GENERAL ELECTRIC CAPITAL CORP
Form 424B3
September 17, 2010

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities Offered	Maximum Aggregate Offering Price	Amount of Registration Fee
Senior Notes	$250,000,000	$17,825

PROSPECTUS	Pricing Supplement Number: 4987
Dated January 23, 2009	Filed Pursuant to Rule 424(b)(3)
PROSPECTUS SUPPLEMENT	Dated September 15, 2010
Dated January 23, 2009	Registration Statement: No. 333-156929

GENERAL ELECTRIC CAPITAL CORPORATION

GLOBAL MEDIUM-TERM NOTES, SERIES A

(Senior Unsecured Fixed Rate-Floating Rate Notes)

Investing in these notes involves risks.

See "Risk Factors" in Item 1A of our Annual Report on Form 10-K for

the year ended December 31, 2009 filed with the Securities and Exchange Commission.

Issuer:	General Electric Capital Corporation
Trade Date:	September 15, 2010
Settlement Date (Original Issue Date):	September 30, 2010
Maturity Date:	September 30, 2015
Principal Amount:	US$ 250,000,000

Price to Public (Issue Price):	100.00%
Underwriters Commission:	1.00%
All-in Price:	99.00%
Net Proceeds to Issuer:	US$247,500,000

Fixed Rate Provisions

Fixed Rate Period:	From and including September 30, 2010 to but excluding September 30, 2011
Re-Offer Yield:	2.250%
Fixed Interest Rate:	2.250%
Fixed Rate Interest Payment Dates:	December 30, 2010, March 30, 2011, June 30, 2011 and September 30, 2011
Day Count Convention:	30/360, Modified Following, Unadjusted

Page 2

Filed Pursuant to Rule 424(b)(3)

Dated September 15, 2010

Registration Statement No. 333-156929

Floating Rate Provisions

Floating Rate Period:	From and including September 30, 2011 to but excluding the Maturity Date
Interest Rate Basis (Benchmark):	LIBOR, as determined by reference to Reuters

Index Currency:	U.S. Dollars
Spread (plus or minus):	Plus 0.65%
Index Maturity:	Three Months
Index Payment Period:	Quarterly
Floating Rate Interest Payment Dates:	Quarterly on each March 30, June 30, September 30 and December 30, beginning December 30, 2011 and ending on the Maturity Date
Initial Interest Rate:	To be determined two London Business Days prior to September 30, 2011 based on three month USD LIBOR plus 0.65%
Minimum Interest Rate:	0.85% per annum
Interest Reset Periods and Dates:	Quarterly on each scheduled Floating Rate Interest Payment Date
Interest Determination Dates:	Quarterly, two London Business Days prior to each Interest Reset Date at the start of such Interest Payment Period
Day Count Convention:	30/360, Modified Following, Unadjusted
Business Day Convention:	New York
Method of Settlement:	Depository Trust Company
Trustee:	The Bank of New York Mellon
Denominations:	Minimum of $1,000 with increments of $1,000 thereafter
Call Dates (if any):	Not Applicable
Call Notice Period:	Not Applicable

Filed Pursuant to Rule 424(b)(3)

Dated September 15, 2010

Registration Statement No. 333-156929

Put Dates (if any):	Not Applicable
Put Notice Period:	Not Applicable
CUSIP	36962G4S0
:	
ISIN:	Not Applicable
Common Code:	Not Applicable

Additional Terms:

Interest

Interest on the Notes for the period from and including September 30, 2010 to but excluding September 30, 2011 (the "Fixed Rate Period") will be payable quarterly in U.S. Dollars on December 30, 2010, March 30, 2011, June 30, 2011 and September 30, 2011 (the "Fixed Rate Interest Payment Dates"); provided that, if any such day falls on a day that is not a Business Day, it will be postponed to the following Business Day and interest thereon will not continue to accrue, except that if such following Business Day would fall in the next calendar month, the Interest Payment Date will be the immediately preceding Business Day. During the Fixed Rate Period, the interest on the Notes will be equal to 2.250% per annum. During the Fixed Rate Period, interest will be computed and paid on a 30/360 basis (based upon the number of days elapsed in each month in a 360-day year of twelve 30-day months).

Interest on the Notes for the period from and including September 30, 2011 to but excluding the Maturity Date (the "Floating Rate Period") will be payable in U.S. Dollars quarterly, in arrears, on each March 30, June 30, September 30 and December 30, beginning December 30, 2011 (each a "Floating Rate Interest Payment Date"); provided that, if any such day falls on a day that is not a Business Day, it will be postponed to the following Business Day and interest thereon will not continue to accrue, except that if such following Business Day would fall in the next calendar month, the Interest Payment Date will be the immediately preceding Business Day. During the Floating Rate Period, the interest rate on the Notes will be equal to the sum of three month USD LIBOR plus 0.65%; provided that such interest rate shall at all times equal or exceed 0.85% per annum (the "Minimum Interest Rate"). The initial floating rate will be determined two London Business Days prior to September 30, 2011 based on three month USD LIBOR plus 0.65%. During the Floating Rate Period, the interest rate will be reset quarterly on each scheduled Floating Rate Interest Payment Date (the "Interest Reset Date"), and will be determined quarterly, two London Business Days prior to each Interest Reset Date. During the Floating Rate Period, interest will be computed and paid on a 30/360 basis (based upon the number of days elapsed in each month in a 360-day year of twelve 30-day months).

Plan of Distribution:

The Notes are being purchased by Morgan Stanley & Co. Incorporated (the "Underwriter"), as principal, at 100.00% of the aggregate principal amount less an underwriting discount equal to 1.00% of the principal amount of the Notes.

The Issuer has agreed to indemnify the Underwriter against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

Page 4

Filed Pursuant to Rule 424(b)(3)

Dated September 15, 2010

Registration Statement No. 333-156929

Additional Information

General

At the quarter ended June 30, 2010, we had outstanding indebtedness totaling $405.714 billion, consisting of notes payable within one year, senior notes payable after one year and subordinated notes payable after one year, and excluding bank deposits and non-recourse borrowings of consolidated securitization entities. The total amount of outstanding indebtedness at June 30, 2010, excluding subordinated notes and debentures payable after one year, was equal to $396.650 billion.

Consolidated Ratio of Earnings to Fixed Charges

The information contained in the Prospectus under the caption "Consolidated Ratio of Earnings to Fixed Charges" is hereby amended in its entirety, as follows:

Year Ended December 31,					Six Months Ended June 30,
2005	2006	2007	2008	2009	2010
1.66	1.63	1.56	1.24	0.85	1.08

For purposes of computing the consolidated ratio of earnings to fixed charges, earnings consist of net earnings adjusted for the provision for income taxes, noncontrolling interests, discontinued operations and undistributed earnings of equity investees.

Fixed charges consist of interest and discount on all indebtedness and one-third of rentals, which we believe is a reasonable approximation of the interest factor of such rentals.

As set forth above, GE Capitals ratio of earnings to fixed charges increased to 1.08:1 in the first six months of 2010 due to higher pre-tax earnings at GECC, which were primarily driven by lower losses and delinquencies.

CAPITALIZED TERMS USED HEREIN WHICH ARE DEFINED IN THE PROSPECTUS SUPPLEMENT SHALL HAVE THE MEANINGS ASSIGNED TO THEM IN THE PROSPECTUS SUPPLEMENT.

assets. We continue to pursue a variety of opportunities that leverage our core competencies of credit and prepayment risk management. We acquire prime nonconforming residential mortgage loans from select mortgage loan originators and secondary market institutions and have established a nonconforming loan securitization program. During the year ended December 31, 2015, we meaningfully increased the number of sellers in our network and completed seven securitizations. Within our MSR business, we continue to purchase the right to control the servicing of mortgage loans from high-quality originators. During 2015, we expanded our flow-sale arrangements within our originator partner network. In addition, we originate and acquire senior and mezzanine commercial real estate assets. These assets are U.S. domiciled and are secured by a diverse mix of property types including office, retail, multifamily and hotel properties. As of December 31, 2015, we had invested in first mortgage and mezzanine commercial real estate loans. We are taking a measured approach as we diversify, keeping true to our strategic long-term plans and our core strengths.

- Maintaining "best in class" investment, corporate governance, investor relations and disclosure practices. We attribute our growth to portfolio alpha generation, innovation and best practice in corporate governance and disclosure.

Factors Affecting our Operating Results

Our net interest income includes income from our RMBS portfolio, including the amortization of purchase premiums and accretion of purchase discounts, and income from our residential mortgage loans and commercial real estate assets. Net interest income, as well as our servicing income, net of subservicing expenses, will fluctuate primarily as a result of changes in market interest rates, our financing costs, and prepayment speeds on our assets. Interest rates, financing costs and prepayment rates vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results will also be affected by default rates and credit losses with respect to the mortgage loans underlying our non-Agency RMBS and in our mortgage loan and commercial real estate portfolios.

Fair Value Measurement

A significant portion of our assets and liabilities are at fair value and, therefore, our consolidated balance sheets and statements of comprehensive income are significantly affected by fluctuations in market prices. At December 31, 2015, approximately 86.3% of total assets, or $12.6 billion, and approximately 18.3% of total liabilities, or $2.0 billion, consisted of financial instruments recorded at fair value. See Note 16 - Fair Value to the consolidated financial statements, included in this Annual Report on Form 10-K, for descriptions of valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized. Although we execute various hedging strategies to mitigate our exposure to changes in fair value, we cannot fully eliminate our exposure to volatility caused by fluctuations in market prices. Although markets for asset-backed securities, including RMBS, have modestly stabilized since the severe dislocations experienced as a result of the financial crisis, these markets continue to experience volatility and, as a result, our assets and liabilities will continue to be subject to valuation adjustment as well as changes in the inputs we use to measure fair value.

Any temporary change in the fair value of our available-for-sale, or AFS, securities, excluding Agency interest-only mortgage-backed securities and GSE credit risk transfer securities, is recorded as a component of accumulated other comprehensive income and does not impact our earnings. Our reported earnings (loss) for U.S. GAAP purposes, or GAAP net income (loss), is affected, however, by fluctuations in market prices on the remainder of our financial assets and liabilities recorded at fair value. For the year ended December 31, 2015, our unrealized fair value gains on interest rate swap and swaption agreements, which are accounted for as derivative trading instruments under U.S. GAAP, positively affected our financial results. The change in fair value of the interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the year ended

December 31, 2015. Our financial results for the year ended December 31, 2015 were negatively affected by unrealized fair value losses on certain U.S. Treasuries classified as trading instruments due to their short-term investment objectives, residential mortgage loans held-for-sale, net economic interests in securitizations and MSR.
For the year ended December 31, 2014, our unrealized fair value losses on interest rate swap and swaption agreements negatively affected our financial results. The change in fair value of the interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the year ended December 31, 2014. Our financial results for the year ended December 31, 2014 were positively affected by unrealized fair value gains on residential mortgage loans held-for-sale and net economic interests in securitizations. Unrealized losses on U.S. Treasuries classified as trading instruments and MSR, however, negatively affected our financial results.
In addition, our financial results for the years ended December 31, 2015 and 2014 were affected by the unrealized gains and losses of certain other derivative instruments that were accounted for as trading derivative instruments (i.e., credit default swaps, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, Markit IOS total return swaps, inverse interest-only securities and forward residential mortgage loan purchase commitments).

Table of Contents

We have numerous internal controls in place to help ensure the appropriateness of fair value measurements. Significant fair value measures are subject to detailed analytics and management review and approval. Our entire investment portfolio is priced by third-party brokers and/or by independent pricing providers. We generally receive three or more broker and vendor quotes on pass-through Agency RMBS, and generally receive multiple broker or vendor quotes on all other RMBS instruments, including interest-only Agency RMBS, inverse interest-only Agency RMBS, and non-Agency RMBS. We also typically receive two vendor quotes for the residential mortgage loans and MSR in our investment portfolio. For Agency RMBS, the third-party pricing providers and brokers use pricing models that commonly incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. For non-Agency RMBS, the third-party pricing providers and brokers utilize both observable and unobservable inputs such as pool-specific characteristics (i.e., loan age, loan size, credit quality of borrowers, vintage, servicer quality), floating rate indices, prepayment and default assumptions, and recent trading of the same or similar securities. For residential mortgage loans and MSR, vendors use pricing models that generally incorporate observable inputs such as principal balance, note rate, address, LTV ratios, FICO, appraised value and other loan characteristics, along with observed market yields, securitization economics and trading levels. Additionally for MSR, pricing providers will customarily incorporate loan servicing cost, servicing fee, ancillary income, and earnings rate on escrow as observable inputs. Unobservable or model-driven inputs include forecast cumulative defaults, default curve, forecast loss severity and forecast voluntary prepayment.
We evaluate the prices we receive from both brokers and independent pricing providers by comparing those prices to actual purchase and sale transactions, our internally modeled prices calculated based on market observable rates and credit spreads, and to each other both in current and prior periods. We review and may challenge broker quotes and valuations from third-party pricing providers to ensure that such quotes and valuations are indicative of fair value as a result of this analysis. We then estimate the fair value of each security based upon the median of the final broker quotes received, and we estimate the fair value of residential mortgage loans and MSR based upon the average of prices received from independent providers, subject to internally-established hierarchy and override procedures.
We utilize “bid side” pricing for our RMBS assets and, as a result, certain assets, especially the most recent purchases, may realize a markdown due to the “bid-offer” spread. To the extent that this occurs, any economic effect of this would be reflected in accumulated other comprehensive income.
Considerable judgment is used in forming conclusions and estimating inputs to our Level 3 fair value measurements. Level 3 inputs such as interest rate movements, prepayments speeds, credit losses and discount rates are inherently difficult to estimate. Changes to these inputs can have a significant effect on fair value measurements. Accordingly, there is no assurance that our estimates of fair value are indicative of the amounts that would be realized on the ultimate sale or exchange of these assets.

Critical Accounting Estimates

The preparation of financial statements in accordance with U.S. GAAP requires us to make certain judgments and assumptions, based on information available at the time of our preparation of the financial statements, in determining accounting estimates used in preparation of the statements. Our significant accounting policies are described in Note 2 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.
Accounting estimates are considered critical if the estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made and if different estimates reasonably could have been used in the reporting period or changes in the accounting estimate are reasonably likely to occur from period to period that would have a material impact on our financial condition, results of operations or cash flows.
The methods used by us to estimate fair value for AFS securities, trading securities, mortgage loans, MSR and collateralized borrowings may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we believe that our valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We use

inputs that are current as of the measurement date, which in periods of market dislocation, may have reduced transparency.

Classification and Valuation of Available-for-Sale and Trading Securities

Our RMBS investments consist primarily of Agency RMBS and non-Agency RMBS that we classify as available-for-sale, or AFS. All assets classified as AFS, excluding Agency interest-only mortgage-backed securities and GSE credit risk transfer securities, are reported at estimated fair value with changes in fair value included in accumulated other comprehensive income, a separate component of stockholders' equity, on an after-tax basis. On July 1, 2015, we elected the fair value option for Agency interest-only securities and GSE credit risk transfer securities acquired on or after such date. All Agency interest-only securities and GSE credit risk transfer securities acquired on or after July 1, 2015 are carried at estimated fair value with changes in fair value recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive income.

Table of Contents

From time to time, we also hold U.S. Treasuries for trading purposes. Our trading securities are carried at estimated fair value with changes in fair value recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive income. If our RMBS AFS were also classified as trading securities, there could be substantially greater volatility in our GAAP net income (loss).

When the estimated fair value of an AFS security is less than amortized cost, we consider whether there is an other-than-temporary impairment in the value of the security that is required to be recognized in GAAP net income (loss). The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to whether we (i) have the intent to sell the investment securities, (ii) are more likely than not to be required to sell the investment securities before recovery, or (iii) do not expect to recover the entire amortized cost basis of the investment securities. Investments with unrealized losses are not considered other-than-temporarily impaired if we have the ability and intent to hold the investments for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the amortized cost basis of the investments. If an impairment is determined to be solely driven by the inability to fully recover the entire amortized cost basis over the remaining life of the security, the security is further analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, is then recognized in GAAP net income, while the balance of impairment related to other factors is recognized in other comprehensive (loss) income.

Classification and Valuation of Residential Mortgage Loans Held-for-Sale

Our residential mortgage loans held-for-sale are carried at fair value as a result of a fair value option election, with changes in fair value recorded in GAAP net income. Fair value is generally determined based on current secondary market pricing or cash flow models using market-based yield requirements.

Classification and Valuation of Residential Mortgage Loans Held-for-Investment in Securitization Trusts

Our residential mortgage loans held-for-investment in securitization trusts are carried at fair value as a result of a fair value option election, with changes in fair value recorded in GAAP net income. An entity is allowed to measure both the financial assets and financial liabilities of a qualifying collateralized financing entity, or CFE, it consolidates using the fair value of either the CFE’s financial assets or financial liabilities, whichever is more observable. As the Company’s securitization trusts are considered qualifying CFEs, the Company determines the fair value of these residential mortgage loans based on the fair value of its collateralized borrowings in securitization trusts and its retained interests from the Company’s on-balance sheet securitizations (eliminated in consolidation in accordance with U.S. GAAP), as the fair value of these instruments is more observable.

Classification and Valuation of Mortgage Servicing Rights

We account for our MSR at fair value, with changes in fair value recorded in GAAP net income, rather than at amortized cost. Fair value is generally determined based on prices obtained from third-party pricing providers. Although MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels and discount rates).

Classification and Valuation of Collateralized Borrowings in Securitization Trusts

Our collateralized borrowings in securitization trusts are carried at fair value as a result of a fair value option election, with changes in fair value recorded in GAAP net (loss) income. Fair value is generally determined based on prices obtained from third-party pricing providers, broker quotes received and other applicable market data.

Impairment of Commercial Real Estate Loans Held-for-Investment

Commercial real estate loans held-for-investment are reported at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless the loans are deemed impaired. Impairment is indicated when it is deemed probable that we will not be able to collect all amounts due pursuant to the contractual terms of the loan. Because our commercial real estate loans are collateralized either by real property or by equity interests in the commercial real estate borrower, impairment is measured by comparing the estimated fair value of the underlying collateral to the amortized cost of the respective loan. The valuation of the underlying collateral requires significant judgment, which includes assumptions regarding capitalization rates, leasing, credit worthiness of major tenants,

occupancy rates, availability of financing, exit plan, loan sponsorship, actions of other lenders, overall economic conditions, the broader commercial real estate market, local geographic sub-markets, and other factors deemed necessary. If a loan is determined to be impaired, we record an allowance to reduce the carrying value of the loan through a charge to provision for loan losses. Actual losses, if any, could ultimately differ from these estimates.

Table of Contents

Interest Income Recognition

Our interest income on our Agency and non-Agency RMBS is accrued based on the actual coupon rate and the outstanding principal balance of such securities. Premiums and discounts are amortized or accreted into interest income over the lives of the securities using the effective yield method, as adjusted for actual prepayments. We estimate prepayments for our Agency interest-only securities, which represent our right to receive a specified portion of the contractual interest flows of specific Agency and collateralized mortgage obligations, or CMO, securities. As a result, if prepayments increase (or are expected to increase), we will accelerate the rate of amortization on the premiums. Conversely, if prepayments decrease (or are expected to decrease), we will decelerate the rate of amortization on the premiums.

Our interest income on our non-Agency RMBS rated below AA, including unrated securities, is recognized in accordance with estimated cash flows. Cash flows from a security are estimated by applying assumptions used to determine the fair value of such security and the excess of the future cash flows over the investment are recognized as interest income under the effective yield method. We review and, if appropriate, make adjustments to our cash flow projections at least quarterly and monitor these projections based on input and analysis received from external sources, internal models, and our judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in interest income recognized on, or the carrying value of, such securities.

For non-Agency RMBS purchased at a discount, we account for differences between contractual cash flows and cash flows expected to be collected from our initial investment in debt securities acquired if those differences are attributable, at least in part, to credit quality. We limit the yield that may be accreted (accretable yield) to the excess of an estimate of undiscounted expected principal, interest, and other cash flows (cash flows expected at acquisition to be collected) over the initial investment. The excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference or designated credit reserve) is not recognized as an adjustment of yield, loss accrual, or valuation allowance. Subsequent increases in cash flows expected to be collected is recognized prospectively through adjustment of the yield over the remaining life of the security. Decreases in cash flows expected to be collected are recognized as impairments.

Interest income on residential mortgage and commercial real estate loans is recognized at the loan coupon rate. Additionally, any acquisition premiums or discounts, loan fees and origination costs on commercial real estate loans held-for-investment are amortized or accreted into interest income over the lives of the loans using the effective interest method. All residential mortgage and commercial real estate loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when loans are placed on nonaccrual status. Generally, loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Derivative Financial Instruments and Hedging Activities

We apply the provisions of ASC 815, which requires the recognition of all derivatives as either assets or liabilities on our consolidated balance sheets and to measure those instruments at fair value. The fair value adjustments of our current derivative instruments affect net income as the hedge for accounting purposes is being treated as an economic, or trading, hedge and not as a qualifying hedging instrument.

Derivatives are primarily used for hedging purposes rather than speculation. We rely on internal models corroborated by quotations from a third party to determine these fair values. If our hedging activities do not achieve their desired results, our reported GAAP net income (loss) may be adversely affected.

Income Taxes

Our financial results are generally not expected to reflect provisions for current or deferred income taxes, except for those taxable benefits or provisions recognized by our taxable REIT subsidiaries. We estimate, based on existence of sufficient evidence, the ability to realize the remainder of any deferred tax asset our TRSs recognize. Any adjustments to such estimates will be made in the period such determination is made. We plan to operate in a manner that will allow us to qualify for taxation as a REIT. As a result of our expected REIT qualification, we do not generally expect to pay U.S. federal corporate level taxes. However, many of the REIT requirements are highly technical and complex. If we were to fail to meet the REIT requirements, we would be subject to U.S. federal, state and local income taxes.

57

Table of Contents

Market Conditions and Outlook

The key macroeconomic factors that impact our business are home prices and the employment and interest rate environments. Home prices increased modestly throughout 2015, and are expected to gradually appreciate over the next several years. Credit standards remain tight, despite a modest easing in recent months, and have limited borrowers' ability to refinance their mortgages notwithstanding low interest rates and government programs that promote refinancing. Employment market conditions remain relatively solid as jobless claims, unemployment and payroll data are showing stable trends, although underemployment levels remain stubbornly high and new job creation has been disappointing. Other than LTV ratios and cash reserves, we believe employment is the most powerful determinant of homeowners' ongoing likelihood to pay their mortgages. Home price performance and employment are particularly important to our non-Agency portfolio.

The interest rate environment remained volatile in the fourth quarter of 2015 as the Federal Reserve announced a rate hike in December for the first time in eight years. The low interest rate environment is expected to persist in the near term, however, as the Federal Reserve has suggested it will take a measured and conservative approach to further interest rate decisions. Additionally, it appears the Federal Reserve will continue to reinvest its mortgage-backed security principal repayments for the foreseeable future.

The U.S. economy continues to navigate headwinds that include global economic lethargy, specifically in China; geopolitical unrest across various regions worldwide; the ongoing European debt crisis; quantitative easing by the European Central Bank; and persistently high underemployment.

Regulatory and legislative actions taken in the past few years in an effort to improve economic conditions and increase liquidity in the financial markets, as well as other actions related to the fall-out from the financial and foreclosure crises, continue to impact the market. Regulatory actions that could affect the value and availability of our target assets, either positively or negatively, include: attempts by the U.S. government to further simplify the refinancing process to allow more borrowers to refinance into lower interest rate mortgage loans; the streamlined loan modification initiative for borrowers that are 90+ days delinquent implemented by the GSEs; the real estate owned, or REO, -to-rental program supported by the GSEs; the extension of both the Home Affordable Modification Program, or HAMP, and the Home Affordable Refinance Program 2.0, or HARP 2.0, through 2016; the strict "ability-to-repay" and "qualified mortgage" regulations promulgated by the Consumer Financial Protection Bureau, or the CFPB; the enforcement of and potential liability associated with TRID; and the application of the risk retention requirements of Section 15G of the Exchange Act.

There have also been a number of legislative proposals aimed at eventually winding down or phasing out the GSEs. It continues to remain uncertain if any proposal will ultimately become legislation, as recently these efforts appear to have little momentum in Congress. We will continue to monitor these and other regulatory and policy activities closely.

In 2014, the U.S. Department of Treasury, or the Treasury, requested comment on the development of a responsible private label securities market. We believe that private capital, through the private label securities market, is a critical component to the long-term stability of the mortgage market and, accordingly, submitted a comment letter in response to the request. The Treasury echoes our sentiment and views a diverse housing finance system with numerous capital streams as critical to promoting competition, market efficiency, and consumer choice.

In January 2016, the FHFA released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the ruling excludes captive insurers from membership eligibility, including our subsidiary member, TH Insurance Holdings Company LLC, or TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a five-year membership grace period, during which new advances or renewals that mature beyond the grace period will be prohibited. However, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as we maintain good standing with the FHLB. If any new advances or renewals occur, TH Insurance's outstanding advances will be limited to forty percent of its total assets. Notwithstanding the FHFA's ruling, we continue to believe our mission aligns well with that of the Federal Home Loan Bank system.

We believe our blended Agency and non-Agency RMBS portfolio and our investing expertise, as well as our operational capabilities to invest in prime nonconforming residential mortgage loans, MSR and commercial real estate assets, will allow us to better navigate the dynamic mortgage market while future regulatory and policy activities take shape. Having a diversified portfolio allows us to mitigate a variety of risks, including interest rate and RMBS spread volatility. As such, we have diversified into several target assets that capitalize on our prepayment and credit expertise.

We expect that a material percentage of our assets will remain in whole-pool Agency RMBS in light of the long-term attractiveness of the asset class and in order to continue to satisfy the requirements of our exemption from registration under the 1940 Act. Interest-only Agency securities and MSR also provide a complementary investment and risk-management strategy to our principal and interest Agency RMBS investments. Risk-adjusted returns in our Agency RMBS portfolio may decline if we are required to pay higher purchase premiums due to lower interest rates or additional liquidity in the market. Additionally, the Federal Reserve's prior quantitative easing programs and continued reinvestment of its mortgage-backed security principal repayments and other policy changes may impact the returns of our Agency RMBS portfolio.

Table of Contents

The following table provides the carrying value of our RMBS portfolio by product type:

(dollars in thousands)	December 31, 2015			December 31, 2014		
Agency						
Fixed Rate	$5,864,294	73.4	%	$11,164,032	76.8	%
Hybrid ARMs	108,596	1.4	%	128,285	0.9	%
Total Agency	5,972,890	74.8	%	11,292,317	77.7	%
Agency Derivatives	157,906	2.0	%	186,404	1.3	%
Non-Agency						
Senior	1,313,695	16.4	%	2,370,435	16.3	%
Mezzanine	532,572	6.7	%	670,421	4.6	%
Interest-only securities	6,163	0.1	%	7,929	0.1	%
Total Non-Agency	1,852,430	23.2	%	3,048,785	21.0	%
Total	$7,983,226			$14,527,506		

Prepayment speeds and volatility due to interest rates

Our Agency RMBS and MSR portfolios are subject to inherent prepayment risk. Generally, a decline in interest rates that leads to rising prepayment speeds will cause the market value of our interest-only securities and MSR to deteriorate, and our fixed coupon Agency pools to increase. The inverse relationship occurs when interest rates increase and prepayments slow. As previously discussed, despite the Federal Reserve raising rates in December, the low interest rate environment is expected to persist in the near term. However, changes in home price performance, key employment metrics and government programs, among other macroeconomic factors, could cause prepayment speeds to increase on many RMBS, which could lead to less attractive reinvestment opportunities. Nonetheless, we believe our portfolio management approach, including our security selection process, positions us to ideally respond to a variety of market scenarios, including an overall faster prepayment environment.

The following table provides the three-month weighted average constant prepayment rate, or CPR, on our Agency RMBS throughout 2015:

Agency RMBS	Three Months Ended							
	December 31, 2015		September 30, 2015		June 30, 2015		March 31, 2015	
Weighted Average CPR	10.3	%	9.7	%	9.0	%	8.2	%

Although we are unable to predict the movement in interest rates in 2016 and beyond, our diversified portfolio management strategy is intended to generate attractive yields with a low level of sensitivity to changes in the yield curve, prepayments and interest rate cycles.

Our portfolio includes Agency securities, which includes securities with explicit prepayment protection, $85,000 maximum loan balance pools (securities collateralized by loans of less than $85,000 in principal), other low loan balances (securities collateralized by loans of less than $175,000, but more than $85,000 in principal), high LTV ratios (securities collateralized by loans with greater or equal to 80% LTV predominantly comprised of Making Homeownership Affordable, or MHA, pools that consist of borrowers who have refinanced through HARP), home equity conversion mortgages (securities collateralized by reverse mortgages), low FICO scores (lower credit borrowers), and seasoned securities reflecting less prepayment risk due to previously experienced high levels of refinancing. We believe these RMBS characteristics reduce the prepayment risk to the portfolio.

Table of Contents

The following tables provide the carrying value of our Agency RMBS portfolio by vintage and prepayment protection:

	As of December 31, 2015					
	Agency RMBS AFS		Agency	Total Agency RMBS		
(dollars in thousands)	Fixed Rate	Hybrid ARMs	Derivatives			
Other low loan balances	$2,101,485	$—	$—	$2,101,485	34	%
$85K Max Pools	1,439,376	—	—	1,439,376	23	%
2006 and subsequent vintages	685,844	24,617	—	710,461	12	%
High LTV (predominantly MHA)	421,446	—	—	421,446	7	%
Home equity conversion mortgages	386,489	—	—	386,489	6	%
Seasoned (2005 and prior vintages)	184,256	81,355	112,356	377,967	6	%
2006 and subsequent vintages - discount	323,152	—	45,550	368,702	6	%
Low FICO	277,945	—	—	277,945	5	%
Pre-pay lock-out or penalty-based	44,301	2,624	—	46,925	1	%
Total	$5,864,294	$108,596	$157,906	$6,130,796	100	%

	As of December 31, 2014					
	Agency RMBS AFS		Agency	Total Agency RMBS		
(dollars in thousands)	Fixed Rate	Hybrid ARMs	Derivatives			
Other low loan balances	$3,815,603	$—	$—	$3,815,603	33	%
$85K Max Pools	2,529,610	—	—	2,529,610	22	%
2006 and subsequent vintages	1,353,827	28,997	—	1,382,824	12	%
High LTV (predominantly MHA)	515,428	—	—	515,428	5	%
Home equity conversion mortgages	1,740,830	—	—	1,740,830	15	%
Seasoned (2005 and prior vintages)	254,921	95,618	130,961	481,500	4	%
2006 and subsequent vintages - discount	347,618	—	55,443	403,061	4	%
Low FICO	113,862	—	—	113,862	1	%
Pre-pay lock-out or penalty-based	492,333	3,670	—	496,003	4	%
Total	$11,164,032	$128,285	$186,404	$11,478,721	100	%

We offset a portion of the Agency exposure to prepayment speeds through our non-Agency portfolio. Our non-Agency RMBS yields are expected to increase if prepayment rates on such assets exceed our prepayment assumptions. To the extent that prepayment speeds increase due to macroeconomic factors, we expect to benefit from the ability to recognize the income from the heavily discounted RMBS prices that principally arose from credit or payment default expectations.

The following tables provide discount information on our non-Agency RMBS portfolio:

	As of December 31, 2015			
	Principal and Interest Securities		Interest-Only	Total
(in thousands)	Senior	Mezzanine	Securities	
Face Value	$1,801,283	$624,253	$229,845	$2,655,381
Unamortized discount				
Designated credit reserve	(373,729)	(35,348)	—	(409,077)
Unamortized net discount	(383,816)	(98,729)	(224,476)	(707,021)
Amortized Cost	$1,043,738	$490,176	$5,369	$1,539,283

Table of Contents

	As of December 31, 2014			
	Principal and Interest Securities		Interest-Only	Total
(in thousands)	Senior	Mezzanine	Securities	
Face Value	$3,213,104	$794,798	$283,970	$4,291,872
Unamortized discount				
Designated credit reserve	(843,106)	(84,499)	—	(927,605)
Unamortized net discount	(531,531)	(158,465)	(277,372)	(967,368)
Amortized Cost	$1,838,467	$551,834	$6,598	$2,396,899

Credit losses

Although our Agency portfolio is supported by U.S. government agency and federally chartered corporation guarantees of payment of principal and interest, we are exposed to credit risk in our non-Agency RMBS, residential mortgage loans and commercial real estate assets.

The credit support built into non-Agency RMBS deal structures is designed to provide a level of protection from potential credit losses for more senior tranches. We evaluate credit risk on our non-Agency investments through a comprehensive asset selection process, which is predominantly focused on quantifying and pricing credit risk, including extensive initial modeling and scenario analysis. In addition, the discounted purchase prices paid for our non-Agency RMBS provide additional insulation from credit losses in the event we receive less than 100% of par on such assets. At purchase, we estimate the portion of the discount we do not expect to recover and factor that into our expected yield and accretion methodology. We may also record an other-than-temporary impairment, or OTTI, for a portion of our investment in a security to the extent we believe that the amortized cost exceeds the present value of expected future cash flows. We review our non-Agency RMBS on an ongoing basis using quantitative and qualitative analysis of the risk-adjusted returns on such investments and through on-going asset surveillance. Nevertheless, unanticipated credit losses could occur, adversely impacting our operating results.

We evaluate credit risk on our residential mortgage loans through a comprehensive asset selection process, which includes pre-acquisition due diligence and underwriting. We review our residential mortgage loans on an ongoing basis using quantitative and qualitative analysis and through on-going asset surveillance.

We also evaluate credit risk on our commercial real estate assets through a comprehensive asset selection process, which includes valuing the underlying collateral property as well as the financial and operating capability of the borrower, borrowing entity or loan sponsor. We also assess the financial wherewithal of any loan guarantors, the borrower’s competency in managing and operating the properties, and the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. We evaluate each commercial real estate asset for impairment at least quarterly and may record an allowance to reduce the carrying value of the asset to the estimated fair value of the underlying collateral, if deemed impaired.

Counterparty exposure and leverage ratio

We monitor counterparty exposure in our broker, banking and lending counterparties on a daily basis. We believe our broker and banking counterparties are well capitalized organizations and we attempt to manage our cash balances across these organizations to reduce our exposure to a single counterparty.

As of December 31, 2015, we had entered into repurchase agreements with 30 counterparties, 21 of which had outstanding balances at December 31, 2015, including one facility that provides short-term financing for our residential mortgage loan collateral with outstanding balances at December 31, 2015. In addition, we held long-term secured advances from the FHLB. As of December 31, 2015, we had a total consolidated debt-to-equity ratio of 3.0 times. The debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives only was 2.5:1.0. We believe the debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives is the most meaningful debt-to-equity measure as U.S. Treasuries are viewed to be highly liquid in nature and collateralized borrowings on residential mortgage loans held-for-investment in securitization trusts represents term financing with no stated

maturity.

Table of Contents

As of December 31, 2015, we had $737.8 million in cash and cash equivalents, approximately $40.9 million of unpledged Agency securities and derivatives and $48.9 million of unpledged non-Agency securities and retained interests from the Company's on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP. As a result, we had an overall estimated unused borrowing capacity on our unpledged RMBS and retained interests of approximately $71.7 million. We also had approximately $18.9 million of unpledged prime nonconforming residential mortgage loans, $11.0 million of unpledged CSL, $36.1 million of unpledged Ginnie Mae buyout residential mortgage loans, and an overall estimated unused borrowing capacity on unpledged residential mortgage loans held-for-sale of approximately $17.0 million. As of December 31, 2015, we had approximately $43.9 million of unpledged mezzanine commercial real estate loans and $255.9 million of unpledged commercial real estate first mortgages, and an overall estimated unused borrowing capacity on unpledged commercial real estate assets of approximately $170.7 million. If borrowing rates and collateral requirements change in the near term, we believe we are subject to less earnings volatility than if we carried higher leverage.

We also monitor exposure to counterparties involved in our mortgage loan conduit and MSR businesses. In connection with securitization transactions and MSR assets, we are required to make certain representations and warranties to the investors in the RMBS we issue or the loans underlying the MSR we own. If the representations and warranties that we are required to make prove to be inaccurate, we may be obligated to repurchase certain mortgage loans, which may impact the profitability of these businesses. Although we obtain similar representations and warranties from the counterparty from which we acquired the relevant asset, if those representations and warranties do not directly mirror those we make to the investor, or if we are unable to enforce the representations and warranties against the counterparty for a variety of reasons, including the financial condition or insolvency of the counterparty, we may not be able to seek indemnification from our counterparties for any losses attributable to the breach.

Summary of Results of Operations and Financial Condition

Our reported GAAP net income was $210.7 million ($0.59 per diluted weighted share) for the three months ended December 31, 2015 and our reported GAAP net income was $492.2 million ($1.35 per diluted weighted share) for the year ended December 31, 2015, as compared to GAAP net loss of $37.0 million ($(0.10) per weighted share) for the three months ended December 31, 2014 and GAAP net income of $167.1 million ($0.46 per weighted share) for the year ended December 31, 2014.

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of AFS securities, excluding Agency interest-only securities and GSE credit risk transfer securities, do not impact our GAAP net income (loss) or taxable income but are recognized on our consolidated balance sheets as a change in stockholders' equity under "accumulated other comprehensive income." As a result of this fair value accounting through stockholders' equity, we expect our net income (loss) to have less significant fluctuations and result in less U.S. GAAP to taxable income timing differences, than if the portfolio were accounted as trading instruments. For the three months ended December 31, 2015, net unrealized losses on AFS securities recognized as other comprehensive (loss) income were $213.9 million and for the three months ended December 31, 2014, net unrealized gains were $79.1 million, which resulted in comprehensive loss of $3.2 million for the three months ended December 31, 2015 as compared to comprehensive income of $42.2 million for the three months ended December 31, 2014. For the year ended December 31, 2015, net unrealized losses on AFS securities were $496.7 million and for the year ended December 31, 2014, net unrealized gains were $411.1 million, which resulted in comprehensive loss of $4.5 million for the year ended December 31, 2015 as compared to comprehensive income of $578.2 million for the year ended December 31, 2014.

On December 16, 2015, we declared a cash dividend of $0.26 per diluted share, bringing our total 2015 cash dividends declared to $1.04 per diluted share. Our book value per diluted common share for U.S. GAAP purposes was $10.11 at December 31, 2015, a decrease from $11.10 book value per diluted common share at December 31, 2014. During this twelve month period, we recognized a decrease in accumulated other comprehensive income due to net unrealized losses on AFS securities of $496.7 million and declared cash dividends of $378.3 million, driving the overall decrease

in book value.

Table of Contents

The following tables present the components of our comprehensive (loss) income for the three and twelve months ended December 31, 2015 and 2014, and the twelve months ended December 31, 2013:

(in thousands)	Three Months Ended December 31,		Year Ended December 31,		
	2015	2014	2015	2014	2013
Interest income:					
Available-for-sale securities	$88,543	$131,694	$458,515	$506,268	$507,180
Trading securities	—	4,739	8,676	12,913	5,963
Residential mortgage loans held-for-sale	7,698	3,536	28,966	16,089	22,185
Residential mortgage loans held-for-investment in securitization trusts	30,832	16,040	95,740	41,220	19,220
Commercial real estate assets	6,297	—	9,138	—	—
Cash and cash equivalents	235	211	902	717	1,043
Total interest income	133,605	156,220	601,937	577,207	555,591
Interest expense:					
Repurchase agreements	14,851	19,493	73,049	76,177	89,470
Collateralized borrowings in securitization trusts	17,815	10,137	57,216	26,760	10,937
Federal Home Loan Bank advances	3,909	2,074	11,921	4,513	—
Interest expense	36,575	31,704	142,186	107,450	100,407
Net interest income	97,030	124,516	459,751	469,757	455,184
Other-than temporary impairment losses	—	(180)	(535)	(392)	(1,662)
Other income (loss):					
Gain (loss) on investment securities	99,867	28,697	363,379	87,201	(54,430)
Gain (loss) on interest rate swap and swaption agreements	42,526	(152,619)	(210,621)	(345,647)	245,229
(Loss) gain on other derivative instruments	(2,077)	(5,184)	(5,049)	(17,529)	95,345
(Loss) gain on residential mortgage loans held-for-sale	(4,015)	11,064	14,285	17,297	(33,846)
Servicing income	32,799	31,587	127,412	128,160	12,011
(Loss) gain on servicing asset	(3,267)	(55,346)	(99,584)	(128,388)	13,881
Other (loss) income	(5,525)	(1,409)	(21,790)	18,539	14,619
Total other income (loss)	160,308	(143,210)	168,032	(240,367)	292,809
Expenses:					
Management fees	12,270	12,244	50,294	48,803	41,707
Securitization deal costs	1,200	1,283	8,971	4,638	4,153
Servicing expenses	8,252	1,330	28,101	25,925	3,761
Other operating expenses	16,130	14,950	64,162	56,231	37,259
Total expenses	37,852	29,807	151,528	135,597	86,880
Income (loss) from continuing operations before income taxes	219,486	(48,681)	475,720	93,401	659,451
Provision for (benefit from) income taxes	8,780	(11,718)	(16,490)	(73,738)	84,411
Net income (loss) from continuing operations	210,706	(36,963)	492,210	167,139	575,040
Income from discontinued operations	—	—	—	—	3,999

Net income (loss)	$210,706	$(36,963)	$492,210	$167,139	$579,039

63

Table of Contents

(in thousands, except share data)	Three Months Ended December 31, 2015	2014	Year Ended December 31, 2015	2014	2013
Basic earnings (loss) per weighted average common share:					
Continuing operations	$0.59	$(0.10)	$1.35	$0.46	$1.64
Discontinued operations	—	—	—	—	0.01
Net income (loss)	$0.59	$(0.10)	$1.35	$0.46	$1.65
Diluted earnings (loss) per weighted average common share:					
Continuing operations	$0.59	$(0.10)	$1.35	$0.46	$1.64
Discontinued operations	—	—	—	—	0.01
Net income (loss)	$0.59	$(0.10)	$1.35	$0.46	$1.65
Dividends declared per common share	$0.26	$0.26	$1.04	$1.04	$1.17
Weighted average number of shares of common stock:					
Basic	360,090,432	366,230,566	365,247,738	366,011,855	350,361,827
Diluted	360,090,432	366,230,566	365,247,738	366,011,855	350,992,387
Comprehensive (loss) income:					
Net income (loss)	$210,706	$(36,963)	$492,210	$167,139	$579,039
Other comprehensive (loss) income, net of tax:					
Unrealized (loss) gain on available-for-sale securities, net	(213,940)	79,141	(496,728)	411,054	(251,723)
Other comprehensive (loss) income	(213,940)	79,141	(496,728)	411,054	(251,723)
Comprehensive (loss) income	$(3,234)	$42,178	$(4,518)	$578,193	$327,316

Results of Operations

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

The following analysis focuses on financial results during the three and twelve months ended December 31, 2015 and 2014.

Interest Income and Average Portfolio Yield

The following tables present the components of interest income and average annualized net asset yield earned by investment type on our AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, commercial real estate assets and Agency Derivatives for the three and twelve months ended December 31, 2015 and 2014:

(dollars in thousands)	Three Months Ended December 31, 2015 Average Balance [1]	Interest Income	Net Asset Yield	Year Ended December 31, 2015 Average Balance [1]	Interest Income	Net Asset Yield
Available-for-sale securities	$8,567,123	$88,543	4.1%	$11,533,417	$458,515	4.0%
Trading securities	—	—	—%	908,052	8,676	1.0%
Residential mortgage loans held-for-sale	767,102	7,698	4.0%	749,025	28,966	3.9%
Residential mortgage loans held-for-investment in	3,177,980	30,832	3.9%	2,467,905	95,740	3.9%

securitization trusts								
Commercial real estate assets	418,946	6,297	6.0	%	142,693	9,138	6.4	%
	12,931,151	133,370	4.1	%	15,801,092	601,035	3.8	%
Agency derivatives (2)	142,218	6,575	18.5	%	149,601	27,848	18.6	%
Total	$13,073,369	$139,945	4.3	%	$15,950,693	$628,883	3.9	%

64

Table of Contents

(dollars in thousands)	Three Months Ended December 31, 2014				Year Ended December 31, 2014			
	Average Balance [1]	Interest Income	Net Asset Yield		Average Balance [1]	Interest Income	Net Asset Yield	
Available-for-sale securities	$12,835,626	$131,694	4.1	%	$12,202,246	$506,268	4.1	%
Trading securities	1,996,045	4,739	0.9	%	1,462,816	12,913	0.9	%
Residential mortgage loans held-for-sale	359,411	3,536	3.9	%	403,141	16,089	4.0	%
Residential mortgage loans held-for-investment in securitization trusts	1,618,508	16,040	4.0	%	1,051,533	41,220	3.9	%
Commercial real estate assets	—	—	—	%	—	—	—	%
	16,809,590	156,009	3.7	%	15,119,736	576,490	3.8	%
Agency derivatives [2]	177,804	7,587	17.1	%	188,824	30,171	16.0	%
Total	$16,987,394	$163,596	3.9	%	$15,308,560	$606,661	4.0	%

(1) Average balance represents average amortized cost on AFS securities, trading securities, commercial real estate assets and Agency Derivatives and average unpaid principal balance, adjusted for purchase price changes, on residential mortgage loans held-for-sale and held-for-investment in securitization trusts.

(2) Interest income on Agency Derivatives is included in (loss) gain on other derivative instruments on the consolidated statements of comprehensive (loss) income.

Total interest income, including interest income on Agency Derivatives, decreased from $163.6 million for the three months ended December 31, 2014 to $139.9 million for the three months ended December 31, 2015, due primarily to sales of AFS securities in 2015, offset by purchases of residential mortgage loans held-for-sale and the completion of multiple securitization transactions in 2015. Conversely, total interest income increased from $606.7 million for the year ended December 31, 2014 to $628.9 million for the year ended December 31, 2015, due primarily to purchases of residential mortgage loans held-for-sale and the completion of multiple securitization transactions in 2015, offset by sales of AFS securities in 2015.

Yields on AFS securities for the three months ended December 31, 2015 were consistent with those for the same period in 2014. The decrease in net yields on AFS securities for the year ended December 31, 2015, as compared to the year ended December 31, 2014, was predominantly driven by the sale of securities previously purchased at higher yields that we believe had reached maximum value. The increase in net yields on Agency Derivatives for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was predominantly driven by slower prepayments due to the rising interest rate environment. The increase in yields on trading securities for the year ended December 31, 2015, as compared to the year ended December 31, 2014, was the result of increases in Treasury rates. We did not recognize any interest income on trading securities during the three months ended December 31, 2015 as we sold our trading security position during the three months ended June 30, 2015.

Yields on residential mortgage loans held-for-sale and held-for-investment were relatively consistent for the three and twelve months ended December 31, 2015, as compared to the three and twelve months ended December 31, 2014, as rates on prime nonconforming residential mortgage loans were generally flat over the course of the past two years. The yields on commercial real estate assets for the three and twelve months ended December 31, 2015 represent interest income on assets purchased during 2015, many of which were settled in the latter half of 2015, which, as a result, are not indicative of future yields.

The following tables present the components of the net yield earned by investment type on our RMBS AFS portfolio as a percentage of our average amortized cost of securities for the three and twelve months ended December 31, 2015

and 2014:

	Three Months Ended December 31, 2015			Year Ended December 31, 2015		
	Agency [1]	Non-Agency	Total	Agency [1]	Non-Agency	Total
Gross yield/stated coupon	4.7 %	3.4 %	4.4 %	4.6 %	3.2 %	4.3 %
Net (premium amortization) discount accretion	(1.5)%	4.4 %	(0.3)%	(1.4)%	4.6 %	(0.3)%
Net yield [2]	3.2 %	7.8 %	4.1 %	3.1 %	7.8 %	4.0 %

65

Table of Contents

	Three Months Ended December 31, 2014			Year Ended December 31, 2014		
	Agency [(1)]	Non-Agency	Total	Agency [(1)]	Non-Agency	Total
Gross yield/stated coupon	4.5 %	3.0 %	4.3 %	4.5 %	3.0 %	4.3 %
Net (premium amortization) discount accretion	(1.3)%	5.1 %	(0.2)%	(1.4)%	5.5 %	(0.2)%
Net yield [(2)]	3.2 %	8.1 %	4.1 %	3.1 %	8.5 %	4.1 %

(1) Excludes Agency Derivatives. For the three and twelve months ended December 31, 2015, the average annualized net yield on total Agency RMBS, including Agency Derivatives, was 3.5% and 3.4%, respectively, compared to 3.4% for both of the same periods in 2014.
(2) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.

The following tables present the components of interest income and net asset yield earned by investment type on our RMBS AFS portfolio for the three and twelve months ended December 31, 2015 and 2014:

	Three Months Ended December 31, 2015			Year Ended December 31, 2015		
(dollars in thousands)	Agency [(1)]	Non-Agency	Total	Agency [(1)]	Non-Agency	Total
Average amortized cost	$6,837,974	$1,729,149	$8,567,123	$9,434,121	$2,099,296	$11,533,417
Coupon interest	80,121	14,554	94,675	429,869	68,224	498,093
Net (premium amortization) discount accretion	(25,331)	19,199	(6,132)	(135,639)	96,061	(39,578)
Interest income	$54,790	$33,753	$88,543	$294,230	$164,285	$458,515
Net asset yield	3.2 %	7.8 %	4.1 %	3.1 %	7.8 %	4.0 %

	Three Months Ended December 31, 2014			Year Ended December 31, 2014		
(dollars in thousands)	Agency [(1)]	Non-Agency	Total	Agency [(1)]	Non-Agency	Total
Average amortized cost	$10,476,049	$2,359,578	$12,835,627	$9,893,488	$2,308,758	$12,202,246
Coupon interest	119,068	17,588	136,656	450,001	69,742	519,743
Net (premium amortization) discount accretion	(35,450)	30,488	(4,962)	(140,827)	127,352	(13,475)
Interest income	$83,618	$48,076	$131,694	$309,174	$197,094	$506,268
Net asset yield	3.2 %	8.1 %	4.1 %	3.1 %	8.5 %	4.1 %

(1) Excludes Agency Derivatives. For the three and twelve months ended December 31, 2015, the average annualized net yield on total Agency RMBS, including Agency Derivatives, was 3.5% and 3.4%, respectively, compared to 3.4% for both of the same periods in 2014.

Net yields on Agency RMBS AFS for the three and twelve months ended December 31, 2015 were consistent with those for the same periods in 2014. The decrease in net yields on non-Agency RMBS for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014,was due to the sale of securities previously purchased at higher yields that we believe had reached maximum value.

Table of Contents

Interest Expense and the Cost of Funds

The following tables present the components of interest expense and average annualized cost of funds on borrowings incurred by investment type on our AFS securities, Agency Derivatives, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts and commercial real estate assets for the three and twelve months ended December 31, 2015 and 2014:

(dollars in thousands)	Three Months Ended December 31, 2015			Year Ended December 31, 2015		
Collateral Type	Average Balance [1]	Interest Expense	Cost of Funds [2]	Average Balance [1]	Interest Expense	Cost of Funds [2]
Available-for-sale securities						
Agency [3]	$6,467,442	$8,429	0.5 %	$9,046,108	$40,352	0.4 %
Non-Agency	1,442,669	7,281	2.0 %	1,764,384	33,786	1.9 %
	7,910,111	15,710	0.8 %	10,810,492	74,138	0.7 %
Agency derivatives	123,115	368	1.2 %	129,853	1,404	1.1 %
Trading securities	—	—	— %	917,682	1,727	0.2 %
Residential mortgage loans held-for-sale	534,970	616	0.5 %	508,650	2,139	0.4 %
Residential mortgage loans held-for-investment in securitization trusts [4]	2,986,853	19,577	2.6 %	2,286,501	62,302	2.7 %
Commercial real estate assets	102,051	304	1.2 %	34,393	476	1.4 %
Total	$11,657,100	$36,575	1.3 %	$14,687,571	$142,186	1.0 %

(dollars in thousands)	Three Months Ended December 31, 2014			Year Ended December 31, 2014		
Collateral Type	Average Balance [1]	Interest Expense	Cost of Funds [2]	Average Balance [1]	Interest Expense	Cost of Funds [2]
Available-for-sale securities						
Agency [3]	$9,990,563	$10,287	0.4 %	$9,331,350	$38,861	0.4 %
Non-Agency	2,304,471	10,154	1.8 %	2,077,668	37,262	1.8 %
	12,295,034	20,441	0.7 %	11,409,018	76,123	0.7 %
Agency derivatives	139,892	354	1.0 %	151,180	1,562	1.0 %
Trading securities	1,997,690	411	0.1 %	1,442,268	(15)	— %
Residential mortgage loans held-for-sale	291,795	361	0.5 %	223,447	3,020	1.4 %
Residential mortgage loans held-for-investment in securitization trusts [4]	1,120,982	10,137	3.6 %	764,921	26,760	3.5 %
Commercial real estate assets	—	—	— %	—	—	— %
Total	$15,845,393	$31,704	0.8 %	$13,990,834	$107,450	0.8 %

(1) Average balance represents average total repurchase agreements and FHLB advances on AFS securities, Agency Derivatives, trading securities, residential mortgage loans held-for-sale and commercial real estate assets, and average collateralized borrowings for residential mortgage loans held-for-investment in securitization trusts.

(2) Cost of funds by investment type is based on the underlying investment type of the asset assigned as collateral. Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive (loss) income. For the three and twelve months ended December 31, 2015, our total average cost of funds on the assets assigned as collateral for repurchase agreements, FHLB advances and collateralized borrowings shown in the table above, including interest spread expense associated with interest rate swaps, was 1.7% and 1.6%, respectively, compared to 1.7% and 1.5% for the same periods in 2014.

(3) Excludes Agency Derivatives. For the three and twelve months ended December 31, 2015, our average cost of funds on total Agency RMBS, including Agency Derivatives, was 0.5% for both respective periods, compared to 0.4% for both of the same periods in 2014.

(4) Includes repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

Table of Contents

Total interest expense increased from $31.7 million and $107.4 million for the three and twelve months ended December 31, 2014 to $36.6 million and $142.2 million for the same periods in 2015, due primarily to increased interest expense on collateralized borrowings due to the completion of multiple securitization transactions in 2015. The increase in cost of funds associated with the financing of Agency RMBS AFS for the three months ended December 31, 2015 and non-Agency RMBS and Agency Derivatives for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was the result of increases in the repurchase agreement borrowing rates offered by counterparties, which are generally based on a specified margin over one-month LIBOR. The cost of funds associated with the financing of Agency RMBS AFS for the year ended December 31, 2015 were consistent with those for the same period in 2014. The increase in cost of funds associated with the financing of trading securities for the year ended December 31, 2015, as compared to the year ended December 31, 2014, was the result of counterparties granting a negative borrowing rate on repurchase agreements financing our U.S. Treasuries in 2014. We also did not recognize any interest expense on the financing of trading securities during the three months ended December 31, 2015 as we sold our trading securities position during the three months ended June 30, 2015. The decrease in cost of funds associated with the financing of residential mortgage loans held-for-sale for the year ended December 31, 2015, as compared to the year ended December 31, 2014, was the result of a decrease in the outstanding balance under repurchase agreements and increase in the outstanding balance under FHLB advances, which provide lower financing rates. The cost of funds associated with the financing of residential mortgage loans held-for-sale for the three months ended December 31, 2015 were consistent with those for the same period in 2014. The decrease in cost of funds associated with the financing of residential mortgage loans held-for-investment in securitization trusts for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was primarily the result of an increase in the outstanding balance of FHLB advances collateralized by retained interests from our on-balance sheet securitizations.

The cost of funds associated with the financing of commercial real estate assets for the three and twelve months ended December 31, 2015 represents financing on assets purchased during 2015, many of which were settled in the latter half of 2015, which, as a result, is not indicative of future cost of funds.

Net Interest Income

The following tables present the components of net interest income and average annualized net interest rate spread earned by investment type on our AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, commercial real estate assets and Agency Derivatives for the three and twelve months ended December 31, 2015 and 2014:

	Three Months Ended December 31, 2015			Year Ended December 31, 2015		
(dollars in thousands)	Net Interest Income	Net Interest Rate Spread [1]		Net Interest Income	Net Interest Rate Spread [1]	
Available-for-sale securities						
Agency [2]	$46,361	2.7	%	$253,878	2.7	%
Non-Agency	26,472	5.8	%	130,499	5.9	%
	72,833	3.3	%	384,377	3.3	%
Agency derivatives [3]	6,207	17.3	%	26,444	17.5	%
Trading securities	—	—	%	6,949	0.8	%
Residential mortgage loans held-for-sale	7,082	3.5	%	26,827	3.5	%
Residential mortgage loans held-for-investment in securitization trusts [4]	11,255	1.3	%	33,438	1.2	%
Commercial real estate assets	5,993	4.8	%	8,662	5.0	%

Total	$103,370	3.0 %	$486,697	3.0 %

68

Table of Contents

	Three Months Ended December 31, 2014			Year Ended December 31, 2014		
(dollars in thousands)	Net Interest Income	Net Interest Rate Spread [1]		Net Interest Income	Net Interest Rate Spread [1]	
Available-for-sale securities						
Agency [2]	$73,332	2.8	%	$270,313	2.7	%
Non-Agency	37,921	6.3	%	159,832	6.7	%
	111,253	3.4	%	430,145	3.4	%
Agency derivatives [3]	7,233	16.1	%	28,609	15.0	%
Trading securities	4,328	0.8	%	12,928	0.9	%
Residential mortgage loans held-for-sale	3,175	3.4	%	13,069	2.6	%
Residential mortgage loans held-for-investment in securitization trusts [4]	5,903	0.4	%	14,460	0.4	%
Commercial real estate assets	—	—	%	—	—	%
Total	$131,892	3.1	%	$499,211	3.2	%

(1) Net interest rate spread does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive (loss) income. For the three and twelve months ended December 31, 2015, our total average net interest rate spread on the assets shown in the table above, including interest spread expense associated with interest rate swaps, was 2.6% and 2.3%, respectively, compared to 2.2% and 2.5% for the same periods in 2014.

(2) Excludes Agency Derivatives. For the three and twelve months ended December 31, 2015, our average annualized net interest rate spread on total Agency RMBS, including Agency Derivatives, was 3.0% and 2.9% , respectively, compared to 3.0% for both of the same periods in 2014.

(3) Interest income on Agency Derivatives is included in (loss) gain on other derivative instruments on the consolidated statements of comprehensive (loss) income, while interest expense on Agency Derivatives is included in interest expense on repurchase agreements on the consolidated statements of comprehensive (loss) income.

(4) Net of interest expense on repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

The decrease in net interest rate spread on Agency RMBS AFS for the three months ended December 31, 2015, as compared to the three months ended December 31, 2014, was predominantly driven by increases in the repurchase agreement borrowing rates offered by counterparties, as discussed above. The net interest spread on Agency RMBS AFS for the year ended December 31, 2015 was consistent with that for the same period in 2014. The decrease in net interest spread on non-Agency RMBS for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014,was due to the sale of securities previously purchased at higher yields that we believe had reached maximum value, combined with increases in the repurchase agreement borrowing rates offered by counterparties.

The increase in net interest rate spread on Agency Derivatives for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was predominantly driven by slower prepayments due to the rising interest rate environment, partially offset by increases in the repurchase agreement borrowing rates offered by counterparties. The decrease in net interest spread on our trading securities for the year ended December 31, 2015, as compared to the year ended December 31, 2014, was generally the result of counterparties granting a negative borrowing rate on repurchase agreements financing our U.S. Treasuries in 2014. We did not recognize any interest

income or expense on trading securities during the three months ended December 31, 2015 as we sold our trading security position during the three months ended June 30, 2015.

The increase in net interest rate spread on our residential mortgage loans held-for-sale for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was generally driven by lower financing rates, as discussed above. The increase in net interest spread on our residential mortgage loans held-for-investment in securitization trusts for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was primarily the result of an increase in the outstanding balance of FHLB advances collateralized by retained interests from our on-balance sheet securitizations.

The net interest rate spread on commercial real estate assets for the three and twelve months ended December 31, 2015 represents interest income, net of interest expense, on assets purchased during 2015, many of which were settled in the latter half of 2015, which, as a result, is not indicative of future spreads.

Table of Contents

Other-Than-Temporary Impairments

We review each of our securities on a quarterly basis to determine if an OTTI charge is necessary. For the three months ended December 31, 2015, we did not recognize any OTTI losses, but for the year ended December 31, 2015, we recognized $0.5 million in OTTI losses. For the three and twelve months ended December 31, 2014, we recognized $0.2 million and $0.4 million in OTTI losses, respectively. For further information about evaluating AFS securities for other-than-temporary impairments, refer to Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the consolidated financial statements.

Gain (Loss) on Investment Securities

During the three and twelve months ended December 31, 2015, we sold AFS securities for $3.3 billion and $7.0 billion with an amortized cost of $3.2 billion and $6.6 billion, for net realized gains of $109.5 million and $369.4 million, respectively. We also sold U.S. Treasuries for $2.0 billion with an amortized cost of $2.0 billion, resulting in net realized gains of $7.4 million for the year ended December 31, 2015. We did not hold or sell any U.S. Treasuries during the three months ended December 31, 2015. During the three and twelve months ended December 31, 2014, we sold AFS securities for $303.1 million and $3.5 billion with an amortized cost of $278.6 million and $3.4 billion, for net realized gains of $24.5 million and $84.4 million, respectively. We also sold U.S. Treasuries for $1.1 billion with an amortized cost of $1.1 billion, for a net realized gain of $5.5 million for the year ended December 31, 2014. We did not sell any U.S. Treasuries during the three months ended December 31, 2014. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that our management believes have higher risk-adjusted returns.

For the three and twelve months ended December 31, 2015, Agency interest-only mortgage-backed securities and GSE credit risk transfer securities experienced a change in unrealized losses of $9.7 million and $12.0 million. For the year ended December 31, 2015, trading securities experienced a change in unrealized losses of $1.4 million, compared to a change in unrealized gains of $4.2 million and losses of $2.7 million for the three and twelve months ended December 31, 2014, respectively. We did not hold any trading securities during the three months ended December 31, 2015. The decrease in change in unrealized losses for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was driven by the sale of our U.S. Treasuries and corresponding recognition of realized gains during the year ended December 31, 2015.

Gain (Loss) on Interest Rate Swap and Swaption Agreements

For the three and twelve months ended December 31, 2015, we recognized $12.6 million and $85.6 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $14.1 billion and $16.1 billion notional for the three and twelve months ended December 31, 2015, respectively, to economically hedge/mitigate interest rate exposure (or duration) risk associated with our investment portfolio and our short-term repurchase agreements and FHLB advances, and receiving either LIBOR interest or a fixed interest rate. For the three and twelve months ended December 31, 2014, we recognized $32.2 million and $91.8 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $22.0 billion and $23.3 billion notional for the three and twelve months ended December 31, 2014, respectively, to economically hedge/mitigate interest rate exposure (or duration) risk associated with our investment portfolio and our short-term repurchase agreements and FHLB advances, and receiving either LIBOR interest or a fixed interest rate.

During the three and twelve months ended December 31, 2015, we terminated, had agreements mature or had options expire on 28 and 97 interest rate swap and swaption positions of $12.7 billion and $60.1 billion notional, respectively. Upon settlement of the early terminations and option expirations, we paid $8.7 million and $41.0 million in full settlement of our net interest spread liability and recognized $101.1 million and $226.2 million in realized losses on the swaps and swaptions for the three and twelve months ended December 31, 2015, respectively, including early termination penalties. During the three and twelve months ended December 31, 2014, we terminated, had agreements mature or had options expire on 21 and 68 interest rate swap and swaption positions of $11.0 billion and $37.4 billion

notional, respectively. Upon settlement of the early terminations and option expirations, we paid $14.1 million and $19.6 million in full settlement of our net interest spread liability and recognized $3.7 million and $55.4 million in realized gains on the swaps and swaptions for the three and twelve months ended December 31, 2014, respectively, including early termination penalties. We elected to terminate certain swaps during these periods to align with our investment portfolio.

Table of Contents

Also included in our financial results for the three and twelve months ended December 31, 2015 was the recognition of a change in unrealized valuation gains of $156.2 million and $101.2 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. For the three and twelve months ended December 31, 2014, we recognized changes in unrealized valuation losses of $116.7 million and gains of $198.5 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. The change in fair value of interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the year ended December 31, 2015. Since these swaps and swaptions are generally used for purposes of hedging our interest rate exposure, their unrealized valuation gains and losses are generally offset by unrealized gains and losses in our Agency RMBS AFS portfolio, which are recorded either directly to stockholders' equity through other comprehensive (loss) income, net of tax, or to gain (loss) on investment securities, in the case of Agency interest-only securities.

The following table provides the net interest spread and gains and losses associated with our interest rate swap and swaption positions:

	Three Months Ended December 31,		Year Ended December 31,	
(in thousands)	2015	2014	2015	2014
Net interest spread	$(12,552)	$(32,243)	$(85,636)	$(91,754)
Early termination, agreement maturation and option expiration losses	(101,159)	(3,677)	(226,143)	(55,389)
Change in unrealized gain (loss) on interest rate swap and swaption agreements, at fair value	156,237	(116,699)	101,158	(198,504)
Gain (loss) on interest rate swap and swaption agreements	$42,526	$(152,619)	$(210,621)	$(345,647)

(Loss) Gain on Other Derivative Instruments

Included in our financial results for the three and twelve months ended December 31, 2015 was the recognition of $2.1 million and $5.0 million of losses, respectively, on other derivative instruments we held for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, Markit IOS total return swaps and inverse interest-only securities. Included within the results for three and twelve months ended December 31, 2015 was the recognition of $6.6 million and $27.8 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $142.2 million and $149.6 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments. As these derivative instruments are considered trading instruments, our financial results include both realized and unrealized gains (losses) associated with these instruments. For the three and twelve months ended December 31, 2014, we recognized $5.2 million and $17.5 million of losses, respectively, on other derivative instruments we held for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs, short U.S. Treasuries, put and call options for TBAs, constant maturity swaps, Markit IOS total return swaps and inverse interest-only securities. Included within the results for the three and twelve months ended December 31, 2014 was the recognition of $7.6 million and $30.2 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $177.8 million and $188.8 million, respectively. The remainder represented realized and unrealized net gains (losses) on other derivative instruments. Since our derivative instruments are generally used for purposes of hedging our interest rate and credit risk exposure, their unrealized valuation gains and losses are generally offset by unrealized losses and gains in our RMBS AFS and loan portfolios.

(Loss) Gain on Residential Mortgage Loans Held-for-Sale

For the three and twelve months ended December 31, 2015, we recorded losses of $4.0 million and gains of $14.3 million on residential mortgage loans held-for-sale, respectively. Included within these results was the recognition of

losses of $3.7 million and gains of $16.0 million, respectively, on residential mortgage loans held-for-sale and losses of $0.3 million and $1.7 million, respectively, on commitments to purchase residential mortgage loans held-for-sale for the three and twelve months ended December 31, 2015, respectively.

Table of Contents

For the three and twelve months ended December 31, 2014, we recorded gains on residential mortgage loans held-for-sale of $11.1 million and $17.3 million, respectively. Included within these results was the recognition of gains of $8.7 million and $12.6 million, respectively, on residential mortgage loans held-for-sale and gains of $2.4 million and $4.7 million, respectively, on commitments to purchase residential mortgage loans held-for-sale for the three and twelve months ended December 31, 2014. The decrease in gains (losses) recorded on residential mortgage loans held-for-sale during the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was due in part to interest rates generally rising during the three and twelve months ended December 31, 2015 as compared to interest rates generally falling during the three and twelve months ended December 31, 2014.

Servicing Income

For the three and twelve months ended December 31, 2015, we recognized total servicing income of $32.8 million and $127.4 million, respectively. These amounts include servicing fee income of $31.9 million and $123.8 million, ancillary fee income of $0.5 million and $2.1 million, and float income of $0.4 million and $1.4 million, respectively. For the three and twelve months ended December 31, 2014, we recognized total servicing income of $31.6 million and $128.2 million, respectively. These amounts include servicing fee income of $30.7 million and $125.1 million, and ancillary fee income of $0.6 million and $2.2 million, and float income of $0.3 million and $0.9 million, respectively. Servicing income for the three and twelve months ended December 31, 2015 was generally consistent with that for the same periods in 2014 due to similar average MSR portfolio sizes during the respective periods.

(Loss) Gain on Servicing Asset

For the three and twelve months ended December 31, 2015, loss on servicing asset of $3.3 million and $99.6 million, respectively, includes a decrease in fair value of MSR due to realization of cash flows (runoff) of $15.2 million and $48.0 million and an increase of $11.9 million and decrease of $51.6 million, respectively, in fair value of MSR due to changes in valuation inputs or assumptions. For the three and twelve months ended December 31, 2014, loss on servicing asset of $55.3 million and $128.4 million, respectively, includes a decrease in fair value of MSR due to realization of cash flows (runoff) of $13.7 million and $54.8 million and a decrease in fair value of MSR due to changes in valuation inputs or assumptions of $41.6 million and $73.6 million, respectively. The decrease in loss on servicing asset for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was the result of decreasing prepayment speeds and delinquencies.

Other (Loss) Income

For the three and twelve months ended December 31, 2015, we recorded other loss of $5.5 million and $21.8 million, which includes $19.4 million and $52.4 million in losses on residential mortgage loans held-for-investment in securitization trusts and $12.3 million and $25.9 million in gains on collateralized borrowings in securitization trusts, respectively. Also included in other (loss) income for the three and twelve months ended December 31, 2015 was other mortgage loan revenue of $0.1 million and $0.5 million and dividend income on our FHLB stock of $1.3 million and $4.0 million, respectively.

For the three and twelve months ended December 31, 2014, we recorded other loss of $1.4 million and other income of $18.5 million, which includes $9.4 million and $41.1 million in gains on residential mortgage loans held-for-investment in securitization trusts and $11.5 million and $24.3 million in losses on collateralized borrowings in securitization trusts. Also included in other (loss) income for the both three and twelve months ended December 31, 2014 was other mortgage loan revenue of $0.2 million and $0.8 million and dividend income on our FHLB stock of $0.5 million and $0.9 million, respectively. The increase in other loss for the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was due in part to interest rates generally rising during the three and twelve months ended December 31, 2015 as compared to interest rates generally falling during the three and twelve months ended December 31, 2014.

Management Fees

We incurred management fees of $12.3 million and $50.3 million, respectively, for the three and twelve months ended December 31, 2015, and $12.2 million and $48.8 million for the same periods in 2014, which are payable to PRCM

Advisers, our external manager, under our management agreement. The management fee is calculated based on our stockholders' equity with certain adjustments outlined in the management agreement. See further discussion of the management fee calculation in Note 25 - Related Party Transactions of the notes to the consolidated financial statements.

Securitization Deal Costs

For the three and twelve months ended December 31, 2015, we recognized $1.2 million and $9.0 million, respectively, in upfront costs related to the sponsoring of securitization trusts, compared to $1.3 million and $4.6 million for the same periods in 2014. These costs are included when evaluating the economics of a securitization; however, the election of the fair value option for the assets and liabilities held in the securitization trusts requires the expense to be recognized upfront on the consolidated statements of comprehensive (loss) income. Changes in securitization deal costs are directly related to the number and size of securitization trusts sponsored by our subsidiaries during the respective periods.

Servicing Expenses

For the three and twelve months ended December 31, 2015, we recognized $8.3 million and $28.1 million, respectively, in servicing expenses generally related to the subservicing of residential mortgage loans held-for-sale and MSR, compared to $1.3 million and $25.9 million for the same periods in 2014. Included in servicing expenses for the three and twelve months ended December 31, 2015 was MSR representation and warranty reserve expense of $0.8 million and $0.3 million, respectively, compared to a decrease in the MSR representation and warranty reserve of $5.1 million and MSR representation and warranty reserve expense of $1.8 million for the same periods in 2014. The increase in servicing expenses during the three and twelve months ended December 31, 2015, as compared to the same periods in 2014, was predominantly driven by the reduction in the MSR representation and warranty reserve in the fourth quarter of 2014.

Other Operating Expenses

For the three and twelve months ended December 31, 2015, we recognized $16.1 million and $64.2 million, respectively, of other operating expenses, which represents an annualized expense ratio of 1.7% and 1.6% of average equity, compared to $14.9 million and $56.2 million of expenses, which represents an annualized expense ratio of 1.5% and 1.4% of average equity, for the same periods in 2014. The increase of our operating expense ratio resulted primarily from an increase in expenses related to the personnel and infrastructure to support our residential mortgage loan, MSR and commercial real estate activities, as well as a decrease in our average equity balance due to share repurchases and a comprehensive loss recognized for both the three and twelve months ended December 31, 2015, as compared to comprehensive income for both the three and twelve months ended December 31, 2014.

Included in other operating expenses are direct and allocated costs incurred by PRCM Advisers on our behalf and reimbursed by us. For the three and twelve months ended December 31, 2015, these direct and allocated costs totaled approximately $6.8 million and $22.9 million, compared to $4.0 million and $15.5 million of costs for the same periods in 2014. Included in these reimbursed costs was compensation paid to employees of Pine River serving as our principal financial officer and general counsel of $0.2 million and $1.7 million for the three and twelve months ended December 31, 2015 and $0.2 million and $1.8 million for the three and twelve months ended December 31, 2014. The allocation of compensation paid to employees of Pine River serving as our principal financial officer and general counsel is based on time spent overseeing our company's activities in accordance with the management agreement.

Equity based compensation expense for the three and twelve months ended December 31, 2015 also includes the amortization of the restricted stock awarded to our executive officers in conjunction with the Plan (see discussion in Note 22 - Equity Incentive Plan), including our chief executive officer, chief investment officer, principal financial officer and general counsel, of $0.8 million and $4.4 million, compared to $1.6 million and $6.6 million for the same periods in 2014.

We have an established accounts payable function and direct relationships with the majority of our third-party vendors. We will continue to have certain costs allocated to us by PRCM Advisers for compensation, data services and proprietary technology, but most direct expenses with third-party vendors are paid directly by us.

Income Taxes

During the three and twelve months ended December 31, 2015, our TRSs recognized a provision for income taxes of $8.8 million and a benefit from income taxes of $16.5 million, compared to a benefit from income taxes of $11.7 million and $73.7 million for the same periods in 2014. The provision recognized for the three months ended December 31, 2015 was primarily due to realized gains on sales of AFS securities held in our TRSs. Conversely, the benefit recognized for the year ended December 31, 2015 and the three and twelve months ended December 31, 2014 was primarily due to losses incurred on derivative instruments held in our TRSs. We currently intend to distribute 100% of our REIT taxable income and comply with all requirements to continue to qualify as a REIT.

Table of Contents

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

The following analysis focuses on financial results during the years ended December 31, 2014 and 2013.

Interest Income and Average Portfolio Yield

The following table presents the components of interest income and average annualized net asset yield earned by investment type on our AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts and Agency Derivatives for the years ended December 31, 2014 and 2013:

(dollars in thousands)	Year Ended December 31, 2014			Year Ended December 31, 2013		
	Average Balance [1]	Interest Income	Net Asset Yield	Average Balance [1]	Interest Income	Net Asset Yield
Available-for-sale securities	$12,202,246	$506,268	4.1 %	$12,939,288	$507,180	3.9 %
Trading securities	1,462,816	12,913	0.9 %	996,914	5,963	0.6 %
Residential mortgage loans held-for-sale	403,141	16,089	4.0 %	469,731	22,185	4.7 %
Residential mortgage loans held-for-investment in securitization trusts	1,051,533	41,220	3.9 %	485,271	19,220	4.0 %
	15,119,736	576,490	3.8 %	14,891,204	554,548	3.7 %
Agency derivatives [2]	188,824	30,171	16.0 %	251,069	14,015	5.6 %
Total	$15,308,560	$606,661	4.0 %	$15,142,273	$568,563	3.8 %

(1) Average balance represents average amortized cost on AFS securities, trading securities and Agency Derivatives and average unpaid principal balance, adjusted for purchase price changes, on residential mortgage loans held-for-sale and held-for-investment in securitization trusts.

(2) Interest income on Agency Derivatives is included in (loss) gain on other derivative instruments on the consolidated statements of comprehensive (loss) income.

Total interest income, including interest income on Agency Derivatives, has increased from $568.6 million for the year ended December 31, 2013 to $606.7 million for the the year ended December 31, 2014, due primarily to the completion of three securitization transactions in 2014 as well as increases in yields on interest-only Agency RMBS. The increase in net yields on AFS securities and Agency Derivatives for the year ended December 31, 2014, as compared to the year ended December 31, 2013 was predominantly driven by slower prepayments on premium-priced RMBS and interest-only Agency RMBS. The increase in yields on trading securities for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of increases in Treasury rates. The decrease in yields on residential mortgage loans held-for-sale for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of the sale of substantially all of our CSL portfolio during the first quarter of 2014. The change in yields on mortgage loans held-for-investment in securitization trusts for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was generally the result of changes in interest rates on mortgage loans securitized throughout 2014.

The following table presents the components of the net yield earned by investment type on our RMBS AFS portfolio as a percentage of our average amortized cost of securities for the years ended December 31, 2014 and 2013:

	Year Ended December 31, 2014			Year Ended December 31, 2013		
	Agency [1]	Non-Agency	Total	Agency [1]	Non-Agency	Total
Gross yield/stated coupon	4.5 %	3.0 %	4.3 %	4.3 %	2.8 %	4.1 %
	(1.4)%	5.5 %	(0.2)%	(1.5)%	6.2 %	(0.2)%

Net (premium amortization) discount accretion												
Net yield [2]	3.1	%	8.5	%	4.1	%	2.8	%	9.0	%	3.9	%

(1) Excludes Agency Derivatives. For the years ended December 31, 2014 and 2013, our average annualized net yield on our Agency RMBS, including Agency Derivatives, was 3.4% and 2.9%, respectively.
(2) These yields have not been adjusted for cost of delay and cost to carry purchase premiums.

Table of Contents

The following table presents the components of interest income and net asset yield earned by investment type on our RMBS AFS portfolio for the years ended December 31, 2014 and 2013:

	Year Ended December 31, 2014			Year Ended December 31, 2013		
(dollars in thousands)	Agency [1]	Non-Agency	Total	Agency [1]	Non-Agency	Total
Average amortized cost	$9,893,488	$2,308,758	$12,202,246	$10,615,981	$2,323,307	$12,939,288
Coupon interest	450,001	69,742	519,743	460,881	65,321	526,202
Net (premium amortization) discount accretion	(140,827)	127,352	(13,475)	(162,229)	143,207	(19,022)
Interest income	$309,174	$197,094	$506,268	$298,652	$208,528	$507,180
Net asset yield	3.1 %	8.5 %	4.1 %	2.8 %	9.0 %	3.9 %

(1) Excludes Agency Derivatives. For the years ended December 31, 2014 and 2013, our average yield on our Agency RMBS, including Agency Derivatives, was 3.4% and 2.9%, respectively.

The increase in net yields on Agency RMBS AFS for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was predominantly driven by slower prepayments on premium-priced RMBS and interest-only Agency RMBS. However, the decrease in net yields on non-Agency RMBS was due to the sale of securities previously purchased at higher yields that we believe had reached maximum value, some of which were replaced with securities at lower yields.

Interest Expense and the Cost of Funds

The following table presents the components of interest expense and average annualized cost of funds on borrowings incurred by investment type on our AFS securities, Agency Derivatives, trading securities, residential mortgage loans held-for-sale and residential mortgage loans held-for-investment in securitization trusts for the years ended December 31, 2014 and 2013:

(dollars in thousands)	Year Ended December 31, 2014			Year Ended December 31, 2013		
Collateral Type	Average Balance [1]	Interest Expense	Cost of Funds [2]	Average Balance [1]	Interest Expense	Cost of Funds [2]
Available-for-sale securities						
Agency [3]	$9,331,350	$38,861	0.4 %	$10,226,860	$49,230	0.5 %
Non-Agency	2,077,668	37,262	1.8 %	1,488,727	33,412	2.2 %
	11,409,018	76,123	0.7 %	11,715,587	82,642	0.7 %
Agency derivatives	151,180	1,562	1.0 %	202,079	2,196	1.1 %
Trading securities	1,442,268	(15)	— %	999,519	1,275	0.1 %
Residential mortgage loans held-for-sale	223,447	3,020	1.4 %	121,944	3,357	2.8 %
Residential mortgage loans held-for-investment in securitization trusts [4]	764,921	26,760	3.5 %	414,373	10,937	2.6 %
Total	$13,990,834	$107,450	0.8 %	$13,453,502	$100,407	0.7 %

(1) Average balance represents average total repurchase agreements and FHLB advances on AFS securities, Agency Derivatives, trading securities and residential mortgage loans held-for-sale, and average collateralized borrowings for residential mortgage loans held-for-investment in securitization trusts.

(2) Cost of funds by investment type is based on the underlying investment type of the asset assigned as collateral. Cost of funds does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive (loss) income. For the years ended December 31, 2014 and 2013, our total average cost of funds on the assets assigned as collateral for repurchase agreements, FHLB advances and collateralized borrowings shown in the table above, including interest spread expense associated with interest rate swaps, was 1.5% and 1.2%, respectively.

(3) Excludes Agency Derivatives. For the years ended December 31, 2014 and 2013, our average cost of funds on total Agency RMBS, including Agency Derivatives, was 0.4% and 0.5%, respectively.

(4) Includes repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

75

Table of Contents

Total interest expense increased from $100.4 million for the year ended December 31, 2013 to $107.4 million for the year ended December 31, 2014, due primarily to increased interest expense on collateralized borrowings due to the completion of three securitization transactions in 2014, offset by a decrease in the outstanding balance under repurchase agreements and increase in the outstanding balance under FHLB advances, which provide lower financing rates.

The decrease in cost of funds associated with the financing of Agency and non-Agency RMBS AFS, Agency Derivatives and residential mortgage loans held-for-sale for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of a decrease in the outstanding balance under repurchase agreements and increase in the outstanding balance under FHLB advances, resulting in our ability to extend our maturity profile without an increase in financing rates. The decrease in cost of funds associated with the financing of trading securities for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of counterparties granting a negative borrowing rate on repurchase agreements financing our U.S. Treasuries in 2014. The increase in cost of funds associated with the financing of residential mortgage loans held-for-investment in securitization trusts for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was generally the result of the securitization transactions completed in the latter half of 2014.

Net Interest Income

The following table presents the components of net interest income and average annualized net interest rate spread earned by investment type on our AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts and Agency Derivatives for the years ended December 31, 2014 and 2013:

	Year Ended December 31, 2014			Year Ended December 31, 2013		
(dollars in thousands)	Net Interest Income	Net Interest Rate Spread [1]		Net Interest Income	Net Interest Rate Spread [1]	
Available-for-sale securities						
Agency [2]	$270,313	2.7	%	$249,423	2.3	%
Non-Agency	159,832	6.7	%	175,115	6.8	%
	430,145	3.4	%	424,538	3.2	%
Agency derivatives [3]	28,609	15.0	%	11,819	4.5	%
Trading securities	12,928	0.9	%	4,688	0.5	%
Residential mortgage loans held-for-sale	13,069	2.6	%	18,828	2.0	%
Residential mortgage loans held-for-investment in securitization trusts [4]	14,460	0.4	%	8,283	1.4	%
Total	$499,211	3.2	%	$468,156	3.2	%

(1) Net interest rate spread does not include the accrual and settlement of interest associated with interest rate swaps. In accordance with U.S. GAAP, those costs are included in (loss) gain on interest rate swap and swaption agreements in the consolidated statements of comprehensive (loss) income. For the years ended December 31, 2014 and 2013, our total average net interest rate spread on the assets shown in the table above, including interest spread expense associated with interest rate swaps, was 2.5% and 2.7%, respectively.

(2) Excludes Agency Derivatives. For the years ended December 31, 2014 and 2013, our average annualized net interest rate spread on total Agency RMBS, including Agency Derivatives, was 3.0% and 2.4%, respectively.

(3) Interest income on Agency Derivatives is included in (loss) gain on other derivative instruments on the consolidated statements of comprehensive (loss) income, while interest expense on Agency Derivatives is included in interest expense on repurchase agreements on the consolidated statements of comprehensive (loss) income.

(4) Net of interest expense on repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

The increase in net interest spread on Agency RMBS AFS for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was predominantly driven by slower prepayments on premium-priced RMBS and interest-only Agency RMBS combined with a decrease in cost of funds due to our extended maturity profile, as discussed above. However, the decrease in net interest rate spread on non-Agency RMBS was due to the sale of securities previously purchased at higher yields that we believe had reached maximum value, which were replaced with securities at lower yields, offset by a decrease in cost of funds on borrowings. In total, the increase in net interest spread on AFS securities and Agency Derivatives for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was predominantly driven by slower prepayments due to the rising interest rate environment.

Table of Contents

The increase in net interest spread on trading securities for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of increases in Treasury rates. The increase in net interest spread on residential mortgage loans held-for-sale for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was generally driven by lower financing rates, as discussed above. The decrease in net interest spread on our mortgage loans held-for-investment in securitization trusts for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was generally the result of the securitization transactions completed in the latter half of 2014.

Other-Than-Temporary Impairments

We review each of our securities on a quarterly basis to determine if an OTTI charge is necessary. For the year ended December 31, 2014, we recognized $0.4 million of OTTI losses, compared to $1.7 million for the year ended December 31, 2013. The decrease in OTTI during the year ended December 31, 2014, as compared to the year ended December 31, 2013, was generally driven by appreciation in the non-Agency market from December 31, 2013 to December 31, 2014. For further information about evaluating AFS securities for other-than-temporary impairments, refer to Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the consolidated financial statements.

Gain (Loss) on Investment Securities

During the year ended December 31, 2014, we sold AFS securities for $3.5 billion with an amortized cost of $3.4 billion, for a net realized gain of $84.4 million. We also sold U.S. Treasuries for $1.1 billion with an amortized cost of $1.1 billion, for a net realized gain $5.5 million for the year ended December 31, 2014. During the year ended December 31, 2013, we sold AFS securities for $4.4 billion with an amortized cost of $4.5 billion, for a net realized loss of $64.5 million. We also sold U.S. Treasuries for $1.0 billion with an amortized cost of $1.0 billion, for a net realized gain of $3.0 million for the year ended December 31, 2013. We do not expect to sell assets on a frequent basis, but may sell assets to reallocate capital into new assets that our management believes have higher risk-adjusted returns.

For the years ended December 31, 2014 and 2013, trading securities experienced unrealized losses of $2.7 million and $1.0 million, respectively. The increase in change in unrealized losses for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was primarily due to the realization of gains on trading securities sold during the year ended December 31, 2014.

On March 18, 2013, we declared a special dividend pursuant to which we distributed 17,824,647 shares of Silver Bay common stock, on a pro rata basis, to our stockholders of record as of April 2, 2013. The dividend was distributed on or about April 24, 2013. As a result, we recognized $13.7 million of realized gains on the distribution as well as $5.9 million of change in unrealized losses within gain (loss) on investment securities for the year ended December 31, 2013, respectively. Also included in gain (loss) on investment securities for the year ended December 31, 2013 was $0.2 million in dividend income from Silver Bay's $0.01 per share dividend declared on March 21, 2013.

Gain (Loss) on Interest Rate Swap and Swaption Agreements

For the years ended December 31, 2014 and 2013 we recognized $91.8 million and $58.5 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with our interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $23.3 billion and $17.0 billion notional, respectively, to hedge a portion of our interest rate risk on our short-term repurchase agreements, funding costs, and macro-financing risk and receiving either LIBOR interest or a fixed interest rate.

During the years ended December 31, 2014 and 2013, we terminated, had agreements mature or had options expire on 68 and 155 notional interest rate swap and swaption positions of $37.4 billion and $33.8 billion, respectively. Upon settlement of the early terminations and option expirations, we paid $19.6 million and $34.5 million, in 2014 and 2013 respectively, in full settlement of our net interest spread liability and recognized $55.4 million in realized losses and $12.3 million in realized gains on the swaps and swaptions in 2014 and 2013, respectively, including early termination penalties. We elected to terminate certain swaps during these periods to align with our investment portfolio.

Also included in our financial results for the years ended December 31, 2014 and 2013 was the recognition of a change in unrealized valuation losses of $198.5 million and gains of $291.5 million, respectively, on our interest rate swap and swaption agreements that were accounted for as trading instruments. The change in fair value of interest rate swaps was a result of changes to LIBOR, the swap curve and corresponding counterparty borrowing rates during the year ended December 31, 2014. Since these swaps and swaptions are generally used for purposes of hedging our interest rate exposure, their unrealized valuation gains and losses are generally offset by unrealized losses and gains in our Agency RMBS AFS portfolio, which are recorded directly to stockholders' equity through other comprehensive (loss) income, net of tax, or to gain on investment securities, in the case of Agency interest-only securities.

77

Table of Contents

The following table provides the net interest spread and gains and losses associated with our interest rate swap and swaption positions:

(in thousands)	Year Ended December 31, 2014	2013
Net interest spread	$(91,754)	$(58,522)
Early termination, agreement maturation and option expiration losses	(55,389)	12,293
Change in unrealized (loss) gain on interest rate swap and swaption agreements, at fair value	(198,504)	291,458
(Loss) gain on interest rate swap and swaption agreements	$(345,647)	$245,229

(Loss) Gain on Other Derivative Instruments

Included in our financial results for the years ended December 31, 2014 and 2013 was the recognition of $17.5 million of losses and $95.3 million of gains, respectively, on other derivative instruments we held for purposes of both hedging and non-hedging activities, principally credit default swaps, TBAs, put and call options for TBAs, constant maturity swaps, Markit IOS total return swaps and inverse interest-only securities. Included within these year ended December 31, 2014 and 2013 results was the recognition of $30.2 million and $14.0 million of interest income, net of accretion on inverse interest-only securities on an average amortized cost basis of $188.8 million and $251.1 million, respectively. The remainder represented realized and unrealized gains and losses on other derivative instruments. As these derivative instruments are considered trading instruments, our financial results include both realized and unrealized gains (losses) associated with these instruments. Since our derivative instruments are generally used for purposes of hedging our interest rate and credit risk exposure, their unrealized valuation gains and losses are generally offset by unrealized losses and gains in our RMBS AFS and mortgage loan portfolios.

(Loss) Gain on Residential Mortgage Loans Held-for-Sale

For the years ended December 31, 2014 and 2013, we recorded gains on residential mortgage loans held-for-sale of $17.3 million and losses of $33.8 million, respectively. Included within these results was the recognition of gains of $12.6 million and losses of $13.8 million, respectively, on residential mortgage loans held-for-sale, and gains of $4.7 million and losses of $20.0 million on commitments to purchase residential mortgage loans held-for-sale for the years ended December 31, 2014 and 2013. The gains recorded on residential mortgage loans held-for-sale during the year ended December 31, 2014, as compared to the losses recorded during the year ended December 31, 2013, were due in part to falling interest rates during the year ended December 31, 2014, as compared to rising interest rates during the year ended December 31, 2013.

Servicing Income

For the year ended December 31, 2014, we recognized total servicing income of $128.2 million, which includes servicing fee income of $125.1 million, ancillary fee income of $2.2 million and float income of $0.9 million. For the year ended December 31, 2013, we recognized total servicing income of $12.0 million, which includes servicing fee income of $11.8 million and ancillary fee income of $0.2 million. The increase in servicing income for the year ended December 31, 2014, as compared to the year ended December 31, 2013 was the result of the significant growth of our MSR portfolio at the end of 2013.

(Loss) Gain on Servicing Asset

For the year ended December 31, 2014, loss on servicing asset of $128.4 million includes a decrease in fair value of MSR due to realization of cash flows (runoff) of $54.8 million and a decrease in fair value of MSR due to changes in valuation inputs or assumptions of $73.6 million. For the year ended December 31, 2013, gain on servicing asset of $13.9 million includes a decrease in fair value of MSR due to realization of cash flows (runoff) of $6.8 million and an increase in fair value of MSR due to changes in valuation inputs or assumptions of $20.7 million. The increase in (loss) gain on servicing asset for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of the significant growth in the size of the MSR portfolio outstanding during the respective

periods combined with changes in interest rates and prepayment assumptions.

78

Table of Contents

Other (Loss) Income

For the year ended December 31, 2014, we recorded other income of $18.5 million, which includes $41.1 million in gains on residential mortgage loans held-for-investment in securitization trusts and $24.3 million in losses on collateralized borrowings in securitization trusts. Also included in other income for the year ended December 31, 2014 was other mortgage loan revenue of $0.8 million and dividend income on our FHLB stock of $0.9 million. For the year ended December 31, 2013, we recorded other income of $14.6 million, which includes $22.9 million in losses on residential mortgage loans held-for-investment in securitization trusts and $37.1 million in gains on collateralized borrowings in securitization trusts. Also included in other income for the year ended December 31, 2013 was other mortgage loan revenue of $0.4 million. The increase in other income (decrease in other loss) for the year ended December 31, 2014, as compared to the year ended December 31, 2013, was due in part to falling interest rates during the year ended December 31, 2014.

Management Fees

We incurred management fees of $48.8 million and $41.7 million for the years ended December 31, 2014 and 2013, which are payable to PRCM Advisers under our management agreement. The management fee is calculated based on our stockholders' equity with certain adjustments outlined in the management agreement. However, these fees were reduced by $4.3 million, on the consolidated statement of comprehensive income for the year ended December 31, 2013, in accordance with the contribution transaction entered into with Silver Bay. See further discussion of the management fee calculation as well as this adjustment in Note 25 - Related Party Transactions of the notes to the consolidated financial statements.

Securitization Deal Costs

For the year ended December 31, 2014, we recognized $4.6 million in upfront costs related to the sponsoring of securitization trusts. For the year ended December 31, 2013, we recognized $2.1 million in upfront costs related to the sponsoring of a securitization trust, and $2.0 million in upfront costs related to the subordinated debt and excess servicing rights acquired from a securitization trust issued by a third party, which was paid upon settlement of the acquisitions. These costs are included when evaluating the economics of a securitization; however, the election of the fair value option for the assets and liabilities held in the securitization trusts requires the expense to be recognized upfront on the consolidated statements of comprehensive (loss) income. Changes in securitization deal costs are directly related to the number and size of securitization trusts sponsored by either third parties or our subsidiaries during the respective periods.

Servicing Expenses

For the year ended December 31, 2014, we recognized $25.9 million in servicing expenses generally related to the subservicing of residential mortgage loans held-for-sale and MSR, compared to $3.8 million for the year ended December 31, 2013. Included in servicing expenses for the year ended December 31, 2014 was MSR representation and warranty reserve expense of $1.8 million. The increase in servicing expenses during the year ended December 31, 2014, as compared to the year ended December 31, 2013, was the result of the significant growth in the size of the MSR portfolio outstanding during the respective periods.

Other Operating Expenses

For the years ended December 31, 2014 and 2013, we recognized $56.2 million and $37.3 million, respectively, of other operating expenses, which represents an expense ratio of 1.4% and 1.0% of average equity for the respective periods. The increase of our operating expense ratio resulted primarily from an increase in expenses related to the personnel, infrastructure and volume-based transaction costs to support our mortgage loan and MSR activities. Included in other operating expenses are direct and allocated costs incurred by PRCM Advisers on our behalf and reimbursed by us. For the years ended December 31, 2014 and 2013, these direct and allocated costs totaled approximately $15.5 million and $9.9 million, respectively. Included in these reimbursed costs was compensation paid to employees of Pine River serving as our executive officers, including our principal financial officer and general counsel of $1.8 million for the year ended December 31, 2014 and $0.8 million for the year ended December 31, 2013. The allocation of compensation paid to employees of Pine River serving as our principal financial officer and

general counsel is based on time spent overseeing our company's activities in accordance with the management agreement. Equity based compensation expense for the years ended December 31, 2014 and 2013 also includes the amortization of the restricted stock awarded to our executive officers in conjunction with the Plan (see discussion in Note 22 - Equity Incentive Plan), including our chief executive officer, chief investment officer, principal financial officer and general counsel of $6.6 million and $2.1 million, respectively.
We have an established accounts payable function and direct relationships with the majority of our third-party vendors. We will continue to have certain costs allocated to us by PRCM Advisers for compensation, data services and proprietary technology, but most of our expenses with third-party vendors are paid directly by us.

Table of Contents

Income Taxes

During the years ended December 31, 2014 and 2013, our TRSs recognized a benefit from income taxes of $73.7 million and a provision from income taxes of $84.4 million, respectively. The benefit in 2014 was primarily due to losses incurred on derivative instruments held in our TRSs, and the provision in 2013 was primarily due to income generated from derivative instruments held in our TRSs. We currently intend to distribute 100% of our REIT taxable income and comply with all requirements to continue to qualify as a REIT.

Financial Condition

Available-for-Sale Securities, at Fair Value

Agency RMBS

Our Agency RMBS AFS portfolio is comprised of adjustable rate and fixed rate mortgage-backed securities backed by single-family and multi-family mortgage loans. All of our principal and interest Agency RMBS AFS were Fannie Mae or Freddie Mac mortgage pass-through certificates or collateralized mortgage obligations that carry an implied rating of "AAA," or Ginnie Mae mortgage pass-through certificates, which are backed by the guarantee of the U.S. Government. The majority of these securities consist of whole pools in which we own all of the investment interests in the securities.

The tables below summarize certain characteristics of our Agency RMBS AFS securities at December 31, 2015 and December 31, 2014:

	December 31, 2015							
(dollars in thousands, except purchase price)	Principal/Current Face	Net (Discount) Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities:								
Fixed	$5,237,112	$354,134	$5,591,246	$82,591	$(37,450)	$5,636,387	4.40 %	$108.14
Hybrid/ARM	101,836	4,457	106,293	2,625	(322)	108,596	3.60 %	$106.06
Total P&I Securities	5,338,948	358,591	5,697,539	85,216	(37,772)	5,744,983	4.39 %	$108.10
Interest-only securities								
Fixed	299,682	(262,868)	36,814	1,810	(1,856)	36,768	4.23 %	$15.15
Fixed Other [(1)]	2,618,400	(2,422,915)	195,485	11,363	(15,709)	191,139	1.63 %	$9.23
Total	$8,257,030	$(2,327,192)	$5,929,838	$98,389	$(55,337)	$5,972,890		

	December 31, 2014							
(dollars in thousands, except purchase price)	Principal/Current Face	Net (Discount) Premium	Amortized Cost	Unrealized Gain	Unrealized Loss	Carrying Value	Weighted Average Coupon Rate	Weighted Average Purchase Price
Principal and interest securities:								
Fixed	$10,065,570	$639,377	$10,704,947	$209,952	$(26,651)	$10,888,248	4.34 %	$107.69
Hybrid/ARM	118,379	5,494	123,873	4,412	—	128,285	3.52 %	$106.11
Total P&I Securities	10,183,949	644,871	10,828,820	214,364	(26,651)	11,016,533	4.33 %	$107.67
Interest-only securities								

Fixed	377,179	(338,747)	38,432	9,705	(380)	47,757	4.27 %	$14.97
Fixed Other [1]	2,860,427	(2,639,265)	221,162	14,222	(7,357)	228,027	1.63 %	$9.25
Total	$13,421,555	$(2,333,141)	$11,088,414	$238,291	$(34,388)	$11,292,317		

(1) Fixed Other represents weighted-average coupon interest-only securities that are not generally used for our interest-rate risk management purposes. These securities pay variable coupon interest based on the weighted average of the fixed rates of the underlying loans of the security, less the weighted average rates of the applicable issued principal and interest securities.

Our three-month average CPR experienced by Agency RMBS AFS owned by us as of December 31, 2015 and December 31, 2014, on an annualized basis, was 10.2% and 7.4%, respectively.

80

Table of Contents

The following table summarizes the number of months until the next reset for our floating or adjustable rate Agency RMBS AFS portfolio at December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
0-12 months	$108,227	$125,280
13-36 months	369	2,081
37-60 months	—	924
Total	$108,596	$128,285

Non-Agency RMBS

Our non-Agency RMBS portfolio is comprised of senior and mezzanine tranches of mortgage-backed securities, and excludes the retained interests from our on-balance sheet securitizations, as they are eliminated in consolidation in accordance with U.S. GAAP. The following tables provide investment information on our non-Agency RMBS as of December 31, 2015 and December 31, 2014:

	As of December 31, 2015						
(in thousands)	Principal/current face	Accretable purchase discount	Credit reserve purchase discount	Amortized cost	Unrealized gain	Unrealized loss	Carrying value
Principal and interest securities:							
Senior	$1,801,283	$(383,816)	$(373,729)	$1,043,738	$275,565	$(5,608)	$1,313,695
Mezzanine	624,253	(98,729)	(35,348)	490,176	52,847	(10,451)	532,572
Total P&I Securities	2,425,536	(482,545)	(409,077)	1,533,914	328,412	(16,059)	1,846,267
Interest-only securities	229,845	(224,476)	—	5,369	794	—	6,163
Total	$2,655,381	$(707,021)	$(409,077)	$1,539,283	$329,206	$(16,059)	$1,852,430

	As of December 31, 2014						
(in thousands)	Principal/current face	Accretable purchase discount	Credit reserve purchase discount	Amortized cost	Unrealized gain	Unrealized loss	Carrying value
Principal and interest securities:							
Senior	$3,213,104	$(531,531)	$(843,106)	$1,838,467	$532,574	$(606)	$2,370,435
Mezzanine	794,798	(158,465)	(84,499)	551,834	119,624	(1,037)	670,421
Total P&I Securities	4,007,902	(689,996)	(927,605)	2,390,301	652,198	(1,643)	3,040,856
Interest-only securities	283,970	(277,372)	—	6,598	1,331	—	7,929
Total	$4,291,872	$(967,368)	$(927,605)	$2,396,899	$653,529	$(1,643)	$3,048,785

Table of Contents

The majority of our non-Agency RMBS were rated at December 31, 2015. Note that credit ratings are based on the par value of the non-Agency RMBS, whereas the distressed non-Agency RMBS assets in our portfolio were acquired at a heavily discounted price. The following table summarizes the credit ratings of our non-Agency RMBS portfolio, based on the Bloomberg Index Rating, a composite of each of the four major credit rating agencies (i.e., DBRS Ltd., Moody's Investors Services, Inc., Standard & Poor's Corporation and Fitch, Inc.), as of December 31, 2015 and December 31, 2014:

	December 31, 2015		December 31, 2014	
AAA	—	%	6.4	%
AA	—	%	—	%
A	0.1	%	—	%
BBB	0.1	%	0.7	%
BB	1.8	%	0.9	%
B	4.7	%	3.9	%
Below B	73.0	%	74.9	%
Not rated	20.3	%	13.2	%
Total	100.0	%	100.0	%

The size of our non-Agency RMBS portfolio has decreased by $1.2 billion since December 31, 2014 as we sold a number of securities, many of which were considered subprime. Our allocation of non-Agency RMBS to subprime securities has decreased from 73.0% at December 31, 2014 to 67.7% at December 31, 2015. As a result, our designated credit reserve as a percentage of total discount and total face value has also decreased (as disclosed in Note 5 - Available-for-Sale Securities, at Fair Value of the notes to the consolidated financial statements). When focused on principal and interest securities, from December 31, 2014 to December 31, 2015, our designated credit reserve as a percentage of total discount decreased from 57.3% to 45.9%, and our designated credit reserve as a percentage of total face value decreased from 23.1% to 16.9%. As our allocation of non-Agency RMBS to subprime securities has decreased over the period from December 31, 2014 to December 31, 2015, we believe these comparable portfolio metrics are reflective of our investment profile, regardless of portfolio size.

A subprime bond may generally be considered higher risk; however, if purchased at a discount that reflects a high expectation of credit losses, it could be viewed less risky than a prime bond, which is subject to unanticipated credit loss performance. Accordingly, we believe our risk profile in owning a heavily discounted subprime bond with known delinquencies affords us the ability to assume a higher percentage of expected credit loss with comparable risk-adjusted returns to a less discounted prime bond with a lower percentage of expected credit loss.

Within our non-Agency RMBS portfolio, we have historically had a substantial emphasis on "legacy" securities, which include securities issued prior to 2009, many subprime. We believe these deeply discounted securities can add relative value as the economy and housing markets continue to improve. There remains upside optionality to lower delinquencies, higher recoveries and faster prepays. Throughout the past year, however, we have sold a number of these securities that we believe had reached maximum value, some of which were replaced with "new issue" non-Agency RMBS. We believe these "new issue" securities, which include some GSE credit risk transfer securities, have enabled us to find attractive returns and further diversify our non-Agency RMBS portfolio.

Table of Contents

The following tables present certain information by investment type and, if applicable, their respective underlying loan characteristics for our senior and mezzanine non-Agency RMBS, excluding our non-Agency interest-only portfolio, at December 31, 2015 and December 31, 2014:

	At December 31, 2015		
Non-Agency Principal and Interest (P&I) RMBS	Senior	Mezzanine	Total P&I RMBS
Carrying Value (in thousands)	$1,313,695	$532,572	$1,846,267
% of Non-Agency Portfolio	71.2 %	28.8 %	100.0 %
Average Purchase Price [1]	$52.88	$79.01	$60.42
Average Coupon	2.8 %	3.0 %	2.9 %
Average Fixed Coupon	5.4 %	5.4 %	5.4 %
Average Floating Coupon	2.5 %	2.9 %	2.6 %
Average Hybrid Coupon	5.2 %	— %	5.2 %
Collateral Attributes			
Average Loan Age (months)	112	85	105
Average Loan Size (in thousands)	$361	$300	$346
Average Original Loan-to-Value	71.3 %	73.0 %	71.8 %
Average Original FICO [2]	634	695	649
Current Performance			
60+ day delinquencies	28.1 %	12.2 %	24.0 %
Average Credit Enhancement [3]	9.1 %	12.9 %	10.1 %
3-Month CPR [4]	4.4 %	10.7 %	6.2 %

	At December 31, 2014		
Non-Agency Principal and Interest (P&I) RMBS	Senior	Mezzanine	Total P&I RMBS
Carrying Value (in thousands)	$2,370,435	$670,421	$3,040,856
% of Non-Agency Portfolio	78.0 %	22.0 %	100.0 %
Average Purchase Price [1]	$56.45	$68.74	$59.16
Average Coupon	2.4 %	2.1 %	2.3 %
Average Fixed Coupon	4.2 %	5.7 %	4.3 %
Average Floating Coupon	1.9 %	2.0 %	1.9 %
Average Hybrid Coupon	5.2 %	— %	5.2 %
Collateral Attributes			
Average Loan Age (months)	91	93	91
Average Loan Size (in thousands)	$374	$304	$359
Average Original Loan-to-Value	70.1 %	71.5 %	70.4 %
Average Original FICO [2]	628	669	636
Current Performance			
60+ day delinquencies	27.4 %	20.2 %	25.9 %
Average Credit Enhancement [3]	8.4 %	18.0 %	10.4 %
3-Month CPR [4]	3.4 %	7.3 %	4.2 %

---

(1) Average purchase price utilized carrying value for weighting purposes. If current face were utilized for weighting purposes, the average purchase price for senior, mezzanine, and total non-Agency RMBS, excluding our non-Agency interest-only portfolio, would be $48.92, $75.63, and $55.80, respectively, at December 31, 2015 and $52.11, $65.59, and $54.78, respectively at December 31, 2014.

(2) FICO represents a mortgage industry accepted credit score of a borrower, which was developed by Fair Isaac Corporation.

(3)

Average credit enhancement remaining on our non-Agency RMBS portfolio, which is the average amount of protection available to absorb future credit losses due to defaults on the underlying collateral.

(4) Three-month CPR is reflective of the prepayment speed on the underlying securitization; however, it does not necessarily indicate the proceeds received on our investment tranche. Proceeds received for each security are dependent on the position of the individual security within the structure of each deal.

Table of Contents

(dollars in thousands)	December 31, 2015 Senior		Mezzanine		Total P&I RMBS	
Collateral Type	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
Prime	$82,775	6.3 %	$18,224	3.4 %	$100,999	5.5 %
Alt-A	59,049	4.5 %	21,638	4.1 %	80,687	4.4 %
POA	120,959	9.2 %	28,885	5.4 %	149,844	8.1 %
Subprime	1,050,912	80.0 %	200,210	37.6 %	1,251,122	67.7 %
Other	—	— %	263,615	49.5 %	263,615	14.3 %
Total	$1,313,695	100.0 %	$532,572	100.0 %	$1,846,267	100.0 %

(dollars in thousands)	December 31, 2014 Senior		Mezzanine		Total P&I RMBS	
Collateral Type	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
Prime	$290,893	12.3 %	$101,290	15.1 %	$392,183	12.9 %
Alt-A	79,785	3.3 %	23,873	3.6 %	103,658	3.4 %
POA	172,938	7.3 %	33,681	5.0 %	206,619	6.8 %
Subprime	1,826,819	77.1 %	391,952	58.5 %	2,218,771	73.0 %
Other	—	— %	119,625	17.8 %	119,625	3.9 %
Total	$2,370,435	100.0 %	$670,421	100.0 %	$3,040,856	100.0 %

(dollars in thousands)	December 31, 2015 Senior		Mezzanine		Total P&I RMBS	
Coupon Type	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
Fixed Rate	$156,864	11.9 %	$22,528	4.2 %	$179,392	9.7 %
Hybrid or Floating	1,156,831	88.1 %	510,044	95.8 %	1,666,875	90.3 %
Total	$1,313,695	100.0 %	$532,572	100.0 %	$1,846,267	100.0 %

(dollars in thousands)	December 31, 2014 Senior		Mezzanine		Total P&I RMBS	
Coupon Type	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
Fixed Rate	$466,624	19.7 %	$23,329	3.5 %	$489,953	16.1 %
Hybrid or Floating	1,903,811	80.3 %	647,092	96.5 %	2,550,903	83.9 %
Total	$2,370,435	100.0 %	$670,421	100.0 %	$3,040,856	100.0 %

(dollars in thousands)	December 31, 2015 Senior		Mezzanine		Total P&I RMBS	
Origination Year	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
2006+	$1,101,308	83.8 %	$323,868	60.8 %	$1,425,176	77.2 %
2002-2005	208,271	15.9 %	208,528	39.2 %	416,799	22.6 %
Pre-2002	4,116	0.3 %	176	— %	4,292	0.2 %
Total	$1,313,695	100.0 %	$532,572	100.0 %	$1,846,267	100.0 %

84

Table of Contents

(dollars in thousands)	December 31, 2014 Senior		Mezzanine		Total P&I RMBS	
Origination Year	Carrying Value	% of Senior Portfolio	Carrying Value	% of Mezzanine Portfolio	Carrying Value	% of Non-Agency Portfolio
2006+	$2,014,544	85.0 %	$265,267	39.6 %	$2,279,811	75.0 %
2002-2005	351,577	14.8 %	397,360	59.3 %	748,937	24.6 %
Pre-2002	4,314	0.2 %	7,794	1.1 %	12,108	0.4 %
Total	$2,370,435	100.0 %	$670,421	100.0 %	$3,040,856	100.0 %

The underlying mortgage loans collateralizing our non-Agency RMBS are located across the U.S. The following table presents the five largest geographic concentrations of the mortgages collateralizing these RMBS at December 31, 2015 and December 31, 2014:

	December 31, 2015		December 31, 2014	
(dollars in thousands)	Carrying Value	% of Non-Agency RMBS	Carrying Value	% of Non-Agency RMBS
California	$443,964	24.0 %	$790,489	25.9 %
New York	200,248	10.8 %	288,797	9.5 %
Florida	179,885	9.7 %	291,700	9.6 %
New Jersey	81,207	4.4 %	119,400	3.9 %
Texas	80,372	4.3 %	142,184	4.7 %
Total	$985,676	53.2 %	$1,632,570	53.6 %

Trading Securities, at Fair Value

From time to time, we hold U.S. Treasuries in a TRS and classify these securities as trading instruments due to short-term investment objectives. We did not have any U.S. Treasuries on our consolidated balance sheet as of December 31, 2015. As of December 31, 2014, we held U.S. Treasuries with an amortized cost of $2.0 billion and a fair value of $2.0 billion, classified as trading securities. The unrealized gains included within trading securities were $1.4 million as of December 31, 2014.

Residential Mortgage Loans Held-for-Sale, at Fair Value

We acquire prime nonconforming residential mortgage loans from select mortgage loan originators and secondary market institutions. As of December 31, 2015 and December 31, 2014, we held prime nonconforming residential mortgage loans with a carrying value of $764.3 million and $500.2 million, respectively, and had outstanding commitments to purchase $286.1 million and $554.8 million of residential mortgage loans, respectively, subject to fallout if the loans do not close. Our intention is to securitize these loans and/or exit through a whole loan sale.

In 2013, we acquired a portfolio of CSL, which are loans that were performing, but with respect to which the borrower had previously experienced payment delinquencies and was more likely to be underwater (i.e., the amount owed on a mortgage loan exceeds the current market value of the home). As a result, there is a higher probability of default than on newly originated residential mortgage loans. We subsequently sold substantially all of our CSL portfolio during the first quarter of 2014. As of December 31, 2015 and December 31, 2014, we had CSL with a carrying value of $11.0 million and $35.6 million remaining.

Additionally, as the owner of MSR on loans from securitizations guaranteed by Ginnie Mae, we are obligated to purchase these loans from time to time in order to complete modifications on the mortgage loans or to convey foreclosed properties to HUD. As of December 31, 2015, we held Ginnie Mae buyout residential mortgage loans with a carrying value of $36.1 million, which, in the majority of instances, will undergo successful loan modifications, return to performing loans and be redelivered to future Ginnie Mae pools or be immediately conveyed to HUD.

85

Table of Contents

The following tables present our residential mortgage loans held-for-sale portfolio by loan type as of December 31, 2015 and December 31, 2014:

	December 31, 2015			
(in thousands)	Unpaid Principal Balance	Fair Value - Purchase Price	Fair Value - Unrealized	Carrying Value
Prime nonconforming residential mortgage loans	$755,185	$15,678	$(6,545)	$764,318
Credit sensitive residential mortgage loans	19,173	(5,713)	(2,416)	11,044
Ginnie Mae buyout residential mortgage loans	38,303	(1,912)	(322)	36,069
Residential mortgage loans held-for-sale	$812,661	$8,053	$(9,283)	$811,431

	December 31, 2014			
(in thousands)	Unpaid Principal Balance	Fair Value - Purchase Price	Fair Value - Unrealized	Carrying Value
Prime nonconforming residential mortgage loans	$486,878	$10,730	$2,551	$500,159
Credit sensitive residential mortgage loans	47,223	(8,486)	(3,184)	35,553
Ginnie Mae buyout residential mortgage loans	—	—	—	—
Residential mortgage loans held-for-sale	$534,101	$2,244	$(633)	$535,712

Residential Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value

We purchase subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or our subsidiaries. The underlying residential mortgage loans held by the trusts, which are consolidated on our consolidated balance sheets, are classified as residential mortgage loans held-for-investment in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the consolidated financial statements for additional information regarding consolidation of the securitization trusts. As of December 31, 2015 and December 31, 2014, residential mortgage loans held-for-investment in securitization trusts had a carrying value of $3.2 billion and $1.7 billion, respectively.

Commercial Real Estate Assets

We originate and purchase commercial real estate debt and related instruments generally to be held as long-term investments. These assets are classified as commercial real estate assets on the condensed consolidated balance sheets. Additionally, we are the sole certificate holder of a trust entity that holds a commercial real estate loan. The underlying loan held by the trust is consolidated on our consolidated balance sheets and classified as commercial real estate assets. See Note 3 - Variable Interest Entities to the consolidated financial statements for additional information regarding consolidation of the trust. Commercial real estate assets are reported at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless the assets are deemed impaired. As of December 31, 2015, our commercial real estate assets were comprised of eighteen first mortgage and mezzanine commercial real estate loans with a carrying value of $661.0 million. We did not have any commercial real estate assets on our consolidated balance sheet as of December 31, 2014.

Mortgage Servicing Rights, at Fair Value

One of our wholly owned subsidiaries has approvals from Fannie Mae, Freddie Mac and Ginnie Mae to own and manage MSR, which represent the right to control the servicing of mortgage loans. We do not directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying our MSR. As of December 31, 2015 and December 31, 2014, our MSR had a fair market value of $493.7 million and $452.0 million, respectively.

86

Table of Contents

As of December 31, 2015 and December 31, 2014, our MSR portfolio included MSR on 245,144 and 224,073 loans with an unpaid principal balance of approximately $51.4 billion and $44.9 billion, respectively. The following tables summarize certain characteristics of the loans underlying our MSR at December 31, 2015 and December 31, 2014:

	At December 31, 2015			
	Government FHA [1]	Government VA/USDA [1]	Conventional Loans [2]	Total
Unpaid principal balance (in thousands)	$7,450,109	$2,555,552	$41,380,480	$51,386,141
Number of loans	52,502	13,881	178,761	245,144
Average Coupon	4.4 %	3.9 %	3.8 %	3.9 %
Average Loan Age (months)	57	45	30	35
Average Loan Size (in thousands)	$142	$184	$231	$210
Average Original Loan-to-Value	92.3 %	96.0 %	68.6 %	73.4 %
Average Original FICO	699	719	762	751
60+ day delinquencies	5.1 %	2.9 %	0.3 %	1.1 %
3-Month CPR	14.2 %	13.3 %	9.9 %	10.8 %

	At December 31, 2014			
	Government FHA [1]	Government VA/USDA [1]	Conventional Loans [2]	Total
Unpaid principal balance (in thousands)	$9,107,538	$3,058,051	$32,783,472	$44,949,061
Number of loans	61,071	16,022	146,980	224,073
Average Coupon	4.4 %	3.9 %	3.8 %	3.9 %
Average Loan Age (months)	45	33	26	31
Average Loan Size (in thousands)	$149	$191	$223	$201
Average Original Loan-to-Value	92.4 %	96.1 %	66.7 %	73.9 %
Average Original FICO	700	718	764	748
60+ day delinquencies	5.5 %	2.9 %	0.3 %	1.5 %
3-Month CPR	13.1 %	11.8 %	8.2 %	9.5 %

(1) Includes loans issued by Ginnie Mae.
(2) Includes loans issued by Fannie Mae, Freddie Mac or private investors.

Repurchase Agreements and Federal Home Loan Bank of Des Moines Advances

Our borrowings consist primarily of repurchase agreements and FHLB advances collateralized by our pledge of AFS and trading securities, derivative instruments, residential mortgage loans, commercial real estate assets and certain cash balances. Substantially all of our Agency RMBS AFS are currently pledged as collateral, and the majority of our non-Agency RMBS have been pledged, either through repurchase agreements or FHLB advances. As of December 31, 2015, the debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives only was 2.5:1.0. We believe our debt-to-equity ratio provides unused borrowing capacity and, thus, improves our liquidity and the strength of our balance sheet.

Table of Contents

As of December 31, 2015 and December 31, 2014, repurchase agreements and FHLB advances had the following characteristics:

(dollars in thousands)	December 31, 2015			December 31, 2014		
Collateral Type	Amount Outstanding	Weighted Average Borrowing Rate	Weighted Average Haircut on Collateral Value	Amount Outstanding	Weighted Average Borrowing Rate	Weighted Average Haircut on Collateral Value
U.S. Treasuries	$—	— %	— %	$1,996,250	0.23 %	0.5 %
Agency RMBS	5,586,480	0.62 %	6.9 %	10,577,735	0.40 %	6.0 %
Non-Agency RMBS [(1)]	2,261,504	1.53 %	23.6 %	2,395,615	1.74 %	28.7 %
Agency Derivatives	122,523	1.18 %	26.6 %	138,133	0.99 %	26.5 %
Residential mortgage loans held-for-sale	596,156	0.61 %	21.7 %	324,730	0.47 %	21.5 %
Commercial real estate assets	226,611	1.12 %	36.8 %	—	— %	— %
Total	$8,793,274	0.88 %	13.2 %	$15,432,463	0.60 %	9.3 %

(1) Includes repurchase agreements and FHLB advances collateralized by retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

As of December 31, 2015, we had outstanding $5.0 billion of repurchase agreements, and the term to maturity ranged from three days to over 6 months. Repurchase agreements had a weighted average borrowing rate of 1.10% and weighted average remaining maturities of 35 days as of December 31, 2015.

As of December 31, 2015, we had outstanding $3.8 billion of FHLB advances. As of December 31, 2015, the weighted average term to maturity of our FHLB advances was 154 months, ranging from approximately 12 months to 20 years. The weighted average cost of funds for our advances was 0.58% at December 31, 2015.

The following table provides the quarterly average balances, the quarter-end balances, and the maximum balances at any month-end within that quarterly period, of repurchase agreements and FHLB advances (total borrowings) for the three months ended December 31, 2015, and the four immediately preceding quarters:

(dollars in thousands)	Quarterly Average [(1)]	End of Period Balance [(1)]	Maximum Balance of Any Month-End [(1)]	Total Borrowings to Equity Ratio
For the Three Months Ended December 31, 2015	$9,601,484	$8,793,274	$10,091,255	2.5:1.0
For the Three Months Ended September 30, 2015	$12,480,799	$11,692,928	$12,701,289	3.1:1.0
For the Three Months Ended June 30, 2015	$12,809,115	$12,422,803	$12,763,673	3.1:1.0
For the Three Months Ended March 31, 2015	$13,598,611	$13,718,628	$13,843,240	3.4:1.0
For the Three Months Ended December 31, 2014	$12,726,721	$13,436,213	$13,436,213	3.3:1.0

(1) Includes repurchase agreements and FHLB advances collateralized by RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives and excludes repurchase agreements collateralized by U.S. Treasuries and collateralized borrowings in securitization trusts.

Collateralized Borrowings in Securitization Trusts, at Fair Value

We purchase subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or our subsidiaries. The underlying debt held by the trusts, which are consolidated on our consolidated balance sheets, is classified as collateralized borrowings in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities to the consolidated financial statements for additional information regarding consolidation of the securitization trusts. As of December 31, 2015 and December 31, 2014, collateralized borrowings in securitization trusts had a carrying value of $2.0 billion and $1.2 billion with a weighted average interest rate of 3.6% for both periods. The stated maturity dates for all collateralized borrowings are greater than five years from December 31, 2015.

88

Table of Contents

Net Economic Interests in Consolidated Securitization Trusts

The net of the underlying residential mortgage loans and the debt held by the securitization trusts discussed above represents the carrying value of the securities that we retained from these securitizations. Because we consolidate these securitization trusts on our consolidated balance sheets, our retained interests are eliminated in consolidation in accordance is U.S. GAAP. However, the carrying value, characteristics and performance of these securities and those of the underlying collateral are relevant to our portfolio as a whole.

The following table presents the carrying value and coupon of our net economic interests in consolidated securitization trusts and certain attributes of the underlying collateral as of December 31, 2015 and December 31, 2014:

	December 31, 2015		December 31, 2014	
Carrying Value (in thousands)	$1,169,894		$530,003	
Average Coupon	3.1	%	2.5	%
Collateral Attributes				
Average Loan Age (months)	16		17	
Average Loan Size (in thousands)	$826		$843	
Average Original Loan-to-Value	65.2	%	66.0	%
Average Original FICO	772		771	
Current Performance				
60+ day delinquencies	0.02	%	—	%

The following table summarizes the carrying values and credit ratings of our net economic interests in consolidated securitization trusts, based on a composite of credit ratings received from DBRS Ltd., Standard & Poor’s Corporation and/or Fitch, Inc. upon issuance of the securities, as of December 31, 2015 and December 31, 2014:

	December 31, 2015			December 31, 2014		
(dollars in thousands)	Carrying Value	% of Retained Portfolio		Carrying Value	% of Retained Portfolio	
AAA	$868,590	74.2	%	$320,807	60.5	%
AA	42,900	3.7	%	8,653	1.6	%
A	49,925	4.3	%	30,623	5.8	%
BBB	41,685	3.6	%	17,316	3.3	%
BB	28,438	2.4	%	18,041	3.4	%
B	—	—	%	—	—	%
Below B	—	—	%	—	—	%
Not rated	138,356	11.8	%	134,563	25.4	%
Total	$1,169,894	100.0	%	$530,003	100.0	%

Table of Contents

Equity

As of December 31, 2015, our stockholders' equity was $3.6 billion and our book value per share was $10.11. As of December 31, 2014, our stockholders' equity was $4.1 billion and our book value per share was $11.10.

The following table provides details of our changes in stockholders' equity from December 31, 2013 to December 31, 2015:

(dollars in millions, except per share amounts)	Book Value	Common Shares Outstanding	Book Value Per Share
Stockholders' equity at December 31, 2013	$3,855.0	364.9	$10.56
Reconciliation of Non-GAAP Measures to GAAP net income:			
Core Earnings, net of tax expense of $6.8 million [1]	343.8		
Realized gains and losses, net of tax benefit of $20.9 million	15.9		
Unrealized mark-to-market gains and losses, net of tax benefit of $59.6 million	(192.5)		
GAAP net income	167.2		
Other comprehensive income	411.0		
Dividend declaration	(380.8)		
Other	15.0	1.4	
Balance before capital transactions	4,067.4	366.3	
Repurchase of common stock	—	—	
Issuance of common stock, net of offering costs	0.6	0.1	
Stockholders' equity at December 31, 2014	$4,068.0	366.4	$11.10
Cumulative effect of adoption of new accounting principle	(3.0)		
Adjusted stockholders' equity at January 1, 2015	4,065.0		
Reconciliation of Non-GAAP Measures to GAAP net income:			
Core Earnings, net of tax expense of $0.2 million [1]	325.8		
Realized gains and losses, net of tax benefit of $24.6 million	134.6		
Unrealized mark-to-market gains and losses, net of tax expense of $7.9 million	31.8		
GAAP net income	492.2		
Other comprehensive loss	(496.7)		
Dividend declaration	(378.3)		
Other	9.0	1.1	
Balance before capital transactions	3,691.2	367.5	
Repurchase of common stock	(115.2)	(13.7)	
Issuance of common stock, net of offering costs	0.6	0.1	
Stockholders' equity at December 31, 2015	$3,576.6	353.9	$10.11

(1) Core Earnings is a non-U.S. GAAP measure that we define as GAAP net income, excluding "realized gains and losses" (impairment losses, realized gains or losses on the aggregate portfolio, amortization of business combination intangible assets, reserve expense for representation and warranty obligations on MSR and certain upfront costs related to securitization transactions) and "unrealized mark to market gains and losses" (unrealized gains and losses on the aggregate portfolio). As defined, Core Earnings includes interest income or expense and premium income or loss on derivative instruments and servicing income, net of estimated amortization on MSR. Core Earnings is provided for purposes of comparability to other peer issuers.

90

Table of Contents

U.S. GAAP to Taxable Income

The following tables provide reconciliations of our GAAP net (loss) income to our taxable (loss) income split between our REIT and taxable REIT subsidiaries for the years ended December 31, 2015 and December 31, 2014:

	Year Ended December 31, 2015			
(dollars in millions)	TRS	REIT	Securitization Trusts	Consolidated
GAAP net (loss) income, pre-tax	$(45.9)	$535.0	$(13.4)	$475.7
State taxes	(0.2)	—	—	(0.2)
Adjusted GAAP net (loss) income, pre-tax	(46.1)	535.0	(13.4)	475.5
Permanent differences				
Securitization trusts consolidated for U.S. GAAP purposes only	—	—	13.4	13.4
Other permanent differences	—	(2.2)	—	(2.2)
Temporary differences				
Net accretion of OID and market discount	(0.1)	(37.5)	—	(37.6)
Unrealized loss on trading securities and derivatives	(23.2)	(33.2)	—	(56.4)
Other temporary differences	0.3	(57.3)	—	(57.0)
Capital loss deferral	60.4	—	—	60.4
Net operating loss carryover	(16.1)	—	—	(16.1)
Taxable income	(24.8)	404.8	—	380.0
Dividend declaration deduction	—	(404.8)	—	(404.8)
Taxable (loss) income post-dividend deduction	$(24.8)	$—	$—	$(24.8)

	Year Ended December 31, 2014			
(dollars in millions)	TRS	REIT	Securitization Trusts	Consolidated
GAAP net income, pre-tax	$(214.7)	$308.7	$(0.6)	$93.4
Permanent differences				
Securitization trusts consolidated for U.S. GAAP purposes only	—	—	0.6	0.6
Other permanent differences	0.2	(2.0)	—	(1.8)
Temporary differences				
Net accretion of OID and market discount	(5.8)	38.1	—	32.3
Unrealized gain on trading securities and derivatives	175.4	54.3	—	229.7
Other temporary differences	2.3	(11.0)	—	(8.7)
Capital loss deferral	60.7	(50.1)	—	10.6
Net operating loss carryover	(3.8)	—	—	(3.8)
Taxable (loss) income	14.3	338.0	—	352.3
Dividend declaration deduction	—	(338.0)	—	(338.0)
Taxable loss post-dividend deduction	$14.3	$—	$—	$14.3

The permanent tax differences recorded in 2014 and 2015 include a recurring difference in the income recognized from the securitization trusts that are consolidated for U.S. GAAP purposes only. The permanent tax differences also include a recurring difference in compensation expense related to restricted stock dividends. Temporary differences are principally timing differences between U.S. GAAP and tax accounting related to unrealized gains and losses from derivative instruments and accretion and amortization from RMBS.

91

Table of Contents

Change in Accumulated Other Comprehensive Income

With our accounting treatment for AFS securities, unrealized fluctuations in the market values of AFS securities, excluding Agency interest-only securities and GSE credit risk transfer securities, do not impact our GAAP net income (loss) or taxable income but are recognized on our consolidated balance sheets as a change in stockholders' equity under "accumulated other comprehensive income." As a result of this fair value accounting through stockholders' equity, we expect our net income to have less significant fluctuations and result in less U.S. GAAP to taxable income timing differences, than if the portfolio were accounted for as trading instruments.

Dividends

For the 2015 taxable year, we declared dividends totaling $1.04 per share. As a REIT, we are required to distribute at least 90% of our taxable income to stockholders, subject to certain distribution requirements. For the fiscal year ended 2015, our board of directors elected to distribute the majority of our taxable income to avoid U.S. Federal Income taxes. As such, temporary differences between GAAP net income (loss) and taxable income can generate deterioration in book value on a permanent and temporary basis as taxable income is distributed that has not been earned for U.S. GAAP purposes. The following table presents cash dividends declared on our common stock for the fiscal years ended December 31, 2015, 2014 and 2013:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share [1]
December 16, 2015	December 30, 2015	January 20, 2016	$0.26
September 16, 2015	September 30, 2015	October 22, 2015	$0.26
June 17, 2015	June 30, 2015	July 21, 2015	$0.26
March 18, 2015	March 31, 2015	April 21, 2015	$0.26
December 16, 2014	December 30, 2014	January 20, 2015	$0.26
September 16, 2014	September 30, 2014	October 21, 2014	$0.26
June 17, 2014	July 2, 2014	July 22, 2014	$0.26
March 17, 2014	March 31, 2014	April 21, 2014	$0.26
December 17, 2013	December 27, 2013	December 31, 2013	$0.26
September 11, 2013	September 26, 2013	October 23, 2013	$0.28
June 18, 2013	June 28, 2013	July 23, 2013	$0.31
March 18, 2013	April 2, 2013	April 24, 2013	$0.32

(1) Per share amounts represent cash dividends only and exclude the distribution of Silver Bay common stock declared on March 18, 2013 and distributed on or about April 24, 2013 to our common stockholders of record as of April 2, 2013 amounting to $1.01 per share, as measured in accordance with U.S. GAAP.

The following table summarizes dividends declared for the years ended December 31, 2015, 2014 and 2013 and their related tax characterization (per share amounts):

		Tax Characterization of Dividends			
Year Ended December 31,	Dividends Declared	Ordinary Dividends (Non-Qualified)	Qualified Ordinary Dividends	Capital Gain Distribution	Nondividend Distribution
2015	$1.04	$0.40	$—	$0.64	$—
2014	$1.04	$0.96	$—	$0.08	$—
2013	$2.12	$1.03	$0.14	$—	$0.95

Equity Incentive Plan

Our Second Restated 2009 Equity Incentive Plan was approved by our stockholders on May 14, 2015. The Plan provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and its affiliates. The Plan is administered by the compensation committee of our board of directors. The Plan provides for grants of common stock, restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 13,000,000 shares. In addition, with respect to awards intended to qualify for relief from the limitations of Section 162(m) of the Code, the maximum number of shares that may underlie awards over any three-year period to any eligible person may not exceed 1,500,000 as options and 600,000 as other grants. Section 162(m) generally disallows a federal income tax deduction for any publicly held corporation with respect to compensation exceeding $1 million (on a per employee basis) paid in any year to the corporation’s chief executive officer or to any of the corporation’s three other most highly compensated executive officers, other than its chief financial officer. Because we do not have any employees, management does not believe that Section 162(m) is applicable to us and, therefore, does not currently consider and has not previously considered the effects of Section 162(m) with respect to the granting of awards under the Plan. As such, restricted stock awards granted to certain individuals, as previously disclosed in our proxy statements and other filings with the SEC, have exceeded 600,000 shares over a three year period, as permitted under the Plan. See Note 22 - Equity Incentive Plan for further details regarding the Plan.

Share Repurchase Program

As of December 31, 2015, our share repurchase program allowed for the repurchase of up to 25,000,000 shares of our common stock. (Subsequent to year end, our board of directors increased this authorization by 50,000,000 shares, or up to 75,000,000 shares under the program). Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, or by any combination of such methods. The manner, price, number and timing of share repurchases are subject to a variety of factors, including market conditions and applicable SEC rules. The share repurchase program does not require the purchase of any minimum number of shares, and purchases may be commenced or suspended at any time without prior notice. The share repurchase program does not have an expiration date. As of December 31, 2015, a total of 16,115,000 shares had been repurchased under the program for an aggregate cost of $139.1 million; of these, 13,664,300 shares were repurchased for a total cost of $115.2 million during the year ended December 31, 2015. No shares were repurchased during the year ended December 31, 2014. The remaining 2,450,700 shares were repurchased during the year ended December 31, 2013 for a total cost of $23.9 million.

Liquidity and Capital Resources

Our liquidity and capital resources are managed and forecast on a daily basis. We believe this ensures that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls, and that we have the flexibility to manage our portfolio to take advantage of market opportunities.

Our principal sources of cash consist of borrowings under repurchase agreements and FHLB advances, payments of principal and interest we receive on our target assets, cash generated from our operating results, and proceeds from capital market transactions. We typically use cash to repay principal and interest on our repurchase agreements, to purchase our target assets, to make dividend payments on our capital stock, and to fund our operations.

To the extent that we raise additional equity capital through capital market transactions, we anticipate using cash proceeds from such transactions to purchase additional RMBS, residential mortgage loans, MSR, commercial real estate assets and other target assets, and for other general corporate purposes.

As of December 31, 2015, we held $737.8 million in cash and cash equivalents available to support our operations; $13.2 billion of AFS securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, commercial real estate assets, MSR and derivative assets; and $10.8 billion of outstanding debt in the form of repurchase agreements, FHLB advances and collateralized borrowings in

securitization trusts. During the year ended December 31, 2015, our total consolidated debt-to-equity ratio decreased from 4.1:1.0 to 3.0:1.0. The debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives only also decreased from 3.3:1.0 to 2.5:1.0 due to the repayment of repurchase agreements as a result of sales of AFS securities during the year ended December 31, 2015. We believe the debt-to-equity ratio funding our RMBS AFS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives is the most meaningful debt-to-equity measure as U.S. Treasuries are viewed to be highly liquid in nature and collateralized borrowings on residential mortgage loans held-for-investment in securitization trusts represents term financing with no stated maturity.

As of December 31, 2015, we had approximately $40.9 million of unpledged Agency RMBS AFS and Agency Derivatives and $48.9 million of unpledged non-Agency securities and retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP. As a result, we had an overall estimated unused borrowing capacity on unpledged RMBS and retained interests of approximately $71.7 million. We also had approximately $18.9 million of unpledged prime nonconforming residential mortgage loans, $11.0 million of unpledged CSL and $36.1 million of unpledged Ginnie Mae buyout residential mortgage loans and an overall estimated unused borrowing capacity on unpledged residential mortgage loans held-for-sale of approximately $17.0 million. As of December 31, 2015, we we had approximately $43.9 million of unpledged mezzanine commercial real estate loans, $255.9 million of unpledged commercial real estate first mortgages, and an overall estimated unused borrowing capacity on unpledged commercial real estate assets of approximately $170.7 million. On a daily basis, we monitor and forecast our available, or excess, liquidity. Additionally, we frequently perform shock analyses against various market events to monitor the adequacy of our excess liquidity. If borrowing rates and/or collateral requirements change in the near term, we believe we are subject to less earnings volatility than a more leveraged organization.

During the year ended December 31, 2015, we did not experience any restrictions to our funding sources, although balance sheet capacity of counterparties tightened due to compliance with the Basel III regulatory capital reform rules as well as management of perceived risk in the volatile interest rate environment. We expect ongoing sources of financing to be primarily repurchase agreements, FHLB advances and similar financing arrangements. We plan to finance our assets with a moderate amount of leverage, the level of which may vary based upon the particular characteristics of our portfolio and market conditions.

As of December 31, 2015, we have master repurchase agreements in place with 30 counterparties (lenders), the majority of which are U.S. domiciled financial institutions, and we continue to evaluate further counterparties to manage and reduce counterparty risk. Under our repurchase agreements, we are required to pledge additional assets as collateral to our lenders when the estimated fair value of the existing pledged collateral under such agreements declines and such lenders, through a margin call, demand additional collateral. Lenders generally make margin calls because of a perceived decline in the value of our assets collateralizing the repurchase agreements. This may occur following the monthly principal reduction of assets due to scheduled amortization and prepayments on the underlying mortgages, or may be caused by changes in market interest rates, a perceived decline in the market value of the investments and other market factors. To cover a margin call, we may pledge additional securities or cash. At maturity, any cash on deposit as collateral is generally applied against the repurchase agreement balance, thereby reducing the amount borrowed. Should the value of our assets suddenly decrease, significant margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes our repurchase agreements and counterparty geographical concentration at December 31, 2015 and December 31, 2014:

	December 31, 2015			December 31, 2014		
(dollars in thousands)	Amount Outstanding	Net Counterparty Exposure[1]	Percent of Funding	Amount Outstanding	Net Counterparty Exposure[1]	Percent of Funding
North America	$3,381,616	$693,667	67.0 %	$8,331,244	$974,519	57.9 %
Europe [2]	1,125,944	303,206	29.3 %	2,950,991	604,711	35.9 %
Asia [2]	500,714	38,912	3.7 %	1,650,228	103,571	6.2 %
Total	$5,008,274	$1,035,785	100.0 %	$12,932,463	$1,682,801	100.0 %

(1) Represents the net carrying value of the securities, residential mortgage loans held-for-sale and commercial real estate assets sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. Payables due to broker counterparties for unsettled securities purchases are not included in the amounts presented above.

However, at both December 31, 2015 and December 31, 2014, we did not have any such payables.

(2) Exposure to European- and Asian-domiciled banks and their U.S. subsidiaries.

Table of Contents

In addition to our master repurchase agreements to fund our RMBS and commercial real estate assets, we have three facilities that provide short-term financing for our residential mortgage loans held-for-sale and other commercial real estate assets. An overview of the facilities is presented in the tables below:

(dollars in thousands)
As of December 31, 2015

Expiration Date		Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
May 10, 2016	(1)	No	$—	$50,000	$50,000	Residential mortgage loans held-for-sale
May 19, 2016	(1)	No	$8,510	$491,490	$500,000	Residential mortgage loans held-for-sale
December 3, 2017	(1)	No	$—	$250,000	$250,000	Commercial real estate assets

(dollars in thousands)
As of December 31, 2014

Expiration Date	Committed	Amount Outstanding	Unused Capacity	Total Capacity	Eligible Collateral
May 12, 2015	No	$9,234	$90,766	$100,000	Residential mortgage loans held-for-sale
May 21, 2015	No	$5,879	$194,121	$200,000	Residential mortgage loans held-for-sale

(1) The facilities are set to mature on the stated expiration date, unless extended pursuant to their terms.

Our wholly owned subsidiary, TH Insurance, is a member of the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of December 31, 2015, TH Insurance had $3.8 billion in outstanding secured advances with a weighted average borrowing rate of 0.6%, and had an additional $215.0 million of available uncommitted capacity for borrowings. To the extent TH Insurance has uncommitted capacity, it may be adjusted at the sole discretion of the FHLB.

The ability to borrow from the FHLB is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB’s credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, commercial real estate loans, Agency RMBS and certain non-Agency RMBS with a rating of A and above.

In January 2016, the FHFA released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the ruling excludes captive insurers from membership eligibility, including our subsidiary member, TH Insurance Holdings Company LLC, or TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a five-year membership grace period, during which new advances or renewals that mature beyond the grace period will be prohibited. However, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as we maintain good standing with the FHLB. If any new advances or renewals occur, TH Insurance’s outstanding advances will be limited to forty percent of its total assets. Notwithstanding the FHFA’s ruling, we continue to believe our mission aligns well with that of the Federal Home Loan Bank system.

We are subject to a variety of financial covenants under our lending agreements. The following represents the most restrictive covenant calculations across the agreements as of December 31, 2015:

•

- Total indebtedness to net worth must be less than the specified threshold ratio in the repurchase agreement. As of December 31, 2015, our debt to net worth, as defined, was 3.0:1.0 while our threshold ratio, as defined, was 4.5:1.0.
- Liquidity must be greater than the sum of 1.5% of indebtedness related to Agency securities and 5.0% of total indebtedness, excluding indebtedness related to Agency securities. As of December 31, 2015, our liquidity, as defined, was $1.1 billion.
- Net worth must be greater than the sum of $1.75 billion plus 40% of the aggregate net cash proceeds of any additional equity issuances made and capital contributions received. As of December 31, 2015, our net worth, as defined, was $3.6 billion.

Table of Contents

We are also subject to additional financial covenants in connection with various other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants.
The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements and FHLB advances.

(in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities, at fair value	$7,767,074	$14,159,315
Trading securities, at fair value	—	1,997,656
Residential mortgage loans held-for-sale, at fair value	745,454	416,779
Commercial real estate assets	361,130	—
Net economic interests in consolidated securitization trusts (1)	1,138,312	367,468
Cash and cash equivalents	15,000	14,117
Restricted cash	119,310	112,435
Due from counterparties	10,211	38,200
Derivative assets, at fair value	157,879	185,067
Total	$10,314,370	$17,291,037

(1) Includes the retained interests from our on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

Although we generally intend to hold our target assets as long-term investments, we may sell certain of our assets in order to manage our interest rate risk and liquidity needs, to meet other operating objectives and to adapt to market conditions. Our RMBS are generally publicly traded and, thus, readily liquid. However, certain of our assets, including residential mortgage loans, commercial real estate assets and MSR, are subject to longer trade timelines, and, as a result, market conditions could significantly and adversely affect the liquidity of our assets. Any illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises. Our ability to quickly sell certain assets, such as residential mortgage loans, commercial real estate assets and MSR, may be limited by delays encountered while obtaining certain regulatory approvals required for such dispositions and may be further limited by delays due to the time period needed for negotiating transaction documents, conducting diligence, and complying with regulatory requirements regarding the transfer of such assets before settlement may occur. Consequently, even if we identify a buyer for our residential mortgage loans, commercial real estate assets and MSR, there is no assurance that we would be able to quickly sell such assets if the need or desire arises.
In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we previously recorded our assets. Assets that are illiquid are more difficult to finance, and to the extent that we use leverage to finance assets that become illiquid, we may lose that leverage or have it reduced. Assets tend to become less liquid during times of financial stress, which is often the time that liquidity is most needed. As a result, our ability to sell assets or vary our portfolio in response to changes in economic and other conditions may be limited by liquidity constraints, which could adversely affect our results of operations and financial condition.
We cannot predict the timing and impact of future sales of our assets, if any. Because many of our assets are financed with repurchase agreements and FHLB advances, and may be financed with credit facilities (including term loans and revolving facilities), a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization are used to repay balances under these financing sources.

Table of Contents

The following table provides the maturities of our repurchase agreements and FHLB advances as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Within 30 days	$2,689,363	$4,013,055
30 to 59 days	1,739,237	4,595,425
60 to 89 days	161,449	903,286
90 to 119 days	175,486	434,550
120 to 364 days [1]	242,739	1,929,164
One to three years	651,238	744,459
Three to five years	815,024	815,024
Five to ten years	—	—
Ten years and over	2,318,738	1,000,000
Open maturity [2]	—	997,500
Total	$8,793,274	$15,432,463

(1) As of December 31, 2015, 120 to 364 days includes the amounts outstanding under the uncommitted mortgage loan warehouse facilities.

(2) Includes repurchase agreements collateralized by U.S. Treasuries with an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.

For the year ended December 31, 2015, our unrestricted cash balance decreased approximately $268.0 million to $737.8 million at December 31, 2015. The cash movements can be summarized by the following:

- Cash flows from operating activities. For the year ended December 31, 2015, operating activities decreased our cash balances by approximately $1.9 billion, primarily driven by purchases of residential mortgage loans held-for-sale, offset by our financial results for the year.
- Cash flows from investing activities. For the year ended December 31, 2015, investing activities increased our cash balances by approximately $8.0 billion, primarily driven by sales of AFS and trading securities.
- Cash flows from financing activities. For the year ended December 31, 2015, financing activities decreased our cash balance by approximately $6.3 billion, primarily driven by repayment of repurchase agreements due to sales of AFS and trading securities.

Off-Balance Sheet Arrangements

We have not participated in transactions that create relationships with unconsolidated entities or financial partnerships which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities. However, as of December 31, 2015, we had unfunded commitments on commercial real estate loans held-for-investment of $52.2 million to be used for future fundings to borrowers, generally to finance lease-related or capital expenditures.

Table of Contents

Aggregate Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements, our non-cancelable office lease and management fees payable under our management agreement:

	Due During the Year Ended December 31,						
(in thousands)	2016	2017	2018	2019	2020	Thereafter	Total
Repurchase agreements	$5,008,274	$—	$—	$—	$—	$—	$5,008,274
Federal Home Loan Bank advances	—	651,238	—	815,024	—	2,318,738	3,785,000
Interest expense on borrowings [1]	29,009	19,268	18,435	15,404	13,107	254,406	349,629
Long-term operating lease obligations	2,121	1,468	1,187	1,205	1,223	1,765	8,969
Management fee - PRCM Advisers [2]	189,926	—	—	—	—	—	189,926
Unfunded commitments on commercial real estate loans [3]	18,695	33,539	—	—	—	—	52,234
Total	$5,248,025	$705,513	$19,622	$831,633	$14,330	$2,574,909	$9,394,032

(1) Interest expense on borrowings, including repurchase agreements and FHLB advances, are calculated based on rates at December 31, 2015.

(2) Contractual obligation for the management fee is estimated through the contract expiration date of October 28, 2016, inclusive of the termination fee as defined in the management agreement between us and PRCM Advisers. Disclosure assumes agreement not renewed or terminated without cause.

(3) Allocation of unfunded commitments on commercial real estate loans held-for-investment is based on the earlier of the commitment expiration date or the loan maturity date.

We are party to a management agreement with PRCM Advisers, pursuant to which PRCM Advisers is entitled to receive a management fee and the reimbursement of certain expenses from us. We reimburse PRCM Advisers for (i) our allocable share of the compensation paid by PRCM Advisers to its personnel serving as our principal financial officer and general counsel and personnel employed by PRCM Advisers as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to us, and (ii) any amounts for personnel of PRCM Advisers' affiliates arising under a shared facilities and services agreement. We also have certain costs allocated to us by PRCM Advisers for data services and proprietary technology, but most direct expenses with third-party vendors are paid directly by us.

We are also party to contracts that contain a variety of indemnification obligations, principally with brokers, underwriters and counterparties to repurchase agreements and investors in the RMBS we issue and the loans underlying our MSR assets. The maximum potential future payment amount we could be required to pay under these indemnification obligations may be unlimited.

Recently Issued Accounting Standards

Refer to Note 2 of the notes to the consolidated financial statements included in Item 8 of this Form 10-K.

Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with U.S. GAAP and dividends are based upon net ordinary income and capital gains as calculated for tax purposes; in each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

Table of Contents

Other Matters

We intend to conduct our business so as to maintain our exempt status under, and not to become regulated as an investment company for purposes of the 1940 Act. If we failed to maintain our exempt status under the 1940 Act and became regulated as an investment company, our ability to, among other things, use leverage would be substantially reduced and, as a result, we would be unable to conduct our business as described in Item 1 - Business - Other Business - Regulation of this Form 10-K. Accordingly, we monitor our compliance with both the 55% Test and the 80% Tests of the 1940 Act in order to maintain our exempt status. As of December 31, 2015, we determined that we maintained compliance with both the 55% Test and the 80% Test requirements.

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the year ended December 31, 2015. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the year ended December 31, 2015. Consequently, we met the REIT income and asset tests. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, for the year ended December 31, 2015, we believe that we qualified as a REIT under the Code.

The recently enacted Protecting Americans from Tax Hikes Act of 2015 contains changes to certain aspects of the U.S. federal income tax rules applicable to REITs. In particular, the act will reduce the maximum allowable value of assets attributable to our TRSs from 25% to 20%, which change will be applicable with respect to tax years beginning after December 31, 2017. We currently monitor our compliance with this TRS asset test and, in light of this change, we intend to continue to meet the requirement.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while providing an opportunity to stockholders to realize attractive risk-adjusted total return through ownership of our capital stock. Although we do not seek to avoid risk completely, we believe that risk can be quantified from historical experience and we seek to manage our risk levels in order to earn sufficient compensation to justify the risks we undertake and to maintain capital levels consistent with taking such risks.

To reduce the risks to our portfolio, we employ portfolio-wide and asset-specific risk measurement and management processes in our daily operations. PRCM Advisers and its affiliates' risk management tools include software and services licensed or purchased from third parties and proprietary software and analytical methods developed by Pine River. There can be no guarantee that these tools will protect us from market risks.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and related financing obligations. Subject to maintaining our qualification as a REIT, we engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the values of our assets.

We may utilize U.S. Treasuries as well as derivative financial instruments, which during the year ended December 31, 2015 were limited to interest rate swaps, swaptions, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, Markit IOS total return swaps and, to a certain extent, inverse interest-only securities, to hedge the interest rate risk associated with our portfolio. In addition, because MSR are negative duration assets, they provide a natural hedge to interest rate exposure on our RMBS portfolio. We seek to hedge interest rate risk with respect to both the fixed income nature of our assets and the financing of our portfolio. In hedging interest rates with respect to our fixed income assets, we seek to reduce the risk of losses on the value of our investments that may result from changes in interest rates in the broader markets. In utilizing interest rate hedges with respect to our financing, we seek to improve risk-adjusted returns and, where possible, to obtain a favorable spread between the yield on our assets and the cost of our financing. We implement part of our hedging strategy through our TRSs, which are subject to U.S. federal, state and, if applicable, local income tax.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate RMBS and residential mortgage loans held-for-sale will remain static. Moreover, interest rates may rise at a faster pace than the yields earned on our leveraged adjustable-rate and hybrid RMBS and adjustable-rate residential mortgage loans held-for-sale. Both of these factors could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Table of Contents

Our hedging techniques are partly based on assumed levels of prepayments of our target assets. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.
We acquire adjustable-rate and hybrid RMBS. These are assets in which some of the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate and hybrid RMBS could effectively be limited by caps. This issue will be magnified to the extent we acquire adjustable-rate and hybrid RMBS that are not based on mortgages that are fully indexed. In addition, adjustable-rate and hybrid RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. If this happens, we could receive less cash income on such assets than we would need to pay for interest costs on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.
We also acquire adjustable-rate residential mortgage loans held-for-sale. These assets are typically subject to periodic and lifetime interest rate caps and floors, which may limit the amount by which the loan's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements are not subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation, while the interest-rate yields on our adjustable-rate residential mortgage loans held-for-sale could effectively be limited by caps.
Interest Rate Mismatch Risk
We fund the majority of our adjustable-rate and hybrid Agency RMBS, adjustable-rate residential mortgage loans held-for-sale and commercial real estate assets with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to other index rates, such as the one-year Constant Maturity Treasury index, or CMT, the Monthly Treasury Average index, or MTA, or the 11th District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to these indices may result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we utilize the hedging strategies discussed above.
The following table provides the indices of our variable rate RMBS AFS, residential mortgage loans held-for-sale and commercial real estate assets as of December 31, 2015 and December 31, 2014, respectively, based on carrying value (dollars in thousands).

	As of December 31, 2015				As of December 31, 2014			
Index Type	Floating	Hybrid [1]	Total	Index %	Floating	Hybrid [1]	Total	Index %
CMT	$1,625	$98,645	$100,270	4 %	$1,121	$115,619	$116,740	4 %
LIBOR	2,488,117	38,698	2,526,815	93 %	2,762,807	42,530	2,805,337	93 %
Other [2]	68,138	17,031	85,169	3 %	68,244	19,228	87,472	3 %
Total	$2,557,880	$154,374	$2,712,254	100 %	$2,832,172	$177,377	$3,009,549	100 %

(1) "Hybrid" amounts reflect those assets with greater than twelve months to reset.
(2) "Other" includes COFI, MTA and other indices.

Our analysis of risks is based on PRCM Advisers' and its affiliates' experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of decisions by PRCM Advisers may produce results that differ significantly from the

estimates and assumptions used in our models.

Table of Contents

We use a variety of recognized industry models, as well as proprietary models, to perform sensitivity analyses which are derived from primary assumptions for prepayment rates, discount rates and credit losses. The primary assumption used in this model is implied market volatility of interest rates. The information presented in the following interest rate sensitivity table projects the potential impact of sudden parallel changes in interest rates on our financial results and financial condition over the next twelve months, based on our interest sensitive financial instruments at December 31, 2015.

All changes in value are measured as the change from the December 31, 2015 financial position. All projected changes in annualized net interest income are measured as the change from the projected annualized net interest income based off current performance returns.

	Changes in Interest Rates			
(dollars in thousands)	-100 bps	-50 bps	+50 bps	+100 bps
Change in value of financial position:				
Available-for-sale securities	$248,749	$136,968	$(152,353)	$(328,671)
As a % of December 31, 2015 equity	7.0%	3.8%	(4.3)%	(9.2)%
Residential mortgage loans held-for-sale	$36,207	$22,071	$(24,840)	$(50,656)
As a % of December 31, 2015 equity	1.0%	0.6%	(0.7)%	(1.4)%
Residential mortgage loans held-for-investment in securitization trusts	$148,256	$91,221	$(102,051)	$(206,365)
As a % of December 31, 2015 equity	4.2%	2.6%	(2.9)%	(5.8)%
Commercial real estate assets	$42	$21	$(120)	$(241)
As a % of December 31, 2015 equity	—%	—%	—%	—%
Mortgage servicing rights	$(153,303)	$(53,648)	$31,751	$53,642
As a % of December 31, 2015 equity	(4.3)%	(1.5)%	0.9%	1.5%
Derivatives, net	$(268,432)	$(108,592)	$101,520	$234,723
As a % of December 31, 2015 equity	(7.5)%	(3.0)%	2.8%	6.6%
Repurchase agreements	$(2,683)	$(2,367)	$2,448	$4,896
As a % of December 31, 2015 equity	(0.1)%	(0.1)%	0.1%	0.1%
Collateralized borrowings in securitization trusts	$(102,336)	$(60,530)	$66,333	$134,457
As a % of December 31, 2015 equity	(2.9)%	(1.7)%	1.9%	3.8%
Federal Home Loan Bank advances	$(2,234)	$(1,802)	$1,880	$3,760
As a % of December 31, 2015 equity	(0.1)%	—%	0.1%	0.1%
Total net assets	$(95,734)	$23,342	$(75,432)	$(154,455)
As a % of December 31, 2014 total assets	(0.7)%	0.2%	(0.5)%	(1.1)%
As a % of December 31, 2015 equity	(2.7)%	0.7%	(2.1)%	(4.3)%
	-100 bps	-50 bps	+50 bps	+100 bps
Change in annualized net interest income:	$(13,619)	$(6,439)	$6,101	$12,201
% change in net interest income	(3.8)%	(1.8)%	1.7%	3.4%

The interest rate sensitivity table quantifies the potential changes in net interest income and portfolio value, which includes the value of swaps and our other derivatives, should interest rates immediately change. The interest rate sensitivity table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with the portfolio for each rate change are calculated based on assumptions, including prepayment speeds, yield on future acquisitions, slope of the yield curve, and size of the portfolio. Assumptions made on the interest rate sensitive liabilities include anticipated interest rates, collateral requirements as a percentage of borrowings and amount and term of borrowing.

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other

events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at December 31, 2015. The analysis utilizes assumptions and estimates based on management's judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

Table of Contents

The change in annualized net interest income does not include any benefit or detriment from faster or slower prepayment rates on our Agency premium RMBS, non-Agency discount RMBS, and instruments that represent the interest payments (but not the principal) on a pool of mortgages, or interest-only securities. We anticipate that faster prepayment speeds in lower interest rate scenarios will generate lower realized yields on Agency and non-Agency premium and interest-only securities and higher realized yields on Agency and non-Agency discount RMBS. Similarly, we anticipate that slower prepayment speeds in higher interest rate scenarios will generate higher realized yields on Agency premium and interest-only securities and lower realized yields on non-Agency discount RMBS. Although we have sought to construct the portfolio to limit the effect of changes in prepayment speeds, there can be no assurance this will actually occur, and the realized yield of the portfolio may be significantly different than we anticipate in changing interest rate scenarios.

Given the low interest rate environment at December 31, 2015, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayment speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and interest-only securities purchased at a premium, and accretion of discount on our non-Agency RMBS purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

Prepayment Risk

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated. As we receive prepayments of principal on our RMBS assets, premiums paid on such assets will be amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the assets. Conversely, discounts on such assets are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the assets.

We believe that we will be able to reinvest proceeds from scheduled principal payments and prepayments at acceptable yields; however, no assurances can be given that, should significant prepayments occur, market conditions would be such that acceptable investments could be identified and the proceeds timely reinvested.

MSR are also subject to prepayment risk in that, generally, an increase in prepayment rates would result in a decline in value of the MSR.

Market Risk

Market Value Risk. Our AFS securities are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value for all AFS securities except Agency interest-only securities and GSE credit risk transfer securities reflected in accumulated other comprehensive income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, market valuation of credit risks, and other factors. Generally, in a rising interest rate environment, we would expect the fair value of these securities to decrease; conversely, in a decreasing interest rate environment, we would expect the fair value of these securities to increase. As market volatility increases or liquidity decreases, the fair value of our assets may be adversely impacted.

Our residential mortgage loans held-for-sale and held-for-investment are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates, market valuation of credit risks and other factors. Generally in a rising rate environment, we would expect the fair value of these loans to decrease; conversely, in a decreasing rate environment, we would expect the fair value of these loans to increase. However, the fair value of the CSL and Ginnie Mae buyout residential mortgage loans included in residential mortgage loans held-for-sale is generally less sensitive to interest rate changes.

Our MSR are reflected at their estimated fair value. The estimated fair value fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, we would expect prepayments to decrease, resulting in an increase in the fair value of our MSR. Conversely, in a decreasing interest rate environment, we would expect prepayments to increase, resulting in a decline in fair value.

Real estate risk. Both residential and commercial property values are subject to volatility and may be affected adversely by a number of factors, including national, regional and local economic conditions; local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; retroactive changes to building or similar codes; and natural disasters and other catastrophes. Decreases in property values reduce the value of the collateral for residential mortgage and commercial real estate loans and the potential proceeds available to borrowers to repay the loans, which could cause us to suffer losses on our non-Agency RMBS investments, residential mortgage loans and commercial real estate assets.

102

Table of Contents

Liquidity Risk

Our liquidity risk is principally associated with our financing of long-maturity assets with shorter-term borrowings in the form of repurchase agreements and FHLB advances. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

Should the value of our assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Additionally, if the FHLB or one or more of our repurchase agreement counterparties chose not to provide ongoing funding, our ability to finance would decline or exist at possibly less advantageous terms. As such, we cannot assure that we will always be able to roll over our repurchase agreements and FHLB advances. See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources” in this Annual Report on Form 10-K for further information about our liquidity and capital resource management.

Credit Risk

We believe that our investment strategy will generally keep our risk of credit losses low to moderate. However, we retain the risk of potential credit losses on all of the loans underlying our non-Agency RMBS and on our residential mortgage and commercial real estate loans. With respect to our non-Agency RMBS that are senior in the credit structure, credit support contained in RMBS deal structures provide a level of protection from losses. We seek to manage the remaining credit risk through our pre-acquisition due diligence process, which includes comprehensive underwriting, and by factoring assumed credit losses into the purchase prices we pay for non-Agency RMBS, residential mortgage loans and commercial real estate assets. In addition, with respect to any particular target asset, we evaluate relative valuation, supply and demand trends, shape of yield curves, prepayment rates, delinquency and default rates, recovery of various sectors and vintage of collateral. We further mitigate credit risk in our residential mortgage and commercial real estate loan portfolios through (i) selecting servicers whose specialties are well matched against the underlying attributes of the borrowers contained in the loan pools, and (ii) an actively managed internal servicer oversight and surveillance program. At times, we enter into credit default swaps or other derivative instruments in an attempt to manage our credit risk. Nevertheless, unanticipated credit losses could adversely affect our operating results.

Table of Contents

Item 8. Financial Statements and Supplementary Data

TWO HARBORS INVESTMENT CORP.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES

	Page
Report of Independent Registered Public Accounting Firm	105
Consolidated Balance Sheets at December 31, 2015 and 2014	106
Consolidated Statements of Comprehensive (Loss) Income for the Years Ended December 31, 2015, 2014 and 2013	107
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2015, 2014 and 2013	109
Consolidated Statements of Cash Flows for the Years Ended December 31, 2015, 2014 and 2013	110
Notes to the Consolidated Financial Statements	113
Schedule IV - Mortgage Loans on Real Estate	169

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
of Two Harbors Investment Corp.

We have audited the accompanying consolidated balance sheets of Two Harbors Investment Corp. (the Company) as of December 31, 2015 and 2014, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Two Harbors Investment Corp. at December 31, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Two Harbors Investment Corp.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 26, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Minneapolis, Minnesota
February 26, 2016

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31, 2015	December 31, 2014
ASSETS		
Available-for-sale securities, at fair value	$7,825,320	$14,341,102
Trading securities, at fair value	—	1,997,656
Residential mortgage loans held-for-sale, at fair value	811,431	535,712
Residential mortgage loans held-for-investment in securitization trusts, at fair value	3,173,727	1,744,746
Commercial real estate assets	660,953	—
Mortgage servicing rights, at fair value	493,688	452,006
Cash and cash equivalents	737,831	1,005,792
Restricted cash	262,562	336,771
Accrued interest receivable	49,970	65,529
Due from counterparties	17,206	35,625
Derivative assets, at fair value	271,509	380,791
Other assets	271,575	188,579
Total Assets [(1)]	$14,575,772	$21,084,309
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	$5,008,274	$12,932,463
Collateralized borrowings in securitization trusts, at fair value	2,000,110	1,209,663
Federal Home Loan Bank advances	3,785,000	2,500,000
Derivative liabilities, at fair value	7,285	90,233
Due to counterparties	34,294	124,206
Dividends payable	92,016	95,263
Other liabilities	72,232	64,439
Total liabilities [(1)]	10,999,211	17,016,267
Stockholders' Equity		
Preferred stock, par value $0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value $0.01 per share; 900,000,000 shares authorized and 353,906,807 and 366,395,920 shares issued and outstanding, respectively	3,539	3,664
Additional paid-in capital	3,705,519	3,811,027
Accumulated other comprehensive income	359,061	855,789
Cumulative earnings	1,684,755	1,195,536
Cumulative distributions to stockholders	(2,176,313)	(1,797,974)
Total stockholders' equity	3,576,561	4,068,042
Total Liabilities and Stockholders' Equity	$14,575,772	$21,084,309

(1) The consolidated balance sheets include assets of consolidated variable interest entities, or VIEs, that can only be used to settle obligations of these VIEs and liabilities of the consolidated VIEs for which creditors do not have recourse to Two Harbors Investment Corp. At December 31, 2015 and December 31, 2014, assets of the VIEs totaled $3,237,918 and $1,754,943, and liabilities of the VIEs totaled $2,017,677 and $1,219,821, respectively. See Note 3 - Variable Interest Entities for additional information.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in thousands)

	Year Ended December 31,		
	2015	2014	2013
Interest income:			
Available-for-sale securities	$458,515	$506,268	$507,180
Trading securities	8,676	12,913	5,963
Residential mortgage loans held-for-sale	28,966	16,089	22,185
Residential mortgage loans held-for-investment in securitization trusts	95,740	41,220	19,220
Commercial real estate assets	9,138	—	—
Cash and cash equivalents	902	717	1,043
Total interest income	601,937	577,207	555,591
Interest expense:			
Repurchase agreements	73,049	76,177	89,470
Collateralized borrowings in securitization trusts	57,216	26,760	10,937
Federal Home Loan Bank advances	11,921	4,513	—
Total interest expense	142,186	107,450	100,407
Net interest income	459,751	469,757	455,184
Other-than-temporary impairments:			
Total other-than temporary impairment losses	(535)	(392)	(1,662)
Non-credit portion of loss recognized in other comprehensive income (loss)	—	—	—
Net other-than-temporary credit impairment losses	(535)	(392)	(1,662)
Other income (loss):			
Gain (loss) on investment securities	363,379	87,201	(54,430)
(Loss) gain on interest rate swap and swaption agreements	(210,621)	(345,647)	245,229
(Loss) gain on other derivative instruments	(5,049)	(17,529)	95,345
Gain (loss) on residential mortgage loans held-for-sale	14,285	17,297	(33,846)
Servicing income	127,412	128,160	12,011
(Loss) gain on servicing asset	(99,584)	(128,388)	13,881
Other (loss) income	(21,790)	18,539	14,619
Total other income (loss)	168,032	(240,367)	292,809
Expenses:			
Management fees	50,294	48,803	41,707
Securitization deal costs	8,971	4,638	4,153
Servicing expenses	28,101	25,925	3,761
Other operating expenses	64,162	56,231	37,259
Total expenses	151,528	135,597	86,880
Income from continuing operations before income taxes	475,720	93,401	659,451
(Benefit from) provision for income taxes	(16,490)	(73,738)	84,411
Net income from continuing operations	492,210	167,139	575,040
Income from discontinued operations	—	—	3,999
Net income	$492,210	$167,139	$579,039

The accompanying notes are an integral part of these consolidated financial statements.

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME, continued
(in thousands, except share data)

	Year Ended December 31,		
	2015	2014	2013
Basic earnings per weighted average common share:			
Continuing operations	$1.35	$0.46	$1.64
Discontinued operations	—	—	0.01
Net income	$1.35	$0.46	$1.65
Diluted earnings per weighted average common share:			
Continuing operations	$1.35	$0.46	$1.64
Discontinued operations	—	—	0.01
Net income	$1.35	$0.46	$1.65
Weighted average number of shares of common stock:			
Basic	365,247,738	366,011,855	350,361,827
Diluted	365,247,738	366,011,855	350,992,387
Comprehensive (loss) income:			
Net income	$492,210	$167,139	$579,039
Other comprehensive (loss) income, net of tax:			
Unrealized (loss) gain on available-for-sale securities	(496,728)	411,054	(251,723)
Other comprehensive (loss) income	(496,728)	411,054	(251,723)
Comprehensive (loss) income	$(4,518)	$578,193	$327,316

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity
Balance, December 31, 2012	298,813,258	$2,988	$2,948,345	$696,458	$449,358	$(646,572)	$3,450,577
Net income	—	—	—	—	579,039	—	579,039
Other comprehensive income before reclassifications, net of tax	—	—	—	(298,165)	—	—	(298,165)
Amounts reclassified from accumulated other comprehensive loss, net of tax	—	—	—	46,442	—	—	46,442
Net other comprehensive income, net of tax	—	—	—	(251,723)	—	—	(251,723)
Issuance of common stock, net of offering costs	57,571,961	576	762,981	—	—	—	763,557
Issuance of common stock in connection with exercise of warrants	9,939,648	99	107,415	—	—	—	107,514
Repurchase of common stock	(2,450,700)	(25)	(23,869)	—	—	—	(23,894)
Common dividends declared	—	—	—	—	—	(427,105)	(427,105)
Special dividends declared	—	—	—	—	—	(343,481)	(343,481)
Non-cash equity award compensation	1,061,001	11	500	—	—	—	511
Balance, December 31, 2013	364,935,168	$3,649	$3,795,372	$444,735	$1,028,397	$(1,417,158)	$3,854,995
Net income	—	—	—	—	167,139	—	167,139
Other comprehensive income before reclassifications, net of tax	—	—	—	463,593	—	—	463,593
	—	—	—	(52,539)	—	—	(52,539)

Amounts reclassified from accumulated other comprehensive loss, net of tax							
Net other comprehensive income, net of tax	—	—	—	411,054	—	—	411,054
Issuance of common stock, net of offering costs	57,218	1	587	—	—	—	588
Repurchase of common stock	—	—	—	—	—	—	—
Common dividends declared	—	—	—	—	—	(380,816)	(380,816)
Non-cash equity award compensation	1,403,534	14	15,068	—	—	—	15,082
Balance, December 31, 2014	366,395,920	$3,664	$3,811,027	$ 855,789	$1,195,536	$(1,797,974)	$4,068,042
Cumulative effect of adoption of new accounting principle	—	—	—	—	(2,991)	—	(2,991)
Adjusted balance, January 1, 2015	366,395,920	3,664	3,811,027	855,789	1,192,545	(1,797,974)	4,065,051
Net income	—	—	—	—	492,210	—	492,210
Other comprehensive income before reclassifications, net of tax	—	—	—	(161,033)	—	—	(161,033)
Amounts reclassified from accumulated other comprehensive loss, net of tax	—	—	—	(335,695)	—	—	(335,695)
Net other comprehensive income, net of tax	—	—	—	(496,728)	—	—	(496,728)
Issuance of common stock, net of offering costs	69,826	1	538	—	—	—	539
Repurchase of common stock	(13,664,300)	(137)	(115,037)	—	—	—	(115,174)
Common dividends declared	—	—	—	—	—	(378,339)	(378,339)
Non-cash equity award compensation	1,105,361	11	8,991	—	—	—	9,002
Balance, December 31, 2015	353,906,807	$3,539	$3,705,519	$ 359,061	$1,684,755	$(2,176,313)	$3,576,561

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31, 2015	2014	2013
Cash Flows From Operating Activities:			
Net income	$492,210	$167,139	$579,039
Adjustments to reconcile net income to net cash used in operating activities:			
Amortization of premiums and discounts on investment securities and commercial real estate assets, net	38,445	12,012	17,640
Other-than-temporary impairment losses	535	392	1,662
Realized and unrealized (gains) losses on investment securities, net	(363,379)	(87,201)	54,608
(Gain) loss on residential mortgage loans held-for-sale	(14,285)	(17,297)	33,846
Loss (gain) on residential mortgage loans held-for-investment and collateralized borrowings in securitization trusts	26,527	(16,840)	(14,204)
Realized gain on sales of commercial real estate assets	(181)	—	—
Loss (gain) on servicing asset	99,584	128,388	(13,881)
Loss (gain) on termination and option expiration of interest rate swaps and swaptions	226,143	55,389	(12,293)
Unrealized loss (gain) on interest rate swaps and swaptions	(101,158)	198,504	(291,458)
Unrealized gain on other derivative instruments	(14,196)	(8,011)	(95)
Equity based compensation	9,002	15,082	511
Depreciation of fixed assets	1,362	1,083	607
Amortization of intangible assets	—	533	1,067
Purchases of residential mortgage loans held-for-sale	(2,599,737)	(1,475,210)	(993,813)
Proceeds from sales of residential mortgage loans held-for-sale	160,559	432,749	25,113
Proceeds from repayment of residential mortgage loans held-for-sale	98,631	38,545	35,267
Net change in assets and liabilities:			
Decrease (increase) in accrued interest receivable	15,559	(15,226)	(7,690)
(Increase) decrease in deferred income taxes, net	(12,638)	(80,261)	83,598
(Increase) decrease in income taxes receivable	(5,286)	—	4,323
Increase in prepaid and fixed assets	(930)	(2,536)	(1,658)
Decrease (increase) in other receivables	8,701	(10,421)	29,772
Increase in servicing advances	(10,009)	(20,192)	(7,298)
(Decrease) increase in accrued interest payable	(5,049)	3,495	1,217
(Decrease) increase in income taxes payable	(1,305)	618	757
Increase in accrued expenses and other liabilities	14,147	11,983	14,014
Net change in assets and liabilities due to purchase of entity	—	—	3,306
Net cash used in operating activities	(1,936,748)	(667,283)	(456,043)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Year Ended December 31, 2015	2014	2013
Cash Flows From Investing Activities:			
Purchases of available-for-sale securities	(1,788,541)	(6,126,579)	(4,471,289)
Proceeds from sales of available-for-sale securities	6,985,567	3,479,329	4,432,696
Principal payments on available-for-sale securities	1,148,407	1,044,487	1,111,906
Short sales and purchases of other derivative instruments	4,081	(81,330)	(55,038)
(Payments for termination) proceeds from sales of other derivative instruments, net	(90,183)	73,966	163,657
Purchases of trading securities	—	(2,138,647)	(995,625)
Proceeds from sales of trading securities	2,004,375	1,145,410	1,000,946
Purchases of beneficial interests in securitization trusts	—	—	(30,550)
Proceeds from repayment of residential mortgage loans held-for-investment in securitization trusts	562,025	111,129	41,314
Purchases of commercial real estate assets	(662,627)	—	—
Proceeds from sales of commercial real estate assets	1,979	—	—
Proceeds from repayment of commercial real estate assets	344	—	—
Purchases of mortgage servicing rights, net of purchase price adjustments	(123,666)	(59,568)	(499,024)
Purchase of entity	—	—	(6,404)
Purchases of Federal Home Loan Bank stock	(56,640)	(100,000)	(10)
Purchases of equity investments	—	(3,000)	—
Decrease in due to counterparties, net	(71,493)	(205,180)	(79,126)
Decrease (increase) in restricted cash	74,209	64,876	(99,325)
Net cash provided by (used in) investing activities	7,987,837	(2,795,107)	514,128
Cash Flows From Financing Activities:			
Proceeds from repurchase agreements	$47,385,219	$213,091,865	$214,649,749
Principal payments on repurchase agreements	(55,309,408)	(212,409,852)	(215,023,809)
Proceeds from issuance of collateralized borrowings in securitization trusts	1,223,302	728,519	307,119
Principal payments on collateralized borrowings in securitization trusts	(406,942)	(182,872)	(42,490)
Proceeds from Federal Home Loan Bank advances	1,490,000	4,796,411	—
Principal payments on Federal Home Loan Bank advances	(205,000)	(2,296,411)	—
Proceeds from issuance of common stock, net of offering costs	539	588	763,557
Proceeds from exercise of warrants	—	—	107,514
Repurchase of common stock	(115,174)	—	(23,894)
Dividends paid on common stock	(381,586)	(285,553)	(591,452)
Net cash (used in) provided by financing activities	(6,319,050)	3,442,695	146,294
Net (decrease) increase in cash and cash equivalents	(267,961)	(19,695)	204,379
Cash and cash equivalents at beginning of period	1,005,792	1,025,487	821,108
Cash and cash equivalents at end of period	$737,831	$1,005,792	$1,025,487

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
(in thousands)

	Year Ended December 31, 2015	2014	2013
Supplemental Disclosure of Cash Flow Information:			
Cash paid for interest	$92,286	$79,276	$99,189
Cash paid (received) for taxes	$2,739	$5,905	$(4,266)
Noncash Investing and Financing Activities:			
Consolidation of residential mortgage loans held-for-investment in securitization trusts	$—	$—	$442,767
Consolidation of collateralized borrowings in securitization trusts	$—	$—	$412,217
Transfers of residential mortgage loans held-for-sale to residential mortgage loans held-for-investment in securitization trusts	$2,046,437	$1,022,360	$413,848
Transfers of residential mortgage loans held-for-sale to other receivables for foreclosed government-guaranteed loans	$16,723	$—	$—
Additions to mortgage servicing rights due to sale of residential mortgage loans held-for-sale	$1,844	$288	$—
Transfer of mortgage servicing rights fair value on buyout of Ginnie Mae residential mortgage loans	$15,756	$6,136	$—
Distribution of Silver Bay Realty Trust Corp. common stock	$—	$—	$343,481
Cashless exercise of warrants	$—	$—	$75
Cumulative-effect adjustment to equity for adoption of new accounting principle	$(2,991)	$—	$—
Dividends declared but not paid at end of period	$92,016	$95,263	$—
Reconciliation of residential mortgage loans held-for-sale:			
Residential mortgage loans held-for-sale at beginning of period	$535,712	$544,581	$58,607
Purchases of residential mortgage loans held-for-sale	2,599,737	1,475,210	993,813
Transfer of mortgage servicing rights fair value on buyout of Ginnie Mae residential mortgage loans	(15,756)	(6,136)	—
Transfers to residential mortgage loans held-for-investment in securitization trusts	(2,046,437)	(1,022,360)	(413,848)
Transfers to other receivables for foreclosed government-guaranteed loans	(16,723)	—	—
Proceeds from sales of residential mortgage loans held-for-sale	(160,559)	(432,749)	(25,113)
Proceeds from repayment of residential mortgage loans held-for-sale	(98,631)	(38,545)	(35,267)
Realized and unrealized gains (losses) on residential mortgage loans held-for-sale	14,088	15,711	(33,611)
Residential mortgage loans held-for-sale at end of period	$811,431	$535,712	$544,581

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 1. Organization and Operations
Two Harbors Investment Corp., or the Company, is a Maryland corporation focused on investing in, financing and managing residential mortgage-backed securities, or RMBS, residential mortgage loans, mortgage servicing rights, or MSR, commercial real estate and other financial assets. The Company is externally managed and advised by PRCM Advisers LLC, or PRCM Advisers, which is a subsidiary of Pine River Capital Management L.P., or Pine River, a global multi-strategy asset management firm. The Company's common stock is listed on the New York Stock Exchange, or NYSE, under the symbol "TWO".
The Company was incorporated on May 21, 2009 and commenced operations as a publicly traded company on October 28, 2009, upon completion of a merger with Capitol Acquisition Corp., or Capitol, which became a wholly owned indirect subsidiary as a result of the merger.
The Company has elected to be treated as a real estate investment trust, or REIT, as defined under the Internal Revenue Code of 1986, as amended, or the Code, for U.S. federal income tax purposes. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income which will not be qualifying income for REIT purposes. The Company has designated certain of its subsidiaries as taxable REIT subsidiaries, or TRSs, as defined in the Code, to engage in such activities, and the Company may in the future form additional TRSs.
On December 19, 2012, the Company completed the contribution of its portfolio of single-family rental properties to Silver Bay Realty Trust Corp., or Silver Bay, a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single-family residential properties for rental income and long-term capital appreciation. The Company contributed its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay, and in exchange for its contribution, received shares of common stock of Silver Bay. Silver Bay completed its initial public offering, or IPO, of its common stock on December 19, 2012. The Company distributed its shares of Silver Bay common stock to our stockholders on or about April 24, 2013. Because the Company will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the year ended December 31, 2013. No remaining associated operating results were recognized during the years ended December 31, 2015 and 2014. See Note 4 - Discontinued Operations for additional information.

Note 2. Basis of Presentation and Significant Accounting Policies
Consolidation and Basis of Presentation
The accompanying consolidated financial statements include the accounts of all subsidiaries; inter-company accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation. The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles, or U.S. GAAP. The Company's Chief Investment Officer manages the investment portfolio as a whole and resources are allocated and financial performance is assessed on a consolidated basis.
All trust entities in which the Company holds investments that are considered VIEs for financial reporting purposes were reviewed for consolidation under the applicable consolidation guidance. Whenever the Company has both the power to direct the activities of a trust that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trust.
Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, the period of time during which the Company anticipates an increase in the fair values of real estate securities sufficient to recover unrealized losses in those securities, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. The Company’s estimates are inherently subjective in nature and actual results could differ from its estimates and the differences may be material.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Significant Accounting Policies
Available-for-Sale Securities, at Fair Value and Trading Securities, at Fair Value
The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other residential mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively “RMBS”) issued by the Federal National Mortgage Association, or Fannie Mae, the Federal Home Loan Mortgage Corporation, or Freddie Mac, and the Government National Mortgage Association, or Ginnie Mae, or collectively, the government sponsored entities, or GSEs. The Company also invests in residential mortgage-backed securities that are not issued by the GSEs, or non-Agency RMBS, and, from time to time, U.S. Treasuries.
Designation
The Company classifies its RMBS securities, excluding inverse interest-only Agency securities classified as derivatives for purposes of U.S. GAAP, as available-for-sale, or AFS, investments. Although the Company generally intends to hold most of its investment securities until maturity, it may, from time to time, sell any of its investment securities as part of its overall management of its portfolio. Accordingly, the Company classifies all of its RMBS investment securities as AFS, including its interest-only strips, which represent the Company’s right to receive a specified portion of the contractual interest flows of specific Agency or Non-Agency securities. All assets classified as AFS, excluding Agency interest-only mortgage-backed securities and GSE credit risk transfer securities, are reported at estimated fair value with unrealized gains and losses, excluding other than temporary impairments, included in accumulated other comprehensive income, on an after-tax basis.
On July 1, 2015, the Company elected the fair value option for Agency interest-only securities and GSE credit risk transfer securities acquired on or after such date. All Agency interest-only securities and GSE credit risk transfer securities acquired on or after July 1, 2015 are carried at estimated fair value with changes in fair value, excluding other than temporary impairments, recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive (loss) income.
The Company classifies its U.S. Treasuries as trading securities. The Company’s trading securities are carried at estimated fair value with changes in fair value recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive (loss) income.
Balance Sheet Presentation
Investment securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. The cost basis for realized gains and losses on sales of investment securities are determined on the first-in, first-out, or FIFO, method.
Determination of RMBS Fair Value
Fair value is determined under the guidance of Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, or ASC 820. The Company determines the fair value of its RMBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae (collectively, “Agency RMBS”), and U.S. Treasuries based upon prices obtained from third-party pricing providers or broker quotes received using the bid price, which are both deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency RMBS, management judgment is used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data.
If listed price data is not available or insufficient, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs. The Company classifies these securities as Level 3 assets. As of December 31, 2015, none of the investment securities portfolio is categorized as Level 3.

The Company's application of ASC 820 guidance is discussed in further detail in Note 16 - Fair Value of these notes to the consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Revenue Recognition, Premium Amortization and Discount Accretion
Interest income on securities is accrued based on the outstanding principal balance and their contractual terms. Premiums and discounts associated with Agency RMBS and non-Agency RMBS rated AA and higher at the time of purchase, are amortized into interest income over the life of such securities using the effective yield method. Adjustments to premium amortization are made for actual prepayment activity. The Company estimates prepayments for its Agency interest-only securities, which represent the Company's right to receive a specified portion of the contractual interest flows of specific Agency and CMO securities. As a result, if prepayments increase (or are expected to increase), the Company will accelerate the rate of amortization on the premiums.
Interest income on the non-Agency RMBS that were purchased at a discount to par value and were rated below AA at the time of purchase is recognized based on the security's effective interest rate. The effective interest rate on these securities is based on the projected cash flows from each security, which are estimated based on the Company's observation of current information and events and include assumptions related to interest rates, prepayment rates, and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the AFS securities are affected by the contractual lives of the associated mortgage collateral, periodic payments of principal, and prepayments of principal. Therefore actual maturities of AFS securities are generally shorter than stated contractual maturities. Stated contractual maturities are generally greater than ten years.
Based on the projected cash flows from the Company's non-Agency RMBS purchased at a discount to par value, a portion of the purchase discount may be designated as credit protection against future credit losses and, therefore, not accreted into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions, and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively. Conversely, if the performance of a security with a credit discount is less favorable than forecasted, an impairment charge and write-down of such security to a new cost basis results.
Impairment
The Company evaluates its investment securities, on a quarterly basis, to assess whether a decline in the fair value of an AFS security below the Company's amortized cost basis is an other-than-temporary impairment, or OTTI. The presence of OTTI is based upon a fair value decline below a security's amortized cost basis and a corresponding adverse change in expected cash flows due to credit related factors as well as non-credit factors, such as changes in interest rates and market spreads. Impairment is considered other-than-temporary if an entity (i) intends to sell the security, (ii) will more likely than not be required to sell the security before it recovers in value, or (iii) does not expect to recover the security's amortized cost basis, even if the entity does not intend to sell the security. Under these scenarios, the impairment is other-than-temporary and the full amount of impairment should be recognized currently in earnings and the cost basis of the investment security is adjusted. However, if an entity does not intend to sell the impaired debt security and it is more likely than not that it will not be required to sell before recovery, the OTTI is separated into (i) the estimated amount relating to credit loss, or credit component, and (ii) the amount relating to all other factors, or non-credit component. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive (loss) income. The difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income in accordance with the effective interest method.
Residential Mortgage Loans Held-for-Sale, at Fair Value

Residential mortgage loans held-for-sale are reported at fair value as a result of a fair value option election. Fair value is determined under the guidance of ASC 820. The Company determines the fair value of its residential mortgage loans held-for-sale by type of loan and the determination is generally based on current secondary market pricing or cash flow models using market-based yield requirements. See Note 16 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement. The Company classifies residential mortgage loans held-for-sale based on management’s intent to sell them in the secondary whole loan market or include them in a securitization.

Interest income on residential mortgage loans held-for-sale is recognized at the loan coupon rate. Loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when mortgage loans are placed on nonaccrual status. Generally, mortgage loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date mortgage loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Mortgage loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Securitizations and Variable Interest Entities

The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. The securitization trusts are considered VIEs for financial reporting purposes and, thus, are reviewed for consolidation under the applicable consolidation guidance. As the Company has both the power to direct the activities of the securitization trusts that most significantly impact the entities’ performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. The underlying loans are classified as residential mortgage loans held-for-investment in securitization trusts and the underlying debt is classified as collateralized borrowings in securitization trusts on the consolidated balance sheets. The interest income on residential mortgage loans held-for-investment and interest expense on collateralized borrowings are recorded on the consolidated statements of comprehensive (loss) income. See Note 16 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.

Residential Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value

Residential mortgage loans held-for-investment in securitization trusts related to the Company's on-balance sheet securitizations are reported at fair value as a result of a fair value option election. These securitized mortgage loans are legally isolated from the Company and have been structured to be beyond the reach of creditors of the Company. Fair value is determined under the guidance of ASC 820. An entity is allowed to measure both the financial assets and financial liabilities of a qualifying collateralized financing entity, or CFE, it consolidates using the fair value of either the CFE’s financial assets or financial liabilities, whichever is more observable. As the Company’s securitization trusts are considered qualifying CFEs, the Company determines the fair value of these residential mortgage loans based on the fair value of its collateralized borrowings in securitization trusts and its retained interests from the Company’s on-balance sheet securitizations (eliminated in consolidation in accordance with U.S. GAAP), as the fair value of these instruments is more observable. See Note 16 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.

Interest income on residential mortgage loans held-for-investment is recognized at the loan coupon rate. Loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when mortgage loans are placed on nonaccrual status. Generally, mortgage loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date mortgage loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Mortgage loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Commercial Real Estate Assets

The Company originates and purchases commercial real estate debt and related instruments generally to be held as long-term investments. These assets are classified as commercial real estate assets on the consolidated balance sheets. Additionally, the Company is the sole certificate holder of a trust entity that holds a commercial real estate loan. The

trust is considered a VIE for financial reporting purposes and, thus, is reviewed for consolidation under the applicable consolidation guidance. As the Company has both the power to direct the activities of the trust that most significantly impact the entity's performance, and the obligation to absorb losses or the right to receive benefits of the entity that could be significant, the Company consolidates the trust. The underlying loan is classified as commercial real estate assets on the consolidated balance sheets. The loan is legally isolated from the Company and has been structured to be beyond the reach of creditors of the Company. Interest income on commercial real estate assets is recorded on the consolidated statements of comprehensive (loss) income.

Table of Contents

Commercial real estate assets are reported at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless the assets are deemed impaired. Impairment is indicated when it is deemed probable that the Company will not be able to collect all amounts due pursuant to the contractual terms of the loan. Because the Company's commercial real estate assets are collateralized either by real property or by equity interests in the commercial real estate borrower, impairment is measured by comparing the estimated fair value of the underlying collateral to the amortized cost of the respective loan. The valuation of the underlying collateral requires significant judgment, which includes assumptions regarding capitalization rates, leasing, credit worthiness of major tenants, occupancy rates, availability of financing, exit plan, loan sponsorship, actions of other lenders, overall economic conditions, the broader commercial real estate market, local geographic sub-markets, and other factors deemed necessary. If a loan is determined to be impaired, the Company records an allowance to reduce the carrying value of the loan through a charge to provision for loan losses. Actual losses, if any, could ultimately differ from these estimates.

Interest income on commercial real estate assets is recognized at the loan coupon rate. Any premiums or discounts, loan fees and origination costs are amortized or accreted into interest income over the lives of the loans using the effective interest method. Loans are considered past due when they are 30 days past their contractual due date. Interest income recognition is suspended when loans are placed on nonaccrual status. Generally, commercial real estate loans are placed on nonaccrual status when delinquent for more than 60 days or when determined not to be probable of full collection. Interest accrued, but not collected, at the date loans are placed on nonaccrual is reversed and subsequently recognized only to the extent it is received in cash or until it qualifies for return to accrual status. However, where there is doubt regarding the ultimate collectability of loan principal, all cash received is applied to reduce the carrying value of such loans. Commercial real estate loans are restored to accrual status only when contractually current or the collection of future payments is reasonably assured.

Mortgage Servicing Rights, at Fair Value

The Company's MSR represent the right to service mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company's MSR. However, as an owner and manager of MSR, the Company may be obligated to fund advances of principal and interest payments due to third-party owners of the loans, but not yet received from the individual borrowers. These advances are reported as servicing advances within the other assets line item on the consolidated balance sheets.

MSR are reported at fair value on the consolidated balance sheets. Although MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels and discount rates). Changes in the fair value of MSR as well as servicing fee income and servicing expenses are reported on the consolidated statements of comprehensive (loss) income.

Cash and Cash Equivalents

Cash and cash equivalents include cash held in bank accounts and cash held in money market funds on an overnight basis.

Restricted Cash

Restricted cash represents the Company's cash held by counterparties as collateral against the Company's securities, derivatives and/or repurchase agreements. Also included is the cash balance held pursuant to a letter of credit on the New York office lease. Cash held by counterparties as collateral, which resides in non-interest bearing accounts, is not available to the Company for general corporate purposes, but may be applied against amounts due to securities, derivatives or repurchase counterparties or returned to the Company when the collateral requirements are exceeded or, at the maturity of the derivative or repurchase agreement.

Accrued Interest Receivable

Accrued interest receivable represents interest that is due and payable to the Company. Cash interest is generally received within 30 days of recording the receivable.

Due from/to Counterparties, net

Due from Counterparties includes cash held by counterparties for payment of principal and interest as well as cash held by counterparties as collateral against the Company's derivatives and/or repurchase agreements but represents excess capacity and deemed unrestricted and a receivable from the counterparty as of the balance sheet date. Due to counterparties includes cash payable by the Company upon settlement of trade positions as well as cash deposited to and held by the Company as collateral against the Company's derivatives and/or repurchase agreements but represents a payable to the counterparty as of the balance sheet date. Due to counterparties also includes purchase price holdbacks on MSR acquisitions for missing documents.

117

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Derivative Financial Instruments, at Fair Value
In accordance with ASC 815, Derivatives and Hedging, as amended and interpreted, or ASC 815, all derivative financial instruments, whether designated for hedging relationships or not, are recorded on the consolidated balance sheets as assets or liabilities and carried at fair value.
At the inception of a derivative contract, the Company determines whether the instrument will be part of a qualifying hedge accounting relationship or whether the Company will account for the contract as a trading instrument. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments. Changes in fair value as well as the accrual and settlement of interest associated with derivatives accounted for as trading instruments are reported in the consolidated statements of comprehensive (loss) income as (loss) gain on interest rate swap and swaption agreements or (loss) gain on other derivative instruments depending on the type of derivative instrument.
The Company enters into interest rate derivative contracts for a variety of reasons, including minimizing fluctuations in earnings or market values on certain assets or liabilities that may be caused by changes in interest rates. The Company may, at times, enter into various forward contracts including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, and caps. Due to the nature of these instruments, they may be in a receivable/asset position or a payable/liability position at the end of an accounting period. Amounts payable to and receivable from the same party under contracts may be offset as long as the following conditions are met: (a) each of the two parties owes the other determinable amounts; (b) the reporting party has the right to offset the amount owed with the amount owed by the other party; (c) the reporting party intends to offset; and (d) the right of offset is enforceable by law. If the aforementioned conditions are not met, amounts payable to and receivable from are presented by the Company on a gross basis in its consolidated balance sheets.
The Company has provided specific disclosure regarding the location and amounts of derivative instruments in the consolidated financial statements and how derivative instruments and related hedged items are accounted for. See Note 13 - Derivative Instruments and Hedging Activities of these notes to the consolidated financial statements.
Property and Equipment
Property and equipment, stated at cost, net of accumulated depreciation, are reported in other assets in the Company's consolidated balance sheets. Included in property and equipment are certain furniture and fixtures, leasehold improvements, and information technology hardware and software. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets, which is generally three years.
Repurchase Agreements
The Company finances the acquisition of certain of its investment securities, residential mortgage loans and commercial real estate assets through the use of repurchase agreements. These repurchase agreements are generally short-term debt, which expire within one year. As of December 31, 2014, certain of the Company's repurchase agreements had contractual terms of greater than one year, and were considered long-term debt. Borrowings under repurchase agreements generally bear interest rates of a specified margin over one-month LIBOR and are generally uncommitted. The repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, as specified in the respective agreements.
Collateralized Borrowings in Securitization Trusts, at Fair Value
Collateralized borrowings in securitization trusts related to the Company's on-balance sheet securitizations are reported at fair value as a result of a fair value option election. This long-term debt is nonrecourse to the Company beyond the assets held in the trusts. Fair value is determined under the guidance of ASC 820. The Company determines the fair value of its collateralized borrowings in securitization trusts based on prices obtained from third-party pricing providers, broker quotes received and other applicable market data. See Note 16 - Fair Value of these notes to the consolidated financial statements for details on fair value measurement.
Federal Home Loan Bank Advances

In December 2013, the Company's wholly owned subsidiary, TH Insurance Holdings Company LLC, or TH Insurance, was accepted for membership in the Federal Home Loan Bank of Des Moines, or the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances.

As of December 31, 2015, the Company had FHLB advances with long-term maturities. The advances with less than five year terms generally bear interest rates of a spread over one- or three-month LIBOR and the advances with 20-year terms generally bear interest rates of or one- or three-month MOVR, or the FHLB member option variable-rate. FHLB advances are treated as secured financing transactions and are carried at their contractual amounts.

118

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Accrued Interest Payable

Accrued interest payable represents interest that is due and payable to third parties. Interest is generally paid within 30 days to three months of recording the payable, based upon the Company's remittance requirements.

Deferred Tax Assets and Liabilities

Income recognition for U.S. GAAP and tax differ in certain respects. These differences often reflect differing accounting treatments for tax and U.S. GAAP, such as accounting for discount and premium amortization, credit losses, asset impairments, recognition of certain operating expenses and certain valuation estimates. Some of these differences are temporary in nature and create timing mismatches between when taxable income is earned and the tax is paid versus when the earnings (losses) for U.S. GAAP purposes, or GAAP net income (loss), are recognized and the tax provision is recorded. Some of these differences are permanent since certain income (or expense) may be recorded for tax purposes but not for U.S. GAAP purposes (or vice-versa). One such significant permanent difference is the Company's ability as a REIT to deduct dividends paid to stockholders as an expense for tax purposes, but not for U.S. GAAP purposes.

As a result of these temporary differences, the Company's taxable REIT subsidiaries, or TRSs, may recognize taxable income in periods prior or subsequent to when it recognizes income for U.S. GAAP purposes. When this occurs, the TRSs pay or defer the tax liability and establish deferred tax assets or deferred tax liabilities, respectively, for U.S. GAAP purposes.

As the income is subsequently realized in future periods under U.S. GAAP, the deferred tax asset is recognized as an expense. Alternatively, as the TRSs realize the deferred taxable income, the deferred tax liability is recognized as a reduction to taxable income. The Company's deferred tax assets and/or liabilities are generated solely by differences in GAAP net income (loss) and taxable income (loss) at our taxable subsidiaries. U.S. GAAP and tax differences in the REIT may create additional deferred tax assets and/or liabilities to the extent the Company does not distribute all of its taxable income.

Income Taxes

The Company has elected to be taxed as a REIT under the Code and the corresponding provisions of state law. To qualify as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to stockholders (not including taxable income retained in its taxable subsidiaries) within the time frame set forth in the tax Code and the Company must also meet certain other requirements. In addition, because certain activities, if performed by the Company, may cause the Company to earn income which is not qualifying for the REIT gross income tests, the Company has formed TRSs, as defined in the Code, to engage in such activities. These TRSs' activities are subject to income taxes as well as any REIT taxable income not distributed to stockholders.

The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with ASC 740, Income Taxes. The Company records these liabilities to the extent the Company deems them more likely than not to be incurred. The Company classifies interest and penalties on material uncertain tax positions as interest expense and operating expense, respectively, in its consolidated statements of comprehensive (loss) income.

Earnings Per Share

Basic and diluted earnings per share are computed by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period. For both basic and diluted per share calculations, potential common shares represents issued and unvested shares of restricted stock, which have full rights to the common stock dividend declarations of the Company. For diluted per share calculations, potential common shares also includes dilutive warrants if the weighted average market value per share of the Company's common stock was above the strike price of the warrants during the period presented. In accordance with ASC 260, Earnings Per Share, or ASC 260, if there is a loss from continuing operations, the common stock equivalents are deemed anti-dilutive and earnings (loss) per share is calculated excluding the potential common shares. At 5:00 p.m. EST on November 7, 2013, all outstanding warrants expired, pursuant to the terms of the warrant agreement. No warrants

remain outstanding as of December 31, 2015.

Other Comprehensive (Loss) Income

Current period net unrealized gains and losses on AFS securities, excluding Agency interest-only securities and GSE credit risk transfer securities, are reported as components of accumulated other comprehensive income on the consolidated statements of stockholders' equity and in the consolidated statements of comprehensive (loss) income. Net unrealized gains and losses on securities held by our taxable subsidiaries that are reported in accumulated other comprehensive income are adjusted for the effects of taxation and may create deferred tax assets or liabilities.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Equity Incentive Plan
The Company’s Second Restated 2009 Equity Incentive Plan, or the Plan, was approved by its stockholders on May 14, 2015. The Plan provides incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and its affiliates. The Plan is administered by the compensation committee of the Company’s board of directors. The Plan permits the granting of restricted shares of common stock, phantom shares, dividend equivalent rights and other equity-based awards. See Note 22 - Equity Incentive Plan for further details regarding the Plan.
The cost of equity-based compensation awarded to employees provided by our manager is measured at fair value at each reporting date based on the price of the Company’s stock as of period end in accordance with ASC 505, Equity, or ASC 505, and amortized over the vesting term.
Offsetting Assets and Liabilities
Certain of the Company’s repurchase agreements are governed by underlying agreements that provide for a right of setoff in the event of default of either party to the agreement. The Company also has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company’s open positions with the counterparty.
Under U.S. GAAP, if the Company has a valid right of setoff, it may offset the related asset and liability and report the net amount. The Company presents repurchase agreements subject to master netting arrangements or similar agreements on a gross basis, and derivative assets and liabilities subject to such arrangements on a net basis, based on derivative type and counterparty, in its consolidated balance sheets. Separately, the Company presents cash collateral subject to such arrangements on a net basis, based on counterparty, in its consolidated balance sheets. However, the Company does not offset financial assets and liabilities with the associated cash collateral on its consolidated balance sheets.
The following tables present information about the Company’s assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company’s consolidated balance sheets as of December 31, 2015 and December 31, 2014:

	December 31, 2015					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$325,755	$(54,246)	$271,509	$(7,285)	$—	$264,224
Total Assets	$325,755	$(54,246)	$271,509	$(7,285)	$—	$264,224
Liabilities						
Repurchase agreements	$(5,008,274)	$—	$(5,008,274)	$5,008,274	$—	$—

Derivative liabilities	(61,531)	54,246	(7,285)	7,285	—	—
Total Liabilities	$(5,069,805)	$54,246	$(5,015,559)	$5,015,559	$—	$—

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

	December 31, 2014					
				Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Balance Sheets (1)		
(in thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets (Liabilities) Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets						
Derivative assets	$443,490	$(62,699)	$380,791	$(90,233)	$—	$290,558
Total Assets	$443,490	$(62,699)	$380,791	$(90,233)	$—	$290,558
Liabilities						
Repurchase agreements	$(12,932,463)	$—	$(12,932,463)	$12,932,463	$—	$—
Derivative liabilities	(152,932)	62,699	(90,233)	90,233	—	—
Total Liabilities	$(13,085,395)	$62,699	$(13,022,696)	$13,022,696	$—	$—

(1) Amounts presented are limited in total to the net amount of assets or liabilities presented in the consolidated balance sheets by instrument. Excess cash collateral or financial assets that are pledged to counterparties may exceed the financial liabilities subject to a master netting arrangement or similar agreement, or counterparties may have pledged excess cash collateral to the Company that exceed the corresponding financial assets. These excess amounts are excluded from the table above, although separately reported within restricted cash, due from counterparties, or due to counterparties in the Company's consolidated balance sheets.

Recently Issued and/or Adopted Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU No. 2014-09, which is a comprehensive revenue recognition standard that supersedes virtually all existing revenue guidance under U.S. GAAP. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. As a result of the issuance of ASU No. 2015-14 in August 2015 deferring the effective date of ASU No. 2014-09 by one year, the ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption prohibited. The Company has determined this ASU will not have a material impact on the Company's financial condition or results of operations.

Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

In June 2014, the FASB issued ASU No. 2014-11, which requires repurchase-to-maturity transactions to be accounted for as secured borrowings, eliminates the existing guidance for repurchase financings, and requires new disclosures for certain transactions accounted for as secured borrowings and sales. This ASU is effective for the first interim or annual period beginning after December 15, 2014, except for the disclosures related to transactions accounted for as secured borrowings, which are effective for periods beginning on or after March 15, 2015. Adoption of this ASU did not have any impact on the Company's financial condition or results of operations, but did impact financial statement

disclosures.

Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity

In August 2014, the FASB issued ASU No. 2014-13, which updates the guidance on measuring the financial assets and financial liabilities of CFEs. The update allows an entity to measure both the financial assets and financial liabilities of a qualifying CFE it consolidates using the fair value of either the CFE's financial assets or financial liabilities, whichever is more observable. The ASU requires certain recurring disclosures and is effective for annual periods beginning on or after December 15, 2015, with early adoption permitted as of the beginning of an annual period. Early adoption of this ASU was applied using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of January 1, 2015, which did not have a material impact on the Company's consolidated financial condition or results of operations.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure
In August 2014, the FASB issued ASU No. 2014-14, which requires that, upon foreclosure, a mortgage loan that is fully guaranteed under certain government programs be derecognized and a separate receivable be recognized when specific criteria are met. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2014, with early adoption permitted. Adoption of this ASU did not have a material impact on the Company’s consolidated financial condition or results of operations.
Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern
In August 2014, the FASB issued ASU No. 2014-15, which requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity’s ability to continue as a going concern for both annual and interim reporting periods. The ASU requires certain disclosures if it concludes that substantial doubt exists and plans to alleviate that doubt. It is effective for annual periods ending after December 15, 2016, and for both annual and interim periods thereafter, with early adoption permitted.
Amendments to the Consolidation Analysis
In February 2015, the FASB issued ASU No. 2015-02, which changes the guidance on the consolidation of certain investment funds as well as both the variable interest model and the voting model. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2015, with early adoption permitted. Early adoption of this ASU did not have a material impact on the Company’s financial condition or results of operations.
Simplifying the Presentation of Debt Issuance Costs
In April 2015, the FASB issued ASU No. 2015-03, which simplifies the presentation of debt issuance costs by requiring debt issuance costs to be presented as a deduction from the corresponding debt liability. The ASU is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2015, with early adoption permitted. Early adoption of this ASU did not have a material impact on the Company’s financial condition or results of operations.
Recognition and Measurement of Financial Assets and Financial Liabilities
In January 2016, the FASB issued ASU No. 2016-01, which changes how entities measure certain equity investments and present changes in the fair value of financial liabilities measured under the fair value option that are attributable to their own credit. The ASU requires certain recurring disclosures and is effective for annual periods, and interim periods within those annual periods, beginning on or after December 15, 2017, with early adoption permitted. The Company has determined this ASU will not have a material impact on the Company’s financial condition or results of operations.

Note 3. Variable Interest Entities
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company’s subsidiaries. Additionally, the Company is the sole certificate holder of a trust entity that holds a commercial real estate loan. All of these trusts are considered VIEs for financial reporting purposes and, thus, were reviewed for consolidation under the applicable consolidation guidance. Because the Company has both the power to direct the activities of the trusts that most significantly impact the entities’ performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant, the Company consolidates the trusts. As the Company is required to reassess VIE consolidation guidance each quarter, new facts and circumstances may change the Company’s determination. A change in the Company’s determination could result in a material impact to the Company’s consolidated financial statements during subsequent reporting periods.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents a summary of the assets and liabilities of all consolidated trusts as reported on the consolidated balance sheets as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Residential mortgage loans held-for-investment in securitization trusts	$3,173,727	$1,744,746
Commercial real estate assets	45,698	—
Accrued interest receivable	18,493	10,197
Total Assets	$3,237,918	$1,754,943
Collateralized borrowings in securitization trusts	2,000,110	1,209,663
Accrued interest payable	5,943	3,678
Other liabilities	11,624	6,480
Total Liabilities	$2,017,677	$1,219,821

The Company is not required to consolidate VIEs for which it has concluded it does not have both the power to direct the activities of the VIEs that most significantly impact the entities' performance, and the obligation to absorb losses or the right to receive benefits of the entities that could be significant. The Company's investments in these unconsolidated VIEs include non-Agency RMBS, which are classified within available-for-sale securities, at fair value on the consolidated balance sheets. As of December 31, 2015 and December 31, 2014, the carrying value, which also represents the maximum exposure to loss, of all non-Agency RMBS in unconsolidated VIEs was $1.9 billion and $3.0 billion, respectively.

Note 4. Discontinued Operations

On December 19, 2012, the Company completed the contribution of its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC, to Silver Bay. Two Harbors Property Investment LLC previously housed the Company's portfolio of single-family rental properties. Because the Company will not have any significant continuing involvement in Two Harbors Property Investment LLC, all of the associated operating results were removed from continuing operations and are presented separately as discontinued operations for the year ended December 31, 2013.

Summarized financial information for the discontinued operations are presented below.

	Year Ended December 31,		
	2015	2014	2013
Gain on contribution of entity	$—	$—	$3,861
Accrual adjustments for transaction expenses	—	—	138
Income from discontinued operations	$—	$—	$3,999

In addition to the gain on contribution of entity that was recorded in 2012 in connection with the closing of the contribution, certain adjustments were agreed to be recognized in 2013. These included an installment sales gain of approximately $4.0 million from Silver Bay, a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay. Of these amounts, $3.9 million of the installment sales gain was recorded as a gain on contribution of entity within discontinued operations, and the full $4.3 million of the reduction of 2013 management fees payable to PRCM Advisers was recorded within management fees, on the consolidated statement of comprehensive (loss) income for the year ended December 31, 2013. The remaining $0.1 million recorded within discontinued operations on the consolidated statement of comprehensive (loss) income for the year ended December 31, 2013 relates to accrual adjustments for transaction expenses related to the contribution. No

further adjustments were recognized during 2015 or 2014. See Note 25 - Related Party Transactions for additional information.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 5. Available-for-Sale Securities, at Fair Value

The Company holds AFS investment securities which are carried at fair value on the consolidated balance sheets. AFS securities exclude the retained interests from the Company's on-balance sheet securitizations, as they are eliminated in consolidation in accordance with U.S. GAAP. The following table presents the Company's AFS securities by collateral type as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Agency		
Federal Home Loan Mortgage Corporation	$1,678,814	$2,418,546
Federal National Mortgage Association	3,602,348	6,768,875
Government National Mortgage Association	691,728	2,104,896
Non-Agency	1,852,430	3,048,785
Total available-for-sale securities	$7,825,320	$14,341,102

At December 31, 2015 and December 31, 2014, the Company pledged AFS securities with a carrying value of $7.8 billion and $14.2 billion, respectively, as collateral for repurchase agreements and FHLB advances. See Note 17 - Repurchase Agreements and Note 19 - Federal Home Loan Bank of Des Moines Advances.

At December 31, 2015 and December 31, 2014, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, Transfers and Servicing, or ASC 860, to be considered linked transactions and therefore classified as derivatives.

The following tables present the amortized cost and carrying value (which approximates fair value) of AFS securities by collateral type as of December 31, 2015 and December 31, 2014:

	December 31, 2015		
(in thousands)	Agency	Non-Agency	Total
Face Value	$8,257,030	$2,655,381	$10,912,411
Unamortized premium	394,787	—	394,787
Unamortized discount			
Designated credit reserve	—	(409,077)	(409,077)
Net, unamortized	(2,721,979)	(707,021)	(3,429,000)
Amortized Cost	5,929,838	1,539,283	7,469,121
Gross unrealized gains	98,389	329,206	427,595
Gross unrealized losses	(55,337)	(16,059)	(71,396)
Carrying Value	$5,972,890	$1,852,430	$7,825,320

	December 31, 2014		
(in thousands)	Agency	Non-Agency	Total
Face Value	$13,421,555	$4,291,872	$17,713,427
Unamortized premium	676,641	—	676,641
Unamortized discount			
Designated credit reserve	—	(927,605)	(927,605)
Net, unamortized	(3,009,782)	(967,368)	(3,977,150)
Amortized Cost	11,088,414	2,396,899	13,485,313
Gross unrealized gains	238,291	653,529	891,820
Gross unrealized losses	(34,388)	(1,643)	(36,031)
Carrying Value	$11,292,317	$3,048,785	$14,341,102

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following tables present the carrying value of the Company's AFS investment securities by rate type as of December 31, 2015 and December 31, 2014:

	December 31, 2015		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$108,596	$1,673,038	$1,781,634
Fixed Rate	5,864,294	179,392	6,043,686
Total	$5,972,890	$1,852,430	$7,825,320

	December 31, 2014		
(in thousands)	Agency	Non-Agency	Total
Adjustable Rate	$128,285	$2,558,832	$2,687,117
Fixed Rate	11,164,032	489,953	11,653,985
Total	$11,292,317	$3,048,785	$14,341,102

When the Company purchases a credit-sensitive AFS security at a significant discount to its face value, the Company often does not amortize into income a significant portion of this discount that the Company is entitled to earn because the Company does not expect to collect the entire discount due to the inherent credit risk of the security. The Company may also record an other-than-temporary impairment, or OTTI, for a portion of its investment in the security to the extent the Company believes that the amortized cost will exceed the present value of expected future cash flows. The amount of principal that the Company does not amortize into income is designated as a credit reserve on the security, with unamortized net discounts or premiums amortized into income over time to the extent realizable. The following table presents the changes for the years ended December 31, 2015 and 2014 of the unamortized net discount and designated credit reserves on non-Agency AFS securities.

	Year Ended December 31,					
	2015			2014		
(in thousands)	Designated Credit Reserve	Unamortized Net Discount	Total	Designated Credit Reserve	Unamortized Net Discount	Total
Beginning balance at January 1	$(927,605)	$(967,368)	$(1,894,973)	$(1,234,449)	$(1,071,559)	$(2,306,008)
Acquisitions	557	(5,124)	(4,567)	(77,506)	(58,007)	(135,513)
Accretion of net discount	—	96,061	96,061	—	127,352	127,352
Realized credit losses	18,068	—	18,068	16,528	—	16,528
Reclassification adjustment for other-than-temporary impairments	1,742	—	1,742	(392)	—	(392)
Transfers from (to)	154,580	(154,580)	—	115,894	(115,894)	—
Sales, calls, other	343,581	323,990	667,571	252,320	150,740	403,060
Ending balance at December 31	$(409,077)	$(707,021)	$(1,116,098)	$(927,605)	$(967,368)	$(1,894,973)

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents the components comprising the carrying value of AFS securities not deemed to be other than temporarily impaired by length of time the securities had an unrealized loss position as of December 31, 2015 and December 31, 2014. At December 31, 2015, the Company held 1,181 AFS securities, of which 121 were in an unrealized loss position for less than twelve consecutive months and 182 were in an unrealized loss position for more than twelve consecutive months. At December 31, 2014, the Company held 1,452 AFS securities, of which 57 were in an unrealized loss position for less than twelve consecutive months and 172 were in an unrealized loss position for more than twelve consecutive months.

	Unrealized Loss Position for Less than 12 Months		12 Months or More		Total	
(in thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2015	$1,503,939	$(26,984)	$1,141,839	$(44,412)	$2,645,778	$(71,396)
December 31, 2014	$413,102	$(3,146)	$1,323,688	$(32,885)	$1,736,790	$(36,031)

Evaluating AFS Securities for Other-Than-Temporary Impairments

In evaluating AFS securities for OTTI, the Company determines whether there has been a significant adverse quarterly change in the cash flow expectations for a security. The Company compares the amortized cost of each security in an unrealized loss position against the present value of expected future cash flows of the security. The Company also considers whether there has been a significant adverse change in the regulatory and/or economic environment as part of this analysis. If the amortized cost of the security is greater than the present value of expected future cash flows using the original yield as the discount rate, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and will not be more likely than not required to sell the security, the credit loss is recognized in earnings and the balance of the unrealized loss is recognized in either other comprehensive (loss) income, net of tax, or gain (loss) on investment securities, depending on the accounting treatment. If the Company intends to sell the security or will be more likely than not required to sell the security, the full unrealized loss is recognized in earnings.

The Company recorded a $0.5 million other-than-temporary credit impairment during the year ended December 31, 2015 on a total of two non-Agency RMBS where the future expected cash flows for each security were less than its amortized cost. As of December 31, 2015, impaired securities with a carrying value of $129.2 million had actual weighted average cumulative losses of 11.1%, a weighted average three-month prepayment speed of 4.3%, weighted average 60+ day delinquencies of 25.0% of the pool balance, and weighted average FICO score of 666. At December 31, 2015, the Company did not intend to sell the securities and determined that it was not more likely than not that the Company will be required to sell the securities; therefore, only the projected credit loss was recognized in earnings. During the years ended December 31, 2014 and 2013, the Company recorded $0.4 million and $1.7 million in other-than-temporary credit impairments on three and four non-Agency RMBS, respectively, where the future expected cash flows for each security were less than its amortized cost.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents the changes in OTTI included in earnings for the years ended December 31, 2015, 2014 and 2013:

(in thousands)	Year Ended December 31, 2015	2014	2013
Cumulative credit loss at beginning of period	$(8,241)	$(9,467)	$(15,561)
Additions:			
Other-than-temporary impairments not previously recognized	(238)	(91)	—
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	(297)	(301)	(1,662)
Reductions:			
Decreases related to other-than-temporary impairments on securities paid down	—	464	1,677
Decreases related to other-than-temporary impairments on securities sold	2,277	1,154	6,079
Cumulative credit loss at end of period	$(6,499)	$(8,241)	$(9,467)

Cumulative credit losses related to OTTI may be reduced for securities sold as well as for securities that mature, are paid down, or are prepaid such that the outstanding principal balance is reduced to zero. Additionally, increases in cash flows expected to be collected over the remaining life of the security cause a reduction in the cumulative credit loss.

Gross Realized Gains and Losses

Gains and losses from the sale of AFS securities are recorded as realized gains (losses) within gain (loss) on investment securities in the Company’s consolidated statements of comprehensive (loss) income. For the years ended December 31, 2015, 2014 and 2013, the Company sold AFS securities for $7.0 billion, $3.5 billion and $4.4 billion with an amortized cost of $6.6 billion, $3.4 billion and $4.5 billion, for net realized gains of $369.4 million and $84.4 million, and losses of $64.5 million, respectively.

The following table presents the gross realized gains and losses on sales of AFS securities for the years ended December 31, 2015, 2014 and 2013:

(in thousands)	Year Ended December 31, 2015	2014	2013
Gross realized gains	$388,392	$162,235	$202,112
Gross realized losses	(19,040)	(77,820)	(266,620)
Total realized gains (losses) on sales, net	$369,352	$84,415	$(64,508)

Note 6. Trading Securities, at Fair Value

At December 31, 2014 and during the year ended December 31, 2015, the Company held U.S. Treasuries in a TRS and classified these securities as trading instruments due to short-term investment objectives. The following table presents the carrying value of the Company’s trading securities as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Amortized cost	$—	$1,996,289
Unrealized gains, net	—	1,367
Carrying value	$—	$1,997,656

127

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

For the years ended December 31, 2015, 2014 and 2013, the Company sold trading securities for $2.0 billion, $1.1 billion and $1.0 billion with an amortized cost of $2.0 billion, $1.1 billion and $997.9 million, resulting in realized gains of $7.4 million, $5.5 million and $3.0 million, respectively, on the sale of these securities. For the years ended December 31, 2015, 2014 and 2013, trading securities experienced change in unrealized losses of $1.4 million, $2.7 million and $1.0 million, respectively. Both realized and unrealized gains and losses are recorded as a component of gain (loss) on investment securities in the consolidated statements of comprehensive (loss) income.
At December 31, 2014, the Company pledged trading securities with a carrying value of $2.0 billion as collateral for repurchase agreements. See Note 17 - Repurchase Agreements.

Note 7. Residential Mortgage Loans Held-for-Sale, at Fair Value
Residential mortgage loans held-for-sale consists of residential mortgage loans carried at fair value as a result of a fair value option election. The following table presents the carrying value of the Company's residential mortgage loans held-for-sale as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Unpaid principal balance	$812,661	$534,101
Fair value adjustment	(1,230)	1,611
Carrying value	$811,431	$535,712

At December 31, 2015 and December 31, 2014, the Company pledged residential mortgage loans with a carrying value of $745.5 million and $416.8 million, respectively, as collateral for repurchase agreements and FHLB advances. See Note 17 - Repurchase Agreements and Note 19 - Federal Home Loan Bank of Des Moines Advances.

Note 8. Residential Mortgage Loans Held-for-Investment in Securitization Trusts, at Fair Value
The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company's subsidiaries. The underlying residential mortgage loans held by the trusts, which are consolidated on the Company's consolidated balance sheets, are classified as residential mortgage loans held-for-investment in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. The following table presents the carrying value of the Company's residential mortgage loans held-for-investment in securitization trusts as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Unpaid principal balance	$3,143,515	$1,699,748
Fair value adjustment	30,212	44,998
Carrying value	$3,173,727	$1,744,746

Note 9. Commercial Real Estate Assets
The Company originates and purchases commercial real estate debt and related instruments generally to be held as long-term investments. These assets are classified as commercial real estate assets on the consolidated balance sheets. Additionally, the Company is the sole certificate holder of a trust entity that holds a commercial real estate loan. The underlying loan held by the trust is consolidated on the Company's consolidated balance sheets and classified as commercial real estate assets. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the trust. Commercial real estate assets are reported at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless the assets are deemed impaired.

128

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following tables summarize the Company's commercial real estate assets by asset type, property type and geographic location as of December 31, 2015:

(in thousands)	December 31, 2015 Mezzanine Loans	December 31, 2015 First Mortgages	December 31, 2015 Total	December 31, 2014 Mezzanine Loans	December 31, 2014 First Mortgages	December 31, 2014 Total
Unpaid principal balance	$153,913	$513,433	$667,346	$—	$—	$—
Unamortized (discount) premium	(237)	—	(237)	—	—	—
Unamortized net deferred origination fees	(830)	(5,326)	(6,156)	—	—	—
Carrying value	$152,846	$508,107	$660,953	$—	$—	$—
Unfunded commitments	$1,900	$50,334	$52,234	$—	$—	$—
Number of loans	6	12	18	—	—	—
Weighted average coupon	8.1%	4.5%	5.4%	—%	—%	—%
Weighted average years to maturity [(1)]	2.6	3.3	3.1	—	—	—

(1) Based on contractual maturity date. Certain loans are subject to contractual extension options which may be subject to conditions as stipulated in the loan agreement. Actual maturities may differ from contractual maturities stated herein as certain borrowers may have the right to prepay with or without paying a prepayment penalty. The Company may also extend contractual maturities in connection with loan modifications.

(in thousands)	December 31, 2015		December 31, 2014	
Property Type	Carrying Value	% of Commercial Portfolio	Carrying Value	% of Commercial Portfolio
Retail	$185,883	28.1%	$—	—%
Hotel	80,843	12.2%	—	—%
Multifamily	139,011	21.1%	—	—%
Office	255,216	38.6%	—	—%
Total	$660,953	100.0%	$—	—%

(in thousands)	December 31, 2015		December 31, 2014	
Geographic Location	Carrying Value	% of Commercial Portfolio	Carrying Value	% of Commercial Portfolio
West	$131,488	19.9%	$—	—%
Southeast	240,839	36.4%	—	—%
Northeast	238,913	36.2%	—	—%
Midwest	49,713	7.5%	—	—%
Total	$660,953	100.0%	$—	—%

At December 31, 2015, the Company pledged commercial real estate assets with a carrying value of $361.1 million as collateral for repurchase agreements and FHLB advances. See Note 17 - Repurchase Agreements and Note 19 - Federal Home Loan Bank of Des Moines Advances. The Company did not hold any commercial real estate assets as of December 31, 2014.

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table summarizes activity related to commercial real estate assets for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31,		
(in thousands)	2015	2014	2013
Balance at beginning of period	$—	$—	$—
Originations and purchases	669,283	—	—
Sales	(1,979)	—	—
Repayments	(344)	—	—
Net discount accretion (premium amortization)	149	—	—
(Increase) decrease in net deferred origination fees	(6,656)	—	—
Amortization of net deferred origination fees	319	—	—
Realized gains on sales	181	—	—
Allowance for loan losses	—	—	—
Balance at end of period	$660,953	$—	$—

The Company evaluates each loan for impairment at least quarterly by assessing the risk factors of each loan and assigning a risk rating based on a variety of factors. Risk factors include property type, geographic and local market dynamics, physical condition, leasing and tenant profile, projected cash flow, loan structure and exit plan, loan-to-value ratio, project sponsorship, and other factors deemed necessary. Risk ratings are defined as follows:

1 – Lower Risk
2 – Average Risk
3 – Acceptable Risk
4 – Higher Risk: A loan that has exhibited material deterioration in cash flows and/or other credit factors, which, if negative trends continue, could be indicative of future loss.
5 – Impaired/Loss Likely: A loan that has a significantly increased probability of default or principal loss.

The following table presents the number of loans, unpaid principal balance and carrying value (amortized cost) by risk rating for commercial real estate assets as of December 31, 2015 and December 31, 2014:

(dollars in thousands)	December 31, 2015			December 31, 2014		
Risk Rating	Number of Loans	Unpaid Principal Balance	Carrying Value	Number of Loans	Unpaid Principal Balance	Carrying Value
1 – 3	18	$667,346	$660,953	—	$—	$—
4 – 5	—	—	—	—	—	—
Total	18	$667,346	$660,953	—	$—	$—

The Company has not recorded any allowances for losses as it is not deemed probable that the Company will not be able to collect all amounts due pursuant to the contractual terms of the loans.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 10. Servicing Activities
Mortgage Servicing Rights, at Fair Value
One of the Company's wholly owned subsidiaries has approvals from Fannie Mae, Freddie Mac and Ginnie Mae to hold and manage MSR, which represent the right to control the servicing of mortgage loans. The Company and its subsidiaries do not originate or directly service mortgage loans, and instead contract with fully licensed subservicers to handle substantially all servicing functions for the loans underlying the Company's MSR. The following table summarizes activity related to MSR for the years ended December 31, 2015, 2014 and 2013.

	Year Ended December 31,		
(in thousands)	2015	2014	2013
Balance at beginning of period	$452,006	$514,402	$—
Additions from purchases of servicing rights	124,261	67,533	500,521
Additions from sales of residential mortgage loans	1,844	288	—
Changes in fair value due to:			
Changes in valuation inputs or assumptions used in the valuation model	(51,634)	(73,573)	20,651
Other changes in fair value [1]	(47,950)	(54,815)	(6,770)
Other changes [2]	15,161	(1,829)	—
Balance at end of period	$493,688	$452,006	$514,402

(1) Other changes in fair value primarily represents changes due to the realization of expected cash flows.
(2) Other changes includes purchase price adjustments, contractual prepayment protection, and changes due to the Company's purchase of the underlying collateral.

As of December 31, 2015 and December 31, 2014, the key economic assumptions and sensitivity of the fair value of MSR to immediate 10% and 20% adverse changes in these assumptions were as follows:

(in thousands)	December 31, 2015	December 31, 2014
Weighted average prepayment speed:	11.8%	11.9%
Impact on fair value of 10% adverse change	$(20,093)	$(14,012)
Impact on fair value of 20% adverse change	$(38,656)	$(31,640)
Weighted average delinquency:	4.0%	5.6%
Impact on fair value of 10% adverse change	$(3,826)	$(3,616)
Impact on fair value of 20% adverse change	$(6,640)	$(6,780)
Weighted average discount rate:	10.1%	9.5%
Impact on fair value of 10% adverse change	$(16,316)	$(16,272)
Impact on fair value of 20% adverse change	$(31,522)	$(31,640)

These assumptions and sensitivities are hypothetical and should be considered with caution. Changes in fair value based on 10% and 20% variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of MSR is calculated without changing any other assumptions. In reality, changes in one factor may result in changes in another (e.g., increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities. Further, these sensitivities show only the change in the asset balances and do not show any expected change in the fair value of the instruments used to manage the interest rates and prepayment risks associated with these assets.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Risk Mitigation Activities
The primary risk of the Company's MSR is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher-than-expected prepayments that could reduce the value of the MSR. The Company economically hedges the impact of these risks with AFS securities and derivative financial instruments. Refer to Note 13 - Derivative Instruments and Hedging Activities for additional information regarding the derivative financial instruments used to economically hedge MSR.
Mortgage Servicing Income
The following table presents the components of servicing income recorded on the Company's consolidated statements of comprehensive (loss) income for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31,		
(in thousands)	2015	2014	2013
Servicing fee income	$123,834	$125,061	$11,807
Ancillary fee income	2,144	2,210	204
Float income	1,434	889	—
Total	$127,412	$128,160	$12,011

Mortgage Servicing Advances
In connection with the servicing of loans, the Company's subservicers make certain payments for property taxes and insurance premiums, default and property maintenance payments, as well as advances of principal and interest payments before collecting them from individual borrowers. Servicing advances, including contractual interest, are priority cash flows in the event of a loan principal reduction or foreclosure and ultimate liquidation of the real estate-owned property, thus making their collection reasonably assured. These servicing advances, which are funded by the Company, totaled $37.5 million and $27.5 million and were included in other assets on the consolidated balance sheets as of December 31, 2015 and December 31, 2014, respectively.
Serviced Mortgage Assets
The Company's total serviced mortgage assets consist of loans owned and classified as residential mortgage loans held-for-sale, loans held in consolidated VIEs classified as residential mortgage loans held-for-investment in securitization trusts and loans underlying MSR. The following table presents the number of loans and unpaid principal balance of the mortgage assets for which the Company manages the servicing as of December 31, 2015 and December 31, 2014:

	December 31, 2015		December 31, 2014	
(dollars in thousands)	Number of Loans	Unpaid Principal Balance	Number of Loans	Unpaid Principal Balance
Residential mortgage loans held-for-sale	1,415	$812,661	1,008	$534,101
Residential mortgage loans held-for-investment in securitization trusts	413	297,379	487	358,458
Mortgage servicing rights [(1)]	245,144	51,386,141	224,073	44,949,061
Total serviced mortgage assets	246,972	$52,496,181	225,568	$45,841,620

(1) Includes residential mortgage loans held-for-investment in securitization trusts for which the Company is the named servicing administrator.

Note 11. Restricted Cash

The Company is required to maintain certain cash balances with counterparties for securities and derivatives trading activity and collateral for the Company's repurchase agreements and FHLB advances in restricted accounts. The Company has also placed cash in a restricted account pursuant to a letter of credit on an office space lease.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents the Company's restricted cash balances as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Restricted cash balances held by trading counterparties:		
For securities and loan trading activity	$12,550	$12,000
For derivatives trading activity	130,355	211,989
As restricted collateral for repurchase agreements and Federal Home Loan Bank advances	119,310	112,435
Total restricted cash balances held by trading counterparties	262,215	336,424
Restricted cash balance pursuant to letter of credit on office lease	347	347
Total	$262,562	$336,771

Note 12. Accrued Interest Receivable
The following table presents the Company's accrued interest receivable by collateral type:

(in thousands)	December 31, 2015	December 31, 2014
U.S. Treasuries	$—	$8,084
Available-for-sale securities:		
Agency		
Federal Home Loan Mortgage Corporation	6,235	8,734
Federal National Mortgage Association	12,407	22,392
Government National Mortgage Association	4,910	10,290
Non-Agency	2,339	3,835
Total available-for-sale securities	25,891	45,251
Residential mortgage loans held-for-sale	4,173	1,997
Residential mortgage loans held-for-investment in securitization trusts	18,339	10,197
Commercial real estate assets	1,567	—
Total	$49,970	$65,529

Note 13. Derivative Instruments and Hedging Activities
The Company enters into a variety of derivative and non-derivative instruments in connection with its risk management activities. The Company's primary objective for executing these derivatives and non-derivative instruments is to mitigate the Company's economic exposure to future events that are outside its control. The Company's derivative financial instruments are utilized principally to manage market risk and cash flow volatility associated with interest rate risk (including associated prepayment risk) related to certain assets and liabilities. As part of its risk management activities, the Company may, at times, enter into various forward contracts including short securities, Agency to-be-announced securities, or TBAs, options, futures, swaps, caps, credit default swaps and total return swaps. In executing on the Company's current risk management strategy, the Company has entered into interest rate swap and swaption agreements, TBAs, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, credit default swaps and total return swaps (based on the Markit IOS Index). The Company has also entered into a number of non-derivative instruments to manage interest rate risk, principally U.S. Treasuries and Agency interest-only securities.
The following summarizes the Company's significant asset and liability classes, the risk exposure for these classes, and the Company's risk management activities used to mitigate certain of these risks. The discussion includes both derivative and non-derivative instruments used as part of these risk management activities. While the Company uses non-derivative and derivative instruments to achieve the Company's risk management activities, it is possible that

these instruments will not effectively mitigate all or a substantial portion of the Company's market rate risk. In addition, the Company might elect, at times, not to enter into certain hedging arrangements in order to maintain compliance with REIT requirements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Balance Sheet Presentation

In accordance with ASC 815, the Company records derivative financial instruments on its consolidated balance sheets as assets or liabilities at fair value. Changes in fair value are accounted for depending on the use of the derivative instruments and whether they qualify for hedge accounting treatment. Due to the volatility of the credit markets and difficulty in effectively matching pricing or cash flows, the Company has elected to treat all current derivative contracts as trading instruments.

The following tables present the gross fair value and notional amounts of the Company's derivative financial instruments treated as trading instruments as of December 31, 2015 and December 31, 2014.

	December 31, 2015			
(in thousands)	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$159,582	$932,037	$—	$—
Interest rate swap agreements	91,757	14,268,806	—	—
Credit default swaps	—	—	(703)	125,000
Swaptions, net	17,374	4,700,000	(4,831)	500,000
TBAs	1,074	847,000	(1,324)	550,000
Put and call options for TBAs, net	—	—	—	—
Constant maturity swaps	—	—	—	—
Markit IOS total return swaps	1,645	889,418	—	—
Forward purchase commitments	77	98,736	(427)	187,384
Total	$271,509	$21,735,997	$(7,285)	$1,362,384

	December 31, 2014			
(in thousands)	Derivative Assets		Derivative Liabilities	
Trading instruments	Fair Value	Notional	Fair Value	Notional
Inverse interest-only securities	$188,592	$1,168,226	$—	$—
Interest rate swap agreements	55,471	9,569,000	(65,392)	9,015,000
Credit default swaps	—	—	(1,672)	125,000
Swaptions, net	121,591	9,550,000	(4,999)	2,860,000
TBAs	10,350	875,000	(17,687)	2,200,000
Put and call options for TBAs, net	90	2,000,000	—	—
Constant maturity swaps	2,013	12,000,000	(483)	2,000,000
Markit IOS total return swaps	1,387	598,459	—	—
Forward purchase commitments	1,297	554,838	—	—
Total	$380,791	$36,315,523	$(90,233)	$16,200,000

Comprehensive (Loss) Income Statement Presentation

The Company has not applied hedge accounting to its current derivative portfolio held to mitigate the interest rate risk and credit risk associated with its portfolio. As a result, the Company is subject to volatility in its earnings due to movement in the unrealized gains and losses associated with its interest rate swaps and its other derivative instruments.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table summarizes the location and amount of gains and losses reported in the consolidated statements of comprehensive (loss) income on the Company's derivative trading instruments:

Trading Instruments	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives		
(in thousands)		Year Ended December 31,		
		2015	2014	2013
Interest rate risk management				
TBAs [1]	(Loss) gain on other derivative instruments	$(39,748)	$(69,921)	$151,021
Short U.S. Treasuries [1]	(Loss) gain on other derivative instruments	125	(8)	(991)
Put and call options for TBAs [1]	(Loss) gain on other derivative instruments	6,846	(14,070)	7,798
Put and call options for U.S. Treasuries [1]	(Loss) gain on other derivative instruments	(837)	—	—
Constant maturity swaps [1]	(Loss) gain on other derivative instruments	6,164	6,340	(11,438)
Interest rate swap agreements - Receivers [1]	(Loss) gain on interest rate swap and swaption agreements	52,785	201,536	(14,472)
Interest rate swap agreements - Payers [1]	(Loss) gain on interest rate swap and swaption agreements	(69,495)	(114,121)	6,400
Swaptions [1]	(Loss) gain on interest rate swap and swaption agreements	(63,797)	(242,795)	123,033
Markit IOS total return swaps [1]	(Loss) gain on other derivative instruments	(13,371)	8,061	(1,087)
Interest rate swap agreements - Payers [2]	(Loss) gain on interest rate swap and swaption agreements	(130,114)	(190,267)	130,268
Credit risk management				
Credit default swaps - Receive protection [3]	(Loss) gain on other derivative instruments	(294)	1,742	(74,840)
Non-risk management				
TBAs	(Loss) gain on other derivative instruments	—	(4,701)	38,297
Inverse interest-only securities	(Loss) gain on other derivative instruments	36,066	55,028	(13,415)
Forward purchase commitments	Gain (loss) on residential mortgage loans held-for-sale	(1,668)	4,729	(20,015)
Total		$(217,338)	$(358,447)	$320,559

(1) Includes derivative instruments held to mitigate interest rate risk associated with the Company's investment portfolio.
(2) Includes derivative instruments held to mitigate interest rate risk associated with the Company's repurchase agreements and FHLB advances.
(3) Includes derivative instruments held to mitigate credit risk associated with the Company's non-Agency RMBS and residential mortgage loans held-for-sale.

For the years ended December 31, 2015, 2014 and 2013, the Company recognized $85.6 million, $91.8 million and $58.5 million, respectively, of expenses for the accrual and/or settlement of the net interest expense associated with its interest rate swaps. The expenses result from paying either a fixed interest rate or LIBOR interest on an average $16.1 billion, $23.3 billion and $17.0 billion notional, respectively, and receiving either LIBOR interest or a fixed interest rate.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following tables present information with respect to the volume of activity in the Company's derivative instruments during the years ended December 31, 2015 and 2014:

	Year Ended December 31, 2015					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net (1)
Inverse interest-only securities	$1,168,226	$12,563	$(248,752)	$932,037	$1,050,906	$64
Interest rate swap agreements	18,584,000	26,868,227	(31,183,421)	14,268,806	16,091,714	(126,870)
Credit default swaps	125,000	—	—	125,000	125,000	—
Swaptions, net	12,410,000	8,550,000	(15,760,000)	5,200,000	9,780,027	(99,273)
TBAs, net	(1,325,000)	(7,266,000)	8,888,000	297,000	(773,381)	(46,835)
Short U.S. Treasuries	—	(50,000)	50,000	—	—	125
Put and call options for TBAs, net	2,000,000	1,250,000	(3,250,000)	—	(120,548)	6,331
Put and call options for U.S. Treasuries, net	—	500,000	(500,000)	—	685	(837)
Constant maturity swaps	14,000,000	6,000,000	(20,000,000)	—	2,257,534	7,694
Markit IOS total return swaps	598,459	1,626,514	(1,335,555)	889,418	950,206	(11,296)
Forward purchase commitments	554,838	3,512,843	(3,781,561)	286,120	563,108	(21)
Total	$48,115,523	$41,004,147	$(67,121,289)	$21,998,381	$29,925,251	$(270,918)

	Year Ended December 31, 2014					
(in thousands)	Beginning of Period Notional Amount	Additions	Settlement, Termination, Expiration or Exercise	End of Period Notional Amount	Average Notional Amount	Realized Gain (Loss), net (1)
Inverse interest-only securities	$1,525,845	$29,372	$(386,991)	$1,168,226	$1,324,581	$414
Interest rate swap agreements	19,619,000	24,215,598	(25,250,598)	18,584,000	23,329,504	(803)
Credit default swaps	427,073	—	(302,073)	125,000	138,418	(13,705)
Swaptions, net	5,130,000	15,860,000	(8,580,000)	12,410,000	9,460,438	(54,586)
TBAs, net	603,000	(10,882,000)	8,954,000	(1,325,000)	827,140	(33,985)
Short U.S. Treasuries	—	(125,000)	125,000	—	342	2
Put and call options for TBAs, net	—	5,500,000	(3,500,000)	2,000,000	772,603	(13,555)
Put and call options for U.S. Treasuries, net	—	—	—	—	—	—
Constant maturity swaps	10,000,000	46,000,000	(42,000,000)	14,000,000	11,715,068	1,037
Markit IOS total return swaps	49,629	586,550	(37,720)	598,459	437,604	—
	12,063	2,753,280	(2,210,505)	554,838	361,326	3,431

Forward purchase commitments						
Total	$37,366,610	$83,937,800	$(73,188,887)	$48,115,523	$48,367,024	$(111,750)

(1) Excludes net interest paid or received in full settlement of the net interest spread liability.

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Cash flow activity related to derivative instruments is reflected within the operating activities and investing activities sections of the consolidated statements of cash flows. Derivative fair value adjustments are reflected within the unrealized loss (gain) on interest rate swaps and swaptions, unrealized gain on other derivative instruments, and (gain) loss on residential mortgage loans held-for-sale line items within the operating activities section of the consolidated statements of cash flows. Realized gains and losses on interest rate swap and swaption agreements are reflected within the loss (gain) on termination and option expiration of interest rate swaps and swaptions line item within the operating activities section of the consolidated statements of cash flows. The remaining cash flow activity related to derivative instruments is reflected within the short sales and purchases of other derivative instruments, (payments for termination) proceeds from sales of other derivative instruments, and decrease in due to counterparties, net line items within the investing activities section of the consolidated statements of cash flows.

Interest Rate Sensitive Assets/Liabilities

The Company’s RMBS investment securities and MSR are generally subject to change in value when mortgage rates decline or increase, depending on the type of investment. Rising mortgage rates generally result in a slowing of refinancing activity, which slows prepayments and results in a decline in the value of the Company’s fixed-rate Agency pools and an increase in the value of the Company’s MSR. To mitigate the impact of this risk, the Company maintains a portfolio of fixed-rate interest-only securities, which increase in value when interest rates increase, as well as TBA positions, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries, constant maturity swaps, interest rate swap and swaption agreements and Markit IOS total return swaps to further mitigate its exposure to higher interest rates, decreased prepayment speeds and widening mortgage spreads.

As of December 31, 2015 and December 31, 2014, the Company had outstanding fair value of $42.9 million and $55.7 million, respectively, of interest-only securities in place to economically hedge its investment securities. These interest-only securities are included in AFS securities, at fair value, in the consolidated balance sheets.

The Company is exposed to interest rate risk on residential mortgage loans from the time it commits to purchase a mortgage loan until it acquires the loan from the originator and subsequently sells the loan to a third party. Changes in interest rates impact the market price for the mortgage loans. For example, as market interest rates decline, the value of residential mortgage loans held-for-sale increases, and vice versa. To mitigate the impact of this risk, the Company may enter into derivative contracts to hedge the interest rate risk related to its commitments to purchase residential mortgage loans and residential mortgage loans held-for-sale, such as interest rate swaps, swaptions, TBA positions, short U.S. Treasuries, put and call options for TBAs and U.S. Treasuries and constant maturity swaps.

TBAs. At times, the Company may use TBAs for risk management purposes or as a means of deploying capital until targeted investments are available and to take advantage of temporary displacements in the marketplace. TBAs are forward contracts for the purchase (long notional positions) or sale (short notional positions) of Agency RMBS. The issuer, coupon and stated maturity of the Agency RMBS are predetermined as well as the trade price, face amount and future settle date (published each month by the Securities Industry and Financial Markets Association). However, the specific Agency RMBS to be delivered upon settlement is not known at the time of the TBA transaction. As a result, and because physical delivery of the Agency RMBS upon settlement cannot be assured, the Company accounts for TBAs as derivative instruments.

As of December 31, 2015, $847.0 million of the Company’s long notional TBA positions and $550.0 million of the Company’s short notional TBA positions were held in order to economically hedge portfolio risk. As of December 31, 2014, $0.9 billion of the Company’s long notional TBA positions and $2.2 billion of the Company’s short notional TBA positions were held in order to economically hedge portfolio risk. The Company discloses these positions on a gross basis according to the unrealized gain or loss position of each TBA contract regardless of long or short notional position. The following tables present the notional amount, cost basis, market value and carrying value (which approximates fair value) of the Company’s TBA positions as of December 31, 2015 and December 31, 2014:

As of December 31, 2015

Net Carrying Value [4]

(in thousands)	Notional Amount [1]	Cost Basis [2]	Market Value [3]	Derivative Assets	Derivative Liabilities
Purchase contracts	$847,000	$858,572	$859,646	$1,074	$—
Sale contracts	(550,000)	(568,813)	(570,137)	—	(1,324)
TBAs, net	$297,000	$289,759	$289,509	$1,074	$(1,324)

137

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

	As of December 31, 2014				
				Net Carrying Value (4)	
(in thousands)	Notional Amount (1)	Cost Basis (2)	Market Value (3)	Derivative Assets	Derivative Liabilities
Purchase contracts	$875,000	$862,868	$873,218	$10,350	$—
Sale contracts	(2,200,000)	(2,294,813)	(2,312,500)	—	(17,687)
TBAs, net	$(1,325,000)	$(1,431,945)	$(1,439,282)	$10,350	$(17,687)

(1) Notional amount represents the face amount of the underlying Agency RMBS.
(2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.
(3) Market value represents the current market value of the TBA (or of the underlying Agency RMBS) as of period-end.
(4) Net carrying value represents the difference between the market value of the TBA as of period-end and its cost basis, and is reported in derivative assets / (liabilities), at fair value, in the consolidated balance sheets.

Put and Call Options for TBAs. As of December 31, 2014, the Company had purchased put options for TBAs with a notional amount of $2.0 billion and paid upfront premiums of approximately $0.6 million. The put options had a net fair market value of $0.1 million included in derivative assets, at fair value, in the consolidated balance sheet as of December 31, 2014. The Company did not hold any put and call options for TBAs at December 31, 2015.
Constant Maturity Swaps. The Company has also entered into constant maturity swaps between the 10-year interest rate swap curve and the yield to maturity on a 30-year Fannie Mae TBA to economically hedge mortgage spread widening risk. The Company had the following constant maturity swaps agreements in place at December 31, 2014:
(notional and dollars in thousands)
December 31, 2014

Determination Date	Average Strike Swap Rate	Notional Amount	Fair Value	Upfront Premium Paid	Unrealized Gain (Loss)
January 2015	0.538 %	$7,000,000	$1,502	$—	$1,502
February 2015	0.572 %	2,000,000	(13)	—	(13)
March 2015	0.552 %	5,000,000	41	—	41
Total	0.548 %	$14,000,000	$1,530	$—	$1,530

The Company did not have any constant maturity swap agreements in place at December 31, 2015.
Interest Rate Swap Agreements. As of December 31, 2015 and December 31, 2014, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company’s investment portfolio whereby the Company receives interest at a 3-month LIBOR rate:
(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2018	$2,040,000	1.563 %	0.487 %	2.94
2020 and Thereafter	1,210,000	2.164 %	0.531 %	5.08
Total	$3,250,000	1.787 %	0.503 %	3.74

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2017	$2,000,000	1.070 %	0.229 %	2.54
2018	2,040,000	1.563 %	0.238 %	3.94
2019 and Thereafter	900,000	2.378 %	0.255 %	6.24
Total	$4,940,000	1.512 %	0.237 %	3.80

Additionally, as of December 31, 2015 and December 31, 2014, the Company held the following interest rate swaps in order to mitigate mortgage interest rate exposure (or duration) risk associated with the Company's investment portfolio whereby the Company pays interest at a 3-month LIBOR rate:
(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amounts	Average Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
2018	$575,000	0.329 %	1.440 %	2.89
2020 and Thereafter	2,589,000	0.453 %	2.301 %	7.00
Total	$3,164,000	0.431 %	2.145 %	6.26

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amounts	Average Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
2018	$575,000	0.231 %	1.440 %	3.89
2019 and Thereafter	1,579,000	0.239 %	2.794 %	9.19
Total	$2,154,000	0.237 %	2.433 %	7.77

The Company monitors its borrowings under repurchase agreements and FHLB advances, which are generally floating rate debt, in relation to the rate profile of its investment securities. When it is cost effective to do so, the Company may enter into interest rate swap arrangements to align the interest rate composition of its borrowings under repurchase agreements and FHLB advances with that of its investment securities and debt portfolios. This particularly applies to borrowing agreements with maturities or interest rate resets of less than six months. Typically, the interest receivable terms (i.e., LIBOR) of the interest rate swaps match the terms of the underlying debt, resulting in an effective conversion of the rate of the related repurchase agreement or FHLB advance from floating to fixed.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

As of December 31, 2015 and December 31, 2014, the Company had the following outstanding interest rate swaps that were utilized as economic hedges of interest rate exposure (or duration) risk associated with the Company's short-term repurchase agreements and FHLB advances:
(notional in thousands)
December 31, 2015

Swaps Maturities	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2016	$1,700,000	0.462 %	0.481 %	0.73
2017	2,375,000	0.765 %	0.510 %	1.59
2018	800,000	0.944 %	0.384 %	2.14
2019	350,000	1.283 %	0.340 %	3.44
2020 and Thereafter	2,629,806	1.821 %	0.371 %	8.04
Total	$7,854,806	1.094 %	0.437 %	3.71

(notional in thousands)
December 31, 2014

Swaps Maturities	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
2016	$4,100,000	0.667 %	0.249 %	1.65
2017	5,285,000	1.063 %	0.248 %	2.55
2018	625,000	0.945 %	0.233 %	3.08
2019 and Thereafter	1,480,000	2.408 %	0.235 %	7.70
Total	$11,490,000	1.089 %	0.246 %	2.92

Interest Rate Swaptions. As of December 31, 2015 and December 31, 2014, the Company had the following outstanding interest rate swaptions (agreements to enter into interest rate swaps in the future for which the Company would either pay or receive a fixed rate) that were utilized as macro-economic hedges:
December 31, 2015

(notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	< 6 Months	$375	$174	0.75	$2,000,000	2.23 %	3M Libor	6.3
Payer	≥ 6 Months	126,273	19,150	39.17	4,500,000	3.69 %	3M Libor	5.8
Total Payer		$126,648	$19,324	38.51	$6,500,000	3.24 %	3M Libor	5.9
Sale contracts:								
Payer	≥ 6 Months	$(81,248)	$(6,738)	18.01	$(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(81,248)	$(6,738)	18.01	$(800,000)	3.44 %	3M Libor	10.0
Receiver	< 6 Months	$(100)	$(43)	0.73	$(500,000)	3M Libor	1.75 %	10.0
Total Receiver		$(100)	$(43)	0.73	$(500,000)	3M Libor	1.75 %	10.0

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

December 31, 2014 (notional and dollars in thousands)	Option				Underlying Swap			
Swaption	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Pay Rate	Average Receive Rate	Average Term (Years)
Purchase contracts:								
Payer	≥ 6 Months	$255,358	$130,120	56.62	$8,210,000	4.12 %	3M Libor	7.4
Total Payer		$255,358	$130,120	56.62	$8,210,000	4.12 %	3M Libor	7.4
Receiver	< 6 Months	$10,715	$6,462	3.38	$5,000,000	3M Libor	1.35 %	5.0
Total Receiver		$10,715	$6,462	3.38	$5,000,000	3M Libor	1.35 %	5.0
Sale contracts:								
Payer	≥ 6 Months	$(81,248)	$(19,990)	30.02	$(800,000)	3.44 %	3M Libor	10.0
Total Payer		$(81,248)	$(19,990)	30.02	$(800,000)	3.44 %	3M Libor	10.0

Markit IOS Total Return Swaps. The Company also enters into total return swaps (agreements whereby the Company receives or makes payments based on the total return of an underlying instrument or index, such as the Markit IOS Index, in exchange for fixed or floating rate interest payments) to help mitigate the potential impact of larger increases or decreases in interest rates on the performance of our investment portfolio (referred to as “convexity risk”). Total return swaps based on the Markit IOS Index are intended to synthetically replicate the performance of interest-only securities. The Company had the following total return swap agreements in place at December 31, 2015 and December 31, 2014:

(notional and dollars in thousands)
December 31, 2015

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
January 12, 2043	$(369,639)	$456	$(866)	$(410)
January 12, 2044	(325,003)	350	(1,679)	(1,329)
January 12, 2045	(194,776)	839	1,162	2,001
Total	$(889,418)	$1,645	$(1,383)	$262

(notional and dollars in thousands)
December 31, 2014

Maturity Date	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
January 12, 2043	$(411,281)	$763	$(1,457)	$(694)
January 12, 2044	(187,178)	624	(275)	349
Total	$(598,459)	$1,387	$(1,732)	$(345)

Credit Risk

The Company’s exposure to credit losses on its U.S. Treasuries and Agency portfolio of investment securities is limited due to implicit or explicit backing from the U.S. Department of the Treasury or the GSEs. The payment of principal and interest on the Freddie Mac and Fannie Mae mortgage-backed securities are guaranteed by those

respective agencies, and the payment of principal and interest on the Ginnie Mae mortgage-backed securities are backed by the full faith and credit of the U.S. Government.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Credit Default Swaps. For non-Agency investment securities, residential mortgage loans and commercial real estate assets, the Company may enter into credit default swaps to hedge credit risk. In future periods, the Company could enhance its credit risk protection, enter into further paired derivative positions, including both long and short credit default swaps and/or seek opportunistic trades in the event of a market disruption (see discussion under “Non-Risk Management Activities” below). The Company also has processes and controls in place to monitor, analyze, manage and mitigate its credit risk with respect to non-Agency RMBS, residential mortgage loans and commercial real estate assets.

As of December 31, 2015 and December 31, 2014, the Company held credit default swaps whereby the Company received credit protection for a fixed premium. The maximum payouts for these credit default swaps are limited to the current notional amounts of each swap contract. Maximum payouts for credit default swaps do not represent the expected future cash requirements, as the Company’s credit default swaps are typically liquidated or expire and are not exercised by the holder of the credit default swaps.

The following tables present credit default swaps whereby the Company is receiving protection held as of December 31, 2015 and December 31, 2014:

(notional and dollars in thousands)
December 31, 2015

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
Receive	June 20, 2016	105.50	$(100,000)	$(502)	$(260)	$(762)
	December 20, 2016	496.00	(25,000)	(201)	(4,062)	(4,263)
	Total	183.60	$(125,000)	$(703)	$(4,322)	$(5,025)

(notional and dollars in thousands)
December 31, 2014

Protection	Maturity Date	Average Implied Credit Spread	Current Notional Amount	Fair Value	Upfront Payable	Unrealized Gain (Loss)
Receive	June 20, 2016	105.50	$(100,000)	$(1,350)	$(260)	$(1,610)
	December 20, 2016	496.00	(25,000)	(322)	(4,062)	(4,384)
	Total	183.60	$(125,000)	$(1,672)	$(4,322)	$(5,994)

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe the Company under such contracts completely fail to perform under the terms of these contracts, assuming there are no recoveries of underlying collateral, as measured by the market value of the derivative financial instruments. As of December 31, 2015, the fair value of derivative financial instruments as an asset and liability position was $271.5 million and $7.3 million, respectively.

The Company attempts to mitigate its credit risk exposure on derivative financial instruments by limiting its counterparties to banks and financial institutions that meet established credit guidelines. The Company also seeks to spread its credit risk exposure across multiple counterparties in order to reduce the exposure to any single counterparty. Additionally, the Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty or clearing agency, in the case of centrally cleared interest rate swaps, upon occurrence of certain events. To further mitigate the risk of counterparty default, the Company maintains collateral agreements with certain of its counterparties and clearing agencies, which require both parties to maintain cash deposits in the event the fair values of the derivative financial instruments exceed established thresholds. As of December 31, 2015, the Company has received cash deposits from

counterparties of $6.3 million and placed cash deposits of $136.5 million in accounts maintained by counterparties, of which the amounts are netted on a counterparty basis and classified within restricted cash, due from counterparties, or due to counterparties on the consolidated balance sheets.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Non-Risk Management Activities
The Company has entered into certain financial instruments that are considered derivative contracts under ASC 815 that are not for purposes of hedging. These contracts are currently limited to forward purchase commitments and inverse interest-only RMBS.
Commitments to Purchase Residential Mortgage Loans Held-for-Sale. Prior to a mortgage loan purchase, the Company may enter into forward purchase commitments with counterparties whereby the Company commits to purchasing the loans at a particular interest rate, provided the borrower elects to close the loan. These commitments to purchase mortgage loans have been defined as derivatives and are therefore recorded on the consolidated balance sheets as assets or liabilities and measured at fair value. Subsequent changes in fair value are recorded on the Company's consolidated balance sheets as adjustments to the carrying value of these assets or liabilities with a corresponding adjustment recognized in current period earnings. As of December 31, 2015 and December 31, 2014, the Company had outstanding commitments to purchase $286.1 million and $554.8 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $0.1 million and a fair value liability of $0.4 million at December 31, 2015, and a fair value asset of $1.3 million at December 31, 2014, respectively.
Inverse Interest-Only Securities. As of December 31, 2015 and December 31, 2014, inverse interest-only securities with a carrying value of $159.6 million and $188.6 million, including accrued interest receivable of $1.7 million and $2.2 million, respectively, were accounted for as derivative financial instruments in the consolidated financial statements. The following table presents the amortized cost and carrying value (which approximates fair value) of inverse interest-only securities as of December 31, 2015 and December 31, 2014:

(in thousands)	December 31, 2015	December 31, 2014
Face Value	$932,037	$1,168,226
Unamortized premium	—	—
Unamortized discount		
Designated credit reserve	—	—
Net, unamortized	(792,178)	(991,715)
Amortized Cost	139,859	176,511
Gross unrealized gains	19,655	14,162
Gross unrealized losses	(1,608)	(4,269)
Carrying Value	$157,906	$186,404

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 14. Other Assets
Other assets as of December 31, 2015 and December 31, 2014 are summarized in the following table:

(in thousands)	December 31, 2015	December 31, 2014
Property and equipment at cost	$5,997	$4,849
Accumulated depreciation [1]	(3,303)	(1,941)
Net property and equipment	2,694	2,908
Prepaid expenses	1,572	1,790
Income taxes receivable	5,286	—
Deferred tax assets, net	44,318	40,847
Servicing advances	37,499	27,490
Federal Home Loan Bank stock	156,650	100,010
Equity investments	3,000	3,000
Other receivables	20,556	12,534
Total other assets	$271,575	$188,579

(1) Depreciation expense for the years ended December 31, 2015 and 2014 was $1.4 million and $1.1 million, respectively.

Note 15. Other Liabilities
Other liabilities as of December 31, 2015 and December 31, 2014 are summarized in the following table:

(in thousands)	December 31, 2015	December 31, 2014
Accrued expenses	$37,052	$29,819
Accrued interest payable	18,723	23,772
Income taxes payable	70	1,375
Other	16,387	9,473
Total other liabilities	$72,232	$64,439

Note 16. Fair Value
Fair Value Measurements
ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity’s own credit standing, when measuring fair value of a liability.
ASC 820 establishes a three level hierarchy to be used when measuring and disclosing fair value. An instrument’s categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Level 2	Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.
Level 3	Unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

Following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

Investment securities. The Company holds a portfolio of AFS and, from time to time, trading securities that are carried at fair value in the consolidated balance sheets. AFS securities are primarily comprised of Agency and non-Agency RMBS while the Company's trading securities are comprised of U.S. Treasuries. The Company determines the fair value of its U.S. Treasuries and Agency RMBS based upon prices obtained from third-party pricing providers or broker quotes received using bid price, which are deemed indicative of market activity. The third-party pricing providers and brokers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of its non-Agency RMBS, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company did not hold any U.S. Treasuries at December 31, 2015. The Company classified 100% of its RMBS AFS securities reported at fair value as Level 2 at December 31, 2015. AFS securities account for 62.2% of all assets reported at fair value at December 31, 2015.

Residential mortgage loans held-for-sale. The Company holds residential mortgage loans held-for-sale that are carried at fair value in the consolidated balance sheets as a result of a fair value option election. The Company determines fair value of its residential mortgage loans based on prices obtained from third-party pricing providers and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon cash flow models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels and credit losses). The Company classified 94.2% and 5.8% of its residential mortgage loans held-for-sale as Level 2 and Level 3 fair value assets, respectively, at December 31, 2015.

Residential mortgage loans held-for-investment in securitization trusts. The Company recognizes on its consolidated balance sheets residential mortgage loans held-for-investment in securitization trusts that are carried at fair value as a result of a fair value option election. An entity is allowed to measure both the financial assets and financial liabilities of a qualifying CFE it consolidates using the fair value of either the CFE's financial assets or financial liabilities, whichever is more observable. As the Company's securitization trusts are considered qualifying CFEs, the Company determines the fair value of these residential mortgage loans based on the fair value of its collateralized borrowings in securitization trusts and its retained interests from the Company's on-balance sheet securitizations (eliminated in consolidation in accordance with U.S. GAAP), as the fair value of these instruments is more observable. The Company classified 100% of its residential mortgage loans held-for-investment in securitization trusts as Level 2 fair value assets at December 31, 2015.

Mortgage servicing rights. The Company holds a portfolio of MSR that are reported at fair value on the consolidated balance sheets. The Company determines fair value of its MSR based on prices obtained from third-party pricing providers. Although MSR transactions are observable in the marketplace, the valuation is based upon cash flow

models that include unobservable market data inputs (including prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its MSR as Level 3 fair value assets at December 31, 2015.

145

Table of Contents

Derivative instruments. The Company may enter into a variety of derivative financial instruments as part of its hedging strategies. The Company principally executes over-the-counter, or OTC, derivative contracts, such as interest rate swaps, swaptions, put and call options for TBAs and U.S. Treasuries, credit default swaps, constant maturity swaps and Markit IOS total return swaps. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps, swaptions put and call options for TBAs, credit default swaps and total return swaps reported at fair value as Level 2 at December 31, 2015. The Company did not hold any put and call options for U.S. Treasuries or constant maturity swaps at December 31, 2015. The Company also enters into certain other derivative financial instruments, such as TBAs, short U.S. Treasuries and inverse interest-only securities. These instruments are similar in form to the Company's AFS and trading securities and the Company utilizes a pricing service to value TBAs and broker quotes to value short U.S. Treasuries and inverse interest-only securities. The Company classified 100% of its inverse interest-only securities at fair value as Level 2 at December 31, 2015. The Company reported 100% of its TBAs as Level 1 as of December 31, 2015. The Company did not hold any short U.S. Treasuries at December 31, 2015.

The Company may also enter into forward purchase commitments on residential mortgage loans whereby the Company commits to purchasing the loans at a particular interest rate. The fair value of these derivatives is determined based on prices currently offered in the marketplace for new commitments. Fallout assumptions if the borrower elects not to close the loan are applied to the pricing. As of December 31, 2015, the Company had outstanding commitments to purchase $286.1 million of mortgage loans, subject to fallout if the loans do not close, with a fair value asset of $0.1 million and a fair value liability of $0.4 million. The Company classified 100% of the forward purchase commitments reported at fair value as Level 2 at December 31, 2015.

The Company's risk management committee governs trading activity relating to derivative instruments. The Company's policy is to minimize credit exposure related to financial derivatives used for hedging by limiting the hedge counterparties to major banks, financial institutions, exchanges, and private investors who meet established capital and credit guidelines as well as by limiting the amount of exposure to any individual counterparty.

The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by ISDA, or central clearing exchange agreements, in the case of centrally cleared interest rate swaps. Additionally, both the Company and the counterparty or clearing agency are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparty. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or to the counterparty or clearing agency is considered materially mitigated. Based on the Company's assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Collateralized borrowings in securitization trusts. The Company recognizes on its consolidated balance sheets collateralized borrowings that are carried at fair value as a result of a fair value option election. In determining the fair value of its collateralized borrowings, management judgment may be used to arrive at fair value that considers prices obtained from third-party pricing providers, broker quotes received and other applicable market data. If observable market prices are not available or insufficient to determine fair value due principally to illiquidity in the marketplace, then fair value is based upon internally developed models that are primarily based on observable market-based inputs but also include unobservable market data inputs (including prepayment speeds, delinquency levels, and credit losses). The Company classified 100% of its collateralized borrowings in securitization trusts as Level 2 fair value liabilities at December 31, 2015.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following tables display the Company's assets and liabilities measured at fair value on a recurring basis. The Company often economically hedges the fair value change of its assets or liabilities with derivatives and other financial instruments. The tables below display the hedges separately from the hedged items, and therefore do not directly display the impact of the Company's risk management activities.

	Recurring Fair Value Measurements At December 31, 2015			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$7,825,320	$—	$7,825,320
Residential mortgage loans held-for-sale	—	764,319	47,112	811,431
Residential mortgage loans held-for-investment in securitization trusts	—	3,173,727	—	3,173,727
Mortgage servicing rights	—	—	493,688	493,688
Derivative assets	1,074	270,435	—	271,509
Total assets	$1,074	$12,033,801	$540,800	$12,575,675
Liabilities				
Collateralized borrowings in securitization trusts	$—	$2,000,110	$—	$2,000,110
Derivative liabilities	1,324	5,961	—	7,285
Total liabilities	$1,324	$2,006,071	$—	$2,007,395

	Recurring Fair Value Measurements At December 31, 2014			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale securities	$—	$14,341,102	$—	$14,341,102
Trading securities	1,997,656	—	—	1,997,656
Residential mortgage loans held-for-sale	—	500,159	35,553	535,712
Residential mortgage loans held-for-investment in securitization trusts	—	1,744,746	—	1,744,746
Mortgage servicing rights	—	—	452,006	452,006
Derivative assets	10,350	370,441	—	380,791
Total assets	$2,008,006	$16,956,448	$487,559	$19,452,013
Liabilities				
Collateralized borrowings in securitization trusts	$—	$1,209,663	$—	$1,209,663
Derivative liabilities	17,687	72,546	—	90,233
Total liabilities	$17,687	$1,282,209	$—	$1,299,896

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under U.S. GAAP. These items would constitute nonrecurring fair value measures under ASC 820. As of December 31, 2015, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.

The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and/or management. The third-party pricing providers and/or management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by the third-party pricing provider in the absence of market information. Assumptions used by the third-party pricing provider due to lack of observable inputs may significantly impact the resulting fair value and therefore the Company's consolidated financial statements. The Company's valuation committee reviews all valuations that are based on pricing information received from a third-party pricing provider. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable. In addition, the Company performs back-testing of pricing information to validate price information and identify any pricing trends of a third-party price provider.

In determining fair value, third-party pricing providers use various valuation approaches, including market and income approaches. Inputs that are used in determining fair value of an instrument may include pricing information, credit data, volatility statistics, and other factors. In addition, inputs can be either observable or unobservable.

The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. The third-party pricing provider uses prices and inputs that are current as of the measurement date, including during periods of market dislocations. In periods of market dislocation, the availability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified to or from various levels within the fair value hierarchy.

Securities for which market quotations are readily available are valued at the bid price (in the case of long positions) or the ask price (in the case of short positions) at the close of trading on the date as of which value is determined. Exchange-traded securities for which no bid or ask price is available are valued at the last traded price. OTC derivative contracts, including interest rate swaps, swaptions, credit default swaps and Markit IOS total return swaps, are valued by the Company using observable inputs, specifically quotations received from third-party pricing providers, and are therefore classified within Level 2.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents the reconciliation for all of the Company's Level 3 assets measured at fair value on a recurring basis:

	Level 3 Recurring Fair Value Measurements			
	Year Ended December 31,			
	2015		2014	
(in thousands)	Residential Mortgage Loans Held-For-Sale	Mortgage Servicing Rights	Residential Mortgage Loans Held-For-Sale	Mortgage Servicing Rights
Beginning of period level 3 fair value	$35,553	$452,006	$424,726	$514,402
Gains (losses) included in net income:				
Realized gains (losses)	25,330	(47,950)	7,734	(54,815)
Unrealized gains (losses)	445 [1]	(51,634) [3]	(3,213) [1]	(73,573) [3]
Total net gains (losses) included in net income	25,775	(99,584)	4,521	(128,388)
Other comprehensive income	—	—	—	—
Purchases	231,782	126,105	66,793	67,821
Sales	(163,449)	—	(433,603)	—
Settlements	(82,549)	15,161	(26,884)	(1,829)
Gross transfers into level 3	—	—	—	—
Gross transfers out of level 3	—	—	—	—
End of period level 3 fair value	$47,112	$493,688	$35,553	$452,006
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period	$566 [2]	$(51,634) [4]	$(3,028) [2]	$(73,573) [4]

(1) The change in unrealized gains or losses on residential mortgage loans held-for-sale was recorded in gain (loss) on residential mortgage loans held-for-sale on the consolidated statements of comprehensive (loss) income.

(2) The change in unrealized gains or losses on residential mortgage loans held-for-sale that were held at the end of the reporting period was recorded in gain (loss) on residential mortgage loans held-for-sale on the consolidated statements of comprehensive (loss) income.

(3) The change in unrealized gains or losses on MSR was recorded in (loss) gain on servicing asset on the consolidated statements of comprehensive (loss) income.

(4) The change in unrealized gains or losses on MSR that were held at the end of the reporting period was recorded in (loss) gain on servicing asset on the consolidated statements of comprehensive (loss) income.

The Company did not incur transfers between Level 1, Level 2 or Level 3 for the years ended December 31, 2015 or 2014. Transfers between Levels are deemed to take place on the first day of the reporting period in which the transfer has taken place.

The Company used a third-party pricing provider in the fair value measurement of its Level 3 residential mortgage loans held-for-sale. The significant unobservable inputs used by the third-party pricing provider included expected default, severity and discount rate. Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement.

149

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The Company also used a third-party pricing provider in the fair value measurement of its Level 3 MSR. The table below presents information about the significant unobservable inputs used by the third-party pricing provider in the fair value measurement of the Company's MSR classified as Level 3 fair value assets at December 31, 2015:

December 31, 2015			
Valuation Technique	Unobservable Input [1]	Range	Weighted Average
Discounted cash flow	Constant prepayment speed	9.6 - 13.5 %	11.8 %
	Delinquency	3.7 - 4.2 %	4.0 %
	Discount rate	8.7 - 11.2 %	10.1 %

(1) Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement. A change in the assumption used for discount rates may be accompanied by a directionally similar change in the assumption used for the probability of delinquency and a directionally opposite change in the assumption used for prepayment rates.

Fair Value Option for Financial Assets and Financial Liabilities

On July 1, 2015, the Company elected the fair value option for Agency interest-only securities and GSE credit risk transfer securities acquired on or after such date. The fair value option was elected to simplify the reporting of changes in fair value. Agency interest-only securities and GSE credit risk transfer securities are carried within AFS securities on the consolidated balance sheets. The Company's policy is to separately record interest income, net of premium amortization or including discount accretion, on these fair value elected securities. Fair value adjustments are reported in gain (loss) on investment securities on the consolidated statements of comprehensive (loss) income.

The Company elected the fair value option for the residential mortgage loans it has acquired. The fair value option was elected to mitigate earnings volatility by better matching the accounting for the assets with the related hedges. The mortgage loans are carried within residential mortgage loans held-for-sale on the consolidated balance sheets. The Company's policy is to separately record interest income on these fair value elected loans. Upfront fees and costs related to the fair value elected loans are not deferred or capitalized. Fair value adjustments are reported in gain (loss) on residential mortgage loans held-for-sale on the consolidated statements of comprehensive (loss) income. The fair value option is irrevocable once the loan is acquired.

The Company elected the fair value option for the equity securities previously carried on the consolidated balance sheets, which consisted solely of shares of Silver Bay common stock. The Company determined fair value of these equity securities based on the closing market price at period end. Fair value adjustments were reported in gain (loss) on investment securities on the consolidated statements of comprehensive (loss) income.

The Company also elected the fair value option for both the residential mortgage loans held-for-investment in securitization trusts and the collateralized borrowings in securitization trusts carried on the consolidated balance sheets. The fair value option was elected to better reflect the economics of the Company's retained interests. The Company's policy is to separately record interest income on the fair value elected loans and interest expense on the fair value elected borrowings. Upfront fees and costs are not deferred or capitalized. Fair value adjustments are reported in other (loss) income on the consolidated statements of comprehensive (loss) income.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following tables summarize the fair value option elections and information regarding the line items and amounts recognized in the consolidated statements of comprehensive (loss) income for each fair value option-elected item.

	Year Ended December 31, 2015					
(in thousands)	Interest income (expense)	Gain (loss) on investment securities	Gain (loss) on residential mortgage loans held-for-sale	Other (loss) income	Total included in net income	Change in fair value due to credit risk
Assets						
Available-for-sale securities	$124	$(68)	$—	$—	$56	NA
Residential mortgage loans held-for-sale	28,966 (1)	—	15,932	—	44,898	(6,365) (3)
Residential mortgage loans held-for-investment in securitization trusts	95,740 (1)	—	—	(52,440)	43,300	— (2)
Liabilities						
Collateralized borrowings in securitization trusts	(57,216)	—	—	25,914	(31,302)	— (2)
Total	$67,614	$(68)	$15,932	$(26,526)	$56,952	$(6,365)

	Year Ended December 31, 2014					
(in thousands)	Interest income (expense)	Gain (loss) on investment securities	Gain (loss) on residential mortgage loans held-for-sale	Other (loss) income	Total included in net income	Change in fair value due to credit risk
Assets						
Available-for-sale securities	$—	$—	$—	$—	$—	NA
Residential mortgage loans held-for-sale	16,089 (1)	—	12,568	—	28,657	1,295 (3)
Residential mortgage loans held-for-investment in securitization trusts	41,220 (1)	—	—	41,125	82,345	— (2)
Liabilities						
Collateralized borrowings in securitization trusts	(26,760)	—	—	(24,285)	(51,045)	— (2)
Total	$30,549	$—	$12,568	$16,840	$59,957	$1,295

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

(in thousands)	Year Ended December 31, 2013 Interest income (expense)	Gain (loss) on investment securities	Gain (loss) on residential mortgage loans held-for-sale	Other (loss) income	Total included in net income	Change in fair value due to credit risk
Assets						
Available-for-sale securities	$—	$—	$—	$—	$—	NA
Equity securities	—	7,843	—	—	7,843	$— [2]
Residential mortgage loans held-for-sale	22,185 [1]	—	(13,831)	—	8,354	6,677 [3]
Residential mortgage loans held-for-investment in securitization trusts	19,220 [1]	—	—	(22,910)	(3,690)	— [2]
Liabilities						
Collateralized borrowings in securitization trusts	(10,937)	—	—	37,114	26,177	— [2]
Total	$30,468	$7,843	$(13,831)	$14,204	$38,684	$6,677

(1) Interest income on residential mortgage loans held-for-sale and held-for-investment in securitization trusts is measured by multiplying the unpaid principal balance on the loans by the coupon rate and the number of days of interest due.
(2) The change in fair value on equity securities, residential mortgage loans held-for-investment in securitization trusts and collateralized borrowings in securitization trusts was due entirely to changes in market interest rates.
(3) The change in fair value due to credit risk on residential mortgage loans held-for-sale was quantified by holding yield constant in the cash flow model in order to isolate the credit risk component.

The table below provides the fair value and the unpaid principal balance for the Company's fair value option-elected loans and collateralized borrowings.

(in thousands)	December 31, 2015 Unpaid Principal Balance	Fair Value [1]	December 31, 2014 Unpaid Principal Balance	Fair Value [1]
Residential mortgage loans held-for-sale				
Total loans	$812,661	$811,431	$534,101	$535,712
Nonaccrual loans	$30,438	$25,771	$26,405	$20,574
Loans 90+ days past due	$26,702	$22,470	$25,263	$19,675
Residential mortgage loans held-for-investment in securitization trusts				
Total loans	$3,143,515	$3,173,727	$1,699,748	$1,744,746
Nonaccrual loans	$860	$868	$—	$—
Loans 90+ days past due	$860	$868	$—	$—
Collateralized borrowings in securitization trusts				
Total borrowings	$2,023,239	$2,000,110	$1,218,589	$1,209,663

(1) Excludes accrued interest receivable.

Table of Contents

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the consolidated balance sheets, for which fair value can be estimated. The following describes the Company's methods for estimating the fair value of financial instruments. Descriptions are not provided for those items that have zero balances as of the current balance sheet date.

- AFS securities, trading securities, residential mortgage loans held-for-sale, residential mortgage loans held-for-investment in securitization trusts, MSR, derivative assets and liabilities, and collateralized borrowings in securitization trusts are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the Fair Value Measurements section of this footnote.
- Commercial real estate assets are carried at cost, net of any unamortized acquisition premiums or discounts, loan fees and origination costs as applicable, unless deemed impaired. Because the Company has not yet recorded any allowances for losses and the rates and terms of the commercial real estate assets held at December 31, 2015 are similar to those observed in the market, carrying value, or amortized cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments. The Company categorizes the fair value measurement of these assets as Level 1.
- As a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is considered a non-marketable, long-term investment, and is carried at cost. Because this stock can only be redeemed or sold at its par value, and only to the FHLB, carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- Equity investments include cost method investments for which fair value is not estimated. Carrying value, or cost, approximates fair value. The Company categorizes the fair value measurement of these assets as Level 3.
- The carrying value of repurchase agreements and FHLB advances that mature in less than one year generally approximates fair value due to the short maturities. The Company holds $3.8 billion of FHLB advances that are considered long-term. The Company's long-term FHLB advances have floating rates based on an index plus a spread and, for members of the FHLB, the credit spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these borrowings are at market and thus carrying value approximates fair value. The Company categorizes the fair value measurement of these liabilities as Level 2.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at December 31, 2015 and December 31, 2014.

	December 31, 2015		December 31, 2014	
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Available-for-sale securities	$7,825,320	$7,825,320	$14,341,102	$14,341,102
Trading securities	$—	$—	$1,997,656	$1,997,656
Residential mortgage loans held-for-sale	$811,431	$811,431	$535,712	$535,712
Residential mortgage loans held-for-investment in securitization trusts	$3,173,727	$3,173,727	$1,744,746	$1,744,746
Commercial real estate assets	$660,953	$660,953	$—	$—
Mortgage servicing rights	$493,688	$493,688	$452,006	$452,006
Cash and cash equivalents	$737,831	$737,831	$1,005,792	$1,005,792
Restricted cash	$262,562	$262,562	$336,771	$336,771
Derivative assets	$271,509	$271,509	$380,791	$380,791
Federal Home Loan Bank stock	$156,650	$156,650	$100,010	$100,010
Equity investments	$3,000	$3,000	$3,000	$3,000
Liabilities				
Repurchase agreements	$5,008,274	$5,008,274	$12,932,463	$12,932,463
Collateralized borrowings in securitization trusts	$2,000,110	$2,000,110	$1,209,663	$1,209,663
Federal Home Loan Bank advances	$3,785,000	$3,785,000	$2,500,000	$2,500,000
Derivative liabilities	$7,285	$7,285	$90,233	$90,233

Note 17. Repurchase Agreements

As of December 31, 2015, the Company had outstanding $5.0 billion of repurchase agreements. Excluding the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 1.10% and weighted average remaining maturities of 35 days as of December 31, 2015. As of December 31, 2014, the Company had outstanding $12.9 billion of repurchase agreements, including repurchase agreements funding the Company's U.S. Treasuries of $2.0 billion. Excluding the debt associated with the Company's U.S. Treasuries and the effect of the Company's interest rate swaps, the repurchase agreements had a weighted average borrowing rate of 0.72% and weighted average remaining maturities of 64 days as of December 31, 2014. As of December 31, 2014, the debt associated with the Company's U.S. Treasuries had a weighted average borrowing rate of 0.23%. The Company did not have any repurchase agreements collateralized by U.S. Treasuries as of December 31, 2015.

At December 31, 2015 and December 31, 2014, the repurchase agreement balances were as follows:

(in thousands)	December 31, 2015	December 31, 2014
Short-term	$5,008,274	$12,839,242
Long-term	—	93,221
Total	$5,008,274	$12,932,463

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

At December 31, 2015 and December 31, 2014, the repurchase agreements had the following characteristics and remaining maturities:

	December 31, 2015 Collateral Type					
(dollars in thousands)	Agency RMBS	Non-Agency RMBS [1]	Agency Derivatives	Residential Mortgage Loans Held-for-Sale	Commercial Real Estate Assets	Total Amount Outstanding
Within 30 days	$1,719,292	$852,436	$58,286	$—	$59,349	$2,689,363
30 to 59 days	1,407,353	271,819	60,065	—	—	1,739,237
60 to 89 days	143,051	15,691	2,707	—	—	161,449
90 to 119 days	68,014	106,007	1,465	—	—	175,486
120 to 364 days	—	234,229	—	8,510	—	242,739
Total	$3,337,710	$1,480,182	$122,523	$8,510	$59,349	$5,008,274
Weighted average borrowing rate	0.65 %	2.03 %	1.18 %	2.87 %	2.62 %	1.10 %

	December 31, 2014 Collateral Type					
(dollars in thousands)	U.S. Treasuries	Agency RMBS	Non-Agency RMBS [1]	Agency Derivatives	Residential Mortgage Loans Held-for-Sale	Total Amount Outstanding
Within 30 days	$998,750	$2,305,726	$630,118	$44,723	$—	$3,979,317
30 to 59 days	—	3,568,049	945,032	82,344	—	4,595,425
60 to 89 days	—	631,992	260,228	11,066	—	903,286
90 to 119 days	—	317,155	117,395	—	—	434,550
120 to 364 days	—	1,635,650	278,401	—	15,113	1,929,164
Open maturity [2]	997,500	—	—	—	—	997,500
One year and over	—	—	93,221	—	—	93,221
Total	$1,996,250	$8,458,572	$2,324,395	$138,133	$15,113	$12,932,463
Weighted average borrowing rate	0.23 %	0.42 %	1.79 %	0.99 %	3.03 %	0.64 %

(1) Includes repurchase agreements collateralized by retained interests from the Company’s on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

(2) Includes repurchase agreements collateralized by U.S. Treasuries with an open maturity period (i.e., rolling 1-day maturity) renewable at the discretion of either party to the agreements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of repurchase agreements:

(in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities, at fair value	$5,354,104	$11,874,783
Trading securities, at fair value	—	1,997,656
Residential mortgage loans held-for-sale, at fair value	9,543	19,123
Commercial real estate assets	108,958	—
Net economic interests in consolidated securitization trusts (1)	274,949	363,564
Cash and cash equivalents	15,000	14,117
Restricted cash	119,310	112,435
Due from counterparties	10,211	32,495
Derivative assets, at fair value	157,879	185,067
Total	$6,049,954	$14,599,240

(1) Includes the retained interests from the Company's on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

Although the transactions under repurchase agreements represent committed borrowings until maturity, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls.
The following table summarizes certain characteristics of the Company's repurchase agreements and counterparty concentration at December 31, 2015 and December 31, 2014:

	December 31, 2015				December 31, 2014			
(dollars in thousands)	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity	Amount Outstanding	Net Counterparty Exposure (1)	Percent of Equity	Weighted Average Days to Maturity
Royal Bank of Canada	$799,527	$217,677	6 %	31.5	$1,373,549	$401,194	10 %	83.8
Barclays Capital Inc.	379,812	176,492	5 %	40.2	1,346,085	365,879	9 %	50.5
All other counterparties (2) (3)	3,828,935	641,616	18 %	35.8	9,215,329	907,066	22 %	57.7
Total	$5,008,274	$1,035,785			$11,934,963	$1,674,139		

(1) Represents the net carrying value of the securities, residential mortgage loans held-for-sale and commercial real estate assets sold under agreements to repurchase, including accrued interest plus any cash or assets on deposit to secure the repurchase obligation, less the amount of the repurchase liability, including accrued interest. Payables due to broker counterparties for unsettled securities purchases are not included in the amounts presented above. However, at both December 31, 2015 and December 31, 2014, the Company did not have any such payables.
(2) Excludes $997.5 million of repurchase agreements collateralized by U.S. Treasuries with a rolling 1-day maturity as of December 31, 2014.
(3) Represents amounts outstanding to 19 and 23 counterparties at December 31, 2015 and December 31, 2014, respectively.

The Company does not anticipate any defaults by its repurchase agreement counterparties. There can be no assurance, however, that any such default or defaults will not occur.

156

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 18. Collateralized Borrowings in Securitization Trusts, at Fair Value

The Company purchases subordinated debt and excess servicing rights from securitization trusts sponsored by either third parties or the Company's subsidiaries. The debt associated with the underlying residential mortgage loans held at the trusts, which are consolidated on the Company's consolidated balance sheets, is classified as collateralized borrowings in securitization trusts and carried at fair value as a result of a fair value option election. See Note 3 - Variable Interest Entities for additional information regarding consolidation of the securitization trusts. As of December 31, 2015 and December 31, 2014, the collateralized borrowings in securitization trusts had a carrying value of $2.0 billion and $1.2 billion with a weighted average interest rate of 3.6% for both periods.. The stated maturity dates for all collateralized borrowings were more than five years from both December 31, 2015 and December 31, 2014.

Note 19. Federal Home Loan Bank of Des Moines Advances

The Company's wholly owned subsidiary, TH Insurance, is a member of the FHLB. As a member of the FHLB, TH Insurance has access to a variety of products and services offered by the FHLB, including secured advances. As of December 31, 2015 and December 31, 2014, TH Insurance had $3.8 billion and $2.5 billion in outstanding secured advances with a weighted average borrowing rate of 0.58% and 0.34%, respectively, and had an additional $215.0 million of available uncommitted capacity for borrowings as of December 31, 2015. As of December 31, 2014, TH Insurance had no additional uncommitted capacity to borrow. To the extent TH Insurance has uncommitted capacity, it may be adjusted at the sole discretion of the FHLB.

The ability to borrow from the FHLB is subject to the Company's continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB's credit and collateral guidelines, as may be revised from time to time by the FHLB. Eligible collateral may include conventional 1-4 family residential mortgage loans, commercial real estate loans, Agency RMBS and non-Agency RMBS with an A rating and above.

At December 31, 2015 and December 31, 2014, FHLB advances had the following remaining maturities:

(in thousands)	December 31, 2015	December 31, 2014
≤ 1 year	$—	$33,738
> 1 and ≤ 3 years	651,238	651,238
> 3 and ≤ 5 years	815,024	815,024
> 5 and ≤ 10 years	—	—
> 10 years	2,318,738	1,000,000
Total	$3,785,000	$2,500,000

The following table summarizes assets at carrying values that are pledged or restricted as collateral for the future payment obligations of FHLB advances:

(in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities, at fair value	$2,412,970	$2,284,532
Residential mortgage loans held-for-sale, at fair value	735,911	397,656
Commercial real estate assets	252,172	—
Net economic interests in consolidated securitization trusts (1)	863,363	80,732
Total	$4,264,416	$2,762,920

(1) Includes the retained interests from the Company's on-balance sheet securitizations, which are eliminated in consolidation in accordance with U.S. GAAP.

157

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The FHLB retains the right to mark the underlying collateral for FHLB advances to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral. In addition, as a condition to membership in the FHLB, the Company is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2015 and December 31, 2014, the Company had stock in the FHLB totaling $156.7 million and $100.0 million, respectively, which is included in other assets on the consolidated balance sheets. FHLB stock is considered a non-marketable, long-term investment, is carried at cost and is subject to recoverability testing under applicable accounting standards. This stock can only be redeemed or sold at its par value, and only to the FHLB. Accordingly, when evaluating FHLB stock for impairment, the Company considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of December 31, 2015 and December 31, 2014, the Company had not recognized an impairment charge related to its FHLB stock.

Note 20. Commitments and Contingencies
The following represent the material commitments and contingencies of the Company as of December 31, 2015:
Management agreement. The Company pays PRCM Advisers a management fee equal to 1.5% per annum, calculated and payable quarterly in arrears, of the Company’s stockholders’ equity. For purposes of calculating the management fee, the Company’s stockholders’ equity means the sum of the net proceeds from all issuances of the Company’s equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus the Company’s retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that the Company pays for repurchases of the Company’s common stock since inception, and excluding any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income). This amount will be adjusted to exclude one-time events pursuant to changes in U.S. GAAP, and certain non-cash items after discussions between PRCM Advisers and the Company’s independent directors and approval by a majority of the Company’s independent directors. To the extent asset impairment reduces the Company’s retained earnings at the end of any completed calendar quarter; it will reduce the management fee for such quarter. The Company’s stockholders’ equity for the purposes of calculating the management fee could be greater than the amount of stockholders’ equity shown on the consolidated financial statements. The current term of the management agreement expires on October 28, 2016, and automatically renews for successive one-year terms annually until terminated in accordance with the terms of the agreement.
The Company reimburses PRCM Advisers for (i) the Company’s allocable share of the compensation paid by PRCM Advisers to its personnel serving as the Company’s principal financial officer and general counsel and personnel employed by PRCM Advisers as in-house legal, tax, accounting, consulting, auditing, administrative, information technology, valuation, computer programming and development and back-office resources to the Company, and (ii) any amounts for personnel of PRCM Adviser’s affiliates arising under a shared facilities and services agreement.
Upon termination of the management agreement by the Company without cause or by PRCM Advisers due to the Company’s material breach of the management agreement, the Company is required to pay a termination fee equal to three times the sum of the average annual base management fee earned by PRCM Advisers during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.
Employment contracts. The Company does not directly employ any personnel. Instead, the Company relies on the resources of PRCM Advisers to conduct the Company’s operations. Expense reimbursements to PRCM Advisers are made in cash on a quarterly basis following the end of each quarter.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Operating leases. As of December 31, 2015, the Company was obligated under non-cancelable operating leases for office space. Future minimum rental payments, including escalation clauses, under leases with terms of one year or more at December 31, 2015 were as follows:

(in thousands)

Year	Minimum Payment
2016	$2,121
2017	1,468
2018	1,187
2019	1,205
2020	1,223
Thereafter	1,765
Total	$8,969

Expenses under the lease agreements were $2.6 million, $2.0 million and $1.3 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Legal and regulatory. From time to time, the Company may be subject to liability under laws and government regulations and various claims and legal actions arising in the ordinary course of business. Liabilities are established for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts established for those claims. Based on information currently available, management is not aware of any legal or regulatory claims that would have a material effect on the Company's consolidated financial statements and therefore no accrual is required as of December 31, 2015.

Commitments to purchase residential mortgage loans. During the years ended December 31, 2015, 2014 and 2013, the Company entered into forward purchase commitments with counterparties whereby the Company committed to purchasing residential mortgage loans at a particular interest rate, provided the borrower elects to close the loan. All of these commitments were accounted for as derivatives at December 31, 2015 and December 31, 2014. See Note 13 - Derivative Instruments and Hedging Activities for additional information.

Unfunded commitments on commercial real estate loans. Certain of the Company's commercial real estate loan agreements contain provisions for future fundings to borrowers, generally to finance lease-related or capital expenditures. As of December 31, 2015, the Company had unfunded commitments of $52.2 million on commercial real estate loans held-for-investment with expirations dates within the next two years.

Representation and warranty obligations. The Company has exposure to representation and warranty obligations in its capacity as owner of MSR and its mortgage loan sales and securitization activities. The specific representations and warranties, or R&W, vary among different transactions and investors, but typically relate to, among other things, the ownership of the loan, the validity of the lien securing the loan, the loan's compliance with the criteria for inclusion in the transaction, including compliance with underwriting standards or loan criteria established by the investor, the ability to deliver required documentation and compliance with applicable laws. In general, the representations and warranties may be enforced at any time unless a sunset provision is in place.

The reserve for R&W obligations reflect management's best estimate of probable lifetime loss. The methodology used to estimate the reserve considers a variety of assumptions including borrower performance (both actual and estimated future defaults), historical loan defect experience, historical and estimated future loss experience, which includes projections of future home price changes as well as other qualitative factors including investor behavior.

In accordance with the purchase and sale agreement with our MSR and conduit counterparties, we have contractually mirrored our R&W obligations to the GSEs and private investors. As a result, we possess the ability to seek indemnification from our counterparties in the event of a realized loss from the fulfillment of our R&W obligation. At December 31, 2015 and December 31, 2014, the reserve (liability) for representation and warranty obligations was

$2.8 million and $2.5 million, respectively.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 21. Stockholders' Equity
Common Stock
As of December 31, 2015, the Company had 353,906,807 shares of common stock outstanding. The following table presents a reconciliation of the common shares outstanding from December 31, 2012 through December 31, 2015:

	Number of common shares
Common shares outstanding, December 31, 2012	298,813,258
Issuance of common stock	67,511,609
Issuance of restricted stock [1]	1,061,001
Repurchase of common stock	(2,450,700)
Common shares outstanding, December 31, 2013	364,935,168
Issuance of common stock	57,218
Issuance of restricted stock [1]	1,403,534
Common shares outstanding, December 31, 2014	366,395,920
Issuance of common stock	69,826
Issuance of restricted stock [1]	1,105,361
Repurchase of common stock	(13,664,300)
Common shares outstanding, December 31, 2015	353,906,807

(1) Represents shares of restricted stock granted under the Second Restated 2009 Equity Incentive Plan, of which 2,290,609 restricted shares remained subject to vesting requirements at December 31, 2015.

Distributions to Stockholders
The following table presents cash dividends declared by the Company on its common stock for the years ended December 31, 2015, 2014 and 2013:

Declaration Date	Record Date	Payment Date	Cash Dividend Per Share
December 16, 2015	December 30, 2015	January 20, 2016	$0.26
September 16, 2015	September 30, 2015	October 22, 2015	$0.26
June 17, 2015	June 30, 2015	July 21, 2015	$0.26
March 18, 2015	March 31, 2015	April 21, 2015	$0.26
December 16, 2014	December 30, 2014	January 20, 2015	$0.26
September 16, 2014	September 30, 2014	October 21, 2014	$0.26
June 17, 2014	July 2, 2014	July 22, 2014	$0.26
March 17, 2014	March 31, 2014	April 21, 2014	$0.26
December 17, 2013	December 27, 2013	December 31, 2013	$0.26
September 11, 2013	September 26, 2013	October 23, 2013	$0.28
June 18, 2013	June 28, 2013	July 23, 2013	$0.31
March 18, 2013	April 2, 2013	April 24, 2013	$0.32

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Special Dividend of Silver Bay Common Stock
On March 18, 2013, the Company's board of directors declared a special dividend pursuant to which the Company distributed 17,824,647 shares of Silver Bay common stock the Company received in exchange for the contribution of its equity interests in Two Harbors Property Investment LLC to Silver Bay on December 19, 2012, on a pro rata basis, to the Company's stockholders of record as of April 2, 2013. The final distribution ratio for the stock dividend was determined to be 0.048825853 shares of Silver Bay common stock for each share of the Company's common stock outstanding as of April 2, 2013. The dividend was distributed on or about April 24, 2013.
Accumulated Other Comprehensive Income
Accumulated other comprehensive income at December 31, 2015 and December 31, 2014 was as follows:

(in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities, at fair value		
Unrealized gains	$405,177	$891,820
Unrealized losses	(46,116)	(36,031)
Accumulated other comprehensive income	$359,061	$855,789

Reclassifications out of Accumulated Other Comprehensive Income
The following table summarizes reclassifications out of accumulated other comprehensive income for the years ended December 31, 2015, 2014 and 2013:

(in thousands)	Affected Line Item in the Consolidated Statements of Comprehensive (Loss) Income	Amount Reclassified out of Accumulated Other Comprehensive Income Year Ended December 31, 2015	2014	2013
Other-than-temporary-impairments on AFS securities	Total other-than-temporary impairment losses	$535	$392	$1,662
Realized (gains) losses on sales of certain AFS securities, net of tax	Gain (loss) on investment securities	(336,230)	(52,931)	44,780
Total		$(335,695)	$(52,539)	$46,442

Public Offering
On March 22, 2013, the Company completed a public offering of 50,000,000 shares of its common stock and issued an additional 7,500,000 shares of common stock pursuant to the underwriters' over-allotments at a price of $13.46 per share, for gross proceeds of approximately $774.0 million. Net proceeds to the Company were approximately $762.9 million, net of issuance costs of approximately $11.1 million.
Dividend Reinvestment and Direct Stock Purchase Plan
The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of the Company's common stock by reinvesting some or all of the cash dividends received on shares of the Company's common stock. Stockholders may also make optional cash purchases of shares of the Company's common stock subject to certain limitation detailed in the plan prospectus. An aggregate of 7.5 million shares of the Company's common stock were originally reserved for issuance under the plan. As of December 31, 2015, 283,292 shares have been issued under the plan for total proceeds of approximately $3.0 million, of which 69,826 shares were issued for total proceeds of $0.7 million during the year ended December 31, 2015. During the years ended December 31, 2014 and 2013, 57,218 and 71,961 shares were issued for total proceeds of $0.6 million and $0.8 million, respectively.

Table of Contents

Share Repurchase Program

As of December 31, 2015, the Company's share repurchase program allowed the Company to repurchase up to 25,000,000 shares of its common stock. (Subsequent to year end, the Company's board of directors authorized an increase of 50,000,000 shares, for up to a total of 75,000,000 shares authorized under the program). Shares may be repurchased from time to time through privately negotiated transactions or open market transactions, pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, or by any combination of such methods. The manner, price, number and timing of share repurchases are subject to a variety of factors, including market conditions and applicable U.S. Securities and Exchange Commission, or SEC, rules. The share repurchase program does not require the purchase of any minimum number of shares, and purchases may be commenced or suspended at any time without prior notice. The share repurchase program does not have an expiration date. As of December 31, 2015, a total of16,115,000 shares had been repurchased by the Company under the program for an aggregate cost of $139.1 million; of these, 13,664,300 shares were repurchased for a total cost of $115.2 million during the year ended December 31, 2015. No shares were repurchased during the year ended December 31, 2014. The remaining 2,450,700 shares were repurchased during the year ended December 31, 2013 for a total cost of $23.9 million.

At-the-Market Offering

On May 25, 2012, the Company entered into an equity distribution agreement under which the Company may sell up to an aggregate of 20,000,000 shares of its common stock from time to time in any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 under the Securities Act of 1933, as amended, or the Securities Act. On May 22, 2015, the Company entered into an amendment to the equity distribution agreement providing that any subsequent offers or sales of the Company's common stock under the equity distribution agreement shall be made pursuant to a new prospectus supplement, which was filed on the same date. As of December 31, 2015, 7,585,869 shares of common stock have been sold under the equity distribution agreement for total accumulated net proceeds of approximately $77.6 million; however, no shares were sold during the years ended December 31, 2015, 2014 and 2013.

Warrants

From January 1, 2013 to April 2, 2013, warrant holders exercised 8,720,690 warrants to purchase 8,720,690 shares of the Company's common stock, at an exercise price of $11.00 per share. On April 2, 2013, the exercise price of the warrants was lowered to $10.25 per warrant share and the number of shares of the Company's common stock issuable for each warrant share exercised was increased to 1.0727 shares. These adjustments were required under the terms of the warrant agreement as a result of the special dividend of Silver Bay common stock. Calculation of the adjustments was determined based on, among other things, the closing price of the Company's common stock on the business day immediately preceding the ex-dividend date for the stock dividend and the fair market value of the stock dividend to be received for each share of the Company's common stock on the ex-dividend date.

From April 3, 2013 to the warrant expiration date, November 7, 2013, warrant holders exercised 1,130,460 warrants to purchase 1,212,607 shares of the Company's common stock, at an exercise price of $10.25 per share. Total proceeds to the Company for warrant exercises during the year ended December 31, 2013 were approximately $107.5 million. Additionally, certain Capitol founders holding warrants containing cashless exercise provisions exercised 100,000 warrants on a cashless basis, resulting in the surrender of 93,649 shares of common stock and the issuance of 6,351 shares of common stock during the year ended December 31, 2013. No proceeds were received by the Company as a result of the cashless exercises.

At 5:00 p.m. EST on November 7, 2013, 3,580,279 warrants expired pursuant to the terms of the warrant agreement. No warrants remained outstanding as of December 31, 2013.

Note 22. Equity Incentive Plan

The Company’s Plan was adopted in 2009 and amended in May 2013 and May 2015. The Company adopted the Plan to provide incentive compensation to attract and retain qualified directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and employees of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company.

On May 14, 2015, the Company’s stockholders approved the Company’s Second Restated 2009 Equity Incentive Plan, which replaced the previous Restated 2009 Equity Incentive Plan, both of which are referred to collectively as the Plan. This stockholder approval effectuated, among other changes, an increase in the number of shares of common stock available for issuance under the Plan by 10,000,000 shares, to a total of 13,000,000 shares.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The Plan is administered by the compensation committee of the Company's board of directors. The compensation committee has the full authority to administer and interpret the Plan, to authorize the granting of awards, to determine the eligibility of directors, officers, advisors, consultants and other personnel, including PRCM Advisers and affiliates and personnel of PRCM Advisers and its affiliates, and any joint venture affiliates of the Company, to receive an award, to determine the number of shares of common stock to be covered by each award (subject to the individual participant limitations provided in the Plan), to determine the terms, provisions and conditions of each award (which may not be inconsistent with the terms of the Plan), to prescribe the form of instruments evidencing awards and to take any other actions and make all other determinations that it deems necessary or appropriate in connection with the Plan or the administration or interpretation thereof. In connection with this authority, the compensation committee may, among other things, establish performance goals that must be met in order for awards to be granted or to vest, or for the restrictions on any such awards to lapse.
The Company's Plan provides for grants of restricted common stock, phantom shares, dividend equivalent rights and other equity-based awards, subject to a ceiling of 13,000,000 shares available for issuance under the Plan. The Plan allows for the Company's board of directors to expand the types of awards available under the Plan to include long-term incentive plan units in the future. If an award granted under the Plan expires or terminates, the shares subject to any portion of the award that expires or terminates without having been exercised or paid, as the case may be, will again become available for the issuance of additional awards. Unless earlier terminated by the Company's board of directors, no new award may be granted under the Plan after the tenth anniversary of the date that such Plan was initially approved by the Company's board of directors. No award may be granted under the Plan to any person who, assuming payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company's common stock.
During the years ended years ended December 31, 2015, 2014 and 2013, the Company granted 61,952, 54,799, and 40,032 shares of common stock, respectively, to its independent directors pursuant to the Plan. The weighted average grant date estimated fair value of these awards was $10.18, $10.31 and $11.34 per share, respectively, based on the closing price of the Company's common stock on the NYSE on the grant date of each award. The grants vested immediately.
Additionally, during the years ended years ended December 31, 2015, 2014 and 2013, the Company granted 1,115,574, 1,374,989 and 1,020,969 shares of restricted common stock, respectively, to key employees of PRCM Advisers pursuant to the Plan. The weighted average grant date estimated fair value of these awards was $10.49, $9.90 and $11.23 per share, respectively, based on the closing market price of the Company's common stock on the NYSE on the grant date of each award. However, as the cost of these awards is measured at fair value at each reporting date based on the price of the Company's stock as of period end in accordance with ASC 505, Equity, or ASC 505, the fair value of these awards as of December 31, 2015 was $8.10 per share, based on the closing market price of the Company's common stock on the NYSE on such date. The shares underlying the grants vest in three equal annual installments commencing on the first anniversary of the grant date, as long as such grantee complies with the terms and conditions of his or her applicable restricted stock award agreement.
The following table summarizes the activity related to restricted common stock for the years ended December 31, 2015 and 2014:

	Year Ended December 31, 2015		2014	
	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value
Outstanding at Beginning of Period	2,002,406	$10.32	1,024,459	$11.22

Granted	1,177,526	10.47	1,429,788	9.91
Vested	(828,164)	(10.42)	(445,712)	(11.11)
Forfeited	(61,159)	(10.17)	(6,129)	(9.79)
Outstanding at End of Period	2,290,609	$10.36	2,002,406	$10.32

For the years ended December 31, 2015, 2014 and 2013, the Company recognized compensation costs related to restricted common stock of $9.0 million, $11.7 million, and $3.9 million, respectively.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 23. Income Taxes

For the years ended December 31, 2015, 2014 and 2013, the Company qualified to be taxed as a REIT under the Code for U.S. federal income tax purposes. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes its net taxable income to stockholders and does not engage in prohibited transactions. The Company intends to distribute 100% of its REIT taxable income and comply with all requirements to continue to qualify as a REIT. The majority of states also recognize the Company's REIT status. The Company's TRSs file separate tax returns and are fully taxed as standalone U.S. C-Corporations. The tables below reflect the net taxes accrued at the TRS level and the tax attributes included in the consolidated financial statements. It is assumed that the Company will retain its REIT status and will incur no REIT level taxation as it intends to comply with the REIT regulations and annual distribution requirements.

Certain activities the Company performs may produce income that will not be qualifying income for REIT purposes. These activities include the designated portion of MSR treated as normal mortgage servicing, swaptions, credit default swaps, TBAs and other risk-management instruments. The Company has designated its TRSs to engage in these activities. The Company also purchases and sells mortgage loans through the secondary whole loan market and/or securitization market and has designated its TRSs to engage in these activities.

The following table summarizes the tax (benefit) provision recorded at the taxable subsidiary level for the years ended December 31, 2015, 2014 and 2013:

(in thousands)	Year Ended December 31, 2015	2014	2013
Current tax (benefit) provision:			
Federal	$(4,027)	$6,507	$808
State	175	16	5
Total current tax (benefit) provision	(3,852)	6,523	813
Deferred tax (benefit) provision	(12,638)	(80,261)	83,598
Total (benefit from) provision for income taxes	$(16,490)	$(73,738)	$84,411

The Company's taxable income before dividend distributions differs from its pre-tax net income for U.S. GAAP purposes primarily due to unrealized gains and losses, the recognition of credit losses for U.S. GAAP purposes but not tax purposes, differences in timing of income recognition due to market discount, and original issue discount and the calculations surrounding each. These book to tax differences in the REIT are not reflected in the financial statements as the Company intends to retain its REIT status.

The following is a reconciliation of the statutory federal and state rates to the effective rates, for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31, 2015		2014		2013	
(dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent
Computed income tax expense at federal rate	$166,502	35 %	$32,691	35 %	$225,573	34 %
State taxes, net of federal benefit, if applicable	114	— %	10	— %	4	— %
Permanent differences in taxable income from GAAP net income	4,203	1 %	1,636	2 %	17,681	3 %
Dividends paid deduction	(187,309)	(39)%	(108,075)	(116)%	(158,847)	(24)%
	$(16,490)	(3)%	$(73,738)	(79)%	$84,411	13 %

(Benefit from) provision for income taxes/
Effective Tax Rate[1]

---

(1) The (benefit from) provision for income taxes is recorded at the taxable subsidiary level.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

The Company's permanent differences in taxable income from GAAP net income in the year ended December 31, 2015 were primarily due to net losses incurred by consolidated securitization trusts that are not subject to federal taxes. The Company's permanent differences in taxable income from GAAP net income in the year ended December 31, 2014 were due primarily to the statutory federal rate change from 34% to 35% and corresponding adjustment to the measurement of beginning deferred tax assets and liabilities. The Company's permanent differences in taxable income from GAAP net income in the year ended December 31, 2013 were due primarily to dividends received by the REIT from the TRSs.

The Company's consolidated balance sheets, as of December 31, 2015 and December 31, 2014, contain the following current and deferred tax liabilities and assets, which are included in other liabilities and other assets, respectively, and are recorded at the taxable subsidiary level:

(in thousands)	December 31, 2015	December 31, 2014
Income taxes receivable (payable)		
Federal income taxes receivable (payable)	$5,216	$(1,375)
State and local income taxes receivable (payable)	—	—
Income taxes receivable (payable), net	5,216	(1,375)
Deferred tax assets (liabilities)		
Deferred tax asset	69,441	60,575 (1)
Deferred tax liability	(25,123)	(19,728)
Total net deferred tax assets	44,318	40,847
Total tax assets, net	$49,534	$39,472

(1) Net of valuation allowance of $0.1 million.

Deferred Tax Assets and Liabilities

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting and tax purposes at the TRS level. Components of the Company's deferred tax assets as of December 31, 2015 and December 31, 2014 are as follows:

(in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities	$(8,673)	$—
Trading securities	—	(478)
Mortgage servicing rights	6,363	4,494
Derivative assets and liabilities	(4,492)	5,978
Other assets	3	16
Other liabilities	978	859
Intangibles	256	277
Alternative minimum tax credit	420	98
Net operating loss carryforward	8,177	9,448
Capital loss carryforward	41,286	20,155
Total net deferred tax assets	$44,318	$40,847

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

At December 31, 2015, the Company had not recorded a valuation allowance for any portion of its deferred tax assets as it did not believe, at a more likely than not level, that any portion of its deferred tax assets would not be realized. At December 31, 2014, a $0.1 million valuation allowance was established because the Company determined that it was more likely than not that the associated deferred tax asset would not be realized. Of the TRS net operating loss carryforward of $8.2 million, $1.3 million is scheduled to expire December 31, 2033, $2.5 million is scheduled to expire December 31, 2034 and $4.4 million is scheduled to expire December 31, 2035. Of the TRS net capital loss carryforward of $41.3 million, $0.1 million is scheduled to expire December 31, 2017, $20.1 million is scheduled to expire December 31, 2019 and $21.1 million is scheduled to expire December 31, 2020. The Company estimates, based on existence of sufficient evidence, the ability to realize the remainder of its deferred tax assets. Any adjustments to such estimates will be made in the period such determination is made.
Based on the Company’s evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company’s consolidated financial statements of a contingent tax liability for uncertain tax positions. Additionally, there were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

Note 24. Earnings Per Share
The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted earnings per share, or EPS, for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31,		
(in thousands, except share data)	2015	2014	2013
Numerator:			
Net income from continuing operations	$492,210	$167,139	$575,040
Income from discontinued operations	—	—	3,999
Net income	$492,210	$167,139	$579,039
Denominator:			
Weighted average common shares outstanding	363,055,228	364,181,059	349,741,902
Weighted average restricted stock shares	2,192,510	1,830,796	619,925
Basic weighted average shares outstanding	365,247,738	366,011,855	350,361,827
Dilutive weighted average warrants	—	—	630,560
Diluted weighted average shares outstanding	365,247,738	366,011,855	350,992,387
Basic Earnings Per Share:			
Continuing operations	$1.35	$0.46	$1.64
Discontinued operations	—	—	0.01
Net income	$1.35	$0.46	$1.65
Diluted Earnings Per Share:			
Continuing operations	$1.35	$0.46	$1.64
Discontinued operations	—	—	0.01
Net income	$1.35	$0.46	$1.65

No warrants were outstanding during the years ended December 31, 2015 and 2014; however, during the year ended December 31, 2013, the weighted average market value per share of the Company’s common stock, after factoring in the number of shares of the Company’s common stock issuable for each warrant of 1.0727 shares, was above the exercise price of the warrants, making the warrants dilutive.

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 25. Related Party Transactions

The following summary provides disclosure of the material transactions with affiliates of the Company.

In accordance with the Management Agreement with PRCM Advisers, the Company incurred $50.3 million, $48.8 million and $46.0 million as a management fee to PRCM Advisers for the years ended December 31, 2015, 2014 and 2013, respectively, which represents approximately 1.5% of stockholders' equity on an annualized basis as defined by the Management Agreement. For purposes of calculating the management fee, stockholders' equity is adjusted to exclude any common stock repurchases as well as any unrealized gains, losses or other items that do not affect realized net income, among other adjustments, in accordance with the Management Agreement. Management fees for the year ended December 31, 2013 were also reduced by $4.3 million on the consolidated statements of comprehensive (loss) income in accordance with the contribution transaction entered into with Silver Bay. See further discussion of this adjustment below. In addition, the Company reimbursed PRCM Advisers for direct and allocated costs incurred by PRCM Advisers on behalf of the Company. These direct and allocated costs totaled approximately $22.9 million, $15.5 million and $9.9 million for the years ended December 31, 2015, 2014 and 2013, respectively. The Company has an established accounts payable function and direct relationships with the majority of its third-party vendors. The Company will continue to have certain costs allocated to it by PRCM Advisers for compensation, data services and proprietary technology, but most direct expenses with third-party vendors are paid directly by the Company.

The Company recognized $9.0 million, $11.7 million and $3.9 million of compensation expense during the years ended December 31, 2015, 2014 and 2013, respectively, related to restricted stock. See Note 22 - Equity Incentive Plan for additional information.

On December 19, 2012, the Company completed the contribution of its portfolio of single-family rental properties to Silver Bay, a newly organized Maryland corporation intended to qualify as a REIT and focused on the acquisition, renovation, leasing and management of single-family residential properties for rental income and long-term capital appreciation. The Company contributed its equity interests in its wholly owned subsidiary, Two Harbors Property Investment LLC to Silver Bay, and in exchange for its contribution, received shares of common stock of Silver Bay. Silver Bay completed its IPO of its common stock on December 19, 2012. See Note 4 - Discontinued Operations for additional information. In connection with the closing of the contribution, all agreements with Silver Bay were terminated, except for certain designated provisions (e.g., protection of confidential information and indemnification), which the parties agreed would survive the termination. Not included in the gain that was recorded on the contribution in 2012 are certain adjustments that were to be recognized in 2013. These include an installment sales gain of approximately $4.0 million from Silver Bay, a reduction of 2013 management fees payable to PRCM Advisers of $4.3 million, and an immaterial amount of additional working capital adjustments determined in accordance with the contribution agreement entered into with Silver Bay. Of these amounts, $3.9 million of the installment sales gain was recorded in gain on contribution of entity within discontinued operations, and the full $4.3 million of the reduction of 2013 management fees payable to PRCM Advisers was recorded within management fees, on the consolidated statements of comprehensive (loss) income for the year ended December 31, 2013. No further adjustments were recognized during 2015 and 2014.

Note 26. Subsequent Events

On January 11, 2016, the Federal Housing Finance Agency, or FHFA, released a final rule regarding membership in the Federal Home Loan Bank system. Among other effects, the ruling excludes captive insurers from membership eligibility, including the Company's subsidiary member, TH Insurance. Since TH Insurance was admitted as a member in 2013, it is eligible for a five-year membership grace period, during which new advances or renewals that mature beyond the grace period will be prohibited. However, any existing advances that mature beyond this grace period will be permitted to remain in place subject to their terms insofar as the Company maintains good standing with the FHLB. If any new advances or renewals occur, TH Insurance's outstanding advances will be limited to forty percent of its total

assets.
On January 27, 2016, the Company's board of directors authorized the repurchase of an additional 50,000,000 shares of the Company's common stock pursuant to its ongoing share repurchase program. The shares are expected to be repurchased from time to time through privately negotiated transactions or open market transactions, including pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934, as amended, or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject a variety of factors, including market conditions and applicable SEC rules. The additional authorization does not have an expiration date and repurchases may be commenced or suspended at any time without prior notice.
Events subsequent to December 31, 2015 were evaluated through the date these financial statements were issued and no additional events were identified requiring further disclosure in these consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
Notes to the Consolidated Financial Statements

Note 27. Quarterly Financial Data - Unaudited

	2015 Quarter Ended			
(in thousands, except share data)	March 31	June 30	September 30	December 31
Total interest income	$162,969	$152,529	$152,834	$133,605
Total interest expense	33,503	35,029	37,079	36,575
Net interest income	129,466	117,500	115,755	97,030
Other-than-temporary impairment losses	(127)	(170)	(238)	—
Total other (loss) income	(7,100)	134,110	(119,286)	160,308
Total expenses	38,103	36,896	38,677	37,852
(Benefit from) provision for income taxes	(10,657)	(6,957)	(7,656)	8,780
Net income (loss)	$94,793	$221,501	$(34,790)	$210,706
Basic and diluted earnings (loss) per weighted average share	$0.26	$0.60	$(0.09)	$0.59
Basic and diluted weighted average number of shares of common stock	366,507,657	367,074,131	367,365,973	360,090,432

	2014 Quarter Ended			
(in thousands, except share data)	March 31	June 30	September 30	December 31
Interest income:				
Total interest income	$138,535	$140,149	$142,303	$156,220
Total interest expense	26,078	24,950	24,718	31,704
Net interest income	112,457	115,199	117,585	124,516
Other-than-temporary impairment losses	(212)	—	—	(180)
Total other (loss) income	(143,422)	(65,432)	111,697	(143,210)
Total expenses	31,870	33,370	40,550	29,807
Benefit from income taxes	(33,902)	(23,260)	(4,858)	(11,718)
Net (loss) income	$(29,145)	$39,657	$193,590	$(36,963)
Basic and diluted (loss) earnings per weighted average share	$(0.08)	$0.11	$0.53	$(0.10)
Basic and diluted weighted average number of shares of common stock	365,611,890	366,078,124	366,118,866	366,230,566

Table of Contents

TWO HARBORS INVESTMENT CORP.
SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE
As of December 31, 2015
(dollars in thousands)

Asset Type/ Description	Number of Loans	Interest Rate	Final Maturity Date (1)	Periodic Payment Terms (2)	Prior Liens (3)	Face Amount	Carrying Amount	Principal Amount Subject to Delinquent Principal or Interest
Residential mortgage loans held-for-sale								
Prime nonconforming residential mortgage loans:								
Fixed rate								
Original loan balance $0 - $999,999	875	3.375% - 5.5%	11/2042 - 1/2046	P&I	$—	$586,190	$593,311	$—
Original loan balance $1,000,000 - $1,999,999	117	3.625% - 5.25%	4/2042 - 12/2045	P&I	—	140,681	142,284	—
Original loan balance $2,000,000 - $2,999,999	3	3.875% - 4.125%	6/2045 - 10/2045	P&I	—	6,457	6,522	—
Adjustable rate								
Original loan balance $0 - $999,999	24	2.875% - 3.875%	4/2044 - 1/2046	P&I	—	14,888	15,135	—
Original loan balance $1,000,000 - $1,999,999	6	2.75% - 4.25%	4/2044 - 11/2045	P&I	—	6,969	7,066	—
Credit sensitive residential mortgage loans:								
Fixed rate	78	1% - 14%	4/2042 - 9/2055	P&I	—	13,310	6,833	3,872
Adjustable rate	25	2.625% - 10.65%	7/2019 - 10/2051	P&I	—	5,863	4,211	744
Ginnie Mae buyout residential mortgage loans:								
Fixed rate	281	2% - 12%	11/2044 - 6/2055	P&I	—	37,512	35,325	21,514
Adjustable rate	6	2.125% - 4.5%	7/2019 - 10/2051	P&I	—	791	744	572
Total residential mortgage loans held-for-sale					$—	$812,661	$811,431	$26,702
Residential mortgage loans held-for-investment in securitization trusts								
Prime nonconforming residential mortgage loans:								
Fixed rate								
Original loan balance $0 - $999,999	3,831	3.375% - 5.125%	11/2041 - 9/2045	P&I	$—	$2,514,339	$2,538,519	$860
	511			P&I	—	595,235	600,935	—

Original loan balance $1,000,000 - $1,999,999		3.5% - 5%	2/2042 - 9/2045					
Original loan balance $2,000,000 - $2,999,999	16	3.625% - 4.25%	10/2042 - 9/2045	P&I	—	33,941	34,273	—
Total residential mortgage loans held-for-investment in securitization trusts					$—	$3,143,515	$3,173,727	$860

169

Table of Contents

TWO HARBORS INVESTMENT CORP.
SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE, continued
As of December 31, 2015
(dollars in thousands)

Asset Type/ Location	Interest Rate	Final Maturity Date (1)	Periodic Payment Terms (2)	Prior Liens (3)	Face Amount	Carrying Amount	Principal Amount Subject to Delinquent Principal or Interest
Commercial real estate loans held-for-investment							
Retail-Mixed Use/ Southeast	L+4.20%	12/2019	P&I	$—	$120,000	$118,595	$—
Retail/ West	L+3.42%	10/2018	IO	—	105,000	104,154	—
Office-Mixed Use/ Northeast	L+4.20%	12/2018	IO	—	76,400	75,514	—
Office/ Diversified US	L+7.25%	9/2018	P&I	708,000	63,260	63,260	—
Hotel/ Diversified US	L+6.75%	1/2017	IO	285,000	45,900	45,698	—
Multifamily/ Southeast	L+4.05%	1/2019	P&I	—	43,500	43,126	—
Office/ Northeast	L+4.65%	1/2020	IO	—	38,766	38,343	—
Office/ Northeast	L+4.55%	12/2019	P&I	—	38,000	37,349	—
Multifamily/ Northeast	L+3.60%	11/2019	P&I	—	23,500	23,323	—
Multifamily/ Southeast	L+4.05%	9/2018	P&I	—	18,700	18,504	—
Hotel/ Southeast	L+8.75%	8/2017	IO	98,500	17,000	16,965	—
Office/ Diversified US	L+6.91%	9/2018	P&I	—	15,000	15,000	—
Multifamily/ Southeast	L+5.25%	8/2018	IO	—	12,400	12,304	—
Hotel/ Midwest	L+4.99%	11/2018	IO	—	11,167	10,976	—
Multifamily/ Southeast	L+4.03%	10/2018	P&I	—	11,000	10,919	—
Office/ Northeast	L+12.25%	7/2018	IO	45,100	9,937	9,887	—
Office/ Southeast	L+9.50%	8/2020	IO	45,303	9,900	9,831	—
Hotel/ Northeast	13.0 %	11/2025	P&I	59,000	7,916	7,205	—
Total commercial real estate loans held-for-investment				$1,240,903	$667,346	$660,953	$—
Total mortgage loans on real estate				$1,240,903	$4,623,522	$4,646,111	$27,562

(1) Based on contractual maturity date. Certain commercial real estate loans are subject to contractual extension options which may be subject to conditions as stipulated in the loan agreement. Actual maturities may differ from contractual maturities stated herein as certain borrowers may have the right to prepay with or without paying a prepayment penalty. The Company may also extend contractual maturities in connection with loan modifications.
(2) Principal and interest (“P&I”); Interest-only (“IO”). Certain commercial real estate loans labeled as P&I are non-amortizing until a specific date when they begin amortizing P&I, as stated in the loan agreements.
(3) Represents third-party priority liens. Third party portions of pari-passu participations are not considered prior liens.

Table of Contents

TWO HARBORS INVESTMENT CORP.
NOTE TO SCHEDULE IV - RECONCILIATION OF MORTGAGE LOANS ON REAL ESTATE
(dollars in thousands)

	Year Ended December 31,		
(in thousands)	2015	2014	2013
Balance at beginning of period	$2,280,458	$1,336,971	$58,607
Additions during period:			
Originations and purchases	3,269,020	1,475,210	993,813
Consolidation of residential mortgage loans held-for-investment in securitization trusts	—	—	442,767
Net discount accretion (premium amortization)	149	—	—
Amortization of net deferred origination fees	319	—	—
Deductions during period:			
Collections of principal	(661,000)	(149,674)	(76,581)
Cost of mortgages sold	(147,713)	(425,505)	(25,413)
(Increase) decrease in net deferred origination fees	(6,656)	—	—
Cumulative-effect adjustment to equity for adoption of new accounting principle	(2,991)	—	—
Change in realized and unrealized (losses) gains	(53,689)	49,719	(56,222)
Other [(1)]	(31,786)	(6,263)	—
Balance at end of period	$4,646,111	$2,280,458	$1,336,971

(1) Includes transfer of mortgage servicing rights fair value on buyout of Ginnie Mae residential mortgage loans and transfers to other receivables for foreclosed government-guaranteed loans.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures
None.

Item 9A. Controls and Procedures
A review and evaluation was performed by our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Annual Report on Form 10-K. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, were effective. Although our CEO and CFO have determined our disclosure controls and
procedures were effective at the end of the period covered by this Annual Report on Form 10-K, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the reports we submit under the Exchange Act.
There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

Management's Report On Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. In making this assessment the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013 framework). Based on its assessment, the Company's management believes that, as of December 31, 2015, the Company's internal control over financial reporting was effective based on those criteria.

The Company's independent auditors, Ernst & Young LLP, have issued an attestation report on the effectiveness of the Company's internal control over financial reporting. This report appears on page 174 of this annual report on Form 10-K.

Table of Contents

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
of Two Harbors Investment Corp.

We have audited Two Harbors Investment Corp.'s (the Company's) internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Two Harbors Investment Corp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Two Harbors Investment Corp. as of December 31, 2015 and 2014, and the related consolidated statements of comprehensive (loss) income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 and the financial statement schedule listed in the Index at Item 15(a)(2) of Two Harbors Investment Corp. and our report dated February 26, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Minneapolis, Minnesota
February 26, 2016

Table of Contents

Item 9B. Other Information
None.

Table of Contents

PART III

Items 10, 11, 12 and 13.
The information required by Items 10, 11, 12 and 13 of Part III of this Annual Report is incorporated by reference to information to be set forth in the Company’s definitive Proxy Statement for its 2016 Annual Meeting of Stockholders, which will be filed with the SEC, pursuant to Regulation 14A, not later than 120 days after December 31, 2015.

Item 14. Principal Accounting Fees and Services
We retained Ernst & Young LLP, or EY, to audit our consolidated financial statements for the years ended December 31, 2015 and 2014. We also retained EY, as well as other accounting and consulting firms, to provide various other services in during the years ended December 31, 2015 and 2014.
The table below presents the aggregate fees billed to us for professional services performed by EY for the years ended December 31, 2015 and 2014:

	Year Ended December 31,	
	2015	2014
Audit fees[(a)]	$1,177,210	$1,160,644
Audit-related fees[(b)]	518,400	272,975
Tax fees[(c)]	218,350	115,648
Total principal accountant fees	$1,913,960	$1,549,267

(a) Audit fees pertain to the audit of our annual Consolidated Financial Statements, including review of the interim financial statements contained in our Quarterly Reports on Form 10-Q, comfort letters to underwriters in connection with our registration statements and common stock offerings, attest services, consents to the incorporation of the EY audit report in publicly filed documents and assistance with and review of documents filed with the SEC.

(b) Audit-related fees pertain to assurance and related services that are traditionally performed by the principal accountant, including accounting consultations and audits in connection with proposed or consummated acquisitions, internal control reviews and consultation concerning financial accounting and reporting standard.

(c) Tax fees pertain to services performed for tax compliance, including REIT compliance, tax planning and tax advice, including preparation of tax returns and claims for refund and tax-payment planning services. Tax planning and advice also includes assistance with tax audits and appeals, and tax advice related to specific transactions.

The services performed by EY in 2015 were pre-approved by our Audit Committee in accordance with the pre-approval policy set forth in our Audit Committee Charter. This policy requires that all engagement fees and the terms and scope of all auditing and non-auditing services be reviewed and approved by the Audit Committee in advance of their formal initiation.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following documents are filed as part of this Annual Report on Form 10-K:

(1)Consolidated Financial Statements:

The consolidated financial statements of the Company, together with the independent registered public accounting firm's report thereon, are set forth in Part II, Item 8 on pages 104 through 112 of this Annual Report on Form 10-K and are incorporated herein by reference.

(2)Schedules to Consolidated Financial Statements:

Schedule IV - Mortgage Loans on Real Estate is set forth in Part II, Item 8 on pages 169 through 171 of this Annual Report on Form 10-K.

All other consolidated financial statement schedules not included have been omitted because they are either inapplicable or the information required is provided in the Company's Consolidated Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

(3)Exhibits:

The exhibits listed on the accompanying Exhibits Index are filed or incorporated by reference as part of this Annual Report on Form 10-K.

Table of Contents

Exhibit Number	Exhibit Index
1.1	Equity Distribution Agreement among Two Harbors Investment Corp., JMP Securities LLC and Keefe, Bruyette & Woods, Inc. dated May 25, 2012 (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 25, 2012).
1.2	Amendment No. 1, dated as of May 22, 2015, by and among Two Harbors Investment Corp., JMP Securities LLC and Keefe, Bruyette & Woods, Inc. to the Equity Distribution Agreement dated May 25, 2012 (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 22, 2015).
2.1	Agreement and Plan of Merger, dated as of June 11, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A filed with Pre Effective Amendment No. 4 to the Registrant's Registration Statement on Form S-4 (File No. 333-160199) filed with the Securities and Exchange Commission, or SEC, on October 8, 2009, or Amendment No. 4).
2.2	Amendment No. 1 to Agreement and Plan of Merger, dated as of August 17, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-2 filed with Amendment No. 4).
2.3	Amendment No. 2 to Agreement and Plan of Merger, dated as of September 20, 2009, by and among Capitol Acquisition Corp., Two Harbors Investment Corp., Two Harbors Merger Corp. and Pine River Capital Management L.P. (incorporated by reference to Annex A-3 filed with Amendment No. 4).
3.1	Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to Annex B filed with Amendment No. 4).
3.2	Articles of Amendment to the Articles of Amendment and Restatement of Two Harbors Investment Corp. (incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the SEC on December 19, 2012).
3.3	Amended and Restated Bylaws of Two Harbors Investment Corp. (incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed with the SEC on November 13, 2015).
4.1	Specimen Common Stock Certificate of Two Harbors Investment Corp. (incorporated by reference to Exhibit 4.2 to Amendment No. 4).
10.1	Management Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-K for the year ended December 31, 2009, filed with the SEC on March 4, 2010).
10.3	Shared Facilities and Services Agreement (incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-K for the year ended December 31, 2009, filed with the SEC on March 4, 2010).
10.4*	Second Restated 2009 Equity Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement filed with the SEC on March 26, 2015).
10.5*	Form of Restricted Stock Agreement under the Second Restated 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on August 5, 2015).
10.6*	Form of Phantom Share Award (incorporated by reference to Exhibit 10.10.2 to Amendment No. 4).
10.7	Letter Agreement, dated as of October 28, 2009, by and between Two Harbors Investment Corp. and Integrated Holding Group LP (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on October 30, 2009 ("Merger Closing 8-K")).
10.8	Letter Agreement, dated as of October 27, 2009, by and among Two Harbors Investment Corp., Federated Kaufmann Fund, Federated Kaufmann Fund II and Federated Kaufmann Growth Fund (incorporated by reference to Exhibit 10.3 to the Merger Closing 8-K).
10.9	Letter Agreement, dated as of October 28, 2009, by and between Two Harbors Investment Corp. and Whitebox Special Opportunities Fund, LP Series A (incorporated by reference to Exhibit 10.4 to the

	Merger Closing 8-K).
10.10	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on November 19, 2009).
10.11	Amendment to Management Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on December 19, 2012).
10.12	Second Amendment to Management Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on November 7, 2014).

Exhibit Number	Exhibit Index
21.1	Subsidiaries of registrant. (filed herewith)
23.1	Consent of Independent Registered Public Accounting Firm of Ernst & Young LLP. (filed herewith)
24.1	Powers of Attorney (included on signature page).
31.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
31.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (filed herewith)
101	Financial statements from the Annual Report on Form 10-K of Two Harbors Investment Corp. for the year ended December 31, 2015, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Comprehensive Income (Loss), (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) the Notes to the Consolidated Financial Statements. (filed herewith)

*Management or compensatory agreement

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		TWO HARBORS INVESTMENT CORP.
Dated: February 26, 2016	By:	/s/ Thomas Siering
		Thomas Siering
		Chief Executive Officer, President and Director (principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Each of the undersigned hereby appoints Thomas E. Siering and Brad Farrell, and each of them (with full power to act alone), as attorneys and agents for the undersigned, with full power of substitution, for and in the name, place and stead of the undersigned, to sign and file with the Securities and Exchange Commission under the Securities Act of 1934, any and all amendments and exhibits to this annual report on Form 10-K and any and all applications, instruments, and other documents to be filed with the Securities and Exchange Commission pertaining to this annual report on Form 10-K or any amendments thereto, with full power and authority to do and perform any and all acts and things whatsoever requisite and necessary or desirable.

Signature	Title	Date
/s/ Thomas Siering Thomas Siering	Chief Executive Officer, President and Director (principal executive officer)	February 26, 2016
/s/ Brad Farrell Brad Farrell	Chief Financial Officer and Treasurer (principal financial officer)	February 26, 2016
/s/ Mary Riskey Mary Riskey	Chief Accounting Officer (principal accounting officer)	February 26, 2016
/s/ Brian C. Taylor Brian C. Taylor	Chairman of the Board of Directors	February 26, 2016
/s/ Stephen G. Kasnet Stephen G. Kasnet	Director	February 26, 2016
/s/ E. Spencer Abraham E. Spencer Abraham	Director	February 26, 2016
/s/ James J. Bender James J. Bender	Director	February 26, 2016
/s/ Lisa A. Pollina Lisa A. Pollina	Director	February 26, 2016
/s/ William Roth William Roth	Chief Investment Officer and Director	February 26, 2016
/s/ W. Reid Sanders W. Reid Sanders	Director	February 26, 2016

/s/ Hope B. Woodhouse Hope B. Woodhouse	Director	February 26, 2016