —	—\$(18,678,000)	5.86

December 31, 2017

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

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

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

respectively.

F-27

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

December 31, 2018

	Gross Amounts	Amounts Eligible for Offset		Net Amounts
		Financial Instruments	Cash Collateral	
(dollars in thousands)				
<b>Assets</b>				
Interest rate swaps, at fair value	\$48,114	\$(29,308)	\$—	\$18,806
Interest rate swaptions, at fair value	7,216	—	—	7,216
TBA derivatives, at fair value	141,688	—	—	141,688
Purchase commitments	844	—	—	844
Credit derivatives	2,641	(2,641 )	—	—
<b>Liabilities</b>				
Interest rate swaps, at fair value	\$420,365	\$(29,308)	\$(11,856 )	\$379,201
Futures contracts, at fair value	462,309	—	(462,309 )	—
Purchase commitments	33	—	—	33
Credit derivatives	7,043	(2,641 )	(4,402 )	—

December 31, 2017

	Gross Amounts	Amounts Eligible for Offset		Net Amounts
		Financial Instruments	Cash Collateral	
(dollars in thousands)				
<b>Assets</b>				
Interest rate swaps, at fair value	\$30,272	\$(27,379)	\$—	\$2,893
Interest rate swaptions, at fair value	36,150	—	—	36,150
TBA derivatives, at fair value	29,067	(12,551 )	—	16,516
Futures contracts, at fair value	218,361	(12,285 )	—	206,076
Purchase commitments	35	—	—	35
<b>Liabilities</b>				
Interest rate swaps, at fair value	\$569,129	\$(27,379)	\$—	\$541,750
TBA derivatives, at fair value	21,776	(12,551 )	—	9,225
Futures contracts, at fair value	12,285	(12,285 )	—	—
Purchase commitments	157	—	—	157
Credit derivatives	4,507	—	(3,520 )	987

The effect of interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss) is as follows:

Location on Consolidated Statements of Comprehensive  
Income (Loss)

	Realized Gains (Losses) on Interest Rate Swaps	Realized Gains (Losses) on Termination of Interest Rate Swaps	Unrealized Gains (Losses) on Interest Rate Swaps
(dollars in thousands)			
For the years ended			
December 31, 2018	\$100,553	\$1,409	\$424,081
December 31, 2017	\$(371,108)	\$(160,133 )	\$512,918



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

December 31, 2016 \$(506,681) \$(113,941 ) \$282,190

The effect of other derivative contracts on the Company's Consolidated Statements of Comprehensive Income (Loss) is as follows:

Year Ended December 31, 2018

Derivative Instruments	Realized Gain (Loss)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	\$(343,594)	\$134,397	\$(209,197 )
Net interest rate swaptions	(98,248 )	2,679	(95,569 )
Futures	564,418	(668,384 )	(103,966 )
Purchase commitments	—	1,002	1,002
Credit derivatives	9,662	(5,945 )	3,717
Total			\$(404,013 )

F-28

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

Year Ended December 31, 2017

Derivative Instruments	Realized Gain (Loss)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Other Derivatives
(dollars in thousands)			
Net TBA derivatives	\$ 154,575	\$ 65,490	\$ 220,065
Net interest rate swaptions	(935 )	(42,660 )	(43,595 )
Futures	20,459	62,778	83,237
Purchase commitments	—	162	162
Credit derivatives	1,521	28	1,549
Total			\$ 261,418

Certain of the Company's derivative contracts are subject to International Swaps and Derivatives Association Master Agreements or other similar agreements which may contain provisions that grant counterparties certain rights with respect to the applicable agreement upon the occurrence of certain events such as (i) a decline in stockholders' equity in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange.

Upon the occurrence of any one of items (i) through (iv), or another default under the agreement, the counterparty to the applicable agreement has a right to terminate the agreement in accordance with its provisions. The aggregate fair value of all derivative instruments with the aforementioned features are in a net asset position at December 31, 2018.

## 11. FAIR VALUE MEASUREMENTS

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments that are accounted for at fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP requires classification of financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

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

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

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

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

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

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

inputs determining the appropriate level.

Residential Securities, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of the security in its estimates of fair value. Fair value estimates for residential mortgage loans are generated by a discounted cash flow model and are primarily based on observable market-based inputs including discount rates, prepayment speeds, delinquency levels, and credit losses. Management reviews and indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. Certain liquid asset classes, such as Agency fixed-rate pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

F-29

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

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

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

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

For the fair value of debt issued by securitization vehicles, refer to the Note titled "Variable Interest Entities" for additional information.

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

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

December 31, 2018

	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets				
Securities				
Agency mortgage-backed securities	\$—	\$90,752,995	\$—	\$90,752,995
Credit risk transfer securities	—	552,097	—	552,097
Non-Agency mortgage-backed securities	—	1,161,938	—	1,161,938
Commercial mortgage-backed securities	—	156,758	—	156,758
Loans				
Residential mortgage loans	—	1,359,806	—	1,359,806
Mortgage servicing rights	—	—	557,813	557,813
Assets transferred or pledged to securitization vehicles	—	3,833,200	—	3,833,200
Derivative assets				
Interest rate swaps	—	48,114	—	48,114
Other derivatives	—	152,389	—	152,389
Total assets	\$—	\$98,017,297	\$557,813	\$98,575,110
Liabilities				
Debt issued by securitization vehicles	—	3,347,062	—	3,347,062
Derivative liabilities				
Interest rate swaps	—	420,365	—	420,365
Other derivatives	462,309	7,076	—	469,385
Total liabilities	\$462,309	\$3,774,503	\$—	\$4,236,812

F-30

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Financial Statements

December 31, 2017

	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
Assets				
Securities				
Agency mortgage-backed securities	\$—	\$90,551,763	\$—	\$90,551,763
Credit risk transfer securities	—	651,764	—	651,764
Non-Agency mortgage-backed securities	—	1,097,294	—	1,097,294
Commercial mortgage-backed securities	—	262,751	—	262,751
Loans				
Residential mortgage loans	—	958,546	—	958,546
Mortgage servicing rights	—	—	580,860	580,860
Assets transferred or pledged to securitization vehicles	—	3,306,133	—	3,306,133
Derivative assets				
Interest rate swaps	—	30,272	—	30,272
Other derivatives	218,361	65,252	—	283,613
Total assets	\$218,361	\$96,923,775	\$580,860	\$97,722,996
Liabilities				
Debt issued by securitization vehicles	\$—	\$2,971,771	\$—	\$2,971,771
Derivative liabilities				
Interest rate swaps	—	569,129	—	569,129
Other derivatives	12,285	26,440	—	38,725
Total liabilities	\$12,285	\$3,567,340	\$—	\$3,579,625

## Quantitative Information about Level 3 Fair Value Measurements

The Company considers unobservable inputs to be those for which market data is not available and that are developed using the best information available to us about the assumptions that market participants would use when pricing the asset. Relevant inputs vary depending on the nature of the instrument being measured at fair value. The sensitivities of significant unobservable inputs along with interrelationships between and among the significant unobservable inputs and their impact on the fair value measurements are described below. The effect of a change in a particular assumption in the sensitivity analysis below is considered independently from changes in any other assumptions. In practice, simultaneous changes in assumptions may not always have a linear effect on the inputs discussed below. Interrelationships may also exist between observable and unobservable inputs. Such relationships have not been included in the discussion below. For each of the individual relationships described below, the inverse relationship would also generally apply. For MSR, in general, increases in the discount, prepayment or delinquency rates or in annual servicing costs in isolation would result in a lower fair value measurement. A decline in interest rates could lead to higher-than-expected prepayments of mortgages underlying the Company's investments in MSRs, which in turn could result in a decline in the estimated fair value of MSRs. Refer to the Note titled "Mortgage Servicing Rights" for additional information.

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

	December 31, 2018		December 31, 2017	
Valuation Technique	Unobservable Input <sup>(1)</sup>	Range (Weighted Average)	Unobservable Input <sup>(1)</sup>	Range (Weighted Average)
Discounted cash flow	Discount rate	9.0% - 12.0% (9.4%)	Discount rate	10.0% - 15.0% (10.4%)
	Prepayment rate	4.7% - 13.9% (8.0%)	Prepayment rate	4.6% - 22.3% (9.4%)
	Delinquency rate	0.0% - 5.0% (2.3%)	Delinquency rate	0.0% - 13.0% (2.2%)

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Cost to service                      \$82 - \$138 (\$110)                      Cost to service                      \$84 - \$181 (\$102)

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

The following table summarizes the estimated fair values for financial assets and liabilities that are not carried at fair value at December 31, 2018 and 2017.

F-31

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

	Level in Fair Value Hierarchy	December 31, 2018		December 31, 2017	
		Carrying Value	Fair Value	Carrying Value	Fair Value
(dollars in thousands)					
Financial assets					
Loans					
Commercial real estate debt and preferred equity, held for investment	3	\$1,296,803	\$1,303,487	\$1,029,327	\$1,035,095
Commercial loans held for sale, net	3	42,184	42,184	—	—
Corporate debt	2	1,887,182	1,863,524	1,011,275	1,014,139
Financial liabilities					
Repurchase agreements	1,2	\$81,115,874	\$81,115,874	\$77,696,343	\$77,697,828
Other secured financing	1,2	4,183,311	4,183,805	3,837,528	3,837,595
Mortgage payable	3	511,056	507,770	309,686	310,218

## 12. GOODWILL AND INTANGIBLE ASSETS

## Goodwill

The Company's acquisitions are accounted for using the acquisition method if the acquisition is deemed to be a business. Under the acquisition method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The purchase prices are allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of the 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 or more frequently 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.

At December 31, 2018 and 2017, Goodwill totaled \$71.8 million.

## Intangible assets, net

Finite life intangible assets are amortized over their expected useful lives. The following table presents the activity of finite lived intangible assets for the year ended December 31, 2018.

## Intangible Assets, net

(dollars in thousands)

Balance at December 31, 2017	\$23,220
Intangible assets acquired	14,483
Intangible assets divested	81
Less: amortization expense	(8,745 )
Balance at December 31, 2018	\$29,039

## 13. SECURED FINANCING



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

F-32

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Financial Statements

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

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

The Company had outstanding \$81.1 billion and \$77.7 billion of repurchase agreements with weighted average borrowing rates of 2.36% and 1.89%, after giving effect to the Company's interest rate swaps used to hedge cost of funds, and weighted average remaining maturities of 77 days and 58 days at December 31, 2018 and 2017, respectively. The Company has select arrangements with counterparties to enter into repurchase agreements for \$1.1 billion with \$406.1 million available to be drawn at December 31, 2018.

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

December 31, 2018

	Agency Mortgage-Backed Securities (dollars in thousands)	RMBS	Non-Agency Mortgage-Backed Securities	Commercial Loans	Commercial Mortgage-Backed Securities	U.S. Treasury Securities	Total Repurchase Agreements	Weighted Average Rate
1 day	\$—	\$—	\$—	\$—	\$—	\$—	\$—	— %
2 to 29 days	30,661,001	284,906	353,429	—	72,840	640,465	32,012,641	3.50 %
30 to 59 days	8,164,165	—	—	—	—	—	8,164,165	2.33 %
60 to 89 days	18,326,399	88,630	251,441	—	23,302	—	18,689,772	2.62 %
90 to 119 days	10,067,183	—	—	—	—	—	10,067,183	2.54 %
Over 120 days <sup>(1)</sup>	11,263,625	—	116,434	693,939	108,115	—	12,182,113	2.92 %
Total	\$78,482,373	\$373,536	\$721,304	\$693,939	\$204,257	\$640,465	\$81,115,874	2.97 %

December 31, 2017

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

<sup>(1)</sup> Approximately 1% of the total repurchase agreements had a remaining maturity over 1 year at each of December 31, 2018 and 2017.

The following table summarizes the gross amounts of reverse repurchase agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition at December 31, 2018 and 2017. Refer to the "Derivative Instruments" Note for information related to the effect of netting arrangements on the Company's derivative instruments.

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	December 31, 2018		December 31, 2017	
	Reverse	Repurchase	Reverse	Repurchase
	Repurchase	Agreements	Repurchase	Agreements
	Agreements		Agreements	
	(dollars in thousands)			
Gross amounts	\$650,040	\$81,115,874	\$1,250,000	\$78,946,343
Amounts offset	—	—	(1,250,000 )	(1,250,000 )
Netted amounts	\$650,040	\$81,115,874	\$—	\$77,696,343

F-33

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

Other Secured Financing - The Company also finances a portion of its financial assets with advances from the Federal Home Loan Bank of Des Moines ("FHLB Des Moines"). Borrowings from FHLB Des Moines are reported in Other secured financing in the Company's Consolidated Statements of Financial Condition. At December 31, 2018, \$3.6 billion of the advances matures between one to three years. At December 31, 2017, \$2.1 billion of advances from the FHLB Des Moines matured beyond three years and \$1.4 billion matures between one to three years. The weighted average rate of the advances from the FHLB Des Moines was 2.78% and 1.49% at December 31, 2018 and 2017, respectively. The Company held \$147.9 million of capital stock in the FHLB Des Moines at December 31, 2018 and 2017, which is reported at cost and included in Other assets on the Company's Consolidated Statements of Financial Condition.

Investments pledged as collateral under secured financing arrangements and interest rate swaps, excluding residential and senior securitized commercial mortgage loans of consolidated VIEs, had an estimated fair value and accrued interest of \$90.2 billion and \$303.1 million, respectively, at December 31, 2018 and \$87.0 billion and \$267.3 million, respectively, at December 31, 2017.

The fair value of collateral received in connection with reverse repurchase agreements was \$650.0 million, which the Company fully repledged, and \$0 as of December 31, 2018 and December 31, 2017, respectively.

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

December 31, 2018

Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Ventures (fixed)	\$316,275	\$318,664	4.03% - 4.96%	Fixed	2024 - 2029	First liens
Joint Ventures (floating)	16,125	16,125	L+2.75%	Floating	3/14/2020	First liens
Virginia	95,827	97,667	2.75% - 4.96%	Fixed	2019-2053	First liens
Texas	32,189	33,735	3.28%	Fixed	1/1/2053	First liens
Utah (floating)	9,703	9,706	L+3.50%	Floating	1/31/2019	First liens
Utah (fixed)	7,279	7,201	3.69%	Fixed	6/1/2053	First liens
Minnesota	13,438	13,473	3.69%	Fixed	6/1/2053	First liens
Tennessee	12,328	12,350	4.01%	Fixed	9/6/2019	First liens
Wisconsin	7,892	7,913	3.69%	Fixed	6/1/2053	First liens
Total	\$511,056	\$516,834				

December 31, 2017

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

The following table details future mortgage loan principal payments at December 31, 2018:

Mortgage Loan

Principal Payments

(dollars in thousands)

2019	\$36,109
2020	19,408

2021	3,490
2022	3,709
2023	3,844
Later years	450,274
Total	\$516,834

F-34

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 14. CAPITAL STOCK

## (A) Common Stock

The following table provides a summary of the Company's common shares authorized and issued and outstanding at December 31, 2018 and 2017.

	Shares authorized		Shares issued and outstanding		Par Value
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017	
Common stock	1,924,050,000	1,929,300,000	1,313,763,450	1,159,585,078	\$0.01

During the year ended December 31, 2018, the Company issued 43.6 million shares of common stock as part of the consideration for the MTGE Acquisition.

During the year ended December 31, 2018, the Company closed the public offering of an original issuance of 75.0 million shares of common stock for proceeds of \$762.8 million before deducting offering expenses. In connection with the offering, the Company granted the underwriters a thirty-day option to purchase up to an additional 11.3 million shares of common stock, which the underwriters exercised in full resulting in an additional \$114.4 million in proceeds before deducting offering expenses.

During the year ended December 31, 2017, the Company issued 140.5 million shares of common stock for proceeds of \$1.7 billion before deducting offering expenses.

No options were exercised during the years ended December 31, 2018, 2017, and 2016.

The following table provides a summary of activity related to the Company's Direct Purchase and Dividend Reinvestment Program.

	December 31, 2018	December 31, 2017
Shares issued through direct purchase and dividend reinvestment program	302,000	219,000
Amount raised from direct purchase and dividend reinvestment program	\$3,144	\$ 2,542

In January 2018, the Company entered into separate Distribution Agency Agreements (collectively, the "Sales Agreements") with each of Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Barclays Capital Inc., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Goldman Sachs & Co. LLC, J.P. Morgan Securities LLC, Keefe, Bruyette & Woods, Inc., RBC Capital Markets, LLC and UBS Securities LLC (the "Sales Agents"). The Company may offer and sell shares of its common stock, having an aggregate offering price of up to \$1.5 billion from time to time through any of the Sales Agents. During the year ended December 31, 2018, the Company issued 24.0 million shares under the at-the-market sales program for proceeds of \$251.1 million, net of commissions and fees.

## (B) Preferred Stock

The following is a summary of the Company's cumulative redeemable preferred stock outstanding at December 31, 2018 and 2017. In the event of a liquidation or dissolution of the Company, the Company's then outstanding preferred stock takes precedence over the Company's common stock with respect to payment of dividends and the distribution of assets.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

	Shares Authorized		Shares Issued And Outstanding		Carrying Value		Contractual Rate	Earliest Redemption Date <sup>(1)</sup>	Date At Which Dividend Rate Becomes Floating	Floating Annual Rate
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017				
Fixed-rate	(dollars in thousands)									
Series C	7,000,000	12,000,000	7,000,000	12,000,000	\$ 169,466	\$ 290,514	7.625%	5/16/2017	NA	NA
Series D	18,400,000	18,400,000	18,400,000	18,400,000	445,457	445,457	7.50%	9/13/2017	NA	NA
Series E	—	11,500,000	—	11,500,000	—	287,500	7.625%	8/27/2017	NA	NA
Series H	2,200,000	—	2,200,000	—	55,000	—	8.125%	5/22/2019	NA	NA
Fixed-to-floating rate										
Series F	28,800,000	28,800,000	28,800,000	28,800,000	696,910	696,910	6.95%	9/30/2022	9/30/2022	3M LIBOR + 4.993%
Series G	19,550,000	—	17,000,000	—	411,335	—	6.50%	3/31/2023	3/31/2023	3M LIBOR + 4.172%
Total	75,950,000	70,700,000	73,400,000	70,700,000	\$ 1,778,168	\$ 1,720,381				

(1) Subject to the Company's right under limited circumstances to redeem preferred stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change in control of the Company.

Each series of preferred stock has a par value of \$0.01 per share and a liquidation and redemption price of \$25.00, plus accrued and unpaid dividends through their redemption date. Through December 31, 2018, the Company had declared and paid all required quarterly dividends on the Company's preferred stock.

During the year ended December 31, 2018, the Company issued 17.0 million shares of its 6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock ("Series G Preferred Stock") for gross proceeds of \$425.0 million before deducting the underwriting discount and other estimated offering expenses and 2.2 million shares of its Series H Cumulative Redeemable Preferred Stock ("Series H Preferred Stock") in connection with the acquisition of MTGE Investment Corp. Refer to the "Acquisition of MTGE Investment Corp." Note for additional information related to the Company's Series H Preferred Stock.

During the year ended December 31, 2018, the Company redeemed 5.0 million shares of its Series C Cumulative Redeemable Preferred Stock ("Series C Preferred Stock") for \$125.0 million and all 11.5 million of its issued and outstanding shares of Series E Cumulative Redeemable Preferred Stock ("Series E Preferred Stock") for \$287.5 million. During the year ended December 31, 2017, the Company issued 28.8 million shares of its 6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock ("Series F Preferred Stock"), liquidation preference of \$25.00 per share, for gross proceeds of \$720.0 million before deducting the underwriting discount and other offering expenses.

On August 25, 2017, the Company redeemed all 7.4 million of its issued and outstanding shares of 7.875% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") for \$187.5 million.

The Series C Preferred Stock, Series D Cumulative Redeemable Preferred Stock, Series F Preferred Stock, Series G Preferred Stock and Series H Preferred Stock rank senior to the common stock of the Company.



(C) Distributions to Stockholders

F-36

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The following table provides a summary of the Company's dividend distribution activity for the periods presented:

	For the Years Ended	
	December 31, 2018	December 31, 2017
	(dollars in thousands, except per share data)	
Dividends and dividend equivalents declared on common stock and share-based awards	\$ 1,457,007	\$ 1,285,701
Distributions declared per common share	\$ 1.20	\$ 1.20
Distributions paid to common stockholders after period end	\$ 394,129	\$ 347,876
Distributions paid per common share after period end	\$ 0.30	\$ 0.30
Date of distributions paid to common stockholders after period end	January 31, 2019	January 31, 2018
Dividends declared to series A preferred stockholders	\$ —	\$ 9,527
Dividends declared per share of series A preferred Stock	\$ —	\$ 1.285
Dividends declared to series C preferred stockholders	\$ 14,323	\$ 22,875
Dividends declared per share of series C preferred stock <sup>(1)</sup>	\$ 1.906	\$ 1.906
Dividends declared to series D preferred stockholders	\$ 34,500	\$ 34,500
Dividends declared per share of series D preferred stock	\$ 1.875	\$ 1.875
Dividends declared to series E preferred stockholders	\$ 2,253	\$ 21,922
Dividends declared per share of series E preferred stock	\$ 0.196	\$ 1.906
Dividends declared to series F preferred stockholders	\$ 50,040	\$ 20,811
Dividends declared per share of series F preferred stock	\$ 1.738	\$ 0.724
Dividends declared to series G preferred stockholders	\$ 26,781	\$ —
Dividends declared per share of series G preferred stock	\$ 1.575	\$ —
Dividends declared to series H preferred stockholders	\$ 1,415	\$ —
Dividends declared per share of series H preferred stock	\$ 0.643	\$ —

<sup>(1)</sup> Includes dividends declared per share for shares outstanding at December 31, 2018.

## 15. INTEREST INCOME AND INTEREST EXPENSE

Refer to the note titled "Significant Accounting Policies" for details surrounding the Company's accounting policy related to net interest income on securities and loans.

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

	Interest Income Methodology
Agency	
Fixed-rate pass-through <sup>(1)</sup>	Effective yield <sup>(3)</sup>
Adjustable-rate pass-through <sup>(1)</sup>	Effective yield <sup>(3)</sup>
Multifamily <sup>(1)</sup>	Contractual Cash Flows
Collateralized mortgage obligation ("CMO")	Effective yield <sup>(3)</sup>
Reverse mortgages <sup>(2)</sup>	Prospective
Interest-only <sup>(2)</sup>	Prospective
Residential credit	
CRT <sup>(2)</sup>	Prospective
Alt-A <sup>(2)</sup>	Prospective
Prime <sup>(2)</sup>	Prospective
Subprime <sup>(2)</sup>	Prospective

NPL/RPL <sup>(2)</sup>	Prospective
Prime jumbo <sup>(2)</sup>	Prospective
Prime jumbo interest-only <sup>(2)</sup>	Prospective

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

F-37

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

The following presents the components of the Company's interest income and interest expense for the years ended December 31, 2018, 2017 and 2016.

	For the Years Ended December 31,		
	2018	2017	2016
Interest income	(dollars in thousands)		
Residential securities	\$2,830,521	\$2,170,041	\$1,944,457
Residential mortgage loans	83,260	30,540	4,147
Commercial investment portfolio <sup>(1)</sup>	356,981	273,884	252,436
U.S. Treasury securities	160	—	—
Reverse repurchase agreements	61,641	18,661	9,911
Total interest income	\$3,332,563	\$2,493,126	\$2,210,951
Interest expense			
Repurchase agreements	1,698,930	891,819	585,826
Debt issued by securitization vehicles	98,013	60,304	44,392
Participation sold	—	195	627
Other	100,917	56,036	26,907
Total interest expense	1,897,860	1,008,354	657,752
Net interest income	\$1,434,703	\$1,484,772	\$1,553,199

<sup>(1)</sup> Includes commercial real estate debt and preferred equity, corporate debt and assets transferred or pledged to securitization vehicles.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 16. NET INCOME (LOSS) PER COMMON SHARE

The following table presents a reconciliation of net income (loss) and shares used in calculating basic and diluted net income (loss) per share for the years ended December 31, 2018, 2017 and 2016.

	For the Years Ended		
	December 31, 2018	December 31, 2017	December 31, 2016
	(dollars in thousands, except per share data)		
Net income (loss)	\$54,148	\$ 1,569,016	\$ 1,432,786
Net income (loss) attributable to noncontrolling interests	(260 )	(588 )	(970 )
Net income (loss) attributable to Annaly	54,408	1,569,604	1,433,756
Dividends on preferred stock	129,312	109,635	82,260
Net income (loss) available (related) to common stockholders	\$(74,904)	\$ 1,459,969	\$ 1,351,496
Weighted average shares of common stock outstanding-basic	1,209,601,800	965,923,652	969,787,583
Add: Effect of stock awards, if dilutive	—	427,964	314,770
Weighted average shares of common stock outstanding-diluted	1,209,601,800	966,351,616	970,102,353
Net income (loss) per share available (related) to common share			
Basic	\$(0.06 )	\$ 1.37	\$ 1.39
Diluted	\$(0.06 )	\$ 1.37	\$ 1.39

Options to purchase 0.2 million shares, 0.8 million shares and 1.1 million shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the years ended December 31, 2018, 2017 and 2016, respectively.

## 17. INCOME TAXES

For the year ended December 31, 2018 the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company will not incur federal income tax to the extent that it distributes its taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its stockholders and meet certain other requirements that relate to, among other things, assets it may hold, income it may generate and its stockholder composition. It is generally the Company's policy to distribute 100% of its REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, the Company distributes such shortfall within the next year as permitted by the Code.

The Company and certain of its direct and indirect subsidiaries, including Annaly TRS, Inc., Arcola Securities, Inc. ("Arcola") and certain subsidiaries of Mountain Merger Sub Corp., have made separate joint elections to treat these subsidiaries as TRSs. As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.

The provisions of ASC 740, Income Taxes ("ASC 740"), clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were deemed necessary at December 31, 2018 and December 31, 2017.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees as well as certain excise, franchise or business taxes. The Company's TRSs are subject to federal, state and local taxes.

During the years ended December 31, 2018, December 31, 2017 and December 31, 2016 the Company recorded (\$2.4) million, \$7.0 million and (\$1.8) million, respectively, of income tax expense (benefit) attributable to its TRSs. The Company's federal, state and local tax returns from 2015 and forward remain open for examination.

F-39

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 18. RISK MANAGEMENT

The primary risks to the Company are liquidity, investment/market risk and credit risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest earning assets and the interest expense incurred in connection with the interest bearing liabilities, by affecting the spread between the interest earning assets and interest bearing liabilities. Changes in the level of interest rates can also affect the value of the interest earning assets and the Company's ability to realize gains from the sale of these assets. A decline in the value of the interest earning assets pledged as collateral for borrowings under repurchase agreements and derivative contracts could result in the counterparties demanding additional collateral or liquidating some of the existing collateral to reduce borrowing levels.

The Company may seek to mitigate the potential financial impact by entering into interest rate agreements such as interest rate swaps, interest rate swaptions and other hedges.

Weakness in the mortgage market, the shape of the yield curve and changes in the expectations for the volatility of future interest rates may adversely affect the performance and market value of the Company's investments. This could negatively impact the Company's book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its investments at an inopportune time when prices are depressed. The Company has established policies and procedures for mitigating risks, including conducting scenario and sensitivity analyses and utilizing a range of hedging strategies.

The payment of principal and interest on the Freddie Mac and Fannie Mae Agency mortgage-backed securities, which exclude CRT securities issued by Freddie Mac and Fannie Mae, is guaranteed by those respective agencies and the payment of principal and interest on Ginnie Mae Agency mortgage-backed securities is backed by the full faith and credit of the U.S. government. Substantially all of the Company's Agency mortgage-backed securities have an actual or implied "AAA" rating.

The Company faces credit risk on the portions of its portfolio which are not guaranteed by the respective Agency or by the full faith and credit of the U.S. government. The Company is exposed to credit risk on CRE Debt and Preferred Equity Investments, real estate investments, commercial mortgage-backed securities, residential mortgage loans, CRT securities, other non-Agency mortgage-backed securities and corporate debt. MSR values may also be adversely impacted if overall costs to service the underlying mortgage loans increase due to borrower performance. The Company is exposed to risk of loss if an issuer, borrower, tenant or counterparty fails to perform its obligations under contractual terms. The Company has established policies and procedures for mitigating credit risk, including reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and continually assessing the creditworthiness of issuers, borrowers, tenants and counterparties.

## 19. RELATED PARTY TRANSACTIONS

### Management Agreement

The Company and the Manager have entered into a management agreement pursuant to which the Company's management is conducted by the Manager through the authority delegated to it in the Management Agreement and pursuant to the policies established by the Board (the "Externalization"). The management agreement was effective as of July 1, 2013 and was amended on November 5, 2014, amended and restated on April 12, 2016, and amended and restated on August 1, 2018 (the management agreement, as amended and restated, is referred to as "Management Agreement").

Under the Management Agreement, the Manager, subject to the supervision and direction of the Company's Board, is responsible for (i) the selection, purchase and sale of assets for the Company's investment portfolio; (ii) recommending alternative forms of capital raising; (iii) supervising the Company's financing and hedging activities; and (iv) day to day management functions. The Manager also performs such other supervisory and management services and

activities relating to the Company's assets and operations as may be appropriate. In exchange for the management services, the Company pays the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of our stockholder's equity (as defined in the Management Agreement), and the Manager is responsible for providing personnel to manage the Company, and paying all compensation and benefit expenses associated with such personnel. The Company does not pay the Manager any incentive fees.

For the years ended December 31, 2018, 2017 and 2016, the compensation and management fee was \$179.8 million (includes \$5.2 million related to compensation expense for the employees of the Company's subsidiaries), \$164.3 million (includes \$7.2 million related to compensation expense for the employees of the Company's subsidiaries), and \$151.6 million (includes \$8.4 million related to compensation expense for the employees of the Company's subsidiaries), respectively.

F-40

---



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

Following the unanimous approval of the Company's independent directors (the "Independent Directors"), in August 2018, the Company began reimbursing the Manager for certain services in connection with the management and operations of the Company and its subsidiaries as permitted under the terms of the Management Agreement. Such reimbursable expenses include the cost for certain legal, tax, accounting and other support and advisory services provided by employees of the Manager to the Company. Pursuant to the Management Agreement, the Company may reimburse the Manager for the cost of such services, provided such costs are no greater than those that would be payable to comparable third party providers. For the year ended December 31, 2018, reimbursement payments to the Manager were \$9.2 million. There were no reimbursement payments to the Manager during the years ended 2017 and 2016. None of the reimbursement payments are attributable to compensation of the Company's executive officers. At December 31, 2018 and 2017, the Company had amounts payable to the Manager of \$16.0 million and \$13.8 million, respectively.

The Management Agreement's current term ends on December 31, 2019 and will automatically renew for successive two-year terms unless at least two-thirds of the Company's independent directors or the holders of a majority of the outstanding shares of the Company's common stock in their sole discretion elect to terminate the agreement for any or no reason upon 365 days prior written notice (such notice, a "Termination Notice").

If the Company makes an election to terminate the Management Agreement, the Company may elect to accelerate the termination date ("the "Termination Date") to a date that is between seven and 90 days after the date of the Company's delivery of a Termination Notice (the "Notice Delivery Date"). If the Company does not make an election to accelerate the Termination Date, then the Manager may elect to accelerate the Termination Date to the date that is 90 days after the Notice Delivery Date. If the Termination Date is accelerated (such date, the "Accelerated Termination Date") by either the Company or the Manager, in addition to any amounts accrued for the period prior to the Accelerated Termination Date, the Company shall pay the Manager an acceleration fee (the "Acceleration Fee") in an amount equal to the average annual management fee earned by the Manager during the 24-month period immediately preceding such Accelerated Termination Date multiplied by a fraction with a numerator of 365 minus the number of days from the Notice Delivery Date to the Accelerated Termination Date, and a denominator of 365.

The Management Agreement may also be terminated by the Manager for any reason or no reason upon 365 days prior written notice, or with shorter notice periods by either the Company or the Manager for cause or by the Company in the event of a sale of the Manager that was not pre-approved by the Independent Directors.

The Management Agreement may be amended or modified by agreement between the Company and the Manager.

## 20. LEASE COMMITMENTS AND CONTINGENCIES

### Commitments

In September 2014, the Company entered into a non-cancelable lease for office space which commenced in July 2014 and expires in September 2025. The lease expense for each of the years ended December 31, 2018, 2017, and 2016 was \$3.0 million, \$3.1 million and \$3.1 million. The Company's aggregate future minimum lease payments total \$25.6 million. The following table details the future lease payments:

Years ended December 31,	Lease Commitments (dollars in thousands)
2019	\$ 3,565
2020	3,652
2021	3,862
2022	3,862
2023	3,862
Later years	6,756
Total	\$ 25,559

Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements. There were no material contingencies at December 31, 2018 and 2017.

F-41

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 21. ARCOLA REGULATORY REQUIREMENTS

Arcola is the Company's wholly owned and consolidated broker-dealer. Arcola is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees.

Arcola is a member of various clearing organizations with which it maintains cash required to conduct its day-to-day clearance activities. Arcola enters into reverse repurchase agreements and repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on settlement date at the contractual amount and are collateralized by mortgage-backed or other securities. Arcola generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. Arcola's policy is to obtain possession of collateral with a market value in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and Arcola will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements or other documentation that give Arcola the right, in the event of default, to liquidate collateral held and in some instances, to offset receivables and payables with the same counterparty.

As a self-clearing, registered broker dealer, Arcola is required to maintain minimum net capital by FINRA. At December 31, 2018 Arcola had a minimum net capital requirement of \$0.3 million. Arcola consistently operates with capital in excess of its regulatory capital requirements. Arcola's regulatory net capital as defined by SEC Rule 15c3-1, at December 31, 2018 was \$393.8 million with excess net capital of \$393.5 million.

## 22. ACQUISITION OF MTGE INVESTMENT CORP.

As previously disclosed in the Company's filings with the SEC, on September 7, 2018, Mountain Merger Sub Corporation, a wholly-owned subsidiary of the Company, completed its acquisition of MTGE Investment Corp. ("MTGE"), an externally managed hybrid mortgage REIT, for aggregate consideration to MTGE common shareholders of \$906.2 million, consisting of \$455.9 million in equity consideration and \$450.3 million in cash consideration (the "MTGE Acquisition"). The Company issued 43.6 million common stock as part of the consideration for the MTGE Acquisition. In addition, as part of the MTGE Acquisition, each share of MTGE 8.125% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share (each, a "MTGE Preferred Share"), that was outstanding as of immediately prior to the completion of the MTGE 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 Series H Preferred Stock, and which have rights, preferences, privileges and voting powers substantially the same as a MTGE Preferred Share.

Series H Preferred Stock, and which have rights, preferences, privileges and voting powers substantially the same as a MTGE Preferred Share.

The Company believes that the MTGE's portfolio is complementary to the Company's pre-acquisition portfolio, that the combined capital base supports continued growth of the Company's businesses and that the acquisition creates efficiency and growth opportunities.

The MTGE Acquisition was accounted for as an asset acquisition in accordance with Accounting Standards Codification 805 Business Combinations ("ASC 805"). Under ASC 805, an acquisition does not qualify as a business combination if the acquisition does not meet the definition of a business. U.S. GAAP defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Since the Company did not acquire the external management agreement with the MTGE's third party manager, there were no substantive processes acquired as part of the acquisition. Therefore, the MTGE Acquisition was not considered a business combination.

Under ASC 805, an asset acquisition is accounted for under the cost accumulation model which allocates the cost of the acquisition which generally includes direct transaction costs to the individual assets acquired and liabilities assumed on the basis of relative fair value with certain exceptions including financial assets and current assets. These exceptions are excluded from the cost accumulation method since recognizing these assets at amounts other than their fair value would result in a subsequent gain or loss upon re-measurement. Since there are no significant non-financial assets to allocate the transaction costs to, the transaction costs of \$58.3 million were expensed as they were incurred and included in Other general and administrative expenses in the Company's Consolidated Statements of Comprehensive Income (Loss) during the year ended December 31, 2018. Similarly, the excess consideration of \$44.5 million over the fair value of the assets acquired was recognized within Other income (loss) in the Company's Consolidated Statements of Comprehensive Income (Loss) on the closing date of the acquisition during the year ended December 31, 2018. The allocation of the consideration paid as part of the transaction and its assignment to the initial carrying value of the MTGE portfolio is noted in the below table.

F-42

---

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

	September 2018 (dollars in thousands)
Consideration transferred	
Cash	\$ 450,287
Common equity	455,943
Preferred shares	
Exchange of MTGE preferred stock for Annaly preferred stock	55,000
Total consideration	\$ 961,230
Net assets	
Cash and cash equivalents	\$ 191,953
Securities	4,111,930
Real estate, net	277,648
Derivative assets	18,629
Reverse repurchase agreements	938,251
Receivable for unsettled trades	6,809
Principal receivable	44,462
Interest receivable	14,282
Intangible assets, net	14,483
Other assets	50,105
Total assets acquired	5,668,552
Repurchase agreements	3,561,816
Mortgages payable	201,629
U.S. Treasury securities sold, not yet purchased	934,149
Derivative liabilities	2,498
Interest payable	22,220
Dividends payable	819
Other liabilities	28,715
Total liabilities assumed	4,751,846
Net assets acquired	\$ 916,706

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
Financial Statements

## 23. SUMMARIZED QUARTERLY RESULTS (UNAUDITED)

The following is a presentation of summarized quarterly results of operations for the years ended December 31, 2018 and 2017. These quarterly results were prepared in accordance with GAAP and reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results. These adjustments are of a normal, recurring nature.

	For the Quarters Ended			
	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
	(dollars in thousands, except per share data)			
Interest income	\$859,674	\$ 816,596	\$776,806	\$879,487
Interest expense	586,774	500,973	442,692	367,421
Net interest income	272,900	315,623	334,114	512,066
Total realized and unrealized gains (losses)	(2,502,035 )	199,716	294,646	844,689
Total other income (loss)	52,377	(10,643 )	34,170	34,023
Less: Total general and administrative expenses	77,073	126,509	63,781	62,510
Income (loss) before income taxes	(2,253,831 )	378,187	599,149	1,328,268
Less: Income taxes	1,041	(7,242 )	3,262	564
Net income (loss)	(2,254,872 )	385,429	595,887	1,327,704
Less: Net income attributable to noncontrolling interests	17	(149 )	(32 )	(96 )
Less: Dividends on preferred stock	32,494	31,675	31,377	33,766
Net income (loss) available (related) to common stockholders	\$(2,287,383)	\$ 353,903	\$564,542	\$1,294,034
Net income (loss) available (related) per share to common stockholders				
Basic	\$(1.74 )	\$ 0.29	\$0.49	\$1.12
Diluted	\$(1.74 )	\$ 0.29	\$0.49	\$1.12

	For the Quarters Ended			
	December 31, 2017	September 30, 2017	June 30, 2017	March 31, 2017
	(dollars in thousands, except per share data)			
Interest income	\$745,423	\$ 622,550	\$537,426	\$587,727
Interest expense	318,711	268,937	222,281	198,425
Net interest income	426,712	353,613	315,145	389,302
Total realized and unrealized gains (losses)	359,215	43,807	(277,794 )	74,265
Total other income (loss)	25,064	28,282	30,865	31,646
Less: Total general and administrative expenses	59,257	57,016	54,023	53,828
Income (loss) before income taxes	751,734	368,686	14,193	441,385
Less: Income taxes	4,963	1,371	(329 )	977
Net income (loss)	746,771	367,315	14,522	440,408
Less: Net income attributable to noncontrolling interests	(151 )	(232 )	(102 )	(103 )
Less: Dividends on preferred stock <sup>(1)</sup>	32,334	30,355	23,473	23,473
Net income (loss) available (related) to common stockholders	\$714,588	\$ 337,192	\$(8,849 )	\$417,038
Net income (loss) available (related) per share to common stockholders				
Basic	\$0.62	\$ 0.31	\$(0.01 )	\$0.41
Diluted	\$0.62	\$ 0.31	\$(0.01 )	\$0.41

<sup>(1)</sup> The quarter ended December 31, 2017 excludes, and the quarter ended September 30, 2017 includes, cumulative and undeclared dividends of \$8.3 million on the Company's Series F Preferred Stock as of September 30, 2017.

#### 24. SUBSEQUENT EVENTS

In January 2019, the Company closed the public offering of 86.3 million shares of the Company's common stock, which includes an over-allotment option exercised of 11.3 million shares, for proceeds of approximately \$840.1 million, before deducting estimated offering expenses.

In January 2019, the Company completed and closed a securitization of residential mortgage loans, OBX 2019-INV1 Trust, with a face value of \$393.9 million. The securitization represented a financing transaction which provided non-recourse financing to the Company collateralized by residential mortgage loans purchased by the Company.

F-44

---

## SCHEDULE III

## Schedule III - Real Estate and Accumulated Depreciation

(dollars in thousands)

December 31, 2018

Location	Number of Encumbered Properties	Initial Cost to Company		Buildings and Improvements	Cost Capitalized Subsequent to Acquisition	Purchase Price Property Adjustments	Gross Amounts Property at Close of Period 12/31/18		Buildings and Improvements	Total	Accumulated Depreciation	Year of Construction
		Land	Buildings				Buildings	Total				
Retail - Carrollton, TX	1	\$12,875	\$3,970	\$14,672	\$—	\$—	\$3,970	\$14,672	\$18,642	\$(2,285)	1996	
Retail - Plano, TX	1	11,817	4,615	12,751	141	—	4,615	12,892	17,507	(2,276)	1994	
Retail - Grapevine, TX	1	12,692	4,713	13,888	—	—	4,713	13,888	18,601	(2,018)	1998	
Retail - Flower Mound, TX	1	13,085	4,963	14,486	53	—	4,963	14,539	19,502	(2,236)	1999	
Retail - Grapevine, TX	1	9,797	3,931	9,972	8	—	3,931	9,980	13,911	(1,644)	1994	
Retail - Flower Mound, TX	1	7,492	2,696	7,417	15	—	2,696	7,432	10,128	(1,675)	1992	
Retail - Flower Mound, TX	1	8,929	3,571	8,287	—	—	3,571	8,287	11,858	(1,230)	1996	
Retail - Plano, TX	1	4,638	1,459	4,564	—	—	1,459	4,564	6,023	(1,757)	1995	
Retail - Largo, FL	1	12,750	4,973	12,831	30	—	4,973	12,861	17,834	(2,220)	1988	
Retail - Grass Valley, CA	1	25,900	9,872	28,965	176	—	9,872	29,141	39,013	(5,615)	1988	
Multifamily - Washington, DC	1	57,500	31,999	42,342	477	—	31,999	42,819	74,818	(5,193)	1978, 2008	
Retail - Penfield, NY	1	23,558	4,122	23,427	407	—	4,122	23,834	27,956	(6,089)	1957	
Retail - Orchard Park, NY	1	12,888	4,189	20,729	—	—	4,189	20,729	24,918	(4,286)	1997, 2000	
Retail - Cheektowaga, NY	1	9,447	1,939	12,519	—	—	1,939	12,519	14,458	(2,443)	1978	
Retail - Amherst, NY	1	8,270	2,132	9,903	(3)	)	2,132	9,900	12,032	(2,209)	1986	
Retail - Ontario, NY	1	5,406	574	6,841	—	—	574	6,841	7,415	(1,789)	1998	
Retail - Irondequoit, NY	1	15,000	2,438	14,980	106	—	2,438	15,086	17,524	(3,700)	1972	



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Retail - LeRoy, NY	1	3,492	343	4,959	—	—	343	4,959	5,302	(1,464 )	1997
Retail - Jamestown, NY	1	7,356	820	4,915	—	—	820	4,915	5,735	(1,540 )	1997
Retail - Warsaw, NY	1	3,415	407	4,122	—	—	407	4,122	4,529	(1,043 )	1998
Retail - Chillicothe, OH	1	7,888	1,262	10,819	57	—	1,262	10,876	12,138	(2,197 )	1981, 1998
Retail - Loganville, GA	1	7,230	3,217	8,386	—	—	3,217	8,386	11,603	(1,910 )	1996
Retail - Chillicothe, OH	1	7,700	2,282	9,775	—	—	2,282	9,775	12,057	(1,763 )	1995
Retail - Newport News, VA	1	11,025	6,394	12,046	—	—	6,394	12,046	18,440	(1,999 )	1994
Retail - Knoxville, TN	1	12,350	3,503	13,310	(1 )	—	3,503	13,309	16,812	(2,098 )	2002
Industrial - Las Vegas, NV	1	—	628	4,053	—	—	628	4,053	4,681	(672 )	1988, 2009
Healthcare - Abingdon, VA	1	13,336	370	15,061	—	—	370	15,061	15,431	(163 )	2012
Healthcare - Abingdon, VA	1	7,689	160	11,894	—	—	160	11,894	12,054	(158 )	2004
Healthcare - Fredericksburg, VA	1	14,920	3,110	18,830	—	—	3,110	18,830	21,940	(400 )	1986
Healthcare - Gainesville, VA	1	13,372	1,470	13,894	—	—	1,470	13,894	15,364	(169 )	2006
Healthcare - Pennington Gap, VA	1	5,936	190	11,549	—	—	190	11,549	11,739	(159 )	2001
Healthcare - Manassas, VA	1	13,449	2,040	14,041	—	—	2,040	14,041	16,081	(171 )	2006
Healthcare - Radford, VA	1	6,917	370	12,623	—	—	370	12,623	12,993	(158 )	2002
Healthcare - Hopewell, VA	1	8,728	560	12,181	—	—	560	12,181	12,741	(158 )	2005
Healthcare - Clifton Forge, VA	1	2,296	710	5,368	—	—	710	5,368	6,078	(121 )	1986
Healthcare - Allen, TX	1	9,148	800	10,858	—	—	800	10,858	11,658	(207 )	2000
Healthcare - Frisco, TX	1	6,782	1,000	7,420	—	—	1,000	7,420	8,420	(119 )	1999
Healthcare - Garland, TX	1	9,306	740	10,705	—	—	740	10,705	11,445	(142 )	2004
Healthcare - Denison, TX	1	4,398	650	6,527	—	—	650	6,527	7,177	(154 )	1992
Healthcare - Lewisville, TX	1	4,101	870	7,020	—	—	870	7,020	7,890	(126 )	2004
	1	7,913	240	8,904	—	—	240	8,904	9,144	(106 )	2009, 2013

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Healthcare - Kaukauna, WI											
Healthcare - Mankato, MN	1	7,598	660	9,040	—	—	660	9,040	9,700	(158 )	2004
Healthcare - Mankato, MN	1	5,875	410	6,618	—	—	410	6,618	7,028	(83 )	2014
Healthcare - St. George, UT	1	9,706	1,050	13,422	—	—	1,050	13,422	14,472	(147 )	2014
Healthcare - St. George, UT	1	7,201	690	7,670	—	—	690	7,670	8,360	(95 )	2011
Healthcare - Covington, LA	1	16,650	410	19,216	18	—	410	19,234	19,644	(242 )	2009
Healthcare - Blue Ridge, GA	1	12,889	630	15,576	542	—	630	16,118	16,748	(174 )	2016
Healthcare - Mission, KS	1	16,125	600	21,501	16	—	600	21,520	22,120	(265 )	2015
	48	\$516,835	\$128,742	\$590,877	\$2,042	\$—	\$128,742	\$592,922	\$721,664	\$(67,026)	

The following table presents our real estate activity during the year ended December 31, 2018 (in thousands):

Real Estate	
Beginning balance, January 1, 2018	\$441,971
Acquisitions and improvements	279,693
Property sold	—
Ending balance, December 31, 2018	\$721,664
Accumulated Depreciation	
Beginning balance, January 1, 2018	\$48,920
Property sold	—
Depreciation	18,106
Ending balance, December 31, 2018	\$67,026

F-45

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

SCHEDULE IV

December 31, 2018

Schedule IV - Mortgage Loans on Commercial Real Estate

Description	Location	Prior Liens <sup>(1)</sup>	Face Amount	Carrying Amount	Interest Rate <sup>(2)</sup>	LIBOR Floor	Payment Terms	Maturity Date <sup>(3)</sup>
Mezzanine debt investments								
(dollars in thousands)								
Hotel	LA	\$85,367	\$13,408	\$13,358	LIBOR+9.50%	N/A	Interest Only	9/9/2022
Mixed	OH	128,812	36,603	36,603	9.50%	N/A	Interest Only	12/1/2023
Multi-Family	NY	330,081	40,053	40,053	LIBOR+7.81%	N/A	Interest Only	10/1/2020
Multi-Family	NY	330,081	56,347	56,347	LIBOR+6.91%	N/A	Interest Only	10/1/2020
Office	LA	61,923	8,700	8,700	10.75%	N/A	Interest Only	10/1/2023
Office	Various	25,998	1,488	1,488	LIBOR+7.50%	0.25%	Interest Only	1/20/2019
Office	TX	50,420	7,000	3,504	10.10%	N/A	Interest Only	12/1/2024
Office	CA	208,708	44,531	44,531	LIBOR+4.81%	N/A	Interest Only	1/2/2021
Office	CA	208,708	20,498	20,498	LIBOR+6.54%	N/A	Interest Only	1/2/2021
Office	FL	—	16,418	16,312	LIBOR+3.30%	1.90%	Interest Only	5/9/2023
Office	CA	75,000	20,000	19,925	LIBOR+7.75%	N/A	Interest Only	4/3/2023
Office	TX	—	18,842	18,643	LIBOR+3.75%	1.25%	Interest Only	8/9/2023
Retail	MA	63,218	10,000	10,000	10.14%	N/A	Interest Only	9/6/2023
Retail	DC	—	16,775	16,719	LIBOR+4.95%	N/A	Interest Only	1/9/2022
Retail	CO	—	9,000	8,920	LIBOR+5.00%	1.20%	Interest Only	10/1/2022
First mortgages								
Hotel	NY	\$—	\$55,000	\$54,863	LIBOR+4.50%	0.85%	Interest Only	8/9/2022
Hotel	IL	—	30,500	30,263	LIBOR+3.65%	1.60%	Interest Only	6/9/2023
Hotel	TX	—	28,400	27,969	LIBOR+3.75%	2.00%	Interest Only	10/9/2023
Industrial	TN	—	21,250	21,061	LIBOR+3.00%	2.00%	Interest Only	9/1/2023
Multi-Family	TX	—	15,031	15,025	4.45%	N/A	Amortizing	10/1/2020
Multi-Family	NC	—	36,689	36,657	4.25%	N/A	Amortizing	11/1/2020
Multi-Family	TX	—	33,000	32,789	LIBOR+3.25%	1.25%	Interest Only	12/9/2022
Multi-Family	LA	—	65,740	65,302	LIBOR+3.25%	1.50%	Interest Only	5/9/2023
Multi-Family	TX	—	45,000	44,700	LIBOR+3.25%	1.50%	Interest Only	6/9/2023
Office	NJ	—	64,390	64,390	LIBOR+4.50%	0.25%	Interest Only	11/8/2019
Office	VA	—	41,000	41,000	LIBOR+3.80%	0.20%	Interest Only	12/9/2020
Office	FL	—	52,000	51,709	LIBOR+3.30%	1.90%	Interest Only	5/9/2023
Office	CO	—	9,589	9,045	LIBOR+3.60%	1.00%	Interest Only	8/9/2022
Office	AZ	—	26,751	26,528	LIBOR+3.90%	1.25%	Interest Only	2/9/2023
Office	VA	—	31,126	30,729	LIBOR+4.00%	1.25%	Interest Only	4/9/2023
Office	CA	—	45,966	45,369	LIBOR+3.25%	1.00%	Interest Only	5/9/2023
Office	VA	—	43,100	42,729	LIBOR+2.80%	1.90%	Amortizing	8/9/2021
Office	TX	—	137,929	136,471	LIBOR+3.75%	1.25%	Interest Only	8/9/2023
Office	CA	—	17,000	16,768	LIBOR+3.50%	2.00%	Interest Only	11/9/2023
Office	CA	—	37,750	37,303	LIBOR+3.25%	2.00%	Interest Only	12/5/2023
Retail	DC	—	50,325	50,157	LIBOR+4.95%	N/A	Interest Only	1/9/2022
Retail	CO	—	21,000	20,930	LIBOR+5.00%	1.20%	Interest Only	10/1/2022
Retail	TN	—	37,528	37,261	LIBOR+4.50%	1.20%	Interest Only	11/6/2022
Retail	DC	—	42,184	42,184	7.50%	N/A	Amortizing	5/10/2023
First mortgages held for sale								
Retail	DC	—	42,184	42,184	7.50%	N/A	Amortizing	5/10/2023

\$1,350,095 \$1,338,987

- (1) Represents third-party priority liens.
- (2) LIBOR represents the one month London Interbank Offer Rate.
- (3) Assumes all extension options are exercised.

F-46

---

SIGNATURES

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

ANNALY CAPITAL MANAGEMENT, INC.

Date: February 14, 2019 By: /s/ Kevin G. Keyes  
 Kevin G. Keyes  
 Chairman, Chief Executive Officer and President (Principal Executive Officer)

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

Signature	Title	Date
/s/ Kevin G. Keyes Kevin G. Keyes	Chairman, Chief Executive Officer, President and Director (Principal Executive Officer)	February 14, 2019
/s/ Glenn A. Votek Glenn A. Votek	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 14, 2019
/s/ Francine J. Bovich Francine J. Bovich	Director	February 14, 2019
/s/ Kevin P. Brady Kevin P. Brady	Director	February 14, 2019
/s/ Wellington J. Denahan Wellington J. Denahan	Director	February 14, 2019
/s/ Katherine Beirne Fallon Katherine Beirne Fallon	Director	February 14, 2019
/s/ Jonathan D. Green Jonathan D. Green	Director	February 14, 2019
/s/ Michael E. Haylon Michael E. Haylon	Director	February 14, 2019
/s/ E. Wayne Nordberg E. Wayne Nordberg	Director	February 14, 2019
/s/ John H. Schaefer John H. Schaefer	Director	February 14, 2019
/s/ Donnell A. Segalas Donnell A. Segalas	Director	February 14, 2019
/s/ Vicki Williams Vicki Williams	Director	February 14, 2019
Kathy Hopinkah Hannan	Director	February 14, 2019