|  |  |  |
| --- | --- | --- |
|  |  | **UNITED STATES** |
|  |  | **SECURITIES AND EXCHANGE COMMISSION** |
|  |  | **Washington, D.C. 20549** |
|  |  | \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |
|  |  | **FORM 10-Q** |
|  |  | \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |
| ☒ | | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934** |
|  |  | **For the quarterly period ended September 30, 2016** |
|  |  | **OR** |
| ☐ | | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934** |
|  |  | **Commission file number 001-34057** |
|  |  | \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |



|  |  |
| --- | --- |
|  | **AGNC INVESTMENT CORP.** |
|  | **(Exact name of registrant as specified in its charter)** |
|  | \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |
| **Delaware** | **26-1701984** |
| **(State or Other Jurisdiction of** | **(I.R.S. Employer** |
| **Incorporation or Organization)** | **Identification No.)** |
|  | **2 Bethesda Metro Center, 12th Floor** |
|  | **Bethesda, Maryland 20814** |
|  | **(Address of principal executive offices)** |
|  | **(301) 968-9315** |
|  | **(Registrant’s telephone number, including area code)** |
|  | \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

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

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

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Large accelerated filer | | ☒ |  | Accelerated filer | ☐ |
| Non-accelerated filer | | ☐ | (Do not check if a smaller reporting company) | Smaller Reporting Company | ☐ |
|  | Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ | | | No ☒ |  |
|  | The number of shares of the issuer's common stock, $0.01 par value, outstanding as of October 31, 2016 was 331,046,077. | | |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **AGNC INVESTMENT CORP.** | |
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**PART I. FINANCIAL INFORMATION**

**Item 1. *Financial Statements***

**AGNC INVESTMENT CORP.**

**CONSOLIDATED BALANCE SHEETS**

**(in millions, except per share data)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **September 30, 2016** |  |  |  | **December 31, 2015** |
|  | **(Unaudited)** |  |  |  |  |
| **Assets:** |  |  |  |  |  |
| Agency securities, at fair value (including pledged securities of $44,089 and $48,380, respectively) | $ | 46,328 |  | $ | 51,331 |
|  |  |  |  |  |  |
| Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities) |  | 890 |  |  | 1,029 |
| Non-agency securities, at fair value (pledged securities) |  | 102 |  |  | 113 |
|  |  |  |  |  |  |
| Credit risk transfer securities, at fair value |  | 36 |  |  | — |
| U.S. Treasury securities, at fair value (pledged securities) |  | 45 |  |  | 25 |
|  |  |  |  |  |  |
| REIT equity securities, at fair value |  | — | |  | 33 |
| Cash and cash equivalents |  | 1,254 |  |  | 1,110 |
|  |  |  |  |  |  |
| Restricted cash and cash equivalents |  | 681 |  |  | 1,281 |
| Derivative assets, at fair value |  | 61 |  |  | 81 |
|  |  |  |  |  |  |
| Receivable for securities sold (pledged securities) |  | 228 |  |  | — |
| Receivable under reverse repurchase agreements |  | 5,441 |  |  | 1,713 |
|  |  |  |  |  |  |
| Goodwill and other intangible assets, net |  | 555 |  |  | — |
| Other assets |  | 268 |  |  | 305 |
|  |  |  |  |  |  |
| Total assets | $ | 55,889 |  | $ | 57,021 |
| **Liabilities:** |  |  |  |  |  |
|  |  |  |  |  |  |
| Repurchase agreements | $ | 37,668 |  | $ | 41,754 |
| Federal Home Loan Bank advances |  | 3,037 |  |  | 3,753 |
|  |  |  |  |  |  |
| Debt of consolidated variable interest entities, at fair value |  | 494 |  |  | 595 |
| Payable for securities purchased |  | 251 |  |  | 182 |
|  |  |  |  |  |  |
| Derivative liabilities, at fair value |  | 947 |  |  | 935 |
| Dividends payable |  | 66 |  |  | 74 |
|  |  |  |  |  |  |
| Obligation to return securities borrowed under reverse repurchase agreements, at |  |  |  |  |  |
| fair value |  | 5,424 |  |  | 1,696 |
| Accounts payable and other accrued liabilities |  | 71 |  |  | 61 |
|  |  |  |  |  |  |
| Total liabilities |  | 47,958 |  |  | 49,050 |
| **Stockholders' equity:** |  |  |  |  |  |
|  |  |  |  |  |  |
| Preferred stock - $0.01 par value; 10.0 shares authorized: |  |  |  |  |  |
| Redeemable Preferred Stock; $0.01 par value; 6.9 shares issued and outstanding (aggregate liquidation preference of $348) |  | 336 |  |  | 336 |
|  |  |  |  |  |  |
| Common stock - $0.01 par value; 600.0 shares authorized; |  |  |  |  |  |
| 331.0 and 337.5 shares issued and outstanding, respectively |  | 3 |  |  | 3 |
|  |  |  |  |  |  |
| Additional paid-in capital |  | 9,932 |  |  | 10,048 |
| Retained deficit |  | (3,350) |  |  | (2,350) |
|  |  |  |  |  |  |
| Accumulated other comprehensive income (loss) |  | 1,010 |  |  | (66) |
| Total stockholders' equity |  | 7,931 |  |  | 7,971 |
|  |  |  |  |  |  |
| Total liabilities and stockholders' equity | $ | 55,889 |  | $ | 57,021 |

See accompanying notes to consolidated financial statements.

2

**AGNC INVESTMENT CORP.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

**(in millions, except per share data)**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended September 30,** | | | | | |  | **Nine Months Ended September 30,** | | | |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | **2016** |  |  |  | **2015** |  |  | **2016** |  |  | **2015** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Interest income:** |  |  |  |  |  |  |  |  |  |  |  |
| Interest income | $ | 315 |  | $ | 295 |  | $ | 928 |  | $ | 1,092 |
| Interest expense |  | 96 |  |  | 77 |  |  | 296 |  |  | 244 |
| Net interest income |  | 219 |  |  | 218 |  |  | 632 |  |  | 848 |
| **Other gain (loss), net:** |  |  |  |  |  |  |  |  |  |  |  |
| Gain (loss) on sale of mortgage-backed securities, net |  | 61 |  |  | (39) |  |  | 114 |  |  | (25) |
| Gain (loss) on derivative instruments and other securities, net |  | 242 |  |  | (778) |  |  | (1,058) |  |  | (1,090) |
| Management fee income |  | 4 |  |  | — | |  | 4 |  |  | — |
| Total other gain (loss), net |  | 307 |  |  | (817) |  |  | (940) |  |  | (1,115) |
| **Expenses:** |  |  |  |  |  |  |  |  |  |  |  |
| Management fee expense |  | — | |  | 29 |  |  | 52 |  |  | 88 |
| Compensation and benefits |  | 9 |  |  | — | |  | 9 |  |  | — |
| Other operating expenses |  | 6 |  |  | 5 |  |  | 27 |  |  | 18 |
| Total operating expenses |  | 15 |  |  | 34 |  |  | 88 |  |  | 106 |
| **Net income (loss)** |  | 511 |  |  | (633) |  |  | (396) |  |  | (373) |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |
| **Net income (loss) available (attributable) to common stockholders** | $ | 504 |  | $ | (640) |  | $ | (417) |  | $ | (394) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss)** | $ | 511 |  | $ | (633) |  | $ | (396) |  | $ | (373) |
| **Other comprehensive income (loss):** |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss) on available-for-sale securities, net |  | (97) |  |  | 467 |  |  | 1,038 |  |  | (14) |
| Unrealized gain on derivative instruments, net |  | 7 |  |  | 24 |  |  | 38 |  |  | 79 |
| Other comprehensive income (loss) |  | (90) |  |  | 491 |  |  | 1,076 |  |  | 65 |
| **Comprehensive income (loss)** |  | 421 |  |  | (142) |  |  | 680 |  |  | (308) |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |
| **Comprehensive income (loss) available (attributable) to common stockholders** | $ | 414 |  | $ | (149) |  | $ | 659 |  | $ | (329) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Weighted average number of common shares outstanding - basic and diluted** |  | 331.0 |  |  | 347.8 |  |  | 332.1 |  |  | 350.9 |
| **Net income (loss) per common share - basic and diluted** | $ | 1.52 |  | $ | (1.84) |  | $ | (1.26) |  | $ | (1.12) |
| **Dividends declared per common share** | $ | 0.56 |  | $ | 0.60 |  | $ | 1.76 |  | $ | 1.88 |

See accompanying notes to consolidated financial statements.

3

**AGNC INVESTMENT CORP.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

**(Unaudited)**

**(in millions)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Preferred Stock** | | | | | **Common Stock** | | | | |  |  |  |  |  |  |  | **Accumulated** | |  |  |  |
|  |  | **Additional** | |  |  |  |  | **Other** | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  | **Paid-in** | |  | **Retained** | |  | **Comprehensive** | |  |  |  |
|  | **Shares** | |  | **Amount** | | **Shares** | |  | **Amount** | |  | **Capital** | |  | **Deficit** | |  | **Income (Loss)** | |  | **Total** |  |
| **Balance, December 31, 2014** | 6.9 |  | $ | 336 |  | 352.8 |  | $ | 4 |  | $ | 10,332 |  | $ | (1,674) |  | $ | 430 |  | $ | 9,428 |  |
| Net loss | — | |  | — | | — | |  | — | |  | — | |  | (373) |  |  | — | |  | (373) |  |
| Other comprehensive income (loss): |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized loss on available-for-sale securities, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | (14) |  |  | (14) |  |
| Unrealized gain on derivative instruments, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 79 |  |  | 79 |  |
| Repurchase of common stock | — | |  | — | | (6.3) |  |  | (1) |  |  | (123) |  |  | — | |  | — | |  | (124) |  |
| Preferred dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (21) |  |  | — | |  | (21) |  |
| Common dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (659) |  |  | — | |  | (659) |  |
| **Balance, September 30, 2015** | 6.9 |  | $ | 336 |  | 346.5 |  | $ | 3 |  | $ | 10,209 |  | $ | (2,727) |  | $ | 495 |  | $ | 8,316 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, December 31, 2015** | 6.9 |  | $ | 336 |  | 337.5 |  | $ | 3 |  | $ | 10,048 |  | $ | (2,350) |  | $ | (66) |  | $ | 7,971 |  |
| Net loss | — | |  | — | | — | |  | — | |  | — | |  | (396) |  |  | — | |  | (396) |  |
| Other comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain on available-for-sale securities, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 1,038 |  |  | 1,038 |  |
| Unrealized gain on derivative instruments, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 38 |  |  | 38 |  |
| Repurchase of common stock | — | |  | — | | (6.5) |  |  | — | |  | (116) |  |  | — | |  | — | |  | (116) |  |
| Preferred dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (21) |  |  | — | |  | (21) |  |
| Common dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (583) |  |  | — | |  | (583) |  |
| **Balance, September 30, 2016** | 6.9 |  | $ | 336 |  | 331.0 |  | $ | 3 |  | $ | 9,932 |  | $ | (3,350) |  | $ | 1,010 |  | $ | 7,931 |  |

See accompanying notes to consolidated financial statements.

4

**AGNC INVESTMENT CORP.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(in millions)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Nine Months Ended September 30,** | | | | |
|  | **2016** |  |  |  | **2015** |
| **Operating activities:** |  |  |  |  |  |
| Net loss | $ | (396) |  | $ | (373) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |  |  |  |  |  |
| Amortization of premiums and discounts on mortgage-backed securities, net |  | 394 |  |  | 330 |
| Amortization of accumulated other comprehensive loss on interest rate swaps de-designated as qualifying hedges |  | 38 |  |  | 79 |
| Amortization of intangible assets |  | 1 |  |  | — |
| Stock based compensation |  | 1 |  |  | — |
| (Gain) loss on sale of mortgage-backed securities, net |  | (114) |  |  | 25 |
| Loss on derivative instruments and other securities, net |  | 1,058 |  |  | 1,090 |
| (Increase) decrease in other assets |  | 37 |  |  | (73) |
| Increase (decrease) in accounts payable and other accrued liabilities |  | 10 |  |  | (8) |
| Net cash provided by operating activities |  | 1,029 |  |  | 1,070 |
| **Investing activities:** |  |  |  |  |  |
| Purchases of mortgage-backed securities |  | (17,275) |  |  | (23,792) |
| Proceeds from sale of mortgage-backed securities |  | 17,032 |  |  | 22,615 |
| Principal collections on mortgage-backed securities |  | 5,997 |  |  | 6,177 |
| Purchases of credit risk transfer securities |  | (36) |  |  | — |
| Purchases of U.S. Treasury securities |  | (2,178) |  |  | (46,774) |
| Proceeds from sale of U.S. Treasury securities |  | 5,741 |  |  | 44,237 |
| Net proceeds from (payments on) reverse repurchase agreements |  | (3,728) |  |  | 3,755 |
| Net payments on other derivative instruments |  | (892) |  |  | (85) |
| Purchases of REIT equity securities |  | — | |  | (11) |
| Proceeds from sale of REIT equity securities |  | 39 |  |  | 35 |
| Purchase of AGNC Mortgage Management, LLC, net of cash acquired |  | (555) |  |  | — |
| (Increase) decrease in restricted cash and cash equivalents |  | 577 |  |  | (700) |
| Other investing cash flows, net |  | — | |  | (28) |
| Net cash provided by investing activities |  | 4,722 |  |  | 5,429 |
| **Financing activities:** |  |  |  |  |  |
| Proceeds from repurchase arrangements |  | 196,015 |  |  | 317,718 |
| Payments on repurchase agreements |  | (200,078) |  |  | (327,000) |
| Proceeds from Federal Home Loan Bank advances |  | 2,098 |  |  | 5,437 |
| Payments on Federal Home Loan Bank advances |  | (2,814) |  |  | (1,935) |
| Payments on debt of consolidated variable interest entities |  | (100) |  |  | (121) |
| Payments for common stock repurchases |  | (116) |  |  | (124) |
| Cash dividends paid |  | (612) |  |  | (689) |
| Net cash used in financing activities |  | (5,607) |  |  | (6,714) |
| Net change in cash and cash equivalents |  | 144 |  |  | (215) |
| Cash and cash equivalents at beginning of period |  | 1,110 |  |  | 1,720 |
| Cash and cash equivalents at end of period | $ | 1,254 |  | $ | 1,505 |

See accompanying notes to consolidated financial statements.

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**AGNC INVESTMENT CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Unaudited Interim Consolidated Financial Statements**

The unaudited interim consolidated financial statements of AGNC Investment Corp. (referred throughout this report as the "Company", "we", "us" and "our") are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Our unaudited interim consolidated financial statements include the accounts of all of our wholly-owned subsidiaries and variable interest entities for which we are the primary beneficiary. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of financial statements for the interim period have been included. The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year.

**Note 2. Organization**

We were organized in Delaware on January 7, 2008, and commenced operations on May 20, 2008 following the completion of our initial public offering ("IPO"). Our common stock is traded on The NASDAQ Global Select Market under the symbol "AGNC."

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

We invest primarily in agency mortgage-backed securities ("agency MBS") on a leveraged basis. These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") for which the principal and interest payments are guaranteed by a government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae") (collectively referred to as "GSEs"). We may also invest in other types of mortgage and mortgage-related securities, such as credit risk transfer ("CRT") securities and non-agency residential and commercial mortgage-backed securities, where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency.

Our principal objective is to provide our stockholders with attractive risk-adjusted returns through a combination of monthly dividends and net asset value (also referred to as "net book value," "NAV" and "stockholders' equity") accretion. We generate income from the interest earned on our investment assets, net of associated borrowing and hedging activities, and net realized gains and losses on our investments and hedging activities. We fund our investments primarily through short-term borrowings structured as repurchase agreements.

Prior to July 1, 2016, we were externally managed by AGNC Management, LLC, (formerly known as American Capital AGNC Management, LLC) (our "Manager"). On July 1, 2016, we completed the acquisition of all of the outstanding membership interests of AGNC Mortgage Management, LLC ("AMM," formerly known as American Capital Mortgage Management, LLC ), the parent company of our Manager, from American Capital Asset Management, LLC ("ACAM"), a wholly owned portfolio company of American Capital, Ltd. ("ACAS"). AMM is also the parent company of MTGE Management, LLC ("MTGE Manager," formerly known as American Capital MTGE Management, LLC), the external manager of MTGE Investment Corp. ("MTGE," formerly known as American Capital Mortgage Investment Corp.). Following the closing of the acquisition of AMM, we became internally managed and are no longer affiliated with ACAS. (See Note 10 for further details.)

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**Note 3. Summary of Significant Accounting Policies**

***Investment Securities***

Accounting Standards Codification ("ASC") Topic 320, *Investments—Debt and Equity Securities* ("ASC 320"), requires that at the time of purchase, we designate a security as held-to-maturity, available-for-sale or trading, depending on our ability and intent to hold such security to maturity. Securities classified as trading and available-for-sale are reported at fair value, while securities classified as held-to-maturity are reported at amortized cost. We may sell any of our securities as part of our overall management of our investment portfolio. Accordingly, we typically designate our investment securities as available-for-sale, unless we have elected the fair value option for such securities under ASC Topic 825, *Financial Instruments*. All securities classified as available-for-sale are reported at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss) ("OCI"), a separate component of stockholders' equity. Upon the sale of a security designated as available-for-sale, we determine the cost of the security and the amount of unrealized gains or losses to reclassify out of accumulated OCI into earnings based on the specific identification method.

If we designate a security as trading or if we elect the fair value option for a security, changes in the fair value of such security are reflected in net income through other gain (loss) during the period in which they occur. We have elected the fair value option to account for CRT securities, interest-only securities and inverse interest-only securities (together referred to as "interest-only securities") and principal-only securities as this election simplifies the accounting for such securities.

CRT securities are risk sharing instruments issued by the GSEs, and similarly structured transactions issued by third party market participants, that transfer a portion of the risk associated with credit losses within pools of conventional residential mortgage loans from the GSEs and/or third parties to private investors. Unlike agency MBS, full repayment of the original principal balance of CRT securities is not guaranteed by a GSE or government agency; rather, "credit risk transfer" is achieved by writing down the outstanding principal balance of the CRT securities if credit losses on a related pool of loans exceed certain thresholds. By reducing the amount that they are obligated to repay to holders of CRT securities, the GSEs and/or other third parties are able to offset credit losses on the related loans.

Non-agency MBS are backed by residential or commercial mortgage loans packaged and securitized by a private institution, such as a commercial bank. Non-agency MBS typically benefit from credit enhancements derived from structural elements, such as subordination, overcollateralization or insurance, but nonetheless carry a higher level of credit exposure than agency MBS.

Interest-only securities represent the right to receive a specified proportion of the contractual interest flows of specific agency CMO securities. Principal-only securities represent the right to receive the contractual principal flows of specific agency CMO securities. Our investments in interest and principal-only securities are included in agency securities, at fair value on the accompanying consolidated balance sheets.

REIT equity securities represent investments in the common stock of other publicly traded mortgage REITs that invest predominantly in agency MBS. We designate our investments in REIT equity securities as trading securities and report them at fair value on the accompanying consolidated balance sheets.

We estimate the fair value of agency and non-agency MBS and CRT securities based on a market approach using "Level 2" inputs from third-party pricing services and non-binding dealer quotes derived from common market pricing methods. Such methods incorporate, but are not limited to, reported trades and executable bid and asked prices for similar securities, benchmark interest rate curves, such as the spread to the U.S. Treasury rate and interest rate swap curves, convexity, duration and the underlying characteristics of the particular security, including coupon, periodic and life caps, rate reset period, issuer, additional credit support and expected life of the security. We estimate the fair value of our REIT equity securities based on a market approach using "Level 1" inputs based on quoted market prices. Refer to Note 8 for further discussion of fair value measurements.

We evaluate our investments designated as available-for-sale for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired may involve judgments and assumptions based on subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if any one of the following three conditions exists as of the financial reporting date: (i) we intend to sell the security (that is, a decision has been made to sell the security), (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis or (iii) we do not expect to recover the security's amortized cost basis, even if we do not intend to sell the security and it is not more likely than not that we will be required to sell the security. A general allowance for unidentified impairments in a portfolio of securities is not permitted.

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***Interest Income***

Interest income is accrued based on the outstanding principal amount of the investment securities and their contractual terms. Premiums or discounts associated with the purchase of agency and non-agency MBS are amortized or accreted into interest income, respectively, over the projected lives of the securities, including contractual payments and estimated prepayments using the effective interest method in accordance with ASC Subtopic 310-20, *Receivables—* *Nonrefundable Fees and Other Costs* ("ASC 310-20").

We estimate long-term prepayment speeds of our mortgage securities using a third-party service and market data. The third-party service estimates prepayment speeds using models that incorporate the forward yield curve, current mortgage rates and mortgage rates of the outstanding loans, age and size of the outstanding loans, loan-to-value ratios, interest rate volatility and other factors. We review the prepayment speeds estimated by the third-party service and compare the results to market consensus prepayment speeds, if available. We also consider historical prepayment speeds and current market conditions to validate the reasonableness of the prepayment speeds estimated by the third-party service and, based on our judgment, we may make adjustments to its estimates. Actual and anticipated prepayment experience is reviewed quarterly and effective yields are recalculated when differences arise between (i) our previously estimated future prepayments and (ii) the actual prepayments to date plus our currently estimated future prepayments. If the actual and estimated future prepayment experience differs from our prior estimate of prepayments, we are required to record an adjustment in the current period to the amortization or accretion of premiums and discounts for the cumulative difference in the effective yield through the reporting date.

At the time we purchase CRT securities, we determine an effective yield based on our estimate of the timing and amount of future cash flows and our cost basis. Our initial cash flow estimates for these investments are based on our observations of current information and events and include assumptions related to interest rates, prepayment rates and the impact of default and severity rates on the timing and amount of credit losses. On at least a quarterly basis, we review the estimated cash flows and make appropriate adjustments, based on inputs 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. Any resulting changes in effective yield are recognized prospectively based on the current amortized cost of the investment as adjusted for credit impairment, if any.

***Derivative Instruments***

We use a variety of derivative instruments to hedge a portion of our exposure to market risks, including interest rate, prepayment, extension and liquidity risk. The objective of our risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates. The principal instruments that we use are interest rate swaps and options to enter into interest rate swaps ("swaptions"). We also utilize U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales, and forward contracts for the purchase or sale of agency MBS securities on a generic pool basis in the "to-be-announced" market ("TBA securities") and on a specified pool basis. We may also purchase or write put or call options on TBA securities and invest in mortgage and other types of derivatives, such as interest and principal-only securities.

We also enter into TBA contracts as a means of investing in and financing agency securities (thereby increasing our "at risk" leverage) or as a means of disposing of or reducing our exposure to agency securities (thereby reducing our "at risk" leverage). Under TBA contracts, we agree to purchase or sell, for future delivery, agency securities with certain principal and interest terms and certain types of collateral, but the particular agency securities to be delivered are not identified until shortly before the TBA settlement date. We may also choose, prior to settlement, to move the settlement of these securities out to a later date by entering into an offsetting short or long position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing or selling a similar TBA contract for a later settlement date. This transaction is commonly referred to as a "dollar roll." The agency securities purchased or sold for a forward settlement date are typically priced at a discount to agency securities for settlement in the current month. This difference (or discount) is referred to as the "price drop." The price drop is the economic equivalent of net interest carry income on the underlying agency securities over the roll period (interest income less implied financing cost) and is commonly referred to as "dollar roll income/loss." Consequently, forward purchases of agency securities and dollar roll transactions represent a form of off-balance sheet financing.

We account for derivative instruments in accordance with ASC Topic 815, *Derivatives and Hedging* ("ASC 815"). ASC 815 requires an entity to recognize all derivatives as either assets or liabilities in our accompanying consolidated balance sheets and to measure those instruments at fair value.

Our derivative agreements generally contain provisions that allow for netting or setting off derivative assets and liabilities with the counterparty; however, we report related assets and liabilities on a gross basis in our consolidated balance sheets. Derivative instruments in a gain position are reported as derivative assets at fair value and derivative instruments in a loss position are reported as derivative liabilities at fair value in our consolidated balance sheets. Changes in fair value of derivative instruments and periodic settlements related to our derivative instruments are recorded in gain (loss) on derivative instruments and other securities, net in

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our consolidated statements of comprehensive income. Cash receipts and payments related to derivative instruments are classified in our consolidated statements of cash flows according to the underlying nature or purpose of the derivative transaction, generally in the investing section.

The use of derivative instruments creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We attempt to minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings, monitoring positions with individual counterparties and adjusting posted collateral as required.

*Discontinuation of hedge accounting for interest rate swap agreements*

Prior to fiscal year 2011, we entered into interest rate swap agreements typically with the intention of qualifying for hedge accounting under ASC 815. However, during fiscal year 2011, we elected to discontinue hedge accounting for our interest rate swaps. Upon discontinuation of hedge accounting, the net deferred loss related to our de-designated interest rate swaps remained in accumulated OCI and is being reclassified from accumulated OCI into interest expense on a straight-line basis over the remaining term of each interest rate swap through October 2016.

*Interest rate swap agreements*

We use interest rate swaps to hedge the variable cash flows associated with borrowings made under our repurchase agreement facilities. Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on one, three or six-month LIBOR ("payer swaps") with terms up to 20 years. The floating rate we receive under our swap agreements has the effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. Our swap agreements are privately negotiated in the over−the−counter ("OTC") market, with swap agreements entered into subsequent to May 2013 subject to central clearing through a registered commodities exchange ("centrally cleared swaps").

We estimate the fair value of our centrally cleared interest rate swaps using the daily settlement price determined by the respective exchange. Centrally cleared swaps are valued by the exchange using a pricing model that references the underlying rates including the overnight index swap rate and LIBOR forward rate to produce the daily settlement price.

We estimate the fair value of our "non-centrally cleared" swaps using a combination of inputs from counterparty and third-party pricing models to estimate the net present value of the future cash flows using the forward interest rate yield curve in effect as of the end of the measurement period. We also incorporate both our own and our counterparties' nonperformance risk in estimating the fair value of our interest rate swaps. In considering the effect of nonperformance risk, we consider the impact of netting and credit enhancements, such as collateral postings and guarantees, and have concluded that our own and our counterparty risk is not significant to the overall valuation of these agreements.

*Interest rate swaptions*

We purchase interest rate swaptions generally to help mitigate the potential impact of larger, more rapid changes in interest rates on the performance of our investment portfolio. Interest rate swaptions provide us the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. Our swaption agreements typically provide us the option to enter into a pay fixed rate interest rate swap, which we refer as "payer swaptions." We may also enter into swaption agreements that provide us the option to enter into a receive fixed interest rate swap, which we refer to as "receiver swaptions." The premium paid for interest rate swaptions is reported as an asset in our consolidated balance sheets. The premium is valued at an amount equal to the fair value of the swaption that would have the effect of closing the position adjusted for nonperformance risk, if any. The difference between the premium and the fair value of the swaption is reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. If a swaption expires unexercised, the realized loss on the swaption would be equal to the premium paid. If we sell or exercise a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash or the fair value of the underlying interest rate swap received and the premium paid.

Our interest rate swaption agreements are privately negotiated in the OTC market and are not subject to central clearing. We estimate the fair value of interest rate swaptions using a combination of inputs from counterparty and third-party pricing models based on the fair value of the future interest rate swap that we have the option to enter into as well as the remaining length of time that we have to exercise the option, adjusted for non-performance risk, if any.

*TBA securities*

A TBA security is a forward contract for the purchase ("long position") or sale ("short position") of agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific agency MBS delivered into the contract upon the settlement date, published each month by the Securities Industry and Financial Markets

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Association, are not known at the time of the transaction. We may enter into TBA contracts as a means of hedging against short-term changes in interest rates. We may also enter into TBA contracts as a means of acquiring or disposing of agency securities and utilize TBA dollar roll transactions to finance agency MBS purchases.

We account for TBA contracts as derivative instruments since either the TBA contracts do not settle in the shortest period of time possible or we cannot assert that it is probable at inception and throughout the term of the TBA contract that we will take physical delivery of the agency security upon settlement of the contract. We account for TBA dollar roll transactions as a series of derivative transactions. Gains, losses and dollar roll income associated with our TBA contracts and dollar roll transactions are recognized in our consolidated statements of comprehensive income in gain (loss) on derivative instruments and other securities, net.

We estimate the fair value of TBA securities based on similar methods used to value our agency MBS securities.

*U.S. Treasury securities*

We purchase or sell short U.S. Treasury securities and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our portfolio. We borrow securities to cover short sales of U.S. Treasury securities under reverse repurchase agreements. We account for these as securities borrowing transactions and recognize an obligation to return the borrowed securities at fair value on our accompanying consolidated balance sheets based on the value of the underlying borrowed securities as of the reporting date. Gains and losses associated with purchases and short sales of U.S. Treasury securities and U.S. Treasury futures contracts are recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

***Goodwill and Other Intangible Assets, Net***

Goodwill is the cost of an acquisition in excess of the fair value of identified assets acquired and liabilities assumed and is recorded as an asset on our balance sheet. Acquired intangible assets that do not meet the criteria for recognition as a separate asset are included in goodwill, which represents the estimated future economic benefit arising from these assets. Goodwill is not subject to amortization but must be tested for impairment at least annually. Intangible assets meeting the criteria for recognition as separate assets are recorded at their respective fair market values at the date of acquisition. Intangible assets with an estimated useful life are amortized over their expected useful life. As of September 30, 2016, we had $526 million of goodwill and $29 million of other intangible assets, net of accumulated amortization, reported in goodwill and other intangible assets, net in our accompanying consolidated balance sheets related to our acquisition of AMM on July 1, 2016 (see Note 10 for further details).

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

**Note 4. Investment Securities**

As of September 30, 2016 and December 31, 2015, our investment portfolio consisted of $47.4 billion and $52.5 billion of investment securities, at fair value, respectively, and a $15.6 billion and $7.4 billion net long TBA position, at fair value, respectively.

Our TBA position is reported at its net carrying value of $46 million and $14 million as of September 30, 2016 and December 31, 2015, respectively, in derivative assets/(liabilities) on our accompanying consolidated balance sheets. The net carrying value of our TBA position represents the difference between the fair value of the underlying agency security in the TBA contract and the cost basis or the forward price to be paid or received for the underlying agency security. (See Note 6 for further details of our net TBA position as of September 30, 2016 and December 31, 2015.)

As of September 30, 2016 and December 31, 2015, the net unamortized premium balance on our MBS was $2.1 billion and $2.3 billion, respectively, including interest and principal-only securities.

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The following tables summarize our investment securities as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **September 30, 2016** | | | | |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gross** | |  |  |  |  |  | **Gross** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Amortized** | | |  |  |  | **Unrealized** | | |  |  |  |  |  | **Unrealized** |  |  |  |  |  |  |
| **Investment Securities** | |  |  |  |  |  |  | **Cost** | |  |  |  |  |  | **Gain** | |  |  |  |  |  | **Loss** |  |  |  |  |  | **Fair Value** |
| Agency MBS: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed rate | |  |  |  |  | $ | | |  |  | 44,641 |  | $ |  |  |  | 980 |  | $ | |  | (10) | $ | | |  |  | 45,611 |
| Adjustable rate | |  |  |  |  |  |  |  |  |  | 401 |  |  |  |  |  | 14 |  |  |  |  | — |  |  |  |  |  | 415 |
| CMO | |  |  |  |  |  |  |  |  |  | 840 |  |  |  |  |  | 25 |  |  |  |  | — |  |  |  |  |  | 865 |
| Interest-only and principal-only strips | |  |  |  |  |  |  |  |  |  | 286 |  |  |  |  |  | 44 |  |  |  |  | (3) |  |  |  |  |  | 327 |
| Total agency MBS | |  |  |  |  |  |  |  |  |  | 46,168 |  |  |  |  |  | 1,063 |  |  |  |  | (13) |  |  |  |  |  | 47,218 |
| Non-agency MBS | |  |  |  |  |  |  |  |  |  | 100 |  |  |  |  |  | 2 |  |  |  |  | — |  |  |  |  |  | 102 |
| CRT securities | |  |  |  |  |  |  |  |  |  | 36 |  |  |  |  |  | — |  |  |  |  | — |  |  |  |  |  | 36 |
| Total investment securities | |  |  |  |  |  | | $ |  |  | 46,304 |  | $ |  |  |  | 1,065 |  |  | $ |  | (13) |  |  | $ |  |  | 47,356 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | | | |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gross** | |  |  |  |  |  | **Gross** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Amortized** | | |  |  |  | **Unrealized** | | |  |  |  |  |  | **Unrealized** |  |  |  |  |  |  |
| **Investments Securities** | |  |  |  |  |  |  | **Cost** | |  |  |  |  |  | **Gain** | |  |  |  |  |  | **Loss** |  |  |  |  |  | **Fair Value** |
| Agency MBS: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed rate | |  |  |  |  | $ | | |  |  | 50,576 |  | $ |  |  |  | 339 |  | $ | |  | (393) | $ | | |  |  | 50,522 |
| Adjustable rate | |  |  |  |  |  |  |  |  |  | 484 |  |  |  |  |  | 11 |  |  |  |  | — |  |  |  |  |  | 495 |
| CMO | |  |  |  |  |  |  |  |  |  | 973 |  |  |  |  |  | 18 |  |  |  |  | (1) |  |  |  |  |  | 990 |
| Interest-only and principal-only strips | |  |  |  |  |  |  |  |  |  | 317 |  |  |  |  |  | 39 |  |  |  |  | (3) |  |  |  |  |  | 353 |
| Total agency MBS | |  |  |  |  |  |  |  |  |  | 52,350 |  |  |  |  |  | 407 |  |  |  |  | (397) |  |  |  |  |  | 52,360 |
| Non-agency MBS | |  |  |  |  |  |  |  |  |  | 114 |  |  |  |  |  | — |  |  |  |  | (1) |  |  |  |  |  | 113 |
| Total investment securities | |  |  |  |  | $ | | |  |  | 52,464 |  | $ |  |  |  | 407 |  | $ | |  | (398) | $ | | |  |  | 52,473 |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **September 30, 2016** | | | |  |  |  |  |  |  |  |  |  |  |  |  |
| **Investment Securities** |  |  | **Fannie Mae** |  |  | **Freddie Mac** | | |  |  | **Ginnie Mae** | | |  |  |  | **Non-Agency** | |  |  |  | **CRT** |  |  |  |  |  | **Total** |
| Available-for-sale securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Par value | | $ | 33,919 |  | $ | 9,930 | | |  | $ |  |  | 48 | $ | | |  |  | 99 | |  | $ |  | — | | | $ | 43,996 |
| Unamortized discount | |  | (27) |  |  | (3) | | |  |  |  |  | — |  |  |  |  |  |  | — | |  |  | — | | |  | (30) |
| Unamortized premium | |  | 1,494 |  |  | 520 | | |  |  |  |  | 1 |  |  |  |  |  | 1 | |  |  |  | — | |  |  | 2,016 |
| Amortized cost | |  | 35,386 |  |  | 10,447 | | |  |  |  |  | 49 |  |  |  |  |  | 100 | |  |  |  | — | | |  | 45,982 |
| Gross unrealized gains | |  | 817 |  |  | 201 | | |  |  |  |  | 1 |  |  |  |  |  | 2 | |  |  |  | — | | |  | 1,021 |
| Gross unrealized losses | |  | (6) |  |  | (4) | | |  |  |  |  | — |  |  |  |  |  |  | — |  |  |  | — | |  |  | (10) |
| Total available-for-sale securities, at fair value | |  | 36,197 |  |  | 10,644 | | |  |  |  |  | 50 |  |  |  |  |  | 102 | |  |  |  | — | | |  | 46,993 |
| Securities remeasured at fair value through earnings: 1 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Par value 2 | |  | 181 |  |  |  |  | — | |  |  |  | — |  |  |  |  |  |  | — | |  | 35 | | |  |  | 216 |
| Unamortized discount | |  | (37) |  |  |  |  | — | |  |  |  | — |  |  |  |  |  |  | — | |  |  | — | | |  | (37) |
| Unamortized premium | |  | 126 |  |  | 16 | | |  |  |  |  | — |  |  |  |  |  |  | — |  |  | 1 | | |  |  | 143 |
| Amortized cost | |  | 270 |  |  | 16 | | |  |  |  |  | — |  |  |  |  |  |  | — | |  | 36 | | |  |  | 322 |
| Gross unrealized gains | |  | 41 |  |  | 3 | | |  |  |  |  | — |  |  |  |  |  |  | — | |  |  | — | | |  | 44 |
| Gross unrealized losses | |  | (2) |  |  | (1) | | |  |  |  |  | — |  |  |  |  |  |  | — |  |  |  | — | |  |  | (3) |
| Total securities remeasured at fair value through earnings | |  | 309 |  |  | 18 | | |  |  |  |  | — |  |  |  |  |  |  | — |  |  | 36 | | |  |  | 363 |
| Total securities, at fair value | | $ | 36,506 |  | $ | 10,662 | | |  | $ |  |  | 50 | $ | | |  |  | 102 | |  | $ | 36 | | |  | $ | 47,356 |
| Weighted average coupon as of September 30, 2016 | |  | 3.63% |  |  | 3.69% | | |  |  |  |  | 2.81% |  |  |  |  |  | 3.50% | |  |  | 4.91% | | |  |  | 3.64% |
| Weighted average yield as of September 30, 2016 3 | |  | 2.68% |  |  | 2.67% | | |  |  |  |  | 1.96% |  |  |  |  |  | 3.00% | |  |  | 4.85% | | |  |  | 2.68% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Securities measured at fair value through earnings includes agency interest-only and principal-only securities.

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1. Par value amount excludes the underlying unamortized principal balance ("UPB") of interest-only securities of $1.0 billion as of September 30, 2016.
2. Incorporates a weighted average future constant prepayment rate assumption of 11% based on forward rates as of September 30, 2016.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  | **December 31, 2015** | |  |  |  |  |  |
| **Investment Securities** |  |  | **Fannie Mae** |  |  | **Freddie Mac** |  |  | **Ginnie Mae** |  | **Non-Agency** |  |  |  | **Total** |
| Available-for-sale securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Par value | | $ | 39,205 |  | $ | 10,575 |  | $ | 62 |  | $ | 113 |  | $ | 49,955 |
| Unamortized discount | |  | (32) |  |  | (4) |  |  | — | |  | — | |  | (36) |
| Unamortized premium | |  | 1,707 |  |  | 519 |  |  | 1 |  |  | 1 |  |  | 2,228 |
| Amortized cost | |  | 40,880 |  |  | 11,090 |  |  | 63 |  |  | 114 |  |  | 52,147 |
| Gross unrealized gains | |  | 286 |  |  | 80 |  |  | 2 |  |  | — | |  | 368 |
| Gross unrealized losses | |  | (283) |  |  | (111) |  |  | — | |  | (1) |  |  | (395) |
| Total available-for-sale securities, at fair value | |  | 40,883 |  |  | 11,059 |  |  | 65 |  |  | 113 |  |  | 52,120 |
| Securities remeasured at fair value through earnings: 1 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Par value 2 | |  | 208 |  |  | — | |  | — | |  | — | |  | 208 |
| Unamortized discount | |  | (42) |  |  | — | |  | — | |  | — | |  | (42) |
| Unamortized premium | |  | 132 |  |  | 19 |  |  | — |  |  | — |  |  | 151 |
| Amortized cost | |  | 298 |  |  | 19 |  |  | — | |  | — | |  | 317 |
| Gross unrealized gains | |  | 35 |  |  | 4 |  |  | — | |  | — | |  | 39 |
| Gross unrealized losses | |  | (2) |  |  | (1) |  |  | — |  |  | — |  |  | (3) |
| Total securities remeasured at fair value through earnings | |  | 331 |  |  | 22 |  |  | — | |  | — | |  | 353 |
| Total securities, at fair value | | $ | 41,214 |  | $ | 11,081 |  | $ | 65 |  | $ | 113 |  | $ | 52,473 |
| Weighted average coupon as of December 31, 2015 | |  | 3.62% |  |  | 3.69% |  |  | 3.18% |  |  | 3.50% |  |  | 3.63% |
| Weighted average yield as of December 31, 2015 3 | |  | 2.79% |  |  | 2.77% |  |  | 1.97% |  |  | 3.33% |  |  | 2.78% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Securities measured at fair value through earnings includes agency interest-only and principal-only securities.
2. Par value amount excludes the underlying unamortized principal balance ("UPB") of interest-only securities of $1.0 billion as of December 31, 2015.
3. Incorporates a weighted average future constant prepayment rate assumption of 8% based on forward rates as of December 31, 2015.

As of September 30, 2016 and December 31, 2015, our investments in non-agency MBS carried a credit rating of AAA. As of September 30, 2016, all of our investments in CRT securities were issued by Fannie Mae or Freddie Mac.

The actual maturities of our investment securities are generally shorter than their stated contractual maturities. Actual maturities are affected by the contractual lives of the underlying mortgages, periodic contractual principal payments and principal prepayments. As of September 30, 2016 and December 31, 2015, our weighted average expected constant prepayment rate ("CPR") over the remaining life of our aggregate investment portfolio was 11% and 8%, respectively. Our estimates differ materially for different types of securities and thus individual holdings have a wide range of projected CPRs.

The following table summarizes our investments classified as available-for-sale as of September 30, 2016 and December 31, 2015 according to their estimated weighted average life classification (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | | | |  |  |  |  |  |  | **December 31, 2015** | | | |  |
|  |  |  |  |  |  |  |  | **Weighted** | | **Weighted** | |  |  |  |  |  |  | **Weighted** | | **Weighted** |
| **Estimated Weighted Average Life of Securities Classified as** | |  |  |  |  | **Amortized** | | **Average** | | **Average** | |  |  |  |  | **Amortized** | | **Average** | | **Average** |
| **Available-for-Sale** |  |  | **Fair Value** |  |  | **Cost** |  | **Coupon** |  | **Yield** |  |  | **Fair Value** |  |  | **Cost** |  | **Coupon** |  | **Yield** |
| ≥ 1 year and ≤ 3 years | | $ | 1,493 |  | $ | 1,467 |  | 3.92% |  | 2.48% |  | $ | 167 |  | $ | 163 |  | 4.02% |  | 2.66% |
| > 3 years and ≤ 5 years | |  | 15,984 |  |  | 15,556 |  | 3.30% |  | 2.44% |  |  | 17,497 |  |  | 17,343 |  | 3.27% |  | 2.40% |
| > 5 years and ≤10 years | |  | 29,490 |  |  | 28,936 |  | 3.65% |  | 2.76% |  |  | 34,206 |  |  | 34,391 |  | 3.67% |  | 2.93% |
| > 10 years | |  | 26 |  |  | 23 |  | 4.67% |  | 3.86% |  |  | 250 |  |  | 250 |  | 3.56% |  | 3.08% |
| Total | | $ | 46,993 |  | $ | 45,982 |  | 3.54% |  | 2.64% |  | $ | 52,120 |  | $ | 52,147 |  | 3.54% |  | 2.75% |

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The following table presents the gross unrealized loss and fair values of our available-for-sale securities by length of time that such securities have been in a continuous unrealized loss position as of September 30, 2016 and

December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Unrealized Loss Position For** | | | |  |  |  |  |  |  |  |  |
|  |  |  | **Less than 12 Months** | | |  |  |  | **12 Months or More** | | |  |  |  |  | **Total** | | |  |
|  |  |  | **Estimated Fair** | | **Unrealized** |  |  | **Estimated** |  |  | **Unrealized** |  |  |  | **Estimated Fair** |  |  |  | **Unrealized** |
| **Securities Classified as Available-for-Sale** |  |  | **Value** |  | **Loss** |  |  | **Fair Value** |  |  | **Loss** |  |  |  | **Value** |  |  |  | **Loss** |
| September 30, 2016 | | $ | 602 |  | $ | (2) |  | $ | 1,851 |  | $ | (8) |  | $ | 2,453 | $ | | | (10) |
| December 31, 2015 | | $ | 24,035 |  | $ | (200) |  | $ | 6,793 |  | $ | (195) |  | $ | 30,828 | $ | | | (395) |

We did not recognize any OTTI charges on our investment securities for the nine months ended September 30, 2016 and 2015. As of the end of each respective reporting period, a decision had not been made to sell any of our securities in an unrealized loss position and we did not believe it was more likely than not that we would be required to sell such securities before recovery of their amortized cost basis. The unrealized losses on our securities were not due to credit losses given the GSE guarantees and credit enhancements on our non-agency securities, but rather were due to changes in interest rates and prepayment expectations. However, as we continue to actively manage our portfolio, we may recognize additional realized losses on our investment securities upon selecting specific securities to sell.

***Gains and Losses on Sale of Mortgage-Backed Securities***

The following table is a summary of our net gain (loss) from the sale of securities classified as available-for-sale for the three and nine months ended September 30, 2016 and 2015 (in millions). Please refer to Note 9 for a summary of changes in accumulated OCI for the same periods.

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended September 30,** | | | | |  | **Nine Months Ended September 30,** | | | |
| **Securities Classified as Available-for-Sale** |  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| MBS sold, at cost | | $ | (6,123) |  | $ | (4,575) |  | $ | (17,146) |  | $ | (22,548) |
| Proceeds from MBS sold 1 | |  | 6,184 |  |  | 4,536 |  |  | 17,260 |  |  | 22,523 |
| Net gain (loss) on sale of MBS | | $ | 61 |  | $ | (39) |  | $ | 114 |  | $ | (25) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross gain on sale of MBS | | $ | 62 |  | $ | 2 |  | $ | 122 |  | $ | 81 |
| Gross loss on sale of MBS | |  | (1) |  |  | (41) |  |  | (8) |  |  | (106) |
| Net gain (loss) on sale of MBS | | $ | 61 |  | $ | (39) |  | $ | 114 |  | $ | (25) |

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1. Proceeds include cash received during the period, plus receivable for MBS sold during the period as of period end.

For the three and nine months ended September 30, 2016, we recognized a net unrealized loss of $6 million and an unrealized gain of $5 million, respectively, and for the three and nine months ended September 30, 2015 we recognized a net unrealized gain of $10 million and $14 million, respectively, for the change in value of investments in interest and principal-only securities in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Over the same periods, we did not recognize any realized gains or losses on our interest or principal-only securities.

***Securitizations and Variable Interest Entities***

As of September 30, 2016 and December 31, 2015, we held investments in CMO trusts, which are variable interest entities ("VIEs"). We have consolidated certain of these CMO trusts in our consolidated financial statements where we have determined we are the primary beneficiary of the trusts. All of our CMO securities are backed by fixed or adjustable-rate agency MBS. Fannie Mae or Freddie Mac guarantees the payment of interest and principal and acts as the trustee and administrator of their respective securitization trusts. Accordingly, we are not required to provide the beneficial interest holders of the CMO securities any financial or other support. Our maximum exposure to loss related to our involvement with CMO trusts is the fair value of the CMO securities and interest and principal-only securities held by us, less principal amounts guaranteed by Fannie Mae and Freddie Mac.

In connection with our consolidated CMO trusts, we recognized agency securities with a total fair value of $0.9 billion and $1.0 billion as of September 30, 2016 and December 31, 2015, respectively, and debt with a total fair value of $494 million and $595 million, respectively, in our accompanying consolidated balance sheets. As of September 30, 2016 and December 31, 2015, the agency securities had an aggregate unpaid principal balance of $0.8 billion and $1.0 billion, respectively, and the debt had an

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aggregate unpaid principal balance of $488 million and $587 million, respectively. We re-measure our consolidated debt at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. For the three and nine months ended September 30, 2016, we recorded a loss of $2 million and $8 million, respectively, associated with our consolidated debt. For the three and nine months ended September 30, 2015, we recorded a gain of $7 million and $16 million, respectively, associated with our consolidated debt. Our involvement with the consolidated trusts is limited to the agency securities transferred by us upon the formation of the trusts and the CMO securities subsequently held by us. There are no arrangements that could require us to provide financial support to the trusts.

As of September 30, 2016 and December 31, 2015, the fair value of our CMO securities and interest and principal-only securities was $1.2 billion and $1.3 billion, respectively, excluding the consolidated CMO trusts discussed above, or $1.6 billion and $1.8 billion, respectively, including the net asset value of our consolidated CMO trusts. Our maximum exposure to loss related to our CMO securities and interest and principal-only securities, including our consolidated CMO trusts, was $222 million and $238 million as of September 30, 2016 and December 31, 2015, respectively.

**Note 5. Repurchase Agreements and Other Secured Borrowings**

We pledge certain of our securities as collateral under our repurchase agreements with financial institutions and under our secured borrowing facility with the Federal Home Loan Bank ("FHLB") of Des Moines. Interest rates on our borrowings are generally based on LIBOR plus or minus a margin and amounts available to be borrowed are dependent upon the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, type of security and liquidity conditions within the banking, mortgage finance and real estate industries. If the fair value of our pledged securities declines, lenders will typically require us to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of our pledged securities increases, lenders may release collateral back to us. As of September 30, 2016, we had met all margin call requirements. For additional information regarding our pledged assets, please refer to Note 7.

***Repurchase Agreements***

As of September 30, 2016 and December 31, 2015, we had $37.7 billion and $41.8 billion, respectively, of repurchase agreements outstanding. The terms and conditions of our repurchase agreements are typically negotiated on a transaction-by-transaction basis. Our repurchase agreements with original maturities greater than 90 days have floating interest rates based on an index plus or minus a fixed spread. Substantially all of our repurchase agreements were used to fund purchases of agency securities ("agency repo"). The remainder of our repurchase agreements were used to fund temporary holdings of U.S. Treasury securities ("U.S. Treasury repo").

The following table summarizes our borrowings under repurchase agreements by their remaining maturities as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **September 30, 2016** | |  |  |  |  |  | **December 31, 2015** | |  |
|  |  |  |  |  | **Weighted** | |  |  |  |  |  | **Weighted** | |  |
|  |  |  |  |  | **Average** | | **Weighted** | |  |  |  | **Average** | | **Weighted** |
|  |  |  |  |  | **Interest** | | **Average Days** | |  |  |  | **Interest** | | **Average Days** |
| **Remaining Maturity** |  |  | **Repurchase Agreements** |  | **Rate** |  | **to Maturity** |  |  | **Repurchase Agreements** |  | **Rate** |  | **to Maturity** |
| Agency repo: | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 1 month | | $ | 17,198 |  | 0.72% |  | 11 |  | $ | 17,579 |  | 0.54% |  | 14 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 1 to ≤ 3 months | |  | 9,318 |  | 0.79% |  | 50 |  |  | 14,283 |  | 0.64% |  | 58 |
| > 3 to ≤ 6 months | |  | 3,617 |  | 0.90% |  | 126 |  |  | 3,154 |  | 0.61% |  | 121 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 6 to ≤ 9 months | |  | 765 |  | 0.85% |  | 221 |  |  | 589 |  | 0.65% |  | 199 |
| > 9 to ≤ 12 months | |  | 615 |  | 0.95% |  | 309 |  |  | 1,201 |  | 0.65% |  | 307 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 12 to ≤ 24 months | |  | 1,985 |  | 1.09% |  | 495 |  |  | 1,473 |  | 0.73% |  | 600 |
| > 24 to ≤ 36 months | |  | 1,100 |  | 1.21% |  | 926 |  |  | 650 |  | 0.81% |  | 901 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 36 to ≤ 48 months | |  | 2,100 |  | 1.15% |  | 1,216 |  |  | 1,300 |  | 0.86% |  | 1,231 |
| > 48 to < 60 months | |  | 925 |  | 1.23% |  | 1,559 |  |  | 1,500 |  | 0.76% |  | 1,477 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total agency repo | |  | 37,623 |  | 0.83% |  | 199 |  |  | 41,729 |  | 0.61% |  | 173 |
| U.S. Treasury repo: | |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1 day | |  | 45 |  | 0.85% |  | 3 |  |  | 25 |  | —% | | 1 |
| Total | | $ | 37,668 |  | 0.83% |  | 198 |  | $ | 41,754 |  | 0.61% |  | 173 |

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***Federal Home Loan Bank Advances***

On January 12, 2016, the Federal Housing Finance Agency ("FHFA") released its final rule on FHLB membership, which requires the termination of our wholly-owned captive insurance subsidiary's FHLB membership and repayment of all FHLB advances after a one year period ending in February 2017. As of September 30, 2016 and December 31, 2015, we had $3.0 billion and $3.8 billion, respectively, of outstanding secured FHLB advances, with a weighted average borrowing rate of 0.63% and 0.53%, respectively, and a weighted average remaining term to maturity of 123 and 141 days, respectively, consisting of 30 day and longer-term floating rate advances:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **September 30, 2016** | |  |  |  |  |  | **December 31, 2015** | |  |
|  |  |  |  |  | **Weighted** | |  |  |  |  |  | **Weighted** | |  |
|  |  |  |  |  | **Average** | | **Weighted** | |  |  |  | **Average** | | **Weighted** |
|  |  |  |  |  | **Interest** | | **Average Days** | |  |  |  | **Interest** | | **Average Days** |
| **Remaining Maturity** |  |  | **FHLB Advances** |  | **Rate** |  | **to Maturity** |  |  | **FHLB Advances** |  | **Rate** |  | **to Maturity** |
| ≤ 1 month | | $ | — | | —% | | — | | $ | 1,952 |  | 0.47% |  | 14 |
| > 1 to ≤ 3 months | |  | — | | —% | | — | |  | 681 |  | 0.60% |  | 84 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 4 to ≤ 6 months | |  | 3,037 |  | 0.63% |  | 123 |  |  | — | | —% | | — |
| 13 months | |  | — | | —% | | — | |  | 1,120 |  | 0.58% |  | 397 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total FHLB advances | | $ | 3,037 |  | 0.63% |  | 123 |  | $ | 3,753 |  | 0.53% |  | 141 |

***Debt of Consolidated Variable Interest Entities***

As of September 30, 2016 and December 31, 2015, debt of consolidated VIEs, at fair value, was $494 million and $595 million, respectively, and had a weighted average interest rate of LIBOR plus 39 and 34 basis points, respectively, and a principal balance of $488 million and $587 million, respectively. The actual maturities of our debt of consolidated VIEs are generally shorter than the stated contractual maturities. The actual maturities are affected by the contractual lives of the underlying agency MBS securitizing the debt of our consolidated VIEs and periodic principal prepayments of such underlying securities. The estimated weighted average life of the debt of our consolidated VIEs as of September 30, 2016 and December 31, 2015 was 5.1 and 4.9 years, respectively.

**Note 6. Derivative and Other Hedging Instruments**

In connection with our risk management strategy, we hedge a portion of our interest rate risk by entering into derivative and other hedging instrument contracts. The principal instruments that we use are interest rate swaps and interest rate swaptions and U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales. We may also utilize TBA securities, purchase or write put or call options on TBA securities or invest in mortgage and other types of derivatives, such as interest and principal-only securities. We also enter into TBA contracts as a means of investing in and financing agency securities (thereby increasing our "at risk" leverage) or as a means of disposing of or reducing our exposure to agency securities (thereby reducing our "at risk" leverage). Our risk management strategy attempts to manage the overall risk of the portfolio, reduce fluctuations in our net book value and generate additional income distributable to stockholders. For additional information regarding our derivative instruments and our overall risk management strategy, please refer to the discussion of derivative and other hedging instruments in Note 3.

Prior to September 30, 2011, our interest rate swaps were typically designated as cash flow hedges under ASC 815; however, as of September 30, 2011, we elected to discontinue hedge accounting for our interest rate swaps in order to increase our funding flexibility. For the three and nine months ended September 30, 2016, we reclassified $7 million and $38 million, respectively, and for the three and nine months ended September 30, 2015 $24 million and $79 million, respectively, of net deferred losses from accumulated OCI into interest expense related to our de-designated interest rate swaps and recognized an equal, but offsetting, amount in other comprehensive income. Our total net periodic interest costs on our swap portfolio were $58 million and $247 million for the three and nine months ended September 30, 2016, respectively, and $131 million and $369 million for the three and nine months ended September 30, 2015, respectively. The difference between our total net periodic interest costs on our swap portfolio and the amount recorded in interest expense related to our de-designated hedges is reported in gain (loss) on derivative instruments and other securities, net in our accompanying consolidated statements of comprehensive income (totaling $51 million and $209 million for the three and nine months ended September 30, 2016, respectively, and $107 million and $290 million for the three and nine months ended September 30, 2015, respectively). As of September 30, 2016, the remaining net deferred loss in accumulated OCI related to de-designated interest rate swaps was $1 million.

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***Derivative and Other Hedging Instrument Assets (Liabilities), at Fair Value***

The table below summarizes fair value information about our derivative and other hedging instrument assets and liabilities as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Derivative and Other Hedging Instruments** |  | **Balance Sheet Location** |  |  | **September 30, 2016** |  |  | **December 31, 2015** |
| Interest rate swaps | | Derivative assets, at fair value | | $ | 5 |  | $ | 31 |
|  |  |  |  |  |  |  |  |  |
| Swaptions | | Derivative assets, at fair value | |  | 6 |  |  | 17 |
| TBA securities | | Derivative assets, at fair value | |  | 50 |  |  | 29 |
|  |  |  |  |  |  |  |  |  |
| U.S. Treasury futures - short | | Derivative assets, at fair value | |  | — | |  | 4 |
| Total derivative assets, at fair value | |  |  | $ | 61 |  | $ | 81 |
|  |  |  |  |  |  |  |  |  |
| Interest rate swaps | | Derivative liabilities, at fair value | | $ | (942) |  | $ | (920) |
|  |  |  |  |  |  |  |  |  |
| TBA securities | | Derivative liabilities, at fair value | |  | (4) |  |  | (15) |
| U.S. Treasury futures - short | | Derivative liabilities, at fair value | |  | (1) |  |  | — |
|  |  |  |  |  |  |  |  |  |
| Total derivative liabilities, at fair value | |  |  | $ | (947) |  | $ | (935) |
|  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long | | U.S. Treasury securities, at fair value | | $ | 45 |  | $ | 25 |
| U.S. Treasury securities - short | | Obligation to return securities borrowed under reverse repurchase agreements, at fair value | |  | (5,424) |  |  | (1,696) |
|  |  |  |  |  |  |  |  |  |
| Total U.S. Treasury securities, net at fair value | |  |  | $ | (5,379) |  | $ | (1,671) |

The following tables summarize our interest rate swap agreements outstanding as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **September 30, 2016** | |  |  |  |  |
|  |  |  |  |  | **Average** | | **Average** | |  | **Net** | | **Average** |
|  |  |  | **Notional** | | **Fixed** | | **Receive** | |  | **Estimated** | | **Maturity** |
| **Payer Interest Rate Swaps** |  |  | **Amount 1** |  | **Pay Rate 2** |  | **Rate 3** |  |  | **Fair Value** |  | **(Years)** |
| ≤ 3 years | | $ | 19,025 |  | 1.05% |  | 0.79% |  | $ | (64) |  | 1.4 |
| > 3 to ≤ 5 years | |  | 5,050 |  | 1.55% |  | 0.76% |  |  | (89) |  | 3.5 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 5 to ≤ 7 years | |  | 7,075 |  | 2.23% |  | 0.76% |  |  | (405) |  | 5.8 |
| > 7 to ≤ 10 years | |  | 1,825 |  | 2.46% |  | 0.83% |  |  | (158) |  | 8.6 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 10 years | |  | 1,175 |  | 3.20% |  | 0.80% |  |  | (221) |  | 14.0 |
| Total payer interest rate swaps | | $ | 34,150 |  | 1.52% |  | 0.78% |  | $ | (937) |  | 3.5 |

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1. Notional amount includes forward starting swaps of $2.2 billion with an average forward start date of 0.5 years and an average maturity of 6.8 years from September 30, 2016.
2. Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.40% as of September 30, 2016.
3. Average receive rate excludes forward starting swaps.

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|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **December 31, 2015** | |  |  |  |  |
|  |  |  |  |  | **Average** | | **Average** | |  | **Net** | | **Average** |
|  |  |  | **Notional** | | **Fixed** | | **Receive** | |  | **Estimated** | | **Maturity** |
| **Payer Interest Rate Swaps** |  |  | **Amount 1** |  | **Pay Rate 2** |  | **Rate 3** |  |  | **Fair Value** |  | **(Years)** |
| ≤ 3 years | | $ | 14,775 |  | 1.06% |  | 0.40% |  | $ | (23) |  | 1.6 |
| > 3 to ≤ 5 years | |  | 9,950 |  | 2.03% |  | 0.40% |  |  | (203) |  | 4.0 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 5 to ≤ 7 years | |  | 7,175 |  | 2.47% |  | 0.44% |  |  | (230) |  | 6.1 |
| > 7 to ≤ 10 years | |  | 7,450 |  | 2.57% |  | 0.39% |  |  | (342) |  | 8.3 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 10 years | |  | 1,175 |  | 3.20% |  | 0.39% |  |  | (91) |  | 14.7 |
| Total payer interest rate swaps | | $ | 40,525 |  | 1.89% |  | 0.40% |  | $ | (889) |  | 4.6 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |

1. Notional amount includes forward starting swaps of $4.5 billion with an average forward start date of 0.7 years and an average maturity of 5.5 years from December 31, 2015.
2. Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.75% as of December 31, 2015.
3. Average receive rate excludes forward starting swaps.

The following table summarizes our interest rate payer swaption agreements outstanding as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Payer Swaptions** | |  |  |  |  | **Option** | |  |  |  |  |  | **Underlying Payer Swap** | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Average** | |  |
|  |  |  |  |  |  |  |  | **Average** | |  |  |  |  |  | **Receive** | | **Average** |
|  |  |  |  |  |  | **Fair** | | **Months to** | |  | **Notional** | | **Average Fixed Pay** | | **Rate** | | **Term** |
| **Years to Expiration** |  |  | **Cost** |  |  | **Value** |  | **Expiration** |  |  | **Amount** |  | **Rate** |  | **(LIBOR)** |  | **(Years)** |
| **September 30, 2016** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total ≤ 1 year | | $ | 44 |  | $ | 6 |  | 5 |  | $ | 700 |  | 3.10% |  | 3M | | 7.0 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total ≤ 1 year | | $ | 74 |  | $ | 17 |  | 4 |  | $ | 2,150 |  | 3.51% |  | 3M |  | 7.0 |

The following table summarizes our U.S. Treasury securities as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | |  |  |  |  |  |  |  | **December 31, 2015** | |  |  |
|  |  |  | **Face Amount Net Long /** | |  |  |  |  |  |  |  | **Face Amount Net Long /** | |  |  |  |  |  |
| **Maturity** |  |  | **(Short)** |  |  | **Cost Basis** |  |  | **Market Value** |  |  | **(Short)** |  |  | **Cost Basis** |  |  | **Market Value** |
| 5 years | | $ | (1,670) |  | $ | (1,683) |  | $ | (1,688) |  | $ | (250) |  | $ | (249) |  | $ | (249) |
| 7 years | |  | (2,941) |  |  | (2,930) |  |  | (2,959) |  |  | (354) |  |  | (353) |  |  | (352) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 10 years | |  | (700) |  |  | (697) |  |  | (732) |  |  | (1,085) |  |  | (1,078) |  |  | (1,070) |
| Total U.S. Treasury securities, net | | $ | (5,311) |  | $ | (5,310) |  | $ | (5,379) |  | $ | (1,689) |  | $ | (1,680) |  | $ | (1,671) |

The following table summarizes our U.S. Treasury futures as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | | |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |
|  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |
| **Maturity** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |
| 5 years | | $ | (730) |  | $ | (886) |  | $ | (887) |  | $ | (1) |  | $ | (730) |  | $ | (866) |  | $ | (864) |  | $ | 2 |
| 10 years | |  | (1,230) |  |  | (1,612) |  |  | (1,612) |  |  | — | |  | (1,130) |  |  | (1,424) |  |  | (1,422) |  |  | 2 |
| Total U.S. Treasury futures | | $ | (1,960) |  | $ | (2,498) |  | $ | (2,499) |  | $ | (1) |  | $ | (1,860) |  | $ | (2,290) |  | $ | (2,286) |  | $ | 4 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Notional amount represents the par value (or principal balance) of the underlying U.S. Treasury security.
2. Cost basis represents the forward price to be paid / (received) for the underlying U.S. Treasury security.

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1. Market value represents the current market value of U.S. Treasury futures as of period-end.
2. Net carrying value represents the difference between the market value and the cost basis of U.S. Treasury futures as of period-end and is reported in derivative assets / (liabilities), at fair value in our consolidated balance sheets.

The following tables summarize our TBA securities as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | | |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |
|  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |
| **TBA Securities by Coupon** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |
| 15-Year TBA securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2.5% |  | $ | 1,839 |  | $ | 1,891 |  | $ | 1,899 |  | $ | 8 |  | $ | (80) |  | $ | (81) |  | $ | (80) |  | $ | 1 |
| 3.0% |  |  | 293 |  |  | 306 |  |  | 307 |  |  | 1 |  |  | 225 |  |  | 233 |  |  | 232 |  |  | (1) |
| 3.5% |  |  | 95 |  |  | 100 |  |  | 100 |  |  | — | |  | 136 |  |  | 143 |  |  | 142 |  |  | (1) |
| Total 15-Year TBAs | |  | 2,227 |  |  | 2,297 |  |  | 2,306 |  |  | 9 |  |  | 281 |  |  | 295 |  |  | 294 |  |  | (1) |
| 30-Year TBA securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 3.0% 5 |  |  | 7,031 |  |  | 7,276 |  |  | 7,303 |  |  | 27 |  |  | 3,914 |  |  | 3,911 |  |  | 3,916 |  |  | 5 |
| 3.5% |  |  | 3,156 |  |  | 3,322 |  |  | 3,327 |  |  | 5 |  |  | 1,497 |  |  | 1,536 |  |  | 1,539 |  |  | 3 |
| 4.0% |  |  | 2,368 |  |  | 2,537 |  |  | 2,542 |  |  | 5 |  |  | 1,575 |  |  | 1,658 |  |  | 1,665 |  |  | 7 |
| 4.5% |  |  | 99 |  |  | 108 |  |  | 108 |  |  | — | |  | 28 |  |  | 30 |  |  | 30 |  |  | — |
| Total 30-Year TBAs | |  | 12,654 |  |  | 13,243 |  |  | 13,280 |  |  | 37 |  |  | 7,014 |  |  | 7,135 |  |  | 7,150 |  |  | 15 |
| Total net TBA securities | | $ | 14,881 |  | $ | 15,540 |  | $ | 15,586 |  | $ | 46 |  | $ | 7,295 |  | $ | 7,430 |  | $ | 7,444 |  | $ | 14 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | | |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |
|  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |  |  | **Notional** | |  | **Cost** | |  | **Market** | |  |  |
| **TBA Securities by Issuer** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |  |  | **Amount - Long (Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Net Carrying Value 4** |
| Fannie Mae | | $ | 12,760 |  | $ | 13,328 |  | $ | 13,365 |  | $ | 37 |  | $ | 6,033 |  | $ | 6,145 |  | $ | 6,159 |  | $ | 14 |
| Freddie Mac | |  | 1,648 |  |  | 1,723 |  |  | 1,729 |  |  | 6 |  |  | 689 |  |  | 703 |  |  | 703 |  |  | — |
| Ginnie Mae | |  | 473 |  |  | 489 |  |  | 492 |  |  | 3 |  |  | 573 |  |  | 582 |  |  | 582 |  |  | — |
| TBA securities, net | | $ | 14,881 |  | $ | 15,540 |  | $ | 15,586 |  | $ | 46 |  | $ | 7,295 |  | $ | 7,430 |  | $ | 7,444 |  | $ | 14 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Notional amount represents the par value (or principal balance) of the underlying agency security.
2. Cost basis represents the forward price to be paid / (received) for the underlying agency security.
3. Market value represents the current market value of the TBA contract (or of the underlying agency security) as of period-end.
4. Net carrying value represents the difference between the market value and the cost basis of the TBA contract as of period-end and is reported in derivative assets / (liabilities), at fair value in our consolidated balance sheets.
5. Includes $2.6 billion of forward purchases of agency MBS specified pools as of September 30, 2016.

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***Gain (Loss) From Derivative Instruments and Other Securities, Net***

The tables below summarize changes in our derivative and other hedge portfolio and their effect on our consolidated statements of comprehensive income for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Three Months Ended September 30, 2016** | | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Amount of** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gain/(Loss)** |
|  |  |  | **Notional Amount** | |  |  | **Settlement, Termination,** | |  | **Notional Amount** | | |  | **Recognized in** |
|  |  |  | **Long/(Short)** | |  |  | **Expiration or** | | **Long/(Short) September 30,** | | | |  | **Income on** |
| **Derivative and Other Hedging Instruments** |  |  | **June 30, 2016** |  | **Additions** |  | **Exercise** |  |  | **2016** |  |  |  | **Derivatives 1** |
| TBA securities, net | | $ | 6,756 |  | 37,881 | (29,756) | |  | $ | 14,881 |  |  | $ | 67 |
| Interest rate swaps | | $ | (35,125) |  | (2,400) | 3,375 | |  | $ | (34,150) |  |  |  | 153 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (1,050) |  | — | 350 | |  | $ | (700) |  |  |  | (1) |
| U.S. Treasury securities - short position | | $ | (2,930) |  | (2,696) | 270 | |  | $ | (5,356) |  |  |  | 14 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long position | | $ | 62 |  | 90 | (107) | |  | $ | 45 |  |  |  | 1 |
| U.S. Treasury futures contracts - short position | | $ | (1,960) |  | (1,960) | 1,960 | |  | $ | (1,960) |  |  |  | 15 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | 249 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net loss of $2 million from debt of consolidated VIEs, a net loss of $6 million from interest and principal-only securities and other miscellaneous net gain of $1 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Three Months Ended September 30, 2015** | | | | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Amount of** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gain/(Loss)** |
|  |  |  | **Notional Amount** | |  |  | **Settlement, Termination,** | |  | **Notional Amount** | | |  | **Recognized in** |
|  |  |  | **Long/(Short)** | |  |  | **Expiration or** | |  | **Long/(Short) September 30,** | | |  | **Income on** |
| **Derivative and Other Hedging Instruments** |  |  | **June 30, 2015** |  | **Additions** |  | **Exercise** |  |  | **2015** |  |  |  | **Derivatives 1** |
| TBA securities, net | | $ | 6,941 |  | 33,403 | (33,216) | |  | $ | 7,128 |  |  | $ | 213 |
| Interest rate swaps | | $ | (44,925) |  | (1,450) | 1,200 | |  | $ | (45,175) |  |  |  | (966) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (5,450) |  | — | 1,800 | |  | $ | (3,650) |  |  |  | (23) |
| U.S. Treasury securities - short position | | $ | (2,250) |  | (4,335) | 5,284 | |  | $ | (1,301) |  |  |  | (25) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long position | | $ | 5,192 |  | 4,704 | (9,121) | |  | $ | 775 |  |  |  | 29 |
| U.S. Treasury futures contracts - short position | | $ | (730) |  | (730) | 730 | |  | $ | (730) |  |  |  | (23) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | (795) |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net gain of $7 million from debt of consolidated VIEs and a net gain of $10 million from interest and principal-only securities recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Nine Months Ended September 30, 2016** | | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Amount of** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gain/(Loss)** |
|  |  |  | **Notional Amount** | |  |  | **Settlement, Termination,** | |  | **Notional Amount** | | |  | **Recognized in** |
|  |  |  | **Long/(Short)** | |  |  | **Expiration or** | | **Long/(Short) September 30,** | | | |  | **Income on** |
| **Derivative and Other Hedging Instruments** |  |  | **December 31, 2015** |  | **Additions** |  | **Exercise** |  |  | **2016** |  |  |  | **Derivatives 1** |
| TBA securities, net | | $ | 7,295 |  | 75,906 | (68,320) | |  | $ | 14,881 |  |  | $ | 391 |
| Interest rate swaps | | $ | (40,525) |  | (5,950) | 12,325 | |  | $ | (34,150) |  |  |  | (1,208) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (2,150) |  | — | 1,450 | |  | $ | (700) |  |  |  | (12) |
| U.S. Treasury securities - short position | | $ | (1,714) |  | (5,329) | 1,687 | |  | $ | (5,356) |  |  |  | (142) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long position | | $ | 25 |  | 495 | (475) | |  | $ | 45 |  |  |  | 7 |
| U.S. Treasury futures contracts - short position | | $ | (1,860) |  | (5,880) | 5,780 | |  | $ | (1,960) |  |  |  | (106) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | (1,070) |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net loss of $8 million from debt of consolidated VIEs, a net gain of $5 million from interest and principal-only securities and other miscellaneous net gains of $15 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Nine Months Ended September 30, 2015** | | | | | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Amount of** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Gain/(Loss)** |  |
|  |  |  | **Notional Amount** | |  |  | **Settlement, Termination,** | |  | **Notional Amount** | | |  | **Recognized in** |  |
|  |  |  | **Long/(Short)** | |  |  | **Expiration or** | |  | **Long/(Short) September 30,** | | |  | **Income on** |  |
| **Derivative and Other Hedging Instruments** |  |  | **December 31, 2014** |  | **Additions** |  | **Exercise** |  |  | **2015** |  |  |  | **Derivatives 1** |  |
| TBA securities, net | | $ | 14,412 |  | 97,270 | (104,554) | |  | $ | 7,128 |  |  | $ | 337 |  |
| Interest rate swaps | | $ | (43,700) |  | (4,950) | 3,475 | |  | $ | (45,175) |  |  |  | (1,278) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (6,800) |  | (500) | 3,650 | |  | $ | (3,650) |  |  |  | (27) |  |
| Receiver swaptions | | $ | 4,250 |  | — | (4,250) | |  | $ | — | |  |  | 4 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - short position | | $ | (5,392) |  | (10,732) | 14,823 | |  | $ | (1,301) |  |  |  | (89) |  |
| U.S. Treasury securities - long position | | $ | 2,411 |  | 31,915 | (33,551) | |  | $ | 775 |  |  |  | (35) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury futures contracts - short position | | $ | (730) |  | (2,190) | 2,190 | |  | $ | (730) |  |  |  | (28) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | (1,116) |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net gain of $16 million from debt of consolidate VIEs, a net gain of $14 million from interest and principal-only securities and other miscellaneous net losses of $4 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

**Note 7. Pledged Assets**

Our funding agreements require us to fully collateralize our obligations under the agreements based upon our counterparties' collateral requirements and their determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. Our derivative contracts similarly require us to fully collateralize our obligations under such agreements, which will vary over time based on similar factors as well as our counterparties' determination of the value of the derivative contract. We are typically required to post initial collateral upon execution of derivative transactions, such as under our interest rate swap agreements and TBA contracts. If we breach our collateral requirements, we will be required to fully settle our obligations under the agreements, which could include a forced liquidation of our pledged collateral.

Our counterparties also apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value and limits the amount we can borrow against our securities. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value. Our agreements do not specify the haircut; rather haircuts are determined on an individual transaction basis. Additionally, the FHLB of Des Moines may adjust the haircut on our outstanding FHLB advances at any time prior to maturity. As a condition of our membership in the FHLB of Des Moines, we are also obligated to purchase membership stock in the FHLB based upon the total assets of our wholly-owned captive insurance company and activity-based stock in the FHLB based upon the aggregate amount of advances obtained from the FHLB.

Consequently, our funding agreements and derivative contracts expose us to credit risk relating to potential losses that could be recognized in the event that our counterparties fail to perform their obligations under such agreements. We minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings or to registered clearinghouses and U.S. government agencies and we monitor our positions with individual counterparties. In the event of a default by a counterparty we may have difficulty obtaining our assets pledged as collateral to such counterparty and may not receive payments provided for under the terms of our derivative agreements. In the case of centrally cleared instruments, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the clearing exchanges' initial and daily mark to market margin requirements and clearinghouse guarantee funds and other resources that are available in the event of a clearing member default.

Further, each of our International Swaps and Derivatives Association ("ISDA") Master Agreements also contains a cross default provision under which a default under certain of our other indebtedness in excess of certain thresholds causes an event of default under the ISDA Master Agreement. Threshold amounts vary by lender. Following an event of default, we could be required to settle our obligations under the agreements. Additionally, under certain of our ISDA Master Agreements, we could be required to settle our obligations under the agreements if we fail to maintain certain minimum stockholders' equity thresholds or our REIT status or if we fail to comply with limits on our leverage up to certain specified levels. As of September 30, 2016, the fair value of additional collateral that could be required to be posted as a result of the credit-risk-related contingent features being triggered was not material to our financial statements.

As of September 30, 2016, our maximum amount at risk with any counterparty related to our repurchase agreements was less than 5% of our stockholders' equity and our maximum amount at risk with any counterparty related to our interest rate swap and swaption agreements, excluding centrally cleared swaps, was less than 1% of our stockholders' equity.

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***Assets Pledged to Counterparties***

The following tables summarize our assets pledged as collateral under our funding, derivative and prime broker agreements by type, including securities pledged related to securities sold but not yet settled, as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **September 30, 2016** | | | |  |  |  |  |  |
|  |  |  | **Repurchase Agreements and FHLB** | |  |  |  |  |  |  |  |  |  |  |  |
| **Assets Pledged to Counterparties** |  |  | **Advances 1** |  |  | **Debt of Consolidated VIEs** |  |  | **Derivative Agreements** |  |  | **Prime Broker Agreements** |  |  | **Total** |
| Agency MBS - fair value | | $ | 42,997 |  | $ | 890 | $ | | 684 |  | $ | 830 |  | $ | 45,401 |
| Non-agency MBS - fair value | |  | 102 |  |  | — |  |  | — | |  | — | |  | 102 |
| U.S. Treasury securities - fair value | |  | 45 |  |  | — |  |  | — | |  | — | |  | 45 |
| Accrued interest on pledged securities | |  | 118 |  |  | 3 |  |  | 2 |  |  | 2 |  |  | 125 |
| Restricted cash and cash equivalents | |  | 15 |  |  | — |  |  | 666 |  |  | — |  |  | 681 |
| Total | | $ | 43,277 |  | $ | 893 | $ | | 1,352 |  | $ | 832 |  | $ | 46,354 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $194 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **December 31, 2015** | | | |  |  |  |  |  |
|  |  |  | **Repurchase Agreements and FHLB** | |  |  |  |  |  |  |  |  |  |  |  |
| **Assets Pledged to Counterparties** |  |  | **Advances 1** |  |  | **Debt of Consolidated VIEs** |  |  | **Derivative Agreements** |  |  | **Prime Broker Agreements** |  |  | **Total** |
| Agency MBS - fair value | | $ | 47,992 |  | $ | 1,029 | $ | | 148 |  | $ | 485 |  | $ | 49,654 |
| Non-agency MBS - fair value | |  | 113 |  |  | — |  |  | — | |  | — | |  | 113 |
| U.S. Treasury securities - fair value | |  | 25 |  |  | — |  |  | — | |  | — | |  | 25 |
| Accrued interest on pledged securities | |  | 135 |  |  | 3 |  |  | — | |  | 2 |  |  | 140 |
| Restricted cash and cash equivalents | |  | 23 |  |  | — |  |  | 1,226 |  |  | 32 |  |  | 1,281 |
| Total | | $ | 48,288 |  | $ | 1,032 | $ | | 1,374 |  | $ | 519 |  | $ | 51,213 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $245 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements.

As of September 30, 2016 and December 31, 2015, we held $126 million and $150 million, respectively, of membership and activity-based stock in the FHLB of Des Moines. FHLB stock is reported at cost, which equals par value, in other assets on our accompanying consolidated balance sheets. FHLB stock can only be redeemed or sold at its par value, and only to the FHLB of Des Moines.

The cash and cash equivalents and agency securities pledged as collateral under our derivative agreements are included in restricted cash and cash equivalents and agency securities, at fair value, respectively, on our consolidated balance sheets.

The following table summarizes our securities pledged as collateral under our repurchase agreements and FHLB advances by the remaining maturity of our borrowings, including securities pledged related to sold but not yet settled securities, as of September 30, 2016 and December 31, 2015 (in millions). For the corresponding borrowings associated with the following amounts and the interest rates thereon, refer to Note 5*.*

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | |  |  |  |  |  |  | **December 31, 2015** | | |  |  |
|  |  |  |  |  |  |  |  |  | **Accrued** | |  |  |  |  |  |  |  | **Accrued** |
|  |  |  |  |  |  |  |  |  | **Interest on** | |  |  |  |  |  |  |  | **Interest on** |
|  |  |  | **Fair Value of Pledged** | |  | **Amortized** | |  | **Pledged** | |  | **Fair Value of Pledged** | |  | **Amortized** | |  | **Pledged** |
| **Securities Pledged by Remaining Maturity of Repurchase Agreements and FHLB Advances** |  |  | **Securities** |  | **Cost of Pledged Securities** | |  |  | **Securities** |  |  | **Securities** |  | **Cost of Pledged Securities** | |  |  | **Securities** |
| MBS:1 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 30 days | | $ | 18,604 |  | $ | 18,204 |  | $ | 51 |  | $ | 20,053 |  | $ | 20,075 |  | $ | 57 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 30 and ≤ 60 days | |  | 7,404 |  |  | 7,258 |  |  | 20 |  |  | 8,311 |  |  | 8,340 |  |  | 23 |
| > 60 and ≤ 90 days | |  | 2,078 |  |  | 2,026 |  |  | 6 |  |  | 7,534 |  |  | 7,525 |  |  | 21 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 90 days | |  | 15,014 |  |  | 14,668 |  |  | 41 |  |  | 12,207 |  |  | 12,187 |  |  | 34 |
| Total MBS | |  | 43,100 |  |  | 42,156 |  |  | 118 |  |  | 48,105 |  |  | 48,127 |  |  | 135 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1 day | |  | 45 |  |  | 45 |  |  | — | |  | 25 |  |  | 25 |  |  | — |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 43,145 |  | $ | 42,201 |  | $ | 118 |  | $ | 48,130 |  | $ | 48,152 |  | $ | 135 |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $194 million and $245 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements, as of September 30, 2016 and December 31, 2015, respectively.

As of September 30, 2016 and December 31, 2015, none of our borrowings backed by MBS were due on demand or mature overnight.

The table above excludes agency securities transferred to our consolidated VIEs. Securities transferred to our consolidated VIEs can only be used to settle the obligations of each respective VIE. However, we may pledge our retained interests in our consolidated VIEs as collateral under our repurchase agreements and derivative contracts. Please refer to Notes 4 and 5 for additional information regarding our consolidated VIEs.

***Assets Pledged from Counterparties***

As of September 30, 2016 and December 31, 2015, we had U.S. Treasury securities pledged to us from counterparties as collateral under our reverse repurchase agreements of $5.4 billion and $1.7 billion, respectively. U.S Treasury securities received as collateral under our reverse repurchase agreements that we use to cover short sales of U.S. Treasury securities are accounted for as securities borrowing transactions. We recognize a corresponding obligation to return the borrowed securities at fair value on the accompanying consolidated balance sheets based on the value of the underlying borrowed securities as of the reporting date.

***Offsetting Assets and Liabilities***

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of setoff under master netting arrangements (or similar agreements), including in the event of default or in the event of bankruptcy of either party to the transactions. Repurchase agreements and reverse repurchase agreements with the same counterparty and the same maturity date are presented net in our consolidated balance sheets when the terms of the agreements permit netting. All other assets and liabilities subject to master netting arrangements are presented on a gross basis in our consolidated balance sheets. The following tables present information about our assets and liabilities that are subject to master netting arrangements and have either been offset or can potentially be offset on our consolidated balance sheets as of September 30, 2016 and December 31, 2015 (in millions):

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **Offsetting of Financial and Derivative Assets** | | | | | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **Net Amounts of Assets** | | | |  | **Gross Amounts Not Offset** | | | | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **in the** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Gross Amounts Offset in** | | | |  | **Presented in the** | | | |  | **Consolidated Balance Sheets** | | | | | |  |  |  |
|  |  |  |  | **Gross Amounts of** | |  | **the Consolidated Balance** | | | | |  | **Consolidated Balance** | | | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  | **Recognized Assets** | |  |  | **Sheets** | | | |  | **Sheets** | | | |  | **Financial Instruments** |  |  |  | **Collateral Received 2** | |  | **Net Amount** |  |
| **September 30, 2016** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap and swaption agreements, at fair value 1 | | $ | | 11 | | $ | | — | | | | $ | 11 |  |  |  | $ | (11) | $ | | | — | | $ | — |  |
| Receivable under reverse repurchase agreements | |  |  | 5,616 | |  |  | (175) |  |  |  |  | 5,441 |  |  |  |  | (4,797) |  |  |  | (644) |  |  | — |  |
| Total | | $ | | 5,627 | | $ | | (175) |  |  |  | $ | 5,452 |  |  |  | $ | (4,808) | $ | | | (644) |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap and swaption agreements, at fair value 1 | | $ | | 48 | | $ | | — | | | | $ | 48 |  |  |  | $ | (31) | $ | | | — | | $ | 17 |  |
| Receivable under reverse repurchase agreements | |  |  | 1,713 | |  |  | — | |  | |  | 1,713 |  |  |  |  | (1,356) |  |  |  | (357) |  |  | — |  |
| Total | |  | $ | 1,761 | |  | $ | — | |  | | $ | 1,761 |  |  |  | $ | (1,387) |  |  | $ | (357) |  | $ | 17 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **Offsetting of Financial and Derivative Liabilities** | | | | | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  | **Net Amounts of Liabilities** | | | | |  | **Gross Amounts Not Offset** | | | | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **in the** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **Presented in the** | | | |  | **Consolidated Balance Sheets** | | | | | |  |  |  |
|  |  |  | **Gross Amounts of** | | | **Gross Amounts Offset in the** | | | | | |  | **Consolidated Balance** | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Recognized Liabilities** | | |  | **Consolidated Balance Sheets** | | |  | |  |  | **Sheets** |  | |  |  | **Financial Instruments** |  |  |  | **Collateral Pledged 2** |  |  | **Net Amount** |  |
| **September 30, 2016** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap agreements, at fair value 1 | | $ |  | 942 |  | $ |  | — | | | | $ | 942 |  |  |  | $ | (11) | $ | | | (931) |  | $ | — |  |
| Repurchase agreements and FHLB advances | |  |  | 40,880 |  |  |  | (175) |  |  |  |  | 40,705 |  |  |  |  | (4,797) |  |  |  | (35,908) |  |  | — |  |
| Total | | $ |  | 41,822 |  | $ |  | (175) |  |  |  | $ | 41,647 |  |  |  | $ | (4,808) | $ | | | (36,839) |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap agreements, at fair value 1 | | $ |  | 920 |  | $ |  | — | | | | $ | 920 |  |  |  | $ | (31) | $ | | | (889) |  | $ | — |  |
| Repurchase agreements | |  |  | 45,507 |  |  |  | — |  | |  |  | 45,507 |  |  |  |  | (1,356) |  |  |  | (44,151) |  |  | — |  |
| Total | | $ |  | 46,427 |  | $ |  | — | | | | $ | 46,427 |  |  |  | $ | (1,387) | $ | | | (45,040) |  | $ | — |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Reported under derivative assets / liabilities, at fair value in the accompanying consolidated balance sheets. Refer to Note 6 for a reconciliation of derivative assets / liabilities, at fair value to their sub-components.
2. Includes cash and securities pledged / received as collateral, at fair value. Amounts presented are limited to collateral pledged sufficient to reduce the net amount to zero for individual counterparties, as applicable.

**Note 8. Fair Value Measurements**

We determine the fair value of our investment securities and debt of consolidated VIEs based upon fair value estimates obtained from multiple third party pricing services and dealers. In determining fair value, third party pricing sources use various valuation approaches, including market and income approaches. Factors used by third party sources in estimating the fair value of an instrument may include observable inputs such as coupons, primary and secondary mortgage rates, pricing information, credit data, volatility statistics, and other market data that are current as of the measurement date. 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. Third party pricing sources may also use certain unobservable inputs, such as assumptions of future levels of prepayment, defaults and foreclosures, especially when estimating fair values for securities with lower levels of recent trading activity. We make inquiries of third party pricing sources to understand the significant inputs and assumptions they used to determine their prices. For further information regarding valuation of our derivative instruments, please refer to the discussion of derivative and other hedging instruments in Note 3.

We review the various third party fair value estimates and perform procedures to validate their reasonableness, including an analysis of the range of third party estimates for each position, comparison to recent trade activity for similar securities, and

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management review for consistency with market conditions observed as of the measurement date. While we do not adjust prices we obtain from third party pricing sources, we will exclude third party prices for securities from our determination of fair value if we determine (based on our validation procedures and our market knowledge and expertise) that the price is significantly different from observable market data would indicate and we cannot obtain an understanding from the third party source as to the significant inputs used to determine the price.

The validation procedures described above also influence our determination of the appropriate fair value measurement classification. We utilize a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. There were no transfers between hierarchy levels during the three and nine months ended September 30, 2016. The three levels of hierarchy are defined as follows:

* Level 1 Inputs —Quoted prices (unadjusted) for identical unrestricted assets and liabilities in active markets that are accessible at the measurement date.
* Level 2 Inputs —Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
* Level 3 Inputs —Instruments with primarily unobservable market data that cannot be corroborated.

The following table provides a summary of our assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **September 30, 2016** | |  |  |  |  |  |  |  | **December 31, 2015** | |  |  |
|  | **Level 1** |  |  |  | **Level 2** | |  | **Level 3** | |  | **Level 1** | |  | **Level 2** | |  | **Level 3** |
| Assets: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Agency securities | $ | — | | $ | 46,328 |  | $ | — | | $ | — | | $ | 51,331 |  | $ | — |
| Agency securities transferred to consolidated VIEs |  | — | |  | 890 |  |  | — | |  | — | |  | 1,029 |  |  | — |
| Non-agency securities |  | — | |  | 102 |  |  | — | |  | — | |  | 113 |  |  | — |
| Credit risk transfer securities |  | — | |  | 36 |  |  | — | |  | — | |  | — | |  | — |
| U.S. Treasury securities |  | 45 |  |  | — | |  | — | |  | 25 |  |  | — | |  | — |
| Interest rate swaps |  | — | |  | 5 |  |  | — | |  | — | |  | 31 |  |  | — |
| Swaptions |  | — | |  | 6 |  |  | — | |  | — | |  | 17 |  |  | — |
| REIT equity securities |  | — | |  | — | |  | — | |  | 33 |  |  | — | |  | — |
| TBA securities |  | — | |  | 50 |  |  | — | |  | — | |  | 29 |  |  | — |
| U.S. Treasury futures |  | — |  |  | — |  |  | — |  |  | 4 |  |  | — |  |  | — |
| Total | $ | 45 |  | $ | 47,417 |  | $ | — | | $ | 62 |  | $ | 52,550 |  | $ | — |
| Liabilities: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Debt of consolidated VIEs | $ | — | | $ | 494 |  | $ | — | | $ | — | | $ | 595 |  | $ | — |
| Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements |  | 5,424 |  |  | — | |  | — | |  | 1,696 |  |  | — | |  | — |
| Interest rate swaps |  | — | |  | 942 |  |  | — | |  | — | |  | 920 |  |  | — |
| TBA securities |  | — | |  | 4 |  |  | — | |  | — | |  | 15 |  |  | — |
| U.S. Treasury futures |  | 1 |  |  | — |  |  | — |  |  | — |  |  | — |  |  | — |
| Total | $ | 5,425 |  | $ | 1,440 |  | $ | — |  | $ | 1,696 |  | $ | 1,530 |  | $ | — |

We elected the option to account for debt of consolidated VIEs at fair value with changes in fair value reflected in earnings during the period in which they occur, because we believe this election more appropriately reflects our financial position as both the consolidated agency securities and consolidated debt are presented in a consistent manner, at fair value, on our consolidated balance sheets. We estimate the fair value of the consolidated debt based on the fair value of the MBS transferred to consolidated VIEs, less the fair value of our retained interests, which are based on valuations obtained from third-party pricing services and non-binding dealer quotes derived from common market pricing methods using "Level 2" inputs.

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Excluded from the table above are financial instruments, including cash and cash equivalents, restricted cash and cash equivalents, receivables, payables and borrowings under repurchase agreements and FHLB advances, which are presented in our consolidated financial statements at cost. The cost basis of these instruments is determined to approximate fair value due to their short duration or, in the case of longer-term repo and FHLB advances, due to floating rates of interest based on an index plus or minus a fixed spread which is consistent with fixed spreads demanded in the market. We estimate the fair value of these instruments using "Level 1" or "Level 2" inputs.

**Note 9. Stockholders' Equity**

***Preferred Stock***

Pursuant to our amended and restated certificate of incorporation, we are authorized to designate and issue up to 10.0 million shares of preferred stock in one or more classes or series. Our Board of Directors has designated 6.9 million shares as 8.000% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") and 8,050 shares as 7.750% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock"). As of September 30, 2016, we had 3.1 million shares of authorized but unissued shares of preferred stock. Our Board of Directors may designate additional series of authorized preferred stock ranking junior to or in parity with the Series A or Series B Preferred Stock or designate additional shares of the Series A or Series B Preferred Stock and authorize the issuance of such shares.

In April 2012, we completed a public offering in which 6.9 million shares of our Series A Preferred Stock were sold to the underwriters at a price of $24.2125 per share for proceeds, net of offering expenses, of $167 million. In May 2014, we completed a public offering in which 7.0 million depositary shares were sold to the underwriters at a price of $24.2125 per depositary share for proceeds, net of offering expenses, of $169 million. Each depositary share represents a 1/1,000th interest in a share of our Series B Preferred Stock.

Our Series A and Series B Preferred Stock have no stated maturity, are not subject to any sinking fund or mandatory redemption and rank on parity with each other. Under certain circumstances upon a change of control, our Series A and Series B Preferred Stock are convertible to shares of our common stock. Holders of our Series A Preferred Stock and depository shares underlying our Series B Preferred Stock have no voting rights, except under limited conditions, and are entitled to receive cumulative cash dividends at a rate of 8.000% and 7.750% per annum, respectively, of their $25.00 per share and $25.00 per depositary share liquidation preference, respectively, before holders of our common stock are entitled to receive any dividends. Shares of our Series A Preferred Stock and depository shares underlying our Series B Preferred Stock are each redeemable at $25.00 per share, plus accumulated and unpaid dividends (whether or not declared) exclusively at our option commencing on April 5, 2017 and May 8, 2019, respectively, or earlier under certain circumstances intended to preserve our qualification as a REIT for federal income tax purposes. Dividends are payable quarterly in arrears on the 15th day of each January, April, July and October. As of September 30, 2016, we had declared all required quarterly dividends on our Series A and Series B Preferred Stock.

***Common Stock Repurchase Program***

In October 2012, our Board of Directors adopted a program that provided for stock repurchases, which, as amended, authorized repurchases of our common stock up to $2 billion through December 31, 2016. As of September 30, 2016, the total remaining amount authorized for repurchases of our common stock was $0.6 billion. In October 2016, our Board of Directors terminated the existing stock repurchase program and replaced it with a new stock repurchase authorization. Under the new stock repurchase program, we are authorized to repurchase up to $1 billion of our outstanding shares of common stock through December 31, 2017.

Shares of our common stock may be purchased in the open market, including through block purchases, or through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The timing, manner, price and amount of any repurchases will be determined at our discretion and the program may be suspended, terminated or modified at any time for any reason. Among other factors, we intend to only consider repurchasing shares of our common stock when the purchase price is less than our estimate of our current tangible net asset value per common share. Generally, when we repurchase our common stock at a discount to our tangible net asset value, the tangible net asset value of our remaining shares of common stock outstanding increases. In addition, we do not intend to repurchase any shares from directors, officers or other affiliates. The program does not obligate us to acquire any specific number of shares, and all repurchases will be made in accordance with Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases.

We did not repurchase any shares of our common stock during the three months ended September 30, 2016. During the nine months ended September 30, 2016, we repurchased 6.5 million shares of our common stock at an average repurchase price of $17.89 per share, including expenses, totaling $116 million. During the three and nine months ended September 30, 2015 we repurchased 2.4 million and 6.3 million shares, respectively, of our common stock at an average repurchase price of $19.08 and $19.57 per share, respectively, including expenses, totaling $45 million and $124 million, respectively.

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***Accumulated Other Comprehensive Income (Loss)***

The following table summarizes changes to accumulated OCI for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  | **Total Accumulated** |
|  |  |  | **Net Unrealized Gain (Loss) on** | |  | **Net Unrealized Gain (Loss)** | |  | **OCI** |
| **Accumulated Other Comprehensive Income (Loss)** |  |  | **Available-for-Sale MBS** |  |  | **on Swaps** |  |  | **Balance** |
| **Three Months Ended September 30, 2016** | |  |  |  |  |  |  |  |  |
| Balance as of June 30, 2016 | | $ | 1,108 |  | $ | (8) |  | $ | 1,100 |
|  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | (36) |  |  | — | |  | (36) |
| Amounts reclassified from accumulated OCI | |  | (61) |  |  | 7 |  |  | (54) |
|  |  |  |  |  |  |  |  |  |  |
| Balance as of September 30, 2016 | | $ | 1,011 |  | $ | (1) |  | $ | 1,010 |
|  |  |  |  |  |  |  |  |  |  |
| **Three Months Ended September 30, 2015** | |  |  |  |  |  |  |  |  |
| Balance as of June 30, 2015 | | $ | 89 |  | $ | (85) |  | $ | 4 |
|  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | 428 |  |  | — | |  | 428 |
| Amounts reclassified from accumulated OCI | |  | 39 |  |  | 24 |  |  | 63 |
|  |  |  |  |  |  |  |  |  |  |
| Balance as of September 30, 2015 | | $ | 556 |  | $ | (61) |  | $ | 495 |
|  |  |  |  |  |  |  |  |  |  |
| **Nine Months Ended September 30, 2016** | |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2015 | | $ | (27) |  | $ | (39) |  | $ | (66) |
|  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | 1,152 |  |  | — | |  | 1,152 |
| Amounts reclassified from accumulated OCI | |  | (114) |  |  | 38 |  |  | (76) |
|  |  |  |  |  |  |  |  |  |  |
| Balance as of September 30, 2016 | | $ | 1,011 |  | $ | (1) |  | $ | 1,010 |
|  |  |  |  |  |  |  |  |  |  |
| **Nine Months Ended September 30, 2015** | |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2014 | | $ | 570 |  | $ | (140) |  | $ | 430 |
|  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | (39) |  |  | — | |  | (39) |
| Amounts reclassified from accumulated OCI | |  | 25 |  |  | 79 |  |  | 104 |
|  |  |  |  |  |  |  |  |  |  |
| Balance as of September 30, 2015 | | $ | 556 |  | $ | (61) |  | $ | 495 |

The following table summarizes reclassifications out of accumulated OCI for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended September 30,** | | | | |  |  | **Line Item in the Consolidated** |  |
|  |  |  |  |  |  |  |  |  | **Statements of Comprehensive Income** |  |
|  |  |  |  |  |  |  |  |  |  |
| **Amounts Reclassified from Accumulated OCI** |  | **2016** |  |  |  | **2015** |  |  | **Where Net Income is Presented** |  |
| (Gain) loss amounts reclassified from accumulated OCI for available-for-sale MBS upon realization | | $ | (61) |  | $ |  | 39 |  | Gain (loss) on sale of mortgage-backed securities, net |  |
| Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net | |  | 7 |  |  |  | 24 |  | Interest expense |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Total reclassifications | | $ | (54) |  | $ |  | 63 |  |  |  |
|  |  | **Nine Months Ended September 30,** | | | | |  |  | **Line Item in the Consolidated** |  |
|  |  |  |  |  |  |  |  |  | **Statements of Comprehensive Income** |  |
|  |  |  |  |  |  |  |  |  |  |
| **Amounts Reclassified from Accumulated OCI** |  | **2016** |  |  |  | **2015** |  |  | **Where Net Income is Presented** |  |
| (Gain) loss amounts reclassified from accumulated OCI for available-for-sale MBS upon realization | | $ | (114) |  | $ |  | 25 |  | Gain (loss) on sale of mortgage-backed securities, net |  |
| Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net | |  | 38 |  |  |  | 79 |  | Interest expense |  |
|  | |  |  |  |  |  | |  |  |  |
| Total reclassifications | | $ | (76) |  | $ | 104 | |  |  |  |

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**Note 10. Business Combination - Acquisition of AGNC Mortgage Management, LLC**

On July 1, 2016, we completed our acquisition of all of the outstanding membership interests of AMM from ACAM, a wholly owned portfolio company of ACAS, for a purchase price of $562 million in cash. Following the closing of the acquisition, we became internally managed and are no longer affiliated with ACAS. The results of AMM's operations have been included in our consolidated financial statements since that date. We believe internalizing our management function will result in lower operating costs as well as provide management fee income from MTGE.

Our acquisition of AMM is accounted for as a business combination using the acquisition method of accounting, whereby the total purchase price has been allocated to identifiable assets acquired and liabilities assumed based on their respective fair values as of the acquisition date. Goodwill is calculated as the excess of the consideration transferred over the net assets acquired that meet the criteria for separate recognition and represents the estimated future economic benefits arising from these and other assets acquired that could not be individually identified or do not qualify for recognition as a separate asset. A large majority of the acquisition price has been recognized as goodwill, which is attributable to our management agreement that does not qualify for separate recognition. Goodwill is expected to be deductible for income tax purposes over a 15 year amortization period. We did not recognize a gain or loss associated with the effective settlement of our pre-existing management agreement with our Manager on the acquisition date based on comparable agreements available in the market.

The fair values of intangible assets acquired were determined using a market-based measurement under the income approach based on primarily unobservable market data that cannot be corroborated and, thus, represent a level 3 measurement (see Note 8). The primary market-based inputs include forecasted revenues and expenses, discount rate and corporate income tax rate.

The following table summarizes the fair values of assets acquired and liabilities assumed at the acquisition date (in millions).

|  |  |  |
| --- | --- | --- |
|  |  | **July 1, 2016(Acquisition Date)** |
|  |  |  |
| Cash | $ | 7 |
| MTGE management agreement |  | 29 |
|  |  |  |
| Other intangible asset |  | 1 |
| Total identifiable assets |  | 37 |
|  |  |  |
| Accounts payable and other liabilities |  | (1) |
| Identifiable net assets acquired |  | 36 |
|  |  |  |
| Goodwill |  | 526 |
| Net assets acquired | $ | 562 |

We recognized $9 million of transaction related costs that were expensed during the nine months ended September 30, 2016. These costs are included in other operating expenses in our consolidated statements of comprehensive income.

AMM's revenue and net income (loss) included in our consolidated statements of comprehensive income from the acquisition date to September 30, 2016 are $4 million and $(6) million, respectively, after elimination of AGNC's management fee and other intercompany transactions. The following table represents our pro forma consolidated revenue and net loss as if AMM had been included in our consolidated results for the nine months ended September 30, 2015 and for the entire nine months ended September 30, 2016 (in millions). Revenue includes interest income and management fee income from MTGE. Amounts have been calculated after applying our accounting policies and adjusting AMM's results to reflect amortization expense that would have been charged assuming the fair value adjustments to intangible assets had been applied on January 1, 2015. All AGNC management fees and all other actual and pro forma intercompany transactions have been eliminated. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the AMM acquisition occurred on January 1, 2015 and may not be indicative of future operating results.

**Pro Forma**

**Consolidated Revenue and Net Loss**



**Nine Months Ended September 30,**



|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2016** |  |  |  | **2015** |
|  |  |  |  |  |  |
| Revenue | $ | 940 |  | $ | 1,105 |
|  |  |  |  |  |  |
| Net loss | $ | (358) |  | $ | (307) |
|  |  |  |  |  |  |

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**Note 11. Subsequent Events**

On October 12, 2016, our Board of Directors declared a monthly dividend of $0.18 per common share, which will be paid on November 8, 2016, to common stockholders of record as of October 31, 2016.

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**Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of AGNC Investment Corp.'s consolidated financial statements with a narrative from the perspective of management, and should be read in conjunction with the consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q for quarterly period ended September 30, 2016. Our MD&A is presented in six sections:

* Executive Overview
* Financial Condition
* Results of Operations
* Liquidity and Capital Resources
* Off-Balance Sheet Arrangements
* Forward-Looking Statements

**EXECUTIVE OVERVIEW**

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

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

We invest primarily in agency mortgage-backed securities ("agency MBS") on a leveraged basis. These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") for which the principal and interest payments are guaranteed by a government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae") (collectively referred to as "GSEs"). We may also invest in other types of mortgage and mortgage-related securities, such as credit risk transfer ("CRT") securities and non-agency residential and commercial mortgage-backed securities, where repayment of principal and interest is not guaranteed by a GSE or U.S. Government agency.

During the third quarter of 2016, we revised our investment guidelines to permit our acquisition of credit-sensitive assets and subsequently made our first investments in CRT securities. In our view the GSE's programmatic sales of a significant portion of their credit risk underlying conforming mortgage loans represents an appealing long-term opportunity for AGNC. Furthermore, we believe that AGNC is particularly well suited to benefit from these assets as a result of our substantial experience with conforming mortgage assets and the correlation between agency prepayments and associated credit exposure. We expect the focus of our credit-sensitive investments to be in CRT or similar securities; however, we will opportunistically invest in other non-agency securities backed by either residential or commercial real estate.

Our principal objective is to provide our stockholders with attractive risk-adjusted returns through a combination of monthly dividends and net asset value (also referred to as "net book value," "NAV" and "stockholders' equity") accretion. We generate income from the interest earned on our investment assets, net of associated borrowing and hedging activities, and net realized gains and losses on our investments and hedging activities. We fund our investments primarily through borrowings structured as repurchase agreements ("repo").

**Our Management Internalization**

On July 1, 2016, we completed the acquisition of AGNC Mortgage Management, LLC ("AMM," formerly known as American Capital Mortgage Management, LLC) from American Capital Asset Management, LLC ("ACAM"), a wholly owned portfolio company of American Capital, Ltd. ("ACAS"), for a purchase price of $562 million in cash. AMM is the parent company of our Manager and of MTGE Management, LLC ("MTGE Manager," formerly known as American Capital MTGE Management, LLC), the external manager of MTGE Investment Corp. ("MTGE," formerly known as American Capital Mortgage Investment Corp.). Following the closing of the acquisition of AMM, we became internally managed and are no longer affiliated with ACAS. We believe that the acquisition represents an important milestone for the Company, and we expect that it will result in lower operating costs for AGNC and generate management fee income from MTGE. As of October 31, 2016, we had

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approximately 53 full-time employees, and all of our significant business functions were fully staffed. As part of the internalization, the Company and AMM entered into a Transition Services Agreement with ACAS and ACAM, pursuant to which ACAS and ACAM will provide certain transition services for a limited period of time following the Internalization.

**Our Investment Strategy**

Our investment strategy is designed to:

* manage an investment portfolio consisting primarily of agency securities with the objective of generating attractive risk-adjusted returns;
* capitalize on discrepancies in the relative valuations and return potential in the agency and non-agency securities market;
* manage a wide range of risks including financing, interest rate, credit, prepayment and extension risks;
* preserve our net book value;
* provide regular monthly distributions to our stockholders;
* continue to qualify as a REIT; and
* remain exempt from the requirements of the Investment Company Act of 1940, as amended (the "Investment Company Act").

The size and composition of our investment portfolio depends on investment strategies we implement, the availability of investment capital and overall market conditions, including the availability of attractively priced investments and suitable financing to appropriately leverage our investment portfolio. Market conditions are influenced by, among other things, current levels of and expectations for future levels of interest rates, mortgage prepayments, market liquidity, housing prices, unemployment rates, general economic conditions, government participation in the mortgage market and evolving regulations or legal settlements that impact servicing practices or other mortgage related activities.

**Our Risk Management Strategy**

We use a variety of strategies to hedge a portion of our exposure to market risks, including interest rate, prepayment, extension and liquidity risk. Our investment and risk management strategy incorporates the cost of hedging transactions and our intention to qualify as a REIT. Consequently, while we use interest rate swaps and other hedges to attempt to protect our net book value against moves in interest rates, we may not hedge certain interest rate, prepayment or extension risks if we believe that bearing such risks enhances our return relative to our risk/return profile, or the hedging transaction would negatively impact our REIT status. We also generally do not hedge the credit exposure embedded in our purchases of CRT securities or other non-agency securities.

The risk management actions we take may lower our earnings and dividends in the short term to further our objective of maintaining attractive levels of earnings and dividends over the long term. In addition, some of our hedges are intended to provide protection against larger rate moves and as a result may be relatively ineffective for smaller changes in interest rates. There can also be no certainty that our projections of our exposures to interest rates, prepayments, extension or other risks will be accurate or that our hedging activities will be effective and, therefore, actual results could differ materially. Furthermore, since our hedging strategies are generally not designed to protect our net book value from spread risk, wider spreads between the market yield on our investment securities and benchmark interests underlying our interest rate hedges will typically cause our net book value to decline and can occur independent of changes in benchmark interest rates. For further discussion of our market risks and risk management strategy, please refer to "Quantitative and Qualitative Disclosures about Market Risk" under Item 3 of this Quarterly Report on Form 10-Q.

**Trends and Recent Market Impacts**

***Quarterly Highlights***

Following the Federal Reserve's (the "Fed") first Federal Funds Rate increase in nearly ten years in December 2015, interest rates across much of the yield curve fell materially during the first quarter of 2016, as concerns regarding global economic weakness dampened the market’s expectations with respect to U.S. economic growth, inflation and the pace of monetary policy normalization. Consistent with this weaker outlook, at its March meeting, the Fed significantly reduced its expectations for future short term interest rate increases and explicitly acknowledged the potential downside risk to the U.S. economy associated with the deteriorating global landscape. The weaker global growth outlook also led to significant additional easing measures

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by the European Central Bank and the Bank of Japan, with the latter instituting negative interest rates for the first time during the first quarter.

Early in the second quarter as the U.S. economy showed signs of improvement, communication from the Fed became decidedly more "hawkish" with respect to its stance on monetary policy. The Fed’s more upbeat assessment of the U.S. economy led the market to believe there was an increased likelihood of additional Fed rate hikes, thus causing interest rates more broadly to rise and retrace some of the rate decline experienced in the first quarter. This trend was subsequently reversed later in the second quarter, as the combination of weaker economic data in the U.S. and the surprise vote by the United Kingdom to withdraw from the European Union drove interest rates to historically low levels.

During the third quarter, both long-term and short-term rates moved somewhat higher, reversing the overall trend of the first half of the year, as the market's expectations regarding a fourth quarter rate hike increased following modest improvements in economic data. In the aggregate, the 10 year U.S. Treasury rate declined 66 bps to 1.61% over the three quarters ended September 30, 2016. The 10 year U.S. swap rate declined 73 bps to 1.46% as of September 30, 2016.

In addition to absolute changes in interest rates, changes in the aggregate spread differential between the market yield on our agency MBS and the benchmark interest rates underlying our interest rate hedges is also a key driver of fluctuations in our total comprehensive income and our NAV per common share. During the first quarter, modest widening in this differential led to a 2.2% decline in our NAV per common share to $22.09 as of March 31, 2016. Conversely, a modest tightening in this spread differential during the second and third quarters helped drive a 0.6% and 3.1% increase, respectively, in our NAV per common share to $22.22 as of June 30, 2016 and $22.91 as of September 30, 2016. Taking into account quarterly dividends of $0.60, $0.60 and $0.56 per common share, our quarterly economic return was 0.4%, 3.3% and 5.6% for the first three quarters, respectively. (For the estimated impact of changes in interests rates and mortgage spreads on our net book value please refer to "Quantitative and Qualitative Disclosures about Market Risk" under Item 3 of this Quarterly Report on Form 10-Q.)

Funding for agency repo was favorably impacted during the third quarter by the recent implementation of money market reform requirements, which took effect in October of 2016 and caused a sizable reallocation of assets from prime funds to U.S. Government bond money market funds. This shift of capital to U.S. Government money market funds has been supportive of repo backed by agency MBS, reducing our funding costs relative to LIBOR. As we receive a floating LIBOR rate on our pay fixed / receive floating interest rate swaps, the resultant decline in the spread between our repo borrowing costs and LIBOR has the effect of lowering our all-in cost of funds on the portion of our debt that we have hedged with pay fixed swaps.

The average projected life CPR on our portfolio increased to 10.6% as of September 30, 2016 from 8.4% as of December 31, 2015, as prepayment expectations increased consistent with the overall decline in long-term interest rates. The actual monthly CPR on our portfolio increased to annualized rate of 16% for September of 2016. Despite elevated prepayments in September, we expect actual monthly speeds to decline for the remainder of the year as a result of the seasonality of housing turnover and modestly higher primary mortgage rates.

Given our view that rates in the U.S. will remain relatively range bound, we adjusted the composition of our hedge portfolio and lowered our hedge ratio to 75% of our funding liabilities and net TBA position as of September 30, 2016, compared to 87% as of December 31, 2015. Our net "duration gap," which is a measure of the risk due to mismatches that can occur between our assets and liabilities, inclusive of hedges, caused by an instantaneous parallel shift in interest rates, also declined from 0.8 years as of December 31, 2015 to a net duration gap of 0.3 years as of the end of the third quarter. Coupled with attractive investment opportunities in agency MBS, we also chose to increase our "at risk" leverage to an average of 7.1x during the first three quarters of the year, compared to 6.8x as of December 31, 2015 and a low of 6.1x as of June 30, 2015.

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***Market Information***

The following table summarizes interest rates and prices of generic fixed rate agency MBS as of each date presented below:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **Sept. 30, 2016** | | | **Sept. 30, 2016** | |
|  |  | **Sept. 30,** | | **Dec. 31,** | | **Mar. 31,** | | **June 30,** | | **Sept. 30,** | | **vs** | | | **vs** | |
| **Interest Rate/Security Price 1** |  | **2015** |  | **2015** |  | **2016** |  | **2016** |  | **2016** |  | **June 30, 2016** | |  | **Dec. 31, 2015** | |
| **LIBOR:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1-Month | | 0.19% |  | 0.43% |  | 0.44% |  | 0.47% |  | 0.53% |  | +0.06 | bps | | +0.10 | bps |
| 3-Month | | 0.33% |  | 0.61% |  | 0.63% |  | 0.65% |  | 0.85% |  | +0.20 | bps | | +0.24 | bps |
| 6-Month | | 0.53% |  | 0.85% |  | 0.90% |  | 0.92% |  | 1.24% |  | +0.32 | bps | | +0.39 | bps |
| **U.S. Treasury Security Rate:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2-Year U.S. Treasury | | 0.64% |  | 1.06% |  | 0.73% |  | 0.59% |  | 0.76% |  | +0.17 | bps | | -0.30 bps | |
| 3-Year U.S. Treasury | | 0.92% |  | 1.32% |  | 0.86% |  | 0.70% |  | 0.87% |  | +0.17 | bps | | -0.45 bps | |
| 5-Year U.S. Treasury | | 1.37% |  | 1.77% |  | 1.22% |  | 1.01% |  | 1.15% |  | +0.14 | bps | | -0.62 bps | |
| 10-Year U.S. Treasury | | 2.06% |  | 2.27% |  | 1.78% |  | 1.49% |  | 1.61% |  | +0.12 | bps | | -0.66 bps | |
| 30-Year U.S. Treasury | | 2.88% |  | 3.01% |  | 2.62% |  | 2.31% |  | 2.33% |  | +0.02 | bps | | -0.68 bps | |
| **Interest Rate Swap Rate:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2-Year Swap | | 0.76% |  | 1.17% |  | 0.85% |  | 0.74% |  | 1.01% |  | +0.27 | bps | | -0.16 bps | |
| 3-Year Swap | | 0.99% |  | 1.41% |  | 0.96% |  | 0.81% |  | 1.07% |  | +0.26 | bps | | -0.34 bps | |
| 5-Year Swap | | 1.40% |  | 1.73% |  | 1.18% |  | 0.99% |  | 1.18% |  | +0.19 | bps | | -0.55 bps | |
| 10-Year Swap | | 2.01% |  | 2.19% |  | 1.64% |  | 1.38% |  | 1.46% |  | +0.08 | bps | | -0.73 bps | |
| 30-Year Swap | | 2.53% |  | 2.62% |  | 2.13% |  | 1.84% |  | 1.78% |  | -0.06 bps | | | -0.84 bps | |
| **30-Year Fixed Rate MBS Price:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 3.0% |  | $101.34 |  | $100.01 |  | $102.59 |  | $103.75 |  | $103.95 |  | +$0.20 | |  | +$3.94 | |
| 3.5% |  | $104.31 |  | $103.18 |  | $104.86 |  | $105.50 |  | $105.53 |  | +$0.03 | |  | +$2.35 | |
| 4.0% |  | $106.67 |  | $105.83 |  | $106.86 |  | $107.23 |  | $107.41 |  | +$0.18 | |  | +$1.58 | |
| 4.5% |  | $108.41 |  | $108.00 |  | $108.82 |  | $109.17 |  | $109.52 |  | +$0.35 | |  | +$1.52 | |
| **15-Year Fixed Rate MBS Price:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2.5% |  | $101.94 |  | $100.80 |  | $102.66 |  | $103.48 |  | $103.56 |  | +$0.08 | |  | +$2.76 | |
| 3.0% |  | $104.11 |  | $103.02 |  | $104.47 |  | $104.84 |  | $104.99 |  | +$0.15 | |  | +$1.97 | |
| 3.5% |  | $105.61 |  | $104.72 |  | $105.59 |  | $105.97 |  | $105.41 |  | -$0.56 | |  | +$0.69 | |
| 4.0% |  | $104.77 |  | $104.41 |  | $104.31 |  | $103.81 |  | $103.73 |  | -$0.08 | |  | -$0.68 | |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Price information is for generic instruments only and is not reflective of our specific portfolio holdings. Price information is as of 3:00 p.m. (EST) on such date and can vary by source. Prices and interest rates in the table above were obtained from Barclays. LIBOR rates were obtained from Bloomberg.

The following table summarizes the weighted average actual one-month annualized constant prepayment rates on our investment portfolio for the nine months ended September 30, 2016.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Annualized Monthly Constant Prepayment Rates 1** |  | **Jan. 2016** |  | **Feb. 2016** |  | **Mar. 2016** |  | **Apr. 2016** |  | **May 2016** |  | **June 2016** |  | **July 2016** |  | **Aug. 2016** |  | **Sep. 2016** |
| AGNC portfolio | | 10% |  | 8% |  | 9% |  | 12% |  | 11% |  | 13% |  | 14% |  | 13% |  | 16% |



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1. Weighted average actual one-month annualized CPR released at the beginning of the month based on securities held/outstanding as of the preceding month-end.

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**FINANCIAL CONDITION**

As of September 30, 2016 and December 31, 2015, our investment portfolio consisted of $47.4 billion and $52.5 billion of investment securities, at fair value, respectively, and a $15.6 billion and $7.4 billion net long TBA position, at fair value, respectively. The following table is a summary of our investment portfolio as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **September 30, 2016** | | |  |  |  |  |  |  |  |  | **December 31, 2015** | | | |  |
| **Investment Portfolio** |  |  | **Amortized Cost** |  |  | **Fair Value** |  |  | **Average Coupon** |  | **%** |  |  | **Amortized Cost** |  |  | **Fair Value** |  | **Average Coupon** |  | **%** |
| Fixed rate agency MBS and TBA securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | | $ | 13,599 |  | $ | 13,942 |  |  | 3.26% |  | 22% |  | $ | 16,725 |  | $ | 16,865 |  | 3.25% |  | 28% |
| 15-year TBA securities | |  | 2,297 |  |  | 2,306 |  |  | 2.61% |  | 4% |  |  | 295 |  |  | 293 |  | 3.38% |  | 1% |
| Total ≤ 15-year | |  | 15,896 |  |  | 16,248 |  |  | 3.17% |  | 26% |  |  | 17,020 |  |  | 17,158 |  | 3.25% |  | 29% |
| 20-year | |  | 839 |  |  | 881 |  |  | 3.49% |  | 1% |  |  | 1,061 |  |  | 1,088 |  | 3.48% |  | 2% |
| 30-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 30-year | |  | 30,205 |  |  | 30,788 |  |  | 3.68% |  | 49% |  |  | 32,790 |  |  | 32,570 |  | 3.70% |  | 54% |
| 30-year TBA securities 1 | |  | 13,243 |  |  | 13,280 |  |  | 3.32% |  | 21% |  |  | 7,135 |  |  | 7,150 |  | 3.34% |  | 12% |
| Total 30-year | |  | 43,448 |  |  | 44,068 |  |  | 3.57% |  | 70% |  |  | 39,925 |  |  | 39,720 |  | 3.63% |  | 66% |
| Total fixed rate agency MBS and TBA securities | |  | 60,183 |  |  | 61,197 |  |  | 3.46% |  | 97% |  |  | 58,006 |  |  | 57,966 |  | 3.52% |  | 97% |
| Adjustable rate agency securities | |  | 401 |  |  | 415 |  |  | 2.98% |  | 1% |  |  | 484 |  |  | 495 |  | 3.05% |  | 1% |
| CMO agency securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| CMO | |  | 840 |  |  | 865 |  |  | 3.41% |  | 1% |  |  | 973 |  |  | 990 |  | 3.40% |  | 2% |
| Interest-only strips | |  | 142 |  |  | 166 |  |  | 5.22% |  | —% | |  | 152 |  |  | 179 |  | 5.28% |  | —% |
| Principal-only strips | |  | 144 |  |  | 161 |  |  | —% | | —% | |  | 165 |  |  | 174 |  | —% | | —% |
| Total CMO agency securities | |  | 1,126 |  |  | 1,192 |  |  | 3.99% |  | 2% |  |  | 1,290 |  |  | 1,343 |  | 3.97% |  | 2% |
| Total agency MBS and TBA securities | |  | 61,710 |  |  | 62,804 |  |  | 3.48% |  | 100% |  |  | 59,780 |  |  | 59,804 |  | 3.53% |  | 100% |
| AAA non-agency securities | |  | 100 |  |  | 102 |  |  | 3.50% |  | —% | |  | 114 |  |  | 113 |  | 3.50% |  | —% |
| GSE credit risk transfer securities | |  | 36 |  |  | 36 |  |  | 4.91% |  | —% | |  | — | |  | — | | —% | | —% |
| Total investment portfolio | | $ | 61,846 |  | $ | 62,942 |  |  | 3.48% |  | 100% |  | $ | 59,894 |  | $ | 59,917 |  | 3.53% |  | 100% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $2.6 billion of forward purchases of agency MBS specified pools as of September 30, 2016

Our TBA positions are recorded as derivative instruments in our accompanying consolidated financial statements, with the TBA dollar roll transactions representing a form of off-balance sheet financing. As of September 30, 2016 and December 31, 2015, our TBA position had a net carrying value of $46 million and $14 million, respectively, reported in derivative assets/(liabilities) on our accompanying consolidated balance sheets. The net carrying value represents the difference between the fair value of the underlying agency security in the TBA contract and the cost basis or the forward price to be paid or received for the underlying agency security.

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The following tables summarize certain characteristics of our agency MBS fixed rate portfolio, inclusive of our net TBA position, as of September 30, 2016 and December 31, 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **September 30, 2016** | | |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | **Includes Net TBA Position** | | | | |  |  |  |  |  | **Excludes Net TBA Position** | | | |  |  |  |  |
|  |  |  |  |  |  | **Amortized** | |  |  |  | **% Lower Loan** |  | **Amortized** | |  |  | **Weighted Average** | | |  |  | **Projected Life** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Fixed Rate Agency Securities** |  |  | **Par Value** |  |  | **Cost** |  |  | **Fair Value** |  | **Balance & HARP 1,2** |  | **Cost Basis** |  | **WAC 3** |  | **Yield 4** |  |  | **Age (Months)** |  | **CPR 4** |  |
| **Fixed rate** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2.5% |  | $ | 5,041 |  | $ | 5,145 |  | $ | 5,222 |  | 26% | 101.6% | |  | 2.96% | 2.05% | |  |  | 47 |  | 10% |  |
| 3.0% |  |  | 3,639 |  |  | 3,749 |  |  | 3,834 |  | 73% | 102.9% | |  | 3.50% | 2.19% | |  |  | 52 |  | 11% |  |
| 3.5% |  |  | 3,597 |  |  | 3,721 |  |  | 3,825 |  | 88% | 103.4% | |  | 3.95% | 2.49% | |  |  | 60 |  | 12% |  |
| 4.0% |  |  | 2,843 |  |  | 2,957 |  |  | 3,034 |  | 89% | 104.0% | |  | 4.40% | 2.67% | |  |  | 69 |  | 13% |  |
| 4.5% |  |  | 306 |  |  | 320 |  |  | 328 |  | 98% | 104.5% | |  | 4.87% | 3.01% | |  |  | 73 |  | 13% |  |
| ≥ 5.0% | |  | 4 |  |  | 4 |  |  | 5 |  | 25% |  | 103.4% |  | 6.57% |  | 4.58% |  |  | 107 |  | 14% |  |
| Total ≤ 15-year | |  | 15,430 |  |  | 15,896 |  |  | 16,248 |  | 65% | 103.0% | |  | 3.72% | 2.36% | |  |  | 57 |  | 11% |  |
| 20-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 3.0% | |  | 234 |  |  | 233 |  |  | 247 |  | 31% | 99.4% | |  | 3.55% | 3.12% | |  |  | 40 |  | 12% |  |
| 3.5% |  |  | 458 |  |  | 468 |  |  | 489 |  | 75% | 102.1% | |  | 4.06% | 2.98% | |  |  | 43 |  | 13% |  |
| 4.0% |  |  | 57 |  |  | 59 |  |  | 62 |  | 49% | 103.9% | |  | 4.54% | 2.91% | |  |  | 61 |  | 15% |  |
| 4.5% |  |  | 72 |  |  | 76 |  |  | 80 |  | 99% | 106.3% | |  | 4.90% | 2.94% | |  |  | 70 |  | 13% |  |
| ≥ 5.0% | |  | 3 |  |  | 3 |  |  | 3 |  | —% |  | 105.8% |  | 5.92% |  | 3.33% |  |  | 100 |  | 19% |  |
| Total 20-year: | |  | 824 |  |  | 839 |  |  | 881 |  | 63% | 101.8% | |  | 4.03% | 3.01% | |  |  | 46 |  | 13% |  |
| 30-year: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 3.0% |  |  | 9,702 |  |  | 9,963 |  |  | 10,086 |  | 1% | 100.6% | |  | 3.59% | 2.90% | |  |  | 40 |  | 8% |  |
| 3.5% |  |  | 18,127 |  |  | 19,082 |  |  | 19,305 |  | 67% | 105.3% | |  | 4.07% | 2.67% | |  |  | 36 |  | 9% |  |
| 4.0% |  |  | 11,900 |  |  | 12,723 |  |  | 12,926 |  | 73% | 106.9% | |  | 4.51% | 2.79% | |  |  | 42 |  | 11% |  |
| 4.5% |  |  | 1,320 |  |  | 1,407 |  |  | 1,465 |  | 87% | 106.3% | |  | 4.97% | 3.24% | |  |  | 64 |  | 13% |  |
| 5.0% |  |  | 126 |  |  | 133 |  |  | 141 |  | 65% | 106.0% | |  | 5.45% | 3.66% | |  |  | 101 |  | 13% |  |
| ≥ 5.5% | |  | 128 |  |  | 140 |  |  | 145 |  | 38% |  | 109.1% |  | 6.20% |  | 3.35% |  |  | 119 |  | 17% |  |
| Total 30-year | |  | 41,303 |  |  | 43,448 |  |  | 44,068 |  | 54% |  | 105.4% |  | 4.23% |  | 2.76% |  |  | 40 |  | 10% |  |
| **Total fixed rate** | | $ | 57,557 |  | $ | 60,183 |  | $ | 61,197 |  | 57% | 104.6% | |  | 4.07% | 2.64% | |  |  | 46 |  | 10% |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Lower loan balance securities represent pools backed by an original loan balance of ≤ $150,000. Our lower loan balance securities had a weighted average original loan balance of $97,000 and $100,000 for 15-year and 30-year securities, respectively, as of September 30, 2016.
2. HARP securities are defined as pools backed by 100% refinance loans with LTV ≥ 80%. Our HARP securities had a weighted average LTV of 113% and 135% for 15-year and 30-year securities, respectively, as of September 30, 2016. Includes $0.8 billion and $5.4 billion of 15-year and 30-year securities, respectively, with >105 LTV pools, which are not deliverable into TBA securities.
3. WAC represents the weighted average coupon of the underlying collateral.
4. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of September 30, 2016.

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | **Includes Net TBA Position** | | | | |  |  |  |  |  | **Excludes Net TBA Position** | | | |  |  |  |  |
|  |  |  |  |  |  | **Amortized** | |  |  |  | **% Lower Loan** |  | **Amortized** | |  |  | **Weighted Average** | | |  |  | **Projected Life** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Agency Fixed Rate Securities** |  |  | **Par Value** |  |  | **Cost** |  |  | **Fair Value** |  | **Balance & HARP 1,2** |  | **Cost Basis** |  | **WAC 3** |  | **Yield 4** |  |  | **Age (Months)** |  | **CPR 4** |  |
| **Fixed rate** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 2.5% | | $ | 4,162 |  | $ | 4,238 |  | $ | 4,221 |  | 47% | 101.8% | |  | 2.97% | 2.04% | |  |  | 38 |  | 8% |  |
| 3.0% |  |  | 4,178 |  |  | 4,307 |  |  | 4,319 |  | 73% | 103.1% | |  | 3.50% | 2.22% | |  |  | 43 |  | 9% |  |
| 3.5% |  |  | 4,332 |  |  | 4,489 |  |  | 4,557 |  | 88% | 103.6% | |  | 3.95% | 2.53% | |  |  | 51 |  | 10% |  |
| 4.0% |  |  | 3,439 |  |  | 3,591 |  |  | 3,662 |  | 89% | 104.4% | |  | 4.40% | 2.71% | |  |  | 60 |  | 11% |  |
| 4.5% |  |  | 372 |  |  | 390 |  |  | 394 |  | 98% | 104.9% | |  | 4.87% | 3.04% | |  |  | 64 |  | 12% |  |
| ≥ 5.0% | |  | 5 |  |  | 5 |  |  | 5 |  | 28% |  | 103.8% |  | 6.51% |  | 4.54% |  |  | 97 |  | 13% |  |
| Total ≤ 15-year | |  | 16,488 |  |  | 17,020 |  |  | 17,158 |  | 75% | 103.2% | |  | 3.71% | 2.38% | |  |  | 48 |  | 10% |  |
| 20-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 3.0% | |  | 287 |  |  | 285 |  |  | 294 |  | 28% | 99.3% | |  | 3.55% | 3.11% | |  |  | 31 |  | 8% |  |
| 3.5% |  |  | 600 |  |  | 613 |  |  | 628 |  | 64% | 102.2% | |  | 4.05% | 3.04% | |  |  | 33 |  | 10% |  |
| 4.0% |  |  | 66 |  |  | 69 |  |  | 70 |  | 48% | 104.5% | |  | 4.54% | 2.97% | |  |  | 52 |  | 11% |  |
| 4.5% |  |  | 84 |  |  | 90 |  |  | 92 |  | 99% | 106.7% | |  | 4.90% | 3.03% | |  |  | 61 |  | 10% |  |
| ≥ 5.0% | |  | 4 |  |  | 4 |  |  | 4 |  | —% |  | 106.1% |  | 5.92% |  | 3.35% |  |  | 92 |  | 18% |  |
| Total 20-year: | |  | 1,041 |  |  | 1,061 |  |  | 1,088 |  | 56% | 101.9% | |  | 4.03% | 3.06% | |  |  | 37 |  | 9% |  |
| 30-year: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 3.0% | |  | 6,837 |  |  | 6,852 |  |  | 6,845 |  | 2% | 100.6% | |  | 3.59% | 2.92% | |  |  | 31 |  | 6% |  |
| 3.5% |  |  | 16,627 |  |  | 17,383 |  |  | 17,188 |  | 51% | 104.7% | |  | 4.09% | 2.84% | |  |  | 26 |  | 7% |  |
| 4.0% |  |  | 12,888 |  |  | 13,733 |  |  | 13,687 |  | 57% | 106.7% | |  | 4.54% | 2.99% | |  |  | 29 |  | 8% |  |
| 4.5% |  |  | 1,524 |  |  | 1,629 |  |  | 1,664 |  | 87% | 106.8% | |  | 4.96% | 3.39% | |  |  | 55 |  | 9% |  |
| 5.0% |  |  | 148 |  |  | 158 |  |  | 163 |  | 66% | 106.4% | |  | 5.45% | 3.74% | |  |  | 92 |  | 11% |  |
| ≥ 5.5% | |  | 155 |  |  | 170 |  |  | 173 |  | 38% |  | 109.5% |  | 6.20% |  | 3.40% |  |  | 109 |  | 16% |  |
| Total 30-year | |  | 38,179 |  |  | 39,925 |  |  | 39,720 |  | 46% |  | 105.2% |  | 4.27% |  | 2.93% |  |  | 30 |  | 8% |  |
| **Total fixed rate** | | $ | 55,708 |  | $ | 58,006 |  | $ | 57,966 |  | 55% | 104.5% | |  | 4.08% | 2.75% | |  |  | 36 |  | 8% |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Lower loan balance securities represent pools backed by an original loan balance of ≤ $150,000. Our lower loan balance securities had a weighted average original loan balance of $97,000 and $98,000 for 15-year and 30-year securities, respectively, as of December 31, 2015.
2. HARP securities are defined as pools backed by 100% refinance loans with LTVs ≥ 80%. Our HARP securities had a weighted average LTV of 110% and 127% for 15-year and 30-year securities, respectively, as of December 31, 2015. Includes $0.9 billion and $4.0 billion of 15-year and 30-year securities, respectively, with >105 LTV pools which are not deliverable into TBA securities.
3. WAC represents the weighted average coupon of the underlying collateral.
4. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2015.

As of September 30, 2016 and December 31, 2015, the combined weighted average yield on our investment securities (excluding TBAs) was 2.68% and 2.78%, respectively.

Our pass-through agency MBS collateralized by adjustable rate mortgage loans, or ARMs, have coupons linked to various indices. As of September 30, 2016 and December 31, 2015, our ARM securities had a weighted average next reset date of 40 months and 46 months, respectively.

**RESULTS OF OPERATIONS**

***Non-GAAP Financial Measures***

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including "adjusted net interest expense," "net spread and dollar roll income," "net spread and dollar roll income, excluding 'catch-up' premium amortization," "estimated taxable income" and the related per common share measures and certain financial metrics derived from such non-GAAP information, such as "cost of funds" and "net interest rate spread."

"Adjusted net interest expense" is measured as interest expense (GAAP measure) adjusted to include other interest rate swap periodic costs. "Net spread and dollar roll income" is measured as (i) net interest income (GAAP measure) adjusted to include other interest rate swap periodic costs, TBA dollar roll income, management fee income and dividends on REIT equity securities

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(referred to as "adjusted net interest and dollar roll income") less (ii) total operating expenses (GAAP measure) adjusted to exclude non-recurring transaction costs (referred to as "adjusted operating expenses"). "Net spread and dollar roll income, excluding 'catch-up' premium amortization," further excludes retrospective "catch-up" adjustments to premium amortization cost or benefit due to changes in projected CPR estimates.

By providing such measures, in addition to the related GAAP measures, we believe we give greater transparency into the information used by our management in its financial and operational decision-making. We also believe it is important for users of our financial information to consider information related to our current financial performance without the effects of certain measures that are not necessarily indicative of our current investment portfolio performance and operations.

Specifically, in the case of "adjusted net interest and dollar roll income," we believe the inclusion of TBA dollar roll income is meaningful as TBAs, which are accounted for under GAAP as derivative instruments with gains and losses recognized in other gain (loss) in our statement of operations, are economically equivalent to holding and financing generic agency MBS using short-term repurchase agreements. Similarly, we believe that the inclusion of periodic interest rate swap settlements in such measure and in "adjusted net interest expense," which are recognized under GAAP in other gain (loss), is meaningful as interest rate swaps are the primary instrument we use to economically hedge against fluctuations in our borrowing costs and inclusion of all periodic interest rate swap settlement costs is more indicative of our total cost of funds than interest expense alone. In the case of "net spread and dollar roll income, excluding 'catch-up' premium amortization," we believe the exclusion of "catch-up" adjustments to premium amortization cost or benefit is meaningful as it excludes the cumulative effect from prior reporting periods due to current changes in future prepayment expectations and, therefore, exclusion of such cost or benefit is more indicative of the current earnings potential of our investment portfolio. We also believe the exclusion of non-recurring transactions costs reported in general, administrative and other expense under GAAP is meaningful as they represent non-recurring transaction costs associated with our acquisition of AMM and are not representative of ongoing operating costs. In the case of estimated taxable income, we believe it is meaningful information because it directly relates to the amount of dividends we are required to distribute in order to maintain our REIT qualification status.

However, because such measures are incomplete measures of our financial performance and involve differences from results computed in accordance with GAAP, they should be considered as supplementary to, and not as a substitute for, results computed in accordance with GAAP. In addition, because not all companies use identical calculations, our presentation of such non-GAAP measures may not be comparable to other similarly-titled measures of other companies. Furthermore, estimated taxable income can include certain information that is subject to potential adjustments up to the time of filing our income tax returns, which occurs after the end of our fiscal year.

***Selected Financial Data***

The following selected financial data is derived from our interim consolidated financial statements and the notes thereto. The tables below present our condensed consolidated balance sheets as of September 30, 2016 and

December 31, 2015 and our condensed consolidated statements of comprehensive income and key statistics for the three and nine months ended September 30, 2016 and 2015 (in millions, except per share amounts):

**($ in millions, except per share amounts)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Balance Sheet Data** |  |  | **September 30, 2016** |  |  | **December 31, 2015** |
|  |  |  | **(unaudited)** | |  |  |
| Investment securities, at fair value | | $ | 47,356 |  | $ | 52,473 |
| Total assets | | $ | 55,889 |  | $ | 57,021 |
|  |  |  |  |  |  |  |
| Repurchase agreements, Federal Home Loan Bank advances and other debt | | $ | 41,199 |  | $ | 46,102 |
| Total liabilities | | $ | 47,958 |  | $ | 49,050 |
|  |  |  |  |  |  |  |
| Total stockholders' equity | | $ | 7,931 |  | $ | 7,971 |
| Net asset value per common share as of period end 1 | | $ | 22.91 |  | $ | 22.59 |
| Tangible net asset value per common share as of period end 2 | | $ | 21.23 |  |  | N/A |

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|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended September 30,** | | | | |  | **Nine Months Ended September 30,** | | | |
| **Statement of Comprehensive Income Data (unaudited)** |  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| Interest income | | $ | 315 |  | $ | 295 |  | $ | 928 |  | $ | 1,092 |
| Interest expense 3 | |  | 96 |  |  | 77 |  |  | 296 |  |  | 244 |
| Net interest income | |  | 219 |  |  | 218 |  |  | 632 |  |  | 848 |
| Other gain (loss), net 3 | |  | 307 |  |  | (817) |  |  | (940) |  |  | (1,115) |
| Operating Expenses | |  | 15 |  |  | 34 |  |  | 88 |  |  | 106 |
| Net income (loss) | |  | 511 |  |  | (633) |  |  | (396) |  |  | (373) |
| Dividend on preferred stock | |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |
| Net income (loss) available (attributable) to common stockholders | | $ | 504 |  | $ | (640) |  | $ | (417) |  | $ | (394) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net income (loss) | | $ | 511 |  | $ | (633) |  | $ | (396) |  | $ | (373) |
| Other comprehensive income (loss) 3 | |  | (90) |  |  | 491 |  |  | 1,076 |  |  | 65 |
| Comprehensive income (loss) | |  | 421 |  |  | (142) |  |  | 680 |  |  | (308) |
| Dividend on preferred stock | |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |
| Comprehensive income (loss) available (attributable) to common stockholders | | $ | 414 |  | $ | (149) |  | $ | 659 |  | $ | (329) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted | |  | 331.0 |  |  | 347.8 |  |  | 332.1 |  |  | 350.9 |
| Net income (loss) per common share - basic and diluted | | $ | 1.52 |  | $ | (1.84) |  | $ | (1.26) |  | $ | (1.12) |
| Comprehensive income (loss) per common share - basic and diluted | | $ | 1.25 |  | $ | (0.43) |  | $ | 1.98 |  | $ | (0.94) |
| Dividends declared per common share | | $ | 0.56 |  | $ | 0.60 |  | $ | 1.76 |  | $ | 1.88 |

**Other Data (unaudited)**

Average investment securities - at par

Average investment securities - at cost

Average net TBA portfolio - at cost

Average total assets - at fair value

Average mortgage borrowings outstanding 4

Average stockholders' equity 5

Average coupon 6

Average asset yield 7

Average cost of funds 8

Average net interest rate spread

Average net interest rate spread, including TBA dollar roll income 9

Average coupon *(as of period end)*

Average asset yield *(as of period end)*

Average cost of funds *(as of period end)* 10

Average net interest rate spread *(as of period end)*

Net comprehensive income return on average common equity - annualized 11

Economic return on common equity 12

Average "at risk" leverage 13

Average tangible net book value "at risk" leverage 15

"At risk" leverage *(as of period end)* 14

Tangible net book value "at risk" leverage *(as of period end)* 15

Expenses % of average total assets

Expenses % of average assets, including average net TBA position

Expenses % of average stockholders' equity

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Three Months Ended September 30,** | | | | **Nine Months Ended September 30,** | | |
| **2016** |  | **2015** |  | **2016** |  | **2015** |
| $46,372 |  | $46,610 |  | $48,201 |  | $52,381 |
| $48,548 |  | $48,711 |  | $50,388 |  | $54,682 |
| $10,748 |  | $9,434 |  | $9,050 |  | $7,464 |
| $57,088 |  | $54,353 |  | $57,361 |  | $61,439 |
| $44,401 |  | $43,308 |  | $45,753 |  | $49,188 |
| $7,803 |  | $8,603 |  | $7,785 |  | $9,037 |
| 3.65 % |  | 3.62 % |  | 3.64 % |  | 3.62 % |
| 2.60 % |  | 2.42 % |  | 2.46 % |  | 2.66 % |
| (1.32)% |  | (1.70)% |  | (1.47)% |  | (1.45)% |
| 1.28 % |  | 0.72 % |  | 0.99 % |  | 1.21 % |
| 1.42 % |  | 1.14 % |  | 1.18 % |  | 1.48 % |
| 3.64 % |  | 3.61 % |  | 3.64 % |  | 3.61 % |
| 2.68 % |  | 2.76 % |  | 2.68 % |  | 2.76 % |
| (1.30)% |  | (1.64)% |  | (1.30)% |  | (1.64)% |
| 1.38 % |  | 1.12 % |  | 1.38 % |  | 1.12 % |
| 22.0 % |  | (7.1)% |  | 11.8 % |  | (5.1)% |
| 22.4 % |  | (6.6)% |  | 12.3 % |  | (4.4)% |
| 7.1:1 |  | 6.2:1 |  | 7.1:1 |  | 6.3:1 |
| 7.6:1 |  | N/A | | 7.3:1 |  | N/A |
| 7.2:1 |  | 6.8:1 |  | 7.2:1 |  | 6.8:1 |
| 7.7:1 |  | N/A | | 7.7:1 |  | N/A |
| 0.10 % |  | 0.25 % |  | 0.20 % |  | 0.23 % |
| 0.09 % |  | 0.21 % |  | 0.18 % |  | 0.21 % |
| 0.76 % |  | 1.57 % |  | 1.51 % |  | 1.57 % |



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* Except as noted below, average numbers for each period are weighted based on days on our books and records. All percentages are annualized. N/A - Not applicable

1. Net asset value per common share is calculated as our total stockholders' equity, less our Series A and Series B Preferred Stock aggregate liquidation preference, divided by our number of common shares outstanding as of period end.
2. Tangible net asset value per common share excludes goodwill and other intangible assets, net.
3. We voluntarily discontinued hedge accounting for our interest rate swaps as of September 30, 2011. Please refer to our *Interest Expense and Cost of Funds* discussion in *Management's Discussion and Analysis of Financial Condition and Results of Operations* and Notes 3 and 6 of our *Consolidated Financial Statements* in this Quarterly Report on Form 10-Q for additional information regarding our discontinuance of hedge accounting.
4. Average mortgage borrowings include agency repo, FHLB advances and debt of consolidated VIEs. Amount excludes U.S. Treasury repo agreements and TBA contracts.
5. Average stockholders' equity calculated as our average month-end stockholders' equity during the period.
6. Average coupon for the period was calculated by dividing our total coupon (or cash) interest income on investment securities by our average investment securities held at par.
7. Average asset yield for the period was calculated by dividing our total cash interest income on investment securities, adjusted for amortization of premiums and discounts, by our average amortized cost of investment securities held.
8. Average cost of funds includes mortgage borrowings and interest rate swap periodic costs. Amount excludes interest rate swap termination fees, forward starting swaps and costs associated with other supplemental hedges, such as interest rate swaptions and U.S. Treasury positions. Average cost of funds for the period was calculated by dividing our total cost of funds by our average mortgage borrowings outstanding for the period.
9. TBA dollar roll income / (loss) is net of short TBAs used for hedging purposes. Dollar roll income excludes the impact of other supplemental hedges, and is recognized in gain (loss) on derivative instruments and other securities, net.
10. Average cost of funds as of period end includes mortgage borrowings outstanding and interest rate swap hedges. Amount excludes costs associated with other supplemental hedges such as swaptions, U.S. Treasuries and TBA positions.
11. Net comprehensive income (loss) return on average common equity for the period was calculated by dividing our comprehensive income/(loss) available /(attributable) to common stockholders by our average stockholders' equity, net of the Series A and Series B Preferred Stock aggregate liquidation preference.
12. Economic return (loss) on common equity represents the sum of the change in our net asset value per common share and our dividends declared on common stock during the period over our beginning net asset value per common share.
13. Average "at risk" leverage is calculated by dividing the sum of our daily weighted average mortgage borrowings outstanding and our weighted average net TBA dollar position (at cost) for the period by the sum of our average stockholders' equity less our average investment in REIT equity securities for the period. Leverage excludes U.S. Treasury repurchase agreements.
14. "At risk" leverage as of period end is calculated by dividing the sum of our mortgage borrowings outstanding, our receivable / payable for unsettled investment securities and our net TBA dollar roll position outstanding as of period end (at cost) by the sum of our total stockholders' equity less the fair value of investments in REIT equity securities at period end. Leverage excludes U.S. Treasury repurchase agreements.
15. Tangible net book value "at risk" leverage includes the components of "at risk" leverage, with stockholders' equity adjusted to exclude goodwill and other intangible assets, net.

***Interest Income and Asset Yield***

The following table summarizes our interest income for the three and nine months ended September 30, 2016 and 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Three Months Ended September 30,** | | | | | |  |  |  |  |  |  | **Nine Months Ended September 30,** | | | |  |  |  |
|  |  | **2016** | | |  |  |  | **2015** | | |  |  |  | **2016** | | |  |  |  |  | **2015** | | |
|  |  | **Amount** |  |  | **Yield** |  |  | **Amount** |  |  | **Yield** |  |  | **Amount** |  |  | **Yield** |  |  | **Amount** |  |  | **Yield** |
| Cash/coupon interest income | $ | 425 |  |  | 3.65 % |  | $ | 423 |  |  | 3.62 % |  | $ | 1,322 |  |  | 3.64 % |  | $ | 1,422 | 3.62 % | | |
| Net premium amortization |  | (110) |  |  | (1.05)% |  |  | (128) |  |  | (1.20)% |  |  | (394) |  |  | (1.18)% |  |  | (330) |  |  | (0.96)% |
| Interest income | $ | 315 |  |  | 2.60 % |  | $ | 295 |  |  | 2.42 % |  | $ | 928 |  |  | 2.46 % |  | $ | 1,092 | 2.66 % | | |
| Weighted average actual portfolio CPR for securities held during the period |  | 14% |  |  |  |  |  | 12% |  |  |  |  |  | 12% |  |  |  |  |  | 11% |  |  |  |
| Weighted average projected CPR for the remaining life of securities held as of period end |  | 11% |  |  |  |  |  | 8% |  |  |  |  |  | 11% |  |  |  |  |  | 9% |  |  |  |
| Average 30-year fixed rate mortgage rate as of period end 1 |  | 3.42% |  |  |  |  |  | 3.85% |  |  |  |  |  | 3.42% |  |  |  |  |  | 3.85% |  |  |  |
| 10-year U.S. Treasury rate as of period end |  | 1.61% |  |  |  |  |  | 2.06% |  |  |  |  |  | 1.61% |  |  |  |  |  | 2.06% |  |  |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1. Source: Freddie Mac Primary Fixed Mortgage Rate Mortgage Market Survey |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The principal elements impacting our interest income are the size of our average investment portfolio and the yield on our investments. The following is a summary of the estimated impact of each of these elements for the three and nine months ended September 30, 2016 compared to the prior year period (in millions):

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**Impact of Changes in the Principal Elements Impacting Interest Income**



**Periods Ended September 30, 2016 vs. September 30, 2015**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average** | | |  |
|  | **Total Increase /** |  |  | **Portfolio** |  |  |  | **Asset** |
|  | **(Decrease)** |  |  | **Size** |  |  |  | **Yield** |
| Three months ended | $ | 20 |  | $ | (1) |  | $ | 21 |
| Nine months ended | $ | (164) |  | $ | (86) |  | $ | (78) |

The size of our average investment portfolio decreased in par value, compared to the prior year period, by 1% and 8% for the three and nine months ended September 30, 2016, respectively. The decline was largely due to a relative shift from investments recognized as securities on our consolidated financial statements to investments in TBA securities recognized as derivative assets / liabilities on our consolidated financial statements. The size of our investment portfolio was also impacted by share repurchase activity and changes in our "at risk" leverage ratio (see *"Leverage"* below).

Our average asset yield differed from the prior year period largely due to fluctuations in "catch-up" premium amortization cost recognized due to changes in our projected CPR estimates. We recognized "catch-up" premium amortization cost of $8 million and $95 million for the three and nine months ended September 30, 2016, respectively, compared to a cost of $33 million and $15 million for the prior year period, respectively. Excluding "catch-up" premium amortization cost, our average asset yield was 2.66% and 2.70% for the three and nine months ended September 30, 2016, respectively, largely unchanged from 2.69% and 2.70%, respectively, for the prior year period.

***Leverage***

Our primary measures of leverage are our "at risk" leverage and our tangible net book value "at risk" leverage ratio. "At risk" leverage is measured as the sum of our mortgage borrowings (consisting of repurchase agreements used to fund our investment securities ("agency repo"), FHLB advances and debt of consolidated VIEs), net TBA position (at cost) and our net receivable / payable for unsettled investment securities divided by the sum of our total stockholders' equity less the fair value of our investments in REIT equity securities. Tangible net book value "at risk" leverage includes adjustments to exclude goodwill and other intangible assets, net of accumulated amortization, related to our acquisition of AMM from stockholders' equity.

We include our net TBA position in our measures of leverage because a long TBA position carries similar risks as if we had purchased the underlying MBS assets and funded the purchases with on-balance sheet funding liabilities. Similarly, a short TBA position has substantially the same effect as selling the underlying MBS assets and reducing our on-balance sheet funding commitments. (Refer to *Liquidity and Capital Resources* for further discussion of TBA dollar roll positions). Repurchase agreements used to fund short-term investments in U.S. Treasury securities ("U.S. Treasury repo") are excluded from our measures of leverage due to the temporary and highly liquid nature of these investments.

Our total "at risk" leverage was 7.2x and 6.8x our stockholders' equity as of September 30, 2016 and December 31, 2015, respectively. Our tangible net book value "at risk" leverage was 7.7x our tangible stockholders' equity as of

September 30, 2016. The table below presents our average and quarter-end mortgage borrowings, net TBA position and leverage ratios for each of the three month periods listed below (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **Net TBA Position** | | | |  |  |  |  |  |  |  | **Tangible Net Book** |  |
|  |  |  |  | **Mortgage Borrowings 1** | | | |  |  |  |  | **Long / (Short) 2** | | |  |  |  |  | **Tangible Net Book Value** | |  |  | **Value "At Risk"** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Average Total** | | **Average Total** | | **"At Risk" Leverage** | | **Leverage** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | **Average Daily** |  |  | **Maximum** | |  | **Ending** | |  | **Average Daily** | |  | **Ending** |  | **"At Risk" Leverage** | | **"At Risk" Leverage during** | | **as of** | | **as of** |  |
| **Quarter Ended** |  |  | **Amount** |  |  | **Daily Amount** |  |  | **Amount** |  |  | **Amount** |  |  | **Amount** |  | **during the Period 3** |  | **the Period 4** |  | **Period End 5** |  | **Period End 4** |  |
| September 30, 2016 | | $ | 44,401 | $ | | 46,555 |  | $ | 41,154 |  | $ | 10,748 |  | $ | 15,540 | 7.1:1 | |  | 7.6:1 |  | 7.2:1 |  | 7.7:1 |  |
| June 30, 2016 | | $ | 46,948 | $ | | 48,875 |  | $ | 45,502 |  | $ | 8,238 |  | $ | 6,975 | 7.2:1 | |  | N/A | | 7.2:1 |  | N/A |  |
| March 31, 2016 | | $ | 45,926 | $ | | 49,767 |  | $ | 48,875 |  | $ | 8,144 |  | $ | 5,983 | 7.0:1 | |  | N/A | | 7.3:1 |  | N/A |  |
| December 31, 2015 | | $ | 47,018 | $ | | 50,078 |  | $ | 46,077 |  | $ | 7,796 |  | $ | 7,430 | 6.8:1 | |  | N/A | | 6.8:1 |  | N/A |  |
| September 30, 2015 | | $ | 43,308 | $ | | 46,049 |  | $ | 44,683 |  | $ | 9,434 |  | $ | 7,265 | 6.2:1 | |  | N/A | | 6.8:1 |  | N/A |  |
| June 30, 2015 | | $ | 50,410 | $ | | 55,097 |  | $ | 45,860 |  | $ | 5,973 |  | $ | 7,104 | 6.2:1 | |  | N/A | | 6.1:1 |  | N/A |  |
| March 31, 2015 | | $ | 53,963 | $ | | 58,217 |  | $ | 55,056 |  | $ | 6,957 |  | $ | 4,815 | 6.5:1 | |  | N/A | | 6.4:1 |  | N/A |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Mortgage borrowings includes agency repo, FHLB advances and debt of consolidated VIEs. Amounts exclude U.S. Treasury repo agreements.
2. Daily average and ending net TBA position outstanding measured at cost.

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1. Average "at risk" leverage during the period was calculated by dividing the sum of our daily weighted average mortgage borrowings outstanding and our daily weighted average net TBA position (at cost) during the period by the sum of our average month-end stockholders' equity less our average investment in REIT equity securities for the period.
2. Tangible net book value "at risk" leverage includes the components of "at risk" leverage with stockholders' equity adjusted to exclude goodwill and other intangible assets, net.
3. "At risk" leverage as of period end was calculated by dividing the sum of the amount of mortgage borrowings outstanding, net payables and receivables for unsettled agency securities and the cost basis (or contract price) of our net TBA position by the sum of our total stockholders' equity less the fair value of our investment in REIT equity securities at period end.

***Interest Expense and Cost of Funds***

Our interest expense is comprised of interest expense on our mortgage borrowings and the reclassification of accumulated OCI into interest expense related to previously de-designated interest rate swaps. Our mortgage borrowings primarily consist of repurchase agreements used to finance our agency MBS. Upon our election to discontinue hedge accounting under GAAP as of September 30, 2011, the net deferred loss related to our de-designated interest rate swaps remained in accumulated OCI and is being reclassified from accumulated OCI into interest expense on a straight-line basis over the remaining term of each interest rate swap through October 2016.

Our "adjusted net interest expense," also referred to as our "cost of funds" when stated as a percentage of our mortgage borrowings outstanding, includes periodic interest costs on our interest rate swaps reported in gain/loss on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Our cost of funds does not include swap termination fees, forward starting swaps and costs associated with our other supplemental hedges, such as swaptions and U.S. Treasury positions. Our cost of funds also does not include the implied financing cost/benefit of our net TBA dollar roll position, but includes interest rate swap hedge costs related to our TBA dollar roll funded assets. Consequently, our cost of funds measured as a percentage of our outstanding mortgage borrowings is higher than if we allocated a portion of our swap hedge costs to our TBA dollar roll funded assets.

Our average cost of funds declined to 1.32% of our average mortgage borrowings outstanding for the three months ended September 30, 2016, compared to 1.70% for the prior year period, while our average cost of funds for the nine months ended September 30, 2016 was 1.47%, compared to 1.45% for the prior year period. The table below presents a reconciliation of our interest expense (the most comparable GAAP financial measure) to our adjusted net interest expense and cost of funds (non-GAAP financial measures) for the three and nine months ended September 30, 2016 and 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended September 30,** | | | | | | | | | | |  | **Nine Months Ended September 30,** | | | | | | | | | |  |
|  |  |  | **2016** | | |  |  |  | **2015** | | |  |  |  | **2016** | | |  |  |  | **2015** | | |  |  |
| **Adjusted Net Interest Expense and Cost of Funds** |  | **Amount** | |  |  | **% 1** |  | **Amount** | |  |  | **% 1** |  | **Amount** | |  |  | **% 1** |  | **Amount** | |  |  | **% 1** |  |
| **Interest expense:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest expense on mortgage borrowings | | $ | 89 |  |  | 0.80% |  | $ | 53 |  |  | 0.49% |  | $ | 258 |  |  | 0.75% |  | $ | 165 |  |  | 0.45% |  |
| Periodic interest costs of interest rate swaps | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| previously designated as hedges under | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| GAAP, net | |  | 7 |  |  | 0.06% |  |  | 24 |  |  | 0.22% |  |  | 38 |  |  | 0.11% |  |  | 79 |  |  | 0.21% |  |
| **Total interest expense** | |  | 96 |  |  | 0.86% |  |  | 77 |  |  | 0.71% |  |  | 296 |  |  | 0.86% |  |  | 244 |  |  | 0.66% |  |
| Other periodic interest costs of interest rate | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| swaps, net | |  | 51 |  |  | 0.47% |  |  | 107 |  |  | 0.99% |  |  | 209 |  |  | 0.60% |  |  | 290 |  |  | 0.79% |  |
| **Total adjusted net interest expense and cost of** | | $ | 147 |  |  | 1.32% |  | $ | 184 |  |  | 1.70% |  | $ | 505 |  |  | 1.47% |  | $ | 534 |  |  | 1.45% |  |
| **funds** | |  |  |  |  |  |  |  |  |  |  |  |  |

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1. Percent of our average mortgage borrowings outstanding for the period annualized.

The principal elements impacting our adjusted net interest expense are the size of our average mortgage borrowings outstanding during the period, the size of our average interest rate swap balance outstanding (excluding forward starting swaps), the average interest rate on our borrowings and the average net pay rate on our pay-fixed receive-floating interest rate swaps. The following is a summary of the estimated impact of the principal elements impacting the increase in our adjusted net interest expense for the three and nine months ended September 30, 2016, compared to the prior year period (in millions):

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**Impact of Changes in the Principal Elements of Adjusted Net Interest Expense**



**Periods Ended September 30, 2016 and September 30, 2015**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average** | | | |
|  |  | **Total Increase / (Decrease)** | |  | **Borrowing / Swap Balance** | |  | **Borrowing / Swap Rate** |
| **Three months ended:** |  |  |  |  |  |  |  |  |
| Interest expense on mortgage borrowings | $ | 36 |  | $ | 1 |  | $ | 35 |
| Periodic interest rate swap costs 1 |  | (73) |  |  | (17) |  |  | (56) |
| Total change in adjusted net interest expense | $ | (37) |  | $ | (16) |  | $ | (21) |
|  |  |  |  |  |  |  |  |  |
| **Nine months ended:** |  |  |  |  |  |  |  |  |
| Interest expense on mortgage borrowings | $ | 93 |  | $ | (11) |  | $ | 104 |
| Periodic interest rate swap costs 1 |  | (122) |  |  | (13) |  |  | (109) |
| Total change in adjusted net interest expense | $ | (29) |  | $ | (24) |  | $ | (5) |

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1. Includes amounts recognized in interest expense and in gain (loss) on derivatives and other securities, net in our consolidated statements of comprehensive income. The change due to interest rate reflects the net impact of the change in the weighted average fixed pay and variable receive rates.

The average interest rate on our borrowings increased for the current year periods largely due to the Fed Funds rate increase in December of 2015. The size of our average borrowings outstanding increased 3% for the current three month period and decreased 7% for the current nine month period due to shifts in asset composition, adjustments to our leverage ratios and share repurchases. The size of our interest rate swap portfolio in absolute dollar terms decreased during the current year periods due to changes in the size and composition of our mortgage borrowings and net TBA position outstanding and hedge repositioning. The decline in the average net pay rate on our pay-fixed receive-floating interest rate swaps was a function of both a lower average pay-fixed rate and a higher average receive-floating rate.

The table below presents a summary of our average mortgage borrowings and our average interest rates swaps outstanding, excluding forward starting swaps, for the three and nine months ended September 30, 2016 and 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended September 30,** | | | | |  | **Nine Months Ended September 30,** | | | |
| **Average Ratio of Interest Rate Swaps Outstanding (Excluding Forward Starting Swaps) to Mortgage Borrowings Outstanding** |  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| Average mortgage borrowings | | $ | 44,401 |  | $ | 43,308 |  | $ | 45,753 |  | $ | 49,188 |
| Average notional amount of interest rate swaps (excluding forward starting swaps) | | $ | 31,839 |  | $ | 36,615 |  | $ | 33,790 |  | $ | 35,057 |
| Average ratio of interest rate swaps to mortgage borrowings | |  | 72 % |  |  | 85 % |  |  | 74 % |  |  | 71 % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average pay rate on interest rate swaps | |  | 1.45 % |  |  | 1.72 % |  |  | 1.60 % |  |  | 1.67 % |
| Weighted average receive rate on interest rate swaps | |  | (0.73)% |  |  | (0.30)% |  |  | (0.63)% |  |  | (0.26)% |
| Weighted average net pay rate on interest rate swaps | |  | 0.72 % |  |  | 1.42 % |  |  | 0.97 % |  |  | 1.41 % |

For the three and nine months ended September 30, 2016, we had an average balance of $4.4 billion and $5.8 billion, respectively, of forward starting interest rate swaps outstanding, compared to $9.1 billion and $10.8 billion, respectively, for the prior year period. Forward starting interest rate swaps do not impact our adjusted net interest expense and cost of funds until they commence accruing net interest settlements on their forward start dates. We enter into forward starting interest rate swaps based on a variety of factors, including our view of the forward yield curve and the timing of potential changes in short-term interest rates, time to deploy new capital, amount and timing of expirations of our existing interest rate swap portfolio, current and anticipated swap spreads and our desire to mitigate our exposure to specific sectors of the yield curve.

Including forward starting swaps and our net TBA position, our average ratio of interest rate swaps outstanding to our average mortgage borrowings and net TBA position (at cost) was 66% and 72% for the three and nine months ended September 30, 2016, compared to 87% and 81%, respectively, for the prior year period.

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|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended September 30,** | | | | |  | **Nine Months Ended September 30,** | | | |
| **Average Ratio of Interest Rate Swaps Outstanding (Including Forward Starting Swaps) to Mortgage Borrowings and Net TBA Position** |  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| Average mortgage borrowings | | $ | 44,401 |  | $ | 43,308 |  | $ | 45,753 |  | $ | 49,188 |
| Average net TBA position - at cost | |  | 10,748 |  |  | 9,434 |  |  | 9,050 |  |  | 7,464 |
| Total average mortgage borrowings and net TBA position | | $ | 55,149 |  | $ | 52,742 |  | $ | 54,803 |  | $ | 56,652 |
| Average notional amount of interest rate swaps (including of forward starting swaps) | | $ | 36,270 |  | $ | 45,686 |  | $ | 39,575 |  | $ | 45,863 |
| Average ratio of interest rate swaps to mortgage borrowings and net TBA position | |  | 66% |  |  | 87% |  |  | 72% |  |  | 81% |

***Net Spread and Dollar Roll Income***

The table below presents a reconciliation of our net interest income (the most comparable GAAP financial measure) to our net spread and dollar roll income and to our net spread and dollar roll income, excluding estimated "catch-up"

premium amortization cost, (non-GAAP financial measures) for the three and nine months ended September 30, 2016 and 2015 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | |  | **Nine Months Ended** | | | |  |
|  |  | **September 30,** | | | | |  | **September 30,** | | | |  |
|  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |  |
| Net interest income | $ | 219 |  | $ | 218 |  | $ | 632 |  | $ | 848 |  |
| Other periodic interest costs of interest rate swaps, net 1 |  | (51) |  |  | (107) |  |  | (209) |  |  | (290) |  |
| TBA dollar roll income 1 |  | 54 |  |  | 73 |  |  | 148 |  |  | 184 |  |
| Management fee income |  | 4 |  |  | — | |  | 4 |  |  | — |  |
| Dividend from REIT equity securities 1 |  | — | |  | 1 |  |  | 2 |  |  | 5 |  |
| Adjusted net interest and dollar roll income |  | 226 |  |  | 185 |  |  | 577 |  |  | 747 |  |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Total operating expenses |  | 15 |  |  | 34 |  |  | 88 |  |  | 106 |  |
| Non-recurring transaction costs |  | — | |  | — | |  | (9) |  |  | — |  |
| Adjusted operating expenses |  | 15 |  |  | 34 |  |  | 79 |  |  | 106 |  |
| Net spread and dollar roll income |  | 211 |  |  | 151 |  |  | 498 |  |  | 641 |  |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |  |
| Net spread and dollar roll income available to common stockholders |  | 204 |  |  | 144 |  |  | 477 |  |  | 620 |  |
| Estimated "catch-up" premium amortization cost due to change in CPR forecast |  | 8 |  |  | 33 |  |  | 95 |  |  | 15 |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, available to | $ | 212 |  | $ | 177 |  | $ | 572 |  | $ | 635 |  |
| common stockholders |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted |  | 331.0 |  |  | 347.8 |  |  | 332.1 |  |  | 350.9 |  |
| Net spread and dollar roll income per common share - basic and diluted | $ | 0.62 |  | $ | 0.41 |  | $ | 1.44 |  | $ | 1.77 |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common | $ | 0.64 |  | $ | 0.51 |  | $ | 1.72 |  | $ | 1.81 |  |
| share - basic and diluted |  |  |  |  |

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1. Reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income

Net spread and dollar roll income, excluding "catch-up" premium amortization adjustments, for the three months ended September 30, 2016 increased to $0.64 from $0.51 per common share for the prior year period, driven by higher "at risk" leverage, lower total cost of funds and lower operating costs. Net spread and dollar roll income, excluding "catch-up" premium amortization adjustments, for the nine months September 30, 2016 decreased to $1.72 from $1.81 per common share for the prior year period, largely due to higher repo costs and a decline in TBA dollar roll income relative to our average TBA position, partially offset by higher "at risk" leverage and lower operating costs.

Our average net interest rate spread and dollar roll income (i.e., the difference between the average yield on our assets and our average cost of funds inclusive of TBAs), excluding catch-up premium amortization cost, was 1.47% and 1.39% for the three and nine months ended September 30, 2016, compared to 1.37% and 1.52% for the prior year period. Including catch-up premium amortization adjustments, our net interest rate spread and dollar roll income was 1.42% and 1.18% for the three and nine months ended September 30, 2016, compared to 1.14% and 1.48%, respectively, for the prior year period.

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***Gain (Loss) on Sale of Mortgage-Backed Securities, Net***

The following table is a summary of our net gain (loss) on sale of MBS for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended September 30,** | | | | | |  | **Nine Months Ended September 30,** | | | |
|  | **2016** |  |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| MBS sold, at cost | $ | (6,123) |  | $ | (4,575) |  | $ | (17,146) |  | $ | (22,548) |
| Proceeds from MBS sold 1 |  | 6,184 |  |  | 4,536 |  |  | 17,260 |  |  | 22,523 |
| Net gain (loss) on sale of MBS | $ | 61 |  | $ | (39) |  | $ | 114 |  | $ | (25) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Gross gain on sale of MBS | $ | 62 |  | $ | 2 |  | $ | 122 |  | $ | 81 |
| Gross loss on sale of MBS |  | (1) |  |  | (41) |  |  | (8) |  |  | (106) |
| Net gain (loss) on sale of MBS | $ | 61 |  | $ | (39) |  | $ | 114 |  | $ | (25) |

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1. Proceeds include cash received during the period, plus receivable for MBS sold during the period as of period end.

Asset sales primarily resulted from leverage adjustments and portfolio repositioning.

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***Gain (Loss) on Derivative Instruments and Other Securities, Net***

The following table is a summary of our gain (loss) on derivative instruments and other securities, net for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended September 30,** | | | | | |  | **Nine Months Ended September 30,** | | | |
|  | **2016** |  |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| Periodic interest costs of interest rate swaps, net | $ | (51) |  | $ | (107) |  | $ | (209) |  | $ | (290) |
| Realized gain (loss) on derivative instruments and other securities, net: |  |  |  |  |  |  |  |  |  |  |  |
| TBA securities - dollar roll income, net |  | 54 |  |  | 73 |  |  | 148 |  |  | 184 |
| TBA securities - mark-to-market net gain (loss) |  | 63 |  |  | (26) |  |  | 210 |  |  | 224 |
| Payer swaptions |  | (10) |  |  | (40) |  |  | (30) |  |  | (52) |
| Receiver swaptions |  | — | |  | — | |  | — | |  | 15 |
| U.S. Treasury securities - long position |  | 1 |  |  | 12 |  |  | 7 |  |  | (35) |
| U.S. Treasury securities - short position |  | (11) |  |  | (5) |  |  | (64) |  |  | (70) |
| U.S. Treasury futures - short position |  | (43) |  |  | (10) |  |  | (102) |  |  | (24) |
| Interest rate swap termination fees |  | (299) |  |  | (2) |  |  | (865) |  |  | (164) |
| REIT equity securities |  | (1) |  |  | — | |  | (1) |  |  | 4 |
| Other |  | (1) |  |  | (1) |  |  | 7 |  |  | — |
| Total realized gain (loss) on derivative instruments and other securities, net |  | (247) |  |  | 1 |  |  | (690) |  |  | 82 |
| Unrealized gain (loss) on derivative instruments and other securities, net: |  |  |  |  |  |  |  |  |  |  |  |
| TBA securities - mark-to-market net gain (loss) |  | (50) |  |  | 166 |  |  | 33 |  |  | (71) |
| Interest rate swaps |  | 503 |  |  | (857) |  |  | (134) |  |  | (824) |
| Payer swaptions |  | 9 |  |  | 17 |  |  | 18 |  |  | 25 |
| Receiver swaptions |  | — | |  | — | |  | — | |  | (11) |
| Interest and principal-only strips |  | (6) |  |  | 10 |  |  | 5 |  |  | 14 |
| U.S. Treasury securities - long position |  | — | |  | 17 |  |  | — | |  | — |
| U.S. Treasury securities - short position |  | 25 |  |  | (20) |  |  | (78) |  |  | (19) |
| U.S. Treasury futures - short position |  | 58 |  |  | (13) |  |  | (4) |  |  | (4) |
| Debt of consolidated VIEs |  | (2) |  |  | 7 |  |  | (8) |  |  | 16 |
| REIT equity securities |  | 2 |  |  | — | |  | 9 |  |  | (8) |
| Other |  | 1 |  |  | 1 |  |  | — | |  | — |
| Total unrealized gain (loss) on derivative instruments and other securities, net |  | 540 |  |  | (672) |  |  | (159) |  |  | (882) |
| Total gain (loss) on derivative instruments and other securities, net | $ | 242 |  | $ | (778) |  | $ | (1,058) |  | $ | (1,090) |

For further details regarding our use of derivative instruments and related activity refer to Notes 3 and 6 of our Consolidated Financial Statements in this Form 10-Q.

***Operating Expenses***

Prior to our acquisition of AMM and related management internalization on July 1, 2016, we paid our Manager a management fee payable monthly in arrears in an amount equal to one-twelfth of 1.25% of our month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in either retained earnings or accumulated OCI, each as computed in accordance with GAAP. There was no incentive compensation payable to our Manager pursuant to the management agreement. We incurred management fees of $52 million for the six months ended June 30, 2016 and $29 million and $88 million for the three and nine months ended September 30, 2015, respectively. Following our management internalization, we no longer incur a management fee, but we incur expenses associated with an internally managed organization, including compensation expense previously borne by our Manager. For the three months ended September 30, 2016, we had compensation and benefits expense of $9 million, consisting of base salary, bonus accruals and benefits expense. As of September 30, 2016, we had not granted stock-based long-term incentive compensation awards to our employees, and, as a result, third quarter compensation and benefits expense does not include long-term compensation expense for our employees. On November 4, 2016, we filed a proxy statement soliciting stockholder approval for our 2016 equity plan, and we intend to make grants thereunder to both attract, motivate and retain high quality employees and directors and align our employees and directors with the interests of our stockholders. We would expect these grants to, in turn, be recognized as compensation and benefits expense in subsequent periods.

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Other operating expenses were $6 million and $5 million for the three months ended September 30, 2016 and 2015, respectively, and $27 million and $18 million for the nine months ended September 30, 2016 and 2015, respectively. Other operating expenses primarily consist of prime broker fees, amortization of intangible assets associated with our acquisition of AMM, information technology costs, accounting fees, legal fees, Board of Director fees, insurance expense and general overhead expenses. For the nine months ended September 30, 2016, our other operating expenses included $9 million of non-recurring transaction costs associated with our acquisition of AMM.

Our total annualized operating expense as a percentage of our average stockholders' equity was 0.76% and 1.57% for the three months ended September 30, 2016 and 2015, respectively, and 1.51% and 1.57% for the nine months ended September 30, 2016 and 2015, respectively. Excluding non-recurring transaction costs, our total annualized operating expense as a percentage of our average stockholders' equity was 1.35% for the nine months ended September 30, 2016.

***Dividends and Income Taxes***

For the three months ended September 30, 2016 and 2015, we had estimated taxable income available to common stockholders of $63 million and $59 million (or $0.19 and $0.17 per common share), respectively, and for the nine months ended September 30, 2016 and 2015, we had estimated taxable income available to common stockholders of $210 million and $340 million (or $0.63 and $0.97 per common share), respectively.

As a REIT, we are required to distribute annually 90% of our ordinary taxable income to maintain our status as a REIT and all of our taxable income to avoid federal and state corporate income taxes. We can treat dividends declared by September 15 and paid by December 31 as having been a distribution of our taxable income for our prior tax year ("spill-back provision"). Income as determined under GAAP differs from income as determined under tax rules because of both temporary and permanent differences in income and expense recognition. The primary differences are (i) unrealized gains and losses associated with interest rate swaps and other derivatives and securities marked-to-market in current income for GAAP purposes, but excluded from taxable income until realized or settled, (ii) timing differences, both temporary and potentially permanent, in the recognition of certain realized gains and losses and (iii) temporary differences related to the amortization of premiums and discounts on investments. Furthermore, our estimated taxable income is subject to potential adjustments up to the time of filing our appropriate tax returns, which occurs after the end of our fiscal year.

The following is a reconciliation of our GAAP net income to our estimated taxable income for the three and nine months ended September 30, 2016 and 2015 (dollars in millions, except per share amounts):

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended September 30,** | | | | |  | **Nine Months Ended September 30,** | | | |
|  |  | **2016** |  |  | **2015** |  |  | **2016** |  |  | **2015** |
| Net income (loss) | $ | 511 |  | $ | (633) |  | $ | (396) |  | $ | (373) |
| Estimated book to tax differences: |  |  |  |  |  |  |  |  |  |  |  |
| Premium amortization, net |  | (15) |  |  | 15 |  |  | 60 |  |  | (14) |
| Realized gain/loss, net |  | 249 |  |  | 12 |  |  | 733 |  |  | (140) |
| Net capital loss/(utilization of net capital loss carryforward) |  | (127) |  |  | — | |  | (325) |  |  | 6 |
| Unrealized gain/loss, net |  | (540) |  |  | 672 |  |  | 158 |  |  | 882 |
| Other |  | (8) |  |  | — | |  | 1 |  |  | — |
| Total book to tax differences |  | (441) |  |  | 699 |  |  | 627 |  |  | 734 |
| Estimated REIT taxable income |  | 70 |  |  | 66 |  |  | 231 |  |  | 361 |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 21 |  |  | 21 |
| Estimated REIT taxable income available to common stockholders | $ | 63 |  | $ | 59 |  | $ | 210 |  | $ | 340 |
| Weighted average number of common shares outstanding - basic and diluted |  | 331.0 |  |  | 347.8 |  |  | 332.1 |  |  | 350.9 |
| Estimated REIT taxable income per common share - basic and diluted | $ | 0.19 |  | $ | 0.17 |  | $ | 0.63 |  | $ | 0.97 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning cumulative non-deductible net capital loss | $ | 486 |  | $ | 767 |  | $ | 684 |  | $ | 761 |
| Utilization of net capital loss carryforward |  | (127) |  |  | — | |  | (325) |  |  | 6 |
| Ending cumulative non-deductible net capital loss | $ | 359 |  | $ | 767 |  | $ | 359 |  | $ | 767 |
| Ending cumulative non-deductible net capital loss per ending common share | $ | 1.08 |  | $ | 2.21 |  | $ | 1.08 |  | $ | 2.21 |

As of September 30, 2016, we had $0.4 billion (or $1.08 per common share) of net capital loss carryforwards, which can be carried forward and applied against future net capital gains through fiscal year 2018.

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The following table summarizes dividends declared on our Series A Preferred Stock, depositary shares underlying our Series B Preferred Stock and common stock during the nine months ended September 30, 2016 and 2015:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Dividends Declared per Share** | | |  |  |
|  |  |  |  |  |  |  | |  |  |
|  |  |  |  |  |  | **Series B Preferred Stock (Per** | |  |  |
| **Quarter Ended** | |  | **Series A Preferred Stock** | |  | **Depositary Share)** | |  | **Common Stock** |
|  |  |  |  |  |  |  |  |  |  |
| September 30, 2016 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.56 |
| June 30, 2016 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.60 |
|  |  |  |  |  |  |  |  |  |  |
| March 31, 2016 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.60 |
| Total | | $ | 1.50000 |  | $ | 1.453125 |  | $ | 1.76 |
|  |  |  |  |  |  |  |  |  |  |
| September 30, 2015 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.60 |
|  |  |  |  |  |  |  |  |  |  |
| June 30, 2015 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.62 |
| March 31, 2015 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.66 |
|  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 1.50000 |  | $ | 1.453125 |  | $ | 1.88 |

The tax characterization of our fiscal year 2016 dividends will be determined and reported to stockholders on their annual Form 1099-DIV statement after the end of the year.

***Other Comprehensive Income (Loss)***

The following table summarizes the components of our other comprehensive income (loss) for the three and nine months ended September 30, 2016 and 2015 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended September 30,** | | | |  |  |  | **Nine Months Ended September 30,** | | | |
|  | **2016** |  |  | **2015** |  |  |  | **2016** |  |  | **2015** |
| Unrealized gain (loss) on available-for-sale securities, net: |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss), net | $ | (36) |  | $ | 428 |  | $ | 1,152 |  | $ | (39) |
| Reversal of prior period unrealized (gain) loss, net, upon realization |  | (61) |  |  | 39 |  |  | (114) |  |  | 25 |
| Unrealized gain (loss) on available-for-sale securities, net: |  | (97) |  |  | 467 |  |  | 1,038 |  |  | (14) |
| Unrealized gain on interest rate swaps designated as cash flow hedges: |  |  |  |  |  |  |  |  |  |  |  |
| Reversal of prior period unrealized loss on interest rate swaps, net, upon reclassification to interest expense |  | 7 |  |  | 24 |  |  | 38 |  |  | 79 |
| Total other comprehensive income (loss) | $ | (90) |  | $ | 491 |  | $ | 1,076 |  | $ | 65 |

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**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of funds are borrowings under master repurchase agreements, asset sales, receipts of monthly principal and interest payments on our investment portfolio and equity offerings. We also enter into TBA contracts as a means of acquiring or disposing of agency securities and utilize TBA dollar roll transactions to finance agency MBS purchases. Because the level of our borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our balance sheet is significantly less important than the potential liquidity available under our borrowing arrangements. Our leverage may vary periodically depending on market conditions and our assessment of risks and returns. We generally would expect our leverage to be within six to eleven times the amount of our stockholders' equity. However, under certain market conditions, we may operate at leverage levels outside of this range for extended periods of time.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, maintenance of any margin requirements and the payment of cash dividends as required for our continued qualification as a REIT. To qualify as a REIT, we must distribute annually at least 90% of our taxable income. As long as we qualify as a REIT, we will generally not be subject to U.S. federal or state corporate taxes on our taxable net income to the extent that we distribute our annual taxable net income to our stockholders in a timely manner. We currently expect to distribute 100% of our taxable income so that we are not subject to federal and state income taxes. This distribution requirement limits our ability to retain earnings and thereby replenish or increase capital from operations.

***Debt Capital***

As of September 30, 2016 and December 31, 2015, our mortgage borrowings and net TBA position consisted of the following ($ in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **September 30, 2016** | | |  |  |  | **December 31, 2015** | | |  |
|  | |  |  | | |  |  |  |  | | |  |
| **Mortgage Funding 1,2** |  |  | **Amount** |  |  | **%** |  |  | **Amount** |  |  | **%** |
| Repurchase agreements used to fund agency MBS | | $ | 37,623 |  |  | 66% |  | $ | 41,729 |  |  | 78% |
| FHLB advances | |  | 3,037 |  |  | 5% |  |  | 3,753 |  |  | 7% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Debt of consolidated variable interest entities, at fair value | |  | 494 |  |  | 1% |  |  | 595 |  |  | 1% |
| Total mortgage borrowings | |  | 41,154 |  |  | 73% |  |  | 46,077 |  |  | 86% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net TBA position, at cost | |  | 15,540 |  |  | 27% |  |  | 7,430 |  |  | 14% |
| Total mortgage funding | | $ | 56,694 |  |  | 100% |  | $ | 53,507 |  |  | 100% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes repurchase agreements used to fund U.S. Treasury securities of $45 million and $25 million as of September 30, 2016 and December 31, 2015, respectively.
2. Excludes net payable for unsettled purchases and sales of investment securities of $23 million and $182 million as of September 30, 2016 and December 31, 2015, respectively.

Our "at risk" leverage ratio was 7.2x as of September 30, 2016, compared to 6.8x as of December 31, 2015, measured as the sum of our total mortgage borrowings, net TBA position (at cost) and net payable for unsettled investment securities divided by the sum of our total stockholders' equity less our investments in REIT equity securities. Our tangible net book value "at risk" leverage was 7.7x our tangible stockholders' equity as of September 30, 2016.

*Repurchase Agreements*

As part of our investment strategy, we borrow against our investment portfolio pursuant to master repurchase agreements. We expect that the majority of our borrowings under such master repurchase agreements will have maturities ranging up to one year, but we may have longer-term borrowings ranging up to five years or longer. Borrowings under our master repurchase agreements with maturities greater than 90 days will typically have floating rates of interest based on LIBOR plus or minus a fixed spread.

As of September 30, 2016 , we had $37.6 billion of repurchase agreements outstanding used to fund acquisitions of investment securities with a weighted average cost of funds of 0.83% and a weighted average remaining days-to-maturity of 199 days, compared $41.7 billion, 0.61% and 173 days, respectively, as of December 31, 2015.

To limit our exposure to counterparty credit risk, we diversify our funding across multiple counterparties and by counterparty region. As of September 30, 2016, we had master repurchase agreements with 38 financial institutions located throughout North America, Europe and Asia. As of September 30, 2016, less than 5% of our stockholders' equity was at risk with any one repo counterparty, with the top five repo counterparties representing less than 12% of our stockholders' equity. The table below includes a summary of our repurchase agreement funding by number of repo counterparties and counterparty region as of September 30,

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2016. For further details regarding our borrowings under repurchase agreements and concentration of credit risk as of September 30, 2016, please refer to Notes 5 and 7 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **September 30, 2016** | | |
|  |  |  |  | **Percent of Repurchase Agreement** |
| **Counter-Party Region** |  | **Number of Counter-Parties** |  | **Funding** |
| North America | | 20 |  | 63% |
| Europe | | 13 |  | 25% |
| Asia | | 5 |  | 12% |
|  |  | 38 |  | 100% |

Amounts available to be borrowed under our repurchase agreements are dependent upon lender collateral requirements and the lender's determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In addition, our counterparties apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value, but conversely subjects us to counterparty risk and limits the amount we can borrow against our investment securities. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the nine months ended September 30, 2016, haircuts on our pledged collateral remained stable and, as of September 30, 2016, our weighted average haircut was approximately 5% of the value of our collateral.

Under our repurchase agreements, we may be required to pledge additional assets to the repurchase agreement counterparties in the event the estimated fair value of the existing pledged collateral under such agreements declines and such counterparties demand additional collateral (a "margin call"), which may take the form of additional securities or cash. Specifically, margin calls would result from a decline in the value of our securities securing our repurchase agreements and prepayments on the mortgages securing such securities. Similarly, if the estimated fair value of our investment securities increases due to changes in interest rates or other factors, counterparties may release collateral back to us. Our repurchase agreements generally provide that the valuations of securities securing our repurchase agreements are to be obtained from a generally recognized source agreed to by the parties. However, in certain circumstances under certain of our repurchase agreements our lenders have the sole discretion to determine their value. In such instances, our lenders are required to act in good faith in making determinations of value. Our repurchase agreements generally provide that in the event of a margin call, we must provide additional securities or cash on the same business day that a margin call is made if the lender provides us notice prior to the margin notice deadline on such day.

As of September 30, 2016, we had met all of our margin requirements and we had unrestricted cash and cash equivalents of $1.3 billion and unpledged securities of approximately $2.2 billion, including securities pledged to us and unpledged interests in our consolidated VIEs, available to meet margin calls on our repurchase agreements and other funding liabilities, derivative instruments and for other corporate purposes.

Although we believe we will have adequate sources of liquidity available to us through repurchase agreement financing to execute our business strategy, there can be no assurances that repurchase agreement financing will be available to us upon the maturity of our current repurchase agreements to allow us to renew or replace our repurchase agreement financing on favorable terms or at all. If our repurchase agreement lenders default on their obligations to resell the underlying collateral back to us at the end of the term, we could incur a loss equal to the difference between the value of the collateral and the cash we originally received.

Our wholly-owned captive broker-dealer subsidiary, Bethesda Securities, LLC ("BES"), formed in 2015, became operational and received final membership approval to the Fixed Income Clearing Corporation ("FICC") during the third quarter of 2016, thereby providing us with access to additional repurchase agreement funding capabilities in the wholesale market. As of September 30, 2016, we had entered into $1.2 billion of repurchase agreement funding through BES and expect to continue to expand our financing activity through BES over the next several quarters.

To help manage the adverse impact of interest rate changes on the value of our investment portfolio as well as our cash flows, we utilize an interest rate risk management strategy under which we use derivative financial instruments. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings of our long-term fixed rate assets during a period of rising interest rates. The principal derivative instruments that we use are interest rate swaps, supplemented with the use of interest rate swaptions, U.S. Treasury securities, U.S. Treasury futures contracts, TBA securities and

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other instruments. Please refer to Notes 3 and 6 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q for further details regarding our use of derivative instruments.

Our derivative agreements typically require that we pledge/receive collateral on such agreements to/from our counterparties in a similar manner as we are required to under our repurchase agreements. Our counterparties, or the clearing agency in the case of centrally cleared interest rate swaps, typically have the sole discretion to determine the value of the derivative instruments and the value of the collateral securing such instruments. In the event of a margin call, we must generally provide additional collateral on the same business day.

Similar to repurchase agreements, our use of derivatives exposes us to counterparty credit risk relating to potential losses that could be recognized in the event that our counterparties to these instruments fail to perform their obligations under the contracts. We minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings and by monitoring positions with individual counterparties. Excluding centrally cleared interest rate swaps, as of September 30, 2016, our amount at risk with any counterparty related to our interest rate swap and swaption agreements was less than 1% of our stockholders' equity. In the case of centrally cleared interest rate swap contracts, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the exchange's initial and daily mark to market margin requirements and a clearinghouse guarantee fund and other resources that are available in the event of a clearing member default.

*TBA Dollar Roll Transactions*

TBA dollar roll transactions represent a form of off-balance sheet financing accounted for as derivative instruments and we may use them as a means of leveraging (or deleveraging) our investment portfolio through the use of long (or short) TBA contracts. (See Notes 3 and 6 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q).

Under certain market conditions, it may be uneconomical for us to roll our TBA contracts into future months and we may need to take or make physical delivery of the underlying securities. If we were required to take physical delivery to settle a long TBA contract, we would have to fund our total purchase commitment with cash or other financing sources and our liquidity position could be negatively impacted. As of September 30, 2016, we had a net long TBA position with a total market value and a total cost basis of $15.6 billion and $15.5 billion, respectively, and a net carrying value of $46 million recognized in derivative assets/(liabilities), at fair value, on our Consolidated Balance Sheets in this Quarterly Report on Form 10-Q.

Our TBA dollar roll contracts are also subject to margin requirements governed by the Mortgage-Backed Securities Division ("MBSD") of the FICC and by our prime brokerage agreements, which may establish margin levels in excess of the MBSD. Such provisions require that we establish an initial margin based on the notional value of the TBA contract, which is subject to increase if the estimated fair value of our TBA contract or the estimated fair value of our pledged collateral declines. The MBSD has the sole discretion to determine the value of our TBA contracts and of the pledged collateral securing such contracts. In the event of a margin call, we must generally provide additional collateral on the same business day.

Settlement of our TBA obligations by taking delivery of the underlying securities as well as satisfying margin requirements could negatively impact our liquidity position. However, since we do not use TBA dollar roll transactions as our primary source of financing, we believe that we will have adequate sources of liquidity to meet such obligations.

*Federal Home Loan Bank Membership*

In April 2015, our wholly-owned captive insurance subsidiary, Old Georgetown Insurance Co., LLC ("OGI"), was approved as a member of the FHLB of Des Moines. The FHLBs provide a variety of products and services to their members, including short and long-term secured loans, called "advances." In January 2016, the FHFA released its final rule on changes to regulations concerning FHLB membership criteria. The final rule terminates OGI's FHLB membership and requires repayment of all advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017). As of September 30, 2016, we had $3.0 billion of FHLB advances outstanding with a weighted average interest rate of 0.63% and a weighted average remaining days to maturity of 123 days up to February 2017. Termination of our FHLB membership could negatively impact our liquidity position; however, since FHLB advances do not represent our primary source of funding, we believe that we will have adequate alternative sources of funding upon such termination.

FHLB members may use a variety of real estate related assets, including agency MBS and non-agency securities, as collateral for advances. The ability to borrow from the FHLB during the duration of our FHLB membership is subject to our subsidiary's continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. FHLB advances typically require higher effective "haircuts" than those required under our current repurchase agreements due to the combination of slightly higher haircuts implemented by the FHLB of Des Moines and the requirement to

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acquire activity-based stock in the FHLB concurrent with such borrowings. The FHLBs also determine the fair value of the securities pledged as collateral and retain the right to adjust collateral haircuts over the term of the secured borrowings.

***Asset Sales and TBA Eligible Securities***

We maintain a portfolio of highly liquid mortgage-backed securities. We may sell our agency securities through the TBA market by delivering them into TBA contracts, subject to "good delivery" provisions promulgated by Securities Industry and Financial Markets Association ("SIFMA"). We may alternatively sell agency securities that have more unique attributes on a specified basis when such securities trade at a premium over generic TBA securities or if the securities are not otherwise eligible for TBA delivery. Since the TBA market is the second most liquid market (second to the U.S. Treasury market), maintaining a significant level of agency securities eligible for TBA delivery enhances our liquidity profile and provides price support for our TBA eligible securities at or above generic TBA prices. As of September 30, 2016, approximately 86% of our fixed rate agency MBS portfolio was eligible for TBA delivery.

***Equity Capital***

To the extent we raise additional equity capital through follow-on equity offerings or under our dividend reinvestment and direct stock purchase plan, we may use cash proceeds from such transactions to purchase additional investment securities, to make scheduled payments of principal and interest on our funding liabilities and for other general corporate purposes. There can be no assurance, however, that we will be able to raise additional equity capital at any particular time or on any particular terms. Furthermore, when the trading price of our common stock is significantly less than our estimate of our current net asset value per common share, among other conditions, we may repurchase shares of our common stock.

*Common Stock Repurchase Program*

In October 2012, our Board of Directors adopted a program that provided for stock repurchases, which, as amended, authorized repurchases of our common stock up to $2 billion through December 31, 2016. As of September 30, 2016, the total remaining amount authorized for repurchases of our common stock was $0.6 billion. In October 2016, our Board of Directors terminated our existing stock repurchase program and replaced it with a new stock repurchase authorization. Under the new stock repurchase program, we are authorized to repurchase up to $1 billion of our outstanding shares of common stock through December 31, 2017. (See Note 9 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q for additional details). During the nine months ended September 30, 2016, we repurchased 6.5 million shares of our common stock at an average repurchase price of $17.89 per share, including expenses, totaling $116 million.

**OFF-BALANCE SHEET ARRANGEMENTS**

As of September 30, 2016, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of September 30, 2016, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

**FORWARD-LOOKING STATEMENTS**

This document contains "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) that inherently involve risks and uncertainties. Our actual results and liquidity can differ materially from those anticipated in these forward-looking statements because of changes in the level and composition of our investments and other factors. These factors may include, but are not limited to, changes in general economic conditions, the availability of suitable investments from both an investment return and regulatory perspective, the availability of new investment capital, fluctuations in interest rates and levels of mortgage prepayments, deterioration in credit quality and ratings, the effectiveness of risk management strategies, the impact of leverage, liquidity of secondary markets and credit markets, increases in costs and other general competitive factors.

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**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate, prepayment, spread, liquidity, extension, credit and inflation risk.

***Interest Rate Risk***

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the mortgage securities that constitute our investment portfolio, which affects our net income and ability to realize gains from the sale of these assets and impacts our ability and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations. The principal instruments that we use are interest rate swaps and swaptions. We also utilize U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales, as well as TBA contracts. We may also purchase or write put or call options on TBA securities and invest in mortgage and other types of derivative instruments, such as interest and principal-only securities. Derivative instruments may expose us to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of our common stock and that the losses may exceed the amount we invested in the instruments.

Our profitability and the value of our investment portfolio (including derivatives used for hedging purposes) may be adversely affected during any period as a result of changing interest rates including changes in the forward yield curve.

Primary measures of an instrument's price sensitivity to interest rate fluctuations are its duration and convexity. Duration measures the estimated percentage change in market value of our mortgage assets or our hedge portfolio that would be caused by a parallel change in short and long-term interest rates. The duration of our investment portfolio changes with interest rates and tends to increase when interest rates rise and decrease when interest rates fall. This "negative convexity" generally increases the interest rate exposure of our investment portfolio in excess of what is measured by duration alone.

We estimate the duration and convexity of our portfolio using both a third-party risk management system and market data. We review the duration estimates from the third-party model and may make adjustments based on our judgment. These adjustments are intended to better reflect the unique characteristics and market trading conventions associated with certain types of securities.

The table below quantifies the estimated changes in (i) net interest income (including periodic interest costs on our interest rate swaps); (ii) the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes); and (iii) our net asset value as of September 30, 2016 and December 31, 2015 should interest rates go up or down by 50 and 100 basis points, assuming instantaneous parallel shifts in the yield curve and including the impact of both duration and convexity.

All changes in income and value in the table below are measured as percentage changes from the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of September 30, 2016 and December 31, 2015. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and the variable leg of our interest rate swaps, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate changes on a static portfolio, we actively manage our portfolio and we continuously make adjustments to the size and composition of our asset and hedge portfolio.

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**Interest Rate Sensitivity 1**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Percentage Change in Projected** | | | | |  |
|  |  |  |  |  | **Portfolio Market** | | |  |
| **Change in Interest Rate** |  | **Net Interest Income 2** |  |  | **Value 3,4** |  |  | **Net Asset Value 3,5** |
| **As of September 30, 2016** | |  |  |  |  |  |  |  |
| -100 Basis Points | | -21.0% | -0.6% | | |  |  | -5.3% |
| -50 Basis Points | | -5.8% | -0.1% | | |  |  | -0.8% |
| +50 Basis Points | | +3.7% | -0.4% | | |  |  | -3.4% |
| +100 Basis Points | | +4.9% | -1.3% | | |  |  | -10.5% |
|  |  |  |  |  |  |  |  |  |
| **As of December 31, 2015** | |  |  |  |  |  |  |  |
| -100 Basis Points | | -17.3% | -0.4% | | |  |  | -2.8% |
| -50 Basis Points | | -4.2% | +0.1% | | |  |  | +0.6% |
| +50 Basis Points | | +2.0% | -0.5% | | |  |  | -3.7% |
| +100 Basis Points | | +2.5% | -1.2% | | |  |  | -9.4% |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties, assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.
2. Represents the estimated dollar change in net interest income expressed as a percent of net interest income based on asset yields and cost of funds as of such date. It includes the effect of periodic interest costs on our interest rate swaps, but excludes costs associated with our forward starting swaps and other supplemental hedges, such as swaptions and U.S. Treasury securities. Amounts also exclude costs associated with our TBA position and TBA dollar roll income/loss, which are accounted for as derivative instruments in accordance with GAAP. Base case scenario assumes interest rates and forecasted CPR of 11% and 8% as of September 30, 2016 and December 31, 2015, respectively. As of September 30, 2016, rate shock scenarios assume a forecasted CPR of 16%, 13%, 9% and 8% for the -100, -50, +50 and +100 basis points scenarios, respectively. As of December 31, 2015, rate shock scenarios assume a forecasted CPR of 12%, 10%, 8% and 7% for such scenarios, respectively. Estimated dollar change in net interest income does not include the impact of retroactive "catch-up" premium amortization adjustments due to changes in our forecasted CPR. Down rate scenarios assume a floor of 0% for anticipated interest rates.
3. Includes the effect of derivatives and other securities used for hedging purposes.
4. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.
5. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A and Series B Preferred Stock liquidation preference, as of such date.

***Prepayment Risk***

Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Various factors affect the rate at which mortgage prepayments occur, including changes in the level of and directional trends in housing prices, interest rates, general economic conditions, loan age and size, loan-to-value ratio, the location of the property and social and demographic conditions. Additionally, changes to GSE underwriting practices or other governmental programs could also significantly impact prepayment rates or expectations. Also, the pace at which the loans underlying our securities become seriously delinquent or are modified and the timing of GSE repurchases of such loans from our securities can materially impact the rate of prepayments. Generally, prepayments on residential mortgage-backed securities increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case.

We may reinvest principal repayments at a yield that is lower or higher than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets. We also amortize or accrete premiums and discounts associated with the purchase of mortgage securities into interest income over the projected lives of the securities, including contractual payments and estimated prepayments using the effective interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate published prepayment data for similar securities, market consensus and current market conditions. If the actual prepayment experienced differs from our estimate of prepayments, we will be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

***Spread Risk***

When the market spread between the yield on our investment securities and benchmark interest rates widens, our net book value could decline if the value of our investment securities fall by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk." The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or

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anticipated monetary policy actions by the Federal Reserve, market liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

The table below quantifies the estimated changes in the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes) and in our net asset value as of September 30, 2016 and December 31, 2015 should spreads widen or tighten by 10 and 25 basis points. The estimated impact of changes in spreads is in addition to our interest rate shock sensitivity included in the interest rate shock table above. The table below assumes a spread duration of 4.5 years and 5.2 years as of September 30, 2016 and December 31, 2015, respectively, based on interest rates and MBS prices as of such dates. However, our portfolio's sensitivity of mortgage spread changes will vary with changes in interest rates and in the size and composition of our investment portfolio. Therefore, actual results could differ materially from our estimates.

**Spread Sensitivity of Agency MBS Portfolio 1**



|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **Percentage Change in Projected** | | |
|  |  | **Portfolio** | |  |
|  |  | **Market** | | **Net Asset** |
| **Change in MBS Spread** |  | **Value 2,3** |  | **Value 2,4** |
| **As of September 30, 2016** | |  |  |  |
| -25 Basis Points | | +1.1% |  | +9.3% |
| -10 Basis Points | | +0.5% |  | +3.7% |
| +10 Basis Points | | -0.5% |  | -3.7% |
| +25 Basis Points | | -1.1% |  | -9.3% |
|  |  |  |  |  |
| **As of December 31, 2015** | |  |  |  |
| -25 Basis Points | | +1.3% |  | +10.2% |
| -10 Basis Points | | +0.5% |  | +4.1% |
| +10 Basis Points | | -0.5% |  | -4.1% |
| +25 Basis Points | | -1.3% |  | -10.2% |



\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Spread sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties, assumes there are no changes in interest rates and assumes a static portfolio. Actual results could differ materially from these estimates.
2. Includes the effect of derivatives and other securities used for hedging purposes.
3. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.
4. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A and Series B Preferred Stock liquidation preference, as of such date.

***Liquidity Risk***

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements, FHLB advances and other short-term funding agreements. As of September 30, 2016, we had unrestricted cash and cash equivalents of $1.3 billion and unpledged securities of approximately $2.2 billion, including securities pledged to us and unpledged interests in our consolidated VIEs, available to meet margin calls on our funding liabilities and derivative contracts and for other corporate purposes. However, should the value of our collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our funding liabilities and derivative agreements could increase, causing an adverse change in our liquidity position. Furthermore, there is no assurance that we will always be able to renew (or roll) our short-term funding liabilities. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge against our funding liabilities, thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll such funding liabilities. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

In addition, we often utilize TBA dollar roll transactions as a means of investing in and financing agency mortgage-backed securities. Under certain economic conditions it may be uneconomical to roll our TBA dollar roll transactions prior to the settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash, which could negatively impact our liquidity position, result in defaults or force us to sell assets under adverse conditions.

***Extension Risk***

The projected weighted-average life and estimated duration, or interest rate sensitivity, of our investments is based on our assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use interest rate

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swaps and swaptions to help manage our funding cost on our investments in the event that interest rates rise. These swaps (or swaptions) allow us to reduce our funding exposure on the notional amount of the swap for a specified period of time by establishing a fixed rate to pay in exchange for receiving a floating rate that generally tracks our financing costs under our funding liabilities.

However, if prepayment rates decrease in a rising interest rate environment, the average life or duration of our fixed rate assets generally extends. This could have a negative impact on our results from operations, as our interest rate swap maturities are fixed and will, therefore, cover a smaller percentage of our funding exposure on our mortgage assets to the extent that their average lives increase due to slower prepayments. This situation may also cause the market value of our fixed rate securities to decline by more than otherwise would be the case while most of our hedging instruments would not receive any incremental offsetting gains. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses.

***Credit Risk***

We are exposed to credit risk related to our CRT and non-agency investments, certain derivative transactions, and our collateral held by funding and derivative counterparties. We accept credit exposure at levels we deem prudent as an integral part of our investment and hedging strategy. We seek to manage this risk through prudent asset selection, pre-acquisition due diligence, post-acquisition performance monitoring, sale of assets where we have identified negative credit trends and the use of various types of credit enhancements. We may also use non-recourse financing, which limits our exposure to credit losses to the specific pool of mortgages subject to the non-recourse financing. Our overall management of credit exposure may also include the use of credit default swaps or other financial derivatives that we believe are appropriate. Additionally, we intend to vary the percentage mix of our investments in an effort to actively adjust our credit exposure and to improve the risk/return profile of our investment portfolio. Our credit risk related to certain derivative transactions is largely mitigated through daily adjustments to collateral pledged based on changes in market value and we limit our counterparties to major financial institutions with acceptable credit ratings. There is no guarantee that our efforts to manage credit risk will be successful and we could suffer losses if credit performance is worse than our expectations or if economic conditions worsen.

***Inflation Risk***

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Further, our consolidated financial statements are prepared in accordance with GAAP and our distributions are determined by our Board of Directors based in part on our net income as calculated for income tax purposes. In each case, our activities and consolidated balance sheets are measured with reference to historical cost and/or fair market value without considering inflation.

**Item 4. *Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934, as amended (the "Exchange Act") reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" as promulgated under the Exchange Act and the rules and regulations thereunder. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2016. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

***Changes in Internal Control over Financial Reporting***

There have been no changes in our "internal control over financial reporting" (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As previously disclosed, we completed the acquisition of AMM on July 1, 2016. Where appropriate, we are reviewing related internal controls and making changes to align and integrate AMM into our financial control environment. This initiative is being done as a part of our integration plan and is not in response to any identified deficiency or weakness in the Company’s or AMM’s internal control over financial reporting.

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**PART II.**

**Item 1. *Legal Proceedings***

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. Neither we, nor any of our consolidated subsidiaries, are currently subject to any material litigation nor, to our knowledge, is any material litigation threatened against us or any consolidated subsidiary.

**Item 1A. *Risk Factors***

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

**Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds***

None.

**Item 3. *Defaults upon Senior Securities***

None.

**Item 4. *Mine Safety Disclosures***

Not applicable.

**Item 5. *Other Information***

None.

**Item 6.** ***Exhibits and Financial Statement Schedules***

1. Exhibit Index

**Exhibit No.** **Description**

3.1 AGNC Investment Corp. Amended and Restated Certificate of Incorporation, effective September 30, 2016, filed herewith.

3.2 AGNC Investment Corp. Third Amended and Restated Bylaws, effective September 30, 2016, filed herewith.

\*3.3 Certificate of Designations of 8.000% Series A Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.1 of Form 8-K (File No 001-34057), filed April 3, 2012.

\*3.4 Certificate of Designations of 7.750% Series B Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.3 of Form 8-A (File No. 001-34057), filed May 7, 2014.

4.1 Instruments defining the rights of holders of securities: See Article IV of our Amended and Restated Certificate of Incorporation, filed herewith.

4.2 Instruments defining the rights of holders of securities: See Article VI of our Third Amended and Restated Bylaws, filed herewith.

4.3 Form of Certificate for Common Stock, filed herewith.

\*4.4 Specimen 8.000% Series A Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-K (File No. 001-34057), filed April 3, 2012.

\*4.5 Specimen 7.750% Series B Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-A (File No. 001-34057), filed May 7, 2014.

\*4.6 Deposit Agreement, dated May 8, 2014, among American Capital Agency Corp., Computershare Inc. and Computershare Trust Company, N.A., jointly as depositary, incorporated herein by reference to Exhibit

4.2 of Form 8-K (File No. 001-34067), filed May 8, 2014.

\*4.7 Form of Depositary Receipt, incorporated herein by reference to Exhibit 4.3 of Form 8-K (File No. 001-34067), filed May 8, 2014.

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| \*10.1 | Employment Agreement, dated September 22, 2014, as amended on July 1, 2016, by and between American Capital Mortgage Management, LLC and Gary Kain, incorporated herein by reference to Exhibit 10.1 |
|  | of Form 8-K (File No. 001-34057), filed July 8, 2016. |
| \*10.2 | Employment Agreement, dated March 30, 2012, as amended on July 1, 2016, by and between American Capital Mortgage Management, LLC and Peter J. Federico, incorporated herein by reference to Exhibit |
|  | 10.2 of Form 8-K (File No. 001-34057), filed July 8, 2016. |
| \*10.3 | Employment Agreement, dated March 30, 2012, as amended on July 1, 2016, by and between American Capital Mortgage Management, LLC and Christopher J. Kuehl, incorporated herein by reference to |
|  | Exhibit 10.3 of Form 8-K (File No. 001-34057), filed July 8, 2016. |
| \*10.4 | Letter Agreement, dated December 1, 2015, as amended on July 1, 2016, by and between American Capital Mortgage Management, LLC and Bernice E. Bell, incorporated herein by reference to Exhibit 10.4 of |
|  | Form 8-K (File No. 001-34057), filed July 8, 2016. |
| \*10.5 | Retention Bonus Grant Letter, dated July 1, 2016, by and between American Capital Mortgage Management, LLC and Bernice E. Bell, incorporated herein by reference to Exhibit 10.5 of Form 8-K (File No. |
|  | 001-34057), filed July 8, 2016. |
| \*10.6 | Transition Services Agreement, dated July 1, 2016, by and among American Capital Agency Corp., American Capital, Ltd., American Capital Asset Management, LLC and American Capital Mortgage |
|  | Management, LLC, incorporated herein by reference to Exhibit 2.1 of Form 8-K (File No. 001-34057), filed July 8, 2016. |
| 31.1 | Certification of CEO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of CFO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS\*\* | XBRL Instance Document |
| 101.SCH\*\* | XBRL Taxonomy Extension Schema Document |
| 101.CAL\*\* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB\*\* | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE\*\* | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF\*\* | XBRL Taxonomy Extension Definition Linkbase Document |

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* Previously filed
* This exhibit is being furnished rather than filed, and shall not be deemed incorporated by reference into any filing, in accordance with Item 601 of Regulation S-K
  1. Exhibits

See the exhibits filed herewith.

* 1. Additional financial statement schedules None.

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**SIGNATURES**

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

|  |  |  |  |
| --- | --- | --- | --- |
|  | AGNC INVESTMENT CORP. | |  |
|  | By: | | /s/ PETER FEDERICO |
|  |  |  | **Peter Federico** |
|  |  |  | **Chief Financial Officer and** |
|  |  |  | **Executive Vice President (Principal Financial Officer)** |
| Date: | November 7, 2016 | |  |
|  |  |  | /s/ GARY KAIN |
|  |  |  | **Gary Kain** |
|  |  |  | **Chief Executive Officer, President and** |
|  |  |  | **Chief Investment Officer (Principal Executive Officer)** |
| Date: | November 7, 2016 | |  |
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Exhibit 3.1

AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION

OF

AGNC INVESTMENT CORP.

As amended and in effect through September 30, 2016

ARTICLE I

NAME

The name of the Corporation is AGNC Investment Corp.

ARTICLE II

ADDRESS OF REGISTERED OFFICE; NAME OF REGISTERED AGENT

The address of the registered office of the Corporation in the State of Delaware is 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at that address is The Corporation Trust Company.

ARTICLE III

PURPOSE AND POWER

The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law.

ARTICLE IV

CAPITAL STOCK

Section 4.1. Total Number of Shares of Capital Stock. The total number of shares of capital stock of all classes that the Corporation shall have authority to issue is 610,000,000 shares. The authorized stock is divided into 10,000,000 shares of preferred stock, with the par value of $0.01 each (the “Preferred Stock”), and 600,000,000 shares of common stock, with the par value of $0.01 each (the “Common Stock”). The Board of Directors of the Corporation (the “Board of Directors”) may classify any unissued shares of stock and reclassify any previously classified but unissued shares of stock from time to time, in one or more classes or series of stock.

Section 4.2 Preferred Stock. Authority is hereby expressly granted to the Board of Directors of the Corporation (the "Board of Directors"), subject to the provisions of this Article IV and to the limitations prescribed by the General Corporation Law, to authorize the issue of one or more classes of Preferred Stock and, with respect to each such class, to fix by resolution or resolutions providing for the issue of such class the voting powers, full or limited, if any, of the shares of such class, the designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof. The authority of the Board of Directors with respect to each class thereof shall include, but not be limited to, the determination or fixing of the following:

(a) the designation of such class;

1. the number of shares to compose such class, which number the Board of Directors may thereafter (except where otherwise provided in a resolution designating a particular class) increase (but not above the total number of authorized shares of the class) or decrease (but not below the number of shares thereof then outstanding);
2. the dividend rate of such class, the conditions and dates upon which such dividends shall be payable, the relation which such dividends shall bear to the dividends payable on any other class or classes of capital stock of the Corporation and whether such dividends shall be cumulative or noncumulative;
3. whether the shares of such class shall be subject to redemption by the Corporation and, if made subject to such redemption, the times, prices and other terms and conditions of

such redemption;

1. the terms and amount of any sinking fund provided for the purchase or redemption of the shares of such class;
2. whether the shares of such class shall be convertible into or exchangeable for shares of any other class or classes of any capital stock or any other securities of the Corporation, and, if provision is made for conversion or exchange, the times, prices, rates, adjustments and other terms and conditions of such conversion or exchange;
3. the extent, if any, to which the holders of shares of such class shall be entitled to vote with respect to the election of directors or otherwise;
4. the restrictions, if any, on the issue or reissue of any additional Preferred Stock;
5. the rights of the holders of the shares of such class upon the dissolution of, voluntary or involuntary liquidation, winding up or upon the distribution of assets of the Corporation;

and

1. the manner in which any facts ascertainable outside the resolution or resolutions providing for the issue of such class shall operate upon the voting powers, designations, preferences, rights and qualifications, limitations or restrictions of such class.

Section 4.3 Common Stock. (a) Subject to all of the rights of the holders of Preferred Stock provided for by resolution or resolutions of the Board of Directors pursuant to this Article IV or by the General Corporation Law, each holder of Common Stock shall have one vote per share of Common Stock held by such holder on all matters on which holders of Common Stock are entitled to vote and shall have the right to receive notice of and to vote at all meetings of the stockholders of the Corporation.

1. The holders of Common Stock shall have the right to receive dividends as and when declared by the Board of Directors in its sole discretion, subject to any limitations on the declaring of dividends imposed by the General Corporation Law or the rights of holders of Preferred Stock provided for by resolution or resolutions of the Board of Directors pursuant to this Article IV.
2. Stockholders shall not have preemptive rights to acquire additional shares of stock of any class which the Corporation may elect to issue or sell.

Section 4.4 Issuance of Rights to Purchase Securities and Other Property. Subject to all of the rights of the holders of Preferred Stock provided for by resolution or resolutions of the Board of Directors pursuant to this Article IV or by the General Corporation Law, the Board of Directors is hereby authorized to create and to authorize and direct the issuance (on either a pro rata or a non-pro rata basis) by the Corporation of rights, options and warrants for the purchase of shares of capital stock of the Corporation, other securities of the Corporation or shares or other securities of any successor in interest of the Corporation (a "Successor"), at such times, in such amounts, to such persons, for such consideration, with such form and content (including without limitation the consideration for which any shares of capital

stock of the Corporation, other securities of the Corporation or shares or other securities of any Successor are to be issued) and upon such terms and conditions as it may from time to time determine, subject only to the restrictions, limitations, conditions and requirements imposed by the General Corporation Law, other applicable laws and this Certificate of Incorporation.

Section 4.5 Certificate of Incorporation and By-laws. All persons who shall acquire stock in the Corporation shall acquire the same subject to the provisions of the Certificate of Incorporation and the By-laws of the Corporation (the "By-laws").

ARTICLE V

BOARD OF DIRECTORS

Section 5.1 Power of the Board of Directors. The business and affairs of the Corporation shall be managed by or under the direction of its Board of Directors. In furtherance, and not in limitation, of the powers conferred by the General Corporation Law, the Board of Directors is expressly authorized to:

1. adopt, amend, alter, change or repeal the By-laws; provided, however, that no By-laws hereafter adopted shall invalidate any prior act of the directors that was valid at the time such

action was taken;

1. determine the rights, powers, duties, rules and procedures that affect the power of the Board of Directors to manage and direct the business and affairs of the Corporation, including the power to designate and empower committees of the Board of Directors to elect, appoint and empower the officers and other agents of the Corporation, and to determine the time and place of, and the notice requirements for, Board meetings, as well as quorum and voting requirements for, and the manner of taking, Board action; and
2. exercise all such powers and do all such acts as may be exercised or done by the Corporation, subject to the provisions of the General Corporation Law, this Certificate of Incorporation and the By-laws.

Section 5.2 Number of Directors. The number of directors constituting the Board of Directors shall be as specified in the By-laws of the Corporation.

Section 5.3 Classes, Election and Term. The directors shall be elected by the stockholders at each annual meeting of the stockholders for a one-year term. The term of all current directors will end at the 2009 annual meeting of stockholders. Commencing with the 2009 annual meeting of stockholders, each director shall hold office for a one-year term and until such director's successor shall have been duly elected and qualified.

Section 5.4 Vacancies. Any vacancies in the Board of Directors for any reason and any newly created directorships resulting by reason of any increase in the number of directors may be filled only by the Board of Directors, acting by a majority of the remaining directors then in office, although less than a quorum, or by a sole remaining director, and any directors so appointed shall hold office until the next annual election of directors and until their successors are duly elected and qualified.

Section 5.5 Removal of Directors. Except as may be provided in a resolution or resolutions providing for any class of Preferred Stock pursuant to Article IV hereof, with respect to any directors elected by the holders of such class, any director, or the entire Board of Directors, may be removed from office at any time with or without cause by the affirmative vote of the holders of at least sixty-six percent (66%) of the voting power of all of the shares of capital stock of the Corporation then entitled to vote generally in the election of directors, voting together as a single class.

Section 5.6 REIT Qualification. If the Corporation elects to qualify for federal income tax treatment as a REIT (as defined in Article VIII hereof), the Board of Directors shall use its reasonable best efforts to take such actions as are necessary or appropriate to preserve the qualification of the Corporation as a REIT; however, if the Board of Directors determines that it is no longer in the best interests of the Corporation to continue to be qualified as a REIT, the Board of Directors may revoke or otherwise terminate the Corporation's REIT election pursuant to Section 856(g) of the Code (as defined in Article VIII hereof). The Board of Directors also may determine that compliance with any restriction or limitation on stock ownership and transfers set forth in Article VIII hereof is no longer required for REIT qualification.

ARTICLE VI

STOCKHOLDER ACTION

Except as may be provided in a resolution or resolutions providing for any class of Preferred Stock pursuant to Article IV hereof, any action required or permitted to be taken by the stockholders of the Corporation must be effected at a duly called annual or special meeting of such holders and may not be effected by any consent in writing by such holders. Meetings of stockholders may be held within or without the State of Delaware, as the By-laws may provide. Elections of directors need not be by written ballot, unless otherwise provided in the By-laws of the Corporation.

ARTICLE VII

INDEMNIFICATION

Section 7.1 Right to Indemnification. Each person who was or is made a party or is threatened to be made a party to or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (hereinafter a "proceeding"), by reason of the fact:

1. that he or she is or was a director or officer of the Corporation, or
2. that he or she, being at the time a director or officer of the Corporation, is or was serving at the request of the Corporation as a director, trustee, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise (collectively, "another enterprise" or "other enterprise"),

whether either in case (a) or in case (b) the basis of such proceeding is alleged action or inaction (x) in an official capacity as a director or officer of the Corporation, or as a director, trustee, officer, employee or agent of such other enterprise, or (y) in any other capacity related to the Corporation or such other enterprise while so serving as a director, trustee, officer, employee or agent, shall be indemnified and held harmless by the Corporation to the fullest extent not prohibited by Section 145 of the General Corporation Law, (or any successor provision or provisions, respectively) as the same exists or may hereafter be amended, respectively (but, in the case of any amendment to Section 145 of the General Corporation Law, with respect to actions taken prior to such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than permitted prior thereto), against all expense, liability and loss (including, without limitation, attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid in settlement) reasonably incurred or suffered by such person in connection therewith if such person satisfied the applicable level of care to permit such indemnification under the General Corporation Law; provided however, that nothing in this Article VII shall indemnify any person to the extent that such person has committed willful misfeasance, bad faith, gross negligence or reckless disregard involved in the conduct of such person's duties to or for the Corporation. The persons indemnified by this Article VII are hereinafter referred to as "indemnities." Such indemnification as to

such alleged action or inaction shall continue as to an indemnitee who has after such alleged action or inaction ceased to be a director or officer of the Corporation, or director, officer, employee or agent of another enterprise; and shall inure to the benefit of the indemnitee's heirs, executors and administrators. The right to indemnification conferred in this Article VII: (i) shall be a contract right;

1. shall not be affected adversely as to any indemnitee by any amendment of this Certificate with respect to any action or inaction occurring prior to such amendment; and (iii) shall, subject to any requirements imposed by law and the By-laws, include the right to be paid by the Corporation the expenses incurred in defending any such proceeding in advance of its final disposition.

Section 7.2. Relationship to Other Rights and Provisions Concerning Indemnification. The rights to indemnification and to the advancement of expenses conferred in this Article VII shall not be exclusive of any other right which any person may have or hereafter acquire under any statute, this Certificate, By-laws, agreement, vote of stockholders or disinterested directors or otherwise. The By-laws may contain such other provisions concerning indemnification, including provisions specifying reasonable procedures relating to and conditions to the receipt by indemnitees of indemnification, provided that such provisions are not inconsistent with the provisions of this Article VII.

Section 7.3 Agents and Employees. The Corporation may, to the extent authorized from time to time by the Board of Directors, grant rights to indemnification, and to the advancement of expenses, to any agent of the Corporation (or any person serving at the Corporation's request as a director, trustee, officer, employee or agent of another enterprise) or to persons who are or were a director, officer, employee or agent of any of the Corporation's affiliates, predecessor or subsidiary corporations or of a constituent corporation absorbed by the Corporation in a consolidation or merger or who is or was serving at the request of such affiliate, predecessor or subsidiary corporation or of such constituent corporation as a director, officer, employee or agent of another enterprise, in each case as determined by the Board of Directors to the fullest extent of the provisions of this Article VII in cases of the indemnification and advancement of expenses of directors and officers of the Corporation, or to any lesser extent (or greater extent, if permitted by law) determined by the Board of Directors.

ARTICLE VIII

RESTRICTION ON TRANSFER AND OWNERSHIP OF SHARES

Section 8.1 Definitions. For the purpose of this Article VIII, the following terms shall have the following meanings:

Aggregate Stock Ownership Limit. The term “Aggregate Stock Ownership Limit” shall mean not more than 9.8 percent (in value or in number of shares, whichever is more restrictive) of the aggregate of the outstanding shares of Capital Stock, subject to the Board of Directors' power under Section 8.2.8 hereof to increase or decrease such percentage. The value and number of the outstanding shares of Capital Stock shall be determined by the Board of Directors of the Corporation in good faith, which determination shall be conclusive for all purposes hereof. For the purposes of determining the percentage ownership of Capital Stock by any Person, shares of Capital Stock that may be acquired upon conversion, exchange or exercise of any securities of the Corporation directly or constructively held by such Person, but not Capital Stock issuable with respect to the conversion exchange or exercise of securities for the Corporation held by other Persons shall be deemed to be outstanding prior to conversion, exchange or exercise.

Beneficial Ownership. The term “Beneficial Ownership” shall mean ownership of Capital Stock by a Person, whether the interest in the shares of Capital Stock is held directly or indirectly (including by a nominee), and shall include interests that would be treated as owned through the application of Section 544 of the Code, as modified by Sections 856(h)(1)(B) and 856(h)(3) of the Code.

The terms “Beneficial Owner,” “Beneficially Owns” and “Beneficially Owned” shall have the correlative meanings.

Business Day. The term “Business Day” shall mean any day, other than a Saturday or Sunday, that is neither a legal holiday nor a day on which banking institutions in New York City are authorized or required by law, regulation or executive order to close.

Capital Stock. The term “Capital Stock” shall mean all classes or series of stock of the Corporation, including, without limitation, Common Stock and Preferred Stock.

Charitable Beneficiary. The term “Charitable Beneficiary” shall mean one or more beneficiaries of the Trust as determined pursuant to Section 8.3.6, provided that each such organization must be described in Section 501(c)(3) of the Code and contributions to each such organization must be eligible for deduction under each of Sections 170(b)(1)(A), 2055 and 2522 of the Code.

Certificate of Incorporation. The term “Certificate of Incorporation” shall mean the Certificate of Incorporation of the Corporation.

Code. The term “Code” shall mean the Internal Revenue Code of 1986, as amended from time to time.

Common Stock Ownership Limit. The term “Common Stock Ownership Limit” shall mean not more than 9.8 percent (in value or in number of shares, whichever is more restrictive) of the aggregate of the outstanding shares of Common Stock, subject to the Board of Directors' power under Section 8.2.8 hereof to increase or decrease such percentage. The number and value of the outstanding shares of Common Stock of the Corporation shall be determined by the Board of Directors of the Corporation in good faith, which determination shall be conclusive for all purposes hereof. For purposes of determining the percentage ownership of Common Stock by any Person, shares of Common Stock that may be acquired upon conversion, exchange or exercise of any securities of the Corporation directly or constructively held by such Person, but not Common Stock issuable with respect to the conversion, exchange or exercise of securities for the Corporation held by other Persons, shall be deemed to be outstanding prior to conversion, exchange or exercise.

Constructive Ownership. The term “Constructive Ownership” shall mean ownership of Capital Stock by a Person, whether the interest in the shares of Capital Stock is held directly or indirectly (including by a nominee), and shall include interests that would be treated as owned actually or constructively through the application of Section 318(a) of the Code, as modified by Section 856(d)(5) of the Code. The terms “Constructive Owner,” “Constructively Owns” and “Constructively Owned” shall have the correlative meanings.

Excepted Holder. The term “Excepted Holder” shall mean a Person for whom an Excepted Holder Limit is created by the Certificate of Incorporation or by the Board of Directors pursuant to Section 8.2.7.

Excepted Holder Limit. The term “Excepted Holder Limit” shall mean, provided that the affected Excepted Holder agrees to comply with the requirements established by the Certificate of Incorporation or by the Board of Directors pursuant to Section 7.2.7 and subject to adjustment pursuant to Section 8.2.8, the percentage limit established for an Excepted Holder by the Board of Directors pursuant to Section 8.2.7.

Initial Date. The term “Initial Date” shall mean the date upon which the Amended and Restated Certificate of Incorporation containing this Article VIII are filed with the Delaware Secretary of State.

Market Price. The term “Market Price” on any date shall mean, with respect to any class or series of outstanding shares of Capital Stock, the Closing Price for such Capital Stock on such date. The “Closing Price” on any date shall mean the last reported sale price for such Capital Stock, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, for such Capital Stock, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on Nasdaq or, if such Capital Stock is not listed or admitted to trading on Nasdaq, as reported on the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which such Capital Stock is listed or admitted to trading or, if such Capital Stock is not listed or admitted to trading on any national securities exchange, the last quoted price, or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by the National Association of Securities Dealers, Inc. Automated Quotation System or, if such system is no longer in use, the principal other automated quotation system that may then be in use or, if such Capital Stock is not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in such Capital Stock selected by the Board of Directors of the Corporation or, in the event that no trading price is available for such Capital Stock, the fair market value of the Capital Stock, as determined in good faith by the Board of Directors of the Corporation.

General Corporation Law. The term “General Corporation Law” shall mean the Delaware General Corporation Law, as amended from time to time.

Nasdaq. The term “Nasdaq” shall mean The NASDAQ Stock Market, Inc.

Person. The term “Person” shall mean an individual, corporation, partnership, limited liability company, estate, trust (including a trust qualified under Sections 401(a) or 501(c)(17) of the Code), a portion of a trust permanently set aside for or to be used exclusively for the purposes described in Section 642(c) of the Code, association, private foundation within the meaning of Section 509(a) of the Code, joint stock company or other entity and also includes a group as that term is used for purposes of Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, and a group to which an Excepted Holder Limit applies.

Prohibited Owner. The term “Prohibited Owner” shall mean, with respect to any purported Transfer (or other event), any Person who, but for the provisions of Section 8.2.1, would Beneficially Own or Constructively Own shares of Capital Stock in violation of the provisions of 8.2.1(a) and, if appropriate in the context, shall also mean any Person who would have been the record owner of the shares of Capital Stock that the Prohibited Owner would have so owned.

REIT. The term “REIT” shall mean a real estate investment trust within the meaning of Section 856 of the Code.

Restriction Termination Date. The term “Restriction Termination Date” shall mean the first day after the Initial Date on which the Corporation determines pursuant to Section 5.6 of the Certificate of Incorporation that it is no longer in the best interests of the Corporation to attempt to, or continue to, qualify as a REIT or that compliance with the restrictions and limitations on Beneficial Ownership, Constructive Ownership and Transfers of shares of Capital Stock set forth herein is no longer required in order for the Corporation to qualify as a REIT.

Transfer. The term “Transfer” shall mean any issuance, sale, transfer, gift, assignment, devise or other disposition, as well as any other event that causes any Person to acquire Beneficial Ownership or Constructive Ownership, or any agreement to take any such actions or cause any such events, of Capital Stock or the right to vote or receive dividends on Capital Stock, including (a) the granting or exercise of any option (or any disposition of any option), (b) any disposition of any securities or rights convertible into or exchangeable for Capital Stock or any interest in Capital Stock or any

exercise of any such conversion or exchange right and (c) Transfers of interests in other entities that result in changes in Beneficial or Constructive Ownership of Capital Stock; in each case, whether voluntary or involuntary, whether owned of record, Constructively Owned or Beneficially Owned and whether by operation of law or otherwise. The terms “Transferring” and “Transferred” shall have the correlative meanings.

Trust. The term “Trust” shall mean any trust provided for in Section 8.3.1.

Trustee. The term “Trustee” shall mean the Person unaffiliated with the Corporation and a Prohibited Owner, that is appointed by the Corporation to serve as trustee of the Trust.

Section 8.2 Capital Stock.

Section 8.2.1 Ownership Limitations. During the period commencing on the Initial Date and prior to the Restriction Termination Date:

1. Basic Restrictions.
   1. (1) No Person, other than an Excepted Holder, shall Beneficially Own or Constructively Own either shares of Capital Stock in excess of the Aggregate Stock Ownership Limit or shares of Common Stock in excess of the Common Stock Ownership Limit and (2) no Excepted Holder shall Beneficially Own or Constructively Own shares of Capital Stock in excess of the Excepted Holder Limit for such Excepted Holder.
   2. No Person shall Beneficially or Constructively Own shares of Capital Stock to the extent that such Beneficial or Constructive Ownership of Capital Stock would result in the Corporation being “closely held” within the meaning of Section 856(h) of the Code (without regard to whether the ownership interest is held during the last half of a taxable year), or otherwise failing to qualify as a REIT (including, but not limited to, Beneficial or Constructive Ownership to the extent that such Beneficial or Constructive Ownership would result in the Corporation owning (actually or Constructively) a 9.9% interest in a tenant that is described in Section 856(d)(2)(B) of the Code (for this purpose, a tenant from whom the Corporation (or an entity owned or controlled by the Corporation) derives (and is expected to continue to derive) a sufficiently small amount of revenue such that, in the opinion of the Board of Directors of the Corporation, rent from such tenant would not adversely affect the Corporation’s ability to qualify as a REIT, shall not be treated as a tenant of the Corporation)).
   3. Notwithstanding any other provisions contained herein, no Person shall Transfer of shares of Capital Stock (whether or not such Transfer is the result of a transaction entered into through the facilities of Nasdaq or any other national securities exchange or automated inter-dealer quotation system) that, if effective, would result in the Capital Stock being Beneficially Owned by less than 100 Persons (determined under the principles of Section 856(a)(5) of the Code).
2. Transfer in Trust. If any Transfer of shares of Capital Stock (whether or not such Transfer is the result of a transaction entered into through the facilities of Nasdaq or any other national securities exchange or automated inter-dealer quotation system) occurs which, if effective, would result in any Person Beneficially Owning or Constructively Owning shares of Capital Stock in violation of Section 8.2.1(a),
   1. then that number of shares of Capital Stock the Beneficial or Constructive Ownership of which otherwise would cause such Person to violate Section 8.2.1(a) (rounded up to the nearest whole share) shall be automatically transferred to a Trust for the benefit of a Charitable Beneficiary, as described in Section 8.3, effective as of the close of business on the Business Day prior to the date of such Transfer (or other event), and such Person shall acquire no rights in such shares of Capital Stock; or

1. if the transfer to the Trust described in clause (i) of this sentence would not be effective for any reason to prevent the violation of Section 8.2.1(a), then the Transfer of that number of shares of Capital Stock that otherwise would cause any Person to violate Section 8.2.1(a) shall be void ab initio, and the intended transferee shall acquire no rights in such shares of Capital Stock.
2. In determining which shares of Capital Stock are to be transferred to a Trust in accordance with this Section 8.2.1(b) and Section 8.3 hereof, shares shall be so transferred to a Trust in such manner that minimizes the aggregate value of the shares that are transferred to the Trust (except to the extent that the Board of Directors determines that the shares transferred to the Trust shall be those directly or indirectly held or Beneficially Owned or Constructively Owned by a Person or Persons that caused or contributed to the application of this Section 8.2.1(b)), and to the extent not inconsistent therewith, on a pro rata basis.
3. To the extent that, upon a transfer of shares of Capital Stock pursuant to this Section 8.2.1(b), a violation of Section 8.2.1(a) would nonetheless be continuing, (for example where the ownership of shares of Capital Stock by a single Trust would result in the Capital Stock being beneficially owned (determined under the principles of Section 856(a)(5) of the Code) by less than 100 persons), the shares of Capital Stock shall be transferred to that number of Trusts, each having a distinct Trustee and a Charitable Beneficiary or Beneficiaries that are distinct from those of each other Trust, such that there is no violation of Section 8.2.1(a).

Section 8.2.2 Remedies for Breach. If the Board of Directors of the Corporation or any duly authorized committee thereof (or other designees if permitted by the General Corporation Law) shall at any time determine in good faith that a Transfer or other event has taken place that results in a violation of Section 8.2.1(a) or that a Person intends to acquire or has attempted to acquire Beneficial Ownership or Constructive Ownership of any shares of Capital Stock in violation of Section 8.2.1(a) (whether or not such violation is intended), the Board of Directors or a committee thereof (or other designees if permitted by the General Corporation Law) shall take such action as it deems advisable to refuse to give effect to or to prevent such Transfer or other event, including, without limitation, causing the Corporation to redeem shares of Capital Stock, refusing to give effect to such Transfer on the books of the Corporation or instituting proceedings to enjoin such Transfer or other event; provided, however, that any Transfer or attempted Transfer or other event in violation of Section 8.2.1(a) shall automatically result in the transfer to the Trust described above and, where applicable, such Transfer (or other event) shall be void ab initio as provided above irrespective of any action (or non-action) by the Board of Directors or a committee thereof.

Section 8.2.3 Notice of Restricted Transfer. Any Person who acquires or attempts or intends to acquire Beneficial Ownership or Constructive Ownership of shares of Capital Stock that will or may violate Section 8.2.1(a) or any Person who would have owned shares of Capital Stock that resulted in a transfer to the Trust pursuant to the provisions of Section 8.2.1(b) shall immediately give written notice to the Corporation of such event, or in the case of such a proposed or attempted transaction, give at least 15 days prior written notice, and shall provide to the Corporation such other information as the Corporation may request in order to determine the effect, if any, of such Transfer on the Corporation’s qualification as a REIT.

Section 8.2.4 Owners Required to Provide Information. From the Initial Date and prior to the Restriction Termination Date:

1. every owner of more than five percent (or such lower percentage as required by the Code or the Treasury Regulations promulgated thereunder) in number or value of the outstanding shares of Capital Stock, within 30 days after the end of each taxable year, shall give written notice to the Corporation stating the name and address of such owner, the number of shares of Capital Stock and other

shares of the Capital Stock Beneficially Owned and a description of the manner in which such shares are held. Each such owner shall provide to the Corporation such additional information as the Corporation may request in order to determine the effect, if any, of such Beneficial Ownership on the Corporation’s qualification as a REIT and to ensure compliance with the Aggregate Stock Ownership Limit and the Common Stock Ownership Limit; and

1. each Person who is a Beneficial or Constructive Owner of Capital Stock and each Person (including the stockholder of record) who is holding Capital Stock for a Beneficial or Constructive Owner shall provide to the Corporation such information as the Corporation may request, in good faith, in order to determine the Corporation’s qualification as a REIT and to comply with requirements of any taxing authority or governmental authority or to determine such compliance and to ensure compliance with the Aggregate Stock Ownership Limit and the Common Stock Ownership Limit.

Section 8.2.5 Remedies Not Limited. Subject to Section 5.6 of the Certificate of Incorporation, nothing contained in this Section 8.2 shall limit the authority of the Board of Directors of the Corporation to take such other action as it deems necessary or advisable to protect the Corporation and the interests of its stockholders in preserving the Corporation’s qualification as a REIT.

Section 8.2.6 Ambiguity. In the case of an ambiguity in the application of any of the provisions of this Section 8.2, Section 8.3 or any definition contained in Section 8.1, the Board of

Directors of the Corporation shall have the power to determine the application of the provisions of this Section 8.2 or Section 8.3 or any such definition with respect to any situation based on the facts known to it. In the event Section 8.2 or Section 8.3 requires an action by the Board of Directors and the Certificate of Incorporation fails to provide specific guidance with respect to such action, the Board of Directors shall have the power to determine the action to be taken so long as such action is not contrary to the provisions of Sections 8.1, 8.2 or 8.3. Absent a decision to the contrary by the Board of Directors (which the Board of Directors may make in its sole and absolute discretion), if a Person would have (but for the remedies set forth in Section 8.2.1) acquired Beneficial Ownership or Constructive Ownership of Capital Stock in violation of Section 8.2.1, such remedies (as applicable) shall apply first to the shares of Capital Stock that, but for such remedies, would have been actually owned by such Person, and second to shares of Capital Stock which, but for such remedies, would have been Beneficially Owned or Constructively Owned (but not actually owned) by such Person, pro rata among the Persons who actually own such shares of Capital Stock based upon the relative number of the shares of Capital Stock held by each such Person.

Section 8.2.7 Exceptions.

1. Subject to Section 8.2.1, the Board of Directors of the Corporation, in its sole discretion, may exempt (prospectively or retroactively) a Person from the Aggregate Stock Ownership Limit, the Common Stock Ownership Limit, or both such limits and may establish or increase an Excepted Holder Limit for such Person if:
   1. the Board of Directors obtains such representations and undertakings from such Person as are reasonably necessary to ascertain that no individual’s Beneficial or Constructive Ownership of such shares of Capital Stock will violate Section 8.2.1(a)(ii);
   2. such Person does not and represents that it will not own, actually or Constructively, an interest in a tenant of the Corporation (or a tenant of any entity owned or controlled by the Corporation) that would cause the Corporation to own, actually or Constructively, more than a 9.9% interest (as set forth in Section 856(d)(2)(B) of the Code) in such tenant and the Board of Directors obtains such representations and undertakings from such Person as are reasonably necessary to ascertain this fact; and

* 1. such Person agrees that any violation or attempted violation of such representations or undertakings (or other action which is contrary to the restrictions contained in Sections 8.2.1 through 8.2.6) will result in such shares of Capital Stock being automatically transferred to a Trust in accordance with Sections 8.2.1(b) and 8.3.

1. Prior to granting any exception pursuant to Section 8.2.7(a), the Board of Directors of the Corporation may require a ruling from the Internal Revenue Service, or an opinion of counsel, in either case in form and substance satisfactory to the Board of Directors in its sole discretion, as it may deem necessary or advisable in order to determine or ensure the Corporation’s qualification as a REIT. Notwithstanding the receipt of any ruling or opinion, the Board of Directors may impose such conditions or restrictions as it deems appropriate in connection with granting such exception.
2. Subject to Section 8.2.1(a)(ii), an underwriter or placement agent that participates in a public offering or a private placement of Capital Stock (or securities convertible into or exchangeable for Capital Stock) may Beneficially Own or Constructively Own shares of Capital Stock (or securities convertible into or exchangeable for Capital Stock) in excess of the Aggregate Stock Ownership Limit, the Common Stock Ownership Limit, or both such limits, but only to the extent necessary to facilitate such public offering or private placement.
3. The Board of Directors may only reduce the Excepted Holder Limit for an Excepted Holder: (i) with the written consent of such Excepted Holder at any time, or (ii) pursuant to the terms and conditions of the agreements and undertakings entered into with such Excepted Holder in connection with the establishment of the Excepted Holder Limit for that Excepted Holder. No Excepted Holder Limit shall be reduced to a percentage that is less than the Aggregate Stock Ownership Limit or the Common Stock Ownership Limit, as the case may be.

Section 8.2.8 Change in Aggregate Stock Ownership Limit and Common Stock Ownership Limit. The Board of Directors may from time to time increase or decrease the Aggregate Stock Ownership Limit and Common Stock Ownership Limit; provided, however, that a decreased Aggregate Stock Ownership Limit or Common Stock Ownership Limit will not be effective for any Person whose percentage ownership of Capital Stock or Common Stock, as the case may be, is in excess of such decreased Aggregate Stock Ownership Limit or Common Stock Ownership Limit until such time as such Person's percentage of Capital Stock or Common Stock, as the case may be, equals or falls below the decreased Aggregate Stock Ownership Limit or Common Stock Ownership, but until such time as such Person's percentage of Capital Stock or Common Stock, as the case may be, falls below such decreased Aggregate Stock Ownership Limit or Common Stock Ownership Limit, any further acquisition of Capital Stock or Common Stock will be in violation of the Aggregate Stock Ownership Limit or Common Stock Ownership Limit and, provided further, that the new Aggregate Stock Ownership Limit or Common Stock Ownership Limit would not allow five or fewer individuals (as defined in Section 542(a)(2) of the Code and taking into account all Excepted Holders) to Beneficially Own more than 49.9% in value of the outstanding Capital Stock. If the Board of Directors changes the Common Stock Ownership Limit and/or Aggregate Stock Ownership Limit, it will (i) notify each stockholder of record of any such change, and (ii) publicly announce any such change, in each case at least 30 days prior to the effective date of such change.

Section 8.2.9 Legend. Each certificate for shares of Capital Stock shall bear substantially the following legend:

“The shares of any class or series of the Corporation’s stock (the “Capital Stock”) represented by this certificate are subject to restrictions on Beneficial Ownership, Constructive Ownership and Transfer (as each such capitalized term is defined in the Corporation’s Certificate of Incorporation, as the same may be amended from time to time (the "Certificate of Incorporation")) for the purpose of the

Corporation's maintenance of its status as a real estate investment trust (a “REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”). Subject to certain further restrictions and except as expressly provided in the Certificate of Incorporation, (i) no Person (as defined in the Certificate of Incorporation) may Beneficially Own or Constructively Own shares of the Corporation’s common stock, par value $0.01 per share (the “Common Stock”) in excess of 9.8% (in value or number of shares, whichever is more restrictive) of the total outstanding shares of Common Stock unless such Person is an Excepted Holder (as defined in the Certificate of Incorporation), in which case the Excepted Holder Limit (as defined in the Certificate of Incorporation) shall be applicable;

1. no Person may Beneficially Own or Constructively Own shares of Capital Stock in excess of 9.8% (in value or number of shares, whichever is more restrictive) of the total outstanding shares of Capital Stock, unless such Person is an Excepted Holder, in which case the Excepted Holder Limit shall be applicable; (iii) no Person may Beneficially Own or Constructively Own shares of Capital Stock that would result in the Corporation being “closely held” under Section 856(h) of the Code or otherwise cause the Corporation to fail to qualify as a REIT; and (iv) no Person may Transfer shares of Capital Stock if such Transfer would result in the Capital Stock of the Corporation being owned by fewer than 100 Persons. Any Person who Beneficially Owns or Constructively Owns, or attempts to Beneficially Own or Constructively Own shares of Capital Stock which causes or will cause a Person to Beneficially Own or Constructively Own shares of Capital Stock in excess or in violation of the above limitations must immediately notify the Corporation. If any of the above restrictions on Beneficial Ownership, Constructive Ownership or Transfer are violated, the shares of Capital Stock represented hereby will be automatically transferred to a Trust (as defined in the Certificate of Incorporation) for the benefit of one or more Charitable Beneficiaries (as defined in the Certificate of Incorporation). In addition, the Board of Directors shall take such action as it deems advisable to refuse to give effect to or to prevent such Transfer or other event, including, without limitation, causing the Corporation to redeem shares of Capital Stock; provided, however, that any Transfer or attempted Transfer or other event in violation of the above restrictions on Beneficial Ownership, Constructive Ownership and Transfer shall automatically result in the above transfer to the Trust and, where applicable, such Transfer (or other event) shall be void ab initio as provided above irrespective of any action (or non-action) by the Board of Directors. The Board of Directors may, pursuant to Section 8.2.8 of the Certificate of Incorporation, increase or decrease the percentage of Common Stock or Capital Stock that a person may Beneficially Own or Constructively Own.

A copy of the Certificate of Incorporation, including the above restrictions on Beneficial Ownership, Constructive Ownership and Transfer, will be furnished to each holder of Capital Stock on request and without charge. Requests for such a copy may be directed to the Secretary of the Corporation at its principal office.”

Instead of the foregoing legend, the certificate may state that the Corporation will furnish a full statement about certain restrictions on transferability to a stockholder on request and without charge.

Section 8.3 Transfer of Capital Stock in Trust.

Section 8.3.1 Ownership in Trust. Upon any purported Transfer or other event described in Section 8.2.1(a) that would result in a transfer of shares of Capital Stock to a Trust, such shares of Capital Stock shall be deemed to have been transferred to the Trustee as trustee of a Trust for the exclusive benefit of one or more Charitable Beneficiaries. Such transfer to the Trustee shall be deemed to be effective as of the close of business on the Business Day prior to the purported Transfer or other event that results in the transfer to the Trust pursuant to Section 8.2.1(b). The Trustee shall be appointed by the Corporation and shall be a Person unaffiliated with the Corporation and any Prohibited Owner. Each Charitable Beneficiary shall be designated by the Corporation as provided in Section 8.3.6.

Section 8.3.2 Status of Shares Held by the Trustee. Shares of Capital Stock held by the Trustee shall continue to be issued and outstanding shares of Capital Stock of the Corporation. The

Prohibited Owner shall have no rights in the shares of Capital Stock held by the Trustee. The Prohibited Owner shall not benefit economically from ownership of any shares held in trust by the Trustee, shall have no rights to dividends or other distributions and shall not possess any rights to vote or other rights attributable to the shares held in the Trust.

Section 8.3.3 Dividend and Voting Rights. The Trustee shall have all voting rights and rights to dividends or other distributions with respect to shares of Capital Stock held in the Trust, which rights shall be exercised for the exclusive benefit of the Charitable Beneficiary. Any dividend or other distribution paid to a Prohibited Owner prior to the discovery by the Corporation that the shares of Capital Stock have been transferred to the Trustee shall be paid with respect to such shares of Capital Stock by the Prohibited Owner to the Trustee upon demand and any dividend or other distribution authorized but unpaid shall be paid when due to the Trustee. Any dividend or distribution so paid to the Trustee shall be held in trust for the Charitable Beneficiary. The Prohibited Owner shall have no voting rights with respect to shares held in the Trust and, subject to the General Corporation Law, effective as of the date that the shares of Capital Stock have been transferred to the Trustee, the Trustee shall have the authority (at the Trustee’s sole discretion) (i) to rescind as void any vote cast by a Prohibited Owner prior to the discovery by the Corporation that the shares of Capital Stock have been transferred to the Trustee and (ii) to recast such vote in accordance with the desires of the Trustee acting for the benefit of the Charitable Beneficiary; provided, however, that if the Corporation has already taken irreversible corporate action, then the Trustee shall not have the authority to rescind and recast such vote. Notwithstanding the provisions of this Article VIII, until the Corporation has received notification that shares of Capital Stock have been transferred into a Trust, the Corporation shall be entitled to rely on its share transfer and other stockholder records for purposes of preparing lists of stockholders entitled to vote at meetings, determining the validity and authority of proxies and otherwise conducting votes of stockholders.

Section 8.3.4 Sale of Shares by Trustee. Within 20 days of receiving notice from the Corporation that shares of Capital Stock have been transferred to the Trust, the Trustee of the Trust shall sell the shares held in the Trust to a person, designated by the Trustee, whose ownership of the shares will not violate the ownership limitations set forth in Section 8.2.1(a). Upon such sale, the interest of the Charitable Beneficiary in the shares sold shall terminate and the Trustee shall distribute the net proceeds of the sale to the Prohibited Owner and to the Charitable Beneficiary as provided in this Section 8.3.4. The Prohibited Owner shall receive the lesser of (i) the price paid by the Prohibited Owner for the shares or, if the Prohibited Owner did not give value for the shares in connection with the event causing the shares to be held in the Trust (e.g., in the case of a gift, devise or other such transaction), the Market Price of the shares on the day of the event causing the shares to be held in the Trust and (ii) the price per share received by the Trustee (net of any commissions and other expenses of sale) from the sale or other disposition of the shares held in the Trust. The Trustee may reduce the amount payable to the Prohibited Owner by the amount of dividends and distributions paid to the Prohibited Owner and owned by the Prohibited Owner to the Trustee pursuant to Section 8.3.3 of this Article VIII. Any net sales proceeds in excess of the amount payable to the Prohibited Owner shall be immediately paid to the Charitable Beneficiary. If, prior to the discovery by the Corporation that shares of Capital Stock have been transferred to the Trustee, such shares are sold by a Prohibited Owner, then (a) such shares shall be deemed to have been sold on behalf of the Trust and (b) to the extent that the Prohibited Owner received an amount for such shares that exceeds the amount that such Prohibited Owner was entitled to receive pursuant to this Section 8.3.4, such excess shall be paid to the Trustee upon demand.

Section 8.3.5 Purchase Right in Stock Transferred to the Trustee. Shares of Capital Stock transferred to the Trustee shall be deemed to have been offered for sale to the Corporation, or its designee, at a price per share equal to the lesser of (i) the price per share in the transaction that resulted in such transfer to the Trust (or, in the case of a devise or gift, the Market Price at the time of such devise or gift) and (ii) the Market Price on the date the Corporation, or its designee, accepts such offer.

The Corporation may reduce the amount payable to the Prohibited Owner by the amount of dividends and distributions paid to the Prohibited Owner and owed by the Prohibited Owner to the Trustee pursuant to Section 8.3.3 of this Article VIII. The Corporation may pay the amount of such reduction to the Trustee for the benefit of the Charitable Beneficiary. The Corporation shall have the right to accept such offer until the Trustee has sold the shares held in the Trust pursuant to Section 8.3.4. Upon such a sale to the Corporation, the interest of the Charitable Beneficiary in the shares sold shall terminate and the Trustee shall distribute the net proceeds of the sale to the Prohibited Owner and any dividends or other distributions held by the Trustee shall be paid to the Charitable Beneficiary.

Section 8.3.6 Designation of Charitable Beneficiaries. By written notice to the Trustee, the Corporation shall designate one or more nonprofit organizations to be the Charitable Beneficiary of the interest in the Trust such that (i) the shares of Capital Stock held in the Trust would not violate the restrictions set forth in Section 8.2.1(a) in the hands of such Charitable Beneficiary and (ii) each such organization must be described in Section 501(c)(3) of the Code and contributions to each such organization must be eligible for deduction under each of Sections 170(b)(1)(A), 2055 and 2522 of the Code.

Section 8.4 Nasdaq Transactions. Nothing in this Article VIII shall preclude the settlement of any transaction entered into through the facilities of Nasdaq or any other national securities exchange or automated inter-dealer quotation system. The fact that the settlement of any transaction occurs shall not negate the effect of any other provision of this Article VIII and any transferee in such a transaction shall be subject to all of the provisions and limitations set forth in this Article VIII.

Section 8.5 Enforcement. The Corporation is authorized specifically to seek equitable relief, including injunctive relief, to enforce the provisions of this Article VIII.

Section 8.6 Non-Waiver. No delay or failure on the part of the Corporation or the Board of Directors in exercising any right hereunder shall operate as a waiver of any right of the Corporation or the Board of Directors, as the case may be, except to the extent specifically waived in writing.

Section 8.7 Severability. If any provision of this Article VIII or any application of any such provision is determined to be invalid by any federal or state court having jurisdiction over the issues, the validity of the remaining provisions shall not be affected and other applications of such provisions shall be affected only to the extent necessary to comply with the determination of such court.

ARTICLE IX

LIMITATION ON LIABILITY OF DIRECTORS

A director of the Corporation shall, to the maximum extent now or hereafter permitted by Section 102(b)(7) of the General Corporation Law (or any successor provision or provisions), have no personal liability to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except to the extent such director has committed willful misfeasance, bad faith, gross negligence or reckless disregard of such director's duties involved in the conduct of the office of director.

ARTICLE X

COMPROMISE

Whenever a compromise or arrangement is proposed between this Corporation and its creditors or any class of them and/or between this Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way

of this Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this Corporation under the provisions of Section 291 of the General Corporation Law, trustees in dissolution or of any receiver or receivers appointed for this Corporation under the provisions of Section 279 of the General Corporation Law, order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this Corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this Corporation, as the case may be, and also on this Corporation.

ARTICLE XI

AMENDMENT OF BY-LAWS

The Board of Directors shall have power to adopt, amend, alter, change and repeal any By-laws by a vote of the majority of the Board of Directors then in office. In addition to any requirements of the General Corporation Law (and notwithstanding the fact that a lesser percentage may be specified by the General Corporation Law), any adoption, amendment, alteration, change or repeal of any By-laws by the stockholders of the Corporation shall require the affirmative vote of the holders of at least sixty-six percent (66%) of the combined voting power of all of the shares of all classes of capital stock of the Corporation then entitled to vote generally in the election of directors.

ARTICLE XII

AMENDMENT OF CERTIFICATE OF INCORPORATION

The Corporation hereby reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation. Except as may be provided in a resolution or resolutions providing for any class of Preferred Stock pursuant to Article IV hereof and which relate to such class of Preferred Stock and except as provided in Article IV hereof, any such amendment, alteration, change or repeal shall require the affirmative vote of both (a) a majority of the members of the Board of Directors then in office and (b) a majority of the combined voting power of all of the shares of all classes of capital stock of the Corporation then entitled to vote generally in the election of directors.

By a vote of the majority of the Board of Directors then in office, the Board of Directors may adopt a resolution providing that at any time prior to the filing of the amendment with the Secretary of State, notwithstanding authorization of the proposed amendment by the stockholders, the Board of Directors may abandon such proposed amendment without further action by the stockholders.

Notwithstanding anything contained in this Certificate of Incorporation to the contrary, the affirmative vote of the holders of at least sixty-six percent (66%) of the combined voting power of all of the shares of all classes of capital stock of the Corporation then entitled to vote shall be required to amend, repeal or adopt any provision inconsistent with Article V herein.

ARTICLE XIII

MISCELLANEOUS

Section 13.1 Books and Records. The books of the Corporation may be kept (subject to any provision contained in the General Corporation Law) outside the State of Delaware at such place or places as may be designated from time to time by the Board of Directors or in the By-laws of the Corporation.

Section 13.2 Section 203. The Corporation expressly elects not to be governed by Section 203 of the General Corporation Law.

Exhibit 3.2

THIRD AMENDED AND RESTATED BY-LAWS OF

AGNC INVESTMENT CORP.

(hereinafter called the "Corporation")

AS AMENDED AND RESTATED SEPTEMBER 30, 2016

**ARTICLE I**

**OFFICES**

Section 1.1 Registered Office. The address of the registered office of the Corporation in the State of Delaware shall be 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of the registered agent at that address is Corporation Trust Company.

Section 1.2 Other Offices. The Corporation may also have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time

determine.

**ARTICLE II**

**MEETINGS OF STOCKHOLDERS**

Section 2.1 Place of Meetings. Meetings of the stockholders for the election of directors or for any other purpose shall be held at such time and place, either within or without the State of Delaware as shall be designated from time to time by the Board of Directors or, in the absence of a designation by the Board of Directors, by the Chair of the Board or the Chief Executive Officer, and stated in the written notice of the meeting. Notwithstanding the foregoing, the Board of Directors may, in its sole discretion, determine that meetings of the stockholders will not be held at any place, but may instead by held by means of remote communications. The Board of Directors or the Chair of the Board may postpone any previously scheduled Annual or Special Meeting of Stockholders.

Section 2.2 Annual Meetings. The Annual Meetings of Stockholders for the election of directors shall be held on such date and at such time as shall be designated from time to time by the Board of Directors. At the Annual Meeting of Stockholders, the stockholders will elect directors of the Corporation and transact any other business as brought before the meeting in accordance with these By-laws.

Section 2.3 Special Meetings. Unless otherwise required by law or by the certificate of incorporation of the Corporation, as amended and restated from time to time (the "Certificate of Incorporation"), Special Meetings of Stockholders, for any purpose or purposes, may be called only by (i) the Chief Executive Officer, pursuant to a resolution adopted by a majority of the Board of Directors or by a committee of the Board of Directors that has been duly designated by the Board of Directors and whose powers and authority include the power to call such meetings or (ii) the Chair of the Board of Directors. At a Special Meeting of Stockholders, only such business shall be conducted as shall be specified in the notice of meeting (or any supplement thereto).

Section 2.4 Notice. Whenever stockholders are required or permitted to take any action at a meeting, a written notice of the meeting shall be given which shall state the place, date and hour of the meeting, the means of remote communications, if any, by which stockholders and proxyholders may be

deemed present in person and vote at such meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called. Unless otherwise required by law and subject to Section 2 of ARTICLE VII hereof, the written notice of any meeting shall be given not less than ten nor more than 60 days before the date of the meeting to each stockholder of record entitled to vote at such meeting.

Section 2.5 List of Stockholders. A complete list of the stockholders entitled to vote at any meeting of stockholders, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder, shall be prepared by the Secretary and shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held, for at least ten days before the meeting and at the place of the meeting during the whole time of the meeting.

Section 2.6 Quorum. Unless otherwise required by law or the Certificate of Incorporation, or as provided by the Delaware General Corporation Law (the "DGCL"), the holders of a majority of the capital stock issued and outstanding and entitled to vote thereat, present in person, by means of remote communication, if applicable, or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business. In the event of a lack of a quorum, the chair of the meeting or a majority in interest of the stockholders present in person, by means of remote communication, if applicable, or represented by proxy may adjourn the meeting from time to time without notice other than an announcement at the meeting, until a quorum shall be obtained. At any such adjourned meeting at which there is a quorum, any business may be transacted that might have been transacted at the meeting originally called.

Section 2.7 Organization. The Chair of the Board, or, in the absence of the Chair of the Board, the Chief Executive Officer, or, in the absence of the Chair of the Board and the Chief Executive Officer, any Executive Vice President, shall preside at meetings of stockholders. The Secretary of the Corporation shall act as secretary, but in the absence of the Secretary, the presiding officer may appoint a secretary.

Section 2.8 Stockholder Nominations and Proposals.

1. No proposal for a stockholder vote shall be submitted by a stockholder (a "Stockholder Proposal") to the Corporation's stockholders unless the stockholder submitting such proposal (the "Proponent") shall have filed a written notice setting forth with particularity (i) the names and business addresses of the Proponent and all Persons (as such term is defined in Section 3(a)(9) of the Securities Exchange Act of 1934, as amended through the date of adoption of these Bylaws) acting in concert with the Proponent; (ii) the names and addresses of the Proponent and the Persons identified in clause (i), as they appear on the Corporation's books (if they so appear); (iii) the class and number of shares of the Corporation beneficially owned by the Proponent and the Persons identified in clause (i); (iv) a description of the Stockholder Proposal containing all material information relating thereto; and (v) such other information as the Board of Directors reasonably determines is necessary or appropriate to enable the Board of Directors and stockholders of the Corporation to consider the Stockholder Proposal. Upon receipt of the Stockholder Proposal and prior to the stockholder meeting at which such Stockholder Proposal will be considered, if the Board of Directors or a designated committee or the officer who will preside at the stockholders meeting determines that the information provided in a Stockholder Proposal does not satisfy the informational requirements of these Bylaws or is otherwise not in accordance with law, the Secretary of the Corporation shall promptly notify such Proponent of the deficiency in the notice. Such Proponent shall have an opportunity to cure the deficiency by providing additional

information to the Secretary within the period of time, not to exceed five days from the date such deficiency notice is given to the Proponent, determined by the Board of Directors, such committee or such officer. If the deficiency is not cured within such period, or if the Board of Directors, such committee or such officer determines that the additional information provided by the Proponent, together with the information previously provided, does not satisfy the requirements of this Section 2.8, then such proposal shall not be presented for action at the meeting in question.

* 1. Only persons who are selected and recommended by the Board of Directors or the Nominating Committee thereof, or who are nominated by stockholders in accordance with the procedures set forth in this Section 2.8, shall be eligible for election, or qualified to serve, as directors. Nominations of individuals for election to the Board of Directors of the Corporation at any annual meeting or any special meeting of stockholders at which directors are to be elected may be made by any stockholder of the Corporation entitled to vote for the election of directors at that meeting by compliance with the procedures set forth in this Section 2.8. Nominations by stockholders shall be made by written notice (a "Nomination Notice"), which shall set forth (i) as to each individual nominated, (A) the name, date of birth, business address and residence address of such individual; (B) the business experience during the past five years of such nominee, including his or her principal occupations and employment during such period, the name and principal business of any corporation or other organization in which such occupations and employment were carried on and such other information as to the nature of his or her responsibilities and level of professional competence as may be sufficient to permit assessment of his or her prior business experience; (C) whether the nominee is or has ever been at any time a director, officer or owner of 5% or more of any class of capital stock, partnership interests or other equity interest of any corporation, partnership or other entity; (D) any directorships held by such nominee in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, as amended, or subject to the requirements of section 15(d) of such Act or any company registered as an investment company under the Investment Company Act of 1940, as amended; and (E) whether, in the last five years, such nominee has been convicted in a criminal proceeding or has been subject to a judgment, order, finding or decree of any federal, state or other governmental entity, concerning any violation of federal, state or other law, or any proceeding in bankruptcy, which conviction, judgment, order, finding, decree or proceeding may be material to an evaluation of the ability or integrity of the nominee; and (ii) as to the Person submitting the Nomination Notice and any Person acting in concert with such Person, (x) the name and business address of such Persons,

1. the name and address of such Persons and as they appear on the Corporation's books (if they so appear) and (z) the class and number of shares of the Corporation which are beneficially owned by such Persons. A written consent to being named in a proxy statement as a nominee, and to serve as a director if elected, signed by the nominee, shall be filed with any Nomination Notice. If the presiding officer at any stockholders meeting determines that a nomination was not made in accordance with the procedures prescribed by these Bylaws, he shall so declare to the meeting and the defective nomination shall be disregarded.
   1. Nomination Notices and Stockholder Proposals shall be delivered to the Secretary at the principal executive office of the Corporation not less than sixty and not more than ninety days prior to the date of the meeting of stockholders if such Nomination Notice or Stockholder Proposal is to be submitted at an annual stockholders meeting (provided, however, that if such annual meeting is called to be held before the date specified in Section 2.2 hereof, such Nomination Notice or Stockholder Proposal shall be so delivered no later than the close of business on the tenth day following the day on which notice of the date of the annual stockholders meeting was given). Nomination Notices and Stockholder Proposals shall be delivered to the Secretary at the principal executive office of the Corporation no later than the close of business on the tenth day following the day on which notice of the date of a special meeting of stockholders was given if the Nomination Notice or Stockholder Proposal is to be submitted at a special stockholders meeting.

Section 2.9 Voting. Unless otherwise required by law, the Certificate of Incorporation or these By-laws, any question brought before any meeting of stockholders, other than the election of directors, shall be decided by the vote of the holders of a majority of the total number of votes of the capital stock represented and entitled to vote thereat, voting as a single class. Abstentions shall not be considered to be votes cast.

Section 2.10 Inspectors. Votes by written ballot at any meeting of stockholders may be conducted by one or more inspectors, appointed for that purpose, either by the Board of Directors or by the chair of the meeting. The inspector or inspectors may decide upon the qualifications of voters and the validity of proxies, and may count the votes and declare the results.

Section 2.11 Remote Communications. If authorized by the Board of Directors and subject to the guidelines and procedures as the Board of Directors may from time to time adopt, stockholders and proxyholders not physically present at a meeting of stockholders may participate in such meeting by means of remote communication, so long as the stockholder or proxyholder participating in the meeting can read or hear the proceedings of the meeting substantially concurrently with such proceedings.

**ARTICLE III**

**DIRECTORS**

Section 3.1 Number and Election of Directors. The Board of Directors shall consist of not less than one nor more than fifteen members, the exact number of which shall initially be fixed by the Incorporator and thereafter from time to time by a majority vote of the members of the Board of Directors then in office, provided that no amendment to the Bylaws decreasing the number of directors shall have the effect of shortening the term of any incumbent director and provided that the number of directors shall not be increased by fifty percent (50%) or more in any twelve-month period without the approval of at least sixty-six percent (66%) of the members of the Board of Directors then in office. Except as provided in Section 3.3 hereof, directors shall be elected by a majority of the votes cast at the Annual Meetings of Stockholders and each director so elected shall hold office until the next Annual Meeting of Stockholders and until such director's successor is duly elected and qualified, or until such director's earlier death, resignation or removal; provided that if the number of nominees exceeds the number of directors to be elected, each director shall be elected by the vote of a plurality of the votes cast. For purposes of this Section, a majority of the votes cast means that the number of votes cast “for” a director nominee must exceed the votes cast “against” that nominee. Directors need not be stockholders.

Section 3.2 Resignation. Any director may resign at any time upon written notice to the Chair of the Board, the Chief Executive Officer or the Secretary. Unless otherwise stated in such notice of resignation, the acceptance thereof shall not be necessary to make it effective; and such resignation shall take effect at the time specified therein or, in the absence of such specification, it shall take effect upon the receipt thereof.

Section 3.3 Vacancies and New Directorships. Unless otherwise required by law or the Certificate of Incorporation, vacancies arising through death, resignation, removal, an increase in the number of directors or otherwise may be filled only by a majority of the directors then in office, though less than a quorum, or by a sole remaining director. The directors so chosen shall hold office until the next annual election and until their successors are duly elected and qualified, or until their earlier death, resignation or removal.

Section 3.4 Duties and Powers. The business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors which may exercise all such powers of the Corporation

and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these By-Laws required to be exercised or done by the stockholders.

Section 3.5 Meetings. The Board of Directors may hold meetings, both regular and special, either within or without the State of Delaware. Regular meetings of the Board of Directors may be held without notice at such time and at such place as may from time to time be determined by the Board of Directors. Special meetings of the Board of Directors may be called by the Chair of the Board, the Vice Chair of the Board, if any, the Chief Executive Officer or at the request in writing of a majority of the members of the Board of Directors then in office. Notice thereof stating the place, date and hour of the meeting shall be given to each director either by mail not less than 48 hours before the date of the meeting, by telephone or telegram on 24 hours' notice, or on such shorter notice as the person or persons calling such meeting may deem necessary or appropriate in the circumstances.

Section 3.6 Quorum. Except as otherwise required by law or the Certificate of Incorporation, at all meetings of the Board of Directors, a majority of the entire Board of Directors shall constitute a quorum for the transaction of business and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board of Directors. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting of the time and place of the adjourned meeting, until a quorum shall be present.

Section 3.7 Actions by Written Consent. Unless otherwise provided in the Certificate of Incorporation, or these By-Laws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all the members of the Board of Directors or committee, as the case may be, consent thereto in writing or by electronic transmission, and the writing or writings or by electronic transmission or transmissions are filed with the minutes of proceedings of the Board of Directors or committee. Such filings shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form.

Section 3.8 Meetings by Means of Remote Communications. Unless otherwise provided in the Certificate of Incorporation, members of the Board of Directors of the Corporation, or any committee thereof, may participate in a meeting of the Board of Directors or such committee by means of a conference telephone or other communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting pursuant to this Section 3.8 shall constitute presence in person at such meeting.

Section 3.9 Presumption of Assent. A Director of the Corporation who is present at a meeting of the Board of Directors when a vote on any matter is taken is deemed to have assented to the action taken unless he votes against or abstains from the action taken, or unless at the beginning of the meeting or promptly upon arrival, the director objects to the holding of the meeting or the transacting of specified business at the meeting. Any such dissenting votes, abstentions or objections shall be entered in the minutes of the meeting.

Section 3.10 Voting. Except as otherwise required by law, the Certificate of Incorporation or these Bylaws, all actions taken by the Board of Directors shall be taken by a majority vote of the members then in office.

Section 3.11 Compensation. The directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors and may be paid a fixed sum for attendance at each meeting of the Board of Directors or a stated salary as director, payable in cash or securities as may be established by the

Board of Directors. No such payment shall preclude any director from serving the Corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

Section 3.12 Loss of Deposits. No director shall be liable for any loss which may occur by reason of the failure of the bank, trust company, savings and loan association, or other institution with whom moneys or stock have been deposited.

Section 3.13 Surety Bonds. Unless required by law, no director shall be obligated to give any bond or surety or other security for the performance of any of his or her duties.

Section 3.14 Reliance. Each director, officer, employee and agent of the Corporation shall, in the performance of his or her duties with respect to the Corporation, be fully justified and protected with regard to any act or failure to act in reliance in good faith upon the books of account or other records of the Corporation, upon an opinion of counsel or upon reports made to the Corporation by any of its officers or employees or by the adviser, accountants, appraisers or other experts or consultants selected by the Board of Directors or officers of the Corporation, regardless of whether such counsel or expert may also be a director.

Section 3.15 Interested Directors. No contract or transaction between the Corporation and one or more of its directors or officers, or between the Corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee thereof which authorizes the contract or transaction, or solely because the director or officer's vote is counted for such purpose if (i) the material facts as to the director or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee, and the Board of Directors or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or (ii) the material facts as to the director or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or (iii) the contract or transaction is fair as to the Corporation as of the time it is authorized, approved or ratified by the Board of Directors, a committee thereof or the stockholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

Section 3.16 Certain Rights of Directors, Officers, Employees and Agents. The directors shall have no responsibility to devote their full time to the affairs of the Corporation. Any director or officer, employee or agent of the Corporation, in his or her personal capacity or in a capacity as an affiliate, employee, or agent of any other person, or otherwise, may have business interests and engage in business activities similar to or in addition to or in competition with those of or relating to the Corporation.

**ARTICLE IV**

**COMMITTEES**

Section 4.1 Nominating Committee. The Board shall, by resolution passed by a majority of the members of the Board of Directors then in office, designate a Nominating Committee to consist of two or more members of the Board. A majority of the Board of Directors then in office shall have the power to

change the membership of the Nominating Committee, fill vacancies therein or remove any members thereof, either with or without cause, at any time. Unless otherwise provided by the Board of Directors or the Nominating Committee, quorum, voting, and other procedures of the Nominating Committee shall be the same as those applicable to actions taken by the Board of Director. The Nominating Committee may fix its rules of procedure, determine its manner of acting and fix the time and place, whether within or without the State of Delaware, of its meetings and specify what notice thereof, if any, shall be given, unless the majority of the Board of Directors shall otherwise by resolution provide.

Section 4.2 Other Committees. The Board of Directors may, by resolutions passed by a majority of the members of the Board of Directors then in office, designate members of the Board of Directors to constitute other committees which shall in each case consist of such number of directors, and shall have and may execute such powers as may be determined and specified in the respective resolutions appointing them. Any such committee may fix its rules of procedure, determine its manner of acting and fix the time and place, whether within or without the State of Delaware, of its meetings and specify what notice thereof, if any, shall be given, unless the Board of Directors shall otherwise by resolution provide. Unless otherwise provided by the Board of Directors or such committee, quorum, voting and other procedures shall be the same as those applicable to actions taken by the Board of Director. A majority of the members of the Board of Directors then in office shall have the power to change the membership of any such committee at any time, to fill vacancies therein and to discharge any such committee or to remove any member thereof, either with or without cause, at any time.

**ARTICLE V**

**OFFICERS**

Section 5.1 General. The officers of the Corporation shall be chosen by the Board of Directors and shall include a Chief Executive Officer, President, Chief Financial Officer and Secretary. The Board of Directors, in its discretion, also may choose a Chair of the Board of Directors (who must be a director), one or more Vice Presidents and select and appoint such other officers it deems necessary. Any number of offices may be held by the same person, unless otherwise prohibited by law or the Certificate of Incorporation. The officers of the Corporation need not be stockholders of the Corporation nor, except in the case of the Chair of the Board of Directors, need such officers be directors of the Corporation.

Section 5.2 Election. The Board of Directors, at its first meeting held after each Annual Meeting of Stockholders (or action by written consent of stockholders in lieu of the Annual Meeting of Stockholders), shall elect the officers of the Corporation who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the Board of Directors; and all officers of the Corporation shall hold office until their successors are chosen and qualified, or until their earlier death, resignation or removal. Any officer elected by the Board of Directors may be removed at any time by the affirmative vote of the Board of Directors. Any vacancy occurring in any office of the Corporation shall be filled by the Board of Directors. The salaries of all officers of the Corporation shall be fixed by the Board of Directors.

Section 5.3 Vacancies. A vacancy in any office may be filled for the unexpired portion of the term by the Board of Directors or, in the case of offices held by officers who may be appointed by other officers, by any officer authorized to appoint such officer.

Section 5.4 Chief Executive Officer. The Chair of the Board shall initially be the Chief Executive Officer of the Corporation and thereafter, at such time as the Board of Directors shall determine, the Chief Executive Officer shall be such officer as the Board of Directors shall designate from time to time. The

Chief Executive Officer shall have general responsibility for implementation of the policies of the Corporation, as determined by the Board of Directors, and for the management of the business and affairs of the Corporation. The Chief Executive Officer may execute any deed, mortgage, bond, contract or other instrument, except in cases where the execution thereof shall be expressly delegated by the Board of Directors or by these Bylaws to some other officer or agent of the Corporation or shall be required by law to be otherwise executed; and in general shall perform all duties incident to the office of Chief Executive Officer and such other duties as may be prescribed by the Board of Directors from time to time.

Section 5.5 Chair of the Board. The Chair of the Board shall have such powers and perform such duties as may be provided for herein and as may be incident to the office and as may be assigned by the Board of Directors.

Section 5.6 President. The President shall have the responsibilities or duties as may be prescribed by the Chief Executive Officer or the Board of Directors from time to time.

Section 5.7 Chief Financial Officer. The Chief Financial Officer shall have the custody of the corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the Corporation in such depositories as may be designated by the Board of Directors. The Chief Financial Officer shall disburse the funds of the Corporation as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the Chief Executive Officer and the Board of Directors, at its regular meetings, or when the Board of Directors so requires, an account of all transactions as Chief Financial Officer and of the financial condition of the Corporation.

Section 5.8 Vice Presidents. Each Vice President shall perform such duties as from time to time may be assigned to such Vice President by the Chief Executive Officer or by the Board of

Directors.

Section 5.9 Secretary. The Secretary shall attend all meetings of the Board of Directors and all meetings of stockholders and record all the proceedings thereat in a book or books to be kept for that purpose; the Secretary shall also perform like duties for committees of the Board of Directors when required. The Secretary shall give, or cause to be given, notice of all meetings of the stockholders and special meetings of the Board of Directors, and shall perform such other duties as may be prescribed by the Board of Directors. The Secretary shall have custody of the seal of the Corporation and the Secretary shall have authority to affix the same to any instrument requiring it and when so affixed, it may be attested by the signature of the Secretary. The Board of Directors may give general authority to any other officer to affix the seal of the Corporation and to attest to the affixing by such officer's signature. The Secretary shall see that all books, reports, statements, certificates and other documents and records required by law to be kept or filed are properly kept or filed, as the case may be.

Section 5.10 Other Officers. Such other officers as the Board of Directors may choose shall perform such duties and have such powers as from time to time may be assigned to them by the Board of Directors. The Board of Directors may delegate to any other officer of the Corporation the power to choose such other officers and to prescribe their respective duties and powers.

Section 5.11 Execution of Instruments. Checks, notes, drafts, other commercial instruments, assignments, guarantees of signatures and contracts (except as otherwise provided herein or by law) shall be executed by the Chair of the Board, any Vice Chair of the Board, the Chief Executive Officer, the President, any Vice President or such officers or employees or agents as the Board of Directors or any of such designated officers may direct.

Section 5.12 Mechanical Endorsement. The Chair of the Board, any Vice Chair of the Board, the Chief Executive Officer, the President, any Vice President or the Secretary may authorize any endorsement on behalf of the Corporation to be made by such mechanical means or stamps as any such officers may deem appropriate.

**ARTICLE VI**

**STOCK**

Section 6.1 Shares of Stock. Except as otherwise provided in a resolution approved by the Board of Directors, all shares of capital stock of the Corporation issued after May 19, 2008 shall be uncertificated shares. Notwithstanding the foregoing, shares of capital stock of the Corporation represented by a certificate issued on or prior to May 19, 2008, shall be certificated shares until such certificate is surrendered to the Corporation. Within a reasonable time after the issuance or transfer of uncertificated shares of stock, the Corporation shall send the registered owner a written notice confirming the information required to be set forth or stated on certificates pursuant to Sections 151, 156, 202(a) or 218(a) of the DGCL or a statement that the Corporation will furnish, without charge, to each stockholder who so requests, the powers, designations, preferences and relative participating, optional or other special rights of each class of stock or shares thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

Section 6.2 Signatures. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if such person were such officer, transfer agent or registrar at the date of issue.

Section 6.3 Lost Certificates. The Board of Directors may direct a new certificate or uncertificated shares be issued in place of any certificate theretofore issued by the Corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing such issuance of a new certificate or uncertificated shares, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate, or such owner's legal representative, to advertise the same in such manner as the Board of Directors shall require and/or to give the Corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate or the issuance of such new certificate or uncertificated shares.

Section 6.4 Transfers. Stock of the Corporation shall be transferable in the manner prescribed by applicable law, the Certificate of Incorporation and in these By-Laws. Transfers of stock shall be made on the books of the Corporation, and in the case of certificated shares of stock, only by the person named in the certificate or by such person's attorney lawfully constituted in writing and upon the surrender of the certificate therefor, properly endorsed for transfer and payment of all necessary transfer taxes; or, in the case of uncertificated shares of stock, upon receipt of proper transfer instructions from the registered holder of the shares or by such person's attorney lawfully constituted in writing, and upon payment of all necessary transfer taxes and compliance with appropriate procedures for transferring shares in uncertificated form; provided, however, that such surrender and endorsement, compliance or payment of taxes shall not be required in any case in which the officers of the Corporation shall determine to waive such requirement. With respect to certificated shares of stock, every certificate exchanged, returned or surrendered to the Corporation shall be marked "Cancelled," with the date of cancellation, by the Secretary or Assistant

Secretary of the Corporation or the transfer agent thereof. No transfer of stock shall be valid as against the Corporation for any purpose until it shall have been entered in the stock records of the Corporation by an entry showing from and to whom transferred.

Section 6.5 Record Date. The Board of Directors may fix in advance a future date, not exceeding sixty days (nor, in the case of a stockholders' meeting, less than ten days) preceding the date of any meeting of stockholders, payment of dividend or other distribution, allotment of rights, or change, conversion or exchange of capital stock or for the purpose of any other lawful action, as the record date for determination of the stockholders entitled to notice of and to vote at any such meeting and any adjournment thereof, or to receive any such dividend or other distribution or allotment of rights, or to exercise the rights in respect of any such change, conversion or exchange of capital stock, or to participate in any such other lawful action, and, in such case, such stockholders and only such stockholders as shall be stockholders of record on the date so fixed shall be entitled to such notice of and to vote at such meeting and any adjournment thereof, or to receive such dividend or other distribution or allotment of rights, or to exercise such rights or to participate in any such other lawful action, as the case may be, notwithstanding any transfer of any stock on the books of the Corporation after any such record date fixed as aforesaid.

Section 6.6 Stock Ledger. The Corporation shall maintain at its principal office or at the office of its counsel, accountants or transfer agent, an original or duplicate share ledger containing the name and address of each stockholder and the number of shares of each class held by such stockholder.

Section 6.7 Record Owners. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise required by law.

Section 6.8 Transfer and Registry Agents. The Corporation may from time to time maintain one or more transfer offices or agencies and registry offices or agencies at such place or places as may be determined from time to time by the Board of Directors.

**ARTICLE VII**

**NOTICES**

Section 7.1 Notices. Whenever written notice is required by law, the Certificate of Incorporation or these By-Laws, to be given to any director, member of a committee or stockholder, such notice may be given by mail, addressed to such director, member of a committee or stockholder, at such person's address as it appears on the records of the Corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Written notice may be given personally or by telegram, telex, cable or other electronic transmission.

Section 7.2 Waivers of Notice. Whenever any notice is required by law, the Certificate of Incorporation or these By-Laws, to be given to any director, member of a committee or stockholder, a waiver thereof in writing, signed, by the person or persons entitled to said notice or a waiver by electronic transmission by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent thereto. Attendance of a person at a meeting, present in person or represented by proxy, shall constitute a waiver of notice of such meeting, except where the person attends the meeting for the express purpose of objecting at the beginning of the meeting to the transaction of any business because the meeting

is not lawfully called or convened.

**ARTICLE VIII**

**GENERAL PROVISIONS**

Section 8.1 Dividends. Dividends upon the capital stock of the Corporation, subject to the requirements of the DGCL and the provisions of the Certificate of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting of the Board of Directors (or any action by written consent in lieu thereof in accordance with Section 3.7 of ARTICLE III hereof), and may be paid in cash, in property, or in shares of the Corporation's capital stock. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the Board of Directors from time to time, in its absolute discretion, deems proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation, or for any proper purpose, and the Board of Directors may modify or abolish any such reserve.

Section 8.2 Disbursements. All checks or demands for money and notes of the Corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate.

Section 8.3 Fiscal Year. The fiscal year of the Corporation shall be fixed by resolution of the Board of Directors.

Section 8.4 Corporate Seal. The corporate seal shall have inscribed thereon the name of the Corporation, the year of its organization and the words "Corporate Seal, Delaware". The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

Section 8.5 Executive Office. The principal executive office of the Corporation shall be located in Bethesda, Maryland or such other location as may be specified by the Board of Directors. The books of account and records shall be kept in such office. The Corporation also may have offices at such other places, both within and without Delaware, as the Board of Directors from time to time shall determine or the business and affairs of the Corporation may require.

**ARTICLE IX**

**INVESTMENT POLICY**

Subject to the provisions of the Certificate of Incorporation, the Board of Directors may from time to time adopt, amend, revise or terminate any policy or policies with respect to investments by the Corporation as it shall deem appropriate in its sole discretion.

**ARTICLE X**

**INDEMNIFICATION**

Section 10.1 Indemnification Provisions in Certificate of Incorporation. The provisions of this ARTICLE X are intended to supplement Article VII of the Certificate of Incorporation pursuant to Section 7.2 therein. To the extent that this ARTICLE X contains any provisions inconsistent with such Article VII, the provisions of the Certificate of Incorporation shall govern. Terms used in this ARTICLE X but not otherwise defined shall have the respective meanings given such terms in such Article VII of the Certificate of Incorporation.

Section 10.2 Undertakings for Advances of Expenses. If and to the extent the DGCL requires, an advancement by the Corporation of expenses incurred by an indemnitee pursuant to clause (iii) of the last sentence of Section 7.1 of the Certificate of Incorporation (hereinafter an "advancement of expenses") shall be made only upon delivery to the Corporation of an undertaking (hereinafter an "undertaking"), by or on behalf of such indemnitee, to repay all amounts so advanced if it shall ultimately be determined by final judicial decision from which there is no further right to appeal (hereinafter a "final adjudication") that such indemnitee is not entitled to be indemnified for such expenses under Article VII of the Certificate of Incorporation or otherwise.

Section 10.3 Claims for Indemnification. If a claim for indemnification under Section 7.1 of the Certificate of Incorporation is not paid in full by the Corporation within sixty (60) days after it has been received in writing by the Corporation, except in the case of a claim for an advancement of expenses, in which case the applicable period shall be twenty (20) days, the indemnitee may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim. If successful in whole or in part in any such suit, or in a suit brought by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the indemnitee shall be entitled to be paid also the expense of prosecuting or defending such suit. In any suit brought by the indemnitee to enforce a right to indemnification hereunder (but not in a suit brought by the indemnitee to enforce a right to an advancement of expenses) it shall be a defense that, and in any suit by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the Corporation shall be entitled to recover such expenses only upon a final adjudication that, the indemnitee has not met the applicable standard of conduct set forth in Section 145 of the DGCL (or any successor provision or provisions). Neither the failure of the Corporation (including the Board of Directors, independent legal counsel or its stockholders) to have made a determination prior to commencement of such suit that indemnification of the indemnitee is proper in the circumstances because the indemnitee has met the applicable standard of conduct set forth in Section 145 of the DGCL (or any successor provision or provisions), nor an actual determination by the Corporation (including the Board of Directors, independent legal counsel, or its stockholders) that the indemnitee has not met such applicable standard of conduct, shall create a presumption that the indemnitee has not met the applicable standard of conduct or, in the case of such a suit brought by the indemnitee, be a defense to such suit. In any suit brought by the indemnitee to enforce a right to indemnification or to an advancement of expenses hereunder, or by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the burden of proving that the indemnitee is not entitled to be indemnified, or to have or retain such advancement of expenses, under Article VII of the Certificate of Incorporation or this ARTICLE X or otherwise, shall be on the Corporation.

Section 10.4 Insurance. The Corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the Corporation would have the power to indemnify such person against such liability under the DGCL or any other provision of law.

Section 10.5 Severability. In the event that any of the provisions of this ARTICLE X (including any provision within a single section, paragraph or sentence) is held by a court of competent jurisdiction to be invalid, void or otherwise unenforceable, the remaining provisions are severable and shall remain enforceable to the full extent permitted by law.

**ARTICLE XI**

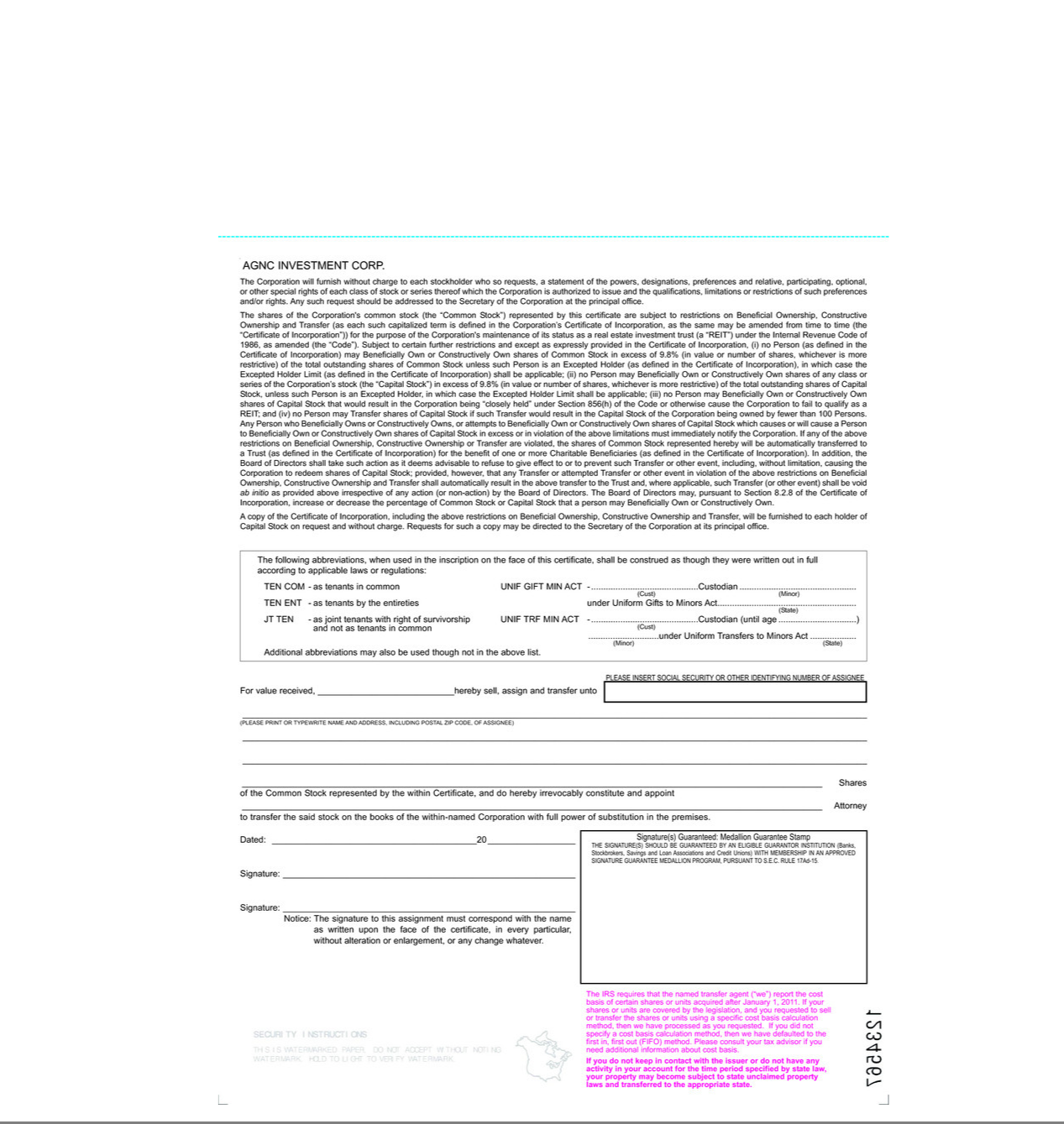
**AMENDMENTS**

Section 11.1 Amendments. These By-Laws may be altered, amended or repealed, in whole or in part, or new By-Laws may be adopted by the stockholders or by the Board of Directors, provided, however, that notice of such alteration, amendment, repeal or adoption of new By-Laws be contained in the notice of such meeting of stockholders or Board of Directors as the case may be. All such amendments must be approved by either the holders of sixty-six percent (66%) of the outstanding capital stock entitled to vote thereon or by a majority of the entire Board of Directors then in office.

Section 11.2 Entire Board of Directors. As used in this ARTICLE XI and in these By-Laws generally, the term "entire Board of Directors" means the total number of directors which the Corporation would have if there were no vacancies.

Adopted as of: September 30, 2016 (amending and restating the Second Amended and Restated By-laws of the Corporation, adopted as of May 26, 2011, as amended)





**Exhibit 31.1**

**AGNC Investment Corp.**

**Certification Pursuant to Section 302(a)**

**of the Sarbanes-Oxley Act of 2002**

I, Gary Kain, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AGNC Investment Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   3. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   1. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2016

/s/ GARY KAIN



Gary Kain

Chief Executive Officer, President and Chief Investment Officer (Principal

Executive Officer)

**Exhibit 31.2**

**AGNC Investment Corp.**

**Certification Pursuant to Section 302(a)**

**of the Sarbanes-Oxley Act of 2002**

I, Peter Federico, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AGNC Investment Corp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entitles, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   3. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   1. All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2016

/s/ PETER FEDERICO



Peter Federico

Chief Financial Officer and Executive Vice President (Principal Financial

Officer)

**Exhibit 32**

**AGNC Investment Corp.**

**Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350,**

**as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

We, Gary Kain, Chief Executive Officer, President and Chief Investment Officer, and Peter Federico, Executive Vice President and Chief Financial Officer of AGNC Investment Corp. (the “Company”), certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that:

1. The Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2016 (the “Report”) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

|  |  |  |
| --- | --- | --- |
|  | /s/ | GARY KAIN |
| Name: | Gary Kain | |
| Title: | Chief Executive Officer, | |
|  | President and Chief Investment Officer (Principal Executive Officer) | |
| Date: | November 7, 2016 | |
|  | /s/ | PETER FEDERICO |
| Name: | Peter Federico | |
| Title: | Chief Financial Officer and | |
|  | Executive Vice President (Principal Financial Officer) | |
| Date: | November 7, 2016 | |

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.