

ANNALY CAPITAL MANAGEMENT INC
Form 10-K
February 26, 2013

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2012

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

MARYLAND 22-3479661
(State or other jurisdiction of incorporation of organization) (I.R.S. Employer Identification Number)

1211 Avenue of the Americas, Suite
2902
New York, New York 10036
(Address of Principal Executive Offices) (Zip Code)

(212) 696-0100
(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$.01 per share	New York Stock Exchange
7.875% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.625% Series C Cumulative Redeemable Preferred Stock	New York Stock Exchange

7.50% Series D Cumulative Redeemable
Preferred Stock

New York Stock Exchange

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

None.

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

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

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

Yes No

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

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

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

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

At June 30, 2012, the aggregate market value of the voting stock held by non-affiliates of the Registrant was \$16,318,867,645.

The number of shares of the Registrant's Common Stock outstanding on February 26, 2013 was 947,250,377.

Documents Incorporated by Reference

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2012. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC.
2012 FORM 10-K ANNUAL REPORT
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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this annual report may not be based on historical facts and are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are based on various assumptions (some of which are beyond our control), may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as “may,” “will,” “believe,” “expect,” “anticipate,” “continue,” or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to:

changes in interest rates,

changes in the yield curve,

changes in prepayment rates,

the availability of mortgage-backed securities, other securities and other real estate assets for purchase,

the availability of financing and, if available, the terms of any financing,

changes in the market value of our assets,

changes in business conditions and the general economy,

our ability to integrate the commercial mortgage business,

our ability to consummate any contemplated investment opportunities,

risks associated with the investment advisory business of our wholly owned subsidiaries, including:

- o the removal by clients of assets managed,

- o their regulatory requirements, and

- o competition in the investment advisory business,

risks associated with the broker-dealer business of our subsidiary,

changes in government regulations affecting our business,

our ability to maintain our exemption from registration under the Investment Company Act of 1940, and

our ability to maintain our qualification as a REIT for federal income tax purposes.

No forward-looking statements can be guaranteed and actual future results may vary materially and we caution you not to place undue reliance on these forward-looking statements. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, please see the information under the caption “Risk Factors” described in this Form 10-K. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements except

as required by law.

PART I

ITEM 1. BUSINESS

All references to “we,” “us,” or “our” mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. The following defines certain of the commonly used terms in this annual report on Form 10-K: Agency refers to a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae; Agency mortgage-backed securities refers to residential mortgage-backed securities that are issued or guaranteed by an Agency; Investment Securities refers to Agency mortgage-backed securities, Agency debentures and corporate debt securities; and Interest-Earning Assets refers to Investment Securities, securities borrowed and U.S. Treasury Securities.

THE COMPANY

Background

We own, manage, and finance a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations (or CMOs), Agency callable debentures, and other securities representing interests in or obligations backed by pools of mortgage loans. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our Investment Securities and the costs of borrowing to finance our acquisition of Investment Securities and from dividends we receive from our subsidiaries. Our wholly-owned subsidiaries offer diversified real estate, asset management and other financial services. To date over 90% of our total assets have consisted of Agency mortgage-backed securities and debentures. While we remain committed to the Agency market, given the current environment, we believe it is prudent to diversify a portion of our investment portfolio. Therefore, we may allocate up to 25% of our stockholders’ equity to assets other than Agency mortgage-backed securities.

We are a Maryland corporation that commenced operations on February 18, 1997. We are self-advised and self-managed. We acquired Fixed Income Discount Advisory Company (or FIDAC) on June 4, 2004 and Merganser Capital Management, Inc. (or Merganser) on October 31, 2008. FIDAC and Merganser manage a number of investment vehicles and separate accounts for which they earn fee income. Our subsidiary, RCap Securities, Inc. (or RCap), operates as a broker-dealer, and was granted membership in the Financial Industry Regulatory Authority (or FINRA) in January 2009. In 2010, we established Shannon Funding LLC (or Shannon), which provides warehouse financing to residential mortgage originators in the United States. In 2010, we also established Charlesfort Capital Management LLC (or Charlesfort), which engages in corporate middle market lending transactions. In 2011, FIDAC established FIDAC Europe Limited (or FIDAC Europe), which we sold in December 2012. In 2011, we established FIDAC FSI LLC (or FIDAC FSI), which invested in trading securities. FIDAC FSI was liquidated in August 2012.

We have elected and believe that we are organized and have operated in a manner that qualifies us to be taxed as a real estate investment trust (or REIT) under the Internal Revenue Code of 1986, as amended (or the Code). If we qualify for taxation as a REIT, we generally will not be subject to federal income tax on our taxable income that is distributed to our stockholders. Therefore, substantially all of our assets, other than FIDAC, Merganser and RCap, which are our taxable REIT subsidiaries, consist of qualified REIT real estate assets (of the type described in Section 856(c)(5)(B) of the Code). We have financed our purchases of Agency mortgage-backed securities and Agency debentures with the net proceeds of equity offerings, convertible notes offerings and borrowings under repurchase agreements whose interest rates adjust based on changes in short-term market interest rates.

Capital Investment Policy

Under our capital investment policy, at least 75% of our total assets must be comprised of high-quality mortgage-backed securities and short-term investments. High quality securities means securities that (1) are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) are unrated but we determine them to be of comparable quality to high-quality rated mortgage-backed securities.

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The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least “investment grade” (rated “BBB” or better by Standard & Poor’s Corporation (or S&P) or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated “BBB” or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics. We intend to structure our portfolio to maintain a minimum weighted average rating (including our deemed comparable ratings for unrated mortgage-backed securities) of our mortgage-backed securities of at least single “A” under the S&P rating system and at the comparable level under the other rating systems.

We may acquire Agency mortgage-backed securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. To date, substantially all of the Agency mortgage-backed securities that we have acquired have been backed by single-family residential mortgage loans.

To date, substantially all of the mortgage-backed securities that we have acquired have been Agency mortgage-backed securities which, although not rated, carry an implied “AAA” rating. Agency mortgage-backed securities consist of agency pass-through certificates and CMOs issued or guaranteed by an Agency. Pass-through certificates provide for a pass-through of the monthly interest and principal payments made by the borrowers on the underlying mortgage loans. CMOs divide a pool of mortgage loans into multiple tranches with different principal and interest payment characteristics.

Our adjustable-rate pass-through certificates are backed by adjustable-rate mortgage loans and have coupon rates which adjust over time, subject to interest rate caps and lag periods, in conjunction with changes in short-term interest rates. Our fixed-rate pass-through certificates are backed by fixed-rate mortgage loans and have coupon rates which do not adjust over time. CMO floaters are tranches of mortgage-backed securities where the interest rate adjusts in conjunction with changes in short-term interest rates. CMO floaters may be backed by fixed-rate mortgage loans or, less often, by adjustable-rate mortgage loans. In this Form 10-K, except where the context indicates otherwise, we use the term “adjustable-rate interest-earning assets” to refer to adjustable-rate pass-through certificates, CMO floaters, Agency debentures and corporate debt.

We may also invest in Agency debentures, which consist of debentures issued by the Federal Home Loan Bank (FHLB), Freddie Mac and Fannie Mae. We intend to continue to invest in adjustable-rate pass-through certificates, fixed-rate mortgage-backed securities, CMO floaters, and Agency debentures. We may also invest on a limited basis in derivative securities which include securities representing the right to receive interest only or a disproportionately large amount of interest as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

Borrowings

We attempt to structure our collateralized borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, correspond generally to the interest rate adjustment indices and periods of our adjustable-rate interest-earning assets. However, periodic rate adjustments on our collateralized borrowings are generally more frequent than rate adjustments on our Investment Securities.

We generally expect to maintain a ratio of debt-to-equity of less than 12:1. This ratio varies from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions. Our debt-to-equity ratios have been below our historical average ratios since the credit crisis of 2008. Specifically, we believe that it is prudent to maintain our existing debt-to-equity ratio because there continues to be volatility in the mortgage and credit markets primarily driven by the uncertainty in Europe and U.S. capital markets. For purposes of calculating this ratio, our debt is equal to our repurchase agreements and convertible senior notes as presented on our Statements of Financial Condition. At December 31, 2012, our ratio of debt-to-equity was 6.5:1.

Our target debt-to-equity ratio is determined under our capital investment policy. Should our actual debt-to-equity ratio increase above the target level due to asset acquisition or market value fluctuations in assets, we would cease to acquire new assets. Our management will, at that time, present a plan to our board of directors to bring us back to our target debt-to-equity ratio; in many circumstances, this would be accomplished over time by the monthly reduction of the balance of our Agency mortgage-backed securities through principal repayments.

During 2010, we issued \$600.0 million in aggregate principal amount of our 4% convertible senior notes due 2015 (4% Convertible Senior Notes) for net proceeds following underwriting expenses of approximately \$582.0 million. Interest on the notes is paid semi-annually at a rate of 4% per year and the notes will mature on February 15, 2015 unless repurchased or converted earlier. As of December 31, 2012 the notes were convertible into shares of common stock at a conversion rate of 70.6980 shares of common stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$14.1447 per share of common stock, subject to adjustment in certain circumstances. During 2012, we repurchased approximately \$492.5 million of the outstanding \$600.0 million of our 4.00% Convertible Senior Notes for \$617.5 million.

During 2012, we issued \$750.0 million in aggregate principal amount of our 5% convertible senior notes due 2015 (5% Convertible Senior Notes) for net proceeds following underwriting expenses of approximately \$727.5 million. Interest on the notes is paid semi-annually at a rate of 5% per year and the notes will mature on May 15, 2015 unless repurchased or converted earlier. As of December 31, 2012 the notes were convertible into shares of common stock at a conversion rate of 52.7969 shares of common stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$18.94 per share of common stock, subject to adjustment in certain circumstances.

Hedging

To the extent consistent with our election to qualify as a REIT, we enter into hedging transactions to attempt to protect our Agency mortgage-backed securities and Agency debentures and related borrowings against the effects of significant interest rate changes. This hedging is used to limit or cap the interest rates on our borrowings. These transactions are entered into solely for the purpose of hedging interest rate or prepayment risk and not for speculative purposes. In connection with our interest rate risk management strategy, we hedge a portion of our interest rate risk by entering into derivative financial instrument contracts. We have elected to not account our interest rate swaps using hedge accounting. Therefore, changes in fair value on our interest rate swaps are reflected in earnings.

Our Subsidiaries

FIDAC, an investment advisor registered with the SEC, is a fixed-income investment management company specializing in managing fixed income investments in residential mortgage-backed securities, commercial mortgage-backed securities and collateralized debt obligations for various investment vehicles and separate accounts. FIDAC also has experience in managing and structuring debt financing associated with various asset classes and as a liquidation agent of collateralized debt obligations. FIDAC commenced active investment management operations in 1994. At December 31, 2012, FIDAC was the adviser or sub-adviser for REITs and other investment vehicles. The team managing Annaly performs the same roles at FIDAC.

Merganser, an investment advisor registered with the SEC, has expertise in a variety of fixed income strategies and focuses on managing each portfolio based on each client's specific investment principles. Merganser serves a diverse group of clients in a variety of disciplines nationwide including pension, public, operating, Taft-Hartley and endowment funds as well as defined contribution plans. Merganser's investment team maintains a careful balance of risk management and performance by employing fundamental security analysis and by trading in an environment supported by state-of-the-art technology, infrastructure and operations.

RCap operates as a broker-dealer and has been a member in the Financial Industry Regulatory Authority since January 2009.

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In 2010, we established Shannon, which provides warehouse financing to residential mortgage originators in the United States. In 2010, we also established Charlesfort, which engages in corporate middle market lending transactions. In 2011, FIDAC established FIDAC Europe, which we sold in December 2012. In 2011, we established FIDAC FSI, which invested in trading securities. FIDAC FSI was liquidated in August 2012. We also own an additional subsidiary which owns trading securities.

Compliance with REIT and Investment Company Requirements

We regularly monitor our investments and the income from these investments and, to the extent we enter into hedging transactions, we monitor income from our hedging transactions as well, so as to ensure at all times that we maintain our qualification as a REIT and our exemption from registration under the Investment Company Act of 1940, as amended.

Executive Officers of the Company

The following table sets forth certain information as of February 25, 2013 concerning our executive officers:

Name	Age	Position held with the Company
Wellington J. Denahan	49	Chairman of the Board and Chief Executive Officer
Kevin G. Keyes	45	President
Kathryn F. Fagan	46	Chief Financial Officer and Treasurer
R. Nicholas Singh	53	Chief Legal Officer, Secretary, and Chief Compliance Officer
James P. Fortescue	39	Chief Operating Officer
Kristopher Konrad	38	Co-Chief Investment Officer
Rose-Marie Lyght	39	Co-Chief Investment Officer

Wellington J. Denahan is Chairman of the Board and Chief Executive Officer of Annaly. Ms. Denahan was appointed Chairman of the Board and Chief Executive Officer of Annaly on November 5, 2012. Previously, Ms. Denahan was appointed to serve as Co-Chief Executive Officer of Annaly effective October 8, 2012. Ms. Denahan was elected on December 5, 1996 to serve as Vice Chairman of the Board and a Chief Investment Officer of Annaly. Ms. Denahan was Annaly's Chief Operating Officer from January 2006 to October 2012 and Chief Investment Officer from 2000 to November 2012. She was a co-founder of Annaly. Ms. Denahan has a Bachelor of Arts from Florida State University.

Kevin G. Keyes, age 45, is President of Annaly and is also a member of the Board of Directors. Prior to being named to his current role, Mr. Keyes served as Chief Strategy Officer and Head of Capital Markets at Annaly. Mr. Keyes has over 20 years of Capital Markets and Investment Banking experience. He joined Annaly in 2009 from Bank of America Merrill Lynch where he served in various senior management and business origination roles since 2005. Prior to that, Mr. Keyes also worked at Credit Suisse First Boston from 1997 until 2005 in various capital markets roles and Morgan Stanley Dean Witter from 1990 until 1997 in various investment banking positions. Mr. Keyes has a B.A. in Economics and a B.S. in Business Administration (ALPA Program) from the University of Notre Dame.

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Kathryn F. Fagan is the Chief Financial Officer and Treasurer of Annaly and FIDAC. Ms. Fagan was employed as Chief Financial Officer and Treasurer of Annaly in April 1997. From June 1, 1991 to February 28, 1997, Ms. Fagan was Chief Financial Officer and Controller of First Federal Savings & Loan Association of Opelousas, Louisiana. Ms. Fagan was employed as a bank and savings and loan auditor by John S. Dowling & Company, a corporation of Certified Public Accountants. Ms. Fagan has a Bachelor of Arts and a Masters Degree in Business Administration each from the University of Southwestern Louisiana.

R. Nicholas Singh is Chief Legal Officer, Secretary and Chief Compliance Officer of Annaly and FIDAC. Mr. Singh was employed by Annaly in February 2005. From 2001 until he joined Annaly, he was a partner in the law firm of McKee Nelson LLP. Mr. Singh has a Bachelors Degree from Carleton College, a Masters Degree from Columbia University and a J.D. from American University.

James P. Fortescue was appointed to serve as to serve as Chief Operating Officer of Annaly and FIDAC effective October 8, 2012. Mr. Fortescue was previously Chief of Staff, Head of Liabilities and Managing Director of Annaly. Mr. Fortescue joined FIDAC in June of 1995. Mr. Fortescue's responsibilities included overseeing FIDAC's financing on mortgage-backed and corporate bonds, as well as maintaining a pricing service for a major broker dealer. In September of 1996, Mr. Fortescue assumed responsibility for overseeing financing activities for the U.S. Dollar Floating Rate Fund Ltd. Mr. Fortescue has been in charge of liability management for Annaly since its inception, and continues to oversee all financing activities for FIDAC. Mr. Fortescue has a Bachelors Degree in Finance from Siena College.

Kristopher Konrad was appointed to serve as to serve as Co-Chief Investment Officer of Annaly effective November 5, 2012. Mr. Konrad was previously a Managing Director and Head Portfolio Manager of Annaly. Mr. Konrad was the Portfolio Manager for Annaly and has served in this capacity since December of 2000. Prior to this, he was head of financing for the U.S. Dollar Floating Rate Fund Ltd. and assisted with the management of FIDAC's high net worth separate accounts. Mr. Konrad was employed by Annaly in October 1997. Mr. Konrad has a Bachelors Degree in Business from Ithaca College and has attended the New York Institute of Finance for intensive mortgage-backed securities studies.

Rose-Marie Lyght was appointed to serve as Co-Chief Investment Officer of Annaly effective November 5, 2012. Ms. Lyght was previously a Managing Director of Annaly and Chief Investment Officer of FIDAC. She has been involved in the asset selection and financing for the investment vehicles managed by FIDAC. Ms. Lyght was employed by Annaly in April 1999. Ms. Lyght has a Bachelor of Science in Finance and a Masters Degree in Business Administration from Villanova University.

Distributions

To maintain our qualification as a REIT, we must distribute substantially all of our taxable income to our stockholders each year (subject to certain adjustments). We have done this in the past and intend to continue to do so in the future. We also have declared and paid regular quarterly dividends in the past and intend to do so in the future. We have adopted a dividend reinvestment plan to enable holders of common stock to reinvest dividends automatically in additional shares of common stock.

BUSINESS STRATEGY

General

Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our Investment Securities and the costs of borrowing to finance our acquisition of Investment Securities, and from dividends we receive from our subsidiaries. To achieve our business objective and generate dividend yields, our strategy is:

§ to acquire Investment Securities that we believe:

- we have the necessary expertise to evaluate and manage;

- we can readily finance;
- are consistent with our balance sheet guidelines and risk management objectives; and
- provide attractive investment returns in a range of scenarios;

§ to finance purchases of mortgage-backed securities with the proceeds from equity and debt offerings and repurchase agreements and, to the extent permitted by our capital investment policy, to utilize leverage to increase potential returns to stockholders through borrowings;