

ANNALY CAPITAL MANAGEMENT INC  
Form 10-Q  
August 06, 2015

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

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FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2015

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)

10036

(Zip Code)

(212) 696-0100

(Registrant's telephone number, including area code)

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

Yes ☐ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at July 31, 2015
Common Stock, \$.01 par value	947,778,980

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FORM 10-Q  
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## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2015 (Unaudited)	December 31, 2014(1)
<b>ASSETS</b>		
Cash and cash equivalents (including cash pledged as collateral of \$1,412,141 and \$1,584,701, respectively)	\$ 1,785,158	\$ 1,741,244
Reverse repurchase agreements	-	100,000
Investments, at fair value:		
Agency mortgage-backed securities (including pledged assets of \$60,926,741 and \$74,006,480, respectively)	67,605,287	81,565,256
Agency debentures (including pledged assets of \$95,239 and \$1,368,350, respectively)	429,845	1,368,350
Agency CRT securities	214,130	-
Commercial real estate debt investments (including pledged assets of \$2,812,824 and \$0, respectively) (2)	2,812,824	-
Investment in affiliate	123,343	143,045
Commercial real estate debt and preferred equity, held for investment (including pledged assets of \$179,300 and \$0, respectively) (3)	1,332,955	1,518,165
Investments in commercial real estate	216,800	210,032
Corporate debt	311,640	166,464
Receivable for investments sold	247,361	1,010,094
Accrued interest and dividends receivable	234,006	278,489
Receivable for investment advisory income (including from affiliate of \$10,589 and \$10,402, respectively)	10,589	10,402
Goodwill	71,815	94,781
Interest rate swaps, at fair value	30,259	75,225
Other derivatives, at fair value	38,074	5,499
Other assets	81,594	68,321
<b>Total assets</b>	<b>\$ 75,545,680</b>	<b>\$ 88,355,367</b>

**LIABILITIES AND STOCKHOLDERS'  
EQUITY**

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<b>Liabilities:</b>		
Repurchase agreements	57,459,552	71,361,926
Other secured financing	203,200	-
Convertible Senior Notes	-	845,295
Securitized debt of consolidated VIEs (4)	2,610,974	260,700
Mortgages payable	146,359	146,553
Participation sold	13,490	13,693
Payable for investments purchased	673,933	264,984
Accrued interest payable	131,629	180,501
Dividends payable	284,331	284,293
Interest rate swaps, at fair value	1,328,729	1,608,286
Other derivatives, at fair value	40,539	8,027
Accounts payable and other liabilities	58,139	47,328
<b>Total liabilities</b>	<b>62,950,875</b>	<b>75,021,586</b>
<b>7.875% Series A Cumulative Redeemable Preferred Stock:</b>		
7,412,500 authorized, issued and outstanding	177,088	177,088
<b>7.625% Series C Cumulative Redeemable Preferred Stock:</b>		
12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
<b>7.50% Series D Cumulative Redeemable Preferred Stock:</b>		
18,400,000 authorized, issued and outstanding	445,457	445,457
Common stock, par value \$0.01 per share, 1,956,937,500 authorized, 947,768,496 and 947,643,079 issued and outstanding, respectively	9,478	9,476
Additional paid-in capital	14,788,677	14,786,509
Accumulated other comprehensive income (loss)	(354,965 )	204,883
Accumulated deficit	(2,766,250 )	(2,585,436 )
<b>Total stockholders' equity</b>	<b>12,589,999</b>	<b>13,328,491</b>
Noncontrolling interest	4,806	5,290
<b>Total equity</b>	<b>12,594,805</b>	<b>13,333,781</b>
<b>Total liabilities and equity</b>	<b>\$ 75,545,680</b>	<b>\$ 88,355,367</b>

(1) Derived from the audited consolidated financial statements at December 31, 2014.

Includes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of \$2.6 billion and \$0 at June 30, 2015 and December 31, 2014, respectively.

(2) Includes senior securitized commercial mortgage loans of a consolidated VIE with a carrying value of \$361.2 million and \$398.6 million carried at amortized cost, net of an allowance for losses of \$0, at June 30, 2015 and December 31, 2014.

(3) Includes securitized debt of consolidated VIEs carried at fair value of \$2.4 billion and \$0 at June 30, 2015 and December 31, 2014, respectively.

See notes to consolidated financial statements.





## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands, except per share data)

(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net interest income:				
Interest income	\$624,346	\$683,962	\$1,143,518	\$1,339,863
Interest expense	113,072	126,107	242,492	251,078
Net interest income	511,274	557,855	901,026	1,088,785
Realized and unrealized gains (losses):				
Realized gains (losses) on interest rate swaps(1)	(144,465 )	(220,934 )	(302,704 )	(481,369 )
Realized gains (losses) on termination of interest rate swaps	-	(772,491 )	(226,462 )	(779,333 )
Unrealized gains (losses) on interest rate swaps	700,792	175,062	234,590	(173,880 )
Subtotal	556,327	(818,363 )	(294,576 )	(1,434,582 )
Net gains (losses) on disposal of investments	3,833	5,893	66,189	85,603
Net gains (losses) on trading assets	(114,230 )	(46,489 )	(121,136 )	(192,717 )
Net unrealized gains (losses) on financial instruments measured at fair value through earnings	17,581	2,085	(15,965 )	(18,708 )
Impairment of goodwill	(22,966 )	-	(22,966 )	-
Subtotal	(115,782 )	(38,511 )	(93,878 )	(125,822 )
Total realized and unrealized gains (losses)	440,545	(856,874 )	(388,454 )	(1,560,404 )
Other income (loss):				
Investment advisory income	10,604	6,109	21,068	12,232
Dividend income from affiliate	4,318	4,048	8,636	17,093
Other income (loss)	(22,344 )	4,687	(23,426 )	6,147
Total other income (loss)	(7,422 )	14,844	6,278	35,472
General and administrative expenses:				
Compensation and management fee	37,014	39,277	75,643	77,798
Other general and administrative expenses	14,995	12,912	27,304	21,769
Total general and administrative expenses	52,009	52,189	102,947	99,567
Income (loss) before income taxes	892,388	(336,364 )	415,903	(535,714 )
Income taxes	(7,683 )	(852 )	(7,669 )	3,149
Net income (loss)	900,071	(335,512 )	423,572	(538,863 )
Net income (loss) attributable to noncontrolling interest	(149 )	-	(239 )	-

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Net income (loss) attributable to Annaly	900,220	(335,512 )	423,811	(538,863 )
Dividends on preferred stock	17,992	17,992	35,984	35,984
Net income (loss) available (related) to common stockholders	\$882,228	\$(353,504 )	\$387,827	\$(574,847 )
Net income (loss) per share available (related) to common stockholders:				
Basic	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Diluted	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Weighted average number of common shares outstanding:				
Basic	947,731,493	947,515,127	947,700,832	947,487,125
Diluted	947,929,762	947,515,127	947,878,958	947,487,125
Dividends declared per share of common stock	\$0.30	\$0.30	\$0.60	\$0.60
Net income (loss)	\$900,071	\$(335,512 )	\$423,572	\$(538,863 )
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	(1,125,043 )	1,522,126	(493,571 )	2,263,298
Reclassification adjustment for net (gains) losses included in net income (loss)	(3,921 )	(5,903 )	(66,277 )	(86,621 )
Other comprehensive income (loss)	(1,128,964 )	1,516,223	(559,848 )	2,176,677
Comprehensive income (loss)	\$(228,893 )	\$1,180,711	\$(136,276 )	\$1,637,814
Comprehensive income (loss) attributable to noncontrolling interest	(149 )	-	(239 )	-
Comprehensive income (loss) attributable to Annaly	(228,744 )	1,180,711	(136,037 )	1,637,814
Dividends on preferred stock	17,992	17,992	35,984	35,984
Comprehensive income (loss) attributable to common stockholders	\$(246,736 )	\$1,162,719	\$(172,021 )	\$1,601,830

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

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(dollars in thousands, except per share data)

(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	Common stock par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholder equity	Noncontr interest
BALANCE, December 31, 2013	\$177,088	\$290,514	\$445,457	\$9,474	\$14,765,761	\$(2,748,933)	\$(534,306 )	\$12,405,055	\$-
Net income (loss) attributable to Annaly	-	-	-	-	-	-	(538,863 )	(538,863 )	-
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	2,263,298	-	2,263,298	-
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(86,621 )	-	(86,621 )	-
Stock compensation expense	-	-	-	-	998	-	-	998	-
Net proceeds from direct purchase and dividend reinvestment	-	-	-	1	1,207	-	-	1,208	-
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	8,336	-	-	8,336	-
Preferred Series A dividends, declared \$0.984 per share	-	-	-	-	-	-	(7,296 )	(7,296 )	-
	-	-	-	-	-	-	(11,438 )	(11,438 )	-

Preferred Series C dividends, declared \$0.953 per share										
Preferred Series D dividends, declared \$0.938 per share	-	-	-	-	-	-	(17,250 )	(17,250 )	-	
Common dividends declared, \$0.60 per share	-	-	-	-	-	-	(568,508 )	(568,508 )	-	
BALANCE, June 30, 2014	\$177,088	\$290,514	\$445,457	\$9,475	\$14,776,302	\$(572,256 )	\$(1,677,661)	\$13,448,919	\$-	
BALANCE, December 31, 2014	\$177,088	\$290,514	\$445,457	\$9,476	\$14,786,509	\$204,883	\$(2,585,436)	\$13,328,491	\$5,29	
Net income (loss) attributable to Annaly	-	-	-	-	-	-	423,811	423,811	-	
Net income (loss) attributable to noncontrolling interest	-	-	-	-	-	-	-	-	(239	
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	(493,571 )	-	(493,571 )	-	
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(66,277 )	-	(66,277 )	-	
Stock compensation expense	-	-	-	-	1,024	-	-	1,024	-	
Net proceeds from direct purchase and dividend reinvestment	-	-	-	2	1,144	-	-	1,146	-	
Equity contributions from (distributions to) noncontrolling interest	-	-	-	-	-	-	-	-	(245	
Preferred Series A dividends, declared \$0.984 per share	-	-	-	-	-	-	(7,296 )	(7,296 )	-	

Preferred Series C dividends, declared \$0.953 per share	-	-	-	-	-	-	(11,438 )	(11,438 )	-
Preferred Series D dividends, declared \$0.938 per share	-	-	-	-	-	-	(17,250 )	(17,250 )	-
Common dividends declared, \$0.60 per share	-	-	-	-	-	-	(568,641 )	(568,641 )	-
BALANCE, June 30, 2015	\$177,088	\$290,514	\$445,457	\$9,478	\$14,788,677	\$(354,965 )	\$(2,766,250)	\$12,589,999	\$4,800

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net income (loss)	\$ 423,572	\$ (538,863 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Investment Securities premiums and discounts, net	378,814	268,629
Amortization of commercial real estate investment premiums and discounts, net	(581 )	391
Amortization of intangibles	3,586	228
Amortization of deferred financing costs	4,561	5,460
Amortization of net origination fees and costs, net	(2,350 )	(2,090 )
Amortization of contingent beneficial conversion feature and equity component of Convertible Senior Notes	12,246	14,241
Depreciation expense	5,687	736
Net gain on sale of commercial real estate	-	(2,748 )
Net loss on sale of commercial real estate debt held for investment	100	-
Net (gains) losses on sales of Investment Securities	(66,289 )	(86,621 )
Stock compensation expense	1,024	998
Impairment of goodwill	22,966	-
Unrealized (gains) losses on interest rate swaps	(234,590 )	173,880
Net unrealized (gains) losses on financial instruments measured at fair value through earnings	15,965	18,708
Net (gains) losses on trading assets	121,136	192,717
Proceeds from repurchase agreements of RCap	895,400,000	531,215,774
Payments on repurchase agreements of RCap	(900,650,000 )	(524,667,907 )
Proceeds from reverse repurchase agreements	26,925,000	55,923,453
Payments on reverse repurchase agreements	(26,825,000 )	(55,823,453 )
Proceeds from securities borrowed	-	23,888,955
Payments on securities borrowed	-	(21,306,062 )
Proceeds from securities loaned	-	41,939,298
Payments on securities loaned	-	(44,466,959 )
Proceeds from U.S. Treasury securities	-	3,159,253
Payments on U.S. Treasury securities	-	(3,920,425 )
Net payments on derivatives	(116,122 )	(92,716 )
Net change in:		

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Due to / from brokers	-	8,596
Other assets	(15,686 )	(9,444 )
Accrued interest and dividends receivable	45,897	(25,419 )
Receivable for investment advisory income	(187 )	459
Accrued interest payable	(48,857 )	12,170
Accounts payable and other liabilities	13,952	(3,925 )
Net cash provided by (used in) operating activities	(4,585,156 )	5,877,314
Cash flows from investing activities:		
Payments on purchases of Investment Securities	(8,638,138 )	(21,722,521 )
Proceeds from sales of Investment Securities	18,278,224	11,375,718
Principal payments on Agency mortgage-backed securities	5,342,053	3,570,508
Payments on purchases of corporate debt	(187,035 )	(69,748 )
Principal payments on corporate debt	42,352	36,429
Purchases of commercial real estate debt investments	(276,918 )	-
Sales of commercial real estate debt investments	41,016	-
Purchase of securitized loans at fair value	(2,574,353 )	-
Origination of commercial real estate investments, net	(180,531 )	(172,120 )
Proceeds from sale of commercial real estate investments	46,806	-
Principal payments on commercial real estate debt investments	1,616	-
Proceeds from sales of commercial real estate held for sale	-	26,019
Principal payments on commercial real estate investments	321,050	171,190
Purchase of investments in real estate	(121 )	(36,743 )
Investment in unconsolidated joint venture	(12,410 )	-
Purchase of equity securities	(8,130 )	(200 )
Net cash provided by (used in) investing activities	12,195,481	(6,821,468 )

Statements continued on following page.

## Cash flows from financing activities:

Proceeds from repurchase agreements	105,819,378	98,482,785
Principal payments on repurchase agreements	(114,471,752)	(96,439,435)
Payments on maturity of convertible senior notes	(857,541 )	-
Proceeds from other secured financing	203,200	5,000
Proceeds from issuance of securitized debt	2,382,810	260,700
Principal repayments on securitized debt	(37,915 )	-
Principal repayments on securitized loans	50	-
Payment of deferred financing cost	(641 )	(4,288 )
Net proceeds from direct purchases and dividend reinvestments	1,144	1,208
Proceeds from mortgages payable	-	11,025
Principal payments on participation sold	(147 )	(139 )
Principal payments on mortgages payable	(165 )	(11 )
Distributions to noncontrolling interests	(245 )	-
Dividends paid	(604,587 )	(604,461 )
Net cash provided by (used in) financing activities	(7,566,411 )	1,712,384
Net (decrease) increase in cash and cash equivalents	43,914	768,230
Cash and cash equivalents, beginning of period	1,741,244	552,436
Cash and cash equivalents, end of period	\$ 1,785,158	\$ 1,320,666
Supplemental disclosure of cash flow information:		
Interest received	\$ 1,541,718	\$ 1,617,804
Dividends received	\$ 8,366	\$ 17,093
Investment advisory income received	\$ 20,881	\$ 12,691
Interest paid (excluding interest paid on interest rate swaps)	\$ 218,272	\$ 267,103
Net interest paid on interest rate swaps	\$ 305,327	\$ 479,006
Taxes paid	\$ 1,901	\$ 5,061
Noncash investing activities:		
Receivable for investments sold	\$ 247,361	\$ 856,983
Payable for investments purchased	\$ 673,933	\$ 781,227
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	\$ (559,848 )	\$ 2,176,677
Noncash financing activities:		
Dividends declared, not yet paid	\$ 284,331	\$ 284,261
Contingent beneficial conversion feature on 4% Convertible Senior Notes	\$ -	\$ 8,336

See notes to consolidated financial statements.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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

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1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the “Company” or “Annaly”) is a Maryland corporation that commenced operations on February 18, 1997. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, Agency debentures, Agency credit risk transfer (“CRT”) securities, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate assets and corporate loans. The Company’s principal business objective is to generate net income for distribution to its stockholders from its investments. The Company is externally managed by Annaly Management Company LLC (the “Manager”).

The Company’s business operations are primarily comprised of the following:

-- Annaly, the parent company, which invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.

-- Annaly Commercial Real Estate Group, Inc. (“ACREG,” formerly known as CreXus Investment Corp. (“CreXus”)), a wholly-owned subsidiary that was acquired during the second quarter of 2013 which specializes in acquiring, financing and managing commercial real estate loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.

-- RCap Securities, Inc. (“RCap”), a wholly-owned subsidiary which operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (“FINRA”).

-- Fixed Income Discount Advisory Company (“FIDAC”), a wholly-owned subsidiary which manages an affiliated real estate investment trust (“REIT”) for which it earns fee

2. BASIS OF PRESENTATION

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

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2014 has been derived from audited consolidated financial statements not included herein.

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in Variable Interest Entities (“VIEs”). A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional

income.

-- Annaly Middle Market Lending LLC (“MML”) (formerly known as Charlesfort Capital Management LLC), a wholly-owned subsidiary which engages in corporate middle market lending transactions.

The Company has elected to be taxed as a REIT as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”).

subordinated financial support from other parties. A variable interest is an investment or other interest that will absorb portions of a VIE's expected losses or receive portions of the entity's expected residual returns. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that (i) has the power to control the activities that most significantly impact the VIE's economic performance and (ii) has the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

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

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

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

**Cash and Cash Equivalents** – Cash and cash equivalents include cash on hand, cash held in money market funds on an overnight basis and cash pledged as collateral with counterparties. Cash and securities deposited with clearing organizations are carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest rate swaps and other derivatives. RCap is a member of various clearing

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

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

**Agency Mortgage-Backed Securities, Agency Debentures and Agency Credit Risk Transfer Securities** – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans and certificates guaranteed by the Government National Mortgage Association (“Ginnie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Federal National Mortgage Association (“Fannie Mae”) (collectively, “Agency mortgage-backed securities”). These Agency mortgage-backed securities may include forward contracts for Agency mortgage-backed securities purchases or sales of a generic pool, on a to-be-announced basis (“TBA securities”). The Company also invests in Agency debentures issued by the Federal Home Loan Banks, Freddie Mac and Fannie Mae and securities in the Agency CRT sector. The CRT sector is comprised of the 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 and Freddie Mac to private investors.

Agency mortgage-backed securities, Agency debentures and Agency CRT securities are referred to herein as “Investment Securities.” Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Investment Securities classified as available-for-sale and reported at fair values estimated by management that are compared to independent sources for reasonableness, with unrealized gains and

organizations with which it maintains cash required to conduct its day-to-day clearance activities. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to its interest rate swaps and other derivatives totaled approximately \$1.4 billion and \$1.6 billion at June 30, 2015 and December 31, 2014, respectively.

losses reported as a component of other comprehensive income (loss). Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. The Company changed its accounting policy for determining the realized gains and losses on sales of Investment Securities from the average cost method to the specific identification method. The Company determined that the specific identification method was preferable because it more accurately matches gains or losses with costs and is the methodology predominantly used by its industry peers, among other considerations. The impact of the change was immaterial to the consolidated financial statements and prior periods.

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

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. The Company uses a third-party supplied model to project prepayment speeds related to Investment Securities. The Company’s prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan to value, 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. Adjustments are made for actual prepayment activity.

**Corporate Debt** – The Company’s investments in corporate debt, which are loans, are designated as held for investment and investments that are debt securities are designated as held to maturity 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 (or other-than-temporary impairment). No allowance for

**Equity Securities** – The Company may invest in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with unrealized gains and losses reported as a component of other comprehensive income (loss). Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets. Dividends are recorded in earnings based on the declaration date.

**Derivative Instruments** – The Company may use a variety of derivative instruments to economically hedge some of its exposure to market risks, including interest rate and prepayment risk. These instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps (“swaptions”), TBA securities without intent to accept delivery (“TBA derivatives”), options on TBA securities (“MBS options”) and U.S. Treasury and Eurodollar futures contracts. The Company may also invest in other types of mortgage derivatives such as interest-only securities and synthetic total return swaps, such as the Markit IOS Synthetic Total Return Swap Index. Derivatives are accounted for in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss). None of the Company’s derivative transactions have been designated as hedging instruments for accounting purposes.

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

**Interest rate swap agreements** - Interest rate swaps are the primary instrument used to mitigate interest rate risk. In particular, the Company uses interest rate swaps

loan losses or other-than temporary impairment was recognized as of June 30, 2015 and December 31, 2014. Interest income from coupon payments is accrued based upon the outstanding principal amounts of the debt and its contractual terms. Premiums and discounts are amortized or accreted into interest income using the interest method.

to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Swap agreements may or may not be cleared through a derivatives clearing organization (“DCO”). Uncleared swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared swaps are fair valued using internal pricing models and compared to the DCO’s market values.

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

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

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

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

assets in the Consolidated Statements of Comprehensive Income (Loss).

**Other-Than-Temporary Impairment** – Management evaluates available-for-sale securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market conditions warrant such evaluation. When the fair value of an available-for-sale security is less than its amortized cost the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of other comprehensive income (loss). There was no other-than-temporary impairment recognized for the quarters and six months ended June 30, 2015 and 2014.

**Loan Loss Reserves** – 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 to verify they meet the covenants of the loan documents. If based on the financial review it is deemed probable that the Company will be unable to collect contractual principal and interest amounts (e.g. financial performance and delinquencies), a loan loss provision would be recorded. No allowance for loan losses was deemed necessary as of June 30, 2015 and December 31, 2014.

**Repurchase Agreements** – The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company examines each of the specified criteria in ASC 860, Transfers and Servicing, at the inception of each transaction and has determined that each of the financings meet the specified criteria in this guidance.

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

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



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operating activities in the Consolidated Statements of Cash Flows.

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

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

Intangible assets with an estimated useful life are amortized over their expected useful lives.

**Convertible Senior Notes** – The Company records the 4% Convertible Senior Notes and 5% Convertible Senior Notes (collectively, the “Convertible Senior Notes”) at their contractual amounts, adjusted by the effects of a beneficial conversion feature and a contingent beneficial conversion feature (collectively, the “Conversion Features”). The Conversion Features’ intrinsic value is included in “Additional paid-in capital” on the Company’s Consolidated Statements of Financial Condition and reduces the recorded liability amount associated with the Convertible Senior Notes. A Conversion Feature may be

compensation expense on a straight-line basis over the requisite service period for the entire award.

**Income Taxes** – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not be subject to federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including FIDAC, RCap and certain subsidiaries of ACREG, have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries (“TRSs”). As such, each of these TRSs is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.

The provisions of ASC 740, Income Taxes, (“ASC 740”) clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of June 30, 2015 and December 31, 2014.

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

### Commercial Real Estate Investments

**Commercial Real Estate Loans** – The Company's commercial real estate loans are comprised of fixed-rate and adjustable-rate loans. Commercial real estate loans are designated as held for investment and are originated

recognized as a result of adjustments to the conversion price for dividends declared to common stockholders. The 4% and 5% Convertible Senior Notes matured in February 2015 and May 2015, respectively.

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

or purchased by the Company and carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the loan. The Company has elected the

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fair value option for multi-family mortgage loans held in securitization trusts that it was required to consolidate. Interest income is recognized as earned determined by the stated coupon and outstanding principal balance. See “Commercial Real Estate Investments” footnote for additional information.

**Preferred Equity Interests Held for Investment** – 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. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the investment.

**Allowance for Losses** – The Company evaluates the need for a loss reserve on its commercial real estate loans and preferred equity interests held for investment (collectively referred to as “CRE Debt and Preferred Equity Investments”). A provision for losses related to CRE Debt and Preferred Equity Investments, including those accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, may be established when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectable. Management assesses the credit quality of the portfolio and adequacy of loan loss reserves on a quarterly basis, or more frequently as necessary. Significant judgment is required in this analysis. Depending on the expected recovery of its investment, the Company considers the estimated net recoverable value of the CRE Debt and Preferred Equity Investments as well as other factors, including but not limited to the fair value of any collateral, the amount and the status of any senior debt, the prospects for the borrower and the competitive landscape where the borrower conducts business. Because this determination is 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 the nature of the assets underlying the investments and

value metrics in the course of quarterly surveillance. Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to, net operating income (“NOI”), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company’s CRE Debt and Preferred Equity Investments, and may consider other factors management deems important. Management also reviews market pricing to determine each borrower’s ability to refinance their respective assets at the maturity of each loan. Management also reviews economic trends, both macro as well as those directly affecting the property, and the supply and demand of competing projects in the sub-market in which each subject property is located.

In connection with the quarterly surveillance review process, loans are assigned an internal rating of “Performing”, “Watch List”, “Defaulted-Recovery” or “Impaired”. Loans that are deemed to be Performing meet all present contractual obligations and do not qualify for Watch List designation. Watch List loans are defined as Performing loans that are significantly lagging expectations and/or for which there is an increased potential for default. Defaulted–Recovery loans are currently in default; however full recovery of contractual principal and interest is expected. Impaired loans may or may not be in default, impairment is anticipated, and a loan loss provision has been recognized to reflect expected losses.

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

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. Management reviews loan-to-value metrics upon either the origination or the acquisition of a new investment but generally does not update the loan-to-

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

Category	Term
Building	31-40 years
Site improvements	1-10 years

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

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

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

The Company's real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property's value is considered impaired if the Company's estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.

**Revenue Recognition – Commercial Real Estate Investments** - Interest income is accrued based on the

#### Broker Dealer Activities

In January 2014, RCap ceased its trading activity in U.S. Treasury securities, derivatives and securities borrowed and loaned transactions.

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

**Securities Borrowed and Loaned Transactions** – RCap recorded securities borrowed and loaned transactions as collateralized financings. Securities borrowed transactions required RCap to provide the counterparty with collateral in the form of cash, or other securities. RCap received collateral in the form of cash or other securities for securities loaned transactions. RCap monitored the fair value of the securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Securities borrowed and securities loaned transactions were recorded at contract value. For these transactions, the rebates accrued by RCap were recorded as interest income or expense.

**U.S. Treasury Securities** – RCap traded in U.S. Treasury securities for its proprietary portfolio, which consisted

outstanding principal amount of the CRE Debt and Preferred Equity Investments and their contractual terms. Premiums and discounts associated with the purchase of CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the projected lives of the CRE Debt and Preferred Equity Investments using the interest method.

of long and short positions on U.S Treasury notes and bonds. U.S. Treasury securities were classified as trading investments and were recorded on the trade date at cost. Changes in fair value were reflected in Net gains (losses) on trading assets in the Company's Consolidated Statement of Comprehensive Income (Loss). Interest income or expense on U.S. Treasury notes and bonds was accrued based on the outstanding principal amount of those investments and their stated terms.

Derivatives - RCap entered primarily into U.S. Treasury, Eurodollar, federal funds, German government and U.S. equity index and currency futures and options contracts.

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RCap maintained a margin account which was settled daily with FCMs. Changes in the unrealized gains or losses on the futures and options contracts as well as any foreign exchange gains and losses were reflected in Net gains (losses) on trading assets in the Company's Consolidated Statements of Comprehensive Income (Loss). Unrealized gains (losses) were excluded from net income (loss) in arriving at cash flows from operating activities in the Consolidated Statements of Cash Flows.

Recent Accounting Pronouncements

The following table provides a brief description of recent accounting pronouncements that could potentially impact the Company's consolidated financial statements:

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Standard	Description	Date of Adoption	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
ASU 2015-10, Technical Corrections and Improvements	This perpetual project updates the Codification for technical corrections and improvements.	January 1, 2016 (early adoption permitted) for amendments subject to the transition guidance	Not expected to have a significant impact on the consolidated financial statements.
ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)	This update removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient and also removes certain disclosure requirements for these investments.	January 1, 2016 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement	This update clarifies that customers should determine whether a cloud computing arrangement includes the license of software by applying the same guidance cloud service providers use. The guidance also eliminates the current requirement that customers analogized to the leasing standard when determining the asset acquired in a software licensing arrangement.	January 1, 2016 (early adoption permitted)	Not expected to have a significant impact on the consolidated financial statements.
ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs	This ASU requires that debt issue costs are presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement of debt issue costs are not affected.	January 1, 2016 (early adoption permitted)	Impacts presentation only and will not have a significant impact on the consolidated financial statements.
ASU 2015-02, Consolidation (Topic 810) Amendments to the Consolidation Analysis	This update affects the following areas of the consolidation analysis: limited partnerships and similar entities, evaluation of fees paid to a decision maker or service provider as a variable interest and in determination of the primary beneficiary, effect of related parties on the primary beneficiary	January 1, 2016 (early adoption permitted)	Not expected to have a significant impact on the consolidated financial statements.



	determination and for certain investment funds.		
ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20)	This update eliminates from GAAP the concept of extraordinary items.	January 1, 2016 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2014-16, Derivatives and Hedging (Topic 815) Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or Equity	This ASU provides additional guidance for evaluating whether conversion rights, redemption rights, voting rights, liquidation rights and dividend payment preferences and other features embedded in a share, including preferred stock, contain embedded derivatives requiring bifurcation. The update requires that an entity determine the nature of the host contract by considering all stated and implied terms and features in a hybrid instrument.	January 1, 2016 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-04) Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern	This ASU requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern within one year after the date the financial statements are issued.	January 1, 2017 (early adoption permitted)	Not expected to have an impact on the consolidated financial statements.
ASU 2014-09, Revenue from Contracts with Customers	This guidance applies to contracts with customers to transfer goods or services and contracts to transfer nonfinancial assets unless those contracts are within the scope of other standards (for example, lease transactions).	January 1, 2017	Not expected to have a significant impact on the consolidated financial statements.

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## Standards that were adopted

ASU 2015-08, Business Combinations Topic 805 Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115	This update amends the codification for SEC Staff Bulletin No. 115	November 18, 2014	Did not have an impact on the consolidated financial statements.
ASU 2014-17, Business Combinations (Topic 805): Pushdown Accounting	This amendment provides an acquired entity with the option to apply push down accounting in its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity.	November 18, 2014	Did not have a significant impact on the consolidated financial statements.
ASU 2014-13, Consolidation (Topic 810) Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity.	This Update provides a practical expedient to measure the fair value of the financial assets and financial liabilities of a consolidated collateralized financing entity, which the reporting entity has elected to or is required to measure on a fair value basis.	January 1, 2015 (early adoption permitted)	The Company early adopted this ASU and applied the guidance to a commercial mortgage backed securitization transaction. See "Commercial Real Estate Investments" footnote for further disclosure.
ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosure.	This update makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements.	January 1, 2015	Impacts disclosures only and does not have a significant impact on the consolidated financial statements.
ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity	This ASU raises the threshold for a disposal to be treated as discontinued operations.	April 1, 2015	Did not have a significant impact on the consolidated financial statements.
ASU 2014-04 Receivables-Troubled Debt Restructurings by Creditors, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure	This update clarifies that an in substance repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, when the creditor	January 1, 2015	Did not have a significant impact on the consolidated financial statements.

	obtains legal title to the property upon completion of a foreclosure or the borrower conveys all interest in the property to the creditor through a deed in lieu of foreclosure or similar arrangement		
ASU 2013-02, Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income	This update requires the provision of information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, it requires presentation of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period	January 1, 2014	Did not have a significant impact on the consolidated financial statements.
ASU 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities	Under this update, the Company is required to disclose both gross and net information about both instruments and transactions eligible for offset in the Company's Consolidated Statements of Financial Condition and transactions subject to an agreement similar to a master netting arrangement. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements and securities borrowing and securities lending arrangements.	January 1, 2014	Did not have a significant impact on the consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## 4. AGENCY MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Agency mortgage-backed securities portfolio as of June 30, 2015 and December 31, 2014, which were carried at their fair value:

June 30, 2015	Freddie Mac	Fannie Mae	Ginnie Mae	Total
		(dollars in thousands)		
Principal outstanding	\$ 23,711,840	\$ 39,327,716	\$ 88,764	\$ 63,128,320
Unamortized premium	1,929,740	2,888,081	18,623	4,836,444
Unamortized discount	(6,475 )	(6,946 )	(351 )	(13,772 )
Amortized cost	25,635,105	42,208,851	107,036	67,950,992
Gross unrealized gains	205,399	439,909	6,763	652,071
Gross unrealized losses	(429,729 )	(564,527 )	(3,520 )	(997,776 )
Estimated fair value	\$ 25,410,775	\$ 42,084,233	\$ 110,279	\$ 67,605,287

	Fixed Rate	Adjustable Rate	Total
		(dollars in thousands)	
Amortized cost	\$ 64,478,692	\$ 3,472,300	\$ 67,950,992
Gross unrealized gains	538,926	113,145	652,071
Gross unrealized losses	(971,629 )	(26,147 )	(997,776 )
Estimated fair value	\$ 64,045,989	\$ 3,559,298	\$ 67,605,287

December 31, 2014	Freddie Mac	Fannie Mae	Ginnie Mae	Total
		(dollars in thousands)		
Principal outstanding	\$ 27,906,221	\$ 47,979,778	\$ 97,000	\$ 75,982,999
Unamortized premium	1,951,798	3,396,368	20,560	5,368,726
Unamortized discount	(8,985 )	(8,857 )	(358 )	(18,200 )
Amortized cost	29,849,034	51,367,289	117,202	81,333,525
Gross unrealized gains	313,761	660,230	8,010	982,001
Gross unrealized losses	(322,094 )	(424,800 )	(3,376 )	(750,270 )
Estimated fair value	\$ 29,840,701	\$ 51,602,719	\$ 121,836	\$ 81,565,256

	Fixed Rate	Adjustable Rate	Total
		(dollars in thousands)	
Amortized cost	\$ 78,250,313	\$ 3,083,212	\$ 81,333,525
Gross unrealized gains	847,615	134,386	982,001
Gross unrealized losses	(732,533 )	(17,737 )	(750,270 )
Estimated fair value	\$ 78,365,395	\$ 3,199,861	\$ 81,565,256

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Actual maturities of Agency mortgage-backed securities are generally shorter than stated contractual maturities because actual maturities of Agency mortgage-backed securities are affected by periodic payments and prepayments of principal on the underlying mortgages.

The following table summarizes the Company's Agency mortgage-backed securities as of June 30, 2015 and December 31, 2014, according to their estimated weighted average life classifications:

Weighted Average Life	June 30, 2015		December 31, 2014	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	\$ 14,192	\$ 14,747	\$ 43,248	\$ 42,831
Greater than one year through five years	21,034,470	20,688,236	42,222,114	41,908,586
Greater than five years through ten years	46,141,855	46,850,242	39,018,833	39,098,352
Greater than ten years	414,770	397,767	281,061	283,756
Total	\$ 67,605,287	\$ 67,950,992	\$ 81,565,256	\$ 81,333,525

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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The weighted average lives of the Agency mortgage-backed securities at June 30, 2015 and December 31, 2014 in the table above are based upon projected principal prepayment rates. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than projected.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities by length of time that such securities have been in a continuous unrealized loss position at June 30, 2015 and December 31, 2014.

	June 30, 2015			December 31, 2014		
	Estimated Fair Value	Gross Unrealized Losses	Number of Securities	Estimated Fair Value	Gross Unrealized Losses	Number of Securities
	(dollars in thousands)					
Less than 12 Months	17,000,465	(168,223 )	515	4,613,599	(36,959 )	205
12 Months or More	23,601,763	(829,553 )	234	35,175,194	(713,311 )	302
Total	40,602,228	(997,776 )	749	39,788,793	(750,270 )	507

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

During the quarter and six months ended June 30, 2015, the Company disposed of \$2.0 billion and \$16.5 billion of Agency mortgage-backed securities, respectively, resulting in a net realized gain of \$6.3 million and \$71.6, respectively.

During the quarter and six months ended June 30, 2014, the Company disposed of \$4.9 billion and \$9.2 billion of Agency mortgage-backed securities, respectively, resulting in a net realized gain of \$41.5 million and \$171.1 million, respectively. The specific identification method is used as the basis on which the realized gain or loss on sale is determined.

Agency interest-only mortgage-backed securities represent the right to receive a specified portion of the contractual interest flows of the underlying outstanding principal balance of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities in the Company's portfolio as of June 30, 2015 and December 31, 2014 had net unrealized gains (losses) of \$(22.7) million and \$(8.0) million and an amortized cost of \$1.4 billion and \$1.2 billion, respectively.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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## 5. COMMERCIAL REAL ESTATE INVESTMENTS

At June 30, 2015 and December 31, 2014, commercial real estate investments held for investment were composed of the following:

## CRE Debt and Preferred Equity Investments

	June 30, 2015			December 31, 2014		
	Outstanding Principal	Carrying Value(1)	Percentage of Loan Portfolio(2) (dollars in thousands)	Outstanding Principal	Carrying Value(1)	Percentage of Loan Portfolio(2)
Senior mortgages	262,546	261,684	19.6 %	384,304	383,895	25.2 %
Senior securitized mortgages(3)	361,672	361,215	27.1 %	399,541	398,634	26.3 %
Mezzanine loans	498,273	498,332	37.3 %	522,474	522,731	34.4 %
Preferred equity	213,213	211,724	16.0 %	214,653	212,905	14.1 %
Total	\$ 1,335,704	\$ 1,332,955	100.0 %	\$ 1,520,972	\$ 1,518,165	100.0 %

(1) Carrying value includes unamortized origination fees of \$2.8 million and \$3.0 million as of June 30, 2015 and December 31, 2014, respectively.

(2) Based on outstanding principal.

(3) Assets of consolidated VIEs.

	June 30, 2015				
	Senior Mortgages	Senior Securitized Mortgages(1)	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)				
Beginning balance	\$ 383,895	\$ 398,634	\$ 522,731	\$ 212,905	\$ 1,518,165
Originations & advances (principal)	156,035	-	27,392	-	183,427
Principal payments	(230,147 )	(37,869 )	(51,592 )	(1,441 )	(321,049 )
Sales (principal)	(46,945 )	-	-	-	(46,945 )
Amortization & accretion of (premium) discounts	(72 )	-	(108 )	50	(130 )
Net (increase) decrease in	(2,660 )	-	(236 )	-	(2,896 )

origination fees

Amortization of  
net origination

fees	1,578	450	145	210	2,383
Transfers	-	-	-	-	-
Allowance for loan losses	-	-	-	-	-
Net carrying value	\$ 261,684	\$ 361,215	\$ 498,332	\$ 211,724	\$ 1,332,955

(1) Assets of  
consolidated VIE.

December 31, 2014

	Senior Mortgages	Senior Securitized Mortgages(1)	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)					
Beginning balance	\$ 667,299	\$ -	\$ 41,408	\$ 628,102	\$ 247,160	\$ 1,583,969
Originations & advances (principal)	127,112	-	-	122,742	-	249,854
Principal payments	(12,756 )	-	(41,059 )	(227,151 )	(35,116 )	(316,082 )
Sales (principal)	-	-	-	-	-	-
Amortization & accretion of (premium) discounts	(138 )	-	(349 )	(1,093 )	108	(1,472 )
Net (increase) decrease in origination fees	(2,427 )	(116 )	-	(478 )	-	(3,021 )
Amortization of net origination fees	2,783	772	-	609	753	4,917
Transfers	(397,978 )	397,978	-	-	-	-
Allowance for loan losses	-	-	-	-	-	-
Net carrying value	\$ 383,895	\$ 398,634	\$ -	\$ 522,731	\$ 212,905	\$ 1,518,165

(1) Assets of  
consolidated VIE.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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## Internal CRE Debt and Preferred Equity Investment Ratings

June 30, 2015

## Internal Ratings

Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio		Performing	Watch List	Defaulted-Recovery (2)	Impaired
				(dollars in thousands)			
Senior mortgages	\$262,546	19.6	%	\$249,573	\$-	\$ 12,973	\$-
Senior securitized mortgages(1)	361,672	27.1	%	352,422	9,250	-	-
Mezzanine loans	498,273	37.3	%	498,273	-	-	-
Preferred equity	213,213	16.0	%	162,213	51,000 (3)	-	-
	\$1,335,704	100.0	%	\$1,262,481	\$60,250	\$ 12,973	\$-

(1) Assets of consolidated VIE.

(2) Related to one loan on non-accrual status.

(3) Borrower made a \$25 million principal payment on July 8, 2015 reducing outstanding principal to \$26 million.

December 31, 2014

## Internal Ratings

Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio		Performing	Watch List	Defaulted-Recovery (2)	Impaired
				(dollars in thousands)			
Senior mortgages	\$384,304	25.2	%	\$371,331	\$-	\$ 12,973	\$-
Senior securitized mortgages(1)	399,541	26.3	%	390,291	9,250	-	-
Mezzanine loans	522,474	34.4	%	522,474	-	-	-
Preferred equity	214,653	14.1	%	214,653	-	-	-
	\$1,520,972	100.0	%	\$1,498,749	\$9,250	\$ 12,973	\$-

(1) Assets of consolidated VIE.

(2) Related to one loan on non-accrual status.

## Real Estate Acquisitions

In November 2014, a joint venture, in which the Company has a 90% interest, acquired eleven retail properties located in New York, Ohio and Georgia. The

Refer to Equity Method Investments below for details related to real estate investment activity during the quarter ended June 30, 2015. The following table summarizes acquisitions of real estate held for investment in 2014:

purchase price was funded with cash and a new \$104.0 million, ten-year, 4.03% fixed-rate interest-only mortgage loan.

Date of Acquisition	Type	Location	Purchase Price	Remaining Lease Term (Years)(1)
April 2014	Single-tenant retail	Tennessee	\$ 19,000	8
June 2014	Multi-tenant retail	Virginia	\$ 17,743	7
November 2014	Multi-tenant retail	New York, Ohio, Georgia	\$ 154,000	4.6

The aforementioned acquisitions were accounted for using the acquisition method of accounting. No additional real estate acquisition costs were expensed during the period ended June 30, 2015.

The following table presents the aggregate final allocation of the purchase price:

	Tennessee	Virginia	Joint Venture	Total
	(dollars in thousands)			
Purchase Price Allocation:				
Land	\$ 3,503	\$ 6,394	\$ 21,441	\$ 31,338
Buildings	11,960	10,862	97,680	120,502
Site improvements	1,349	1,184	12,705	15,238
Tenant Improvements	-	-	9,365	9,365
Real estate held for investment	16,812	18,440	141,191	176,443
Intangible assets (liabilities):				
Leasehold intangible assets	4,288	3,218	22,297	29,803
Above market lease	-	-	5,458	5,458
Below market lease value	(2,100 )	(3,915 )	(14,946 )	(20,961 )
Total purchase price	\$ 19,000	\$ 17,743	\$ 154,000	\$ 190,743

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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The weighted average amortization period for intangible assets and liabilities is 3.7 years. Above market leases and leasehold intangible assets are included in Other assets and below market leases are included in Accounts payable and other liabilities in the Consolidated Statements of Financial Condition. The fair value of the 10% non-controlling interest in the joint venture at the acquisition date was \$15.4 million. The fair value of the acquisition and the

related non-controlling interest was determined based on the purchase price.

During June 2015 the purchase price allocation related to the joint venture was finalized resulting in a net increase to amortization and depreciation expense of \$1.3 million during the quarter ended June 30, 2015.

## Total Commercial Real Estate Investments

	June 30, 2015	December 31, 2014
	(dollars in thousands)	
Real estate held for investment, at amortized cost		
Land	\$ 37,977	\$ 38,117
Buildings and improvements	176,324	176,139
Subtotal	214,301	214,256
Less: accumulated depreciation	(9,911 )	(4,224 )
Total real estate held for investment, at amortized cost, net	204,390	210,032
Equity in unconsolidated joint venture	12,410	-
Total investment in commercial real estate, net	216,800	210,032
Net carrying value of CRE Debt and Preferred Equity Investments	1,332,955	1,518,165
Total commercial real estate investments	\$ 1,549,755	\$ 1,728,197

Depreciation expense was \$2.9 million and \$5.7 million for the quarter and six months ended June 30, 2015, respectively. Depreciation expense was \$0.4 million and \$0.7 million for the quarter and six months ended June 30, 2014, respectively. Depreciation expense is included in Other income (loss) in the Consolidated Statements of Comprehensive Income (Loss). The table below presents the minimum future rentals on noncancelable leases of the Company's commercial real estate investments as of June 30, 2015.

## Rental Income

The minimum rental amounts due under the leases are generally either subject to scheduled fixed increases or adjustments. The leases generally also require that the tenants reimburse us for certain operating costs. Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at June 30, 2015 for the consolidated properties, including consolidated joint venture properties are as follows (in thousands):

	June 30, 2015
	(dollars in thousands)
2015 (remaining)	\$ 10,346
2016	18,784
2017	16,055
2018	13,695
2019	11,375

Later years	50,702
	\$ 120,957

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

Mortgage loans payable as of June 30, 2015 and December 31, 2014, were as follows:

June 30, 2015						
Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Venture	\$ 103,950	\$ 103,950	4.03 %	Fixed	12/6/2024	First liens
Tennessee	12,350	12,350	4.01 %	Fixed	6/6/2019	First liens
Virginia	11,025	11,025	3.58 %	Fixed	9/6/2019	First liens
Arizona	16,552	16,495	3.50 %	Fixed	1/1/2017	First liens
Nevada	2,482	2,471	3.45 %	Floating (1)	3/29/2017	First liens
	\$ 146,359	\$ 146,291				

(1) Rate is fixed via an interest rate swap (pay fixed 3.45%, receive floating rate of L+200).

December 31, 2014						
Property	Mortgage Carrying Value	Mortgage Principal	Interest Rate	Fixed/Floating Rate	Maturity Date	Priority
(dollars in thousands)						
Joint Venture	\$ 103,950	\$ 103,950	4.03 %	Fixed	12/6/2024	First liens
Tennessee	12,350	12,350	4.01 %	Fixed	6/6/2019	First liens
Virginia	11,025	11,025	3.58 %	Fixed	9/6/2019	First liens
Arizona	16,709	16,600	3.50 %	Fixed	1/1/2017	First liens
Nevada	2,519	2,505	3.45 %	Floating (1)	3/29/2017	First liens
	\$ 146,553	\$ 146,430				

(1) Rate is fixed via an interest rate swap (pay fixed 3.45%, receive floating rate of L+200).

The following table details future mortgage loan principal payments as of June 30, 2015:

Mortgage Loan Principal Payments (dollars in thousands)	
2015 (remaining)	\$ 228
2016	400
2017	18,338
2018	-
2019	23,375
Later years	103,950
	\$ 146,291

## Equity Method Investments

In January 2014, the Company closed NLY Commercial Mortgage Trust 2014-FL1 (the "Trust"), a \$399.5 million

In May 2015, the Company acquired a multifamily property located in Florida through a joint venture partnership and contributed approximately \$12 million of capital. The Company has a seventy-five percent interest in the joint venture, but as all major decisions require unanimous consent by the joint venture partners, the Company is not considered to have a controlling financial interest and accounts for its investment under the equity method of accounting.

VIEs

Securitizations

securitization financing transaction which provides permanent, non-recourse financing collateralized by floating-rate first mortgage debt investments originated or co-originated by the Company and is not subject to margin calls. A total of \$260.7 million of investment grade bonds were issued by the Trust, representing an advance rate of 65.3% at a weighted average coupon of LIBOR plus 1.74% at closing. The Company used the proceeds to originate commercial real estate investments. The Company retained bonds rated below investment grade and the only interest-only bond issued by the Trust, which are referred to as the subordinate bonds.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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The Company incurred approximately \$4.3 million of costs in connection with the securitization that have been capitalized and are being amortized to interest expense. Deferred financing costs are included in Other assets in the accompanying Consolidated Statements of Financial Condition.

The Trust is structured as a pass-through entity that receives principal and interest on the underlying collateral and distributes those payments to the certificate holders. The Trust is a VIE and the Company is the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership interest in the subordinate bonds. The Company's exposure to the obligations of the VIE is generally limited to the Company's investment in the Trust. Assets of the Trust may only be used to settle obligations of the Trust. Creditors of the Trust have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the Trust. No gain or loss was recognized upon initial consolidation of the Trust.

As of June 30, 2015 the carrying value of the Trust's assets was \$361.2 million, net of \$0.5 million of unamortized origination fees, which are included in Commercial real estate debt and preferred equity in the accompanying Consolidated Statements of Financial Condition. As of June 30, 2015, the carrying value of the Trust's liabilities was \$222.8 million, classified as Securitized debt of consolidated VIE's in the accompanying Consolidated Statements of Financial Condition.

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

and FREMF 2015-KF07 are collectively referred to herein as the FREMF Trusts.

The FREMF Trusts are structured as pass-through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The FREMF Trusts are VIEs and the Company is considered to be the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership of the Class C Certificates and its current designation as the directing certificate holder. The Company's exposure to the obligations of the VIEs are generally limited to the Company's investment in the FREMF Trusts of \$191.5 million. Assets of the FREMF Trusts may only be used to settle obligations of the FREMF Trusts. Creditors of the FREMF Trusts have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the FREMF Trusts. No gain or loss was recognized upon initial consolidation of the FREMF Trusts, but \$0.8 million of related costs were expensed.

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

In April 2015, the Company purchased the junior most tranche, Class C Certificate of the Freddie Mac securitization, FREMF Mortgage Trust 2015-KF07 (“FREMF 2015-KF07”) for \$89.4 million. The underlying portfolio is a pool of 40 floating rate multifamily mortgage loans with a cut-off principal balance of \$1.2 billion. The Company was required to consolidate the FREMF 2015-KF07 Trust’s assets and liabilities of \$1.2 billion and \$1.1 billion, respectively, at June 30, 2015. FREMF 2015-KLSF

FREMF Trusts are an aggregate fair value derived from the fair value of the financial liabilities, the Company has determined that the fair value of each of the financial assets in their entirety should be classified in Level 2 of the fair value measurement hierarchy.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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The statement of financial condition of the FREMF Trust, that is reflected in the Company's Consolidated

Statements of Financial Condition at June 30, 2015 follows:

	June 30, 2015 (dollars in thousands)
Senior securitized commercial mortgages carried at fair value	\$ 2,579,687
Accrued interest receivable	4,672
Total assets	\$ 2,584,359
Liabilities and equity	
Securitized debt (non-recourse) at fair value	\$ 2,388,142
Accrued interest payable	4,062
	\$ 2,392,204
Equity	192,155
Total liabilities and equity	\$ 2,584,359

The FREMF Trust mortgage loans had an unpaid principal balance of \$2.6 billion, at June 30, 2015. As of June 30, 2015 there are no loans 90 days or more past due or on nonaccrual status. There is no gain or loss attributable to instrument-specific credit risk of the underlying loans or securitized debt securities as of June 30, 2015 based upon the Company's process of

monitoring events of default on the underlying mortgage loans.

The statement of comprehensive income (loss) of the FREMF Trust that is reflected in the Company's Consolidated Statements of Comprehensive Income (Loss) at June 30, 2015 follows:

	For the period February 25, 2015 to June 30, 2015 (dollars in thousands)
Net interest income:	
Interest income	\$ 14,472
Interest expense	(4,575)
Net interest income	9,897
Other income (loss):	
Unrealized gain (loss) on financial instruments at fair value (1)	(5)
General, administrative, transaction and acquisition expenses	5,904
Other income (loss)	5,899
General and administration expenses	58
Net income	\$ 3,940

(1) Included in Net unrealized gains (losses) on financial instruments measured at fair value through earnings.

The geographic concentrations of credit risk exceeding 5% of the total loan balances related to the FREMF Trusts as of June 30, 2015 follows:

Securitized Loans at Fair Value Geographic Concentration of Credit Risk

Property Location	Principal Balance	% of Balance
	(dollars in thousands)	
North Carolina	\$ 537,375	21.0%
Texas	749,569	29.4%
Ohio	197,455	7.7%
Florida	391,291	15.3%

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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#### 6. FAIR VALUE MEASUREMENTS

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments. 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 level 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 financial instruments as available for sale or trading depending upon the type of instrument and the Company’s intent and ability to hold such instrument to maturity. Instruments classified as available for sale and trading are reported at fair value on a recurring basis.

liabilities across the three level fair value hierarchy, with the observability of inputs determining the appropriate level.

U.S. Treasury securities, futures contracts and investment in affiliate are valued using quoted prices for identical instruments in active markets. Investment Securities, interest rate swaps, swaptions and other derivatives are valued using quoted prices or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of the security in its estimates of fair value. 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.

The Investment Securities, interest rate swap and swaption markets 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 Investment Securities, interest rate swaps, swaptions, TBA derivatives and MBS options markets and the similarity of the Company’s securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair value measurements. Consequently, the Company has classified Investment Securities, interest rate swaps, swaptions, TBA derivatives and MBS options as Level 2 inputs in the fair value hierarchy. Additionally, as discussed in the “Commercial Real Estate Investments” footnote, Commercial real estate debt investments carried at fair value are classified as Level 2.

The following table presents the estimated fair values of financial instruments measured 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

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June 30, 2015	Level 1	Level 2	Level 3	Total
		(dollars in thousands)		
Assets:				
Agency mortgage-backed securities	\$-	\$67,605,287	\$-	\$67,605,287
Agency debentures	-	429,845	-	429,845
Agency CRT securities	-	214,130	-	214,130
Commercial real estate debt investments	-	2,812,824	-	2,812,824
Investment in affiliate	123,343	-	-	123,343
Interest rate swaps	-	30,259	-	30,259
Other derivatives	7,734	30,340	-	38,074
Total assets	\$131,077	\$71,122,685	\$-	\$71,253,762
Liabilities:				
Securitized debt of consolidated VIEs	\$-	\$2,610,974	\$-	\$2,610,974
Interest rate swaps	-	1,328,729	-	1,328,729
Other derivatives	16,162	24,377	-	40,539
Total liabilities	\$16,162	\$3,964,080	\$-	\$3,980,242

December 31, 2014	Level 1	Level 2	Level 3	Total
		(dollars in thousands)		
Assets:				
Agency mortgage-backed securities	\$-	\$81,565,256	\$-	\$81,565,256
Agency debentures	-	1,368,350	-	1,368,350
Investment in affiliate	143,045	-	-	143,045
Interest rate swaps	-	75,225	-	75,225
Other derivatives	117	5,382	-	5,499
Total assets	\$143,162	\$83,014,213	\$-	\$83,157,375
Liabilities:				
Interest rate swaps	\$-	\$1,608,286	\$-	\$1,608,286
Other derivatives	3,769	4,258	-	8,027
Total liabilities	\$3,769	\$1,612,544	\$-	\$1,616,313

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the financial statements, for which it is practical to estimate the value. In cases where quoted market prices are not available, fair values are based upon discounted cash flows using market yields, methodologies that incorporate market-based transactions or other valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair values. Accordingly, fair values are not necessarily indicative of the amount the Company would realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

The estimated fair value of commercial real estate debt and preferred equity investments takes into consideration changes in credit spreads and interest rates from the date of origination or purchase to the reporting date. The fair value also reflects consideration of asset-specific maturity dates and other items that could have an impact on the fair value as of the reporting date.

Estimates of fair value of corporate debt require the use of judgments and inputs including, but not limited to, the enterprise value of the borrower (i.e., an estimate of the total fair value of the borrower's debt and equity), the nature and realizable value of any collateral, the borrower's ability to make payments when due and its

The carrying value of short term instruments, including cash and cash equivalents, reverse repurchase agreements and repurchase agreements whose term is less than twelve months, generally approximates fair value due to the short term nature of the instruments.

earnings history. Management also considers factors that affect the macro and local economic markets in which the borrower operates.

The fair value of repurchase agreements with remaining maturities greater than one year or with embedded optionality are valued as structured notes, with term to maturity, LIBOR rates and the Treasury

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curve being primary determinants of estimated fair value.

The fair value of mortgages payable is calculated using the estimated yield of a new par loan to value the remaining terms in place. A par loan is created using the identical terms of the existing loan; however, the coupon is derived by using the original spread against the interpolated Treasury. The fair value of mortgages payable also reflects consideration of the value of the underlying collateral and changes in credit risk from the time the debt was originated.

The carrying value of participation sold is based on the loan's amortized cost. The fair value of participation

sold is based on the fair value of the underlying related commercial loan.

The fair value of Convertible Senior Notes was determined using end of day quoted prices in active markets.

The fair value of securitized debt of consolidated VIEs is determined using the average of external vendor pricing services.

The following table summarizes the estimated fair value for financial assets and liabilities as of June 30, 2015 and December 31, 2014.

		June 30, 2015		December 31, 2014	
	Level in Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
(dollars in thousands)					
<b>Financial assets:</b>					
Cash and cash equivalents	1	\$ 1,785,158	\$ 1,785,158	\$ 1,741,244	\$ 1,741,244
Reverse repurchase agreements	1	-	-	100,000	100,000
Agency mortgage-backed securities	2	67,605,287	67,605,287	81,565,256	81,565,256
Agency debentures	2	429,845	429,845	1,368,350	1,368,350
Agency CRT securities	2	214,130	214,130	-	-
Commercial real estate debt investments, at fair value	2	2,812,824	2,812,824	-	-
Investment in affiliate	1	123,343	123,343	143,045	143,045
Commercial real estate debt and preferred equity, held for investment	3	1,332,955	1,339,843	1,518,165	1,528,444
Corporate debt	2	311,640	309,709	166,464	166,056
Interest rate swaps	2	30,259	30,259	75,225	75,225
Other derivatives	1,2	38,074	38,074	5,499	5,499
<b>Financial liabilities:</b>					
Repurchase agreements	1,2	\$ 57,459,552	\$ 57,639,127	\$ 71,361,926	\$ 71,587,222
Other secured financing	2	203,200	203,376	-	-
Convertible Senior Notes	1	-	-	845,295	863,470
Securitized debt of consolidated VIEs	2	2,610,974	2,610,543	260,700	262,061
Mortgages payable	2	146,359	147,149	146,553	146,611

Participation sold	3	13,490	13,483	13,693	13,655
Interest rate swaps	2	1,328,729	1,328,729	1,608,286	1,608,286
Other derivatives	1,2	40,539	40,539	8,027	8,027

## 7. SECURED FINANCING

The Company had outstanding \$57.5 billion and \$71.4 billion of repurchase agreements with weighted average borrowing rates of 1.73% and 1.62%, after giving effect to the Company's interest rate swaps used to hedge cost of funds, and weighted average

remaining maturities of 149 days and 141 days as of June 30, 2015 and December 31, 2014, respectively.

At June 30, 2015 and December 31, 2014, the repurchase agreements had the following remaining maturities, collateral types and weighted average rates:



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June 30, 2015					
Repurchase Agreements					
	Collateralized by Agency Mortgage-backed Securities and Debentures	Collateralized by Commercial Loans (dollars in thousands)	Total Repurchase Agreements	Weighted Average Rate	
1 day	\$ 7,150,000	\$ -	\$ 7,150,000	0.82	%
2 to 29 days	16,013,749	-	16,013,749	0.43	%
30 to 59 days	8,157,729	-	8,157,729	0.52	%
60 to 89 days	7,132,012	-	7,132,012	0.42	%
90 to 119 days	1,507,387	-	1,507,387	0.43	%
Over 120 days(1)	17,376,675	122,000	17,498,675	1.32	%
Total	\$ 57,337,552	\$ 122,000	\$ 57,459,552	0.76	%

December 31, 2014					
Repurchase Agreements Collateralized by Agency Mortgage-backed Securities and Debentures (dollars in thousands)					
				Weighted Average Rate	
1 day	\$ -			0.00	%
2 to 29 days	28,354,167			0.35	%
30 to 59 days	17,336,469			0.43	%
60 to 89 days	4,040,677			0.38	%
90 to 119 days	2,945,495			0.50	%
Over 120 days(1)	18,685,118			1.24	%
Total	\$ 71,361,926			0.61	%

(1) Approximately 17% and 15% of the total repurchase agreements had a remaining maturity over 1 year as of June 30, 2015 and December 31, 2014, respectively.

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

amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition as of June 30, 2015 and December 31, 2014. Refer to "Derivative Instruments" footnote for information related to the effect of netting arrangements on the Company's derivative instruments.

June 30, 2015

December 31, 2014

	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
	(dollars in thousands)			
Gross Amounts	\$ -	\$ 57,459,552	\$ 700,000	\$ 71,961,926
Amounts Offset	-	-	(600,000 )	(600,000 )
Netted Amounts	\$ -	\$ 57,459,552	\$ 100,000	\$ 71,361,926

Investment Securities pledged as collateral under these secured financings and interest rate swaps had an estimated fair value and accrued interest of \$61.0 billion and \$180.5 million, respectively, at June 30, 2015 and \$75.4 billion and \$226.6 million, respectively, at December 31, 2014.

#### 8. DERIVATIVE INSTRUMENTS

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

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into TBA derivatives, MBS options and U.S. Treasury or eurodollar futures contracts 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, notional amount and remaining term of the derivative contract. In the event of a default by the counterparty, the Company could have difficulty obtaining its Investment Securities pledged as collateral as well as receiving payments in accordance with the terms of the derivative contracts.

The table below summarizes fair value information about our derivative assets and liabilities as of June 30, 2015 and December 31, 2014:

Derivatives Instruments	Balance Sheet Location	June 30, 2015	December 31, 2014
Assets:		(dollars in thousands)	
Interest rate swaps	Interest rate swaps, at fair value	\$30,259	\$75,225
Interest rate swaptions	Other derivative contracts, at fair value	6	5,382
TBA derivatives	Other derivative contracts, at fair value	30,334	-
Futures contracts	Other derivative contracts, at fair value	7,734	117
		\$68,333	\$80,724
Liabilities:			
Interest rate swaps	Interest rate swaps, at fair value	\$1,328,729	\$1,608,286
TBA derivatives	Other derivative contracts, at fair value	24,377	4,258
Futures contracts	Other derivative contracts, at fair value	16,162	3,769
		\$1,369,268	\$1,616,313

The following table summarizes certain characteristics of the Company's interest rate swaps at June 30, 2015 and December 31, 2014:

Maturity	June 30, 2015						
	Current Notional (1)	Weighted Average Pay Rate (2) (3)		Weighted Average Receive Rate (2)		Weighted Average Years to Maturity (2)	
		(dollars in thousands)					
0 - 3 years	\$ 2,852,471	1.78	%	0.20	%	2.20	
3 - 6 years	11,163,000	1.81	%	0.46	%	4.77	
6 - 10 years	11,201,350	2.45	%	0.44	%	8.36	
Greater than 10 years	3,734,400	3.70	%	0.23	%	19.87	
Total / Weighted Average	\$ 28,951,221	2.29	%	0.40	%	7.76	

Maturity	December 31, 2014					
	Current Notional (1)	Weighted Average Pay Rate (2) (3)		Weighted Average Receive Rate (2)		Weighted Average Years to Maturity (2)
		(dollars in thousands)				
0 - 3 years	\$ 2,502,505	1.63	%	0.17	%	2.64
3 - 6 years	11,138,000	2.06	%	0.22	%	5.18
6 - 10 years	13,069,200	2.67	%	0.23	%	8.57
Greater than 10 years	4,751,800	3.58	%	0.20	%	19.53
Total / Weighted Average	\$ 31,461,505	2.49	%	0.22	%	8.38

(1) Notional amount includes \$2.6 billion and \$500.0 million in forward starting pay fixed swaps as of June 30, 2015 and December 31, 2014, respectively.

(2) Excludes forward starting swaps.

(3) Weighted average fixed rate on forward starting pay fixed swaps was 1.77% and 3.25% as of June 30, 2015 and December 31, 2014, respectively.

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The following table summarizes certain characteristics of the Company's interest rate swaptions at June 30, 2015 and December 31, 2014:

	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
June 30, 2015					
(dollars in thousands)					
Long	\$ 500,000	2.87%	3M LIBOR	8.55	0.47
December 31, 2014					
(dollars in thousands)					
Long	\$ 1,750,000	2.88%	3M LIBOR	9.17	3.59

The following table summarizes certain characteristics of the Company's TBA derivatives as of June 30, 2015 and December 31, 2014:

June 30, 2015				
Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	\$ 13,000,000	\$ 13,311,297	\$ 13,317,254	\$ 5,957
Sale contracts	-	-	-	-
Net TBA derivatives	\$ 13,000,000	\$ 13,311,297	\$ 13,317,254	\$ 5,957
December 31, 2014				
Purchase and sale contracts for derivative TBAs	Notional	Implied Cost Basis	Implied Market Value	Net Carrying Value
(dollars in thousands)				
Purchase contracts	\$ -	\$ -	\$ -	\$ -
Sale contracts	(375,000 )	(375,430 )	(379,688 )	(4,258 )
Net TBA derivatives	\$ (375,000 )	\$ (375,430 )	\$ (379,688 )	\$ (4,258 )

The following table summarizes certain characteristics of the Company's futures derivatives as of June 30, 2015:

	Notional - Long Positions	Notional - Short Positions (dollars in thousands)	Weighted Average Years to Maturity
2-year swap equivalent Eurodollar contracts	\$ -	\$ (5,000,000 )	2.00
U.S. Treasury futures - 5 year	-	(2,273,000 )	4.42
U.S. Treasury futures - 10 year and greater	-	(1,007,500 )	6.92
Total	\$ -	\$ (8,280,500 )	3.26

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 as of June 30, 2015 and December 31, 2014, respectively.

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June 30, 2015		Amounts Eligible for Offset		
	Gross Amounts	Financial Instruments	Cash Collateral	Net Amounts
(dollars in thousands)				
<b>Assets:</b>				
Interest rate swaps, at fair value	\$ 30,259	\$ (27,869 )	\$ -	\$ 2,390
Interest rate swaptions, at fair value	6	-	-	6
TBA derivatives, at fair value	30,334	(17,976 )	-	12,358
Futures contracts, at fair value	7,734	(1,594 )	-	6,140
<b>Liabilities:</b>				
Interest rate swaps, at fair value	\$ 1,328,729	\$ (27,869 )	\$ (709,143 )	\$ 591,717
TBA derivatives, at fair value	24,377	(17,976 )	-	6,401
Futures contracts, at fair value	16,162	(1,594 )	(14,568 )	-
<b>December 31, 2014</b>				
	Gross Amounts	Financial Instruments	Cash Collateral	Net Amounts
(dollars in thousands)				
<b>Assets:</b>				
Interest rate swaps, at fair value	\$ 75,225	\$ (66,180 )	\$ -	\$ 9,045
Interest rate swaptions, at fair value	5,382	-	-	5,382
Futures contracts, at fair value	117	(117 )	-	-
<b>Liabilities:</b>				
Interest rate swaps, at fair value	\$ 1,608,286	\$ (66,180 )	\$ (869,302 )	\$ 672,804
TBA derivatives, at fair value	4,258	-	-	4,258
Futures contracts, at fair value	3,769	(117 )	-	3,652

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)

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	Realized Gains (Losses) on Interest Rate Swaps(1)	Realized Gains (Losses) on Termination of Interest Rate Swaps (dollars in thousands)	Unrealized Gains (Losses) on Interest Rate Swaps
Quarter Ended:			
June 30, 2015	\$ (144,465 )	\$ -	\$ 700,792
June 30, 2014	\$ (220,934 )	\$ (772,491 )	\$ 175,062
Six Months Ended:			
June 30, 2015	\$ (302,704 )	\$ (226,462 )	\$ 234,590
June 30, 2014	\$ (481,369 )	\$ (779,333 )	\$ (173,880 )

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss).

The effect of other derivative contracts on the Company's Consolidated Statements of Comprehensive Income (Loss) is as follows:



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Derivative Instruments	Realized Gain (Loss) (dollars in thousands)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Three Months Ended June 30, 2015			
Net TBA derivatives (1)	\$ (50,801 )	\$ (106,974 )	\$ (157,775 )
Net interest rate swaptions	(7,600 )	7,033	(567 )
U.S. Treasury futures	(9,230 )	53,351	44,121
			\$ (114,221 )

Derivative Instruments	Realized Gain (Loss) (dollars in thousands)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Three Months Ended June 30, 2014			
Net TBA derivatives (1)	\$ (7,046 )	\$ (3,628 )	\$ (10,674 )
Net interest rate swaptions	(31,039 )	1,786	(29,253 )
U.S. Treasury futures	(6,806 )	225	(6,581 )
			\$ (46,508 )

Derivative Instruments	Realized Gain (Loss) (dollars in thousands)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Six Months Ended June 30, 2015			
Net TBA derivatives (1)	\$ (106,445 )	\$ 10,213	\$ (96,232 )
Net interest rate swaptions	(29,491 )	24,116	(5,375 )
Futures	(14,737 )	(4,775 )	(19,512 )
			\$ (121,119 )

Derivative Instruments	Realized Gain (Loss) (dollars in thousands)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Six Months Ended June 30, 2014			

Net TBA derivatives (1)	\$ (44,883 )	\$ (15,038 )	\$ (59,921 )
Net interest rate swaptions	\$ (71,981 )	\$ (51,131 )	\$ (123,112 )
U.S. Treasury futures	\$ (12,475 )	\$ (2,824 )	\$ (15,299 )
			\$ (198,332 )

(1) Includes options on TBA securities.

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 (NYSE). 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 that are in a net liability position at June 30, 2015 was approximately \$1.3 billion, which represents the maximum amount the Company would be required to pay upon termination. This amount is fully collateralized.

## 9. CONVERTIBLE SENIOR NOTES

In 2010, the Company issued \$600.0 million in aggregate principal amount of its 4% Convertible Senior Notes for net proceeds of approximately \$582.0 million. In 2012, the Company repurchased \$492.5 million in aggregate principal amount of its 4% Convertible Senior Notes. In February 2015, the 4% Convertible Senior Notes matured and the Company repaid the remaining 4% Convertible Senior Notes for the face amount of \$107.5 million.

In May 2012, the Company issued \$750.0 million in aggregate principal amount of its 5% Convertible Senior Notes due 2015 for net proceeds of approximately \$727.5 million. In May 2015, the 5% Convertible Senior Notes matured and the Company repaid the 5% Convertible Senior Notes for the face amount of \$750.0 million.

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#### 10. COMMON STOCK AND PREFERRED STOCK

The Company's authorized shares of capital stock, par value of \$0.01 per share, consists of 1,956,937,500 shares classified as common stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock, 12,650,000 shares classified as 7.625% Series C Cumulative Redeemable Preferred Stock and 18,400,000 shares classified as 7.50% Series D Cumulative Redeemable Preferred Stock.

##### (A) Common Stock

At June 30, 2015 and December 31, 2014, the Company had issued and outstanding 947,768,496 and 947,643,079 shares of common stock, with a par value of \$0.01 per share.

No options were exercised during the six months ended June 30, 2015 and 2014.

During the six months ended June 30, 2015 and 2014, the Company raised \$1.1 million and \$1.2 million by issuing 111,000 shares and 108,000 shares, respectively, through the Direct Purchase and Dividend Reinvestment Program.

In March 2012, the Company entered into six separate Distribution Agency Agreements ("Distribution Agency Agreements") with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC and RCap Securities, Inc. (together, the Agents). Pursuant to the terms of the Distribution Agency Agreements, the Company may sell from time to time through the Agents, as its sales agents, up to 125,000,000 shares of the Company's common stock. The Company did not make any sales under the Distribution Agency Agreements during the six months ended June 30, 2015 and 2014.

##### (B) Preferred Stock

exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). Through June 30, 2015, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

At June 30, 2015 and December 31, 2014, the Company had issued and outstanding 12,000,000 shares of Series C Preferred Stock, with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series C Preferred Stock is entitled to a dividend at a rate of 7.625% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series C Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on May 16, 2017 (subject to the Company's right under limited circumstances to redeem the Series C Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through June 30, 2015, the Company had declared and paid all required quarterly dividends on the Series C Preferred Stock.

At June 30, 2015 and December 31, 2014, the Company had issued and outstanding 18,400,000 shares of Series D Preferred Stock, with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series D Preferred Stock is entitled to a dividend at a rate of 7.50% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series D Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on September 13, 2017 (subject to the Company's right under limited circumstances to redeem the Series D Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through June 30, 2015, the Company had declared and paid all required quarterly

At June 30, 2015 and December 31, 2014, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock is entitled to a dividend at a rate of 7.875% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared)

dividends on the Series D Preferred Stock.

The 7.875% Series A Cumulative Redeemable Preferred Stock, 7.625% Series C Cumulative Redeemable Preferred Stock and 7.50% Series D Cumulative Redeemable Preferred Stock rank senior to the common stock of the Company.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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## (C) Distributions to Stockholders

During the six months ended June 30, 2015, the Company declared dividends to common stockholders totaling \$568.6 million, or \$0.60 per common share, of which \$284.3 million, or \$0.30 per common share, was paid to common stockholders on July 30, 2015. During the six months ended June 30, 2015, the Company declared and paid dividends to Series A Preferred Stock stockholders totaling approximately \$7.3 million, or \$0.984 per preferred share, Series C Preferred Stock stockholders totaling approximately \$11.4 million, or \$0.953 per preferred share and Series D Preferred Stock stockholders totaling approximately \$17.3 million, or \$0.938 per preferred share.

During the six months ended June 30, 2014, the Company declared dividends to common stockholders

totaling \$568.5 million, or \$0.60 per common share, of which \$284.3, or \$0.30 per common share, was paid to common stockholders on July 29, 2014. During the six months ended June 30, 2014, the Company declared and paid dividends to Series A Preferred stockholders totaling approximately \$7.3 million, or \$0.984 per preferred share, Series C Preferred stockholders totaling approximately \$11.4 million, or \$0.953 per preferred share, Series D Preferred stockholders totaling approximately \$17.3 million, or \$0.938 per preferred share.

## 11. INTEREST INCOME AND INTEREST EXPENSE

The table below presents the components of the Company's interest income and interest expense for the quarters and six months ended June 30, 2015 and 2014.

	For the Quarter Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(dollars in thousands)			
Interest income:				
Investment Securities	\$ 570,493	\$ 640,287	\$ 1,048,732	\$ 1,254,706
Commercial investment portfolio(1)	52,429	43,325	92,765	82,811
U.S. Treasury securities	-	-	-	1,329
Securities loaned	-	-	-	114
Reverse repurchase agreements	1,355	271	1,894	771
Other	69	79	127	132
Total interest income	624,346	683,962	1,143,518	1,339,863
Interest expense:				
Repurchase agreements	101,225	103,773	203,973	206,904
Convertible Senior Notes	6,113	20,319	29,740	39,216
U.S. Treasury securities sold, not yet purchased	-	-	-	1,076
Securities borrowed	-	-	-	95
Securitized debt of consolidated VIEs	5,475	1,853	8,357	3,464
Participation sold	159	162	318	323
Other	100	-	104	-
Total interest expense	113,072	126,107	242,492	251,078
Net interest income	\$ 511,274	\$ 557,855	\$ 901,026	\$ 1,088,785

(1) Includes commercial real estate debt, preferred equity and corporate debt.

12. GOODWILL

At June 30, 2015 and December 31, 2014, goodwill totaled \$71.8 million and \$94.8 million, respectively. The decline in goodwill is due to a \$23.0 million reduction of goodwill related to FIDAC as a result of the Company's intention to wind down FIDAC's investment advisory operations.

13. 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 quarters and six months ended June 30, 2015 and 2014.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

	For the Quarter Ended		For the Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
	(dollars in thousands, except per share data)		(dollars in thousands, except per share data)	
Net income (loss)	\$900,071	\$(335,512 )	\$423,572	\$(538,863 )
Less: Net income (loss) attributable to noncontrolling interest	(149 )	-	(239 )	-
Net income (loss) attributable to Annaly	900,220	(335,512 )	423,811	(538,863 )
Less: Preferred stock dividends	17,992	17,992	35,984	35,984
Net income (loss) per share available (related) to common stockholders, prior to adjustment for dilutive potential common shares, if necessary	882,228	(353,504 )	387,827	(574,847 )
Add: Interest on Convertible Senior Notes, if dilutive	-	-	-	-
Net income (loss) available to common stockholders, as adjusted	882,228	(353,504 )	387,827	(574,847 )
Weighted average shares of common stock outstanding-basic	947,731,493	947,515,127	947,700,832	947,487,125
Add: Effect of stock awards and Convertible Senior Notes, if dilutive	198,269	-	178,126	-
Weighted average shares of common stock outstanding-diluted	947,929,762	947,515,127	947,878,958	947,487,125
Net income (loss) per share available (related) to common share:				
Basic	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Diluted	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )

Options to purchase 2.0 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 quarters and six months ended June 30, 2015, respectively.

Options to purchase 2.4 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 quarters and six months ended June 30, 2014, respectively.

#### 14. LONG-TERM STOCK INCENTIVE PLAN

The Company adopted the 2010 Equity Incentive Plan (the "Plan"), which authorizes the Compensation Committee of the Board of Directors to grant options, stock appreciation rights, dividend equivalent rights, or

Plan. The Company had previously adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Prior Plan"). The Prior Plan authorized the Compensation Committee of the Board of Directors to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Prior Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to a ceiling of 8,932,921 shares. No further awards will be made under the Prior Plan, although existing awards remain effective.

Stock options were issued at the 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

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

10 years.

The following table sets forth activity related to the Company's stock options awarded under the Plan:

	For the Six Months Ended June 30,			
	2015		2014	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of period	2,259,335	\$ 15.35	3,581,752	\$ 15.44
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	(259,799 )	15.26	(863,167 )	15.12
Expired	(6,250 )	17.24	(305,750 )	17.34
Options outstanding at the end of period	1,993,286	\$ 15.36	2,412,835	\$ 15.31
Options exercisable at the end of period	1,993,286	\$ 15.36	2,412,835	\$ 15.31

The weighted average remaining contractual term was approximately 2.6 years and 3.6 years for stock options outstanding and exercisable as of June 30, 2015 and 2014, respectively.

As of June 30, 2015 and 2014, there was no unrecognized compensation cost related to nonvested share-based compensation awards.

## 15. INCOME TAXES

For the quarter ended June 30, 2015 the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its stockholders. To



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

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 such as 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. For years prior to 2013, the Company retained the amount of taxable income attributable to certain employee remuneration deductions disallowed for tax purposes pursuant to Section 162(m) of the Code ("Section 162(m)"). As a result of the externalization of management effective as of July 1, 2013, the Company was not subject to the Section 162(m) disallowance for the 2014 tax year.

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 quarter and six months ended June 30, 2015, the Company recorded a net income tax benefit of \$7.7 million for losses attributable to its TRSs. During the quarter and six months ended June 30, 2014, the Company recorded \$1.4 million and \$5.4 million, respectively, of income tax expense for income attributable to its TRSs.

The Company's 2013, 2012 and 2011 federal, state and local tax returns remain open for examination.

## 16. LEASE COMMITMENTS AND CONTINGENCIES

### Commitments

The Company had a non-cancelable lease for office space which commenced in May 2002 and expired in December 2014. In June 2014, the Company entered into a non-cancelable lease for office space which commenced in July 2014 and expires in September 2025. FIDAC has a lease for office space which commenced in October 2010 and expires in February 2016. The lease expense for the quarters ended June 30, 2015 and 2014 was \$0.8 million and \$0.7 million, respectively. The Company's aggregate future minimum lease payments total \$37.3 million. The following table details the lease payments.

Years Ending December 31,	Lease Commitments (dollars in thousands)
2015 (remaining)	\$ 1,071
2016	3,575
2017	3,565
2018	3,565
2019	3,565
Later years	21,993
	\$ 37,334

The Company had no material unfunded loan commitments as of June 30, 2015 and December 31, 2014.

### Contingencies

## 17. RISK MANAGEMENT

The primary risks to the Company are liquidity and investment/market 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

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 as of June 30, 2015 and December 31, 2014.

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Financial Statements

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 pledges or liquidation of 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 Investment Securities at an inopportune time when prices are depressed. The Company has established policies and procedures for mitigating risks, including conducting scenario 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, excluding Agency CRT securities, are guaranteed by those respective agencies and the payment of principal and interest on Ginnie Mae Agency mortgage-backed securities are backed by the full faith and credit of the U.S. government. Principal and interest on Agency debentures are guaranteed by the Agency issuing the debenture. Substantially all of the Company's Investment 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, investments in commercial real estate, commercial

creditworthiness of issuers, borrowers, tenants and counterparties.

18. RCAP REGULATORY REQUIREMENTS

RCap is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees.

As a self-clearing, registered broker dealer, RCap is required to maintain minimum net capital by FINRA. As of June 30, 2015 RCap had a minimum net capital requirement of \$0.3 million. RCap consistently operates with capital in excess of its regulatory capital requirements. RCap's regulatory net capital as defined by SEC Rule 15c3-1, as of June 30, 2015 was \$397.9 million with excess net capital of \$397.6 million.

19. RELATED PARTY TRANSACTIONS

Investment in Affiliate, Available-For-Sale Equity Security

At June 30, 2015, the Company's available-for-sale equity securities represented shares of Chimera Investment Corporation ("Chimera"), which are reported at fair value. The Company owned approximately 9.0 million shares of Chimera at a fair value of approximately \$123.3 million at June 30, 2015 and approximately 9.0 million shares of Chimera at a fair value of approximately \$143.0 million at December 31, 2014. On April 6, 2015, Chimera executed a 1:5 reverse stock split. At June 30, 2015 and December 31, 2014, the investment in Chimera had an unrealized gain (loss) of \$(15.5) million and \$4.2 million, respectively.

The Company evaluates the near-term prospects of its current investment in Chimera in relation to the severity and length of time of impairment, if any. Based on this evaluation, management has determined that its investment in Chimera was not considered to be other-than-temporarily impaired as of June 30, 2015 as the Company had the intent and ability to retain its investments for a period of time sufficient to allow for

mortgage-backed securities, Agency CRT securities and corporate debt. 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

any anticipated recovery in fair value. As of December 31, 2014, the Company's investment in Chimera was in an unrealized gain position.

Advisory fees

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 1. Financial Statements

For the quarter and six months ended June 30, 2015, the Company recorded advisory fees from Chimera totaling \$10.6 million and \$21.1 million, respectively. In August 2014, the management agreement between FIDAC and Chimera was amended and restated to amend certain of the terms and conditions of the prior agreement. Among other amendments to the terms of the prior agreement, effective August 8, 2014, the management fee was increased from 0.75% to 1.20% of Chimera's gross stockholders' equity (as defined in the amended and restated management agreement). For the quarter and six months ended June 30, 2014, the Company recorded advisory fees from Chimera totaling \$6.1 million and \$12.2 million, respectively. At June 30, 2015 and December 31, 2014, the Company had amounts receivable from Chimera of \$10.6 million and \$10.4 million, respectively.

#### 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 of Directors (the "Externalization"). The management agreement was effective as of July 1, 2013 and applicable for the entire 2013 calendar year and was amended on November 5, 2014 (the management agreement, as amended, is referred to as "Management Agreement").

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

The Management Agreement provides for a two year term ending December 31, 2016 with automatic two-year renewals unless at least two-thirds of the Company's independent directors or the holders of a majority of the Company's 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 the Company may

The Management Agreement also provides that the Manager may terminate the Management Agreement by providing to the Company prior written notice of its intention to terminate the Management Agreement no less than one year prior to the date designated by the Manager on which the Manager would cease to provide services or such earlier date as determined by the Company in its sole discretion.

Effective July 1, 2013, a majority of the Company's employees were terminated by the Company and were hired by the Manager. The Company has a limited number of employees following the Externalization, all of whom are employees of the Company's subsidiaries for regulatory or corporate efficiency reasons. All compensation expenses associated with such retained employees reduce the amount paid to the Manager.

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

#### 20. Subsequent Events

On August 5, 2015, FIDAC entered into an agreement with Chimera to internalize the management of Chimera. As part of the agreement, the companies agreed to terminate the management agreement between FIDAC and Chimera effective August 5, 2015.

In connection with the transaction, Annaly and Chimera entered into a share repurchase agreement pursuant to which Chimera will purchase the Company's approximately 9.0 million shares of Chimera at an aggregate price of \$126.4 million. The share repurchase agreement was entered into on August 5, 2015 and is expected to close on August 17, 2015.

On August 5, 2015, the Company also announced that its Board of Directors authorized the repurchase of up to \$1 billion of its outstanding common shares through December 31, 2016.

deliver to the Manager written notice of the Company's intention to terminate the Management Agreement. The Company must designate a date not less than one year from the date of the notice on which the Management Agreement will terminate.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the SEC or the Commission), in our press releases or in our other public or stockholder communications may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, which are based on various assumptions (some of which are beyond our control) 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 financings; changes in the market value of our assets; changes in business conditions and the general economy; our ability to grow the commercial mortgage business; credit risks related to our investments in Agency CRT securities, residential mortgage-backed

securities and related residential mortgage credit assets, commercial real estate assets and corporate debt; our ability to grow our residential mortgage credit business; our ability to consummate any contemplated investment opportunities; changes in government regulations affecting our business; our ability to maintain our qualification as a REIT for federal income tax purposes; and our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended. 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 our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q. 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.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our most recent annual report on Form 10-K. 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 Glossary of Terms for definitions of commonly used terms in this quarterly report on Form 10-Q.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

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## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### Overview

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

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

We are primarily organized around the following operations:

Annaly, the parent company	Invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
Annaly Commercial Real Estate Group, Inc. (or ACREG)	Wholly-owned subsidiary that was acquired during the second quarter of 2013 and specializes in originating or acquiring, financing and managing commercial loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
RCap Securities, Inc.	Wholly-owned subsidiary that operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority.
Fixed Income Discount Advisory Company (or FIDAC)	Wholly-owned subsidiary that manages an affiliated REIT for which it earns fee income.
Annaly Middle Market Lending LLC	Wholly-owned subsidiary that engages in corporate middle market lending transactions.

#### Business Environment

The size of our Agency mortgage-backed securities portfolio declined modestly in the second quarter of 2015 relative to the first quarter of 2015. This past quarter brought about significant interest rate and spread volatility as longer term yields increased meaningfully and Agency mortgage-backed securities spreads widened substantially. We remain cautious as the Federal Reserve (or Fed) is likely to increase the federal funds rate target later in 2015 with subsequent rate hikes priced into the yield curve throughout 2016 and beyond. Additionally, further financial and housing regulatory reform is possible, and its effect on our business is unclear.

strongly to 0.6%. Consumer spending increased a solid 2.9% in the second quarter, bolstered by the windfall from lower energy prices. The year-over-year GDP growth rate was a modest 2.3%, but still running above the Fed's estimate of potential growth. Continued hiring and signs of budding wage growth provide optimism for a continued rebound over the rest of 2015.

The Fed currently conducts monetary policy with a dual mandate: full employment and price stability. The employment situation improved vastly in 2014, with average monthly employment gains of 260,000 through December 2014 compared to 199,000 per month in 2013, according to the Bureau of Labor Statistics. Nonfarm payrolls have grown at a slower pace so far in 2015, averaging 208,000 over the first six months of the year. The unemployment rate continued to decline, down to 5.3% in June 2015 compared to 5.6% in December 2014. This is approaching the upper-end of

#### Economic Environment

Economic growth, as measured by real gross domestic product (or GDP), improved to a seasonally-adjusted annualized rate of 2.3% in the second quarter of 2015, according to the Bureau of Economic Analysis. Additionally, GDP in the first quarter, previously estimated to have contracted -0.2%, was revised up

the Fed's own estimate of their mandate-consistent unemployment rate, which was placed at 5.0-5.2% as of their June 17, 2015 meeting. Some signs of labor market slack persist as measures of long-term

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

unemployment, the part-time employment share and those out of the labor force who desire a job remain elevated versus long-term averages. However, as the Fed notes, “a range of labor market indicators suggests that underutilization of labor resources has diminished since early this year.” Inflation remained below the Fed’s 2% target through the second quarter of 2015, as measured by the year-over-year changes in the Personal Consumer Expenditure Chain Price Index (or PCE). The headline PCE measure remained low at 0.2% year-over-year in June 2015, down from 0.8% in December 2014 and 0.3% in March 2015. The more stable core PCE measure, which excludes food and energy prices, remained below the Fed’s 2.0% target at 1.24% year-over-year in May 2015, unchanged from December 2014 but lower than 1.35% in March 2015. The Federal Open Market Committee (FOMC or the Committee) has noted that “inflation persistently below its 2% objective could pose risks to economic performance”, and believes the current level of inflation below target is “partly reflecting earlier declines in energy prices and decreasing prices of non-energy imports.” The Committee expects inflation to rise gradually toward 2% over the medium term. Indeed, the pace of price increases improved in the second quarter, with headline PCE rising an annualized 2.0% compared to 0.1% in the first quarter, and core PCE rising an annualized 1.8% compared to a previous 1.0%.

At their April 28-29th, 2015 meeting, the Fed noted that in spite of the recent slowdown, they expected

economic activity to rebound. Following their June 16-17th, 2015 meeting the Fed struck a slightly more optimistic tone, noting that economic activity bounced back “moderately” in the second quarter. The FOMC’s Summary of Economic Projections also indicated optimism, as fifteen of the seventeen members expected an interest rate hike would be appropriate this year. The Fed made a few subtle changes to the statement for their July 28-29th meeting, upgrading their labor market assessment slightly in noting “solid” job gains and that labor resource underutilization has diminished since earlier in the year.

During the second quarter of 2015, the 10-year U.S. Treasury yielded between 1.9% and 2.5%, gradually rising throughout the period as the effects of the European Central Bank’s new Quantitative Easing program lessened. The market’s pricing of future inflation, as measured by trading in the Treasury Inflation-Protected Securities market, rose over the period, with the longer-dated 5-year, 5-year forward breakeven rate moving slightly above the Fed’s 2% goal. The mortgage basis, or the spread between the 30-year Agency mortgage-backed security current coupon and 10-year U.S. Treasury, declined and then rose during the quarter, reacting to fluctuations in volatility.

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

	June 30, 2015	December 31, 2014	June 30, 2014
30-Year mortgage current coupon	3.10%	2.83%	3.18%
Mortgage basis	75 bps	66 bps	65 bps
10-Year U.S. Treasury rate	2.35%	2.17%	2.53%
<b>LIBOR:</b>			
1-Month	0.19%	0.17%	0.16%
6-Month	0.44%	0.36%	0.33%

## Financial Regulatory Reform

Uncertainty remains surrounding financial regulatory reform and its impact on the markets and the broader

legislative and other regulatory outcomes of these efforts. We continue to monitor these legislative and regulatory developments to evaluate their potential impact on our business.

economy. In particular, the government is attempting to change its involvement through the Agencies in the mortgage market. There have been numerous legislative initiatives introduced regarding the Agencies, and it is unclear which approach, if any, may become law. In addition, regulators remain focused on the wholesale funding markets, bank capital levels and shadow banking. It is difficult to predict the ultimate

#### 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

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Statements”) and in Part I, Item 1A. “Risk factors” of our most recent annual report on Form 10-K.

## Net Income (Loss) Summary

The following table presents summarized financial information related to our results of operations as of and for the quarters and six months ended June 30, 2015 and 2014.

	For the Quarter Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(dollars in thousands, except per share data)			
Interest income	\$624,346	\$683,962	\$1,143,518	\$1,339,863
Interest expense	113,072	126,107	242,492	251,078
Net interest income	511,274	557,855	901,026	1,088,785
Realized and unrealized gains (losses)	440,545	(856,874 )	(388,454 )	(1,560,404 )
Other income (loss)	(7,422 )	14,844	6,278	35,472
General and administrative expenses	52,009	52,189	102,947	99,567
Income (loss) before income taxes	892,388	(336,364 )	415,903	(535,714 )
Income taxes	(7,683 )	(852 )	(7,669 )	3,149
Net income (loss)	900,071	(335,512 )	423,572	(538,863 )
Net income (loss) attributable to noncontrolling interest	(149 )	-	(239 )	-
Net income (loss) attributable to Annaly	900,220	(335,512 )	423,811	(538,863 )
Dividends on preferred stock	17,992	17,992	35,984	35,984
Net income (loss) available (related) to common stockholders	\$882,228	\$(353,504 )	\$387,827	\$(574,847 )
Net income (loss) per share available (related) to common stockholders:				
Basic	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Diluted	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Weighted average number of common shares outstanding:				
Basic	947,731,493	947,515,127	947,700,832	947,487,125
Diluted	947,929,762	947,515,127	947,878,958	947,487,125
Non-GAAP financial measures (1):				
Economic interest expense	\$252,845	\$347,041	\$540,504	\$732,447
Economic net interest income	\$371,501	\$336,921	\$603,014	\$607,416
Core earnings	\$411,055	\$300,428	\$665,137	\$540,172
Core earnings per average basic common share	\$0.41	\$0.30	\$0.66	\$0.53
Other information:				
Asset portfolio at period-end	\$72,923,481	\$84,215,932	\$72,923,481	\$84,215,932
Average total assets	\$77,110,679	\$84,782,861	\$80,858,908	\$83,829,394
Average equity	\$12,859,698	\$13,006,816	\$13,017,725	\$12,806,229
Leverage at period-end (2)	4.8	5.3	4.8	5.3
Economic leverage at period-end (3)	5.9	5.3	5.9	5.3

Capital ratio (4)	14.2	%	15.4	%	14.2	%	15.4	%
Net interest margin	2.01	%	1.57	%	1.64	%	1.45	%
Net interest spread	1.64	%	1.26	%	1.22	%	1.08	%
Return on average total assets	4.67	%	(1.58	%)	1.05	%	(1.29	%)
Return on average equity	28.00	%	(10.32	%)	6.51	%	(8.42	%)
Constant prepayment rate	12	%	7	%	11	%	7	%
Common stock book value per share	\$12.32		\$13.23		\$12.32		\$13.23	

- (1) See “Non-GAAP Financial Measures” for a reconciliation of our non-GAAP measures to their corresponding GAAP amounts.
- (2) Includes repurchase agreements, other secured financing, Convertible Senior Notes and non-recourse securitized debt, loan participation and mortgages payable.
- (3) Computed as the sum of debt, TBA derivative notional outstanding and net forward purchases of Investment Securities divided by total equity.
- (4) Represents the ratio of stockholders’ equity to total assets (inclusive of total market value of TBA derivatives).

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

#### GAAP

Net income (loss) was \$900.1 million, which includes (\$0.1) million attributable to a noncontrolling interest, or \$0.93 per average basic common share, for the quarter ended June 30, 2015 compared to (\$335.5) million, or (\$0.37) per average basic common share, for the same period in 2014. We attribute the majority of the change in net income (loss) to favorable changes in realized and unrealized gains (losses) on interest rate swaps, partially offset by lower interest income. Net

realized and unrealized gains (losses) on interest rate swaps was \$556.3 million for the quarter ended June 30, 2015 compared to (\$818.4) million for the same period in 2014. The quarter ended June 30, 2015, in comparison to the same period in 2014, resulted in a favorable change of \$772.5 million in realized gains (losses) on the termination of interest rate swaps as there were no terminated swap positions during the quarter ended June 30, 2015 compared to the termination of a significant portion of swaps positions during the same period in 2014. Unrealized gains on interest rate swaps increased \$525.7 million, reflecting rising forward interest rates for the quarter ended June 30, 2015 compared to falling forward interest rates during the same period in 2014. Interest income

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decreased \$59.6 million, primarily due to lower average interest earning assets offset by lower amortization expense on Investment Securities during the quarter ended June 30, 2015 compared to the same period in 2014.

Net income (loss) was \$423.6 million, which includes (\$0.2) million attributable to a noncontrolling interest, or \$0.41 per average basic common share, for the six months ended June 30, 2015 compared to (\$538.9) million, or (\$0.61) per average basic common share, for the same period in 2014. We attribute the majority of the change in net income (loss) to lower net realized and unrealized losses on interest rate swaps, partially offset by lower interest income. Net realized and unrealized losses on interest rate swaps was (\$294.6) million for the six months ended June 30, 2015 compared to (\$1.4) billion for the same period in 2014. Realized losses on termination of interest swaps decreased \$552.9 million to (\$226.5) million for the six months ended June 30, 2015 as fewer swaps positions were terminated during the six months ended June 30, 2015 compared to the same period in 2014. Unrealized gains (losses) on interest rate swaps was \$234.6 million for the six months ended June 30, 2015 compared to (\$173.9) million for the same period in 2014, reflecting rising forward interest rates during the six months ended June 30, 2015 compared to falling forward interest rates during the same period in 2014. Interest income decreased \$196.3 million, primarily due to higher amortization expense, reflecting a higher projected CPR, and lower average Interest Earning Assets during the six months ended June 30, 2015 compared to the same period in 2014.

#### Non-GAAP

Core earnings increased \$110.6 million to \$411.1 million, or \$0.41 per average basic common share, for the quarter ended June 30, 2015 compared to \$300.4 million, or \$0.30 per average basic common share, for the same period in 2014. We attribute the majority of the increase to lower amortization expense on Investment Securities and a decrease in interest expense on interest rate swaps reflecting a decline in swap notional amounts. These drivers were partially offset by lower interest income primarily attributable to an \$8.3 billion

interest rate swaps reflecting a decline in swap notional amounts, partially offset by lower interest income primarily due to higher amortization expense, reflecting a higher projected CPR, a \$3.1 billion decrease in average Interest Earning Assets and a 36 basis point decrease in the average yield on Interest Earning Assets for the six months ended June 30, 2015 compared to the same period in 2014.

#### Non-GAAP Financial Measures

This Management Discussion and Analysis section contains analysis and discussion of non-GAAP measurements. The non-GAAP measurements include the following:

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

Core earnings represents a non-GAAP measure and is defined as net income (loss) excluding gains or losses on disposals of investments and termination of interest rate swaps, unrealized gains or losses on interest rate swaps and financial instruments measured at fair value through earnings, net gains and losses on trading assets, impairment losses, GAAP net income (loss) attributable to noncontrolling interest and certain other non-recurring gains or losses, and inclusive of TBA dollar roll income (a component of Net gains (losses) on trading assets). TBA dollar roll income is defined as the difference in price between two TBA contracts with the same terms but different settlement dates. Dollar roll income represents the equivalent of interest income on the underlying security less an implied cost of financing.

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



decline in average Interest Earning Assets.

and operations.

Core earnings increased \$125.0 million to \$665.1 million, or \$0.66 per average basic common share, for the six months ended June 30, 2015 compared to \$540.2 million, or \$0.53 per average basic common share, for the same period in 2014. We attribute the majority of the increase to lower interest expense on

Our presentation of non-GAAP financial measures has important limitations. Other market participants may calculate core earnings, core earnings per average basic common share, economic interest expense and

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economic net interest income differently than we calculate them, making comparative analysis difficult.

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

common stockholders, interest expense and net interest income computed in accordance with GAAP.

## Core Earnings

The following table provides GAAP measures of net income (loss) and net income (loss) per basic share available to common stockholders for the quarters and six months ended June 30, 2015 and 2014 and details with respect to reconciling the aforementioned line items on a non-GAAP basis:

	For the Quarter Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(dollars in thousands, except per share data)			
GAAP net income (loss)	\$900,071	\$(335,512 )	\$423,572	\$(538,863 )
Less:				
Realized (gains) losses on termination of interest rate swaps	-	772,491	226,462	779,333
Unrealized (gains) losses on interest rate swaps	(700,792 )	(175,062 )	(234,590 )	173,880
Net (gains) losses on disposal of investments	(3,833 )	(5,893 )	(66,189 )	(85,603 )
Net (gains) losses on trading assets	114,230	46,489	121,136	192,717
Net unrealized (gains) losses on financial instruments measured at fair value through earnings	(17,581 )	(2,085 )	15,965	18,708
Impairment of goodwill	22,966	-	22,966	-
GAAP net (income) loss attributable to noncontrolling interest	149	-	239	-
Plus:				
TBA dollar roll income (loss) (1)	95,845	-	155,576	-
Core earnings	\$411,055	\$300,428	\$665,137	\$540,172
GAAP net income (loss) per average basic common share	\$0.93	\$(0.37 )	\$0.41	\$(0.61 )
Core earnings per average basic common share	\$0.41	\$0.30	\$0.66	\$0.53

(1) This amount is included as a component of Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

## Economic Interest Expense and Economic Net Interest Income

We believe the economic value of our investment strategy is depicted by the economic net interest income we earn. We calculate economic net interest income by determining our GAAP net interest income and reducing it by realized losses on interest rate swaps used to hedge cost of funds, which represents interest expense on

funds. Our economic interest expense, which is composed of interest expense on our Interest Bearing Liabilities plus interest expense on interest rate swaps used to hedge cost of funds, reflects total contractual interest payments.

The following table provides GAAP measures of interest expense and net interest income and details with respect to reconciling the aforementioned line items on a

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interest rate swaps used to hedge cost of

non-GAAP basis for each respective period:

	GAAP Interest Expense	Add: Realized Losses on Interest Rate Swaps (1)	Economic Interest Expense	GAAP Net Interest Income	Less: Realized Losses on Interest Rate Swaps (1)	Economic Net Interest Income
For the Quarter Ended:						
June 30, 2015	\$113,072	\$139,773	\$252,845	\$511,274	\$139,773	\$371,501
June 30, 2014	\$126,107	\$220,934	\$347,041	\$557,855	\$220,934	\$336,921

For the Six Months Ended:

June 30, 2015	\$242,492	\$298,012	\$540,504	\$901,026	\$298,012	\$603,014
June 30, 2014	\$251,078	\$481,369	\$732,447	\$1,088,785	\$481,369	\$607,416

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

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- (1) Represents interest expense related to our interest rate swaps used to hedge cost of funds and is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss).

## Interest Income and Average Yield on Interest Earning Assets

Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds 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 on our Agency mortgage-backed securities portfolio for the periods presented.

Quarter Ended	CPR
June 30, 2015	12%
June 30, 2014	7%

Six Months Ended	CPR
June 30, 2015	11%
June 30, 2014	7%

Our interest income for the quarters ended June 30, 2015 and 2014 was \$624.3 million and \$684.0 million, respectively. We had average Interest Earning Assets of \$77.3 billion and \$85.6 billion, and the average yield on Interest Earning Assets was 3.23% and 3.20% for the quarters ended June 30, 2015 and 2014, respectively. The decline in interest income of \$59.6

million for the quarter ended June 30, 2015 compared to the same period in 2014 was primarily due to an \$8.3 billion decrease in average Interest Earning Assets.

Our interest income for the six months ended June 30, 2015 and 2014 was \$1.1 billion and \$1.3 billion, respectively. We had average Interest Earning Assets of \$80.6 billion and \$83.7 billion, and the average yield on Interest Earning Assets was 2.84% and 3.20% for the six months ended June 30, 2015 and 2014, respectively. The decline in interest income of \$196.3 million for the six months ended June 30, 2015 compared to the same period in 2014 was primarily due to a \$3.1 billion decrease in average Interest Earning Assets and a 36 basis point decrease in the average yield on Interest Earning Assets.

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

Typically, our largest expense is the cost of Interest Bearing Liabilities and interest expense on interest rate swaps, which is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss). The table below shows our average Interest Bearing Liabilities and average cost of Interest Bearing Liabilities as compared to average one-month and average six-month LIBOR 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(1)	Average Cost of Interest Bearing Liabilities	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average	Average Cost of Interest Bearing Liabilities Relative to	Average Cost of Interest Bearing Liabilities Relative to
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Six-Month LIBOR to Average Six-Month LIBOR  
Average OneMonth LIBOR

For the  
Quarter  
Ended:

(dollars in thousands)

June

30,

2015 \$ 63,504,983 \$ 60,287,216 \$ 252,845 1.59 % 0.18 % 0.42 % (0.24 %) 1.41 % 1.17 %

June

30,

2014 \$ 71,403,320 \$ 71,482,958 \$ 347,041 1.94 % 0.15 % 0.32 % (0.17 %) 1.79 % 1.62 %

For the  
Six  
Months  
Ended:

June

30,

2015 \$ 66,821,183 \$ 60,287,216 \$ 540,504 1.62 % 0.18 % 0.40 % (0.22 %) 1.44 % 1.22 %

June

30,

2014 \$ 69,136,927 \$ 71,482,958 \$ 732,447 2.12 % 0.15 % 0.33 % (0.18 %) 1.97 % 1.79 %

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

Economic interest expense for the quarter and six months ended June 30, 2015 decreased by \$94.2 million and \$191.9 million compared to the same periods in 2014, respectively, primarily due to lower interest expense on interest rate swaps and lower average Interest Bearing Liabilities.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year

end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number should be expected to differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the amount of mortgage-backed securities we have

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

As of June 30, 2015 and December 31, 2014, 95% and 98%, respectively, of our debt consisted of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our Consolidated Statements of Financial Condition as Repurchase Agreements. All of our Agency mortgage-backed securities and debentures are currently accepted as collateral for these borrowings. However, we limit our

borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet. As of June 30, 2015, the term to maturity of our repurchase agreements ranged from one day to four years.

Additionally, we have entered into borrowings giving the counterparty the right to call the balance prior to maturity. At June 30, 2015 and December 31, 2014, the weighted average cost of funds for all our borrowings was 1.65%, including the effect of the interest rate swaps used to hedge cost of funds, 4% Convertible Senior Notes which matured in February 2015, 5% Convertible Senior Notes which matured in May 2015 (collectively, the Convertible Senior Notes) and securitized debt of consolidated VIEs, and the weighted average days to maturity was 256 days and 142 days, respectively.

## Economic Net Interest Income

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

## Economic Net Interest Income

Quarter Ended:	Average		Average			Average		Economic		Net		Net	
	Interest Earning Assets(1)	Total Interest Income	Yield on Interest Earning Assets	Average Interest Bearing Liabilities	Economic Interest Expense(2)	Cost of Interest Bearing Liabilities		Net Interest Income(3)		Net Interest Spread		Net Interest Margin(4)	
June 30, 2015	\$77,331,773	\$624,346	3.23 %	\$63,504,983	\$ 252,845	1.59 %		\$ 371,501		1.64 %		2.01 %	
June 30, 2014	\$85,585,484	\$683,962	3.20 %	\$71,403,320	\$ 347,041	1.94 %		\$ 336,921		1.26 %		1.57 %	

For the  
Six  
Months  
Ended:

June 30, 2015	\$80,621,891	\$1,143,518	2.84 %	\$66,821,183	\$ 540,504	1.62 %	\$ 603,014	1.22 %	1.64 %
June 30, 2014	\$83,719,047	\$1,339,863	3.20 %	\$69,136,927	\$ 732,447	2.12 %	\$ 607,416	1.08 %	1.45 %

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

(2) Economic interest expense includes interest expense on interest rate swaps used to hedge cost of funds.

(3) Economic net interest income includes interest expense on interest rate swaps used to hedge cost of funds.

(4) Represents the sum of annualized economic net interest income, inclusive of interest expense on interest rate swaps used to hedge costs of funds, plus TBA dollar roll income less interest expense on interest rate swaps used to hedge dollar roll transactions divided by the sum of average Interest Earning Assets plus average outstanding TBA contract balances.

#### 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 trading assets and net unrealized gains (losses) on

financial instruments measured at fair value through earnings. These components of realized and unrealized gains (losses) for the quarters and six months ended June 30, 2015 and 2014 were as follows:

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	For the Quarters Ended,		For the Six Months Ended,	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
	(dollars in thousands)			
Net gains (losses) on interest rate swaps (1)	\$ 556,327	\$ (818,363 )	\$ (294,576 )	\$ (1,434,582 )
Net gains (losses) on disposal of investments	3,833	5,893	66,189	85,603
Net gains (losses) on trading assets	(114,230 )	(46,489 )	(121,136 )	(192,717 )
Net unrealized gains (losses) on financial instruments measured at fair value through earnings	17,581	2,085	(15,965 )	(18,708 )
Impairment of goodwill	(22,966 )	-	(22,966 )	-

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

The change in net gains (losses) on interest rate swaps was primarily attributable to the favorable changes in realized gains (losses) on the termination of interest rate swaps as fewer interest rate swaps positions were terminated during the quarter and six months ended June 30, 2015 compared to the same periods in 2014 and increases in unrealized gains on interest rate swaps, reflecting rising forward interest rates during the quarter and six months ended June 30, 2015 compared to falling forward interest rates during the same periods in 2014.

For the quarter ended June 30, 2015, we disposed of Investment Securities with a carrying value of \$2.5 billion for an aggregate net gain of \$3.9 million. For the same period in 2014, we disposed of Investment Securities with a carrying value of \$6.1 billion for an aggregate net gain of \$5.9 million. For the six months ended June 30, 2015, we disposed of Investment Securities with a carrying value of \$17.4 billion for an aggregate net gain of \$66.3 million. For the same period in 2014, we disposed of Investment Securities with a carrying value of \$11.1 billion for an aggregate net gain of \$86.6 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 unrealized gains (losses) on financial instruments measured at fair value through earnings increased \$15.5 million for the quarter ended June 30, 2015 compared to the same period in 2014 and losses decreased \$2.7 million for the six months ended June 30, 2015 compared to the same period in 2014, primarily attributable to higher unrealized gains on Agency interest-only mortgage-backed securities reflecting higher forward interest rates at June 30, 2015.

## Other Income (Loss)

We report in "Other income (loss)" items that are non-recurring in nature or whose amounts, either individually or in the aggregate, would not, in the opinion of management, be meaningful to readers of the financial statements. The composition of this line item consists of non-recurring revenues and expenses and certain revenues and costs associated with our investments in commercial real estate, including rental income and recoveries, operating and transaction costs as well as depreciation and amortization expense. Given the non-routine nature of certain components of this line item, balances may fluctuate from period to period.

## General and Administrative Expenses

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



Net losses on trading assets increased \$67.7 million for the quarter ended June 30, 2015 compared to the same period in 2014, primarily attributable to higher net losses on TBA derivatives and decreased \$71.6 million for the six months ended June 30, 2015 compared to the same period in 2014, primarily attributable to lower losses on swaptions.

expenses.

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

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

Quarter Ended:	Total G&A Expenses	Total G&A Expenses/Average Assets (dollars in thousands)	Total G&A Expenses/Average Equity
June 30, 2015	\$ 52,009	0.27%	1.62%
June 30, 2014	\$ 52,189	0.25%	1.60%
For the Six Months Ended:			
June 30, 2015	\$ 102,947	0.25%	1.58%
June 30, 2014	\$ 99,567	0.24%	1.55%

G&A expenses remained relatively unchanged at \$52.0 million for the quarter ended June 30, 2015 compared to the same period in 2014 as higher other general and administrative expenses, primarily professional fees, were offset by a lower compensation and management fee reflecting lower adjusted stockholders' equity.

G&A expenses was \$102.9 million for the six months ended June 30, 2015, an increase of \$3.4 million compared to the same period in 2014. The change was attributable to higher other general and administrative expenses, primarily professional fees, partially offset by a lower compensation and management fee reflecting lower adjusted stockholders' equity.

With our available-for-sale accounting treatment on our Agency mortgage-backed securities which represent the largest portion of assets on balance sheet, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders' equity under Accumulated Other Comprehensive Income (Loss). As a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used amortized cost accounting. As a result, 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.

## Unrealized Gains and Losses

	June 30, 2015	December 31, 2014
	(dollars in thousands)	
Unrealized gain	\$ 607,959	\$ 950,072
Unrealized loss	(962,924 )	(745,189 )
Net unrealized gain (loss)	\$ (354,965 )	\$ 204,883

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

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

tend to reduce borrowing capacity under our investment policy. A very large negative change in the net fair value of our available-for-sale investment securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

The fair value of these securities being below amortized cost for the quarter ended June 30, 2015 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

before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal amount of the securities by the respective issuing government agency.

#### Net Income (Loss) and Return on Average Equity

We recorded net income (loss) of \$900.1 million, which includes a (\$0.1) million net income (loss) attributable to a noncontrolling interest, and (\$335.5) million for the quarters ended June 30, 2015 and 2014, respectively. Our return (loss) on average equity was 28.00% and (10.32)% for the quarters ended June 30, 2015 and 2014, respectively.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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We recorded net income (loss) of \$423.6 million, which includes a (\$0.2) million net income (loss) attributable to a noncontrolling interest, and (\$538.9) million for the six months ended June 30, 2015 and 2014, respectively. Our return (loss) on average equity

was 6.51% and (8.42)% for the six months ended June 30, 2015 and 2014, respectively.

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

## Components of Return on Average Equity

Quarter Ended:	Economic Net Interest Income/ Average Equity(1)		Realized and Unrealized Gains and Losses/Average Equity(2)		Other Income (Loss)/Average Equity(3)		G&A Expenses/ Average Equity		Income Taxes/ Average Equity		Return on Average Equity	
June 30, 2015	11.56	%	18.20	%	(0.38	%)	(1.62	%)	0.24	%	28.00	%
June 30, 2014	10.35	%	(19.56	%)	0.46	%	(1.60	%)	0.03	%	(10.32	%)
For the Six Months Ended:												
June 30, 2015	9.26	%	(1.31	%)	0.02	%	(1.58	%)	0.12	%	6.51	%
June 30, 2014	9.48	%	(16.85	%)	0.55	%	(1.55	%)	(0.05	%)	(8.42	%)

(1) Economic net interest income includes interest expense on interest rate swaps used to hedge cost of funds.

(2) Realized and unrealized gains and losses include impairment of goodwill and swaps used to hedge TBAs.

(3) Other income (loss) includes dividend income from affiliate, and other income (loss).

## Financial Condition

Total assets were \$75.5 billion and \$88.4 billion as of June 30, 2015 and December 31, 2014, respectively. The change was primarily due to a \$14.0 billion decrease in Agency mortgage-backed securities as we repositioned our Agency portfolio into TBA derivative contracts with a notional value of \$13.0 billion at June 30, 2015.

## Investment Securities

Substantially all of our Agency mortgage-backed securities at June 30, 2015 and December 31, 2014 were backed by single-family mortgage loans. Substantially all of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating.

related Interest Earning Assets. At June 30, 2015 and December 31, 2014 we had on our Consolidated Statements of Financial Condition a total of \$17.4 million and \$19.6 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Investment Securities acquired at a price below principal value) and a total of \$4.8 billion and \$5.4 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current amortized cost of our Investment Securities acquired at a price above principal value).

We received mortgage principal repayments of \$2.7 billion and \$1.9 billion for the quarter ended June 30, 2015 and 2014, respectively. The weighted average experienced prepayment speed for the quarters ended June 30, 2015 and 2014 was 12% and 7%, respectively. Given our current portfolio composition, if mortgage principal prepayment rates were to increase

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

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.

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The table below summarizes certain characteristics of our Investment Securities (excluding Agency interest-only mortgage-backed securities) and Agency interest-

only mortgage-backed securities as of the dates presented.

	June 30, 2015		December 31, 2014	
	(dollars in thousands)			
Investment Securities: (1)				
Principal Amount	\$63,789,094		\$77,391,804	
Net Premium	3,424,457		4,118,679	
Amortized Cost	67,213,551		81,510,483	
Amortized Cost/Principal Amount	105.37	%	105.32	%
Carrying Value	66,874,124		81,711,172	
Carrying Value / Principal Amount	104.84	%	105.58	%
Weighted Average Coupon Rate	3.64	%	3.69	%
Weighted Average Yield	2.82	%	2.81	%
Adjustable-Rate Investment Securities:(1)				
Principal Amount	\$3,369,354		\$3,870,609	
Weighted Average Coupon Rate	2.93	%	2.82	%
Weighted Average Yield	2.55	%	2.73	%
Weighted Average Term to Next Adjustment	44 Months		35 Months	
Weighted Average Lifetime Cap	9.05	%	7.95	%
Principal Amount at Period End as % of Total Investment Securities	5.28	%	5.00	%
Fixed-Rate Investment Securities: (1)				
Principal Amount	\$60,419,740		\$73,521,195	
Weighted Average Coupon Rate	3.68	%	3.73	%
Weighted Average Yield	2.83	%	2.82	%
Principal Amount at Period End as % of Total Investment Securities	94.72	%	95.00	%
Agency Interest-Only Mortgage-Backed Securities:				
Notional Amount	\$8,711,248		\$8,008,538	
Net Premium	1,397,875		1,230,471	
Amortized Cost	1,397,875		1,230,471	
Amortized Cost/Notional Amount	16.05	%	15.36	%
Carrying Value	1,375,138		1,222,434	
Carrying Value/Notional Amount	15.79	%	15.26	%
Weighted Average Coupon Rate	4.08	%	4.00	%
Weighted Average Yield	9.47	%	7.29	%

(1)

Excludes Agency interest-only mortgage-backed securities.



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## Investment Securities by Index

June 30, 2015

	One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indices(1)
Weighted average term to next adjustment	1 mo.	4 mo.	58 mo.	1 mo.	1 mo.	23 mo.	14 mo.
Weighted average annual period cap	7.29 %	1.79 %	2.00 %	-	-	2.00 %	-
Weighted average lifetime cap	12.17 %	11.34 %	9.11 %	9.14 %	10.64 %	10.37 %	4.73 %
Investment principal value as percentage of Investment Securities	0.34 %	0.20 %	3.79 %	0.14 %	0.20 %	0.13 %	0.48 %

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

Investment Securities by Index  
December 31, 2014

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

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

## Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for

sold, the non-cancelable office leases as of June 30, 2015. 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



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repurchase agreements, interest expense on repurchase agreements, securitized debt of consolidated VIEs, mortgages payable, participation

on monthly changes in the receive rate. As of June 30, 2015, the interest rate swaps had a net negative fair value of \$1.3 billion.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
(dollars in thousands)					
Repurchase agreements	\$ 47,937,740	\$ 9,421,812	\$ 100,000	\$ -	\$ 57,459,552
Interest expense on repurchase agreements(1)	232,981	108,722	2,292	-	343,995
Securitized debt of consolidated VIE (principal)	159,555	63,465	-	2,362,299	2,585,319
Mortgages payable (principal)	392	18,574	23,375	103,950	146,291
Participation sold (principal)	302	12,984	-	-	13,286
Long-term operating lease obligations	2,567	7,129	7,129	20,509	37,334
Total	\$ 48,333,537	\$ 9,632,686	\$ 132,796	\$ 2,486,758	\$ 60,585,777

(1) Interest expense on repurchase agreements calculated based on rates at June 30, 2015.

We had no material unfunded loan commitments issued as of June 30, 2015.

In the coming periods, we expect to continue to finance our Agency mortgage-backed securities in a manner that is largely consistent with our current operations via repurchase agreements. We may use Federal Home Loan Bank of Des Moines (FHLB Des Moines) advances, securitization structures, mortgages payable or other term financing structures to finance certain of our assets. During the six months ended June 30, 2015, we received \$5.3 billion from principal repayments and

\$18.3 billion in cash from disposal of Investment Securities, respectively. During the six months ended June 30, 2014, we received \$3.6 billion from principal repayments and \$11.4 billion in cash from disposal of Investment Securities.

#### Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

#### 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 (or ICAAP) framework supports capital and business performance measurement, and is integrated within the overall risk governance framework. The ICAAP framework is designed to align capital measurement with our risk appetite.

Our objective is to maintain an active ICAAP that reflects sound governance, requires active assessment and reporting of internal capital adequacy, incorporates stress testing based on internal and external factors and identifies potential capital actions to ensure our capital and available financial resources remain in excess of internal capital requirements.

The 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. The 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.

It is considered the capital needed to remain solvent under extreme scenarios. It is a probabilistic measure of potential future losses at a given confidence level over a given time horizon.

The major risks impacting capital applicable to us are liquidity, investment/market, credit, counterparty, operational, and other risks such as compliance, legal and regulatory risks. For further discussion of the risks we are subject to, please see Part I, Item 1A. "Risk Factors" of our most recent 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 (or AFR) 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

Other loss absorption instruments

In the event we fall short of our internal limits we will take 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 as of June 30, 2015 and December 31, 2014:

Economic capital is our internal quantification of the risks inherent in our business and considers the amount of capital we need as a buffer to protect against risks.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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	June 30, 2015	December 31, 2014
Stockholders' Equity:	(dollars in thousands)	
7.875% Series A Cumulative Redeemable Preferred Stock	\$ 177,088	\$ 177,088
7.625% Series C Cumulative Redeemable Preferred Stock	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock	445,457	445,457
Common stock	9,478	9,476
Additional paid-in capital	14,788,677	14,786,509
Accumulated other comprehensive income (loss)	(354,965 )	204,883
Accumulated deficit	(2,766,250 )	(2,585,436 )
Total stockholders' equity	\$ 12,589,999	\$ 13,328,491

## Common and Preferred Stock

The following table provides a summary of option and direct purchase activity for the periods presented:

	Options Exercised	Aggregate Exercise Price	Shares Issued Through Direct Purchase	Amount Raised from Direct Purchase and Dividend Reinvestment Program
For the Six Months Ended:	(dollars in millions)			
June 30, 2015	-	\$ -	111,000	\$ 1.1
June 30, 2014	-	\$ -	108,000	\$ 1.2

In March 2012, we entered into six separate Distribution Agency Agreements (or Distribution Agency Agreements) with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC and RCap (together, the Agents). Pursuant to the terms of the Distribution Agency Agreements, we may sell from time to time through the Agents, as our sales agents, up to 125,000,000 shares of our common stock. We did not make any sales under the Distribution Agency Agreements during the six months ended June 30, 2015 and 2014.

## Distributions to Stockholders

Our policy is to distribute at least 100% of our REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, we distribute such shortfall within the next year as permitted by the Code. REIT taxable income will differ from GAAP net income (loss) due to timing differences, such as the amortization/accretion of premiums/discounts from purchases of Investment Securities and unrealized gains (losses) included in net income (loss).

We seek to generate income for distribution to our stockholders, typically by earning a spread between the yield on our assets and the cost of our borrowings. Our REIT taxable income, which serves as the basis for distributions to our stockholders, is generated primarily from this spread income.

The following table provides a summary of dividend distribution activity for the periods presented:

	For the Six Months Ended:	
	June 30, 2015	June 30, 2014
	(dollars in thousands, except per share data)	
Dividends declared to common stockholders	\$ 568,640	\$ 568,509
Dividends declared per common share	\$ 0.60	\$ 0.60
Dividends paid to common stockholders after period end	\$ 284,331	\$ 284,261
Dividends paid per common share after period end	\$ 0.30	\$ 0.30
Date of dividends paid to common stockholders after period end	July 30, 2015	July 29, 2014
Dividends declared to Series A Preferred stockholders	\$ 7,297	\$ 7,297
Dividends declared per Series A Preferred share	\$ 0.984	\$ 0.984
Dividends declared to Series C Preferred stockholders	\$ 11,438	\$ 11,438
Dividends declared per Series C Preferred share	\$ 0.953	\$ 0.953
Dividends declared to Series D Preferred stockholders	\$ 17,250	\$ 17,250
Dividends declared per Series D Preferred share	\$ 0.938	\$ 0.938

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

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## Leverage and Capital

We believe that it is prudent to maintain conservative debt-to-equity and economic leverage ratios as there continues to 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 a ratio of debt-to-equity of less than 12:1. Our actual leverage ratio varies from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions.

Our debt-to-equity ratio at June 30, 2015 and December 31, 2014 was 4.8:1 and 5.4:1, respectively. Our economic leverage ratio, which is computed as the sum of debt, TBA derivative notional outstanding and net forward purchases of Investment Securities divided by total equity, at June 30, 2015 and December 31, 2014 was 5.9:1 and 5.4:1, respectively. Our capital ratio, which represents our ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives), was 14.2% and 15.1% at June 30, 2015 and December 31, 2014, 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 measure, monitor and manage 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 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. Fundamentally, we will only engage in risk activities based on our core expertise that enhance value for our stockholders. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage posture.

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

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

Governance

Risk management begins with our board of directors, 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 of directors exercises its oversight of risk management primarily through the Board Risk Committee (or BRC) and Board Audit Committee (or BAC). The BRC is responsible for oversight of our risk governance structure, risk management and risk assessment guidelines and policies, our risk tolerance and our capital, liquidity and funding. The BAC is

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

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. Three 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,

Asset and Liability Committee and the Financial Reporting and Disclosure Committee.

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.

## 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
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.
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 invested securities and other investment instruments.
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. This risk is present in lending, investing, funding and hedging activities.
Operational Risk	Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events. Model risk is included in operational risk.
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.

## Liquidity Risk Management

Our liquidity 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 liquidity risk management practices consist of the following primary elements:

Funding	Availability of diverse and stable sources of funds.
Excess Liquidity	Excess liquidity primarily in the form of unencumbered assets.
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.
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## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Funding

Our primary financing sources are repurchase agreements and various forms of equity. Through the judicious use of leverage, we maintain excess liquidity through investing in high quality unencumbered assets, which serve as our capital buffer.

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

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 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.

At June 30, 2015, we had total financial instruments and cash pledged as collateral for repurchase agreements and interest rate swaps of \$62.5 billion. The weighted average haircut was approximately 5% on repurchase agreements. The quality and character of the Agency mortgage-backed securities that we pledge as collateral under the repurchase agreements and interest rate swaps did not materially change during the quarter ended June 30, 2015 compared to the quarter ended December 31, 2014, 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 quarter ended June 30, 2015.

The table below presents our quarterly average and quarter-end repurchase agreement and reverse repurchase agreement balances outstanding for the periods presented:

	Repurchase Agreements		Reverse Repurchase Agreements	
	Average Daily Amount Outstanding	Ending Amount Outstanding	Average Daily Amount Outstanding	Ending Amount Outstanding
Quarters Ended:	(dollars in thousands)			
June 30, 2015	\$ 60,643,597	\$ 57,459,552	\$ 1,779,121	\$ -
March 31, 2015	68,572,119	60,477,378	100,000	100,000
December 31, 2014	72,117,895	71,361,926	10,870	100,000
September 30, 2014	71,312,473	69,610,722	-	-
June 30, 2014	70,133,219	70,372,218	227,640	-
March 31, 2014	64,443,248	64,543,949	379,042	444,375
December 31, 2013	67,509,177	61,781,001	345,470	100,000
September 30, 2013	76,265,080	69,211,309	217,693	31,074
June 30, 2013	93,250,767	81,397,335	2,569,531	171,234

At June 30, 2015, the repurchase agreements outstanding had weighted average remaining maturities of 149 days and the following remaining maturities and weighted average rates:

Repurchase Agreements	June 30, 2015	% of Total
	Weighted Average Rate (dollars in thousands)	

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1 day	\$	7,150,000	0.82	%	12.4	%
2 to 29 days		16,013,749	0.43	%	27.9	%
30 to 59 days		8,157,729	0.52	%	14.2	%
60 to 89 days		7,132,012	0.42	%	12.4	%
90 to 119 days		1,507,387	0.43	%	2.6	%
Over 120 days(1)		17,498,675	1.32	%	30.5	%
Total	\$	57,459,552	0.76	%	100.0	%

(1) Approximately 17% of the total repurchase agreements had a remaining maturity over 1 year.

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## 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 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 as of June 30, 2015:

## Encumbered and Unencumbered Assets

	Encumbered Assets	Unencumbered Assets (dollars in thousands)	Total
Financial Assets:			
Cash and cash equivalents	\$ 1,412,141	\$ 373,017	\$ 1,785,158
Investments, at carrying value:(1)			
Agency mortgage-backed securities	60,926,741	6,240,228	67,166,969
Agency debentures	95,239	334,605	429,844
Agency CRT securities	-	214,130	214,130
Commercial real estate debt investments	2,812,824	-	2,812,824
Commercial real estate debt and preferred equity, held for investment	539,807	793,148	1,332,955
Corporate debt	-	311,640	311,640
Total financial assets	\$ 65,786,752	\$ 8,266,768	\$ 74,053,520

(1) 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.

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 considered as well and is subject to certain parameters. The composition is monitored for concentration risk, asset type and ratings. We believe the assets we consider liquid can be readily converted into cash, through liquidation or used as collateral in

financing arrangements (including certain collateral currently supporting 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 as of June 30, 2015.

Liquid Assets	Carrying Value(1) (dollars in thousands)
Cash and cash equivalents	\$ 1,785,158
Investment Securities(2)	67,810,943

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Commercial real estate debt investments	234,000	
Total liquid assets	\$	69,830,101
Percentage of liquid assets to total assets	92.43	%

(1) Carrying value represents the market value of assets. The assets listed in this table include \$62.7 billion of assets that have been pledged as collateral against existing liabilities as of June 30, 2015. Please refer to the Encumbered and Unencumbered Assets table for related information.

(2) 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.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

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 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 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 prepayment expectations for assets that exhibit prepayment characteristics. Cash and cash equivalents are included in the 'within 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 an institution 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 for 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, which 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 table below could vary substantially based on actual prepayment experience.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

	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	\$ 1,785,158	\$ -	\$ -	\$ -	\$ 1,785,158
Agency mortgage-backed securities (principal)	1,603	11,340	650,489	62,464,888	63,128,320
Agency debentures (principal)	-	-	443,803	-	443,803
Agency CRT securities (principal)	-	-	30,000	186,971	216,971
Senior securitized commercial mortgages loans of a consolidated VIE (principal)	-	-	-	2,915,510	2,915,510
Corporate debt (principal)	-	8,665	7,474	295,502	311,641
Commercial real estate debt and preferred equity (principal)	88,904	319,730	642,451	284,619	1,335,704
Total financial assets	\$ 1,875,665	\$ 339,735	\$ 1,774,217	\$ 66,147,490	\$ 70,137,107
Financial Liabilities:					
Repurchase agreements	\$ 38,453,490	\$ 9,484,250	\$ 9,421,812	\$ 100,000	\$ 57,459,552
Other secured financing	113,200	-	-	90,000	203,200
Securitized debt of consolidated VIE (principal)	46,500	113,055	63,465	2,362,299	2,585,319
Participation sold (principal)	73	229	12,984	-	13,286
Total financial liabilities	\$ 38,613,263	\$ 9,597,534	\$ 9,498,261	\$ 2,552,299	\$ 60,261,357
Maturity gap	\$ (36,737,598)	\$ (9,257,799 )	\$ (7,724,044 )	\$ 63,595,191	\$ 9,875,750
	\$ (36,737,598)	\$ (45,995,397)	\$ (53,719,441)	\$ 9,875,750	

Cumulative maturity gap						
Interest rate sensitivity gap	\$ (14,971 )	\$ (8,371,712 )	\$ (11,818,402)	\$ 30,080,835	\$ 9,875,750	
Cumulative rate sensitivity gap	\$ (14,971 )	\$ (8,386,683 )	\$ (20,205,085)	\$ 9,875,750		
Cumulative rate sensitivity gap as a % of total rate sensitive assets	(0.02 %)	(11.96 %)	(28.81 %)	14.08 %		

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.

#### 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 macro environmental conditions. The metrics assess both the short-term and long-term 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.

#### Stress Testing

We utilize liquidity stress testing to ensure we have sufficient liquidity under a variety of scenarios and stresses. These stress tests are considered and 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.

#### Investment/Market Risk Management

One of the primary risks we are subject to is interest rate 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 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. 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



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

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 increase or decrease by 25, 50 or 75 basis points, and the effect of portfolio market value

if mortgage option-adjusted spreads 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 June 30, 2015 and various estimates regarding prepayments and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

Change in Interest Rate	Projected Percentage Change in Economic Net Interest Income(1)	Estimated Percentage Change in Portfolio Value(2)	Estimated Change as a % on NAV(2)(3)
-75 Basis Points	(16.9%)	0.7%	4.2%
-50 Basis Points	(6.2%)	0.7%	3.8%
-25 Basis Points	(1.5%)	0.4%	2.5%
Base Interest Rate	-	-	-
+25 Basis Points	5.2%	(0.5%)	(3.1%)
+50 Basis Points	7.1%	(1.2%)	(6.8%)
+75 Basis Points	7.4%	(1.9%)	(11.0%)

MBS Spread Shock	Estimated Change in Portfolio Market Value	Estimated Change as a % on NAV(2)(3)
-25 Basis Points	1.4%	8.3%
-15 Basis Points	0.9%	5.0%
-5 Basis Points	0.3%	1.6%
Base Interest Rate	-	-
+5 Basis Points	(0.3%)	(1.6%)
+15 Basis Points	(0.9%)	(4.9%)
+25 Basis Points	(1.4%)	(8.1%)

(1) Scenarios include Investment Securities, repurchase agreements and interest rate swaps only. Economic net interest income includes interest expense on interest rate swaps.

(2) Scenarios include Investment Securities and derivative instruments.

(3) NAV represents book value of equity.

## Credit and Counterparty Risk Management

Key risk parameters have been established to specify Annaly's credit risk appetite. We will maintain a high quality asset portfolio with at least 75% of the portfolio

contractual obligations. We have 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

to be high quality mortgage-backed securities and short term investments (equivalency rating of AA+ or better), and an aggregate weighted average equivalency rating of single “A” or better.

While we do not expect to encounter credit risk in our Agency investments, we face credit risk on the Agency CRT securities in our portfolio. We are exposed to credit risk on commercial real estate investments and corporate debt. We generally face more credit risk on investments where we hold subordinated debt or equity positions. We are exposed to risk of loss if an issuer, borrower or counterparty fails to perform its

assessing the creditworthiness of counterparties, borrowers and issuers. We only 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 and determine the appropriate allocation of capital to apply to each investment under our capital policy. Our management will monitor the overall portfolio risk and

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

determine estimates of provision for loss. Our portfolio composition as of June 30, 2015 and December 31,

2014 was as follows:

## Asset Portfolio (using balance sheet values)

Category	June 30, 2015		December 31, 2014	
Agency mortgage-backed securities(1)	92.7	%	96.2	%
Agency debentures	0.6	%	1.6	%
Agency CRT securities	0.3	%	0.0	%
Commercial real estate(2)	6.0	%	2.0	%
Corporate debt, held for investment	0.4	%	0.2	%

(1) Including TBAs held for delivery.

(2) Net of unamortized origination fees.

Our use of repurchase and derivative agreements create exposure to credit 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 Agency mortgage-backed securities are financed with repurchase agreements by pledging our agency securities as collateral to the lender. The collateral we pledge usually 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 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 exceeds 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 as of June 30, 2015:

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure(1)
(dollars in thousands)				
North America	16	\$ 41,461,531	\$ (973,418 )	\$ 2,828,159
Europe	10	12,407,601	(325,052 )	724,313
Asia (non-Japan)	1	373,364	-	23,079
Japan	4	3,217,056	-	181,645
Total	31	\$ 57,459,552	\$ (1,298,470 )	\$ 3,757,196

(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 which cover topics such as business continuity, personal conduct and vendor management. Other tools include training on topics such as cyber security awareness; testing, including disaster recovery testing; systems controls, including access controls; and monitoring, which

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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, an independent operational risk working group which reports to the Chief Risk Officer of our Manager, testing by our internal audit staff, and our overall governance framework.

#### 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 Enterprise Risk Committee.

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 the 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 Enterprise Risk Committee.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the U.S. Commodity Futures Trading Commission (or CFTC) gained jurisdiction over the regulation of interest rate swaps. The CFTC has asserted that this causes 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 to claim the relief are that the mortgage real estate investment trust 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 that 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 which 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

##### Investment Securities

There is an active market for Agency mortgage-backed securities, Agency debentures and Agency CRT securities. Since we primarily invest in securities that can be measured from actively quoted prices, there is a high degree of observable inputs and less subjectivity in measuring fair value. Internal market values are

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 (or CPO), and, absent relief from the Division or the Commission, 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

determined using quoted prices from the To-Be-Announced (or TBA) security 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 are a significant estimate requiring judgment in the valuation of Agency mortgage-backed securities. All internal market values are compared to

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

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.

#### Interest rate swaps

We use the overnight indexed swap (or OIS) curve as an input to value substantially all of our 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 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 interest rate swaps.

#### Revenue Recognition

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. We use a third-party supplied model to project prepayment speeds. Our prepayment speed projections incorporate underlying loan characteristics (e.g., coupon, term, original loan size, original loan to value, 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 Investment 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 obligation to absorb losses that could be potentially significant to the VIE.

#### 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 from those estimates.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

Glossary of Terms

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A

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**Adjustable-Rate Mortgage (ARM)**

A mortgage loan on which interest rates are adjusted at regular intervals according to predetermined criteria. An ARM's 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 Credit Risk Transfer ("CRT") Securities**

The CRT sector is comprised of the 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 and Freddie Mac to private investors.

**Agency Debentures**

Debt issued by a federal agency or a government-sponsored enterprise (GSE) for financing purposes. These types of debentures are not backed by collateral, but by the integrity and credit worthiness of the issuer. Agency debentures issued by a GSE are backed only by that GSE's ability to pay. The callable feature allows the Agency to repay the bond prior to maturity.

**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

B

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**Basis Point (BPs)**

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.

**Bond**

(1) 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. (2) For purposes of computations tied in to "per bond," a \$1,000 increment of an issue is used (no matter what the actual denominations are); (3) Bonds are long-term securities with an original maturity of greater than one year.

**Book Value Per Share**



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.

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.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### C

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##### Capital Buffer

Includes unencumbered financial assets which can be 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.

##### Carry

The cost of borrowing funds to finance an underwriting or trading position. 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.

##### 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 (CMBS)

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)

##### 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 Basic Share

Non-GAAP measure that is defined as net income (loss) excluding gains (losses) on disposals of investments and termination of interest rate swaps, unrealized gains (losses) on interest rate swaps and financial instruments measured at fair value through earnings, net gains (losses) on trading assets, impairment losses, net income (loss) attributable to noncontrolling interest and certain other non-recurring gains or losses, and inclusive of dollar roll income (a component of Net gains (losses) on trading assets).

##### 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.

##### Current Face

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.

**Conventional Mortgage Loan**

A mortgage loan granted by a bank or thrift institution that is based solely on real estate as security and is not insured or guaranteed by a government agency.

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**

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**Dealer**

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

# ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

### 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 (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

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### 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 composed of GAAP interest expense adjusted for realized gains or losses on interest rate swaps used to hedge cost of funds.

### Economic Leverage Ratio

Calculated as the sum of debt, TBA derivative notional outstanding and net forward purchases divided by total equity.

### Economic Net Interest Income

Non-GAAP financial measure that is composed of GAAP net interest income adjusted for realized gains or losses on interest rate swaps used to hedge cost of funds.

### Encumbered Assets

### F

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### 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.

### Fixed-Rate Mortgage

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

### 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.

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

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.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### G

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##### GAAP

Accounting principles generally accepted in the United States of America.

##### Ginnie Mae

Government National Mortgage Association.

#### H

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##### Hedge

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

#### I

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##### 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, Convertible Senior Notes, securitized debt of consolidated VIE, participation sold, FHLB Des Moines advances, U.S. Treasury securities sold, not yet purchased and securities loaned. Average Interest Bearing Liabilities is based on daily balances.

##### Interest Earning Assets

Refers to Investment Securities, securities borrowed, U.S. Treasury securities, reverse repurchase agreements, cash and cash equivalents, commercial real estate investments and commercial real estate debt and preferred equity interests. 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.

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.

##### 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 invested securities and other investment instruments.

**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

**Investment Securities**

Refers to Agency mortgage-backed securities, Agency debentures and Agency CRT securities.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### L

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##### 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, securitized debt of consolidated VIEs, Convertible Senior Notes and loan participations sold and mortgages payable which are non-recourse to us, subject to customary carveouts.

##### 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 Debt

Debt which matures in more than one year.

#### M

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##### Master Netting Agreement

An agreement between two counterparties who have multiple derivative contracts or repurchase / reverse repurchase agreements with each other that provides for the net settlement of all contracts, as well as cash collateral, through a single payment, in a single currency, in the event of default on or termination of any one contract.

##### Monetary Policy

Action taken by the Board of Governors of the Federal Reserve System to influence the money supply or interest rates.

Net asset value.

##### Net Equity Yield

Calculated using GAAP net income, excluding depreciation and amortization expense, divided by average net equity.

##### Net Interest Income

Represents interest income earned on our portfolio investments, less interest expense paid for borrowings.

##### Net Interest Margin

Represents annualized economic net interest income, inclusive of interest expense on interest rate swaps used to hedge cost of funds, plus TBA dollar roll income less interest expense on interest rate swaps used to hedge dollar roll transactions divided by the sum of its average Interest Earning Assets plus average outstanding TBA derivative balances.

##### Net Interest Spread

Calculated by taking the average yield on interest earning assets minus the average cost of interest bearing liabilities, including the net interest payments on interest rate swaps used to hedge cost of funds.

##### Notional Amount

A stated principal amount in a derivative contract on which the contract is based.

#### O

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##### 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.



**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.

**Operational Risk**

Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events.

**Original Face**

The face value or original principal amount of a security on its issue date.

N

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**Out-of-the-Money**

Description for an option that has no intrinsic value and

NAV

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

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

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#### Pass Through Security

The 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.

#### 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.

#### 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.

#### 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.

#### Prepayment

#### Prime Rate

The indicative interest rate on loans that banks quote to their best commercial customers.

## R

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#### 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.

#### Reinvestment Risk

The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

#### 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.

#### Residual

In a CMO, the residual is that tranche which 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. From the customer's perspective, the customer provides a collateralized loan to the seller.

#### Risk Appetite Statement

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 heavy prepayments of mortgage or other loans, forcing the investor to reinvest at lower prevailing rates.

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**

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**Secondary Market**

Ongoing market for bonds previously offered or sold in the primary market.

**Settlement Date**

The date securities must be delivered and paid for to complete a transaction.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### 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, an individual investor 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

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#### Target Assets

Includes Agency mortgage-backed securities, to-be-announced forward contracts, Agency debentures, commercial real estate investments, other mortgage-backed securities 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. 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

#### 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.

#### V

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#### 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.

#### 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

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#### 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

counterparty.

U

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Unencumbered Assets

Assets on our balance sheet which have not been pledged as collateral against an existing liability.

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

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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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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Quantitative and qualitative disclosures about market risk are contained within the section titled “Risk Management” of Item 2. “Management’s Discussion

and Analysis of Financial Condition and Results of Operations.”

ITEM 4. 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 quarterly report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is accumulated and communicated to our management, including our CEO

and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC’s rules and forms.

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

PART II – OTHER INFORMATION

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ITEM 1. LEGAL PROCEEDINGS

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From time-to-time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate

disposition of these matters will not have a material effect on our consolidated financial statements.

ITEM 1A. RISK FACTORS

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There have been no material changes to the risk factors disclosed in Item 1A – Risk Factors of our most recent annual report on Form 10-K. The materialization of any risks and uncertainties identified in our Special Note Regarding Forward-Looking Statements contained in this report together with those previously disclosed in our most recent annual report on Form 10-K or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Special Note Regarding Forward-Looking Statements” in this quarterly report or our most recent annual report on Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 6. Exhibits

ITEM 6. EXHIBITS

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Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto.

Exhibit Number	Exhibit Description
3.1	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 with the Securities and Exchange Commission on August 5, 1997).
3.2	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 with the Securities and Exchange Commission on June 12, 2002).
3.3	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on August 3, 2006)).
3.4	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Form 10-Q (filed with the Securities and Exchange Commission on May 7, 2008)).
3.5	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on June 23, 2011)).
3.6	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 8-A filed April 1, 2004).
3.7	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 8-K filed October 4, 2004).
3.8	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 8-K filed April 10, 2006).
3.9	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).
3.10	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).
3.11	Amended and Restated Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on March 22, 2011)).
3.12	



Amendment to the Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.12 of the Registrant's Quarterly Report on Form 10-Q filed on August 8, 2013).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 6. Exhibits

- 4.1 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 with the Securities and Exchange Commission on September 17, 1997).
- 4.2 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 with the Securities and Exchange Commission on December 5, 2001).
- 4.3 Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed with the SEC on April 1, 2004).
- 4.4 Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 10, 2006).
- 4.5 Specimen Series C Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on May 16, 2012).
- 4.6 Specimen Series D Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on September 13, 2012).
- 4.7 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 Form 8-K filed with the Securities and Exchange Commission on February 12, 2010).
- 4.8 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 Form 8-K filed with the Securities and Exchange Commission on February 12, 2010).
- 4.9 Form of 4.00% Convertible Senior Note due 2015 (included in Exhibit 4.8).
- 4.10 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 Form 8-K filed with the Securities and Exchange Commission on May 14, 2012).
- 4.11 Form of 5.00% Convertible Senior Note due 2015 (included in Exhibit 4.10).
- 18.1 Preferability letter from Ernst & Young LLP dated August 6, 2015.
- 31.1 Certification of Wellington J. Denahan, Chairman and Chief 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.
- 31.2 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.
- 32.1 Certification of Wellington J. Denahan, Chairman and Chief 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.
- 32.2 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.
- Exhibit 101.INS  
XBRL Instance Document †
- Exhibit 101.SCH  
XBRL Taxonomy Extension Schema Document †
- Exhibit 101.CAL  
XBRL Taxonomy Extension Calculation Linkbase Document †  
Additional Taxonomy Extension Definition Linkbase Document Created†

Exhibit 101.DEF

XBRL

Exhibit 101.LAB

XBRL Taxonomy Extension Label Linkbase Document †

Exhibit 101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document †

\* 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 June 30, 2015 (Unaudited) and December 31, 2014 (Derived from the audited Consolidated Statement of Financial Condition at December 31, 2014); (ii) Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the quarters and six months ended June 30, 2015 and 2014; (iii) Consolidated Statements of Stockholders' Equity (Unaudited) for the six months ended June 30, 2015 and 2014; (iv) Consolidated Statements of Cash Flows (Unaudited) for the six months ended June 30, 2015 and 2014; and (v) Notes to Consolidated Financial Statements (Unaudited). 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

Signatures

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.

Dated: August 6, 2015

By: /s/ Wellington J. Denahan

Wellington J. Denahan  
(Chief Executive Officer, and authorized  
officer of the registrant)

Dated: August 6, 2015

By: /s/ Glenn A. Votek

Glenn A. Votek  
(Chief Financial Officer and  
principal financial officer of the registrant)