AGNC Investment Corp.
Form 10-K
February 26, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the year ended December 31, 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-34057
AGNC INVESTMENT CORP.
(Exact name of registrant as specified in its charter)

Delaware	26-1701984
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

2 Bethesda Metro Center, 12th Floor
Bethesda, Maryland 20814
(Address of principal executive offices)
(301) 968-9315
(Registrant’s telephone number, including area code)
Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value per share	The Nasdaq Global Select Market
7.750% Series B Cumulative Redeemable Preferred Stock	The Nasdaq Global Select Market
7.00% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	The Nasdaq Global Select Market

Securities registered pursuant to section 12(g) of the Act: NONE
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No ý
Indicate by check mark whether the registrant (1) has filed all reports 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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	¨

Emerging growth company ¨

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

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

As of June 30, 2017, the aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant was approximately $6.3 billion based upon the closing price of the Registrant's common stock of $21.29 per share as reported on The Nasdaq Global Select Market on that date. (For this computation, the Registrant has excluded the market value of all shares of its common stock reported as beneficially owned by executive officers and directors of the Registrant and certain other stockholders; such an exclusion shall not be deemed to constitute an admission that any such person is an "affiliate" of the Registrant.)

The number of shares of the issuer's common stock, $0.01 par value, outstanding as of January 31, 2018 was 391,316,840.

DOCUMENTS INCORPORATED BY REFERENCE. The Registrant's definitive proxy statement for the 2018 Annual Meeting of Stockholders is incorporated by reference into certain sections of Part III herein.

Certain exhibits previously filed with the Securities and Exchange Commission are incorporated by reference into Part IV of this report.

AGNC INVESTMENT CORP.
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PART I

Item 1. Business

AGNC Investment Corp. ("AGNC," the "Company," "we," "us" and "our") was organized on January 7, 2008 and commenced operations on May 20, 2008 following the completion of our initial public offering. Our common stock is traded on The Nasdaq Global Select Market under the symbol "AGNC."

We operate to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). As a REIT, we are required to distribute annually 90% of our taxable income. So long as we continue to qualify as a REIT, we will generally not be subject to U.S. Federal or state corporate taxes on our taxable income to the extent that we distribute all our annual taxable income to our stockholders on a timely basis. It is our intention to distribute 100% of our taxable income within the time limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

We earn income primarily from investing in Agency residential mortgage-backed securities ("Agency RMBS") on a leveraged basis. These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations for which the principal and interest payments are guaranteed by a U.S. Government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac," and together with Fannie Mae, the "GSEs"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae"). We may also invest in other types of mortgage and mortgage-related residential and commercial mortgage-backed securities where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency.

Our principal objective is to provide our stockholders with attractive risk-adjusted returns through a combination of monthly dividends and tangible net book value accretion. We generate income from the interest earned on our investments, net of associated borrowing and hedging costs, and net realized gains and losses on our investment and hedging activities. We fund our investments primarily through borrowings structured as repurchase agreements.

Investment Strategy

Our investment strategy is designed to:

- generate attractive risk-adjusted returns for our stockholders through monthly dividend distributions and tangible net book value accretion;
- manage an investment portfolio consisting primarily of Agency securities;
- invest a subset of the portfolio in mortgage credit risk oriented assets;
- capitalize on discrepancies in the relative valuations in the Agency and non-Agency securities market;
- manage financing, interest rate, prepayment, extension and credit risks;
- continue to qualify as a REIT; and
- remain exempt from the requirements of the Investment Company Act of 1940 (the "Investment Company Act").

Targeted Investments

Agency Securities

- Agency Residential Mortgage-Backed Securities. Our primary investments consist of Agency pass-through certificates representing interests in "pools" of mortgage loans secured by residential real property. Monthly payments of principal and interest made by the individual borrowers on the mortgage loans underlying the pools are in effect "passed through" to the security holders, after deducting GSE or U.S. Government agency guarantee and servicer fees. In general, mortgage pass-through certificates distribute cash flows from the underlying collateral on a pro rata basis among the security holders. Security holders also receive guarantor advances of principal and interest for delinquent loans in the mortgage pools. We also invest in Agency collateralized mortgage obligations ("CMOs"), which are structured instruments representing interests in Agency residential pass-through certificates, and interest-only, inverse interest-only and principal-only securities, which represent the right to receive a specified proportion of the contractual interest or principal flows of specific Agency CMO securities.
- To-Be-Announced Forward Contracts ("TBAs"). TBAs are forward contracts to purchase or sell Agency RMBS. TBA contracts specify the coupon rate, issuer, term and face value of the bonds to be delivered, with the actual bonds to be delivered only identified shortly before the TBA settlement date.

Non-Agency Securities

- Credit Risk Transfer Securities ("CRT"). CRT securities are risk sharing instruments that transfer a portion of the risk associated with credit losses within pools of conventional residential mortgage loans from the GSEs and/or third-parties to private investors. Unlike Agency RMBS, full repayment of the original principal balance of CRT securities is not guaranteed by a GSE or other third-party; rather, "credit risk transfer" is achieved by writing down the outstanding principal balance of the CRT security if credit losses on the related pool of loans exceed certain thresholds. The reduced amount that issuers are obligated to repay to the security holders offsets the issuer's credit losses on the related pool of loans.
- Non-Agency Residential Mortgage-Backed Securities ("Non-Agency RMBS"). Non-Agency RMBS are securities backed by residential mortgages, for which payment of principal and interest is not guaranteed by a GSE or U.S. Government agency. Instead, a private institution such as a commercial bank will package residential mortgage loans and securitize them through the issuance of RMBS. Non-Agency RMBS may benefit from credit enhancement derived from structural elements, such as subordination, overcollateralization or insurance. We may purchase highly-rated instruments that benefit from credit enhancement or non-investment grade instruments that absorb credit risk. We focus primarily on non-Agency securities where the underlying mortgages are secured by residential properties within the United States. Residential non-Agency securities are backed by residential mortgages that can be comprised of prime mortgage or nonprime mortgage loans. We may also purchase Agency or non-Agency multifamily securities where the collateral backing the securitization consists of loans for properties housing multiple tenants.
- Commercial Mortgage-Backed Securities ("CMBS"). CMBS are securities that are structured utilizing collateral pools comprised of commercial mortgage loans. CMBS can be structured as pass-through securities, where the cash flows generated by the collateral pool are passed on pro rata to investors after netting servicer or other fees, or where cash flows are distributed to numerous classes of securities following a predetermined waterfall, which may give priority to selected classes while subordinating other classes. We may invest across the capital structure of these securities, and we intend to focus on CMBS where the underlying collateral is secured by commercial properties located within the United States.

Active Portfolio Management Strategy

We employ an active management strategy designed to achieve our principal objectives of generating attractive risk-adjusted returns and managing our net book value within reasonable bands. We invest in securities based on our assessment of the relative risk-return profile of the securities and our ability to effectively hedge a portion of the securities' exposure to market risks. The composition of our portfolio and strategies that we use will vary based on our view of prevailing market conditions and the availability of suitable investment, hedging and funding opportunities. We may experience investment gains or losses when we sell securities that we believe no longer provide attractive risk-adjusted returns or when we believe more attractive alternatives exist elsewhere in the mortgage or mortgage-related securities market. We may also experience gains or losses from our hedging strategies or due to credit losses on non-Agency securities.

Financing Strategy

As part of our investment strategy, we use leverage on our investment portfolio to increase potential returns to our stockholders. Our primary source of financing is through repurchase agreements. A repurchase (or "repo") agreement transaction acts as a financing arrangement under which we effectively pledge our investment securities as collateral to secure a loan. Our borrowings pursuant to repurchase transactions generally have maturities ranging from 30 days to one year, but may have maturities less than 30 days or up to five or more years. Our financing rates typically track one or three-month London Interbank Offered Rate ("LIBOR"), plus or minus a fixed spread.

Our leverage depends on market conditions, our assessment of risk and returns and our ability to borrow funds sufficient to fund the acquisition of mortgage securities. We generally expect our leverage to be within six to twelve times the amount of our tangible stockholders' equity. However, under certain market conditions, we may operate at leverage levels outside of this range for extended periods of time.

We seek to diversify our funding exposure by entering into repurchase agreements with multiple counterparties. We had master repurchase agreements with 43 financial institutions as of December 31, 2017. The terms of our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association ("SIFMA") as to repayment, margin requirements and the segregation of all securities sold under the repurchase transaction. In addition, each lender may require that we include supplemental terms and conditions to the standard master repurchase agreement to address such matters as additional margin maintenance requirements, cross default and other provisions. The specific provisions may differ for each lender and certain terms may not be determined until we engage in individual repurchase transactions.

During 2015, we formed a wholly-owned captive broker-dealer subsidiary, Bethesda Securities, LLC ("BES"). BES became operational and received final membership approval to the Fixed Income Clearing Corporation ("FICC") during the third quarter of 2016. BES has direct access to bilateral and triparty repo funding as a Financial Industry Regulatory Authority ("FINRA") member broker-dealer. As an eligible institution, BES also raises repo funding through the General Collateral Finance ("GCF") Repo service offered by the FICC, with the FICC acting as the central counterparty, which provides us greater depth and diversity of repurchase agreement funding while also lowering our funding cost, reducing our collateral requirements and limiting our counterparty exposure.

We also effectively finance the acquisition of Agency RMBS by entering into TBA dollar roll transactions in which we would sell a TBA contract for current month settlement and simultaneously purchase a similar TBA contract for a forward settlement date. Prior to the forward settlement date, we may choose to roll the position to a later date by entering into an offsetting TBA position, net settling the paired off positions for cash, and simultaneously entering into a similar TBA contract for a later settlement date. The TBA contract purchased for the forward settlement date is priced at a discount to the TBA contract sold for settlement/pair off in the current month. The difference (or discount) is referred to as the "price drop" and is the economic equivalent of net interest carry income on the underlying Agency RMBS over the roll period (interest income less implied financing cost), which is commonly referred to as "dollar roll income." We recognize TBA contracts as derivative instruments on our consolidated financial statements at their net carrying value (fair value less the purchase price to be paid or received under the TMA contract). Consequently, dollar roll transactions represent a form of off-balance sheet financing. In evaluating our overall leverage at risk, we consider both our on-balance sheet and off-balance sheet financing.

Risk Management Strategy

We use a variety of strategies to reduce our exposure to market risks, including interest rate, prepayment, extension and credit risks. Our investment strategies are based on our assessment of these risks, the cost of hedging transactions and our intention to qualify as a REIT. Our hedging strategies are generally not designed to protect our net book value from "spread risk," which is the risk that the yield differential between our investments and our hedges fluctuates. In addition, while we use interest rate swaps and other supplemental hedges to attempt to protect our net book value against moves in interest rates, we may not hedge certain interest rate, prepayment or extension risks if we believe that bearing such risks enhances our return profile, or if the hedging transaction would negatively impact our REIT status.

- Interest Rate Risk. We hedge a portion of our interest rate risk with respect to both the fixed income nature of our long-term assets and the short-term, variable rate nature of our financing. A majority of our funding is in the form of repurchase agreements, and, as a result, our financing costs fluctuate based on short-term interest rate indices, such as LIBOR. Our investments are assets that primarily have fixed rates of interest and maturities up to 40 years, and the interest we earn on those assets generally does not move in tandem with the interest that we pay on our repurchase agreements. As such, we may experience reduced income or losses due to adverse interest rate movements. To mitigate a portion of such risk, we utilize hedging techniques to attempt to lock in a portion of the net interest spread between the interest we earn on our assets and the interest we pay on our financing costs. We also use certain hedges, such as short U.S. Treasury securities and U.S. Treasury futures positions, to hedge a portion of the price risk associated with our largely fixed-rate asset portfolio due to changes in interest rates.

Prepayments on residential mortgages generally accelerate when interest rates decrease and slow when interest rates rise, and, as a result, mortgage securities may increase in price more slowly than similar duration bonds, or even fall in value, as interest rates decline. Mortgage securities could also decrease in value more quickly than similar duration bonds as interest rates rise. This is referred to as "negative convexity." To manage our convexity exposure, we monitor the interest rate sensitivity of our assets relative to the interest rate sensitivity of our liabilities and interest rate hedge portfolio, referred to as our "duration gap," and we monitor how our convexity and duration gap change if interest rates and prepayment expectations were to increase or decrease.

The value of our mortgage assets may also be adversely impacted by fluctuations in the shape of the yield curve or by changes in the market's expectation about future interest rate volatility. We analyze our exposure to non-parallel changes in interest rates and to changes in the market's expectation of future interest rate volatility and attempt to mitigate these risks.

- Prepayment Risk. Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Prepayment risk generally increases when interest rates decline. In this scenario, our financial results may be adversely affected as we may have to invest that principal at potentially lower yields.

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- Extension Risk. Because residential borrowers have the option to make only scheduled payments on their mortgage loans, we face the risk that a return of capital on our investment will occur slower than anticipated. Extension risk generally increases when interest rates rise. In this scenario, our financial results may be adversely affected as we may have to finance our investments at potentially higher costs without the ability to reinvest principal into higher yielding securities because borrowers prepay their mortgages at a slower pace than originally expected.
- Spread Risk. Because the market spread between the yield on our investments and the yield on benchmark interest rates, such as U.S. Treasury rates and interest rate swap rates, may vary, we are exposed to spread risk. The inherent spread risk associated with our investments and the resulting fluctuations in fair value of these securities can occur independent of interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve (the "Fed"), liquidity, or changes in required rates of return on different assets. Our strategies are generally not designed to protect our net book value from spread risk.
- Credit Risk. We accept mortgage credit exposure related to our CRT and other non-Agency securities at levels we deem to be prudent within the context of our overall investment strategy. We seek to manage this risk through prudent asset selection, pre-acquisition due diligence, post-acquisition performance monitoring, and sale of assets where we identify negative credit trends. We may also manage credit risk with credit default swaps or other financial derivatives that we believe are appropriate. Additionally, we may vary the mix of our Agency and non-Agency mortgage investments or our duration gap, when we believe credit performance is inversely correlated with changes in interest rates, to adjust our credit exposure and/or to improve the return profile of our investment portfolio.

The principal instruments that we use to hedge a portion of our exposure to interest rate, prepayment and extension risks are interest rate swaps, options to enter into interest rate swaps ("swaptions"), U.S. Treasury securities and U.S. Treasury futures contracts. We also use TBA forward contracts to periodically reduce our exposure to Agency RMBS.

The risk management actions we take may lower our earnings and dividends in the short term to further our objective of maintaining attractive levels of earnings and dividends over the long term. In addition, some of our hedges are intended to provide protection against larger rate moves and as a result may be relatively ineffective for smaller interest rate changes. Our projections of exposures to interest rate, prepayment, extension and other risks are also based on models that are dependent on a number of assumptions and inputs, and actual results could differ materially from our projections.

Income from hedging transactions that we enter to manage risk may not constitute qualifying gross income under one or both of the gross income tests applicable to REITs (see Real Estate Investment Trust Requirements below). Therefore, we may have to limit our use of certain hedging techniques, which could expose us to greater risks than we would otherwise want to bear, or implement those hedging techniques through a taxable REIT subsidiary ("TRS"). Implementing our hedges through a TRS could increase the cost of our hedging activities because a TRS would be subject to tax on income and gains.

Management Internalization

Prior to July 1, 2016, we were externally managed by AGNC Management, LLC (our "Manager"). On July 1, 2016, we completed the acquisition of all the outstanding membership interests of AGNC Mortgage Management, LLC ("AMM"), the parent company of our Manager, from American Capital Asset Management, LLC ("ACAM"), a wholly owned portfolio company of American Capital, Ltd. AMM is also the parent company of MTGE Management, LLC, the external manager of MTGE Investment Corp. ("MTGE") (Nasdaq: MTGE). Following the closing of the acquisition of AMM, we became internally managed and the external manager of MTGE.

Prior to our management internalization, we paid our Manager a management fee equal to 1.25% of our stockholders' equity, as defined in our management agreement, and we were obligated to reimburse our Manager for its expenses incurred directly related to our operations, excluding employment-related expenses. Following our management internalization, we no longer incur a management fee, but we incur expenses associated with being an internally managed organization, including compensation expenses previously borne by our Manager.

Employees

As of December 31, 2017, we had 56 full-time employees.

Exemption from Regulation under the Investment Company Act

We conduct our business so as not to become regulated as an investment company under the Investment Company Act (the "Act"), in reliance on the exemption provided by Section 3(c)(5)(C) of the Act. So long as we qualify for this exemption, we will not be subject to leverage and other restrictions imposed on regulated investment companies, which would significantly reduce our ability to use leverage. Section 3(c)(5)(C), as interpreted by the staff of the U.S. Securities and Exchange Commission ("SEC"), requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" or "qualifying real estate interests" and at least 80% of our assets in qualifying real estate interests and "real estate-related assets." In satisfying this 55% requirement, based on pronouncements of the SEC staff and in certain instances our own judgment, we treat Agency RMBS issued with respect to an underlying pool of mortgage loans in which we hold all the certificates issued by the pool ("whole pool" securities) as qualifying real estate interests. We typically treat "partial pool" and other mortgage securities where we hold less than all the certificates issued by the pool as real estate-related assets.

Real Estate Investment Trust Requirements

We have elected to be taxed as a REIT under the Internal Revenue Code. So long as we qualify as a REIT, we generally will not be subject to U.S. Federal or state corporate income tax on our taxable income to the extent that we annually distribute all our taxable income to stockholders within the time limits prescribed by the Internal Revenue Code. Qualification and taxation as a REIT depends on our ability to continually meet requirements imposed upon REITs by the Internal Revenue Code, including satisfying certain organizational requirements, an annual distribution requirement and quarterly asset and annual income tests. The REIT asset and income tests are significant to our operations as they restrict the extent to which we can invest in certain types of securities and conduct certain hedging activities within the REIT. Consequently, we may be required to limit these activities or conduct them through a TRS. We believe that we have been organized and operate in such a manner as to qualify for taxation as a REIT.

Income Tests

To continue to qualify as a REIT, we must satisfy two gross income requirements on an annual basis.

1. At least 75% of our gross income for each taxable year generally must be derived from investments in real property or mortgages on real property.
2. At least 95% of our gross income in each taxable year generally must be derived from some combination of income that qualifies under the 75% gross income test described above, as well as other dividends, interest, and gains from the sale or disposition of stock or securities, which need not have any relation to real property.

Interest income from obligations secured by mortgages on real property (such as Agency and non-Agency MBS) generally constitutes qualifying income for purposes of the 75% gross income test described above. Interest income from CRT securities is treated as non-qualifying income for the 75% gross income test. There is no direct authority with respect to the qualification of income or gains from TBAs for the 75% gross income test; however, we treat these as qualifying income for this purpose based on an opinion of legal counsel. Income and gains from instruments that we use to hedge the interest rate risk associated with our borrowings incurred, or to be incurred, to acquire real estate assets will generally be excluded from both gross income tests, provided that specified requirements are met.

Asset Tests

At the close of each calendar quarter, we must satisfy five tests relating to the nature of our assets.

1. At least 75% of the value of our total assets must be represented by some combination of "real estate assets," cash, cash items, U.S. Government securities, and, under some circumstances, temporary investments in stock or debt instruments purchased with new capital. For this purpose, mortgage-backed securities and mortgage loans are generally treated as "real estate assets." Assets that do not qualify for purposes of the 75% asset test are subject to the additional asset tests described below.
2. The value of any one issuer's securities that we own may not exceed 5% of the value of our total assets.
3. We may not own more than 10% of any one issuer's outstanding securities, as measured by either voting power or value. The 5% and 10% asset tests do not apply to securities of TRSs and qualified REIT subsidiaries and the 10% asset test does not apply to "straight debt" having specified characteristics and to certain other securities.
4. The aggregate value of all securities of all TRSs that we hold may not exceed 20% of the value of our total assets.
5. No more than 25% of the total value of our assets may be represented by certain non-mortgage debt instruments issued by publicly offered REITs (even though such debt instruments qualify under the 75% asset test).

If we should fail to satisfy the income or asset tests, such a failure would not cause us to lose our REIT qualification if we were able to eliminate the discrepancy within a 30-day cure period, in the case of the asset test, or satisfy certain relief provisions

and pay any applicable penalty taxes and other fines. Please also refer to the "Risks Related to Our Taxation as a REIT" in "Item 1A. Risk Factors" of this Form 10-K for further discussion of REIT qualification requirements and related items.

Corporate Information

Our executive offices are located at Two Bethesda Metro Center, 12^{th} Floor, Bethesda, MD 20814 and our telephone number is (301) 968-9315.

We make available our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports as well as our Code of Ethics and Conduct on our internet website at www.AGNC.com as soon as reasonably practical after such material is electronically filed with or furnished to the SEC. These reports are also available on the SEC internet website at www.sec.gov.

Competition

Our success depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring mortgage assets, we compete with mortgage REITs, mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, other lenders, governmental bodies and other entities. These entities and others that may be organized in the future may have similar asset acquisition objectives and increase competition for the available supply of mortgage assets suitable for purchase. Additionally, our investment strategy is dependent on the amount of financing available to us in the repurchase agreement market, which may also be impacted by the overall supply of repo funding and competing borrowers. Our investment strategy will be adversely impacted if we are not able to secure financing on favorable terms, if at all.

Item 1A. Risk Factors

You should carefully consider the risks described below and all other information contained in this Annual Report on Form 10-K, including our annual consolidated financial statements and the related notes thereto before deciding to purchase our securities. If any of the following risks were to occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our securities could decline, and you may lose all or part of your investment. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance.

Risks Related to Our Investing, Portfolio Management and Financing Activities

An increase in our borrowing costs would adversely affect our financial condition and results of operations.

We rely primarily on short-term and/or variable rate borrowings to acquire fixed-rate securities with long-term maturities. Due to the short-term or adjustable rate nature of our financing, our borrowing costs are particularly sensitive to increases in short-term interest rates, as well as overall funding availability, market liquidity, fluctuations in asset values and "haircut" levels applied to assets pledged under repurchase agreements and other factors.

The relationship between short and longer-term interest rates is often referred to as the "yield curve." Ordinarily, short-term interest rates are lower than longer-term interest rates, but a flattening of the yield curve can occur if short-term interest rates rise disproportionately relative to longer-term interest rates. It is also possible that the yield curve could invert, with short-term rates exceeding longer-term rates. If either of these conditions occur our borrowing costs could increase more rapidly than the interest income earned on our fixed rate assets and our net interest margin would decline, or in extreme scenarios even turn negative. In this event, we could incur operating losses and our financial condition and ability to make distributions to our stockholders could be adversely affected.

Changes to the pace of the Fed's purchases or sales of Agency mortgage-backed securities may adversely affect the price and return associated with Agency securities.

In October 2017, the Fed began to taper its reinvestments of principal payments from its U.S. Treasury, Agency debt and Agency RMBS portfolios acquired as a function of its quantitative easing programs. We cannot predict the impact that these or future actions will have on the prices and liquidity of Agency RMBS or on mortgage spreads relative to interest rate hedges tied to benchmark interest rates. During periods in which the Fed further reduces or ceases reinvestment of principal or undertakes outright sales of its securities portfolio, the price of Agency RMBS and U.S.

Treasury securities could decline, mortgage spreads could widen, refinancing volumes could be lower and market volatility could be considerably higher than would have been the case absent such actions and our results of operations and financial condition could be adversely affected.

We may change our targeted investments, investment guidelines and other operational policies without stockholder consent, which may adversely affect the market price of our common stock and our ability to make distributions to stockholders.

We may change our targeted investments and investment guidelines at any time without the consent of our stockholders, which could result in our making investments that are different from, and possibly riskier than, the investments described herein. Our Board of Directors also determines our other operational policies, including our policies with respect to our REIT qualification, acquisitions, dispositions, operations, indebtedness and distributions. Our Board of Directors may amend or revise such policies or approve transactions that deviate from them, without a vote of, or notice to, our stockholders. A change in our targeted investments, investment guidelines or other operational policies may increase our exposure to interest rate, spread, credit, prepayment, extension, liquidity and other risks, all of which could adversely affect our results of operations, financial condition and ability to make distributions to our common and preferred stockholders.

Our active portfolio management strategy may expose us to significant realized gains or losses.

We employ an active management strategy to achieve our principal objective of preserving our net book value while generating attractive risk-adjusted returns. The composition of our investment portfolio will vary as we believe changes to market conditions, risks and valuations warrant. Consequently, we may experience significant investment gains or losses when we sell investments that we no longer believe provide attractive risk-adjusted returns or when we believe more attractive alternatives are available. We may be incorrect in our assessment and select an investment portfolio that could generate lower returns than a more static management strategy. Also, investors may be less able to assess the changes in our valuation and performance by observing changes in the mortgage market since we may have changed our strategy and portfolio from the last publicly available data. Our leverage and hedging levels may also fluctuate as we pursue our active management strategy.

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

We expect our leverage to vary with market conditions and our assessment of the risks and returns on our investments. We incur leverage by borrowing against a substantial portion of the market value of our assets. While leverage is fundamental to our investment strategy, it also creates significant risks. For example, we may incur substantial losses if our borrowing costs increase or if the value of our investments declines.

Failure to procure adequate financing or to renew or replace existing financing as it matures (to which risk we are specifically exposed due to the short-term nature of the financing arrangements on our mortgage investments) could adversely affect our financial condition and results of operations.

We use debt financing as a strategy to increase our return on equity, and because we rely primarily on short-term borrowings to finance our mortgage investments, our ability to achieve our investment objectives depends not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace our maturing short-term borrowings on a continuous basis. However, we may be unable to borrow sufficient funds to achieve our desired leverage ratio for several reasons, including the following:

- our lenders do not make repurchase or other financing agreements available to us at acceptable rates and terms;
- our lenders exit the market;
- our lenders require additional collateral to cover our borrowings, which we may be unable to deliver; or
- we determine that the leverage would expose us to excessive risk.

Additionally, our wholly-owned captive broker-dealer subsidiary's ability to access bilateral and triparty repo funding, including through the FICC's GCF Repo service, requires that it continually meet regulatory and membership requirements established by FINRA and the FICC, which could change over time, potentially resulting in BES to lose access to these funding sources.

If we are unable to renew or replace maturing borrowings, we may have to sell assets, possibly under adverse market conditions. In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability. Consequently, we cannot make any assurance that financing will be available to us in the future on terms that are acceptable to us. If we cannot obtain sufficient funding on acceptable terms, our investment returns, financial condition and results of operations could be adversely affected and there may be a negative impact on the value of our common and preferred stock and our ability to make distributions to our stockholders.

A decline in the fair value of our assets will adversely affect our financial condition and results of operations, and make it costlier to finance our assets.

Our investments are recorded at fair value with changes in fair value reported in net income or other comprehensive income (a component of equity). As a result, a decline in the fair value of our investments could reduce both our net income and stockholders' equity. We also use our investments as collateral for our financings. A decline in fair value, or perceived market uncertainty about the value of our assets, could make it difficult for us to obtain financing on favorable terms or at all, or for us to maintain our compliance with terms of any financing arrangements already in place. Since we primarily invest in long-term fixed rate securities, our investment portfolio is particularly sensitive to changes in longer-term interest rates. If interest rates or other market conditions result in a decline in the fair value of our assets we would be subject to margin calls on our existing repurchase agreements and it will decrease the amounts we may borrow to purchase additional investments. If this occurs, we could be required to sell assets at adverse prices and our ability to maintain or increase our net income could be significantly restricted, negatively impacting our financial condition and results of operations and ability to make distributions to stockholders.

Our hedging strategies may not be successful in mitigating the risks associated with changes in interest rates.

Subject to complying with REIT tax requirements, we employ techniques that are intended to limit, or "hedge," the adverse effect of changes in interest rates on the value of our assets and financing costs. Hedging strategies are complex and there are no perfect hedges. Our business model also calls for accepting certain amounts of risk. Consequently, our hedging activities are generally designed to limit our interest rate exposure, but not to eliminate it, and they are generally not designed to hedge against spread risk and other risks inherent to our business model.

Our hedging strategies vary in scope based on our portfolio composition, liabilities and our assessment of the level and volatility of interest rates, expected prepayments, credit and other market conditions, and is expected to change over time. We could fail to properly assess a risk or fail to recognize a risk entirely, leaving us exposed to losses without the benefit of any offsetting hedges. The derivative financial instruments we select may not have the effect of reducing our risk, and the nature and timing of hedging transactions may influence their effectiveness in risk mitigation. Poorly designed hedging strategies or improperly executed transactions could increase our risk of loss. Hedging activities could also result in losses if the hedged event does not occur. Numerous other factors can also impact the effectiveness of our hedging strategies including, but are not limited to, the following:

- the cost of interest rate hedges can be expensive, particularly during periods of rising and volatile interest rates due to higher costs demanded by counterparties and additional charges that may be incurred to adjust our hedges in such circumstances;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought such that the reference rates could reset at a different time or times from the shorter-term rates intended to be limited;
- the duration of the hedge may not match the duration of the related asset or liability;
- the amount of income that a REIT may earn from hedging transactions other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a TRS is limited by Federal tax provisions governing REITs;
- the party in the hedging transaction owing money to us may default on its obligation to pay;
- the credit quality of the party owing money to us on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of our interest rate hedges declines due to interest rate fluctuations, lapse of time or other factors.

Furthermore, our hedging activities involve costs that we incur regardless of the effectiveness of the hedging activity or whether we receive any corresponding economic benefit. For these reasons, our hedging strategies may fail to protect us from loss and could even result in greater losses than if we had not entered in the hedge transaction, which would negatively impact our operating results and financial condition.

Our hedging strategies are generally not designed to mitigate spread risk.

When the spread between the market yield on our mortgage assets and benchmark interest rates widens, our net book value could decline. We refer to this as "spread risk" or "basis risk," and we generally do not seek to hedge this risk. The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities is a risk inherent to our business and can occur independent of changes in benchmark interest rates. Spread risk may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Fed, market liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other hedges to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk. If the value of our

mortgage assets falls by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates, our financial condition and results of operations could be materially adversely affected.
Changes in prepayment rates may adversely affect our profitability and are difficult to predict.
Our investment portfolio includes securities backed by pools of mortgage loans which receive payments related to the underlying mortgage loans. When borrowers prepay their mortgage loans at rates faster or slower than expected, it results in faster or slower prepayment of our assets. We are exposed to prepayment or extension risk in the event prepayments occur at a faster or slower rate than we anticipated. Generally, prepayments increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case as other factors can affect the rate of prepayments, including loan age and size, loan-to-value ratios, housing price trends, general economic conditions and other factors.
If our assets prepay at a faster rate than anticipated, we may be unable to reinvest the repayments at acceptable yields. If the proceeds are reinvested at lower yields than our existing assets, our net interest margins would be negatively impacted. We also amortize or accrete any premiums and discounts we pay or receive at purchase relative to the stated principal of our assets into interest income over their projected lives using the effective interest method. If the actual and estimated future prepayment experience differs from our prior estimates, we are required to record an adjustment to interest income for the impact of the cumulative difference in the effective yield, which could negatively affect our interest income.
If our assets prepay at a slower rate than anticipated, our assets could extend beyond their expected maturities and we may have to finance our investments at potentially higher costs without the ability to reinvest principal into higher yielding securities. Additionally, if prepayment rates decrease due to a rising interest rate environment, the average life or duration of our fixed-rate assets would extend, but our interest rate swap maturities would remain fixed and, therefore, cover a smaller percentage of our funding exposure. This situation may also cause the market value of our assets to decline, while most of our hedging instruments would not receive any incremental offsetting gains.
Prepayment rates are difficult to predict. Prepayments also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage or when borrowers default on their mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property. Fannie Mae and Freddie Mac will generally purchase mortgages that are 120 days or more delinquent from RMBS trusts when the cost of guarantee payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the nonperforming loans in their portfolios. Consequently, prepayment rates can be affected by conditions in the housing and financial markets that impact delinquencies on mortgage loans, GSE's cost of capital and their decisions as to when to repurchase delinquent loans, general economic conditions and the relative interest rates on fixed and adjustable rate loans, which could impact refinancing rates. In addition, the introduction of U.S. Government programs, or changes to existing programs, could increase the availability of mortgage credit to homeowners, which could impact prepayment rates, particularly for Fannie Mae and Freddie Mac Agency RMBS.
To the extent that actual prepayment speeds differ from our expectations, our operating results could be adversely affected and we could be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses. In addition, should significant prepayments occur, there is no certainty that acceptable new investments could be identified and proceeds of such prepayments could be timely reinvested.
Market conditions may disrupt the historical relationship between interest rate changes and prepayment trends, which may make it more difficult to analyze our investment portfolio.
Our success depends, in part, on our ability to analyze the relationship between changing interest rates and the rate of prepayments. Changes in interest rates and prepayments affect the market price of mortgage assets. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. To a large extent our analysis is based on models that are dependent on a number of assumptions and inputs. Many of the assumptions we use are based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. There is risk that our assumptions are incorrect. Dislocations in the residential mortgage market and other developments may disrupt the relationship between the way that prepayment trends have historically responded to interest rate changes and, consequently, may negatively impact our ability to (i) assess the market value of our investment portfolio,

(ii) implement hedging strategies and (iii) implement techniques to reduce our prepayment rate volatility, which could materially adversely affect our financial condition and results of operations.

Recent changes to the U.S. Federal income tax code could have a material impact on the residential mortgage market, which could impact the pricing of RMBS.

On December 22, 2017, the President signed the Tax Cuts and Jobs Act ("TCJA"), which provides for substantial changes to the taxation of individuals and business entities, generally with an effective date of January 1, 2018. For individual taxpayers, the changes included, among others, lower ordinary income tax rates, higher standard deductions, and suspension or modification of several itemized deductions. The changes to the categories of itemized deductions include a limit on deductions of state and local income and property taxes of $10,000 and a modification to the amount of residential mortgage interest that would be deductible. The new rule would limit the deduction available for mortgage interest by reducing the amount of debt that can qualify from $1 million to $750,000, however mortgage debt borrowed prior to December 15, 2017 would not be affected by the reduction. In addition, home equity mortgage interest is no longer deductible. Many of the changes affecting individual taxpayers would cease to apply after December 31, 2025 and would revert to their pre-2018 form with future legislation required to make the provisions effective beyond 2025. As a result of these changes, it is expected that the number of individual taxpayers that itemize deductions will decrease significantly causing the income tax benefits of residential home ownership to decline materially. It is likely that these factors could result in a decline in the pricing of residential real estate as well as alter the prepayment patterns of residential mortgages, which could have a significant impact on the pricing and returns of RMBS.

The mortgage loans referenced by our CRT securities or that underlie our non-Agency securities may be or could become subject to delinquency or foreclosure, which could result in significant losses to us.

Investments in mortgage-related securities, such as CRT securities and non-Agency MBS, where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency, subject us to the potential risk of loss of principal and/or interest due to delinquency, foreclosure and related losses on the underlying mortgage loans.

CRT securities are risk sharing instruments issued by Fannie Mae and Freddie Mac, and similarly structured transactions arranged by third-party market participants. The CRT securities issued by Fannie Mae and Freddie Mac are designed to transfer mortgage credit risk from the entities to private investors. The transactions are structured as unsecured and unguaranteed bonds issued by the GSEs whose principal payments are determined by the delinquency and prepayment experience of a reference pool of mortgages guaranteed by the GSE. CRT transactions arranged by third-party market participants are similarly structured to reference a specific pool of loans that have been securitized by Fannie Mae or Freddie Mac and transfer mortgage credit risk related to those loans to the purchaser of the securities. The holder of CRT securities bears the risk that the borrowers may default on their obligations to make full and timely payments of principal and interest. The return of the principal invested in CRT securities is dependent on the level of borrower defaults on the underlying pool of mortgages. An investor in CRT securities bears the risk that the borrowers in the reference pool of loans may default on their obligations to make full and timely payments of principal and interest.

Residential mortgage loans underlying non-Agency RMBS are secured by residential property and are subject to risks of delinquency, foreclosure and loss. The ability of a borrower to repay a loan secured by residential property is dependent upon the income or assets of the borrower. Many factors could impair a borrower's ability to repay the loan, including: loss of employment, divorce, illness, acts of God, acts of war or terrorism, adverse changes in economic and market conditions, changes in laws and regulations, changes in fiscal policies and zoning ordinances, costs of remediation and liabilities associated with environmental conditions such as mold, and the potential for uninsured or under-insured property losses.

Commercial mortgage loans underlying CMBS are generally secured by multifamily or other commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that are greater than similar risks associated with loans made on the security of residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income producing property can be affected by, among other things: tenant mix; success of tenant businesses; property management decisions; property location and condition; competition from comparable types of properties; changes in laws that increase operating expense or limit rents that may be charged; any need to address environmental contamination at the property; the occurrence of any uninsured casualty at the property; changes in national, regional or local economic conditions or specific industry segments; declines in regional or local real estate values; declines in regional or local rental or occupancy rates; increases in interest rates; real estate tax rates and other operating expenses; changes in governmental rules, regulations and fiscal policies, including environmental legislation; acts of God, acts of war or

terrorism, social unrest and civil disturbances.
Our assets are also not subject to any geographic, diversification or concentration limitations. Accordingly, our investments in CRT and non-Agency securities could be concentrated by geography, asset, property type and/or borrower. Such concentrations could subject us to a greater risk of loss due to adverse developments. For example, adverse conditions in the areas where the properties securing or otherwise referenced to our investments are located (such as business layoffs or downsizing, industry slowdowns, changing demographics and other factors) and local real estate conditions (such as oversupply or reduced demand) could in an adverse way disproportionately affect the value of our investments and our ability to recover interest and principal on our investments.

Our investments in CRT and non-Agency securities may benefit from private mortgage insurance, but this insurance may not be sufficient to cover losses.

In certain instances, mortgage loans in reference to our CRT securities or underlying our non-Agency RMBS may have private insurance. This insurance is often structured to absorb only a portion of the loss if a loan defaults and, as such, we may be exposed to losses on these loans in excess of the insurance. Rescission and denial of mortgage insurance may affect the ability to collect on this insurance. If private mortgage insurers fail to remit insurance payments for insured portions of loans when losses are incurred and where applicable, whether due to breach of contract or to an insurer's insolvency, we may experience a loss on related CRT or non-Agency RMBS securities for the amount that was insured by such insurers.

Any credit ratings assigned to our credit risk oriented investments will be subject to ongoing evaluations and revisions and we cannot assure you that those ratings will not be downgraded.

Some of our investments are rated by Moody's Investors Service, Fitch Ratings or Standard & Poor's. Any credit ratings on our investments are subject to ongoing evaluation by credit rating agencies, and we cannot assure you that any such ratings will not be changed or withdrawn by a rating agency in the future. If rating agencies assign a lower-than-expected rating or reduce or withdraw, or indicate that they may reduce or withdraw, their ratings of our investments in the future, the value of these investments could significantly decline, which would adversely affect the value of our investment portfolio and could result in losses upon disposition.

Changes in credit spreads may adversely affect our profitability.

A significant component of the fair value of CRT and non-Agency securities and other credit risk oriented investments is attributable to the credit spread, or the difference between the value the credit instrument and the value of a financial instrument with similar interest rate exposure, but with no credit risk, such as a U.S. Treasury note, and the credit instrument. Credit spreads are subject to market factors and can be highly volatile. In addition, hedging fair value changes associated with credit spreads can be inefficient and our hedging strategies are generally not designed to mitigate credit spread risk. Consequently, changes in credit spreads could adversely affect our profitability and financial condition.

Actions of the U.S. Government, including the U.S. Congress, Fed, U.S. Treasury, Federal Housing Finance Administration ("FHFA") and other governmental and regulatory bodies may adversely affect our business.

U.S. Government actions may have an adverse impact on the financial markets. To the extent the markets do not respond favorably to any such actions or such actions do not function as intended, they could have broad adverse market implications and could negatively impact our financial condition and results of operations. New regulatory requirements could adversely affect the availability or terms of financing from our lender counterparties, could impose more stringent capital rules on financial institutions, could restrict the origination of residential mortgage loans and the formation of new issuances of mortgage-backed securities and could limit the trading activities of certain banking entities and other systemically significant organizations that are important to our business. Together or individually these new regulatory requirements could materially affect our financial condition or results of operations in an adverse way.

Pursuant to the terms of borrowings under master repurchase agreements, we are subject to margin calls that could result in defaults or force us to sell assets under adverse market conditions or through foreclosure.

We enter into master repurchase agreements with multiple financial institutions. We borrow under these agreements to finance the assets for our investment portfolio. Pursuant to the terms of borrowings under our master repurchase agreements, a decline in the value of the collateral may result in our lenders initiating margin calls, where the lender requires us to pledge additional collateral. The specific collateral value to borrowing ratio that would trigger a margin call is not set in the master repurchase agreements and is not determined until we engage in a repurchase transaction under these agreements. Our fixed-rate collateral generally may be more susceptible to margin calls as increases in interest rates tend to affect more negatively the market value of fixed-rate securities. In addition, some collateral may be less liquid than other instruments, which could cause them to be more susceptible to margin calls in a volatile market environment. Moreover, collateral that prepays more quickly increases the frequency and magnitude of potential margin calls as there is a time lag between when the prepayment is reported (which reduces the market value of the security) and when the principal payment is received. If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. The threat of or occurrence of a margin call could force us to sell, either directly or through a foreclosure, our collateral under adverse market conditions, which could result in substantial losses.

Our derivative agreements expose us to margin calls that could result in defaults or force us to sell assets under adverse market conditions.

Our derivative agreements typically require that we pledge collateral to our counterparties. Our counterparties, or the central clearing agency, typically have the sole discretion to determine the value of the derivative instruments and the value of the collateral securing such instruments. In the event of a margin call, we must generally provide additional collateral on the same business day. Furthermore, our derivative agreements may also contain cross default provisions under which a default under certain of our other indebtedness above a certain threshold amount would cause an event of default under the derivative agreement. Following an event of default, we could be required to settle our obligations under the agreements at their termination values. The threat of or occurrence of margin calls or the forced settlement of our obligations under our derivative agreements at their termination values could force us to sell our investments under adverse market conditions, which could result in substantial losses.

Regulations adopted by the U.S. Commodity Futures Trading Commission ("CFTC") and regulators of other countries could impose increased margin requirements and require additional operational and compliance costs, which could negatively affect our financial condition and results of operations.

The CFTC subjects certain swaps to clearing and exchange trading requirements, margin requirements, reporting and record keeping requirements and counterparties to business conduct rules. Current and future rules and regulations promulgated by the CFTC and regulators of other countries may adversely affect our ability to engage in derivative transactions or may increase the cost of our hedging activity and potentially result in higher collateral requirements. Such increased costs and potentially higher collateral requirements could have an adverse impact on our business and results of operations.

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

We utilize TBA dollar roll transactions as a means of investing in and financing Agency RMBS. TBA contracts enable us to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of collateral, but the specific securities to be delivered are not identified until shortly before the TBA settlement date. Prior to settlement of the TBA contract we may choose to move the settlement of the securities to a later date by entering into an offsetting position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing a similar TBA contract for a later settlement date, collectively referred to as a "dollar roll." The Agency RMBS purchased for a forward settlement date under the TBA contracts are typically priced at a discount to Agency RMBS for settlement in the current month. This difference (or discount) is referred to as the "price drop." The price drop is the economic equivalent of net interest carry income on the underlying Agency RMBS over the roll period (interest income less implied financing cost) and is commonly referred to as "dollar roll income." Consequently, dollar roll transactions and such forward purchases of Agency RMBS represent a form of off-balance sheet financing and increase our "at risk" leverage.

Under certain market conditions, TBA dollar roll transactions may result in negative carry income whereby the Agency RMBS purchased for a forward settlement date under TBA contracts are priced at a premium to Agency RMBS for settlement in the current month. Additionally, sales or declines in purchases of Agency RMBS by the Fed could adversely impact the dollar roll market. Under such conditions, it may be uneconomical to roll our TBA positions prior to the settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. In addition, pursuant to the margin provisions established by the Mortgage-Backed Securities Division ("MBSD") of the FICC we are subject to margin calls on our TBA contracts. Further, our prime brokerage agreements may require us to post additional margin above the levels established by the MBSD. Negative carry income on TBA dollar roll transactions or failure to procure adequate financing to settle our obligations or meet margin calls under our TBA contracts could result in defaults or force us to sell assets under adverse market conditions or through foreclosure and adversely affect our financial condition and results of operations.

Defaults by our repurchase agreement counterparties on their obligations to resell the underlying collateral back to us at the end of the transaction term, declines in the value of our collateral, or defaults by us on our obligations under the transaction could cause us to lose money on repurchase transactions.

When we engage in a repurchase transaction, we initially transfer securities to the financial institution under one of our master repurchase agreements in exchange for cash, and our counterparty is obligated to resell such assets to us at the end of the term of the transaction. The cash we receive when we initially sell the collateral is less than the value of that collateral and this difference is referred to as the "haircut." As a result, we borrow a smaller amount than the collateral we initially sell in these transactions, and increases in "haircuts" may require us to post additional collateral. The haircut rates under our master repurchase agreements are not set until we engage in a specific repurchase transaction. If a counterparty defaults on an obligation to resell collateral to us, we could incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities), which could adversely affect our earnings, and, thus, our cash available for distribution to our stockholders.

If we default on one of our obligations under a repurchase transaction the counterparty could terminate the transaction and cease entering into other repurchase transactions with us. In that case, we would likely need to establish a replacement repurchase facility with another financial institution to continue to leverage our investment portfolio and carry out our investment strategy. We may not be able to secure a suitable replacement facility on acceptable terms or at all.

Further, financial institutions providing the repurchase agreements may require us to maintain a certain amount of cash or to set aside non-leveraged assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations should the fair value of our collateral decline. As a result, we may not be able to leverage our assets as fully as we would otherwise choose, which could reduce our return on equity. If we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly and our counterparties could choose to cease entering into further repurchase transactions with us.

Our rights under repurchase agreements are subject to the effects of bankruptcy laws in the event of our or our lender's bankruptcy or insolvency.

In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code, the effect of which, among other things, would be to allow the lender under the applicable repurchase agreement to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to foreclose on the collateral without delay. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to recover our assets under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. Recoveries on these claims could be subject to significant delay and, if received, could be substantially less than the damages incurred.

Our use of derivative agreements may expose us to counterparty risk.

Certain hedging instruments, such as interest rate swaptions, are not traded on regulated exchanges or guaranteed by an exchange or its clearinghouse and, consequently, there may not be the same level of protections with respect to margin requirements, record keeping, segregation of customer funds and positions and other requirements designed to protect both us and our counterparties. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory, commodity and other regulatory requirements and, depending on the domicile of the counterparty, applicable international requirements. Consequently, if a counterparty fails to perform under a derivative agreement we could incur a significant loss.

Our investments are recorded at fair value, which may not be readily determinable or may be materially different from the value that we ultimately realize upon their disposal.

We measure the fair value of our investments quarterly, in accordance with guidance set forth in Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures. Fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. Our determination of the fair value of our investments includes inputs provided by third-party dealers and pricing services. Valuations of certain investments in which we invest may be difficult to obtain or unreliable. In general, dealers and pricing services heavily disclaim their valuations and we do not have recourse against them due to liabilities and other damages arising from inaccurate price quotes or other inputs used to determine the fair value of our investments. Depending on the complexity and illiquidity of a security, valuations of the same security can vary substantially from one dealer or pricing service to another. Moreover, fair value and estimates of fair value may fluctuate over short periods of time. For these reasons, the fair value at which our investments are recorded may not be an indication of their realizable value. Furthermore, the ultimate realization of the value of an asset depends on economic and other conditions that are beyond our control. Consequently, if we were to liquidate an asset, particularly in a forced liquidation, the realized value may be less than the amount at which the asset is recorded, which would negatively affect our results of operations and financial condition.

Investments in the common stock of other publicly traded mortgage REITs expose us to incremental risks and costs.

We may invest in other mortgage REITs that primarily invest in Agency securities, non-Agency securities, other mortgage related instruments and/or real estate on a leveraged basis, utilizing short-term borrowings as their primary source of funding. Such mortgage REITs are, therefore, exposed to similar risk factors as those described herein and other risks inherent to investment strategies that they may pursue that diverge from our own. In addition, our investments in other mortgage REITs may expose us to incremental risks and costs due to our lack of control, lack of transparency into their underlying investment portfolios and business operations, stock market volatility and management fees, each of which could adversely affect our financial condition and results of operations. Furthermore, with regard to investments in MTGE common stock, we may be unable to sell, or dispose of, shares of MTGE common stock in a time frame that we may desire. We are subject to daily transaction volume limits established under the SEC's safe harbor provisions of Rule 10b-18. We may also be subject to "closed window" periods, during which we are generally limited in the extent to which we can transact in MTGE common stock.

The Federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between these agencies and the U.S. Government, may adversely affect our business.

The payments of principal and interest we receive on our Agency RMBS are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The guarantees on Agency securities created by Ginnie Mae are backed by the full faith and credit of the U.S. Government, whereas the guarantees on Agency securities created by Fannie Mae and Freddie Mac are not. The future roles of Fannie Mae and Freddie Mac could be significantly modified and the nature of their guarantee obligations could be considerably limited relative to historical measurements. Any such changes to the nature of their guarantee obligations could re-define what constitutes an Agency security and could have broad adverse implications for the market and our business, operations and financial condition.

Future changes to Fannie Mae or Freddie Mac may create market uncertainty and may reduce the actual or perceived credit quality of securities issued or guaranteed by these agencies. If the guarantee obligations of Freddie Mac or Fannie Mae were repudiated by FHFA, payments of principal and/or interest to holders of Agency RMBS issued by Freddie Mac or Fannie Mae would be reduced in the event of any borrower delinquencies or a servicer's failure to remit borrower payments to the trust and trust administration and servicing fees could be paid from mortgage payments prior to distributions to holders of Agency RMBS. Any actual direct compensatory damages owed due to the repudiation of Freddie Mac or Fannie Mae's guarantee obligations may not be sufficient to offset any shortfalls experienced by holders of Agency RMBS.

As a result, such laws or changes could increase the risk of loss on our investments in Agency mortgage investments guaranteed by Fannie Mae or Freddie Mac or adversely impact the market for such securities and spreads at which they trade and could materially and adversely affect our financial condition and results of operations.

There are conflicts of interest with other funds that we manage.

Through our wholly-owned subsidiary, MTGE Management, LLC, we manage MTGE, which is also a mortgage REIT that invests in securities and instruments of the type invested by us. Although we have policies in place to seek to mitigate the effects of conflicts of interest, including potential conflicts relating to the allocation of certain types of securities that meet our investment objectives and those of MTGE, these policies will not eliminate the conflicts of interest that our officers and employees may face in making investment decisions on behalf of us and MTGE. Furthermore, we do not have any agreement or understanding with MTGE that would give us priority over it in opportunities to invest in overlapping investments. Accordingly, we may compete for access to investments with MTGE.

Our executive officers and other key personnel are critical to our success and the loss of any executive officer or key employee may materially adversely affect our business.

We operate in a highly specialized industry and our success is dependent upon the efforts, experience, diligence, skill and network of business contacts of our executive officers and key personnel. The departure of any of our executive officers and/or key personnel could have a material adverse effect on our operations and performance.

We rely on information technology in our operations, and any material failure, inadequacy, interruption or security failure of that technology could disrupt our business and result in the loss of confidential information.

We rely on information technology networks and systems to process, transmit and store electronic information, and to manage or support a variety of business processes. We purchase some of our information technology from third-party vendors and rely on commercially available systems, software, tools and monitoring to provide security for the processing, transmission and storage of confidential data. While we select third-party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from breakdowns or other disruptions in communication services, failure to handle current or higher volumes, cyber-attacks and other security breaches could adversely affect our ability to conduct our business.

While we employ measures to protect the security of our information systems and data, it is possible that these measures will not prevent the systems' improper functioning or damage, or the improper access or disclosure of information in the event of cyber-attacks. In some cases, it may be difficult to anticipate or immediately detect a security breach and the damage caused. Any failure to maintain proper function, security and availability of our information systems could interrupt our operations, damage our reputation, subject us to liability claims or regulatory penalties and could have a materially adverse effect on our business, financial condition and results of operations.

Risks Related to Our Taxation as a REIT

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

We believe that we operate in a manner that allows us to qualify as a REIT for Federal income tax purposes under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and Treasury Regulations promulgated thereunder (or the Code). We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control and our compliance with the annual REIT income and quarterly asset requirements depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. Additionally, our ability to satisfy the REIT asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Furthermore, the proper classification of an instrument as debt or equity for Federal income tax purposes may be uncertain in some circumstances, which could affect the application of the REIT asset requirements. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain).

If we fail to qualify as a REIT in any tax year, we would be subject to U.S. Federal and state corporate income tax on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and would, therefore, have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our equity. In addition, the tax law would no longer require us to make distributions to our stockholders.

If we should fail to satisfy one or more requirements for REIT qualification, we may still qualify as a REIT if there is reasonable cause for the failure and not due to willful neglect and other applicable requirements are met, including completion of applicable IRS filings. It is not possible to state whether we would be entitled to the benefit of these relief provisions in all circumstances. If these relief provisions are inapplicable, we will not qualify as a REIT. Furthermore, if we satisfy the relief provisions and maintain our qualification as a REIT, we may be still subject to a penalty tax. The amount of the penalty tax will be at least $50,000 per failure, and, in the case of certain asset test failures, will be determined as the amount of net income generated by the assets in question multiplied by the highest U.S. Federal corporate tax rate in effect at the time of the failure if that amount exceeds $50,000 per failure, and, in case of income test failures, will be a 100% tax on an amount based on the magnitude of the failure, as adjusted to reflect the profit margin associated with our gross income.

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

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

The recently enacted TCJA makes substantial changes to the Internal Revenue Code. Among those changes are a significant permanent reduction in the generally applicable corporate tax rate, a temporary reduction in the highest marginal income tax rate applicable to individuals subject to a "sunset" provision, the elimination or modification of various currently allowed deductions (including substantial limitations on the deductibility of interest), certain additional limitations on the deduction of net operating losses, and preferential rates of taxation on most ordinary REIT dividends and certain business income derived by non-corporate taxpayers in comparison to other ordinary income recognized by such taxpayers. The effect of these, and the many other, changes made in the TCJA is highly uncertain, both in terms of their direct effect on the taxation of an investment in our common stock and their indirect effect on the value of our assets or shares of our common stock or market conditions generally. Furthermore, many of the provisions of the TCJA will require guidance through the issuance of Treasury regulations in order to assess their effect. There may be a substantial delay before such regulations are promulgated, increasing the uncertainty as to the ultimate effect of the statutory amendments on us. There may also be technical corrections legislation proposed with respect to the TCJA, the effect and timing of which cannot be predicted and which may be adverse to us or our stockholders.

Revisions in Federal tax laws and interpretations thereof could affect or cause us to change our investments and affect the tax considerations of an investment in us.

REIT distribution requirements could adversely affect our ability to execute our business plan.

We generally must distribute annually at least 90% of our taxable income, subject to certain adjustments and excluding any net capital gain, for U.S. Federal and state corporate income tax not to apply to earnings that we distribute. Distributions of our taxable income must generally occur in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for the year and if paid with or before the first regular dividend payment after such declaration. We may also elect to retain, rather than distribute, our net long-term capital gains and pay tax on such gains if required, in which case, we could elect for our stockholders to include their proportionate share of such undistributed long-term capital gains in income, and to receive a corresponding credit for their share of the tax that we paid. Our stockholders would then increase the adjusted basis of their stock by the difference between (a) the amounts of capital gain dividends that we designated and that they include in their taxable income, minus (b) the tax that we paid on their behalf with respect to that income. We intend to make distributions to our stockholders to comply with the REIT qualification requirements of the Internal Revenue Code.

To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. Federal and state corporate income tax on our undistributed taxable income. Furthermore, if we should fail to distribute during each calendar year at least the sum of (a) 85% of our REIT ordinary income for such year, (b) 95% of our REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, we would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (x) the amounts actually distributed, (y) the amounts of income we retained and on which we have paid corporate income tax and (z) any excess distributions from prior periods.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash, or the deductibility of expenses and the actual payment of cash in respect of those expenses, may occur. For example, if we purchase mortgage securities at issuance with a discount, we are generally required to accrete the discount into taxable income prior to receiving the cash proceeds. In addition, we generally will be required to take certain amounts into income no later than the time such amounts are reflected on certain financial statements. The application of this rule may require the accrual of, among other categories of income, income with respect to certain debt instruments or mortgage-backed securities, such as original issue discount or market discount, earlier than would be the case under the general tax rules, although the precise application of this rule is unclear at this time. This rule generally will be effective for tax years beginning after December 31, 2017 or, for debt instruments or mortgage-backed securities issued with original issue discount, for tax years beginning after December 31, 2018. Moreoever, we are not allowed to reduce our taxable income for a net capital loss incurred; instead, the net capital loss may be carried forward for a period of up to five years and applied against future capital gains subject to our ability to generate sufficient capital gains, which cannot be assured. If we do not have funds available in these situations, we could be required to borrow funds on unfavorable terms, sell investments at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to maintain our qualification as a REIT or avoid corporate income tax and the 4% annual excise tax. These alternatives could increase our costs and reduce our stockholders' equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

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

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

determine to sell shares of our common stock to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.
Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.
Even if we remain qualified for taxation as a REIT, we may nonetheless be subject to certain Federal, state and local taxes on our income and assets, including, but not limited to, the following items. Any of these or other taxes we may incur would decrease cash available for distribution to our stockholders.

- Regular U.S. Federal and state corporate income taxes on any undistributed taxable income, including undistributed net capital gains.

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- A non-deductible 4% excise tax if the actual amount distributed to our stockholders in a calendar year is less than a minimum amount specified under Federal tax laws.
- Corporate income taxes on the earnings of subsidiaries, to the extent that such subsidiaries are subchapter C corporations and are not qualified REIT subsidiaries or other disregarded entity for Federal income tax purposes.
- A 100% tax on certain transactions between us and our TRSs that do not reflect arm's-length terms.
- If we acquire appreciated assets from a corporation that is not a REIT (i.e., a corporation taxable under subchapter C of the Internal Revenue Code) in a transaction in which the adjusted tax basis of the assets in our hands is determined by reference to the adjusted tax basis of the assets in the hands of the subchapter C corporation, we may be subject to tax on such appreciation at the highest corporate income tax rate then applicable if we subsequently recognize a gain on a disposition of any such assets during the five-year period following their acquisition from the subchapter C corporation.
- A 100% tax on net income and gains from "prohibited transactions"
- Penalty taxes and other fines for failure to satisfy one or more requirements for REIT qualification.

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

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

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

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

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

We enter into financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the assets that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we could fail to remain qualified as a REIT.

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

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

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.
The REIT provisions of the Internal Revenue Code could substantially limit our ability to hedge our liabilities. Any income from a properly designated hedging transaction to manage risk of interest rate changes with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets generally does not constitute "gross

income" for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both gross income tests. As such, we may have to limit our use of advantageous hedging techniques or implement those hedges through our TRS. This could increase the cost of our hedging activities as our TRS would be subject to tax on gains, or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in our TRS will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRS.

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

There is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property or other qualifying income for purposes of the 75% gross income test. However, we treat our TBAs as qualifying assets for purposes of the REIT 75% asset test, and we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of Skadden, Arps, Slate, Meagher & Flom LLP substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of the underlying Agency RMBS, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of the underlying Agency RMBS. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of Skadden, Arps, Slate, Meagher & Flom LLP is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets or income are not qualifying assets or income. If the IRS were to successfully challenge the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, we could be subject to a penalty tax or we could fail to remain qualified as a REIT if a sufficient portion of our assets consists of TBAs or a sufficient portion of our income consists of income or gains from the disposition of TBAs.

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

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

The tax on prohibited transactions could limit our ability to engage in certain transactions.

Net income that we derive from a prohibited transaction is subject to a 100% tax. The term "prohibited transaction" generally includes a sale or other disposition of property that is held primarily for sale to customers in the ordinary course of a trade or business by us or by a borrower that has issued a shared appreciation mortgage or similar debt instrument to us. We could be subject to this tax if we were to dispose of or structure CMOs in a manner that was treated as a prohibited transaction for Federal income tax purposes.

We intend to conduct our operations so that no asset that we own (or are treated as owning) at the REIT level will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having been in the ordinary course of our business. As a result, we may choose not to engage in certain transactions at the REIT level that might otherwise be beneficial to us. In addition, whether property is held "primarily for sale to customers in the ordinary course of a trade or business" depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Internal Revenue Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We intend to structure our activities to avoid prohibited transaction characterization.

Distributions to tax-exempt investors, or gains on sale of our common stock by tax-exempt investors, may be classified as unrelated business taxable income.
Distributions with respect to our common stock and gains from the sale of our common stock should generally not constitute unrelated business taxable income to a tax-exempt investor. However, there are certain exceptions to this rule. For example, if (i) all or a portion of our assets are subject to the rules relating to "taxable mortgage pools" or we hold residual interests in a real estate mortgage investment conduit (or "REMIC"); (ii) we are a "pension held REIT;" (iii) a tax-exempt stockholder has incurred debt to purchase or hold our common stock; or (iv) a tax-exempt stockholder is classified as a social club, voluntary employee benefit association, supplemental unemployment benefit trust or a qualified group legal services plan, then a portion of our

distributions to tax-exempt stockholders and, in the case of stockholders described in clauses (iii) and (iv), gains realized on the sale of our common stock by tax-exempt stockholders may be subject to U.S. Federal income tax as unrelated business taxable income under the Internal Revenue Code.

Our inability to deduct for tax purposes compensation paid to our executives could require us to increase our distributions to stockholders or pay entity level taxes in order to maintain REIT status.

Section 162(m) of the Internal Revenue Code prohibits publicly held corporations from taking a tax deduction for annual compensation in excess of $1 million paid to any of the corporation’s “covered employees.” Prior to the enactment of the TCJA, a publicly held corporation’s covered employees included its chief executive officer and the three other most highly compensated executive officers (other than the chief financial officer), and certain performance-based compensation” was excluded from the $1 million cap. The TCJA made certain changes to Section 162(m), effective for taxable years beginning after December 31, 2017. These changes include, among others, expanding the definition of “covered employee” to include the chief financial officer and repealing the performance-based compensation exception to the $1 million cap, subject to certain transition rules. The TCJA also added that once an individual becomes a covered employee after December 31, 2016, that individual will remain a covered employee for all future years including after termination or death. Since we qualify as a REIT under the Internal Revenue Code and we are generally not subject to Federal income taxes, if compensation did not qualify for deduction under Section 162(m), the payment of compensation that fails to satisfy the requirements of Section 162(m) would not have a material adverse consequence to us, provided we continue to distribute 100% of our taxable income. In the future, if we make compensation payments subject to Section 162(m) limitations on deductibility, we may be required to make additional distributions to shareholders or pay entity level tax to comply with REIT requirements.

Risks Related to Our Business Structure

Loss of our exemption from regulation pursuant to the Investment Company Act would adversely affect us.

We conduct our business so as not to become regulated as an investment company under the Investment Company Act in reliance on the exemption provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consists of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consists of qualifying real estate interests plus "real estate-related assets."

The specific real estate related assets that we acquire are limited by the provisions of the Investment Company Act and the rules and regulations promulgated thereunder. In satisfying the 55% requirement, we treat Agency RMBS issued with respect to an underlying pool of mortgage loans in which we hold all the certificates issued by the pool ("whole pool" securities) as qualifying real estate interests based on pronouncements of the SEC staff. We treat partial pool securities, CRT and other mortgage related securities as real estate-related assets. If the SEC determines that any of these securities are not qualifying interests in real estate or real estate-related assets, adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exceptions or changes its interpretation of the above exceptions, we could be required to restructure our activities or sell certain of our assets. Our compliance with these requirements may at times lead us to adopt less efficient methods of financing certain of our investments, and we may be precluded from acquiring higher yielding securities. Importantly, if we fail to qualify for this exemption, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as we currently conduct it, which could materially and adversely affect our business.

Risks Related to Our Common Stock

The market price and trading volume of our common stock may be volatile.

The market price and trading volume of our common stock may be highly volatile and subject to wide fluctuations. Price variations may be unrelated to our operating performance. If the market price of our common stock declines significantly, stockholders may be unable to resell shares at a gain. Further, fluctuations in the trading price of our common stock may adversely affect the liquidity of the trading market for our common stock and our ability to raise additional equity capital

Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- actual or anticipated variations in our quarterly operating results or distributions;

- changes in our earnings estimates or publication of research reports about us or the real estate or specialty finance industry;
- increases in market interest rates that lead purchasers of our shares of common stock to demand a higher yield;
- changes in market valuations of similar companies;

- adverse market reaction to any increased indebtedness we incur in the future;
- issuance of additional equity securities;
- our repurchases of shares of our common stock;
- actions by institutional stockholders;
- additions or departures of key management personnel;
- speculation in the press or investment community;
- price and volume fluctuations in the stock market from time to time, which are often unrelated to our operating performance;
- changes in regulatory policies, tax laws and financial accounting and reporting standards, particularly with respect to REITs, or applicable exemptions from the Investment Company Act of 1940, as amended;
- actual or anticipated changes in our dividend policy and earnings or variations in operating results;
- any shortfall in revenue or net income or any increase in losses from levels expected by securities analysts;
- decreases in our net book value per share;
- loss of major repurchase agreement providers; and
- general market and economic conditions.

In addition, the price of our common stock may be below our reported net book value per common share. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future.

Future offerings of debt securities, which would rank senior to our common and preferred upon our liquidation, and future offerings of equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common stock.

In the future, we may raise capital through the issuance of debt or equity securities. Upon liquidation, holders of our debt securities, if any, preferred stock and lenders with respect to other borrowings will be entitled to our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Our preferred stock has a preference on liquidating distributions and a preference on dividend payments that could limit our ability to pay dividends to the holders of our common stock. Sales of substantial amounts of our common stock, or the perception that these sales could occur, could have a material adverse effect on the price of our common stock. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us.

Future sales of shares of our common stock may depress the price of our shares.

We cannot predict the effect, if any, of future sales of our common stock or the availability of shares for future sales on the market price of our common stock. Any sales of a substantial number of our shares in the public market, or the perception that sales might occur, may cause the market price of our shares to decline.

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

We intend to pay monthly dividends to our common stockholders in an amount that all or substantially all our taxable income is distributed within the limits prescribed by the Internal Revenue Code. However, we have not established a minimum dividend payment level and the amount of our dividend may fluctuate. Our ability to pay dividends may be adversely affected by the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings and financial condition, the requirements for REIT qualification and such other factors as our Board of Directors deems relevant from time to time. We may not be able to make distributions in the future or our Board of Directors may change our dividend policy. In addition, some of our distributions may include a return of capital. To the extent that we decide to pay dividends in excess of our current and accumulated tax earnings and profits, such distributions would generally be considered a return of capital for Federal income tax purposes. A return of capital reduces the cost basis of a stockholder's investment in our common stock to the extent of such basis and is treated as capital gain thereafter.

An increase in market interest rates may cause a material decrease in our net book value and the market price of our common stock.
Market interest rate fluctuations and capital market conditions can have a significant adverse effect on our net book value and the market price of our common stock. For instance, rising interest rates would result in increased interest expense on our variable rate debt, thereby reducing cash flow and our ability to service our indebtedness and pay distributions. In addition, if market interest rates rise without an increase in our distribution rate, the market price of our common stock could decrease as potential investors may require a higher distribution yield on our common stock or seek other investments paying higher distributions or interest.
The stock ownership limit imposed by the Internal Revenue Code for REITs and our amended and restated certificate of incorporation may restrict our business combination opportunities.
To qualify as a REIT under the Internal Revenue Code, not more than 50% of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities) at any time during the last half of each taxable year in which we qualify as a REIT. Our amended and restated certificate of incorporation, with certain exceptions, authorizes our Board of Directors to take the actions that are necessary and desirable to qualify as a REIT. Pursuant to our amended and restated certificate of incorporation, no person may beneficially or constructively own more than 9.8% in value or in number of shares, whichever is more restrictive, of our common or capital stock.
Our Board of Directors may grant an exemption from this 9.8% stock ownership limitation, in its sole discretion, subject to such conditions, representations and undertakings as it may determine are reasonably necessary. Pursuant to our amended and restated certificate of incorporation, our Board of Directors has the power to increase or decrease the percentage of common or capital stock that a person may beneficially or constructively own. However, any decreased stock ownership limit will not apply to any person whose percentage ownership of our common or capital stock is in excess of such decreased stock ownership limit until that person's percentage ownership of our common or capital stock equals or falls below the decreased stock ownership limit. Until such a person's percentage ownership of our common or capital stock falls below such decreased stock ownership limit, any further acquisition of our common or capital stock will be in violation of the decreased stock ownership limit.
The ownership limits imposed by the tax law are based upon direct or indirect ownership by "individuals," but only during the last half of a tax year. The ownership limits contained in our amended and restated certificate of incorporation apply to the ownership at any time by any "person," which term includes entities. Any attempt to own or transfer shares of our common stock or capital stock in violation of these restrictions may result in the shares being transferred to a charitable trust or may be void. These ownership limitations are intended to assist us in complying with the tax law requirements, and to minimize administrative burdens. However, these ownership limits might also delay or prevent a transaction or a change in our control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

The stock ownership limitation contained in our amended and restated certificate of incorporation generally does not permit ownership in excess of 9.8% of our common or capital stock, and attempts to acquire our common or capital stock in excess of these limits will be ineffective unless an exemption is granted by our Board of Directors.

As described above, our amended and restated certificate of incorporation generally prohibits beneficial or constructive ownership by any person of more than 9.8% (by value or by number of shares, whichever is more restrictive) of our common or capital stock, unless exempted by our Board of Directors. Our amended and restated certificate of incorporation's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to our amended and restated certificate of incorporation's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board of Directors will result in the shares being automatically transferred to a charitable trust or, if the transfer to a charitable trust would not be effective, such transfer being treated as invalid from the outset.

Anti-takeover provisions in our amended and restated certificate of incorporation and bylaws could discourage a change of control that our stockholders may favor, which could also adversely affect the market price of our common stock.

Provisions in our amended and restated certificate of incorporation and bylaws may make it more difficult and expensive for a third-party to acquire control of us, even if a change of control would be beneficial to our stockholders. We could issue a series of preferred stock to impede the completion of a merger, tender offer or other takeover attempt. The anti-takeover provisions in our amended and restated certificate of incorporation and bylaws may impede takeover attempts, or other transactions, that may be in the best interests of our stockholders and, in particular, common stockholders. In addition, the market price of our common stock could be adversely affected to the extent that provisions of our amended and restated certificate of incorporation and bylaws discourage potential takeover attempts, or other transactions, that our stockholders may favor.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We do not own any property. Our executive offices are in Bethesda, Maryland.

Item 3. Legal Proceedings

AGNC is named as a nominal defendant in three stockholder derivative lawsuits filed against the Company and certain of our current and former directors and officers. One case, H&N Management Group and AFF Cos. Frozen Money Purchase Plan v. Couch, et al., (the “Delaware Action”) was filed in the Chancery Court of the State of Delaware on October 21, 2016, and an amended complaint was filed on December 12, 2016. The other two cases, Clem v. Kain, et al., and Wall v. Kain, et al., were filed in the U.S. District Court in the District of Maryland on September 21, 2016 and September 30, 2016, respectively, and were consolidated on October 25, 2016, under the name In re American Capital Agency Stockholder Derivative Litigation, (collectively, the “Maryland Action” and collectively, with the Delaware Action, the “Derivative Lawsuits”). An amended complaint in the Maryland Action was filed on December 23, 2016.

The amended complaint in the Delaware Action alleges breach of fiduciary duty and corporate waste by certain of our current and former directors and officers relating to decisions not to terminate our management agreement with our former external Manager and the internalization of our management through the acquisition of AMM, which was completed on July 1, 2016. The amended complaint in the Maryland Action alleges breach of fiduciary duties against the same individuals related to substantially the same events. In addition, the Maryland Action alleges violations of Section 14(a) of the Securities Exchange Act of 1934, as amended, due to purported omissions from our proxy statements in 2014, 2015 and 2016 and aiding and abetting by ACAM. The plaintiffs in the Derivative Lawsuits demand an unspecified amount of damages, pre-judgment and post-judgment interest, restitution from the individual defendants, attorneys’ fees and other costs, and further relief as the Court deems just and proper. The plaintiffs in the Maryland Action also seek a directive that the Company and the individual defendants take certain actions with respect to our corporate governance and procedures. A motion to dismiss the Delaware Action was denied on August 1, 2017, and the Delaware Action is currently in the discovery phase. A motion to dismiss the Maryland Action was filed on September 30, 2017 and is currently pending. We believe the claims in the Derivative Lawsuits lack merit, and we expect that the defendants will vigorously defend these cases. See also "Loss Contingencies" in Note 2 to the Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Quarterly Stock Prices and Dividend Declarations

Our common stock is listed on the Nasdaq Global Select Market under the symbol "AGNC." As of January 31, 2018, we had 1,100 stockholders of record. Most of the shares of our common stock are held by brokers and other institutions on behalf of stockholders.

The following table sets forth the range of high and low sales prices of our common stock as reported on the Nasdaq Global Select Market and dividends declared on our common stock for fiscal years 2017 and 2016:

	Common Stock Sales Prices		Dividends
	High	Low	Declared [1]
Fiscal Year 2017			
Fourth Quarter	$21.90	$19.26	$ 0.54
Third Quarter	$21.94	$20.76	$