# FORM 10-K

## Arlington Asset Investment Corp. - AI

**Filed: February 21, 2017 (period: December 31, 2016)**

Annual report with a comprehensive overview of the company

# UNITED STATES
# 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, 2016**

**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: 001-34374**

# ARLINGTON ASSET INVESTMENT CORP.
**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Virginia** | **54-1873198** |
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification No.)** |

**1001 Nineteenth Street North,**
**Arlington, VA 22209**
**(Address of Principal Executive Offices) (Zip Code)**

**(703) 373-0200**
**(Registrant's telephone number, including area code)**

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

| Title of Each Class of Securities | Name of Each Exchange on Which Registered |
|---|---|
| **Class A Common Stock, Par Value $0.01** | **New York Stock Exchange** |
| **6.625% Senior Notes due 2023** | **New York Stock Exchange** |
| **6.75% Senior Notes due 2025** | **New York Stock Exchange** |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes ☐ 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 (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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K:☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (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 Exchange Act): Yes ☐ No ☒

The aggregate market value of the registrant's Class A and Class B common stock held by non-affiliates computed by reference to the last reported price at which the registrant's Class A common stock was sold on the New York Stock Exchange on June 30, 2016 was $293 million. There is no public trading market for the registrant's Class B common stock; however, the Class B common stock is convertible into Class A common stock on a share-for-share basis.

As of February 10, 2017, there were 23,628,167 shares of the registrant's Class A common stock outstanding and no shares of the registrant's Class B common stock outstanding.

**Documents incorporated by reference:** Portions of the registrant's Definitive Proxy Statement for the 2017 Annual Meeting of Shareholders (to be filed with the Securities and Exchange Commission no later than 120 days after the end of the registrant's fiscal year end) are incorporated by reference in this Annual Report on Form 10-K in response to Part II, Item 5 and Part III, Items 10, 11, 12, 13 and 14.

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## CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING INFORMATION

When used in this Annual Report on Form 10-K, in future filings with the Securities and Exchange Commission ("SEC") or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may" or similar expressions, are intended to identify "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and, as such, may involve known and unknown risks, uncertainties and assumptions. The forward-looking statements we make in this Annual Report on Form 10-K include, but are not limited to, statements about the following:

- the availability and terms of, and our ability to deploy, capital and our ability to grow our business through our current strategy focused on acquiring primarily residential mortgage-backed securities ("MBS") that are either issued by U.S. government agencies or guaranteed as to principal and interest by U.S. government agencies or U.S. government sponsored agencies ("agency MBS"), and MBS issued by private organizations ("private-label MBS");
- our ability to forecast our tax attributes, which are based upon various facts and assumptions, and our ability to protect and use our net operating losses ("NOLs") and net capital losses ("NCLs") to offset future taxable income, including whether our shareholder rights plan ("Rights Plan") will be effective in preventing an ownership change that would significantly limit our ability to utilize such losses;
- our business, acquisition, leverage, asset allocation, operational, investment, hedging and financing strategies and the success of these strategies;
- the effect of changes in prepayment rates, interest rates and default rates on our portfolio;
- the effect of governmental regulation and actions on our business, including, without limitation, changes to monetary and fiscal policy and tax laws;
- our ability to quantify and manage risk;
- our ability to roll our repurchase agreements on favorable terms, if at all;
- our liquidity;
- our asset valuation policies;
- our decisions with respect to, and ability to make, future dividends;
- investing in assets other than MBS or pursuing business activities other than investing in MBS;
- our ability to maintain our exclusion from the definition of "investment company" under the Investment Company Act of 1940, as amended (the "1940 Act");
- our decision to not elect to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code; and
- the effect of general economic conditions on our business.

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account information currently in our possession. These beliefs, assumptions and expectations may change as a result of many possible events or factors, not all of which are known to us or are within our control. If a change occurs, the performance of our portfolio and our business, financial condition, liquidity and results of operations may vary materially from those expressed, anticipated or contemplated in our forward-looking statements. You should carefully consider these risks, along with the following factors that could cause actual results to vary from our forward-looking statements, before making an investment in our securities:

- the overall environment for interest rates, changes in interest rates, interest rate spreads, the yield curve and prepayment rates, including the timing of increases in the Federal Funds rate by the U.S. Federal Reserve;
- current conditions and further adverse developments in the residential mortgage market and the overall economy;
- potential risk attributable to our mortgage-related portfolios, including changes in fair value;
- our use of leverage and our dependence on repurchase agreements and other short-term borrowings to finance our mortgage-related holdings;
- the availability of certain short-term liquidity sources;

- competition for investment opportunities, including competition from the U.S. Department of Treasury ("U.S. Treasury") and the U.S. Federal Reserve, for investments in agency MBS, as well as the timing of the termination by the U.S. Federal Reserve of its purchases of agency MBS;
- the federal conservatorship of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government;
- mortgage loan prepayment activity, modification programs and future legislative action;
- changes in, and success of, our acquisition, hedging and leverage strategies, changes in our asset allocation and changes in our operational policies, all of which may be changed by us without shareholder approval;
- failure of sovereign or municipal entities to meet their debt obligations or a downgrade in the credit rating of such debt obligations;
- fluctuations of the value of our hedge instruments;
- fluctuating quarterly operating results;
- changes in laws and regulations and industry practices that may adversely affect our business;
- volatility of the securities markets and activity in the secondary securities markets in the United States and elsewhere;
- our ability to successfully expand our business into areas other than investing in MBS and our expectations of the returns of expanding into any such areas; and
- the other important factors identified in this Annual Report on Form 10-K under the caption "Item 1A - Risk Factors."

These and other risks, uncertainties and factors, including those described elsewhere in this Annual Report on Form 10-K, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## ITEM 1. BUSINESS

Unless the context otherwise requires or indicates, all references in this Annual Report on Form 10-K to "Arlington Asset" refer to Arlington Asset Investment Corp., and all references to "we," "us," "our," and the "Company," refer to Arlington Asset Investment Corp. and its consolidated subsidiaries.

### Our Company

We are an investment firm that currently focuses on acquiring and holding a levered portfolio of residential mortgage-backed securities ("MBS"), consisting of agency MBS and private-label MBS. Agency MBS include residential mortgage pass-through certificates for which the principal and interest payments are guaranteed by a U.S. government agency or government sponsored enterprise ("GSE"), such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Private-label MBS, or non-agency MBS, include residential MBS that are not guaranteed by a GSE or the U.S. government. As of December 31, 2016, nearly all of our investment capital was allocated to agency MBS.

We leverage prudently our investment portfolio so as to increase potential returns to our shareholders. We fund our investments primarily through short-term financing arrangements. We enter into various hedging transactions to mitigate the interest rate sensitivity of our cost of borrowing and the value of our MBS portfolio.

We are a Virginia corporation and taxed as a C corporation for U.S. federal tax purposes. We are an internally managed company and do not have an external investment advisor.

### Investment Strategy

We manage our investment portfolio with the goal of obtaining a high risk-adjusted return on capital. We evaluate the rates of return that can be achieved in each asset class and for each individual security within an asset class in which we invest. We then evaluate opportunities against the returns available in each of our investment alternatives and attempt to allocate our assets and capital with an emphasis toward what we believe to be the highest risk-adjusted return available. We expect this strategy will cause us to have different allocations of capital and leverage in different market environments.

Currently, based on market conditions, we believe our residential MBS portfolio has provided us with higher relative risk-adjusted rates of return than most other investment opportunities we have evaluated. Consequently, we have maintained a high allocation of our assets and capital in this sector and have continued to analyze other opportunities and compare risk-adjusted returns to our residential MBS assets. Within our residential MBS investment portfolio, we have gradually increased our investment capital allocation to agency MBS from private-label MBS. Currently, we believe that investments in agency MBS will provide a higher risk-adjusted return as compared to private-label MBS. As of December 31, 2016, nearly all of our investment capital was allocated to agency MBS.

In the future, we may invest in other types of residential mortgage assets such as residential mortgage loans, mortgage servicing rights and GSE credit risk transfer securities, as well as other types of assets, including commercial MBS, asset backed securities, other structured securities, commercial mortgage loans, commercial loans, and other real estate-related loans and securities. In addition, we also may pursue other business activities that would utilize our experience in analyzing investment opportunities and applying similar portfolio management skills. We may change our investment strategy at any time without the consent of our shareholders; accordingly, in the future, we could make investments or enter into hedging transactions that are different from, and possibly riskier than, the investments and associated hedging transactions described in this Annual Report on Form 10-K.

**MBS Portfolio**

The following table summarizes our MBS investment portfolio at fair value as of December 31, 2016 and 2015 (dollars in thousands):

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Specified agency MBS | $ 3,909,452 | $ 3,865,316 |
| Inverse interest-only agency MBS | 1,923 | — |
| Total agency MBS | 3,911,375 | 3,865,316 |
| Net long agency TBA dollar roll positions (1) | 720,027 | 389,258 |
| Total agency investment portfolio | 4,631,402 | 4,254,574 |
| Private-label MBS | 1,173 | 130,435 |
| Private-label interest-only MBS | 93 | 118 |
| Total private-label investment portfolio | 1,266 | 130,553 |
| Total MBS investment portfolio | $ 4,632,668 | $ 4,385,127 |

(1) Represents the fair value of the agency MBS which underlie our TBA forward purchase and sale commitments executed as dollar roll transactions. In accordance with GAAP, our TBA forward purchase and sale commitments are reflected on the consolidated balance sheets as a component of "derivative assets, at fair value" and "derivative liabilities, at fair value," with a collective net asset carrying value of $1,156 and a net liability carrying value of $553 as of December 31, 2016 and 2015, respectively.

***Agency MBS***

Agency MBS consist of residential pass-through certificates that are securities representing undivided interests in "pools" of mortgage loans secured by residential real property. The monthly payments of both principal and interest of the securities are guaranteed by a U.S. government agency or GSE to holders of the securities, in effect "passing through" the monthly payments made by the individual borrowers on the mortgage loans that underlie the securities plus "guarantee payments" made in the event of any defaults on such mortgage loans, net of fees paid to the issuer/guarantor and servicers of the underlying mortgage loans, to the holders of the securities. Mortgage pass-through certificates distribute cash flows from the underlying collateral on a pro rata basis among the holders of the securities. Although the principal and interest payments are guaranteed by a U.S. government agency or GSE to the security holder, the market value of the agency MBS is not guaranteed by a U.S. government agency or GSE.

The agency MBS that we primarily invest in are Fannie Mae and Freddie Mac agency MBS. Fannie Mae and Freddie Mac are stockholder-owned corporations chartered by Congress with a public mission to provide liquidity, stability, and affordability to the U.S. housing market. Fannie Mae and Freddie Mac are currently regulated by the Federal Housing Finance Agency ("FHFA"), the U.S. Department of Housing and Urban Development ("HUD"), the U.S. Securities and Exchange Commission ("SEC"), and the U.S. Department of the Treasury ("U.S. Treasury"), and are currently operating under the conservatorship of the FHFA. The U.S. Treasury has agreed to support the continuing operations of Fannie Mae and Freddie Mac with any necessary capital contributions while in conservatorship. However, the U.S. government does not guarantee the securities, or other obligations, of Fannie Mae or Freddie Mac.

Fannie Mae and Freddie Mac operate in the secondary mortgage market. They provide funds to the mortgage market by purchasing residential mortgages from primary mortgage market institutions, such as commercial banks, savings and loan associations, mortgage banking companies, seller/servicers, securities dealers and other investors. Through the mortgage securitization process, they package mortgage loans into guaranteed MBS for sale to investors, such as us, in the form of pass-through certificates and guarantee the payment of principal and interest on the securities or on the underlying loans held within the securitization trust in exchange for guarantee fees. The underlying loans must meet certain underwriting standards established by Fannie Mae and Freddie Mac (referred to as "conforming loans") and may be fixed or adjustable rate loans with original terms to maturity generally up to 40 years.

Agency MBS differ from other forms of traditional fixed-income securities which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity. Instead, agency MBS provide for a monthly payment that consists of both interest and principal. In addition, outstanding principal on the agency MBS may be prepaid, without penalty, at par at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with more traditional fixed-income securities.

As of December 31, 2016, the Company's agency MBS portfolio was comprised of securities collateralized by pools of fixed rate mortgages that have original terms to maturity of 30 years. In the future, we may also invest in agency MBS collateralized by adjustable-rate mortgage loans ("ARMs") or hybrid ARMs.

We may also invest in agency MBS through agency collateralized mortgage obligations (“CMO”), which are securities that are structured instruments representing interests in agency residential pass-through certificates. Agency CMOs consist of multiple classes of securities, with each class having specific characteristics, including stated maturity dates, weighted average lives and rules governing principal and interest distribution. Monthly payments of principal and interest, including prepayments, are typically returned to different classes based on rules described in the trust documents. Principal and interest payments may also be divided between holders of different securities in an agency CMO; some securities may only receive interest payments while others may only receive principal payments.

We purchase agency MBS either in initial offerings or in the secondary market through broker-dealers or similar entities. We may also utilize to-be-announced (“TBA”) forward contracts in order to invest in agency MBS or to hedge our investments. A TBA security is a forward contract for the purchase or the sale of agency securities at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date, 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 position (referred to as a “pair off”), net settling the paired off positions for cash, and simultaneously entering into a similar TBA contract for a later settlement date, which is commonly collectively referred to as a “dollar roll” transaction.

***Private-Label MBS***

We have and, depending upon market conditions, may in the future invest in private-label MBS, which are residential MBS that are not issued or guaranteed by a U.S. government agency or a GSE. Private-label MBS are often referred to as non-agency MBS. The private-label MBS in which we invest are generally backed by a pool of single-family residential mortgage loans. These certificates are issued by originators of, investors in, and other owners of residential mortgage loans, including savings and loan associations, savings banks, commercial banks, mortgage banks, investment banks and special purpose “conduit” subsidiaries of these institutions. Private-label MBS can carry a significantly higher level of credit exposure relative to the credit exposure of agency MBS. The private-label MBS that we invest in are generally non-investment grade or not rated by major rating agencies.

While agency MBS are backed by the express obligation or guarantee of a U.S. government agency or GSE as described above, private-label MBS are generally only supported by one or more forms of private (*i.e.*, non-governmental) credit enhancement. These credit enhancements provide an extra layer of loss coverage in the event that losses are incurred upon foreclosure sales or other liquidations of underlying mortgaged properties in amounts that exceed the equity holder’s equity interest in the property. Forms of credit enhancement include limited issuer guarantees, reserve funds, private mortgage guaranty pool insurance, overcollateralization and subordination. Subordination is a form of credit enhancement frequently used and involves the issuance of classes of MBS that are subordinate to senior class MBS and, accordingly, are the first to absorb credit losses realized on the underlying mortgage loans. In addition, private-label MBS are generally purchased at a discount to par value, which may provide further protection to credit losses of the underlying residential mortgage loan collateral.

Private-label MBS are backed by pools of residential mortgages that can be composed of prime or non-prime mortgage loans. Prime mortgage loans are residential mortgage loans that generally conform to the underwriting guidelines of a U.S. government agency or a GSE but that do not carry any credit guarantee from either a U.S. government agency or a GSE. Jumbo prime mortgage loans are prime mortgage loans that conform to such underwriting guidelines except with respect to maximum loan size. Non-prime mortgage loans are residential mortgage loans that do not meet all of the underwriting guidelines of a U.S. government agency or a GSE. Consequently, these loans may carry higher credit risk than prime mortgage loans. Non-prime mortgage loans may have been originated through programs that allow borrowers to qualify for a mortgage loan with reduced or alternative forms of documentation. Non-prime mortgage loans include loans commonly referred to as alternative A-paper (“Alt-A”) or as subprime. Alt-A mortgage loans are generally considered riskier than prime mortgage loans and less risky than subprime mortgage loans. Alt-A mortgage loans are typically characterized by borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios and include a higher percentage of investment properties as collateral. Subprime mortgage loans are considered to be of the lowest credit quality. These loans may also include “option-ARM” loans, which contain a feature providing the borrower the option, within certain constraints, to make lesser payments than otherwise required by the stated interest rate for a number of years, leading to negative amortization and increased loan balances.

Private-label MBS are generally issued by a securitization trust referred to as a Real Estate Mortgage Investment Conduit (“REMIC”). The securitization trust will generally issue both senior and subordinated interests. Senior securities are those interests in a securitization that have the first right to cash flows and are last in line to absorb losses, and, therefore, have the least credit risk in a securitization transaction. In general, most, if not all, principal collected from the underlying mortgage loan pool is used to pay down the senior securities until certain performance tests are satisfied. If certain performance tests are satisfied, principal payments are allocated, generally on a pro rata basis, between the senior securities and the subordinated securities. Conversely, the most subordinate securities are those interests in a securitization that have the last right to cash flows and are first in line to absorb losses. Subordinate securities absorb the initial credit losses from a securitization structure, thus protecting the senior securities. Subordinate securities generally receive interest payments even if they do not receive principal payments.

In addition, private-label MBS also may include a re-securitization of MBS which is also referred to as a “re-REMIC” security. For example, a re-REMIC security may consist of re-securitized senior classes of REMIC securities. In turn, the collateral of these senior class REMIC securities consists of the underlying residential mortgage loans. The re-REMIC securitization trust will generally issue both senior and subordinated interests similar to a REMIC securitization trust. A subordinated interest in a re-securitized senior class of REMIC securities may also be referred to as a “mezzanine” interest.

**Financing Strategy**

We use leverage to finance a portion of our MBS portfolio and to seek to increase potential returns to our shareholders. To the extent that revenue derived from our MBS portfolio exceeds our interest expense and other costs of the financing, our net income will be greater than if we had not borrowed funds and had not invested in the assets. Conversely, if the revenue from our MBS portfolio does not sufficiently cover the interest expense and other costs of the financing, our net income will be less or our net loss will be greater than if we had not borrowed funds.

Because of the credit and interest rate risks inherent in our strategy, we closely monitor the leverage (debt-to-equity ratio) of our MBS portfolio. Our leverage may vary from time to time depending upon several factors, including changes in the value of the underlying MBS and hedge portfolio, the timing and amount of investment purchases or sales, and our assessment of risk and returns.

We finance our investments in MBS using short-term borrowings, which primarily consist of repurchase agreements. We have also issued, and may issue in the future, long-term notes as an additional source of financing.

When we engage in a repurchase transaction, we initially sell securities to the counterparty under a master repurchase agreement in exchange for cash from the counterparty. The counterparty is obligated to resell the same securities back to us at the end of the term of the repurchase agreement, which typically is 30 to 90 days, but may have maturities as short as one day and as long as one year. 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, for the purposes of the repurchase transaction, at less than market value. Under our repurchase agreements, we typically pay a floating rate based on the London Interbank Offered Rate (“LIBOR”), plus or minus a fixed spread. These transactions are accounted for as secured financings, and we present the investment securities and related funding on our consolidated balance sheets.

We may also seek to obtain other sources of financing depending on market conditions. We may finance the acquisition of agency MBS by entering into TBA dollar roll transactions in which we would sell a TBA contract for current month settlement and simultaneously purchase a similar TBA contract for a forward settlement date. Prior to the forward settlement date, we may choose to roll the position out to a later date by entering into an offsetting TBA position, net settling the paired off positions for cash, and simultaneously entering into a similar TBA contract for a later settlement date. In such transactions, the TBA contract purchased for a forward settlement date is priced at a discount to the TBA contract sold for settlement/pair off in the current month. This difference (or discount) is referred to as the “price drop.” As discussed under “Non-GAAP Core Operating Income—Economic Net Interest Income” below, we believe this price drop is the economic equivalent of net interest carry income on the underlying agency MBS over the roll period (interest income less implied financing cost), which is commonly referred to as “dollar roll income.” Consequently, dollar roll transactions represent a form of off-balance sheet financing. In evaluating our overall leverage at risk, we consider both our on-balance and off-balance sheet financing.

**Risk Management Strategy**

In conducting our business, we are exposed to market risks, including interest rate, prepayment, extension, credit, liquidity and regulatory risks. We use a variety of strategies to hedge a portion of our exposure to these risks to the extent we believe to be prudent, taking into account our investment strategy and the cost of the hedging transactions. As a result, we may not hedge certain interest rate, prepayment, extension or credit risks if we believe that bearing such risks enhances our return relative to our risk/return profile.

- **Interest Rate Risk**

  We hedge some of our exposure to potential interest rate mismatches between the interest we earn on our longer term investments and the interest we pay on our shorter term borrowings. We enter into various hedging transactions to mitigate the interest rate sensitivity of our cost of borrowing and the value of our MBS portfolio. Because a majority of our funding is in the form of repurchase agreements, our financing costs fluctuate based on short-term interest rate indices, such as LIBOR. Because the vast majority of our investments are assets that have fixed rates of interest and could mature in up to 40 years, the interest we earn on these assets generally does not move in tandem with the interest rates that we pay on our funding repurchase agreements, which generally have a maturity of less than one year. We may experience reduced income, losses, or a significant reduction in our book value due to adverse interest rate movements. In order to attempt to mitigate a portion of such risk, we utilize certain hedging techniques to attempt to lock in a portion of the net spread between the interest we earn on our assets and the interest we pay on our financing costs and to protect our net book value.

Additionally, because prepayments on residential mortgages generally accelerate when interest rates decrease and slow when interest rates increase, mortgage securities typically have "negative convexity." In other words, certain mortgage securities in which we invest may increase in value to a lesser degree than similar duration bonds, or even fall in value, as interest rates decline. Conversely, certain mortgage securities in which we invest may decrease in value to a greater degree than similar duration bonds as interest rates increase. In order to manage this risk, we monitor, among other things, the "duration gap" between our mortgage assets and our hedge portfolio as well as our convexity exposure. Duration is an estimate of the relative expected 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. Convexity exposure relates to the way the duration of our mortgage assets or our hedge portfolio changes when the interest rate or prepayment environment changes.

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

- **Prepayment Risk**

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

We may purchase securities that have a higher interest rate than the then-prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire such securities. In accordance with GAAP, we amortize this premium as a reduction to interest income under the contractual interest method so that a proportional amount of the unamortized premium is amortized as principal prepayments occur. If a security is prepaid in whole or in part at a faster rate than originally expected, we will amortize the purchase premium at a faster pace, resulting in a lower effective return on our investment than originally expected.

We also may purchase securities that have a lower interest rate than the then-prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire such securities. In accordance with GAAP, we accrete this discount as an increase to interest income under the contractual interest method so that a proportional amount of the unamortized discount is accreted as principal prepayments occur. If a security is prepaid in whole or in part at a slower rate than originally expected, we will accrete the purchased discount at a slower pace resulting in a lower effective return on our investment than originally expected.

- **Extension Risk**

Because residential borrowers have the option to make only scheduled payments on their mortgage loans, rather than prepay their mortgage loans, we face the risk that a return of capital on our investment will occur more slowly than anticipated, which we refer to as extension risk. Extension risk generally increases when interest rates rise. In this scenario, our financial results may be adversely affected as we may have to finance our investments at potentially higher costs without the ability to reinvest principal into higher yielding securities.

- **Credit Risk**

We accept mortgage credit exposure at levels we deem prudent within the context of our investment strategy. Therefore, we may retain all or a portion of the credit risk on the loans underlying our private-label MBS. We seek to manage this risk through prudent asset selection, pre-acquisition due diligence, post-acquisition performance monitoring, and the sale of assets for which we identify negative credit trends. Additionally, we vary the percentage mix of our private-label and agency MBS investments in an effort to actively adjust our credit exposure and to improve the risk/return profile of our investment portfolio.

- **Liquidity Risk**

Liquidity risk is the risk that we may be unable to meet our obligations as they come due because of our inability to liquidate assets or obtain funding. Liquidity risk also includes the risk of having to sell assets at a loss to generate liquid funds.

- **Regulatory Risk**

Regulatory risk is the risk of loss, including fines, penalties or restrictions in our activities from failing to comply with current or future federal, state or local laws (including federal and state securities laws), and rules and regulations pertaining to financial services activities, including the loss of our exclusion from regulation as an investment company under the 1940 Act.

The principal instruments that we use to hedge a portion of our exposure to interest rate, prepayment and extension risks are interest rate derivative instruments, including interest rate swaps, interest rate swap futures, U.S. Treasury note futures, Eurodollar futures, and options on U.S. Treasury note futures. Our hedging instruments are generally not designed to protect our net book value from "spread risk" (also referred to as "basis risk"), which is the risk of an increase of the market spread between the yield on our agency MBS and the benchmark yield on U.S. Treasury securities or interest rate swap rates. The inherent spread risk associated with our agency MBS and the resulting fluctuations in fair value of these securities can occur independent of interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the U. S. Federal Reserve, liquidity, or changes in market participants' required rates of return on different assets. Consequently, while we use interest rate derivative instruments to attempt to protect our net book value against moves in interest rates, such instruments typically will not protect our net book value against spread risk and, therefore, the value of our agency MBS and our net book value could decline.

In addition to the hedging instruments discussed above, we also manage our exposure to interest rate, prepayment and extension risk through asset selection. We generally seek to invest in agency MBS that are specifically selected for their relatively lower propensity for prepayment. The pools of residential mortgage loans securing these agency MBS are commonly referred to as "specified pools." These specified pools may include mortgage loans that (i) have low loan balances, (ii) are originated through the Home Affordable Refinance Program ("HARP") or some other government program, (iii) are originated in certain states or geographic areas, (iv) have high loan-to-value ratios, (v) are the obligations of borrowers with credit scores that fall toward the lower end of the range of GSEs' underwriting standards, or (vi) are secured by investor properties. The borrowers of these mortgage loans are believed to have less incentive to refinance. Accordingly, agency MBS collateralized by mortgage loans with these characteristics are believed to be better "protected" from prepayment risk than agency MBS collateralized by more generic pools of mortgage loans. In general, agency MBS backed by specified pools trade at a price premium over generic agency TBA securities. As of December 31, 2016, our on-balance sheet agency MBS portfolio is comprised primarily of securities backed by specified pools selected for their lower prepayment characteristics.

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 be no certainty that our projections of our exposures to interest rate, prepayment, extension, credit or other risks will be accurate or that our hedging activities will be effective and, therefore, actual results could differ materially.

**Competition**

Our success depends, in large part, on our ability to acquire MBS at favorable spreads over our borrowing costs. In acquiring these assets, we compete with mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, mortgage real estate investment trusts, investment banking firms, other lenders, the U.S. Treasury, Fannie Mae, Freddie Mac, other governmental bodies, and other entities. In addition, there are numerous entities with similar asset acquisition objectives and others may be organized in the future which may increase competition for the available supply of MBS that meet our investment objectives. Additionally, our investment strategy is dependent on the amount of financing available to us in the repurchase agreement market, which may also be impacted by competing borrowers. Our investment strategy will be adversely impacted if we are not able to secure financing on favorable terms, if at all. In addition, competition is intense for the recruitment and retention of qualified professionals. Our ability to continue to compete effectively in our businesses will depend upon our continued ability to attract new professionals and retain and motivate our existing professionals. For a further discussion of the competitive factors affecting our business, see "Item 1A - Risk Factors" in this Annual Report on Form 10-K.

**Our Tax Status**

Arlington Asset is subject to taxation as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended (the "Code"). As of December 31, 2016, the Company had net operating loss ("NOL") carry-forwards of $96 million that can be used to offset future taxable ordinary income. The Company's NOL carry-forwards begin to expire in 2027. As of December 31, 2016, the Company had net capital loss ("NCL") carry-forwards of $311 million that can be used to offset future capital gains. The scheduled expirations of the Company's NCL carry-forwards are $137 million in 2019, $103 million in 2020 and $71 million in 2021. The Company is subject to the federal alternative minimum tax ("AMT") and state and local taxes on its taxable income and gains that are not offset by its NOL and NCL carry-forwards.

The Company's ability to use its NOLs, NCLs and built-in losses would be limited if it experienced an "ownership change" under Section 382 of the Code. In general, an "ownership change" would occur if there is a cumulative change in the ownership of the Company's common stock of more than 50% by one or more "5% shareholders" during a three-year period. The Board of Directors adopted and the Company's shareholders approved a shareholder rights agreement ("Rights Plan") in an effort to protect against a possible limitation on the Company's ability to use its NOL carry-forwards, NCL carry-forwards, and built-in losses under Sections 382 and 383 of the Code. The Rights Plan was adopted to dissuade any person or group from acquiring 4.9% or more of the Company's outstanding Class A common stock without the approval of the Board of Directors and triggering an "ownership change" as defined by Section 382.

**Our Exclusion from Regulation as an Investment Company**

We intend to operate so as to be excluded from regulation under the 1940 Act. We rely on Section 3(c)(5)(C) of the 1940 Act, which provides an exclusion for entities that are "primarily engaged in purchasing or otherwise acquiring . . . interests in real estate." Section 3(c)(5)(C) as interpreted by the staff of the SEC provides an exclusion from registration for a company if at least 55% of its assets, on an unconsolidated basis, consist of qualified assets such as whole loans and whole pool agency certificates, and if at least 80% of its assets, on an unconsolidated basis, are real estate related assets. We will need to ensure not only that we qualify for an exclusion or exemption from regulation under the 1940 Act, but also that each of our subsidiaries qualifies for such an exclusion or exemption. We intend to maintain our exclusion by monitoring the value of our interests in our subsidiaries. We may not be successful in this regard.

If we fail to maintain our exclusion or secure a different exclusion or exemption if necessary, we may be required to register as an investment company, or we may be required to acquire or dispose of assets in order to meet our exemption. Any such asset acquisitions or dispositions may include assets that we would not acquire or dispose of in the ordinary course of business, may be at unfavorable prices and result in a decline in the price of our common stock. If we are required to register under the 1940 Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the 1940 Act), and portfolio composition, including restrictions with respect to diversification and industry concentration and other matters. Accordingly, registration under the 1940 Act could limit our ability to follow our current investment and financing strategies and result in a decline in the price of our common stock.

**Available Information**

You may read and copy the definitive proxy materials and any other reports, statements or other information that we file with the SEC at the SEC's public reference room at 100 F Street, N.E., Washington, DC 20549. You may call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public from commercial document retrieval services and at the internet website maintained by the SEC at *http://www.sec.gov.* These SEC filings may also be inspected at the offices of the New York Stock Exchange (NYSE), which is located at 20 Broad Street, New York, New York 10005.

Our website address is *http://www.arlingtonasset.com.* We make available free of charge through our website this Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as well as the annual report to shareholders and Section 16 reports on Forms 3, 4 and 5 as soon as reasonably practicable after such documents are electronically filed with, or furnished to, the SEC. In addition, our Bylaws, Statement of Business Principles (our code of ethics), Corporate Governance Guidelines, and the charters of our Audit, Compensation, and Nominating and Governance Committees are available on our website and are available in print, without charge, to any shareholder upon written request in writing c/o our Secretary at 1001 Nineteenth Street North, Arlington, Virginia 22209. Information on our website should not be deemed to be a part of this report or incorporated into any other filings we make with the SEC.

**Employees**

As of December 31, 2016, we had 11 employees. Our employees are not subject to any collective bargaining agreement, and we believe that we have good relations with our employees.

## ITEM 1A. RISK FACTORS

*Investing in our company involves various risks, including the risk that you might lose your entire investment. Our results of operations depend upon many factors including our ability to implement our business strategy, the availability of opportunities to acquire assets, the level and volatility of interest rates, the cost and availability of short- and long-term credit, financial market conditions and general economic conditions.*

*The following discussion concerns the material risks associated with our business. These risks are interrelated, and you should consider them as a whole. Additional risks and uncertainties not presently known to us may also materially and adversely affect the value of our capital stock and our ability to pay dividends to our shareholders. In connection with the forward-looking statements that appear in this Annual Report on Form 10-K, including these risk factors and elsewhere, you should carefully review the section entitled "Cautionary Statement About Forward-Looking Information."*

### Risks Related to our Investing and Financing Activities

***Changes in interest rates and adverse market conditions could negatively affect the value of our MBS investments and increase the cost of our borrowings, which could result in reduced earnings or losses and negatively affect the cash available for distribution to our shareholders.***

Our investment portfolio consists primarily of fixed-rate agency MBS with long-term maturities. The majority of our funding is in the form of repurchase agreements with short-term maturities with a floating interest rate based on LIBOR. We are exposed to interest rate risk that fluctuates based on changes in the level or volatility of interest rates and in the shape and slope of the yield curve. Under a normal yield curve, long-term interest rates are higher relative to short-term interest rates. In certain instances, the yield curve can become inverted when the short-term interest rates are higher than the long-term interest rates.

A significant risk associated with our portfolio of mortgage-related assets is the risk that both long-term and short-term interest rates will increase significantly. If long-term rates were to increase significantly, the market value of fixed-rate agency MBS would decline and the duration and weighted average life of these MBS would increase. We could realize a loss in the future if the agency MBS in our portfolio are sold. If short-term interest rates were to increase, the financing costs on the repurchase agreements we enter into in order to finance the purchase of MBS would increase, thereby decreasing net interest margin if all other factors remain constant.

***Hedging against interest rate exposure may not completely insulate us from interest rate risk and may adversely affect our earnings, which could adversely affect cash available for distribution to our shareholders.***

We engage in certain hedging transactions to limit our exposure from the adverse effects of changes in interest rates on our short-term financing agreements and our net book value, and therefore may expose our company to the risks associated with such transactions. We have historically entered into and may enter into interest rate swap agreements, Eurodollar futures, interest rate swap futures, U.S. Treasury note futures, put options on U.S. Treasury note futures, TBAs or pursue other hedging strategies. Our hedging activities are generally designed to limit certain exposures and not to eliminate them. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. Such hedging transactions may also limit the opportunity for gain if the values of the portfolio positions should increase. Moreover, it may not be possible to hedge against an interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price.

There are no perfect hedging strategies, and interest rate hedging may fail to protect us from loss. The success of our hedging transactions depends on our ability to accurately predict movements of interest rates and credit spreads. In addition, the degree of correlation between price movements of the instruments used in a hedging strategy and price movements in the portfolio positions being hedged may vary. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss. Furthermore, our hedging strategies may adversely affect us because hedging activities involve costs that we incur regardless of the effectiveness of the hedging activity, which may decrease our net interest margin. Our hedging activity will vary in scope based on the level and volatility of interest rates and principal prepayments, the amount of leverage, the type of MBS held, and other changing market conditions.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related asset or liability;

- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the party owing money in the hedging transaction may default on its obligation to pay.

Our hedging activity may adversely affect our earnings and result in volatile fluctuations in the fair value of our hedges, net income and book value per share, which could adversely affect cash available for distribution to our shareholders and the value of your investment in our securities.

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

When the market spread widens between the yield on our mortgage assets and benchmark interest rates, our net book value could decline if the fair value of our mortgage assets falls by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates or if the fair value of our mortgage assets do not increase as much as the fair value decreases on our hedging instruments. We refer to this scenario as an example of "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 independently of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve, market liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swap agreements, Eurodollar futures, U.S. Treasury note futures, put options and interest rate swap futures 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, which could adversely affect our financial condition and results of operations.

***Declines in the market values of our MBS portfolio may adversely affect our financial condition, results of operations, and market price of our Class A common stock or Senior Notes.***

Our MBS investments are recorded at fair value with changes in fair value reported in either net income or other comprehensive income. As a result, a decline in the fair value of our investments would reduce our net income and book value per share. Fair values for our MBS investments can be volatile. The fair values can change rapidly and significantly and changes can result from various factors, including changes in interest rates, actual and perceived risk, supply, demand, expected prepayment rates, and actual and projected credit performance. Declines in the market values of our MBS portfolio would adversely affect our financial condition, results of operations, and market price of our Class A common stock or Senior Notes.

***Our mortgage investing strategy involves leverage, which could adversely affect our operations and negatively affect cash available for distribution to our shareholders.***

We may increase our investment exposure in MBS or other investment opportunities by funding a portion of those acquisitions with repurchase agreements or other borrowing arrangements. To the extent that revenue derived from such levered assets exceeds our interest expense, hedging expense and other costs of the financing, our net income will be greater than if we had not borrowed funds and had not invested in such assets on a leveraged basis. Conversely, if the revenue from our MBS does not sufficiently cover the interest expense, hedging expense and other costs of the financing, our net income will be less or our net loss will be greater than if we had not borrowed funds. Because of the credit and interest rate risks inherent in our strategy, we closely monitor the leverage of our MBS portfolio. From time to time, our leverage ratio may increase or decrease due to several factors, including changes in the value of the underlying portfolio holdings and the timing and amount of acquisitions.

***An increase in our borrowing costs relative to the interest we receive on our assets may impair our profitability and thus our cash available for distribution to our shareholders.***

As our repurchase agreements and other short-term borrowings mature, we must either enter into new borrowings or liquidate certain of our investments at times when we might not otherwise choose to do so. Lenders may also seek to use a maturity date as an opportune time to demand additional terms or increased collateral requirements that could be adverse to us and harm our operations. Due to the short-term nature of our repurchase agreements used to finance our MBS investments, our borrowing costs are particularly sensitive to changes in short-term interest rates. An increase in short-term interest rates when we seek new borrowings would reduce the spread between our returns on our assets and the cost of our borrowings. This would reduce the returns on our assets, which might reduce earnings and in turn cash available for distribution to our shareholders.

***Differences in the stated maturity of our fixed-rate assets and short-term borrowings may adversely affect our profitability.***

We rely primarily on short-term, variable rate borrowings to acquire fixed-rate securities with long-term maturities. The relationship between short-term and longer-term interest rates is often referred to as the "yield curve." Ordinarily, short-term interest rates are lower than longer-term interest rates. If short-term interest rates rise disproportionately relative to longer-term interest rates, resulting in a "flattening" of the yield curve, our borrowing costs may increase more rapidly than the interest income earned on our assets. Because our investments generally bear interest at longer-term rates than we pay on our borrowings under our repurchase agreements, a flattening of the yield curve would tend to decrease our net interest income and the market value of our investment portfolio. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve "inversion"), in which event, our borrowing costs may exceed our interest income and we could incur operating losses and our ability to make distributions to our shareholders could be hindered.

***Our lenders may require us to provide additional collateral, especially when the market values for our investments decline, which may restrict us from leveraging our assets as fully as desired, and reduce our liquidity, earnings and cash available for distribution to our shareholders.***

We currently use repurchase agreements to finance our investments in residential MBS. Our repurchase agreements allow the lenders, to varying degrees, to determine a new market value of the collateral to reflect current market conditions. If the market value of the securities pledged or sold by us to a funding source declines in value, we may be required by the lender to provide additional collateral or pay down a portion of the funds advanced on minimal notice, which is known as a margin call. Posting additional collateral will reduce our liquidity and limit our ability to leverage our assets, which could adversely affect our business. Additionally, in order to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses and adversely affect our results of operations and financial condition, and may impair our ability to make distributions to our shareholders. In the event we do not have sufficient liquidity to satisfy these margin calls, lending institutions can accelerate our indebtedness, increase our borrowing rates, liquidate our collateral and terminate our ability to borrow. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for protection under the bankruptcy code.

***If we fail to maintain adequate financing through repurchase agreements or to renew or replace existing borrowings upon maturity, we will be limited in our ability to implement our investing activities, which will adversely affect our results of operations and may, in turn, negatively affect the market value of our Class A common stock or Senior Notes and our ability to make dividends to our shareholders.***

We depend upon repurchase agreement financing to purchase our target assets and reach our target leverage ratio. We cannot assure you that sufficient repurchase agreement financing will be available to us in the future on terms that are acceptable to us. Investors and financial institutions that lend in the securities repurchase market have tightened lending standards and some have stopped lending entirely in the repurchase market in response to regulatory capital requirements imposed upon our lenders and the difficulties and changed economic conditions that have materially adversely affected the MBS market. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings based on, among other factors, the regulatory environment and their perceived risk. If we fail to obtain adequate funding or to renew or replace existing funding upon maturity, we will be limited in our ability to implement our business strategy, which will adversely affect our results of operations and may, in turn, negatively affect the market value of our Class A common stock or Senior Notes and our ability to make dividends to our shareholders.

***New regulatory requirements could affect the availability or terms of our financing arrangements or could restrict the origination or formation of new issuances of residential MBS.***

New regulatory requirements, when implemented, could adversely affect the availability or terms of financing from our lender counterparties, could impose more stringent capital rules on large financial institutions, could restrict the origination of residential mortgage loans and the formation of new issuances of MBS and could limit the trading activities of certain banking entities and other systemically significant organizations that are important to us.

In response to various financial crises and the volatility of financial markets, the Basel Committee on Banking Supervision adopted the Third Basel Accord ("Basel III"), a global, voluntary framework to strengthen the regulation, supervision, and risk management of the banking sector focusing on bank capital adequacy, stress testing and market liquidity risk. Basel III recommends that financial institutions fully adopts its standards by 2019. The quantitative measurements and phase-in schedules for Basel III were approved by the member jurisdictions, central banks and supervisory authorities. Individual countries can make modifications to suit their specific needs and priorities when implementing national bank capital requirements. U.S. regulators implemented substantially all of the Basel III standards. In addition, U.S. regulators adopted rules requiring enhanced supplemental leverage ratio standards beginning in January 2018, which would impose capital requirements more stringent than those of the Basel III standards. These regulatory standards may negatively impact our access to financing or affect the terms of our future financing arrangements.

***New assets we acquire may not generate yields as attractive as yields on our current assets, resulting in a decline in our earnings over time.***

We receive monthly cash flows consisting of principal and interest payments from many of our assets. Principal payments reduce the size of our current portfolio (i.e., reduce the amount of our long-term assets) and generate cash for us. We may also sell assets from time to time as part of our portfolio management and capital reallocation strategies. In order to maintain and grow our portfolio size and our earnings, we must reinvest in new assets a portion of the cash flows we receive from principal and interest payments and asset sales. New investment opportunities may not generate the same investment returns as our current investment portfolio. If the assets we acquire in the future earn lower returns than the assets we currently own, our reported earnings will likely decline over time as the older assets pay down, are called, or are sold.

***Clearing facilities or exchanges upon which some of our hedging instruments are traded may increase margin requirements on our hedging instruments in the event of adverse economic developments.***

Our hedging agreements typically require that we pledge collateral on such agreements. Our interest rate swaps are centrally cleared on an exchange with the central clearinghouse having the sole discretion to determine the value of interest rate swaps and the value of the collateral required to secure such instruments. The central clearinghouse requires market participants to deposit and maintain an “initial margin” amount and subsequently exchanges collateral at least on a daily basis based upon daily changes in fair value (also known as “variation margin”). Exchange-traded hedging instruments, such as Eurodollar futures, interest rate swap futures and U.S. Treasury note futures are, in effect, settled on a daily basis by the exchange of cash variation margin. In the event of a margin call of hedging instruments, we must generally pledge additional collateral on the same business day. In response to events having or expected to have adverse economic consequences or which create market uncertainty, clearing facilities or exchanges upon which our hedging instruments are traded may require us to pledge additional collateral against our hedging instruments. In the event that future adverse economic developments or market uncertainty result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

***Our agency MBS investments that are guaranteed by Fannie Mae and Freddie Mac are subject to the risk that these GSEs may not be fully able to satisfy their guarantee obligations or that these guarantee obligations may be repudiated, which would adversely affect the value of our investment portfolio and our ability to sell or finance these securities.***

All of the agency MBS in which we invest depend on a steady stream of payments on the mortgages underlying the MBS. The interest and principal payments we receive on agency MBS issued by Fannie Mae or Freddie Mac are guaranteed by these GSEs, but are not guaranteed by the U.S. government. To the extent these GSEs are not able to fully satisfy their guarantee obligations or that these guarantee obligations are repudiated or otherwise defaulted upon, the value of our investment portfolio and our ability to sell or finance these securities would be adversely affected.

***The conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government, may adversely affect our business.***

In response to the general market instability, and more specifically, the financial condition of Fannie Mae and Freddie Mac, the Housing and Economic Recovery Act of 2008 established the FHFA as the new regulator for Fannie Mae and Freddie Mac. In 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship, which is a statutory process pursuant to which the FHFA operates Fannie Mae and Freddie Mac in an effort to stabilize the entities. The FHFA, together with the U.S. Treasury and the U.S. Federal Reserve, has also undertaken actions designed to boost investor confidence in Fannie Mae and Freddie Mac, support the availability of mortgage financing and protect taxpayers. As part of these actions, the U.S. Treasury has agreed to support the continuing operations of Fannie Mae and Freddie Mac with any necessary capital contributions while in conservatorship. Although the U.S. Treasury has committed to support the positive net worth of Fannie Mae and Freddie Mac, the two GSEs could default on their guarantee obligations, which would materially and adversely affect the value of our agency MBS.

In addition, the future roles of Fannie Mae and Freddie Mac could be significantly reduced or eliminated and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes agency MBS, have broad adverse market implications and negatively impact us. The FHFA and both houses of Congress have each discussed and considered separate measures intended to restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac. The passage of any additional new legislation affecting Fannie Mae and Freddie Mac may create market uncertainty and reduce the actual or perceived credit quality of securities issued or guaranteed by the U.S. government through a new or existing successor entity to Fannie Mae and Freddie Mac. If the charters of Fannie Mae and Freddie Mac were revoked, it is unclear what effect, if any, this would have on the value of the existing Fannie Mae and Freddie Mac agency MBS. We anticipate debate and discussion on residential housing and mortgage reform to continue throughout 2017; however, we cannot be certain if any housing and/or mortgage-related legislation will emerge from committee, be approved by Congress, or be affected by any executive actions and, if so, what the effect will be on our business.

In addition, the FHFA established a goal of developing a new secondary mortgage infrastructure for Fannie Mae and Freddie Mac referred to as the common securitization platform (“CSP”). To achieve this strategic goal, Fannie Mae and Freddie Mac formed a joint venture, Common Securitization Solutions, LLC (“CSS”), to develop and operate a CSP that will support the GSE’s single-family mortgage securitization activities, including the issuance by both GSEs of a single mortgage-backed security (“Single Security”) and to develop it in a way that allows for the integration of additional market participants in the future. The Single Security would finance the same types of fixed-rate mortgages that currently back agency MBS eligible for delivery into the TBA market. One of the stated goals of the Single Security is to establish a single, liquid market for agency MBS issued by both GSEs that are backed by fixed-rate loans and to maintain the liquidity of this market over time, including reducing the trading value disparities between Fannie Mae and Freddie Mac agency MBS. CSS is currently in the process of developing the CSP and Single Security. Freddie Mac announced on December 8, 2016 that it had implemented the CSP for certain single family fixed-rate MBS. If the objectives of those initiatives are fully realized, it is unclear what the effects might be on the agency MBS market and its impact on the Company’s investments in agency MBS.

***Market conditions and actions by governmental authorities may disrupt the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.***

Our success depends on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our MBS. Changes in interest rates and prepayments affect the market price of MBS that we intend to purchase and any MBS that we hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting our analysis, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If recent or future government actions or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (i) assess impact of future changes in interest rates and prepayments on the market value of our investment portfolio, (ii) implement our hedging strategies, and (iii) implement techniques to reduce our prepayment rate volatility would be significantly affected. If we are unable to accurately forecast interest and prepayment rates, our financial position and results of operations could be materially adversely affected.

***Changes in prepayment rates may adversely affect our profitability and are difficult to predict.***

Our investment portfolio includes securities backed by pools of residential mortgage loans. For securities backed by pools of residential mortgage loans, we receive income, generally, from the payments that are made by the borrowers of the underlying mortgage loans. When borrowers prepay their mortgage loans at rates that are faster or slower than expected, it results in prepayments that are faster or slower than expected on our investments. These faster or slower than expected payments may adversely affect our profitability.

We may purchase securities that have a higher interest rate than the then-prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire such securities. In accordance with GAAP, we amortize this premium as a reduction to interest income under the contractual interest method so that a proportional amount of the unamortized premium is amortized as principal prepayments occur. If a security is prepaid in whole or in part at a faster rate than originally expected, we will amortize the purchased premium at a faster pace resulting in a lower effective return on our investment than originally expected.

We also may purchase securities that have a lower interest rate than the then-prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire such securities. In accordance with GAAP, we accrete this discount as an increase to interest income under the contractual interest method so that a proportional amount of the unamortized discount is accreted as principal prepayments occur. If a security is prepaid in whole or in part at a slower rate than originally expected, we will accrete the purchased discount at a slower pace resulting in a lower effective return on our investment than originally expected.

Moreover, if prepayment rates decrease due to a rising interest rate environment, the average life or duration of our fixed-rate assets will generally be extended. This could have a negative impact on our results from operations, as the maturities of our interest rate hedges are fixed and will, therefore, cover a smaller percentage of our funding exposure on our MBS assets to the extent that the average lives of the mortgages underlying such MBS increase due to slower prepayments.

Homeowners tend to prepay mortgage loans more quickly when interest rates decline. Although prepayment rates generally increase when interest rates fall and decrease when interest rates rise, changes in prepayment rates are difficult to predict. Prepayments may also occur as the result of an improvement in the borrower’s ability to refinance the loan as a result of home price appreciation or wage growth. Prepayments can also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage as part of a physical relocation or when borrowers default on their mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property. Fannie Mae and Freddie Mac will generally, among other conditions, purchase mortgages that are 120 days or more delinquent from holders of such mortgages when the cost of guarantee payments to such holders, including advances of interest at the loan coupon rate, exceeds the cost of holding the nonperforming loans in their portfolios. Consequently, prepayment rates also may be affected by conditions in the housing and financial markets, which may result in increased delinquencies on mortgage loans, the GSEs' cost of capital, general economic conditions and the relative interest rates on fixed and adjustable rate loans, which could lead to an acceleration of the payment of the related principal. Furthermore, changes in the GSEs' policies regarding the repurchase of delinquent loans can materially impact prepayment rates. In addition, the introduction of new government programs could increase the availability of mortgage credit to a large number of homeowners in the United States, which could impact the prepayment rates for the entire MBS market, and in particular for agency MBS. Any new programs or changes to existing programs could cause substantial uncertainty around the magnitude of changes in prepayment speeds.

Faster or slower than expected prepayments may adversely affect our profitability and cash available for distribution to our shareholders and are difficult to predict.

***Mortgage loan modification and refinancing programs, future legislative action and changes in the requirements necessary to qualify for refinancing a mortgage with a GSE may adversely affect the value of, and the returns on, the MBS in which we invest.***

The U.S. government has implemented a number of federal programs designed to assist homeowners, including providing homeowners with assistance in avoiding residential mortgage loan foreclosures, allowing certain distressed homeowners to refinance their mortgages into FHA-insured loans, and allowing certain borrowers to modify their mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans or to extend the payment terms of the loans.

It is likely that loan modifications would result in increased prepayments on agency MBS. Faster or slower than expected prepayments may adversely affect our profitability and cash available for distribution to our shareholders. Loan modification programs and future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing a mortgage with a GSE, may adversely affect the value of, and the returns on, our MBS investments.

***Purchases and sales of agency MBS by the Federal Reserve may adversely affect the price and return associated with agency MBS.***

From time to time, the Federal Reserve may engage in large scale purchases of agency MBS and U.S. Treasury securities in the private market through a competitive process, with the goal of supporting mortgage markets and promoting its monetary policy objectives. We cannot predict the impact of the Federal Reserve's actions on the prices and liquidity of agency MBS. During periods in which the Federal Reserve purchases significant volumes of agency MBS, yields on agency MBS will likely be lower, refinancing volumes will likely be higher, and market volatility will likely be considerably higher than would have been absent its large scale purchases. Further, there is also a risk that when the Federal Reserve reduces its purchases of agency MBS through the reinvestment of its principal and interest payments it receives on its agency MBS holdings, or sells some or all of its holdings of agency MBS, the pricing of our agency MBS portfolio and our net book value could be adversely affected.

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

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

Under certain market conditions, TBA dollar roll transactions may result in negative carry income whereby the agency MBS purchased for a forward settlement date under the TBA contract are priced at a premium to agency MBS for settlement in the current month. Additionally, sales of some or all of the agency MBS held by Federal Reserve or declines in purchases of agency MBS by the Federal Reserve could adversely impact the dollar roll market. Under such conditions, it may be uneconomical to roll our TBA positions prior to the settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations.

In addition, pursuant to the margin provisions established by the Mortgage-Backed Securities Division ("MBSD") of the FICC we are subject to margin calls on our TBA contracts. If the market value of a TBA security falls below the purchase price of a forward commitment to purchase a TBA security, we may be required to post cash collateral to the counterparty.

Negative carry income on TBA dollar roll transactions or failure to procure adequate financing to settle our obligations or meet margin calls under our TBA contracts could result in defaults or force us to sell assets under adverse market conditions or through foreclosure and adversely affect our financial condition and results of operations.

***Our use of repurchase agreements may give our lenders greater rights in the event that either we or any of our lenders file for bankruptcy, which may make it difficult for us to recover our collateral.***

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and take possession of and liquidate our collateral under the repurchase agreements without delay if we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that any of our lenders file for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either our lenders or us. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970 or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our investment under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes.

***If the lending institution under one or more of our repurchase agreements defaults on its obligation to resell the underlying security back to us at the end of the agreement term, we will lose money on our repurchase transactions.***

When we engage in a repurchase transaction, we initially sell securities to the transaction counterparty under a master repurchase agreement in exchange for cash from the counterparty. The counterparty is obligated to resell the same securities back to us at the end of the term of the repurchase agreement, which typically is 30 to 90 days, but may have terms from one day to up to three years or more. The cash we receive when we initially sell the collateral is less than the value of the collateral, which is referred to as the "haircut." If the counterparty in a repurchase transaction defaults on its obligation to resell the securities back to us, we will incur a loss on the transaction equal to the amount of the haircut (assuming no change in the value of the securities). Losses incurred on our repurchase transactions would adversely affect our earnings and our cash available for distribution to our shareholders.

***If we default on our obligations under our repurchase agreements, we may be unable to establish a suitable replacement facility on acceptable terms or at all.***

If we default on one of our obligations under a repurchase agreement, the counterparty may terminate the agreement and cease entering into any other repurchase agreements with us. In that case, we would likely need to establish a replacement repurchase facility with another financial institution in order to continue to leverage the assets in our investment portfolio and to carry out our investment strategy. We may be unable to establish a suitable replacement repurchase facility on acceptable terms or at all.

***Despite current indebtedness levels, we may still be able to incur substantially more debt, which could have important consequences to you.***

As of December 31, 2016, we had total unsecured indebtedness (excluding payables, derivative liabilities and recourse liability) of $75.3 million, which includes $25.0 million in principal amount of our 6.625% senior notes due 2023, $35.3 million in principal amount of our 6.75% senior notes due 2025, and $15.0 million in principal amount of subordinated unsecured long-term debentures due between 2033 and 2035. Our level of indebtedness could have important consequences to you, because:

- it could affect our ability to satisfy our financial obligations;
- a substantial portion of our cash flows from operations will have to be dedicated to interest and principal payments and may not be available for operations, expansion, acquisitions or general corporate or other purposes;
- it may impair our ability to obtain additional debt or equity financing in the future;
- it may limit our ability to refinance all or a portion of our indebtedness on or before maturity;
- it may limit our flexibility in planning for, or reacting to, changes in our business and industry; and
- it may make us more vulnerable to downturns in our business, our industry or the economy in general.

Our operations may not generate sufficient cash to enable us to service our debt. If we fail to make payment on the senior notes, we could default on the senior notes.

***Limitations on our access to capital could impair our liquidity and our ability to conduct our business.***

Liquidity, or ready access to funds, is essential to our business. Failures of similar businesses have often been attributable in large part to insufficient liquidity. Liquidity is of particular importance to our business and perceived liquidity issues may affect our counterparties' willingness to engage in transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption, the payment of significant legal defense and indemnification costs, expenses, damages or settlement amounts, or an operational problem that affects us or third parties. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time or the market is experiencing significant volatility. Our inability to maintain adequate liquidity would materially harm our business and operations.

***Investments in non-investment grade private-label MBS may be illiquid, may have a higher risk of default and may not produce current returns.***

We may invest in private-label MBS that are non-investment grade, which means that major rating agencies rate them below the top four investment-grade rating categories (*i.e.*, "AAA" through "BBB"). Non-investment grade, private-label MBS tend to be less liquid, may have a higher risk of default and may be more difficult to value than investment grade bonds. Recessions or poor economic or pricing conditions in the markets associated with private-label MBS may cause defaults or losses on loans underlying such securities. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their governing indentures is not certain.

***Mortgage loans that serve as collateral of private-label MBS that we may invest in may be subject to delinquency, foreclosure and loss, which could result in significant losses to us.***

Residential mortgage loans are secured by residential property and are subject to risks of delinquency, foreclosure and loss. The ability of a borrower to repay a loan secured by residential property is dependent upon the income of the borrower. A number of factors may impair a borrower's ability to repay its loan, including loss of employment, divorce, illness, acts of God, acts of war, terrorism or civil unrest, adverse changes in national and local economic and market conditions, changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of complying with such laws and regulations, costs of remediation and liabilities associated with environmental conditions, and the potential for uninsured or under-insured property losses.

In the event of a default under a mortgage loan, the holder of the mortgage loan bears the risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan. In the event of a bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of the bankruptcy, and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process.

Private-label MBS evidence interests in, or are secured by, pools of residential mortgage loans. Accordingly, these securities may be subject to all of the risks of the respective underlying mortgage loans.

***Our investments may include subordinated tranches of private-label MBS, which are subordinate in right of payment to more senior securities.***

Our investments may include subordinated tranches of private-label MBS, which are subordinated classes of securities in a structure of securities collateralized by a pool of mortgage loans and, accordingly, are the first or among the first classes of securities in such a structure to bear the loss upon a restructuring or liquidation of the underlying collateral and the last to receive payment of interest and principal. Furthermore, our private-label MBS may also consist of subordinate classes of re-securitized senior class MBS. Estimated fair values of these subordinated interests tend to be more sensitive to changes in economic conditions than more senior securities. As a result, such subordinated interests generally are not actively traded and may not provide holders thereof with liquid investments.

***Our investment portfolio may be concentrated in terms of credit risk.***

Our investment portfolio may at times be concentrated in certain asset types that are subject to higher risk of foreclosure or secured by properties concentrated in a limited number of geographic locations. To the extent that our portfolio is concentrated in any one region or type of asset, downturns relating generally to such region or type of asset may result in defaults on a number of our assets within a short time period, which may reduce our net asset value, our net income, the value of our securities and our ability to pay dividends to our stockholders. Our portfolio may contain other concentrations of risk, and we may fail to identify, detect or hedge against those risks, resulting in large or unexpected losses.

***Our due diligence of potential investments may not reveal all of the liabilities associated with those investments and may not reveal aspects of the investments which could lead to investment losses.***

Before making certain investments, we may undertake due diligence efforts with respect to various aspects of the acquisition, including investigating the strengths and weaknesses of the originator or issuer of the asset and, in the case of acquisitions of private-label MBS, verifying certain aspects of the underlying securities, loans or properties themselves as well as other factors and characteristics that may be material to the performance of the investment. In making the assessment and otherwise conducting due diligence, we rely on resources available to us and, in some cases, third party information. There can be no assurance that any due diligence process that we conduct will uncover relevant facts that could be determinative of whether or not an investment will be successful.

***We may invest in non-prime mortgage loans or investments collateralized by non-prime mortgage loans, which are subject to increased risks.***

We may invest in non-prime mortgage loans or investments collateralized by pools of non-prime mortgage loans. In general, non-prime mortgage loans are loans that have been originated using underwriting standards that do not conform to the underwriting guidelines of Fannie Mae or Freddie Mac. Non-prime mortgage loans may allow borrowers to qualify for a mortgage loan with reduced or alternative forms of documentation. They are typically characterized by borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios and include a higher percentage of investment properties.

Non-prime mortgage loans may experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of the higher delinquency rates and losses associated with non-prime mortgage loans, the performance of non-prime mortgage loans or investments backed by non-prime mortgage loans in which we may invest could be correspondingly adversely affected, which could adversely impact our results of operations, financial condition and business.

***The lack of liquidity in our investments may adversely affect our business.***

We may hold investments that are not liquid or that could become illiquid. It may be difficult or impossible to obtain third party valuations on illiquid investments and these instruments may typically experience greater price volatility than instruments for which a ready market exists. In addition, validating pricing for illiquid instruments may be more subjective than more liquid investments. The lack of liquidity for certain asset classes that we may invest in may make it difficult for us to sell such investments should the need or desire arise. In addition, if we are required to liquidate all or a portion of our investment portfolio quickly, we may realize significant losses. As a result, our ability to change our investment portfolio in response to changing market conditions may be limited, which could adversely affect our results of operations and financial condition.

Additionally, recent legislation and regulations could limit certain market participants' abilities to make markets in certain securities, including private-label MBS. These rules have the potential to significantly reduce the liquidity within these markets, making it more difficult for us to sell such investments and may significantly impact the price volatility of the asset class.

***Our investments are recorded at fair value based upon assumptions that are inherently subjective, and our results of operations and financial condition could be adversely affected if our determinations regarding the fair value of our investments are materially higher than the values that we ultimately realize upon their disposal.***

We measure the fair value of our investments quarterly, in accordance with guidance set forth in FASB Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurements and Disclosures.* Ultimate realization of the value of an asset depends to a great extent on economic and other conditions that are beyond our control. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold because market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our Class A common stock and Senior Notes could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

Our determination of the fair value of our agency MBS is based on price estimates provided by third-party pricing services. In general, pricing services heavily disclaim their valuations. Depending on the complexity and liquidity of a security, valuations of the same security can vary substantially from one pricing service to another. Private-label MBS trade infrequently and may be considered illiquid. To the extent we invest in private-label MBS, our determination of the fair value is based on significant unobservable inputs based on various assumptions made by management of the Company. These significant unobservable inputs may include assumptions regarding future interest rates, prepayment rates, discount rates, credit loss rates, and the timing of credit losses. These assumptions are inherently subjective and involve a high degree of management judgment, and our determinations of fair value may differ materially from the values that would have been used if a public market for these securities existed. Therefore, our results of operations for a given period could be adversely affected if our determinations regarding the fair market value of these investments are materially different than the values that we ultimately realize upon their disposal.

***Credit ratings assigned to investment debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities.***

We make certain investment decisions after factoring in a series of data, including credit ratings assigned by credit rating agencies. However, a credit rating may not accurately reflect the risks associated with a particular debt security, such as private-label MBS. Rating agencies rate certain debt securities based upon their assessment of the safety of the receipt of principal and interest payments. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of debt securities and, therefore, the assigned credit rating may not fully reflect the true risks of an investment. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, such that our investments may be of higher or lower credit risk than the ratings indicate. A downgrade in credit rating can materially adversely affect the fair value of a rated security. Our assessment of the quality of a potential investment that relies, in part, on that security's credit rating may prove to be inaccurate, and we may incur credit losses in excess of our initial expectations.

Furthermore, credit rating agencies may change their methods of evaluating credit risk and determining ratings on MBS. These changes may occur quickly and often. The market's ability to understand and absorb these changes, and the impact to the securitization market in general, are difficult to predict. Such changes will have an impact on the amount of investment-grade and non-investment-grade securities that are created or placed on the market in the future. A change in the amount of investment-grade and non-investment-grade securities that are created or placed in the market could materially adversely impact the value of the MBS in our portfolio and potentially limit or increase the value of MBS available for purchase in the future.

***Credit ratings may not reflect all risks, are not recommendations to buy or hold the Senior Notes or our other senior unsecured debt that we may issue from time to time, and may be subject to revision, suspension or withdrawal at any time.***

One or more independent credit rating agencies may assign and maintain credit ratings to our Senior Notes and other indebtedness that we may offer from time to time. The credit ratings reflect rating agencies' assessment of our ability to perform our obligations under the Senior Notes, including an assessment of credit risks in determining the likelihood that payments will be made when due under such debt. The ratings may not reflect the potential impact of all risks related to the structure, market, risk and other factors relating to, and that may affect the value of, such securities. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal by the rating agency at any time. Ratings do not reflect market prices or suitability of a security for a particular investor. No assurance can be given that a credit rating will remain constant for any given period of time or that a credit rating will not be lowered or withdrawn entirely by the credit rating agency if, in its judgment, circumstances in the future so warrant. A suspension, reduction or withdrawal at any time of the credit rating assigned to the Senior Notes by one or more of the credit rating agencies may adversely affect the cost and terms and conditions of our financings and could adversely affect the value and trading of the Senior Notes, as well as other of our senior unsecured debt that we may issue from time to time.

***We may change our investment strategy, hedging strategy, asset allocation and operational policies without shareholder consent, which may result in riskier investments and adversely affect the market value of our Class A common stock and Senior Notes and our ability to make distributions to our shareholders.***

We may change our investment strategy, hedging strategy, asset allocation and operational policies at any time without the consent of our shareholders, which could result in our making investment or hedge decisions that are different from, and possibly riskier than, the investments and hedges described in this Annual Report on Form 10-K. A change in our investment or hedging strategy may increase our exposure to interest rate and real estate market fluctuations. A change in our asset allocation could result in us making investments in securities, assets or business different from those described in this Annual Report on Form 10-K. Our Board of Directors oversees our operational policies, including those with respect to our acquisitions, growth, operations, indebtedness, capitalization and distributions or approves transactions that deviate from these policies without a vote of, or notice to, our shareholders. Operational policy changes could adversely affect the market value of our Class A common stock or Senior Notes and our ability to make distributions to our shareholders. Investing in assets other than residential MBS or pursuing business activities other than investing in residential MBS may not be successful and could adversely affect our results of operations and the market value of our Class A common stock or Senior Notes.

***We may enter into new lines of business, acquire other companies or engage in other strategic initiatives, each of which may result in additional risks and uncertainties in our businesses.***

We may pursue growth through acquisitions of other companies or other strategic initiatives that may require approval by our Board of Directors, stockholders, or both. To the extent we pursue strategic investments or acquisitions, undertake other strategic initiatives or consider new lines of business, we will face numerous risks and uncertainties, including risks associated with:

- the availability of suitable opportunities;
- the level of competition from other companies that may have greater financial resources;
- our ability to value potential acquisition opportunities accurately and negotiate acceptable terms for those opportunities;
- the required investment of capital and other resources;
- the lack of availability of financing and, if available, the terms of any financings;
- the possibility that we have insufficient expertise to engage in such activities profitably or without incurring inappropriate amounts of risk;
- the diversion of management's attention from our core businesses;
- assumption of liabilities in any acquired business;
- the disruption of our ongoing businesses;
- the increasing demands on or issues related to combining or integrating operational and management systems and controls;
- compliance with additional regulatory requirements; and
- costs associated with integrating and overseeing the operations of the new businesses.

Entry into certain lines of business may subject us to new laws and regulations with which we are not familiar, or from which we are currently exempt, and may lead to increased litigation and regulatory risk. In addition, if a new business generates insufficient revenues or if we are unable to efficiently manage our expanded operations, our results of operations will be adversely affected. Our strategic initiatives may include joint ventures, in which case we will be subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to, systems, controls and personnel that are not under our control.

***Our Board of Directors does not approve each of our investment, financing and hedging decisions.***

Our Board of Directors oversees our operational policies and periodically reviews our investment guidelines and our investment portfolio. However, our Board of Directors does not review all of our proposed investments. In addition, in conducting periodic reviews, our Board of Directors may rely primarily on information provided to them by our management. Furthermore, transactions entered into or structured for us by our management may be difficult or impossible to unwind by the time they are reviewed by our Board of Directors.

***We operate in a highly-competitive market for investment opportunities, which could make it difficult for us to purchase or originate investments at attractive yields and thus have an adverse effect on our business, results of operations and financial condition.***

We gain access to investment opportunities only to the extent that they become known to us. Gaining access to investment opportunities is highly competitive. Many of our competitors are substantially larger than us and have considerably greater financial, technical and marketing resources, more long-standing relationships, broader product offerings and other advantages. Some of our competitors may have a lower cost of funds and access to funding sources that are not available to us. The Federal Reserve's continuing reinvestment of principal and interest payments on the MBS held in its portfolio may result in increased competition for attractive opportunities in our target investments. As a result of this competition, we may not be able to purchase or originate our target investments at attractive yields, which could have an adverse effect on our business, results of operations and financial condition.

***Uncertainty over the Trump administration's policies, together with questions regarding the administration's ability to work with Congress in order to implement such policies, are likely to increase market and credit volatility over 2017.***

We expect vigorous debate and discussion in a number of areas, including residential housing and mortgage reform, taxation, fiscal policy, and monetary policy to continue over the next few years; however, we cannot be certain if or when any specific proposal or policy might be announced, emerge from committee, or be approved by Congress and, if so, what the effects on us may be.

**Risks Related to our Business and Structure**

***Our Rights Plan could inhibit a change in our control.***

We have a Rights Plan designed to protect against a possible limitation on our ability to use our NOLs, NCLs and built-in losses by dissuading investors from aggregating ownership of our Class A common stock and triggering an "ownership change" for purposes of Sections 382 and 383 of the Code. Under the terms of the Rights Plan, in general, if a person or group acquires or commences a tender or exchange offer for beneficial ownership of 4.9% or more of the outstanding shares of our Class A common stock upon a determination by our Board of Directors (an "Acquiring Person"), all of our other Class A and Class B common shareholders will have the right to purchase securities from us at a discount to such securities' fair market value, thus causing substantial dilution to the Acquiring Person. The Rights Plan may have the effect of inhibiting or impeding a change in control not approved by our Board of Directors and, notwithstanding its purpose, could adversely affect our shareholders' ability to realize a premium over the then-prevailing market price for our common stock in connection with such a transaction. In addition, because our Board of Directors can prevent the Rights Plan from operating, in the event our Board of Directors approves of an Acquiring Person, the Rights Plan gives our Board of Directors significant discretion over whether a potential acquirer's efforts to acquire a large interest in us will be successful. Consequently, the Rights Plan could impede transactions that would otherwise benefit our shareholders.

***The trading price of our Class A common stock or Senior Notes may be adversely affected by factors outside of our control.***

Any negative changes in the public's perception of the prospects for our business or the types of assets in which we invest could depress our stock price regardless of our results. The following factors, among others, could contribute to the volatility of the price of our Class A common stock or Senior Notes:

- actual or unanticipated variations in our quarterly results;
- changes in our financial estimates by securities analysts;
- conditions or trends affecting companies that make investments similar to ours;
- changes in interest rate environments and the mortgage market that cause our borrowing costs to increase, our reported yields on our MBS portfolio to decrease or that cause the value of our MBS portfolio to decrease;
- changes in the market valuations of the securities in our MBS portfolio and other principal investments;
- negative changes in the public's perception of the prospects of investment or financial services companies;
- changes in the regulatory environment in which our business operates or changes in federal fiscal or monetary policies;
- dilution resulting from new equity issuances;
- general economic conditions such as a recession, or interest rate or currency rate fluctuations; and
- additions or departures of our key personnel.

Many of these factors are beyond our control.

***We may experience significant fluctuations in quarterly operating results.***

Our revenues and operating results may fluctuate from quarter to quarter and from year to year due to a combination of factors, many of which are beyond our control, including the market value of the MBS we acquire, the performance of our hedging instruments, prepayment rates and changes in interest rates. As a result, we may fail to meet profitability or dividend expectations, which could negatively affect the market price of our Class A common stock and Senior Notes and our ability to pay dividends to our shareholders.

***We cannot assure you that we will pay dividends in the future.***

Pursuant to our variable dividend policy, our Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. Our Board of Directors is not obligated to maintain a minimum dividend payment level and the amount of our dividend may fluctuate.  Our dividend policy differs from many of our competitors who qualify as REITs that must distribute to their shareholders at least 90% of their REIT taxable income each taxable year. As a corporation that is taxed as a C corporation for U.S. federal tax purposes, we do not have any minimum distribution requirements. There can be no assurances that our Board of Directors will continue to approve the payment of future dividends at the current levels, if any at all.

***We may pay distributions to shareholders that are considered a return of capital for U.S. federal income tax purposes.***

We may pay distributions to shareholders that may include a return of capital.  To the extent that our Board of Directors decides to pay a distribution in excess of our current or accumulated earnings and profits, such distributions would generally be considered a return of capital for U.S. federal income tax purposes.  A return of capital reduces the basis of a stockholder's investment in our common stock to the extent of such basis and is treated as a capital gain thereafter.

***Indemnification obligations to certain of our current and former directors and officers may increase the costs to us of legal proceedings involving our company.***

Our charter contains a provision that limits the liability of our directors and officers to us and our shareholders for money damages, except for liability resulting from willful misconduct or a knowing violation of the criminal law or any federal or state securities law. Our charter also requires us to indemnify our directors and officers in connection with any liability incurred by them in connection with any action or proceeding (including any action by us or in our right) to which they are or may be made a party by reason of their service in those or other capacities if the conduct in question was in our best interests and the person was acting on our behalf or performing services for us, unless the person engaged in willful misconduct or a knowing violation of the criminal law. The Virginia Stock Corporation Act requires a Virginia corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he is made a party by reason of his service in that capacity.

In addition, we have entered into indemnification agreements with certain of our current and former directors and officers under which we are generally required to indemnify them against liability incurred by them in connection with any action or proceeding to which they are or may be made a party by reason of their service in those or other capacities, if the conduct in question was in our best interests and the person was conducting themselves in good faith (subject to certain exceptions, including liabilities arising from willful misconduct, a knowing violation of the criminal law or receipt of an improper benefit).

In the future we may be the subject of indemnification assertions under our charter, Virginia law or these indemnification agreements by our current and former directors and officers who are or may become party to any action or proceeding. We maintain directors' and officers' insurance policies that may limit our exposure and enable us to recover a portion of any amounts paid with respect to such obligations. However, if our coverage under these policies is reduced, denied, eliminated or otherwise not available to us, our potential financial exposure would be increased. The maximum potential amount of future payments we could be required to make under these indemnification obligations could be significant. Amounts paid pursuant to our indemnification obligations could adversely affect our financial results and the amount of cash available for distribution to our shareholders.

***Loss of our exclusion from regulation as an investment company under the 1940 Act would adversely affect us and may reduce the market price of our shares.***

We rely on Section 3(c)(5)(C) of the 1940 Act for our exclusion from the registration requirements of the 1940 Act. This provision requires that 55% of our assets, on an unconsolidated basis, consist of qualifying assets, such as agency whole pool certificates, and 80% of our assets, on an unconsolidated basis, consist of qualifying assets or real estate-related assets. We will need to ensure not only that we qualify for an exclusion or exemption from regulation under the 1940 Act, but also that each of our subsidiaries qualifies for such an exclusion or exemption. We intend to maintain our exclusion by monitoring the value of our interests in our subsidiaries. We may not be successful in this regard.

If we fail to maintain our exclusion and another exclusion or exemption is not available, we may be required to register as an investment company, or we may be required to acquire or dispose of assets in order to meet our exemption. Any such asset acquisitions or dispositions may include assets that we would not acquire or dispose of in the ordinary course of business, may be at unfavorable prices and result in a decline in the price of our Class A common stock or Senior Notes. If we are required to register as an investment company under the 1940 Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the 1940 Act), and portfolio composition, including restrictions with respect to diversification and industry concentration and other matters. Accordingly, registration under the 1940 Act could limit our ability to follow our current investment and financing strategies and result in a decline in the price of our Class A common stock or Senior Notes.

***Failure to obtain and maintain an exemption from being regulated as a commodity pool operator could subject us to additional regulation and compliance requirements and may result in fines and other penalties which could materially adversely affect our business, financial condition and results of operations.***

The Dodd-Frank Act established a comprehensive new regulatory framework for derivative contracts commonly referred to as “swaps.” As a result, any investment fund that trades in swaps or other derivatives may be considered a “commodity pool,” which would cause its operators (in some cases the fund’s directors) to be regulated as “commodity pool operators,” or CPOs. Under rules adopted by the U.S. Commodity Futures Trading Commission (“CFTC”) for which the compliance date generally was December 31, 2012 as to those funds that become commodity pools solely because of their use of swaps, CPOs must by then have filed an application for registration with the National Futures Association (“NFA”) and have commenced and sustained good faith efforts to comply with the Commodity Exchange Act and CFTC’s regulations with respect to capital raising, disclosure, reporting, recordkeeping and other business conduct applicable for their activities as CPOs as if the CPOs were in fact registered in such capacity (which also requires compliance with applicable NFA rules). However, the CFTC’s Division of Swap Dealer and Intermediary Oversight issued a no-action letter saying, although it believes that mortgage REITs are properly considered commodity pools, it would not recommend that the CFTC take enforcement action against the operator of a mortgage REIT who does not register as a CPO if, among other things, the mortgage REIT limits the initial margin and premiums required to establish its swaps, futures and other commodity interest positions to not more than five percent (5%) of its total assets, the mortgage REIT limits the net income derived annually from those commodity interest positions which are not qualifying hedging transactions to less than five percent (5%) of its gross income, and interests in the mortgage REIT are not marketed to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures, commodity options or swaps markets.

We use hedging instruments in conjunction with our investment portfolio and related borrowings to reduce or mitigate risks associated with changes in interest rates, yield curve shapes and market volatility. These hedging instruments may include interest rate swaps, interest rate swap futures, Eurodollar futures, U.S. Treasury note futures and options of futures. We do not currently engage in any speculative derivatives activities or other non-hedging transactions using swaps, futures or options on futures. We do not use these instruments for the purpose of trading in commodity interests, and we do not consider our company or its operations to be a commodity pool as to which CPO registration or compliance is required. We have claimed the relief afforded by the above-described no-action letter. Consequently, we will be restricted to operating within the parameters discussed in the no-action letter and will not enter into hedging transactions covered by the no-action letter if they would cause us to exceed the limits set forth in the no-action letter. However, there can be no assurance that the CFTC will agree that we are entitled to the no-action letter relief claimed.

The CFTC has substantial enforcement power with respect to violations of the laws over which it has jurisdiction, including their anti-fraud and anti-manipulation provisions. For example, the CFTC may suspend or revoke the registration of or the no-action relief afforded to a person who fails to comply with commodities laws and regulations, prohibit such a person from trading or doing business with registered entities, impose civil money penalties, require restitution and seek fines or imprisonment for criminal violations. In the event that the CFTC staff does not provide the no action letter relief we requested or asserts that we are not entitled to the mortgage REIT no-action letter relief claimed or if CFTC otherwise determines that CPO registration and compliance is required of us, we may be obligated to furnish additional disclosures and reports, among other things. Further, a private right of action exists against those who violate the laws over which the CFTC has jurisdiction or who willfully aid, abet, counsel, induce or procure a violation of those laws. In the event that we fail to comply with statutory requirements relating to derivatives or with the CFTC’s rules thereunder, including the mortgage REIT no-action letter described above, we may be subject to significant fines, penalties and other civil or governmental actions or proceedings, any of which could have a materially adverse effect on our business, financial condition and results of operations.

***We face competition for personnel, which could adversely affect our business and in turn negatively affect the market price of our Class A common stock or Senior Notes and our ability to pay dividends to our shareholders.***

We are dependent on the highly-skilled, and often highly-specialized, individuals we employ. Retention of specialists to manage our portfolio is particularly important to our prospects. Competition for the recruiting and retention of employees may increase elements of our compensation costs. We may not be able to recruit and hire new employees with our desired qualifications in a timely manner. Our incentives may be insufficient to recruit and retain our employees. Increased compensation costs could adversely affect the amount of cash available for distribution to shareholders and our failure to recruit and retain qualified employees could materially and adversely affect our future operating results.

***We are dependent upon a small number of key senior professionals and the loss of any of these individuals could adversely affect our financial results which may, in turn, negatively affect the market price of our Class A common stock and Senior Notes and our ability to pay dividends to our shareholders.***

We currently do not have employment agreements with any of our senior officers and other key professionals. We cannot guarantee that we will continue to have access to members of our senior management team or other key professionals. The loss of any members of our senior management and other key professionals could materially and adversely affect our operating results.

***We are highly dependent upon communications and information systems operated by third parties, and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our Class A common stock and Senior Notes and our ability to pay dividends to our shareholders.***

Our business is highly dependent upon communications and information systems that allow us to monitor, value, buy, sell, finance and hedge our investments. These systems are primarily operated by third parties and, as a result, we have limited ability to ensure their continued operation. Furthermore, in the event of systems failure or interruption, we will have limited ability to affect the timing and success of systems restoration. Any failure or interruption of our systems or third-party trading or information systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our Class A common stock and Senior Notes and our ability to pay dividends to our shareholders.

***If we issue additional debt securities or other equity securities that rank senior to our common stock, our operations may be restricted and we will be exposed to additional risk and the market price of our Class A common stock and Senior Notes could be adversely affected.***

If we decide to issue additional debt securities in the future, it is likely that such securities will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally, any convertible or exchangeable or other securities registered pursuant to our shelf registration statement that we issue in the future may have rights, preferences and privileges more favorable than those of our Class A common stock. Also shares of preferred stock, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our Class A common stock. We, and indirectly our shareholders, will bear the cost of issuing and servicing such securities. Holders of debt securities may be granted specific rights, including but not limited to, the right to hold a perfected security interest in certain of our assets, the right to accelerate payments due under the indenture, rights to restrict dividend payments, and rights to approve the sale of assets. Such additional restrictive covenants, operating restrictions and preferential dividends could have a material adverse effect on our operating results and negatively affect the market price of our Class A common stock and Senior Notes and our ability to pay distributions to our shareholders.

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

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

**Tax Risks of our Business and Structure**

***We may not be able to generate future taxable income to fully utilize our tax benefits.***

We recognize the expected future tax benefit from a deferred tax asset when the tax benefit is considered more likely than not to be realized. Otherwise, a valuation allowance is applied against the deferred tax asset. Assuming the recoverability of a deferred tax asset requires management to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecasted cash flow from operations, the character of expected income or loss as either ordinary or capital and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and the amount or character of taxable income differ significantly from estimates, our ability to realize the deferred tax asset could be impacted. To the extent our estimates of our ability to realize our tax benefits change, we would be required to record changes to our valuation allowance applied against our deferred tax asset. In addition, our NOL carry-forwards begin to expire in 2027 and our NCL carry-forwards begin to expire in 2019. We may not generate sufficient taxable income of the appropriate tax character to fully utilize these carry-forwards prior to their expiration. To the extent that our NOL or NCL carry-forwards expire unutilized, we would be required to write off the corresponding deferred tax asset. If we were to increase our valuation allowances against our deferred tax asset or if we were to write off expired loss carry-forwards, our net income and net book value would be adversely impacted.

***A reduction in future enacted tax rates could have material impact to the value of our deferred tax assets.***

Our net deferred tax assets are measured using the tax rates under the current enacted tax law expected to apply to taxable income in future years. The effects of future changes in tax laws or rates are not anticipated in the determination of the value of our deferred tax assets and liabilities. Under GAAP, the effects of a change in tax rates and laws on deferred tax balances are recognized in the period the new legislation is enacted.

As part of his presidential campaign platform, President Trump proposed a change to the federal tax laws that would, among other changes, lower the federal corporate tax rate from 35% to 15%. In addition, in June 2016, the House of Representative Republicans issued a tax reform plan that would, among other changes, lower the federal corporate tax rate from 35% to 20%. It is difficult to predict whether any change to the federal tax rate will occur, or if any change to the federal tax rate did occur, what the magnitude or timing of any change would be. However, if the future federal corporate tax rate is lowered from its current 35% rate, the Company would likely record a tax provision resulting in a reduction of its deferred tax asset and shareholders' equity in the period any change in tax law or rate is enacted, which could adversely impact the price of our Class A common stock.

***Our ability to use our tax benefits could be substantially limited if we experience an "ownership change."***

Our NOL and NCL carry-forwards and certain recognized built-in losses may be limited by Sections 382 and 383 of the Code if we experience an "ownership change." In general, an "ownership change" occurs if 5% shareholders increase their collective ownership of the aggregate amount of the outstanding shares of our company by more than 50 percentage points looking back over the relevant testing period. If an ownership change occurs, our ability to use our NOLs, NCLs and certain recognized built-in losses to reduce our taxable income in a future year would be limited to a Section 382 limitation equal to the fair market value of our stock immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate in effect for the month of the ownership change. The long-term tax-exempt rate for January 2017 is 2.75%. In the event of an ownership change, NOLs and NCLs that exceed the Section 382 limitation in any year will continue to be allowed as carry-forwards for the remainder of the carry-forward period and such losses can be used to offset taxable income for years within the carry-forward period subject to the Section 382 limitation in each year. However, if the carry-forward period for any NOL or NCL were to expire before that loss had been fully utilized, the unused portion of that loss would be lost. Our use of new NOLs or NCLs arising after the date of an ownership change would not be affected by the Section 382 limitation (unless there were another ownership change after those new losses arose).

We have a Rights Plan designed to protect against the occurrence of an ownership change. The Rights Plan is intended to act as a deterrent to any person or group acquiring 4.9% or more of our outstanding Class A common stock without the approval of our Board of Directors. See "Risks Related to our Business and Structure - Our Rights Plan could inhibit a change in our control" for information on our Rights Plan. The Rights Plan, however, does not protect against all transactions that could cause an ownership change, such as public issuances and repurchases of shares of Class A common stock. The Rights Plan may not be successful in preventing an ownership change within the meaning of Sections 382 and 383 of the Code, and we may lose all or most of the anticipated tax benefits associated with our prior losses.

Based on our knowledge of our stock ownership, we do not believe that an ownership change has occurred since our losses were generated. Accordingly, we believe that at the current time there is no annual limitation imposed on our use of our NOLs and NCLs to reduce future taxable income. The determination of whether an ownership change has occurred or will occur is complicated and depends on changes in percentage stock ownership among shareholders. Other than the Rights Plan, there are currently no restrictions on the transfer of our stock that would discourage or prevent transactions that could cause an ownership change, although we may adopt such restrictions in the future. As discussed above, the Rights Plan is intended to discourage transactions that could cause an ownership change. In addition, we have not obtained, and currently do not plan to obtain, a ruling from the Internal Revenue Service, regarding our conclusion as to whether our losses are subject to any such limitations. Furthermore, we may decide in the future that it is necessary or in our interest to take certain actions that could result in an ownership change. Therefore, no assurance can be provided as to whether an ownership change has occurred or will occur in the future.

***Preserving the ability to use our NOLs and NCLs may cause us to forgo otherwise attractive opportunities.***

Limitations imposed by Sections 382 and 383 of the Code may discourage us from, among other things, repurchasing our stock or issuing additional stock to raise capital or to acquire businesses or assets. Accordingly, our desire to preserve our NOLs and NCLs may cause us to forgo otherwise attractive opportunities.

***If we elect in the future to be treated as a REIT, complying with the REIT requirements may cause us to forego otherwise attractive opportunities, may result in higher income tax rates on dividends you may receive, and could result in a reduction in our net book value.***

We revoked our status as a REIT effective January 1, 2009, in part to maximize the use of tax benefits associated with our NOLs and NCLs. In the future, we might make an election again to be taxed as a REIT for various business reasons, including if we no longer have the benefit of NOL carry-forwards. To qualify as a REIT for federal income tax purposes, we would be required to continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our shareholders and the ownership of our stock. In order to meet these tests, we may be required to forego attractive business or investment opportunities. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits. In addition, in order to qualify as a REIT, an entity must distribute to its shareholders, each calendar year, at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gain. As a result, if we elect to be treated as a REIT, we generally will be required to distribute most of our earnings to our shareholders rather than having the option to retain our earnings for reinvestment in our business.

Currently as a C corporation, distributions to our shareholders of current or accumulated earnings and profits are “qualified dividends” whereas similar distributions to shareholders of a REIT are nonqualified dividends. Qualified dividends to domestic shareholders that are individuals, trusts or estates are subject to the same federal income tax rates as long-term capital gains for which the current maximum rate is 23.8% (inclusive of the 3.8% Medicare tax). Nonqualified dividends are subject to the higher federal income tax rate on ordinary income for which the current maximum rate is 43.4% (inclusive of the 3.8% Medicare tax). If we were to elect to be treated as a REIT, future dividends you receive could be subjected to a higher tax rate. If our dividends are subject to a higher tax rate, the market value of our common stock could also be adversely affected.

If we were to elect in the future to be treated as a REIT, any remaining net deferred tax asset would likely need to be written off for GAAP accounting purposes. As a result, our net income and net book value could be adversely affected upon our election to be taxed as a REIT.

The decision to elect REIT status is in the sole discretion of our Board of Directors, and no assurance can be given that we will, or will not, elect such status for 2017 or in the future.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our executive and administrative office is located at 1001 Nineteenth Street North, Arlington, Virginia 22209. We lease our office space.

We sublease office space to Billings Capital Management, LLC ("BCM"), which is an investment management company owned and operated by Eric F. Billings, our Executive Chairman of the Board of Directors, and his sons. The lease term is month-to-month, based on the pro-rata share of the space occupied by BCM. The lease payments to us totaled approximately $100 thousand for the year ended December 31, 2016.

## ITEM 3. LEGAL PROCEEDINGS

We are from time to time involved in civil lawsuits, legal proceedings and arbitration matters that we consider to be in the ordinary course of our business. There can be no assurance that these matters individually or in the aggregate will not have a material adverse effect on our financial condition or results of operations in a future period. We are also subject to the risk of litigation, including litigation that may be without merit. As we intend to actively defend such litigation, significant legal expenses could be incurred. An adverse resolution of any future litigation against us could materially affect our financial condition, results of operations and liquidity. Furthermore, we operate in highly-regulated markets that currently are under intense regulatory scrutiny, and we have received, and we expect in the future that we may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. In addition, one or more of our subsidiaries have received requests to repurchase loans from various parties in connection with the former securitization business conducted by a subsidiary. We believe that the continued scrutiny of MBS, structured finance, and derivative market participants increases the risk of additional inquiries and requests from regulatory or enforcement agencies and other parties. We cannot provide any assurance that these inquiries and requests will not result in further investigation of or the initiation of a proceeding against us or that, if any such investigation or proceeding were to arise, it would not materially adversely affect our Company.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

**PART II**

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our Class A common stock is listed on the NYSE under the symbol "AI." As of January 31, 2017, there were approximately 140 record holders of our Class A common stock. However, most of the shares of our Class A common stock are held by brokers and other institutions on behalf of shareholders. The following table shows the high and low sales prices of our Class A common stock during each fiscal quarter during the years ended December 31, 2016 and 2015.

| | Price Range of Class A Common Stock | |
|---|---|---|
| | High | Low |
| **Year Ended December 31, 2016** | | |
| Fourth Quarter | $ 17.13 | $ 14.08 |
| Third Quarter | 15.71 | 12.61 |
| Second Quarter | 14.04 | 11.99 |
| First Quarter | 13.82 | 9.42 |
| **Year Ended December 31, 2015** | | |
| Fourth Quarter | 15.53 | 12.07 |
| Third Quarter | 20.36 | 13.71 |
| Second Quarter | 24.28 | 19.25 |
| First Quarter | 27.18 | 24.01 |

There is no established public trading market for our Class B common stock. As of February 10, 2017, there were no shares of Class B common stock issued and outstanding. For the periods presented below, holders of shares of our Class B common stock received dividends in the same amounts and on the same dates as holders of shares of our Class A common stock.

Pursuant to our variable dividend policy, our Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. Our dividend payments, if any, may vary significantly from quarter to quarter. The Board of Directors approved and we declared and paid the following dividends for 2016:

| Quarter Ended | Dividend Amount | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|
| December 31 | $ 0.625 | December 16 | December 30 | January 31, 2017 |
| September 30 | 0.625 | September 15 | September 30 | October 31 |
| June 30 | 0.625 | June 17 | June 30 | July 29 |
| March 31 | 0.625 | March 15 | March 31 | April 29 |

The Board of Directors approved and we declared and paid the following dividends for 2015:

| Quarter Ended | Dividend Amount | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|
| December 31 | $ 0.625 | December 17 | December 31 | January 29, 2016 |
| September 30 | 0.625 | September 17 | September 30 | October 30 |
| June 30 | 0.875 | June 17 | June 30 | July 31 |
| March 31 | 0.875 | March 10 | March 31 | April 30 |

### Securities Authorized for Issuance Under Equity Compensation Plans

Information about securities authorized for issuance under our equity compensation plans is incorporated by reference from our Definitive Proxy Statement for the 2017 Annual Meeting of Shareholders.

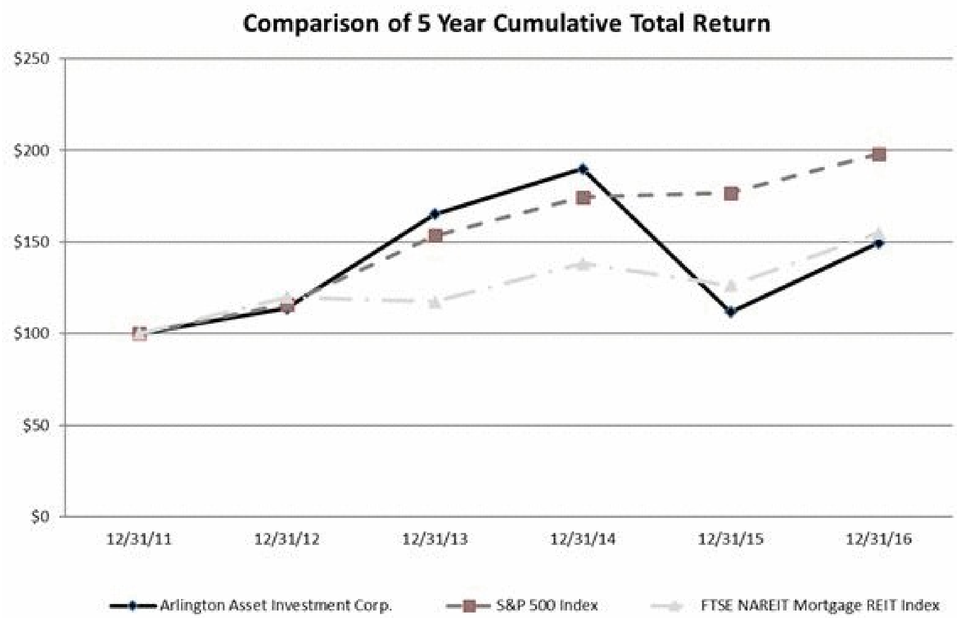
**Purchases of Equity Securities by the Issuer**

The Company's Board of Directors authorized a share repurchase program pursuant to which the Company may repurchase up to 2,000,000 shares of its Class A common stock (the "Repurchase Program"). Repurchases under the Repurchase Program may be made from time to time on the open market and in private transactions at management's discretion in accordance with applicable federal securities laws. The timing of repurchases and the exact number of shares of Class A common stock to be repurchased will depend upon market conditions and other factors. The Repurchase Program is funded using the Company's cash on hand and cash generated from operations. The Repurchase Program has no expiration date and may be suspended or terminated at any time without prior notice. There were no repurchases of common stock for the three months ended December 31, 2016.

**Performance Graph**

The following graph compares the cumulative total shareholder return for our Class A common stock from December 31, 2011 to December 31, 2016 with the comparable cumulative return of the Standard & Poor's ("S&P") 500 Stock Index and the FTSE NAREIT Mortgage REIT Index. The FTSE NAREIT Mortgage REIT Index is a free-float adjusted, market capitalization-weighted index of U.S. mortgage REITs, which include all tax-qualified REITs with more than 50% of total assets invested in mortgage loans or MBS secured by interests in real property.

The graph assumes $100 invested on December 31, 2011 in our Class A common stock and $100 invested at the same time in each of the above-mentioned indices, assuming that all dividends are reinvested.




| | AI | S&P 500 Index | FTSE NAREIT Mortgage REIT Index |
|---|---|---|---|
| December 31, 2011 | $ 100.00 | $ 100.00 | $ 100.00 |
| December 31, 2012 | 113.75 | 115.98 | 119.98 |
| December 31, 2013 | 165.30 | 153.51 | 117.39 |
| December 31, 2014 | 189.87 | 174.47 | 138.34 |
| December 31, 2015 | 111.80 | 176.88 | 126.34 |
| December 31, 2016 | 149.68 | 197.98 | 154.99 |

## ITEM 6. SELECTED FINANCIAL DATA

### SELECTED CONSOLIDATED FINANCIAL INFORMATION

**(Dollars in thousands, except per share amounts)**

| | Year Ended December 31, 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| **Consolidated Statement of Comprehensive Income Data (audited)** (1) | | | | | |
| Interest income | $ 105,336 | $ 121,263 | $ 105,577 | $ 72,233 | $ 59,141 |
| Interest expense | 29,222 | 18,889 | 11,391 | 8,529 | 4,965 |
| Net interest income | 76,114 | 102,374 | 94,186 | 63,704 | 54,176 |
| Investment loss, net | (69,318) | (118,429) | (20,287) | (32,557) | (5,664) |
| General and administrative expenses | 20,756 | 14,787 | 18,499 | 17,008 | 17,507 |
| (Loss) income before income taxes | (13,960) | (30,842) | 55,400 | 14,139 | 31,005 |
| Income tax provision (benefit) | 27,387 | 38,561 | 47,647 | (38,684) | (157,939) |
| Net (loss) income | (41,347) | (69,403) | 7,753 | 52,823 | 188,944 |
| Other comprehensive (loss) income, net of taxes | (12,371) | (23,501) | (10,397) | 11,743 | (3,841) |
| Comprehensive (loss) income | $ (53,718) | $ (92,904) | $ (2,644) | $ 64,566 | $ 185,103 |
| Basic (loss) earnings per share | $ (1.79) | $ (3.02) | $ 0.39 | $ 3.30 | $ 18.51 |
| Diluted (loss) earnings per share | $ (1.79) | $ (3.02) | $ 0.38 | $ 3.26 | $ 18.45 |

| | December 31, 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| **Consolidated Balance Sheet Data (audited)** | | | | | |
| Agency MBS, at fair value | $ 3,911,375 | $ 3,865,316 | $ 3,414,340 | $ 1,576,499 | $ 1,566,510 |
| Private-label MBS, at fair value | 1,266 | 130,553 | 267,437 | 341,299 | 199,086 |
| Deferred tax assets, net | 73,432 | 97,530 | 125,607 | 167,294 | 154,940 |
| Total assets | 4,141,554 | 4,202,939 | 4,016,898 | 2,195,476 | 2,066,817 |
| Short-term debt | 3,649,102 | 3,621,680 | 3,179,775 | 1,547,630 | 1,497,191 |
| Long-term debt | 73,656 | 73,433 | 39,167 | 39,067 | 15,000 |
| Total stockholders' equity | 383,416 | 484,031 | 645,274 | 553,271 | 457,815 |
| **Other Financial Data (unaudited)** | | | | | |
| Book value per share (2) | $ 16.21 | $ 21.05 | $ 28.09 | $ 33.19 | $ 34.69 |
| Tangible book value per share (2)(3) | $ 13.11 | $ 16.81 | $ 22.62 | $ 23.15 | $ 22.95 |
| Market price per share of Class A common stock (4) | $ 14.82 | $ 13.23 | $ 26.61 | $ 26.39 | $ 20.77 |
| Cash dividends declared per common share | $ 2.50 | $ 3.00 | $ 3.50 | $ 3.50 | $ 3.50 |

(1) On January 1, 2016, the Company elected to change its accounting policy for recognizing interest income on its agency MBS classified as trading securities by amortizing purchase premiums (or accreting purchase discounts) as an adjustment to interest income in accordance with the "interest method" permitted by GAAP. The Company retrospectively applied this change in accounting policy to all historical periods. See Note 2, "Summary of Significant Accounting Policies" of Notes to Consolidated Financial Statements included in this Report on Form 10-K for further information. In addition, certain amounts in the consolidated financial information for prior periods have been reclassified to conform to the current year's presentation. These reclassifications had no impact on the previously reported net interest income, net income or other comprehensive income.

(2) Based on shares of Class A common stock and Class B common stock outstanding plus vested restricted stock units convertible into shares of Class A common stock less unvested restricted shares of Class A common stock. As of the year ended on the indicated date.

(3) Tangible book value represents total shareholders' equity less net deferred tax assets.

(4) Represents the last reported sale price of the Company's Class A common stock on the NYSE as of the year ended on the indicated date.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

We are a principal investment firm that currently acquires and holds a levered portfolio of residential mortgage-backed securities ("MBS"), consisting of agency MBS and private-label MBS. Agency MBS include residential mortgage pass-through certificates for which the principal and interest payments are guaranteed by a U.S. government agency or government sponsored enterprise ("GSE"), such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Private-label MBS, or non-agency MBS, include residential MBS that are not guaranteed by a GSE or the U.S. government. As of December 31, 2016, nearly all of our investment capital was allocated to agency MBS.

We leverage prudently our investment portfolio so as to increase potential returns to our shareholders. We fund our investments primarily through short-term financing arrangements, principally through repurchase agreements. We enter into various hedging transactions to mitigate the interest rate sensitivity of our cost of borrowing and the value of our MBS portfolio.

We are a Virginia corporation and taxed as a C corporation for U.S. federal tax purposes. We are an internally managed company and do not have an external investment advisor.

### Factors that Affect our Results of Operations and Financial Condition

Our business is materially affected by a variety of industry and economic factors, including:

- conditions in the global financial markets and economic conditions generally;
- changes in interest rates and prepayment rates;
- conditions in the residential real estate and mortgage markets;
- actions taken by the U.S. government, U.S. Federal Reserve, the U.S. Treasury and foreign central banks;
- changes in laws and regulations and industry practices; and
- other market developments.

### Current Market Conditions and Trends

Following the United Kingdom's referendum vote on June 23, 2016 to exit the European Union (the "Brexit"), there was speculation that Brexit could adversely affect global economic and market conditions. Global financial markets initially experienced severe volatility in response to the Brexit, creating selling pressure in riskier asset classes and increased demand for U.S. Treasuries driving the U.S. Treasury rate to historic lows in early July. However, as economic concerns regarding Brexit began to subside and domestic market conditions appeared more favorable, investor demand for risk assets increased driving bond yields gradually higher leading up to the U.S. Presidential election on November 8, 2016.

The surprising election victory by Republican Donald Trump, together with the Republican party securing control of both houses of Congress, triggered a major repricing in nearly every financial market. The new administration's expected pro-growth economic policies, including potential income tax reform, infrastructure spending and deregulation, raised expectations for faster economic growth and higher inflation. In turn, this led to increased demand for U.S. equity assets and a sell-off in U.S. Treasuries driving the 10-year U.S. Treasury rate up to a high of 2.60% for the year, a 72 basis point increase post the election. In response, the dramatic increase in rates and volatility led to meaningful widening in agency MBS spreads relative to swap and U.S. Treasury rates.

On December 14, 2016, the Federal Open Market Committee ("FOMC") announced that it was raising the target federal funds rate range by 25 basis points to 0.50% to 0.75%, the first increase in nearly one year. In its February 1, 2017 statement, the FOMC announced that it was maintaining its target federal funds rate while acknowledging that the labor market has continued to strengthen and that economic activity has been expanding at a moderate pace since its December meeting. The FOMC commented further that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, labor market conditions will strengthen somewhat further, and inflation will rise to 2% over the medium term. The FOMC commented further that it expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate, and will likely remain, for some time, below levels that are expected to prevail in the longer run. Based on federal fund futures prices, the majority of market participants currently believe that it is likely that the FOMC will raise its target federal funds rate up to two to three times during 2017.

On October 14, 2016, new rules issued by the Securities and Exchange Commission governing money market funds went into effect. Under the new rules, prime institutional money market funds are now required to mark their daily net asset value and impose temporary redemption gates and fees during volatile periods. In anticipation of the new rules going effective, many investors began moving toward money market funds that invest only in government securities and away from prime money market funds prior to the effective date of the new rules. As a result of this diminished demand for prime money market funds both prior to and after the effective date of the new rules, issuers of commercial paper and certificates of deposit that supply prime money market funds have experienced higher funding costs as yields moved higher and funding risk premium widened, while demand increased for high quality short-term assets such as repurchase agreement financing secured by agency MBS. As a result, many funding benchmark rates, such as LIBOR, have risen significantly while financing rates on repurchase agreement financing secured by agency MBS became more competitive. In general, this led to improved net funding costs of short-term repurchase agreement financing hedged with interest rate swaps as the three-month LIBOR received on interest rate swaps has increased more than the financing rates paid on repurchase agreement financing during the second half of 2016.

For most of the 2016 year, the residential mortgage environment was characterized by historically low interest rates, steady home price appreciation and increased lender origination capacity, which resulted in high mortgage refinancing volumes leading to elevated prepayments speeds in residential mortgage loans. With the significant rise in mortgage rates post the Presidential election, market expectations are that prepayment speeds should begin to fall in the near term although continued wage growth and home price appreciation could mitigate some of the expected declines in prepayment speeds from the rise of interest rates.

Housing prices have recovered from their post-financial crisis lows with the S&P CoreLogic Case-Shiller U.S. National Home Price NSA index reporting a 5.6% annual gain in November 2016, now exceeding the record high set in July 2006. The recovery has been supported by various economic factors, including low interest rates, falling unemployment and consistent gains in per-capita disposable personal income. The new Presidential administration is seeking faster economic growth, increased investment in infrastructure, and changes in tax policy which could affect housing and home prices. Mortgage rates have increased since the election and stronger economic growth could push rates higher. Further gains in personal income and employment may increase the demand for housing and add to price pressures when home prices are currently rising significantly faster than inflation.

**Recent Government Activity**

Uncertainty over the new administration's policies, together with questions regarding the administration's ability to work with Congress in order to implement such policies, are likely to increase market and credit volatility over 2017. We expect vigorous debate and discussion in a number of areas, including residential housing and mortgage reform, taxation, fiscal policy and monetary policy, to continue over the next few years; however, we cannot be certain if or when any specific proposal or policy might be announced, emerge from committee or be approved by Congress, and if so, what the effects on us may be.

**Executive Summary**

As of December 31, 2016, the Company's book value was $16.21 per share, a decrease of 23.0% from $21.05 per share as of December 31, 2015. The Company's tangible book value, which is calculated as shareholders' equity less the Company's net deferred tax asset, was $13.11 per share as of December 31, 2016, a decrease of 22.0% from $16.81 per share as of December 31, 2015. For the year ended December 31, 2016, the Company declared dividends of $2.50 per share, resulting in an economic loss of 7.1% measured as the change in tangible book value plus dividends declared during the year.

The decrease in tangible book value per share during the year is attributable primarily to a decrease in value of the Company's hedged agency MBS portfolio driven by interest rate volatility and a widening of agency MBS investment spreads relative to swap and U.S. Treasury rates resulting in an underperformance of the Company's agency MBS investment portfolio relative to its interest rate hedges. However, the wider agency MBS spreads should lead to more attractive investment opportunities benefiting investment returns going forward.

For the year ended December 31, 2016, the Company had a net loss of $1.79 per diluted share compared to a net loss of $3.02 per diluted share in the prior year. The Company had non-GAAP core operating income of $2.75 per diluted share for the year ended December 31, 2016. For further information on the use of non-GAAP core operating income, see "Management's Discussion and Analysis of Financial Condition and Results of Operation – Non-GAAP Core Operating Income."

Since the Company's fixed-rate agency MBS have generally been purchased at a premium to par value, high prepayments can have a negative impact on the Company's asset yields and interest income, while slow prepayments can have a positive impact. The actual constant prepayment rate ("CPR") for the Company's agency MBS increased to 11.29% for the year ended December 31, 2016 from 10.21% in the prior year, resulting in a decline in the average asset yield to 2.70% during the current year compared to 2.86% in the prior year.

The Company's average cost of short-term funding during the year ended December 31, 2016 was 0.70%, an increase of 29 basis points from the prior year attributable primarily to the increase in benchmark short-term rates. In the second half of 2016, the Company's spread earnings benefited from an improvement in the spread between the three-month LIBOR that the Company receives on its interest rate swap agreements and the funding rates that it pays on its repurchase agreement financing. The average rate the

Company receives on its interest rate swap agreements increased more than the average financing rate the Company pays on its repurchase agreement financing during the second half of 2016.

As of December 31, 2016, the Company's agency investment portfolio totaled $4,631 million, comprised of $3,911 million of specified agency MBS and $720 million of net TBA agency MBS. During the year ended December 31, 2016, the Company increased its agency investment allocation to TBA agency MBS to take advantage of higher risk adjusted returns in the TBA dollar roll market as compared to owning specified agency MBS financed with repurchase agreement financing. The Company generated TBA dollar roll income of $19.3 million during the year ended December 31, 2016 compared to $6.7 million in the prior year.

The Company continues to maintain a substantial hedge position with the intent to protect the Company's capital and earnings potential against increased interest rates over the long-term. As of December 31, 2016, the Company's interest rate hedge position consisted solely of interest rate swaps coupled with put and call options on 10-year U.S. Treasury note futures. The Company purchases and sells put and call options on U.S. Treasury note futures with the objective of protecting the Company's capital against a significant rise in interest rates while limiting its exposure to a significant fall in interest rates.

We believe our hedging strategy will continue to enable the Company to maintain an attractive return on its agency MBS portfolio in order to produce resilient and predictable non-GAAP core operating income that supports consistent dividends to our shareholders. In a falling interest rate and wider spread environment, this hedging strategy will likely result in a temporary decline in book value. However, the Company would expect temporary declines in book value to be recovered over time either through higher future spread earnings if interest rates remain low and spreads wide, or through a reversal of temporary decline in book value if future interest rates rise and spreads narrow. The consistent execution of our hedging strategy may also result in an increase in leverage during periods of temporary declines in book value or decreases in leverage during periods of temporary increases in book value.

The Company constantly monitors its allocation of its available capital between agency MBS and private-label MBS in an effort to maximize returns to its shareholders. During the year ended December 31, 2016, the Company opportunistically sold substantially all of its private-label MBS investments and reinvested the net proceeds into agency MBS in order to pursue a strategy that it believes will deliver higher risk adjusted returns. As of December 31, 2016, the Company's available capital was allocated nearly 100% to agency MBS, compared to 80% to agency MBS and 20% to private-label MBS as of December 31, 2015.

The Company continues to utilize its tax benefits afforded to it as a C-corporation that allow it to shield substantially all of its income from taxes. As of December 31, 2016, the Company had NOL carry-forwards of $95.7 million and NCL carry-forwards of $310.9 million. From a GAAP accounting perspective, the Company had a net deferred tax asset of $73.4 million, or $3.10 per share, as of December 31, 2016. The Company continues to record a valuation allowance against a portion of the deferred tax asset attributable to NCL carry-forwards that the Company believes will likely expire prior to utilization. During the year ended December 31, 2016, the Company recorded an increase to the valuation allowance of $35.6 million, or $1.55 per diluted share, due largely to an increase in its NCL carry-forwards as a result of net capital losses during the year, primarily from losses on certain of its interest rate derivative instruments.

**Portfolio Overview**

The following table summarizes our MBS investment portfolio at fair value as of December 31, 2016 and 2015 (dollars in thousands):

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Specified agency MBS | $ 3,909,452 | $ 3,865,316 |
| Inverse interest-only agency MBS | 1,923 | — |
| Total agency MBS | 3,911,375 | 3,865,316 |
| Net long agency TBA dollar roll positions (1) | 720,027 | 389,258 |
| Total agency investment portfolio | 4,631,402 | 4,254,574 |
| Private-label MBS | 1,173 | 130,435 |
| Private-label interest-only MBS | 93 | 118 |
| Total private-label investment portfolio | 1,266 | 130,553 |
| Total MBS investment portfolio | $ 4,632,668 | $ 4,385,127 |

(1) Represents the fair value of the agency MBS which underlie our TBA forward purchase and sale commitments executed as dollar roll transactions. In accordance with GAAP, our TBA forward purchase and sale commitments are reflected on the consolidated balance sheets as a component of "derivative assets, at fair value" and "derivative liabilities, at fair value," with a collective net asset carrying value of $1,156 and a net liability carrying value of $553 as of December 31, 2016 and 2015, respectively.

*Agency MBS Investment Portfolio*

Our specified agency MBS, excluding our inverse interest-only agency MBS, consisted of the following as of December 31, 2016 (dollars in thousands):

| | Unpaid Principal Balance | Net Unamortized Purchase Premiums | Amortized Cost Basis | Net Unrealized Gain (Loss) | Fair Value | Market Price | Coupon | Weighted Average Expected Remaining Life |
|---|---|---|---|---|---|---|---|---|
| 30-year fixed rate: | | | | | | | | |
| 3.5% | $ 2,082,197 | $ 107,193 | $ 2,189,390 | $ (47,680) | $ 2,141,710 | $ 102.86 | 3.50% | 8.2 |
| 4.0% | 1,671,822 | 101,201 | 1,773,023 | (5,304) | 1,767,719 | 105.74 | 4.00% | 6.9 |
| 5.5% | 21 | — | 21 | 2 | 23 | 112.19 | 5.50% | 5.7 |
| Total/weighted-average | $ 3,754,040 | $ 208,394 | $ 3,962,434 | $ (52,982) | $ 3,909,452 | 104.14 | 3.72% | 7.6 |

| | Unpaid Principal Balance | Net Unamortized Purchase Premiums | Amortized Cost Basis | Net Unrealized Gain (Loss) | Fair Value | Market Price | Coupon | Weighted Average Expected Remaining Life |
|---|---|---|---|---|---|---|---|---|
| Fannie Mae | $ 2,155,504 | $ 119,343 | $ 2,274,847 | $ (31,617) | $ 2,243,230 | $ 104.07 | 3.71% | 7.7 |
| Freddie Mac | 1,598,536 | 89,051 | 1,687,587 | (21,365) | 1,666,222 | 104.23 | 3.74% | 7.6 |
| Total/weighted-average | $ 3,754,040 | $ 208,394 | $ 3,962,434 | $ (52,982) | $ 3,909,452 | 104.14 | 3.72% | 7.6 |

The actual CPR for the Company's agency MBS was 11.29% for the year ended December 31, 2016 compared to 10.21% for the year ended December 31, 2015. As of December 31, 2016, the Company's agency MBS was comprised of securities specifically selected for their relatively lower propensity for prepayment, which includes approximately 94% in specified pools of low balance loans while the remainder includes specified pools of loans originated in certain geographical areas, loans refinanced through the U.S. Government sponsored Home Affordable Refinance Program ("HARP") or with other characteristics selected for their relatively lower propensity for prepayment.

Our agency MBS investment portfolio also includes net long TBA positions, which are primarily the result of executing sequential series of "dollar roll" transactions that are settled on a net basis. In accordance with GAAP, we account for our net long TBA positions as derivative instruments. Information about the Company's net long TBA positions as of December 31, 2016 is as follows (dollars in thousands):

| | Notional Amount: Long (Short) Position (1) | Implied Cost Basis (2) | Implied Fair Value (3) | Net Carrying Amount (4) |
|---|---|---|---|---|
| 30-year 3.0% coupon purchase commitments | $ 725,000 | $ 718,887 | $ 720,027 | $ 1,140 |
| 30-year 3.5% coupon purchase commitments | 25,000 | 25,586 | 25,613 | 27 |
| 30-year 3.5% coupon sale commitments | (25,000) | (25,602) | (25,613) | (11) |
| Total net long agency TBA dollar roll positions | $ 725,000 | $ 718,871 | $ 720,027 | $ 1,156 |

(1) "Notional amount" represents the unpaid principal balance of the underlying agency MBS.

(2) "Implied cost basis" represents the contractual forward price for the underlying agency MBS.

(3) "Implied fair value" represents the current fair value of the underlying agency MBS.

(4) "Net carrying amount" represents the difference between the implied cost basis and the current fair value of the underlying MBS. This amount is reflected on the Company's consolidated balance sheets as a component of "derivative assets, at fair value" and "derivative liabilities, at fair value."

*Private-Label MBS Investment Portfolio*

Our private-label MBS, excluding our interest-only MBS, consisted of the following as of December 31, 2016 (dollars in thousands):

| Face Amount | Discount | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted-average Coupon | Weighted-average GAAP Yield |
|---|---|---|---|---|---|---|---|
| $ 2,098 | $ (752) | $ 1,346 | $ — | $ (173) | $ 1,173 | 2.25% | 5.67% |

As of December 31, 2016, the private-label MBS portfolio consists of "re-REMIC" securities. The Company's investments in re-REMIC securities represent "mezzanine" interests in underlying, re-securitized senior class MBS issued by private-label Real Estate Mortgage Investment Conduit ("REMIC") securitization trusts. The senior class REMIC securities that serve as collateral to the Company's investments in re-REMIC securities represent beneficial interests in pools of prime or Alt-A residential mortgage loan collateral that hold the first right to cash flows and absorb credit losses only after their respective subordinate REMIC classes have been fully extinguished. The trusts that issued the Company's investments in re-REMIC securities employ a "sequential" principal repayment structure. Accordingly, the Company's mezzanine class re-REMIC securities are not entitled to receive principal repayments until the principal balance of the senior interest in the respective collateral group has been reduced to zero. Principal shortfalls are allocated on a "reverse sequential" basis. Accordingly, any principal shortfalls on the underlying senior class REMIC securities are first absorbed by the Company's mezzanine class re-REMIC securities, to the extent of their respective principal balance, prior to being allocated to the senior interest in the respective collateral pool. Periodic interest accrues on each re-REMIC security's outstanding principal balance at its contractual coupon rate.

During the year ended December 31, 2016, we received proceeds of $125.0 million from sales of our private-label MBS, realizing $4.5 million in net gains.

*Economic Hedging Instruments*

The Company attempts to hedge a portion of its exposure to interest rate fluctuations associated with its agency MBS primarily through the use of interest rate derivatives. Specifically, these interest rate derivatives are intended to economically hedge changes, attributable to changes in benchmark interest rates, in agency MBS fair values and future interest cash flows on the Company's short-term financing arrangements. As of December 31, 2016, the interest rate derivative instruments used by the Company were centrally cleared interest rate swap agreements and exchange-traded put and call options on 10-year U.S. Treasury note futures.

The Company's interest rate swap agreements represent agreements to make semiannual interest payments based upon a fixed interest rate and receive quarterly variable interest payments based upon the prevailing three-month LIBOR on the date of reset. Information about the Company's outstanding centrally cleared interest rate swap agreements in effect as of December 31, 2016 is as follows (dollars in thousands):

| | Notional Amount | Weighted-average: Fixed Pay Rate | Weighted-average: Variable Receive Rate | Weighted-average: Remaining Life (Years) | Fair Value |
|---|---|---|---|---|---|
| Years to maturity: | | | | | |
| Less than 3 years | $ 1,375,000 | 1.10% | 0.97% | 1.7 | $ 6,470 |
| 3 to less than 7 years | 350,000 | 1.84% | 1.00% | 3.7 | (769) |
| 7 to 10 years | 1,600,000 | 1.93% | 0.96% | 9.2 | 50,511 |
| Total / weighted-average | $ 3,325,000 | 1.58% | 0.97% | 5.5 | $ 56,212 |

The Company also has forward-starting interest rate swap agreements as of December 31, 2016 which have effective dates in September and October of 2017 and mature two years from their respective effective dates. The effective dates of these forward-starting interest rate swap agreements were set to occur within reasonable proximity to the maturity dates of certain of the Company's existing interest rate swap agreements, economically extending the life of the maturing instruments. Information about the Company's forward-starting interest rate swap agreements as of December 31, 2016 is as follows (dollars in thousands):

| | Notional Amount | Weighted-average: Fixed Pay Rate | Weighted-average: Term After Effective Date (Years) | Fair Value |
|---|---|---|---|---|
| Effective in September / October 2017 | $ 375,000 | 1.13% | 2.0 | $ 5,154 |

In addition to interest rate swap agreements, the Company had also purchased and sold exchange-traded options on U.S. Treasury note futures contracts as of December 31, 2016 with the objective of hedging a portion of the interest rate sensitivity of the Company's agency MBS portfolio. As of December 31, 2016, the Company holds put options which provide the Company with the right to sell 10-year U.S. Treasury note futures to a counterparty with an equivalent notional amount of $1,650 million that were struck at a weighted average strike price that equates to a 10-year U.S. Treasury note rate of approximately 2.77%. In addition, the Company has sold, or written, call options that provide a counterparty with the option to buy 10-year U.S. Treasury note futures from the Company with an equivalent notional amount of $1,000 million that were struck at a weighted average strike price per contract that equates to a 10-year U.S. Treasury note rate of approximately 2.24%. In order to limit its exposure on the sold call options from a significant decline in long-term interest rates, the Company also purchased contracts that provide the Company with the option to buy 10-year U.S. Treasury note futures from a counterparty with an equivalent notional amount of $1,000 million as of December 31, 2016 that were struck at a weighted average strike price per contract that equates to a 10-year U.S. Treasury note rate of approximately 2.12%. The options may be exercised at any time prior to their expiry, which occurs in the first quarter of 2017, and, if exercised, are expected to be net settled in cash.

Information about the Company's outstanding put and call options on 10-year U.S. Treasury note futures contracts as of December 31, 2016 is as follows (dollars in thousands):

| | Notional Amount Long/(Short) | Weighted-average Strike Price | Implied Strike Rate (1) | Net Fair Value |
|---|---|---|---|---|
| Purchased put options: | | | | |
| January 2017 expiration | $ 950,000 | 120.8 | 2.87% | $ 539 |
| February 2017 expiration | 700,000 | 122.6 | 2.64% | 3,281 |
| Total / weighted average for purchased put options | $ 1,650,000 | 121.6 | 2.77% | $ 3,820 |
| Sold call options: | | | | |
| January 2017 expiration | $ (100,000) | 126.0 | 2.25% | $ (141) |
| February 2017 expiration | (900,000) | 126.0 | 2.24% | (3,765) |
| Total / weighted average for sold call options | $ (1,000,000) | 126.0 | 2.24% | $ (3,906) |
| Purchased call options: | | | | |
| January 2017 expiration | $ 1,000,000 | 127.1 | 2.12% | $ 469 |
| | | | | $ 383 |

(1) The implied strike rate is estimated based upon the weighted average strike price per option contract and the price of an equivalent 10-year U.S. Treasury note futures contract.

**Results of Operations**

***Net Interest Income***

Net interest income determined in accordance with GAAP primarily represents the interest income recognized from our investments in specified agency MBS and private-label MBS (including the amortization of purchase premiums and accretion of purchase discounts), net of the interest expense incurred from repurchase agreement financing arrangements or other short- and long-term borrowing transactions.

Net interest income determined in accordance with GAAP does not include TBA agency MBS dollar roll income, which we believe represents the economic equivalent of net interest income generated from our investments in non-specified fixed-rate agency MBS, nor does it include the implied net interest income or expense of our interest rate swap agreements, which are not designated as hedging instruments for financial reporting purposes. In our consolidated statements of comprehensive income prepared in accordance with GAAP, TBA agency MBS dollar roll income and the implied net interest income or expense incurred from our interest rate swap agreements are reported as a component of the overall periodic change in the fair value of derivative instruments within the line item "gain (loss) from derivative instruments, net" of the "investment gain (loss), net" section.

***Investment Gain (Loss), Net***

"Investment gain (loss), net" primarily consists of periodic changes in the fair value (whether realized or unrealized) of investments in MBS classified as trading securities, periodic changes in the fair value (whether realized or unrealized) of derivative instruments, gains (losses) realized upon the sale of investments in MBS classified as available-for-sale, and other-than-temporary impairment charges for investments in MBS classified as available-for-sale.

***General and Administrative Expenses***

"Compensation and benefits expense" includes base salaries, annual incentive cash compensation, and non-cash stock-based compensation. Annual cash incentive compensation is based on meeting estimated annual performance measures and discretionary components. Non-cash stock-based compensation includes expenses associated with stock-based awards granted to employees, including the Company's performance share units to named executive officers.

"Other general and administrative expenses" primarily consists of the following:

- professional services expenses, including accounting, legal and consulting fees;
- insurance expenses, including liability and property insurance;
- occupancy and equipment expense, including rental costs for our facilities, and depreciation and amortization of equipment and software;
- fees and commissions related to transactions in interest rate derivative agreements;
- Board of Director fees; and
- other operating expenses, including information technology expenses, business development costs, public company reporting expenses, proxy solicitation expenses, business licenses and taxes, office supplies and other miscellaneous expenses.

***Comparison of the years ended December 31, 2016 and 2015***

The following table presents the total comprehensive loss for the years ended December 31, 2016 and 2015 (dollars in thousands, except per share amounts):

| | Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Interest income | $ 105,336 | $ 121,263 |
| Interest expense | 29,222 | 18,889 |
| Net interest income | 76,114 | 102,374 |
| Investment loss, net | (69,318) | (118,429) |
| General and administrative expenses | 20,756 | 14,787 |
| Loss before income taxes | (13,960) | (30,842) |
| Income tax provision | 27,387 | 38,561 |
| Net loss | (41,347) | (69,403) |
| Other comprehensive loss, net of taxes | (12,371) | (23,501) |
| Comprehensive loss | $ (53,718) | $ (92,904) |
| Diluted loss per share | $ (1.79) | $ (3.02) |
| Weighted-average diluted shares outstanding | 23,051 | 23,002 |

*Net Interest Income*

Net interest income determined in accordance with GAAP ("GAAP net interest income") decreased $26.3 million, or 25.7%, from $102.4 million for the year ended December 31, 2015 to $76.1 million for the year ended December 31, 2016. The decrease is primarily attributable to (i) a meaningful increase in the proportion of our agency MBS portfolio represented by net long positions in non-specified TBA securities (which are accounted for as derivative instruments) with a corresponding reduction in the proportion represented by specified agency MBS, (ii) lower asset yields on the Company's agency MBS driven by higher relative prepayments in the current year, and (iii) a 29 basis point increase in the average interest costs of our short-term financing arrangements for the year ended December 31, 2016 relative to the prior year, due primarily to an increase in prevailing benchmark short-term interest rates. As previously noted, TBA dollar roll income is not included in net interest income determined in accordance with GAAP.

The components of GAAP net interest income from our MBS portfolio, excluding interest expense on unsecured long-term debt, are summarized in the following table (dollars in thousands):

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | 2015 | | |
| | Average Balance | Income (Expense) | Yield (Cost) | Average Balance | Income (Expense) | Yield (Cost) |
| Agency MBS | $ 3,597,293 | $ 97,053 | 2.70% | $ 3,697,789 | $ 105,914 | 2.86% |
| Private-label MBS | 74,889 | 7,910 | 10.56% | 159,853 | 15,342 | 9.60% |
| Other | — | 373 | | — | 7 | |
| | $ 3,672,182 | 105,336 | 2.87% | $ 3,857,642 | 121,263 | 3.14% |
| Repurchase agreements | $ 3,391,465 | (24,298) | (0.70)% | $ 3,390,402 | (14,319) | (0.42)% |
| FHLB advances | 35,114 | (135) | (0.38)% | 126,428 | (382) | (0.30)% |
| | $ 3,426,579 | (24,433) | (0.70)% | $ 3,516,830 | (14,701) | (0.41)% |
| Net interest income/spread | | $ 80,903 | 2.17% | | $ 106,562 | 2.73% |
| Net interest margin | | | 2.20% | | | 2.76% |

The effects of changes in the composition of our investments on our GAAP net interest income from our MBS investment activities are summarized below (dollars in thousands):

| | Year Ended December 31, 2016 vs. Year Ended December 31, 2015 | | |
|---|---|---|---|
| | Rate (1) | Volume (1) | Total Change |
| MBS: | | | |
| Agency MBS | $ (6,036) | $ (2,825) | $ (8,861) |
| Private-label MBS | 1,440 | (8,872) | (7,432) |
| Total MBS | (4,596) | (11,697) | (16,293) |
| Other | — | 366 | 366 |
| Repurchase agreements | (9,975) | (4) | (9,979) |
| FHLB advances | (83) | 330 | 247 |
| | $ (14,654) | $ (11,005) | $ (25,659) |

(1) The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the change in each.

During the year ended December 31, 2016, the percentage allocation of our total agency MBS portfolio to net long positions in TBA securities and specified agency MBS was 18% and 82%, respectively, as compared to 6% and 94%, respectively, for the year ended December 31, 2015 as illustrated by the following table (dollars in thousands):

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Average Balance | Relative Allocation | Average Balance | Relative Allocation |
| Specified agency MBS | $ 3,597,293 | 82% | $ 3,697,789 | 94% |
| Net long TBA position (1) | 788,338 | 18% | 237,442 | 6% |
| Total agency MBS portfolio | $ 4,385,631 | 100% | $ 3,935,231 | 100% |

(1) Net long TBA position average balance (average cost basis) is based upon the contractual price of the initial TBA purchase trade of each individual series of dollar roll transactions.

As a result of the substantial increase in our TBA portfolio, TBA dollar roll income increased $12.6 million to $19.3 million for the year ended December 31, 2016 from $6.7 million for the year ended December 31, 2015. When adjusting our net interest income determined in accordance with GAAP to include TBA dollar roll income (which is net of implied financing costs), the total net spread income earned from our aggregate MBS investment portfolio for the year ended December 31, 2016 decreased by $13.1 million (or 11.6%) million relative to the prior year. The reduction in total spread income in the current year periods relative to the prior year periods is due primarily to (i) a reduction in asset revenues driven by relatively higher prepayments on our specified agency MBS resulting a lower weighted average yield on those assets as well as (ii) an increase in the costs of our short-term financing arrangements and the implied financing costs of our TBA dollar rolls driven primarily by an increase in prevailing short-term interest rates. The following tables provide a comparison of GAAP interest income, GAAP net interest income (excluding interest expense from long-term debt), and TBA dollar roll income for periods indicated (dollars in thousands):

| | For the Year Ended December 31, | | Increase (Decrease) Expressed in: | |
|---|---|---|---|---|
| | 2016 | 2015 | Amount | Percentage |
| GAAP interest income | $ 105,336 | $ 121,263 | $ (15,927) | (13.13)% |
| TBA dollar roll income (1) | 19,261 | 6,743 | 12,518 | 185.64% |
| GAAP interest income plus TBA dollar roll income | 124,597 | 128,006 | (3,409) | (2.66)% |
| Interest expense on short-term debt | 24,433 | 14,701 | 9,732 | 66.20% |
| Net interest income plus TBA dollar roll income | $ 100,164 | $ 113,305 | $ (13,141) | (11.60)% |

(1) TBA dollar roll income is net of implied financing costs.

Interest expense related to long-term debt was $4.8 million and $4.2 million for the years ended December 31, 2016 and 2015, respectively. The increase in interest expense on long-term debt is attributable to the issuance of $35.3 million of senior notes in March 2015.

*Investment Loss, Net*

"Total investment loss, net" decreased $49.1 million from a loss of $118.4 million for the year ended December 31, 2015 to a loss of $69.3 million for the year ended December 31, 2016. Within each of these comparative periods, MBS spread widening coupled with volatility in prevailing longer-term interest rates drove the recognition of fair value losses on our interest rate derivative instruments as well as our agency MBS investments.

Further detail about the gains and losses recognized due to the changes in the fair value of our agency MBS, TBA transactions, and interest rate derivative instruments for the periods indicated is as follows (dollars in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Realized gains on sale of available-for-sale investments, net | $ 4,777 | $ 17,725 |
| OTTI charges on available-for-sale securities | (1,737) | (2,417) |
| Losses on trading investments, net | (41,249) | (31,058) |
| TBA and specified agency MBS commitments, net: | | |
| TBA dollar roll income | 19,261 | 6,743 |
| Other losses from TBA and specified agency MBS commitments, net | (28,805) | (5,059) |
| Total (losses) gains on TBA and specified agency MBS commitments, net | (9,544) | 1,684 |
| Interest rate derivatives: | | |
| Net interest expense on interest rate swaps | (17,825) | (1,282) |
| Other losses from interest rate derivative instruments, net | (4,291) | (105,145) |
| Total losses on interest rate derivatives, net | (22,116) | (106,427) |
| Other, net | 551 | 2,064 |
| Investment loss, net | $ (69,318) | $ (118,429) |

Available-for-sale investments substantially consist of our private-label MBS acquired prior to 2015. The realized gains on the sale of available-for-sale investments, net, recognized for the years ended December 31, 2016 and 2015 were the result of $114.0 million and $130.1 million, respectively, of proceeds received from the sales of private-label MBS resulting in net realized gains of $4.8 million and $17.7 million, respectively.

We recorded credit related other-than-temporary impairment charges of $1.7 million and $2.4 million for the years ended December 31, 2016 and 2015, respectively, on available-for-sale, private-label MBS. Credit related other-than-temporary impairment charges represent the excess of the amortized cost basis over the present value of expected future cash flows discounted at the security's existing effective interest rate used for interest income recognition.

Investments classified as trading securities primarily consist of agency MBS. The $41.2 million and $31.1 million of net losses recognized for the years ended December 31, 2016 and 2015, respectively, were primarily driven by meaningful agency MBS spread widening and an increase in long-term interest rates that occurred during the periods.

Commitments to purchase and sell MBS consist primarily of forward-settling purchases of TBA agency MBS that are generally settled on a net basis through the execution of dollar roll transactions and, to a lesser extent, certain commitments to purchase specified agency MBS that will be settled by the physical delivery of the securities. We recognized net losses of $9.5 million for the year ended December 31, 2016 and net gains of $1.7 million for the year ended December 31, 2015 from forward-settling commitments to purchase and sell agency MBS, which consists of both TBA dollar roll income as well as other fair value gains and losses stemming from these forward-settling commitments.

Our interest rate derivative instruments currently consist of centrally-cleared interest rate swaps and exchange-traded put and call options on U.S. Treasury note futures, and have historically also included U.S. Treasury note futures, Eurodollar futures, and interest rate swap futures. While we use interest rate derivatives to economically hedge a portion of our interest rate risk, we have not designated such contracts as hedging instruments for financial reporting purposes. As a result, the implied economic financing costs of our interest rate derivatives are included in the change in fair value of the instruments recognized in "investment gain (loss), net" rather than in net interest income. During periods of falling interest rates, we will generally experience losses on our interest rate derivative instruments and during periods of rising interest rates, we will generally experience gains on our interest rate derivative instruments. The $22.1 million of net losses recognized for interest rate derivative instruments for the year ended December 31, 2016 were primarily attributable to implied net economic financing costs of our interest rate swap agreements. The $106.4 million of net losses recognized for interest rate derivative instruments for the year ended December 31, 2015 were primarily driven by substantial volatility in prevailing long-term interest rates coupled with the implied net economic financing costs of certain of the interest rate derivatives.

The fair value of our hedging instruments is expected to fluctuate inversely relative to the change in fair value of the agency MBS portfolio. However, the degree of correlation between the price movements of our hedging instruments and those of our agency MBS portfolio may vary. While our hedging instruments are designed to protect our agency MBS portfolio from interest rate risk, they are not generally designed to protect our net book value from spread risk, which is the risk of an increase of the market spread between the yield on our agency MBS and the benchmark yield on U.S. Treasury securities or interest rate swaps.

*General and Administrative Expenses*

General and administrative expenses increased by $6.0 million, or 40.5%, from $14.8 million for the year ended December 31, 2015 to $20.8 million for the year ended December 31, 2016.

Compensation and benefits expensed increased by $1.8 million, or 18.6%, from $9.7 million for the year ended December 31, 2015 to $11.5 million for the year ended December 31, 2016. The increase in compensation and benefits expense is attributable primarily to an increase in long-term performance oriented stock-based compensation. Employee stock-based compensation increased by $1.9 million from $0.6 million for the year ended December 31, 2015 to $2.5 million for the year ended December 31, 2016. During the year ended December 31, 2015, the Company did not achieve certain performance measures for certain of the Company's performance share units granted to executive officers, which resulted in the reversal of stock-based compensation expense that had been recognized in prior periods.

Other general and administrative expenses increased by $4.1 million, or 80.4%, from $5.1 million for the year ended December 31, 2015 to $9.2 million for the year ended December 31, 2016, primarily due to non-recurring proxy contest related expenses. During the year ended December 31, 2016, we incurred $4.0 million in expenses stemming from the 2016 proxy contest that are in excess of the level of expenses normally incurred for an annual meeting of shareholders. In March 2016, Imation Corp., an IT data storage and data security company, acting in concert with the Clinton Group, Inc. (together, "Imation Group") nominated a controlling slate of five candidates to stand for election to our eight-member board of directors at the 2016 annual meeting of shareholders. As of the record date for the 2016 meeting, the Imation Group owned collectively 11,000 shares of our Class A common stock, representing less than 0.05% of our outstanding common stock. At our annual shareholder meeting on June 9, 2016, our shareholders overwhelmingly voted to elect all of our eight director nominees. In connection with the proxy contest, we incurred non-recurring legal fees, financial advisory fees, proxy solicitor fees, mailing and printing costs of proxy solicitation materials, and other costs in excess of the level of expenses normally incurred for an annual meeting of shareholders.

*Income Tax Provision*

We recognized an income tax provision of $27.4 million and $38.6 million for the years ended December 31, 2016 and 2015, respectively. The income tax provision for the years ended December 31, 2016 and 2015 includes an increase in the valuation allowance against the deferred tax assets of $35.6 million and $56.4 million, respectively. The increase in the valuation allowance against the deferred tax assets for the years ended December 31, 2016 and 2015 is due mostly to net capital losses generated during the periods primarily as a result of realized and unrealized losses on certain of our economic interest rate hedging instruments. The valuation allowance represents the portion of our net capital loss carryforward that is more-likely-than-not to expire unutilized.

*Other Comprehensive Loss*

Other comprehensive loss was $12.4 million and $23.5 million for the years ended December 31, 2016 and 2015, respectively. For the year ended December 31, 2016, other comprehensive loss included net unrealized holding losses of $10.1 million on the available-for-sale MBS portfolio, net of a tax benefit of $3.9 million, $7.2 million of reversal of prior period net unrealized gains upon the sale of available-for-sale MBS, and $1.7 million of other-than-temporary impairment charges on available-for-sale securities, net of a tax provision of $0.7 million.

For the year ended December 31, 2015, other comprehensive loss included net unrealized holding losses of $11.3 million on the available-for-sale MBS portfolio, net of a tax benefit of $4.3 million, $23.0 million of reversal of prior period net unrealized gains upon the sale of available-for-sale MBS, net of a tax benefit of $5.1 million, and $2.4 million of other-than-temporary impairment charges on available-for-sale securities, net of a tax provision of $0.9 million.

***Comparison of the years ended December 31, 2015 and 2014***

The following table presents the total comprehensive loss for the years ended December 31, 2015 and 2014 (dollars in thousands, except per share amounts):

| | Year Ended December 31, | |
|---|---|---|
| | 2015 | 2014 |
| Interest income | $ 121,263 | $ 105,577 |
| Interest expense | 18,889 | 11,391 |
| Net interest income | 102,374 | 94,186 |
| Investment loss, net | (118,429) | (20,287) |
| General and administrative expenses | 14,787 | 18,499 |
| (Loss) income before income taxes | (30,842) | 55,400 |
| Income tax provision | 38,561 | 47,647 |
| Net (loss) income | (69,403) | 7,753 |
| Other comprehensive loss, net of taxes | (23,501) | (10,397) |
| Comprehensive loss | $ (92,904) | $ (2,644) |
| Diluted (loss) earnings per share | $ (3.02) | $ 0.38 |
| Weighted-average diluted shares outstanding | 23,002 | 20,397 |

*Net Interest Income*

GAAP net interest income increased $8.2 million, or 8.7%, from $94.2 million for the year ended December 31, 2014 to $102.4 million for the year ended December 31, 2015. The increase is primarily attributable to a higher average MBS investment portfolio during the year ended December 31, 2015 as a result of investing the net proceeds from two equity offerings during 2014 into MBS, partially offset by a 4 basis point increase in the average interest costs of our short-term financing arrangements for the year ended December 31, 2015 relative to the prior year from the prior year due primarily to an increase in prevailing benchmark short-term interest rates.

The components of GAAP net interest income from our MBS portfolio, excluding interest expense on unsecured long-term debt, are summarized in the following table (dollars in thousands):

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | | |
| | Average Balance | Income (Expense) | Yield (Cost) | Average Balance | Income (Expense) | Yield (Cost) |
| Agency MBS | $ 3,697,789 | $ 105,914 | 2.86% | $ 2,569,118 | $ 79,930 | 3.11% |
| Private-label MBS | 159,853 | 15,342 | 9.60% | 254,211 | 25,624 | 10.08% |
| Other | — | 7 | | — | 23 | |
| | $ 3,857,642 | 121,263 | 3.14% | $ 2,823,329 | 105,577 | 3.74% |
| Repurchase agreements | $ 3,390,402 | (14,319) | (0.42)% | $ 2,438,479 | (9,181) | (0.37)% |
| FHLB advances | 126,428 | (382) | (0.30)% | — | — | — |
| | $ 3,516,830 | (14,701) | (0.41)% | $ 2,438,479 | (9,181) | (0.37)% |
| Net interest income/spread | | $ 106,562 | 2.73% | | $ 96,396 | 3.37% |
| Net interest margin | | | 2.76% | | | 3.41% |

The effects of changes in the composition of our investments on our GAAP net interest income from our MBS investment activities are summarized below (dollars in thousands):

| | Year Ended December 31, 2015 vs. Year Ended December 31, 2014 | | |
|---|---|---|---|
| | Rate (1) | Volume (1) | Total Change |
| MBS: | | | |
| Agency MBS | $ (6,770) | $ 32,754 | $ 25,984 |
| Private-label MBS | (1,175) | (9,107) | (10,282) |
| Total MBS | (7,945) | 23,647 | 15,702 |
| Other | — | (16) | (16) |
| Repurchase agreements | (1,222) | (3,916) | (5,138) |
| FHLB advances | — | (382) | (382) |
| | $ (9,167) | $ 19,333 | $ 10,166 |

(1) The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Interest expense related to long-term debt was $4.2 million and $2.2 million for the years ended December 31, 2015 and 2014, respectively. The increase in interest expense on long-term debt is attributable to the issuance of $35.3 million of senior notes in March 2015.

*Investment Loss, Net*

"Total investment loss, net" increased $98.1 million from a loss of $20.3 million for the year ended December 31, 2014 to a loss of $118.4 million for the year ended December 31, 2015. Further detail about the gains and losses recognized due to changes in the fair value of our agency MBS, TBA transactions and interest rate derivative instruments for the years ended December 31, 2015 and 2014 follows (dollars in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2015 | 2014 |
| Realized gains on sale of available-for-sale investments, net | $ 17,725 | $ 17,257 |
| OTTI charges on available-for-sale securities | (2,417) | (449) |
| (Losses) gains on trading investments, net | (31,058) | 102,122 |
| Gains from TBA and specified agency MBS commitments, net | 1,684 | 5,778 |
| Net interest expense on interest rate swaps | (1,282) | — |
| Other losses from interest rate derivative instruments, net | (105,145) | (145,716) |
| Other, net | 2,064 | 721 |
| Investment loss, net | $ (118,429) | $ (20,287) |

Available-for-sale investments substantially consist of our private-label MBS acquired prior to 2015. The realized gains on the sale of available-for-sale investments, net, recognized for the year ended December 31, 2015 and 2014 were the result of $130.1 million and $86.3 million, respectively, of proceeds received from the sales of private-label MBS resulting in net realized gains of $17.7 million and $17.3 million, respectively.

We recorded credit related other-than-temporary impairment charges of $2.4 million and $0.5 million for the years ended December 31, 2015 and 2014, respectively, on available-for-sale, private-label MBS. Credit related other-than-temporary impairment charges represent the excess of the amortized cost basis over the present value of expected future cash flows discounted at the security's existing effective interest rate used for interest income recognition.

Investments classified as trading securities primarily consist of agency MBS. The $31.1 million of net losses recognized for the year ended December 31, 2015, were primarily driven by meaningful agency MBS spread widening and an increase in long-term interest rates that occurred during the year. The $102.1 million of net gains recognized for the year ended December 31, 2014, were primarily driven by meaningful agency MBS spread narrowing and a significant decrease in long-term interest rates that occurred during the year.

Commitments to purchase and sell MBS consist primarily of forward-settling purchases of TBA agency MBS that are generally settled on a net basis through the execution of dollar roll transactions and, to a lesser extent, certain commitments to purchase specified agency MBS that will be settled by the physical delivery of the securities. We recognized net gains of $1.7 million and $5.8 million for the years ended December 31, 2015 and 2014, respectively from forward-settling commitments to purchase and sell agency MBS, which consists of both TBA dollar roll income as well as other fair value gains stemming from these forward-settling commitments.

For the years ended December 31, 2015 and 2014, the interest rate derivative instruments we utilized generally consisted of exchange traded U.S. Treasury note futures, Eurodollar futures and interest rate swap futures. In late 2015, we also began to utilize centrally cleared interest rate swap agreements. While we use interest rate derivatives to economically hedge a portion of our interest rate risk, we have not designated such contracts as hedging instruments for financial reporting purposes. As a result, the implied economic financing costs of our interest rate derivatives are included in the change in fair value of the instruments recognized in "investment gain (loss), net" rather than in net interest income. During periods of falling interest rates, we will generally experience losses on our interest rate derivative instruments and during periods of rising interest rates, we will generally experience gains on our interest rate derivative instruments. The $106.4 million and $145.7 million of net losses recognized for interest rate derivative instruments for the years ended December 31, 2015 and 2014, respectively, were primarily attributable to periods of falling interest rates and substantial interest rate volatility coupled with the implied net economic financing costs of our interest rate swap agreements.

The fair value of our hedging instruments is expected to fluctuate inversely relative to the change in fair value of the agency MBS portfolio. However, the degree of correlation between the price movements of our hedging instruments and those of our agency MBS portfolio may vary. While our hedging instruments are designed to protect our agency MBS portfolio from interest rate risk, they are not generally designed to protect our net book value from spread risk, which is the risk of an increase of the market spread between the yield on our agency MBS and the benchmark yield on U.S. Treasury securities or interest rate swaps.

*General and Administrative Expenses*

General and administrative expenses decreased by $3.7 million, or 20.0%, from $18.5 million for the year ended December 31, 2014 to $14.8 million for the year ended December 31, 2015.

Compensation and benefits expensed decreased by $3.8 million, or 28.1%, from $13.5 million for the year ended December 31, 2014 to $9.7 million for the year ended December 31, 2015. The decrease in compensation and benefits expense is attributable primarily to a decrease in both long-term performance oriented stock-based compensation and annual cash incentive compensation. Employee stock-based compensation decreased by $2.8 million from $3.4 million for the year ended December 31, 2014 to $0.6 million for the year ended December 31, 2015. During the year ended December 31, 2015, the Company did not achieve certain performance measures for certain of the Company's performance share units granted to executive officers, which resulted in the reversal of stock-based compensation expense that had been recognized in prior periods.

Other general and administrative expenses remained effectively unchanged for the years ended December 31, 2015 and 2014, at $5.1 million and $5.0 million, respectively.

*Income Tax Provision*

The Company's income tax provision was $38.6 million and $47.6 million for the years ended December 31, 2015 and 2014, respectively. The income tax provision for the years ended December 31, 2015 and 2014 includes an increase in the valuation allowance against the deferred tax assets of $56.4 million and $24.2 million, respectively. The increase in the valuation allowance against the deferred tax assets for the years ended December 31, 2015 and 2014 is due mostly to net capital losses generated during the periods primarily as a result of realized and unrealized losses on certain of our economic interest rate hedging instruments. The valuation allowance represents the portion of our net capital loss carryforward that is more-likely-than-not to expire unutilized.

*Other Comprehensive Loss*

Other comprehensive loss was $23.5 million and $10.4 million for the years ended December 31, 2015 and 2014, respectively. For the year ended December 31, 2015, other comprehensive loss included net unrealized holding losses of $11.3 million on the available-for-sale MBS portfolio, net of a tax benefit of $4.3 million, $23.0 million of reversal of prior period net unrealized gains upon the sale of available-for-sale MBS, net of a tax benefit of $5.1 million, and $2.4 million of other-than-temporary impairment charges on available-for-sale securities, net of a tax provision of $0.9 million.

For the year ended December 31, 2014, other comprehensive loss included net unrealized holding gains of $1.6 million on the available-for-sale MBS portfolio, net of a tax provision of $0.6 million, $17.2 million of reversal of prior period net unrealized gains upon the sale of available-for-sale MBS, net of a tax benefit of $5.5 million, and $0.4 million of other-than-temporary impairment charges on available-for-sale securities, net of a tax provision of $0.2 million.

**Non-GAAP Core Operating Income**

In addition to the results of operations determined in accordance with generally accepted accounting principles as consistently applied in the United States ("GAAP"), we reported "non-GAAP core operating income". We define core operating income as "economic net interest income" less "core general and administrative expenses."

*Economic Net Interest Income*

Economic net interest income, a non-GAAP financial measure, represents the interest income earned net of the interest expense incurred from all of our interest bearing financial instruments as well as the agency MBS which underlie, and are implicitly financed through, our TBA dollar roll transactions. Economic net interest income is comprised of the following: periodic (i) net interest income determined in accordance with GAAP, (ii) TBA agency MBS "dollar roll" income, and (iii) net interest income or expense incurred from interest rate swap agreements.

We believe that economic net interest income assists investors in understanding and evaluating the financial performance of the Company's long-term-focused, net interest spread-based investment strategy, prior to the deduction of core general and administrative expenses.

- *Net interest income determined in accordance with GAAP.* Net interest income determined in accordance with GAAP primarily represents the interest income recognized from our investments in specified agency MBS and private-label MBS (including the amortization of purchase premiums and accretion of purchase discounts), net of the interest expense incurred from repurchase agreement financing arrangements or other short- and long-term borrowing transactions. In the first quarter of 2016, we implemented a change in our accounting policy for recognizing interest income on our investments in agency MBS classified as trading securities by amortizing purchase premiums (or accreting purchase discounts) as an adjustment to interest income in accordance with the "interest method" permitted by GAAP.

- *TBA agency MBS dollar roll income.* Dollar roll income represents the economic equivalent of net interest income (implied interest income net of financing costs) generated from our investments in non-specified fixed-rate agency MBS, executed through sequential series of forward-settling purchase and sale transactions that are settled on a net basis (known as "dollar roll" transactions). Dollar roll income is generated as a result of delaying, or "rolling," the settlement of a forward-settling purchase of a TBA agency MBS by entering into an offsetting "spot" sale prior to the settlement date, net settling the "paired-off" positions in cash, and contemporaneously entering another forward-settling purchase of a TBA agency MBS of the same essential characteristics for a later settlement date at a price discount relative to the spot sale. The price discount of the forward-settling purchase relative to the contemporaneously executed spot sale reflects compensation for the interest income (inclusive of expected prepayments) that, at the time of sale, is expected to be foregone as a result of relinquishing beneficial ownership of the MBS from the settlement date of the spot sale until the settlement date of the forward purchase, net of implied repurchase financing costs. We calculate dollar roll income as the excess of the spot sale price over the forward-settling purchase price, and recognize this amount ratably over the period beginning on the settlement date of the sale and ending on the settlement date of the forward purchase. In our consolidated statements of comprehensive income prepared in accordance with GAAP, TBA agency MBS dollar roll income is reported as a component of the overall periodic change in the fair value of TBA forward commitments within the line item "gain (loss) from derivative instruments, net" of the "investment gain (loss), net" section.

- *Net interest income earned or expense incurred from interest rate swap agreements.* We utilize centrally-cleared interest rate swap agreements to economically hedge a portion of our exposure to variability in future interest cash flows, attributable to changes in benchmark interest rates, associated with future roll-overs of our short-term financing arrangements. Accordingly, the net interest income earned or expense incurred (commonly referred to as "net interest carry") from our interest rate swap agreements in combination with interest expense recognized in accordance with GAAP represents our effective "economic interest expense." In our consolidated statements of comprehensive income prepared in accordance with GAAP, the net interest income earned or expense incurred from interest rate swap agreements is reported as a component of the overall periodic change in the fair value of derivative instruments within the line item "gain (loss) from derivative instruments, net" of the "investment gain (loss), net" section.

*Core General and Administrative Expenses*

Core general and administrative expenses are non-interest expenses reported within the line item "total general and administrative expenses" of the consolidated statements of comprehensive income less stock-based compensation expense. For the year ended December 31, 2016, core general and administrative expenses also exclude non-recurring expenses related to the 2016 proxy contest that are in excess of those normally incurred for an annual meeting of shareholders.

*Non-GAAP Core Operating Income*

The following table presents our computation of non-GAAP core operating income for the years ended December 31, 2016 and 2015 (amounts in thousands, except per share amounts):

| | For the Year Ended December 31, 2016 | For the Year Ended December 31, 2015 |
|---|---|---|
| GAAP net interest income | $ 76,114 | $ 102,374 |
| TBA dollar roll income | 19,261 | 6,743 |
| Interest rate swap net interest expense | (17,825) | (1,282) |
| Economic net interest income | 77,550 | 107,835 |
| Core general and administrative expenses | (13,802) | (13,642) |
| Non-GAAP core operating income | $ 63,748 | $ 94,193 |
| | | |
| Non-GAAP core operating income per diluted share | $ 2.75 | $ 4.08 |
| Weighted average diluted shares outstanding | 23,202 | 23,088 |

Non-GAAP core operating income for the year ended December 31, 2016 is not directly comparable to the amount for the year ended December 31, 2015 as it relates to the line item "interest rate swap net interest expense." Prior to November 2015, we solely utilized hedging instruments other than interest rate swap agreements. The economic costs or benefits of hedging instruments other than interest rate swap agreements do not affect the computation of non-GAAP core operating income. As a result, the non-GAAP core operating income computed for the year ended December 31, 2015 includes less than two months of interest rate swap net interest expense while the amount for the year ended December 31, 2016 includes a full year of interest rate swap net interest expense.

The following table provides a reconciliation of GAAP pre-tax net income to non-GAAP core operating income for the years ended December 31, 2016 and 2015 (amounts in thousands):

| | For the Year Ended December 31, 2016 | For the Year Ended December 31, 2015 |
|---|---|---|
| GAAP loss before income taxes | $ (13,960) | $ (30,842) |
| *Less:* | | |
| Total investment loss, net | 69,318 | 118,429 |
| Stock-based compensation expense | 2,975 | 1,145 |
| Non-recurring proxy contest related expenses | 3,979 | — |
| *Add back:* | | |
| TBA dollar roll income | 19,261 | 6,743 |
| Interest rate swap net interest expense | (17,825) | (1,282) |
| Non-GAAP core operating income | $ 63,748 | $ 94,193 |

Non-GAAP core operating income is used by management to evaluate the financial performance of the Company's long-term-focused, net interest spread-based investment strategy and core business activities over periods of time as well as assist with the determination of the appropriate level of periodic dividends to stockholders. In addition, we believe that non-GAAP core operating income assists investors in understanding and evaluating the financial performance of the Company's long-term-focused, net interest spread-based investment strategy and core business activities over periods of time as well as its earnings capacity.

Periodic fair value gains and losses recognized with respect to our investments in MBS and our economic hedging instruments, which are reported in line item "total investment gain (loss), net" of our consolidated statements of comprehensive income, are excluded from the computation of non-GAAP core operating income as such gains on losses are not reflective of the economic interest income earned or interest expense incurred from our interest-bearing financial assets and liabilities during the indicated reporting period. Because our long-term-focused investment strategy for our agency MBS investment portfolio is to generate a net interest spread on the leveraged assets while prudently hedging periodic changes in the fair value of those assets attributable to changes in benchmark interest rates, we generally expect the fluctuations in the fair value of our agency MBS investments and our economic hedging instruments to largely offset one another over time.

A limitation of utilizing this non-GAAP financial measure is that the effect of accounting for "non-core" events or transactions in accordance with GAAP does, in fact, reflect the financial results of our business and these effects should not be ignored when evaluating and analyzing our financial results. For example, the economic cost or benefit of hedging instruments other than interest rate swap agreements, such as U.S. Treasury note futures or options on U.S. Treasury note futures, do not affect the computation of non-GAAP core operating income. Therefore, we believe that non-GAAP core operating income should be considered as a supplement to, and in conjunction with, net income and comprehensive income determined in accordance with GAAP.

**Liquidity and Capital Resources**

Liquidity is a measurement of our ability to meet potential cash requirements including ongoing commitments to repay borrowings, fund investments, meet margin calls on our short-term borrowings and hedging instruments, and for other general business purposes. Our primary sources of funds for liquidity consist of existing cash balances, short-term borrowings (for example, repurchase agreements), principal and interest payments from our investments in MBS, and proceeds from sales of MBS. Other sources of liquidity include proceeds from the offering of common stock, preferred stock, debt securities, or other securities registered pursuant to our effective shelf registration statement filed with the Securities and Exchange Commission ("SEC").

Liquidity, or ready access to funds, is essential to our business. Perceived liquidity issues may affect our counterparties' willingness to engage in transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects us or third parties. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time. If we cannot obtain funding from third parties or from our subsidiaries, our results of operations could be negatively impacted.

As of December 31, 2016, our debt-to-equity leverage ratio was 9.7 to 1 measured as the ratio of the sum of our total debt to our shareholders' equity as reported on our consolidated balance sheet. In evaluating our liquidity and leverage ratios, we also monitor our "at risk" short-term financing to investable capital ratio. Our "at risk" short-term financing to investable capital ratio is measured as the ratio of the sum of our short-term financing (i.e. repurchase agreement financing), net payable or receivable for unsettled securities and net contractual forward price of our TBA commitments compared to our investable capital. Our investable capital is calculated as the sum of our tangible stockholders' equity and long-term unsecured debt. Tangible stockholders' equity is measured as our stockholders' equity less our net deferred tax asset, and our long-term unsecured debt is measured as our long-term unsecured debt excluding any unamortized issuance costs. As of December 31, 2016, our "at risk" short-term financing to investable capital ratio was 11.3 to 1.

***Cash Flows***

As of December 31, 2016, our cash and cash equivalents totaled $54.8 million representing a net increase of $17.8 million from $37.0 million as of December 31, 2015. Cash provided by operating activities of $88.6 million during 2016 was attributable primarily to net interest income less our general and administrative expenses. Our cash used in investing activities of $49.8 million during 2016 relates primarily to purchases of agency MBS and funding of deposits for margin calls on the Company's interest rate hedges, partially offset by sales of agency and private-label MBS and the principal payments received on agency MBS. Our cash used in financing activities of $20.9 million during 2016 relates primarily to dividend payments on common stock, partially offset by net proceeds from repurchase agreements and FHLB advances used to finance a portion of the MBS portfolio and proceeds from issuance of common stock.

***Sources of Funding***

We believe that our existing cash balances, net investments in MBS, cash flows from operations, borrowing capacity, and other sources of liquidity will be sufficient to meet our cash requirements for at least the next twelve months. We may, however, seek debt or equity financings, in public or private transactions, to provide capital for corporate purposes and/or strategic business opportunities, including possible acquisitions, joint ventures, alliances or other business arrangements which could require substantial capital outlays. Our policy is to evaluate strategic business opportunities, including acquisitions and divestitures, as they arise. There can be no assurance that we will be able to generate sufficient funds from future operations, or raise sufficient debt or equity on acceptable terms, to take advantage of investment opportunities that become available. Should our needs ever exceed these sources of liquidity, we believe that most of our investments could be sold, in most circumstances, to provide cash. However, we may be required to sell our assets in such instances at depressed prices.

As of December 31, 2016, liquid assets consisted primarily of cash and cash equivalents of $54.8 million and net investments in MBS of $263.5 million. Cash equivalents consist primarily of money market funds invested in debt obligations of the U.S. government. The Company's net investments in MBS is calculated as the sum of the Company's total MBS investments at fair value and receivable for sold MBS, less the sum of the repurchase agreements outstanding and payable for purchased MBS.

## *Debt Capital*

*Long-Term Debt*

As of December 31, 2016, we had $73.7 million of total long-term debt, net of unamortized debt issuance costs of $1.6 million. Our trust preferred debt with a principal amount of $15.0 million outstanding as of December 31, 2016 accrues and requires payment of interest quarterly at annual rates of three-month LIBOR plus 2.25% to 3.00% and matures between 2033 and 2035. Our 6.625% Senior Notes due 2023 with a principal amount of $25.0 million outstanding as of December 31, 2016 accrue and require payment of interest quarterly at an annual rate of 6.625% and mature on May 1, 2023. Our 6.75% Senior Notes due 2025 with a principal amount of $35.3 million outstanding as of December 31, 2016 accrue and require payment of interest quarterly at an annual rate of 6.75% and mature on March 15, 2025.

*Repurchase Agreements*

We have short-term financing facilities that are structured as repurchase agreements with various financial institutions to fund our investments in MBS. We have obtained, and believe we will be able to continue to obtain, short-term financing in amounts and at interest rates consistent with our financing objectives. Funding for MBS through repurchase agreements continues to be available to us at rates we consider to be attractive from multiple counterparties.

Our repurchase agreements include provisions contained in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association (“SIFMA”) and may be amended and supplemented in accordance with industry standards for repurchase facilities. Our repurchase agreements include financial covenants, with which the failure to comply would constitute an event of default under the applicable repurchase agreement. Similarly, each repurchase agreement includes events of insolvency and events of default on other indebtedness as similar financial covenants. As provided in the standard master repurchase agreement as typically amended, upon the occurrence of an event of default or termination, the applicable counterparty has the option to terminate all repurchase transactions under such counterparty’s repurchase agreement and to demand immediate payment of any amount due from us to the counterparty.

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (commonly referred to as a “margin call”), which may take the form of additional securities or cash. Margin calls on repurchase agreements collateralized by our MBS investments primarily result from events such as declines in the value of the underlying mortgage collateral caused by factors such as rising interest rates or prepayments. Our repurchase agreements generally provide that valuations for MBS securing our repurchase agreements are to be obtained from a generally recognized source agreed to by both parties. However, in certain circumstances and under certain of our repurchase agreements, our lenders have the sole discretion to determine the value of the MBS securing our repurchase agreements. 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 the margin call is made if the lender provides us notice prior to the margin notice deadline on such day.

To date, we have not had any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should we encounter increases in interest rates or prepayments, margin calls on our repurchase agreements could result in a material adverse change in our liquidity position.

Our repurchase agreements generally mature within 30 to 90 days, but may have maturities as short as one day and as long as one year. In the event that market conditions are such that we are unable to continue to obtain repurchase agreement financing for our investments in MBS in amounts and at interest rates consistent with our financing objectives, we may liquidate such investments and may incur significant losses on any such sales of MBS.

In the event that market conditions are such that we are unable to obtain financing for our investments in MBS in amounts and at interest rates consistent with our financing objectives, to the extent deemed appropriate, we may use cash to finance our investments or we may liquidate such investments. Accordingly, depending upon market conditions, we may incur significant losses on any such sales of MBS.

The following table provides information regarding our outstanding repurchase agreement borrowings as of dates and periods indicated (dollars in thousands):

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| Pledged with agency MBS: | | | | |
| Repurchase agreements outstanding | $ | 3,649,102 | $ | 2,797,561 |
| Agency MBS collateral, at fair value | | 3,851,269 | | 2,946,684 |
| Net amount (1) | | 202,167 | | 149,123 |
| Weighted-average rate | | 0.96% | | 0.61% |
| Weighted-average term to maturity | | 19.3 days | | 12.8 days |
| Pledged with private-label MBS: | | | | |
| Repurchase agreements outstanding | $ | — | $ | 37,219 |
| Private-label MBS collateral, at fair value | | — | | 70,511 |
| Net amount (1) | | — | | 33,292 |
| Weighted-average rate | | — | | 2.42% |
| Weighted-average term to maturity | | — | | 16.9 days |
| Total MBS: | | | | |
| Repurchase agreements outstanding | $ | 3,649,102 | $ | 2,834,780 |
| MBS collateral, at fair value | | 3,851,269 | | 3,017,195 |
| Net amount (1) | | 202,167 | | 182,415 |
| Weighted-average rate | | 0.96% | | 0.64% |
| Weighted-average term to maturity | | 19.3 days | | 12.8 days |
| Maximum amount outstanding at any month-end during the period | $ | 3,653,114 | $ | 3,911,987 |

(1) Net amount represents the value of collateral in excess of corresponding repurchase obligation. The amount of collateral at-risk is limited to the outstanding repurchase obligation and not the entire collateral balance.

To limit our exposure to counterparty risk, we diversify our repurchase agreement funding across multiple counterparties and by counterparty region. As of December 31, 2016, we had outstanding repurchase agreement balances with 14 counterparties and have master repurchase agreements in place with a total of 18 counterparties located throughout North America, Europe and Asia. As of December 31, 2016, less than 7% of our stockholders' equity was at risk with any one counterparty, with the top five counterparties representing 27.6% of our stockholders' equity. The table below includes a summary of our repurchase agreement funding by number of counterparties and counterparty region as of December 31, 2016:

| | Number of Counterparties | Percent of Repurchase Agreement Funding |
|---|---|---|
| North America | 11 | 76.5% |
| Europe | 1 | 9.0% |
| Asia | 2 | 14.5% |
| | 14 | 100.0% |

***Derivative Instruments***

In the normal course of our operations, we are a party to financial instruments that are accounted for as derivative financial instruments including (i) interest rate derivative instruments such as interest rate swaps, Eurodollar futures, interest rate swap futures, U.S. Treasury note futures, and put and call options on U.S. Treasury note futures, and (ii) derivative instruments that economically serve as investments such as TBA contracts.

*Interest Rate Derivative Instruments*

We exchange collateral with the counterparties to our interest rate derivative instruments at least on a daily basis based upon daily changes in fair value (also known as "variation margin") as measured by the central clearinghouse through which those derivatives are cleared. In addition, the central clearinghouse requires market participants to deposit and maintain an "initial margin" amount which is determined by the clearinghouse and is generally intended to be set at a level sufficient to protect the clearinghouse from the maximum estimated single-day price movement in that market participant's contracts. The clearing exchanges have the sole discretion to determine the value of derivative instruments. In the event of a margin call, we must generally provide additional collateral on the same business day. To date, we have not had any margin calls on our derivative agreements that we were not able to satisfy. However, if we encounter significant decreases in long-term interest rates, margin calls on our derivative agreements could result in a material adverse change in our liquidity position.

As of December 31, 2016, we had outstanding centrally cleared interest rate swaps and exchange-traded options on 10-year U.S. Treasury note futures with the following net fair value and corresponding margin posted and received (in thousands):

| | December 31, 2016 | | |
|---|---|---|---|
| | Net Fair Value | Collateral Deposit | Collateral Received |
| Interest rate swaps | $ 61,366 | $ 65,728 | $ 61,367 |
| Options on 10-year U.S. Treasury note futures | 383 | 5,314 | — |

*TBA Dollar Roll Transactions*

TBA dollar roll transactions represent a form of off-balance sheet financing accounted for as derivative instruments. In a TBA dollar roll transaction, we do not intend to take physical delivery of the underlying agency MBS and will generally enter into an offsetting position and net settle the paired off position in cash. However, 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.

Our TBA contracts are subject to master securities forward transaction agreements published by SIFMA as well as supplemental terms and conditions with each counterparty. Under the terms of these agreements, we may be required to pledge collateral to our counterparty in the event the fair value of our TBA contracts declines and such counterparty demands collateral through a margin call. Margin calls on TBA contracts are generally caused by such factors as rising interest rates or prepayments. Our TBA contracts generally provide that valuations for our TBA commitments and any pledged collateral are to be obtained from a generally recognized source agreed to by both parties. However, in certain circumstances, our counterparties have the sole discretion to determine the value of the TBA commitment and any pledged collateral. In such instances, our counterparties are required to act in good faith in making determinations of value. In the event of a margin call, we must generally provide additional collateral on the same business day.

***Equity Capital***

*Equity Distribution Agreements*

On May 24, 2013, we entered into separate equity distribution agreements (the "Equity Distribution Agreements") with each of RBC Capital Markets, LLC, JMP Securities LLC, Ladenburg Thalmann & Co. Inc. and MLV & Co. LLC (the "Equity Sales Agents"), pursuant to which we may offer and sell, from time to time, up to 1,750,000 shares of the Company's Class A common stock. Pursuant to the Equity Distribution Agreements, shares of our common stock may be offered and sold through the Equity Sales Agents in transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, including sales made directly on the NYSE or sales made to or through a market maker other than on an exchange or, subject to the terms of a written notice from the Company, in privately negotiated transactions.

During the year ended December 31, 2016, we issued 595,342 shares of Class A common stock at a weighted average public offering price of $16.57 per share for proceeds net of underwriting discounts and commissions of $9.7 million. As of December 31, 2016, we had 1,154,658 shares of Class A common stock available for sale under the Equity Distribution Agreements.

*Share Repurchase Program*

The Company's Board of Directors authorized a share repurchase program pursuant to which the Company may repurchase up to 2.0 million shares of its Class A common stock. During the year ended December 31, 2015, the Company repurchased 48,695 shares of its Class A common stock at an average price of $12.15 per share for a total cost of $0.6 million. As of December 31, 2016, 1,951,305 shares of Class A common stock remain available for repurchase under the repurchase program.

*Dividends*

Pursuant to our variable dividend policy, our Board of Directors evaluates on a quarterly basis and, in its sole discretion, approves the payment of dividends on our common stock. Our dividend payments, if any, may vary significantly quarter to quarter.

***Contractual Obligations***

We have contractual obligations to make future payments in connection with long-term debt and non-cancelable lease agreements and other contractual commitments. The following table sets forth these contractual obligations by fiscal year (in thousands):

| | 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Long-term debt maturities | $ — | $ — | $ — | $ — | $ — | $ 75,300 | $ 75,300 |
| Interest on long-term debt (1) | 4,584 | 4,584 | 4,584 | 4,584 | 4,584 | 17,036 | 39,956 |
| Minimum rental commitments | 458 | 471 | 483 | 497 | — | — | 1,909 |
| | $ 5,042 | $ 5,055 | $ 5,067 | $ 5,081 | $ 4,584 | $ 92,336 | $ 117,165 |

(1) Includes interest on (i) $25.0 million of Senior Notes due 2023 with a fixed annual interest rate of 6.625% that will mature on May 1, 2023 and (ii) $35.3 million of Senior Notes due 2025 with a fixed annual interest rate of 6.75% that will mature on March 15, 2025. Also includes interest on $15.0 million of trust preferred debt with variable interest rates indexed to three-month LIBOR and reset quarterly. Interest on trust preferred debt is based upon a weighted-average interest rate of 3.63%, which represents the weighted-average contractual interest rate in effect as of December 31, 2016. The trust preferred debt will mature beginning in October 2033 through July 2035.

***Off-Balance Sheet Arrangements and Other Commitments***

As of December 31, 2016, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities ("VIEs"), established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Our economic interests held in unconsolidated VIEs are limited in nature to those of a passive holder of MBS issued by a securitization trust. As of December 31, 2016, we had not consolidated for financial reporting purposes any securitization trusts as we do not have the power to direct the activities that most significantly impact the economic performance of such entities. Further, as of December 31, 2016, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities. See Note 14 to our consolidated financial statements under "Item 8 - Financial Statements and Supplementary Data."

**Critical Accounting Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States ("GAAP") requires the Company to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Although the Company bases these estimates and assumptions on historical experience and all other information available as of the time that the financial statements are prepared, such estimates frequently require management to exercise significant subjective judgment about matters that are inherently uncertain. Actual results may differ from these estimates, which could have a significant and potentially adverse effect on our financial condition, results of operations, and cash flows. A summary of our significant accounting policies is included in "Note 3. Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements.

Our most critical accounting estimates, which are those accounting estimates that require the highest degree of management judgment due to the inherent level of estimation uncertainty, relate to the measurement of the fair value of our investments in MBS, the recognition of interest income from our investments in private-label MBS, and income taxes.

*Fair Value of Investments in MBS*

*Investments in agency MBS* - Inputs to fair value measurements of the Company's investments in agency MBS include price estimates obtained from third-party pricing services. In determining fair value, third-party pricing services use a market approach. The inputs used in the fair value measurements performed by the third-party pricing services are based upon readily observable transactions for securities with similar characteristics (such as issuer/guarantor, coupon rate, stated maturity, and collateral pool characteristics) occurring on the measurement date. The Company makes inquiries of the third party pricing sources to understand the significant inputs and assumptions used to determine prices. The Company reviews the various third-party fair value estimates and performs procedures to validate their reasonableness, including comparison to recent trading activity for similar securities and an overall review for consistency with market conditions observed as of the measurement date. Changes in the market environment that may occur over the holding period of our agency MBS investments may cause the gains or losses that are ultimately realized to differ from those currently recognized in our consolidated financial statements based upon their current valuations.

*Investments in private-label MBS* - Private-label MBS trade infrequently and, therefore, the measurement of their fair value requires the use of significant unobservable inputs. In determining fair value, the Company primarily utilizes present value techniques based on estimated cash flows of each instrument taking into consideration various assumptions derived by management based on their observations of assumptions used by market participants. These assumptions are corroborated by evidence such as historical collateral performance data, evaluation of historical collateral performance data for other securities with comparable or similar risk characteristics, and observed completed or pending transactions in similar instruments, when available. The significant inputs to the Company's valuation process include collateral default, loss severity, prepayment, and discount rates (i.e., the rate of return demanded by market participants as of the measurement date). In general, significant increases (decreases) in default, loss severity, or discount rate assumptions, in isolation, would result in a significantly lower (higher) fair value measurement. However, significant increases (decreases) in prepayment rate assumptions, in isolation, may result in a significantly higher (lower) fair value measurement depending upon the instrument's specific characteristics and the overall payment structure of the issuing securitization vehicle. It is difficult to generalize the interrelationships between these significant inputs as the actual results could differ considerably on an individual security basis. Therefore, each significant input is closely analyzed to ascertain its reasonableness for the Company's purposes of fair value measurement.

The following table provides information about the significant unobservable inputs used to measure the fair value of the Company's private-label MBS as of the dates indicated:

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | Weighted-average (1) | Range | Weighted-average (1) | Range |
| Discount rate | 6.50% | 6.50 - 6.50% | 5.57% | 5.50 - 10.00% |
| Default rate | 2.25% | 2.25 - 2.25% | 2.78% | 1.45 - 6.20% |
| Loss severity rate | 45.00% | 45.00 - 45.00% | 45.84% | 35.00 - 65.00% |
| Prepayment rate | 10.25% | 10.25 - 10.25% | 11.02% | 7.75 - 17.70% |

(1) Based on face value.

The assumptions the Company applies are specific to each security. Although the Company relies on its internal calculations to estimate the fair value of these private-label MBS, the Company considers indications of value from actual sales of similar private-label MBS to assist in the valuation process and to calibrate its models.

*Interest Income Recognition for Investments in Private-Label MBS*

Interest income from our investments in private-label MBS is recognized using a prospective level-yield methodology which is based upon each security's effective interest rate. The amount of periodic interest income recognized is determined by applying the security's effective interest rate to its amortized cost basis or reference amount. At the time of acquisition, the security's effective interest rate is calculated by solving for the single discount rate that equates the present value of our estimate of the amount and timing of the cash flows expected to be collected from the security to its purchase price. The difference between the undiscounted expected cash flows and the purchase price represents an accretable yield that is expected to be recognized as interest income over the remaining life of the security. The difference between the contractually required payments and the undiscounted expected cash flows represents the non-accretable difference. Based on actual payment activities and changes in the estimate of undiscounted expected future cash flows, the accretable yield and the non-accretable difference can change over time. Actual cash collections that exceed our prior estimates and/or positive changes in our periodic estimates of expected future cash flows increase the accretable yield and are recognized prospectively, through the use of a revised effective interest rate, as incremental interest income over the remaining life of the security.

To prepare our quarterly estimate of the amount and timing of remaining cash flows expected to be collected for each private-label MBS, we consider current information and events to develop a number of assumptions about the future performance of the pool of mortgage loans that serve as collateral for our investment, including assumptions about the timing and amount of prepayments and credit losses. These assumptions require a high degree of management judgment as they represent forecasts about future events for which the ultimate outcome is inherently uncertain. If our periodic estimates of future cash flows are higher than those actually received in future periods, we may recognize non-cash interest income over certain portions of the security's holding period that exceeds the level of effective interest income that will ultimately be realized. In addition, as a result of upward revisions in a security's effective interest rate, we may be subject to relatively more frequent other-than-temporary impairment charges that are cumulatively higher than actual losses ultimately realized on our investments in private-label MBS classified as available-for-sale.

*Income Taxes*

Deferred tax assets and liabilities reflect the impact of temporary differences between the carrying amount of assets and liabilities pursuant to the application of GAAP and their respective tax bases and are stated at tax rates expected to be in effect when the taxes are actually paid or recovered. Deferred tax assets are also recorded for net operating loss carry-forwards, net capital loss carry-forwards and any tax credit carry-forwards. We recognize the expected future tax benefit from a deferred tax asset when the tax benefit is considered more likely than not to be realized. Otherwise, a valuation allowance is applied against the deferred tax asset.

Assuming the recoverability of a deferred tax asset requires management to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecasted cash flow from operations, the character of expected income or loss as either ordinary or capital and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and the amount or character of taxable income differ significantly from our estimates, our ability to realize the deferred tax asset could be impacted. To the extent our estimates of our ability to realize our tax benefits change, we would be required to record changes to our valuation allowance applied against our deferred tax asset. In addition, our NOL carry-forwards begin to expire in 2027 and our NCL carryforwards begin to expire in 2019. If we are not able to generate sufficient taxable income of the appropriate tax character to fully utilize these carry-forwards prior to their expiration, we would be required to write off the corresponding deferred tax asset. If we were to increase our valuation allowances against our deferred tax asset or if we were to write off expired loss carry-forwards for which a valuation allowance had not been previously recognized, our financial position and results of operations would be adversely impacted.

**Recently Issued Accounting Pronouncements**

Refer to “Note 3. Summary of Significant Accounting Policies” in the Notes to Consolidated Financial Statements for a summary of recently issued accounting pronouncements and their effect on our consolidated financial statements.

## ITEM 7A. 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, equity prices and other market changes that affect market risk sensitive instruments. The primary market risks that we are exposed to are interest rate risk, prepayment risk, extension risk, credit risk, spread risk, liquidity risk and regulatory risk. See “Item 1 - Business” in this Annual Report on Form 10-K for discussion of our risk management strategies related to these market risks. The following is additional information regarding certain of these market risks.

***Interest Rate Risk***

We are exposed to interest rate risk in our MBS portfolio. Our investments in MBS are financed with short-term borrowing facilities such as repurchase agreements, which are interest rate sensitive financial instruments. Our exposure to interest rate risk fluctuates based upon changes in the level and volatility of interest rates, mortgage prepayments, and in the shape and slope of the yield curve, among other factors. Through the use of interest rate derivative instruments, we attempt to economically hedge a portion of our exposure to changes, attributable to changes in benchmark interest rates, in certain MBS fair values and future interest cash flows on our short-term financing arrangements. Our primary interest rate derivatives include centrally cleared interest rate swaps as well as exchange-traded instruments, such as U.S. Treasury note futures, and options on U.S. Treasury note futures. Historically, we have also utilized exchange-traded Eurodollar futures and interest rate swap futures.

Changes in both short- and long-term interest rates affect us in several ways, including our financial position. As interest rates increase, the fair value of fixed-rate agency MBS may be expected to decline, prepayment rates may be expected to decrease and duration may be expected to extend. However, an increase in interest rates results in an increase in the fair value of our interest rate derivative instruments. Conversely, if interest rates decline, the fair value of fixed-rate agency MBS is generally expected to increase while the fair value of our interest rate derivatives is expected to decline.

The tables that follow illustrate the estimated change in fair value for our current investments in agency MBS and derivative instruments under several hypothetical scenarios of interest rate movements. For the purposes of this illustration, interest rates are defined by the U.S. Treasury yield curve. Changes in fair value are measured as percentage changes from their respective fair values presented in the column labeled “Value.” Our estimate of the change in the fair value of agency MBS is based upon the same assumptions we use to manage the impact of interest rates on the portfolio. The interest rate sensitivity of our agency MBS and TBA commitments is derived from The Yield Book, a third-party model. Actual results could differ significantly from these estimates. The effective durations are based on observed fair value changes, as well as our own estimate of the effect of interest rate changes on the fair value of the investments, including assumptions regarding prepayments based, in part, on age and interest rate of the mortgages underlying the MBS, prior exposure to refinancing opportunities, and an overall analysis of historical prepayment patterns under a variety of historical interest rate conditions.

The interest rate sensitivity analyses illustrated by the tables that follow have certain limitations, most notably the following:

- The 50 and 100 basis point upward and downward shocks to interest rates that are applied in the analyses represent parallel shocks to the forward yield curve. The analyses do not consider the sensitivity of stockholders' equity to changes in the shape or slope of the forward yield curve.

- The analyses assume that spreads remain constant and, therefore, do not reflect an estimate of the impact that changes in spreads would have on the value of our MBS investments or our LIBOR-based derivative instruments, such as our interest rate swap agreements.

- The analyses assume a static portfolio and do not reflect activities and strategic actions that management may take in the future to manage interest rate risk in response to significant changes in interest rates or other market conditions.

- The yield curve that results from applying an instantaneous parallel 100 basis point decrease in interest rates reflects an interest rate of less than 0% in certain earlier portions of the curve. The results of the analysis included in the applicable table to follow reflect the effect of these negative interest rates.

- The analyses do not reflect any estimated changes in the fair value of our investments in private-label MBS.

- The analyses do not reflect any changes in the value of our net deferred tax asset, including any changes to the assumptions that would be incorporated into the determination of the deferred tax asset valuation allowance.

These analyses are not intended to provide a precise forecast. Actual results could differ materially from these estimates (dollars in thousands, except per share amounts).

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Value | Value with 50 Basis Point Increase in Interest Rates | Percent Change | Value with 50 Basis Point Decrease in Interest Rates | Percent Change |
| Agency MBS | $ 3,911,375 | $ 3,802,098 | (2.79)% | $ 4,005,886 | 2.42% |
| TBA commitments, net | 3,586 | (20,543) | (672.87)% | 24,333 | 578.56% |
| Interest rate swaps, net | 61,366 | 146,534 | 138.79% | (23,802) | (138.79)% |
| Options on U.S. Treasury note futures, net | 383 | 26,916 | 6927.57% | (9,557) | (2595.30)% |
| Shareholders' equity | 383,416 | 361,710 | (5.66)% | 403,567 | 5.26% |
| Book value per share | $ 16.21 | $ 15.29 | (5.66)% | $ 17.06 | 5.26% |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Value | Value with 100 Basis Point Increase in Interest Rates | Percent Change | Value with 100 Basis Point Decrease in Interest Rates | Percent Change |
| Agency MBS | $ 3,911,375 | $ 3,681,450 | (5.88)% | $ 4,073,776 | 4.15% |
| TBA commitments, net | 3,586 | (46,711) | (1402.59)% | 38,799 | 981.97% |
| Interest rate swaps, net | 61,366 | 231,701 | 277.57% | (108,969) | (277.57)% |
| Options on U.S. Treasury note futures, net | 383 | 79,364 | 20621.74% | (11,147) | (3010.44)% |
| Shareholders' equity | 383,416 | 352,511 | (8.06)% | 399,165 | 4.11% |
| Book value per share | $ 16.21 | $ 14.90 | (8.06)% | $ 16.88 | 4.11% |

***Spread Risk***

Our investments in MBS expose us to "spread risk." Spread risk, also known as "basis risk," is the risk of an increase in the spread between market participants' required rate of return (or "market yield") on our MBS and prevailing benchmark interest rates, such as the U.S. Treasury or interest rate swap rates.

The spread risk inherent to our investments in agency MBS and the resulting fluctuations in fair value of these securities can occur independent of changes in prevailing benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the U. S. Federal Reserve, liquidity, or changes in market participants' required rates of return on different assets. While we use interest rate derivative instruments to attempt to mitigate the sensitivity of our net book value to changes in prevailing benchmark interest rates, such instruments are generally not designed to mitigate spread risk inherent to our investment in agency MBS. Consequently, the value of our agency MBS and, in turn, our net book value, could decline independent of changes in interest rates.

The tables that follow illustrate the estimated change in fair value for our investments in agency MBS and TBA commitments under several hypothetical scenarios of agency MBS spread movements. Changes in fair value are measured as percentage changes from their respective fair values presented in the column labeled "Value." The sensitivity of our agency MBS and TBA commitments to changes in MBS spreads is derived from The Yield Book, a third-party model. The analysis to follow reflects an assumed spread duration for our investment in agency MBS of 5.9 years, which is a model-based assumption that is dependent upon the size and composition of our investment portfolio as well as economic conditions present as of December 31, 2016.

These analyses are not intended to provide a precise forecast. Actual results could differ materially from these estimates (dollars in thousands, except per share amounts).

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Value | Value with 10 Basis Point Increase in Agency MBS Spreads | Percent Change | Value with 10 Basis Point Decrease in Agency MBS Spreads | Percent Change |
| Agency MBS | $ 3,911,375 | $ 3,888,186 | (0.59)% | $ 3,934,564 | 0.59% |
| TBA commitments, net | 3,586 | (1,102) | (130.74)% | 8,274 | 130.73% |
| Shareholders' equity | 383,416 | 355,539 | (7.27)% | 411,293 | 7.27% |
| Book value per share | $ 16.21 | $ 15.03 | (7.27)% | $ 17.39 | 7.27% |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Value | Value with 25 Basis Point Increase in Agency MBS Spreads | Percent Change | Value with 25 Basis Point Decrease in Agency MBS Spreads | Percent Change |
| Agency MBS | $ 3,911,375 | $ 3,853,404 | (1.48)% | $ 3,969,346 | 1.48% |
| TBA commitments, net | 3,586 | (8,135) | (326.84)% | 15,306 | 326.84% |
| Shareholders' equity | 383,416 | 313,724 | (18.18)% | 453,108 | 18.18% |
| Book value per share | $ 16.21 | $ 13.26 | (18.18)% | $ 19.16 | 18.18% |

***Credit Risk***

We are exposed to credit risk to the extent we invest in private-label MBS. The private-label MBS in which we invest are generally backed by a pool of single-family residential mortgage loans. The private-label MBS in which we invest are not issued or guaranteed by a U.S. government agency or GSE and are generally non-investment grade or not rated by major rating agencies.

Private-label MBS are generally only supported by one or more forms of private credit enhancements that may provide an extra layer of loss coverage in the event that credit losses are incurred upon foreclosure sale or other liquidations of underlying mortgage properties in amounts that exceed the equity holder's equity interest in the property. Forms of credit enhancement include issuer guarantees, reserve funds, private mortgage guaranty pool insurance, overcollateralization and structural subordination. In addition, private-label MBS are generally purchased at a discount to par value, which may provide further protection to credit losses of the underlying residential mortgage loan collateral.

***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 far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our distributions are determined by our Board of Directors in its sole discretion pursuant to our variable dividend policy; in each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item appears in a subsequent section of this report. See "Index to Consolidated Financial Statements of Arlington Asset Investment Corp." on page F-1.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that as of December 31, 2016, our disclosure controls and procedures, as designed and implemented, (i) were effective in ensuring that information is made known to our management, including our CEO and CFO, by our officers and employees, as appropriate to allow timely decisions regarding required disclosure and (ii) were effective in ensuring that information the Company must disclose in its reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms.

### Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

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

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

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. In making this assessment, the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework* (2013 version). Based on management's assessment, the Company's management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2016.

The effectiveness of the Company's internal control over financial reporting was audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page F-2 of this Annual Report on Form 10-K.

### Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Part III, Item 10 of this Annual Report on Form 10-K will be provided in the Definitive Proxy Statement relating to our 2017 Annual Meeting of Shareholders (our 2017 Proxy Statement) and is hereby incorporated by reference.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by Part III, Item 11 of this Annual Report on Form 10-K will be provided in our 2017 Proxy Statement and is hereby incorporated by reference.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Part III, Item 12 of this Annual Report on Form 10-K will be provided in our 2017 Proxy Statement and is hereby incorporated by reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Part III, Item 13 of this Annual Report on Form 10-K will be provided in our 2017 Proxy Statement and is hereby incorporated by reference.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Part III, Item 14 of this Annual Report on Form 10-K will be provided in our 2017 Proxy Statement and is hereby incorporated by reference.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) *Financial Statements*. The Arlington Asset Investment Corp. consolidated financial statements for the year ended December 31, 2016, included in "Item 8 - Financial Statements and Supplementary Data", of this Annual Report on Form 10-K, are incorporated by reference into this Part IV, Item 15:

- Report of Independent Registered Public Accounting Firm (page F-2)
- Consolidated Balance Sheets as of December 31, 2016 and 2015 (page F-3)
- Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014 (page F-4)
- Consolidated Statements of Changes in Equity for the years ended December 31, 2016, 2015 and 2014 (page F-5)
- Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014 (page F-6)
- Notes to Consolidated Financial Statements (page F-7)

(2) *Financial Statement Schedules*. All schedules are omitted because they are not required or because the information is shown in the financial statements or notes thereto.

(3) *Exhibits*

| Exhibit Number | Exhibit Title |
|---|---|
| 3.01 | Amended and Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q filed on November 9, 2009). |
| 3.02 | Amended and Restated Bylaws, as amended (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on July 28, 2011). |
| 3.03 | Amendment No. 1 to the Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on February 4, 2015). |
| 3.04 | Amendment No. 2 to the Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on October 26, 2016). |

| Exhibit Number | Exhibit Title |
| --- | --- |
| 4.01 | Form of Indenture governing the Senior Debt Securities by and between the Company and The Bank of New York Mellon, as Trustee (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 (File No. 333-215384) filed on December 30, 2016). |
| 4.02 | Form of Indenture governing the Subordinated Debt Securities by and between the Company and The Bank of New York Mellon, as Trustee (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-3 (File No. 333-215384) filed on December 30, 2016). |
| 4.03 | Indenture dated as of May 1, 2013 between the Company and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed on May 1, 2013). |
| 4.04 | First Supplemental Indenture dated as of May 1, 2013 between the Company and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed on May 1, 2013). |
| 4.05 | Form of Senior Note. (incorporated by reference to Exhibit 4.5 to the Company's Registration Statement on Form S-3 (File No. 333-215384) filed on December 30, 2016). |
| 4.06 | Form of Subordinated Note. (incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-3 (File No. 333-215384) filed on December 30, 2016). |
| 4.07 | Form of 6.625% Senior Notes due 2023 (incorporated by reference to Exhibit 4.3 to Current Report on Form 8-K filed by the Company on May 1, 2013). |
| 4.08 | Form of Certificate for Class A common stock (incorporated by reference to Exhibit 4.01 of the Annual Report on Form 10-K filed with the SEC on February 24, 2010). |
| 4.09 | Shareholder Rights Agreement, dated June 5, 2009 (incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K filed with the SEC on June 5, 2009). |
| 4.10 | Second Supplemental Indenture, dated as of March 18, 2015, between the Company, Wells Fargo Bank, National Association, as Trustee and The Bank of New York Mellon, as Series Trustee (incorporated by reference to Exhibit 4.3 to the Company's Form 8-A filed on March 18, 2015). |
| 4.11 | Form of 6.750% Notes due 2025 (incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K filed by the Company on March 17, 2015). |
| 10.01 | Friedman, Billings, Ramsey Group, Inc. 2004 Long-Term Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on April 29, 2004).* |
| 10.02 | Friedman, Billings, Ramsey Group, Inc. 1997 Stock and Annual Incentive Plan (incorporated by reference to Exhibit 10.06 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-39107) filed by Friedman, Billings, Ramsey Group, Inc. on December 19, 1997).* |
| 10.03 | Friedman, Billings, Ramsey Group, Inc. Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 10.07 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-39107) filed by Friedman, Billings, Ramsey Group, Inc. on December 19, 1997).* |
| 10.04 | Friedman, Billings, Ramsey Group, Inc. Amended and Restated Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 10.04 to the Registrant's Annual Report on Form 10-K filed on February 23, 2012).* |
| 10.05 | Arlington Asset Investment Corp. 2011 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 6, 2011).* |
| 10.06 | Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014). |
| 10.07 | Form of Restricted Stock Unit Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014). |
| 10.08 | Form of Restricted Stock Award Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014). |
| 10.09 | Form of Performance Share Unit Award Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014). |
| 10.10 | Form of Change in Control Continuity Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 27, 2017).* |
| 10.11 | Form of Indemnification Agreement (incorporated by reference to Exhibit 10.08 to the Registrant's Annual Report on Form 10-K, filed on February 23, 2012).* |
| 10.12 | Equity Distribution Agreement, dated May 24, 2013, by and between the Company and RBC Capital Markets, LLC (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed on May 28, 2013). |
| 10.13 | Equity Distribution Agreement, dated May 24, 2013, by and between the Company and JMP Securities LLC (incorporated by reference to Exhibit 1.2 to the Registrant's Current Report on Form 8-K filed on May 28, 2013). |
| 10.14 | Equity Distribution Agreement, dated May 24, 2013, by and between the Company and Ladenburg Thalmann & Co. Inc. (incorporated by reference to Exhibit 1.3 to the Registrant's Current Report on Form 8-K filed on May 28, 2013). |
| 10.15 | Equity Distribution Agreement, dated May 24, 2013, by and between the Company and MLV & Co. LLC (incorporated by reference to Exhibit 1.4 to the Registrant's Current Report on Form 8-K filed on May 28, 2013). |

| Exhibit Number | Exhibit Title |
|---|---|
| 11.01 | Statement regarding Computation of Per Share Earnings (included in Part II, Item 8, and Note 2 to the Registrant's Consolidated Financial Statements).† |
| 12.01 | Computation of Ratio of Earnings to Fixed Charges.† |
| 21.01 | List of Subsidiaries of the Registrant.† |
| 23.01 | Consent of PricewaterhouseCoopers LLP.† |
| 24.01 | Power of Attorney (included on the signature page to this Annual Report on Form 10-K and incorporated by reference herein).† |
| 31.01 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.† |
| 31.02 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.† |
| 32.01 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.† |
| 32.02 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.† |
| 101.INS | INSTANCE DOCUMENT** |
| 101.SCH | SCHEMA DOCUMENT** |
| 101.CAL | CALCULATION LINKBASE DOCUMENT** |
| 101.LAB | LABELS LINKBASE DOCUMENT** |
| 101.PRE | PRESENTATION LINKBASE DOCUMENT** |
| 101.DEF | DEFINITION LINKBASE DOCUMENT** |

† Filed herewith.

* Compensatory plan or arrangement.

** Submitted electronically herewith. Attached as Exhibit 101 are the following materials from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2016 and December 31, 2015; (ii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014; (iii) Consolidated Statements of Changes in Equity for the years ended December 31, 2016, 2015 and 2014; and (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014.

## SIGNATURES

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

**ARLINGTON ASSET INVESTMENT CORP.**

Date: February 21, 2017

By: /s/ RICHARD E. KONZMANN
**Richard E. Konzmann**
**Executive Vice President, Chief Financial Officer and Treasurer**

## POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints J. Rock Tonkel, Jr. and Richard E. Konzmann and each of them as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K for the fiscal year ended December 31, 2016, and to file the same, with all exhibits thereto, and any other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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

| Signature | Title | Date |
|---|---|---|
| /s/ J. ROCK TONKEL, JR.<br>**J. ROCK TONKEL, JR.** | President, Chief Executive Officer and Director<br>(Principal Executive Officer) | February 21, 2017 |
| /s/ RICHARD E. KONZMANN<br>**RICHARD E. KONZMANN** | Executive Vice President, Chief Financial Officer and Treasurer<br>(Principal Financial and Accounting Officer) | February 21, 2017 |
| /s/ ERIC F. BILLINGS<br>**ERIC F. BILLINGS** | Executive Chairman of the Board | February 21, 2017 |
| /s/ DANIEL J. ALTOBELLO<br>**DANIEL J. ALTOBELLO** | Director | February 21, 2017 |
| /s/ DANIEL E. BERCE<br>**DANIEL E. BERCE** | Director | February 21, 2017 |
| /s/ DAVID W. FAEDER<br>**DAVID W. FAEDER** | Director | February 21, 2017 |
| /s/ PETER A. GALLAGHER<br>**PETER A. GALLAGHER** | Director | February 21, 2017 |
| /s/ RALPH S. MICHAEL III<br>**RALPH S. MICHAEL III** | Director | February 21, 2017 |
| /s/ ANTHONY P. NADER III<br>**ANTHONY P. NADER III** | Director | February 21, 2017 |

**FINANCIAL STATEMENTS OF ARLINGTON ASSET INVESTMENT CORP.**

**Index to Arlington Asset Investment Corp. Consolidated Financial Statements**

**Report of Independent Registered Public Accounting Firm**

To The Board of Directors and Shareholders of
Arlington Asset Investment Corp.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of comprehensive income, of changes in equity and of cash flows present fairly, in all material respects, the financial position of Arlington Asset Investment Corp. and its subsidiaries (the "Company") at December 31, 2016 and December 31, 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework* (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 3 to the consolidated financial statements, the Company changed the manner in which it accounts for interest income on investments in agency mortgage-backed securities classified as trading securities from the coupon rate method to the contractual effective interest method in 2016.

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

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

/s/ PricewaterhouseCoopers LLP
McLean, VA

February 21, 2017

**ARLINGTON ASSET INVESTMENT CORP.**

**CONSOLIDATED BALANCE SHEETS**
**(Dollars in thousands, except share amounts)**

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 54,794 | $ 36,987 |
| Interest receivable | 11,646 | 11,936 |
| Mortgage-backed securities, at fair value | | |
| Agency | 3,911,375 | 3,865,316 |
| Private-label | 1,266 | 130,553 |
| Derivative assets, at fair value | 74,889 | 12,991 |
| Deferred tax assets, net | 73,432 | 97,530 |
| Deposits, net | 11,149 | 29,429 |
| Other assets | 3,003 | 18,197 |
| **Total assets** | **$ 4,141,554** | **$ 4,202,939** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Liabilities:** | | |
| Repurchase agreements | $ 3,649,102 | $ 2,834,780 |
| Federal Home Loan Bank advances | — | 786,900 |
| Interest payable | 3,434 | 2,436 |
| Accrued compensation and benefits | 5,406 | 5,170 |
| Dividend payable | 15,739 | 14,504 |
| Derivative liabilities, at fair value | 9,554 | 553 |
| Other liabilities | 1,247 | 1,132 |
| Long-term debt | 73,656 | 73,433 |
| **Total liabilities** | **3,758,138** | **3,718,908** |
| **Commitments and contingencies (Note 11)** | | |
| **Stockholders' Equity:** | | |
| Preferred stock, $0.01 par value, 25,000,000 shares authorized, none issued and outstanding | — | — |
| Class A common stock, $0.01 par value, 450,000,000 shares authorized, 23,607,111 and 22,874,819 shares issued and outstanding, respectively | 236 | 229 |
| Class B common stock, $0.01 par value, 100,000,000 shares authorized, 20,256 and 102,216 shares issued and outstanding, respectively | — | 1 |
| Additional paid-in capital | 1,910,284 | 1,898,085 |
| Accumulated other comprehensive income, net of taxes of $-0- and $3,230, respectively | — | 12,371 |
| Accumulated deficit | (1,527,104) | (1,426,655) |
| **Total stockholders' equity** | **383,416** | **484,031** |
| **Total liabilities and stockholders' equity** | **$ 4,141,554** | **$ 4,202,939** |

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

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
**(Dollars in thousands except per share amounts)**

| | Year Ended December 31, 2016 | 2015 | 2014 |
|---|---|---|---|
| **Interest income** | | | |
| Agency mortgage-backed securities | $ 97,053 | $ 105,914 | $ 79,930 |
| Private-label mortgage-backed securities | 7,910 | 15,342 | 25,624 |
| Other | 373 | 7 | 23 |
| Total interest income | 105,336 | 121,263 | 105,577 |
| **Interest expense** | | | |
| Short-term debt | 24,433 | 14,701 | 9,181 |
| Long-term debt | 4,789 | 4,188 | 2,210 |
| Total interest expense | 29,222 | 18,889 | 11,391 |
| Net interest income | 76,114 | 102,374 | 94,186 |
| **Investment loss, net** | | | |
| Realized gain on sale of available-for-sale investments, net | 4,777 | 17,725 | 17,257 |
| Other-than-temporary impairment charges | (1,737) | (2,417) | (449) |
| (Loss) gain on trading investments, net | (41,249) | (31,058) | 102,122 |
| Loss from derivative instruments, net | (31,660) | (104,743) | (139,938) |
| Other, net | 551 | 2,064 | 721 |
| Total investment loss, net | (69,318) | (118,429) | (20,287) |
| **General and administrative expenses** | | | |
| Compensation and benefits | 11,526 | 9,719 | 13,467 |
| Other general and administrative expenses | 9,230 | 5,068 | 5,032 |
| Total general and administrative expenses | 20,756 | 14,787 | 18,499 |
| **(Loss) income before income taxes** | (13,960) | (30,842) | 55,400 |
| Income tax provision | 27,387 | 38,561 | 47,647 |
| **Net (loss) income** | $ (41,347) | $ (69,403) | $ 7,753 |
| Basic (loss) earnings per share | $ (1.79) | $ (3.02) | $ 0.39 |
| Diluted (loss) earnings per share | $ (1.79) | $ (3.02) | $ 0.38 |
| **Weighted-average shares outstanding (in thousands)** | | | |
| Basic | 23,051 | 23,002 | 20,043 |
| Diluted | 23,051 | 23,002 | 20,397 |
| **Other comprehensive (loss) income, net of taxes** | | | |
| Unrealized gains (losses) on available-for-sale securities (net of taxes of $(3,946), $(4,281), and $633, respectively) | $ (6,197) | $ (7,033) | $ 995 |
| Reclassification | | | |
| Included in investment loss, net, related to sales of available-for-sale securities (net of taxes of $40, $(5,095), and $(5,499), respectively) | (7,235) | (17,945) | (11,666) |
| Included in investment loss, net, related to other-than-temporary impairment charges on available-for-sale securities (net of taxes of $676, $940, $175, respectively) | 1,061 | 1,477 | 274 |
| **Comprehensive loss** | $ (53,718) | $ (92,904) | $ (2,644) |

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

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
**(Dollars in thousands)**

| | Class A Common Stock (#) | Class A Amount ($) | Class B Common Stock (#) | Class B Amount ($) | Additional Paid-In Capital | Accumulated Other Comprehensive Income | Accumulated Deficit | Total |
|---|---|---|---|---|---|---|---|---|
| **Balances, December 31, 2013** | 16,047,965 | $ 160 | 554,055 | $ 6 | $1,727,398 | $ 46,269 | $(1,220,562) | $ 553,271 |
| Net income | — | — | — | — | — | — | 7,753 | 7,753 |
| Conversion of Class B common stock to Class A common stock | 448,186 | 5 | (448,186) | (5) | — | — | — | — |
| Issuance of Class A common stock | 6,225,000 | 63 | — | — | 166,820 | — | — | 166,883 |
| Issuance of Class A common stock under stock-based compensation plans | 194,247 | 1 | — | — | (1) | — | — | — |
| Repurchase of Class A common stock under stock-based compensation plans | (54,476) | — | — | — | (1,478) | — | — | (1,478) |
| Stock-based compensation | — | — | — | — | 3,813 | — | — | 3,813 |
| Income tax benefit from stock-based compensation | — | — | — | — | 475 | — | — | 475 |
| Other comprehensive loss | — | — | — | — | — | (10,397) | — | (10,397) |
| Dividends declared | — | — | — | — | — | — | (75,046) | (75,046) |
| **Balances, December 31, 2014** | 22,860,922 | $ 229 | 105,869 | $ 1 | $1,897,027 | $ 35,872 | $(1,287,855) | $ 645,274 |

| | Class A Common Stock (#) | Class A Amount ($) | Class B Common Stock (#) | Class B Amount ($) | Additional Paid-In Capital | Accumulated Other Comprehensive Income | Accumulated Deficit | Total |
|---|---|---|---|---|---|---|---|---|
| **Balances, December 31, 2014** | 22,860,922 | $ 229 | 105,869 | $ 1 | $ 1,897,027 | $ 35,872 | $ (1,287,855) | $ 645,274 |
| Net loss | — | — | — | — | — | — | (69,403) | (69,403) |
| Conversion of Class B common stock to Class A common stock | 3,653 | — | (3,653) | — | — | — | — | — |
| Issuance of Class A common stock under stock-based compensation plans | 97,651 | — | — | — | — | — | — | — |
| Repurchase of Class A common stock | (48,695) | — | — | — | (593) | — | — | (593) |
| Repurchase of Class A common stock under stock-based compensation plans | (38,712) | — | — | — | (572) | — | — | (572) |
| Stock-based compensation | — | — | — | — | 1,145 | — | — | 1,145 |
| Income tax benefit from stock-based compensation | — | — | — | — | 1,078 | — | — | 1,078 |
| Other comprehensive loss | — | — | — | — | — | (23,501) | — | (23,501) |
| Dividends declared | — | — | — | — | — | — | (69,397) | (69,397) |
| **Balances, December 31, 2015** | 22,874,819 | $ 229 | 102,216 | $ 1 | $ 1,898,085 | $ 12,371 | $ (1,426,655) | $ 484,031 |

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

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY – (continued)
**(Dollars in thousands)**

| | Class A Common Stock (#) | Class A Amount ($) | Class B Common Stock (#) | Class B Amount ($) | Additional Paid-In Capital | Accumulated Other Comprehensive Income | Accumulated Deficit | Total |
|---|---|---|---|---|---|---|---|---|
| **Balances, December 31, 2015** | 22,874,819 | $ 229 | 102,216 | $ 1 | $1,898,085 | $ 12,371 | $(1,426,655) | $ 484,031 |
| Net loss | — | — | — | — | — | — | (41,347) | (41,347) |
| Conversion of Class B common stock to Class A common stock | 81,960 | 1 | (81,960) | (1) | — | — | — | — |
| Issuance of Class A common stock | 595,342 | 6 | — | — | 9,669 | — | — | 9,675 |
| Issuance of Class A common stock under stock-based compensation plans | 73,457 | — | — | — | — | — | — | — |
| Repurchase of Class A common stock under stock-based compensation plans | (18,467) | — | — | — | (269) | — | — | (269) |
| Stock-based compensation | — | — | — | — | 2,974 | — | — | 2,974 |
| Income tax provision from stock-based compensation | — | — | — | — | (175) | — | — | (175) |
| Other comprehensive loss | — | — | — | — | — | (12,371) | — | (12,371) |
| Dividends declared | — | — | — | — | — | — | (59,102) | (59,102) |
| **Balances, December 31, 2016** | 23,607,111 | $ 236 | 20,256 | $ — | $1,910,284 | $ — | $(1,527,104) | $ 383,416 |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS
**(Dollars in thousands)**

| | Year Ended December 31, 2016 | 2015 | 2014 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net (loss) income | $ (41,347) | $ (69,403) | $ 7,753 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities | | | |
| Net investment loss, net | 69,318 | 118,429 | 20,287 |
| Net premium amortization on mortgage-backed securities | 28,810 | 24,877 | 5,400 |
| Deferred tax provision | 27,330 | 36,399 | 46,378 |
| Other | 2,709 | 558 | 2,336 |
| Changes in operating assets | | | |
| Interest receivable | 290 | (1,235) | (5,528) |
| Other assets | 1,759 | 754 | (7,234) |
| Changes in operating liabilities | | | |
| Interest payable and other liabilities | (531) | 1,456 | (340) |
| Accrued compensation and benefits | 236 | (897) | 483 |
| Net cash provided by operating activities | 88,574 | 110,938 | 69,535 |
| **Cash flows from investing activities** | | | |
| Purchases of private-label mortgage-backed securities | (5,357) | (2,870) | — |
| Purchases of agency mortgage-backed securities | (2,917,361) | (2,040,883) | (2,030,995) |
| Proceeds from sales of private-label mortgage-backed securities | 124,962 | 130,138 | 86,318 |
| Proceeds from sales of agency mortgage-backed securities | 2,302,011 | 1,057,842 | 65,251 |
| Receipt of principal payments on private-label mortgage-backed securities | 496 | 2,077 | 2,431 |
| Receipt of principal payments on agency mortgage-backed securities | 495,852 | 467,770 | 212,055 |
| Payments for derivatives and deposits, net | (66,278) | (109,225) | (150,031) |
| Other | 15,855 | (14,112) | 353 |
| Net cash used in investing activities | (49,820) | (509,263) | (1,814,618) |
| **Cash flows from financing activities** | | | |
| Proceeds from (repayments of) repurchase agreements, net | 814,323 | (344,995) | 1,632,145 |
| (Repayments of) proceeds from Federal Home Loan Bank advances, net | (786,900) | 786,900 | — |
| Proceeds from stock issuance, net | 9,675 | — | 167,148 |
| Proceeds from long-term debt issuance, net | — | 34,063 | — |
| Excess tax (provisions) benefits associated with stock-based awards | (175) | 1,192 | 475 |
| Dividends paid | (57,870) | (75,087) | (69,481) |
| Repurchase of common stock | — | (593) | — |
| Net cash (used in) provided by financing activities | (20,947) | 401,480 | 1,730,287 |
| Net increase (decrease) in cash and cash equivalents | 17,807 | 3,155 | (14,796) |
| Cash and cash equivalents, beginning of year | 36,987 | 33,832 | 48,628 |
| Cash and cash equivalents, end of year | $ 54,794 | $ 36,987 | $ 33,832 |
| **Supplemental cash flow information** | | | |
| Cash payments for interest | $ 28,000 | $ 17,353 | $ 10,959 |
| Cash payments for taxes | $ 322 | $ 433 | $ 2,309 |
| **Non-cash investing activity:** | | | |
| Receipt of non-public equity securities upon dissolution of investee fund | $ 619 | $ — | $ — |

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

### Note 1. Organization and Nature of Operations

Arlington Asset Investment Corp. ("Arlington Asset") and its consolidated subsidiaries (unless the context otherwise provides, collectively, the "Company") is an investment firm that acquires and holds residential mortgage-related assets, primarily comprised of residential mortgage-backed securities ("MBS"). The Company's investments in residential MBS include (i) residential mortgage pass-through certificates for which the principal and interest payments are guaranteed by a government-sponsored enterprise ("GSE") such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac"), which are collectively referred to as "agency MBS," and (ii) residential MBS issued by private institutions for which the principal and interest payments are not guaranteed by a GSE, which are referred to as "private-label MBS" or "non-agency MBS."

### Note 2. Basis of Presentation

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and include the accounts of Arlington Asset and all other entities in which the Company has a controlling financial interest. All intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Although the Company bases these estimates and assumptions on historical experience and all other reasonably available information that the Company believes to be relevant under the circumstances, such estimates frequently require management to exercise significant subjective judgment about matters that are inherently uncertain. Actual results may differ from these estimates.

Certain amounts in the consolidated financial statements and notes for prior periods have been reclassified to conform to the current year's presentation. These reclassifications had no impact on the previously reported net income, other comprehensive income, total assets or total liabilities.

### Note 3. Summary of Significant Accounting Policies

***Cash Equivalents***

Cash equivalents include demand deposits with banks, money market accounts and highly liquid investments with original maturities of three months or less. As of December 31, 2016 and 2015, approximately 99% and 98%, respectively, of the Company's cash equivalents were invested in money market funds that invest primarily in U.S. Treasuries and other securities backed by the U.S. government.

***Investment Security Purchases and Sales***

Purchases and sales of investment securities are recorded on the settlement date of the transfer unless the trade qualifies as a "regular-way" trade and the associated commitment qualifies for an exemption from the accounting guidance applicable to derivative instruments. A regular-way trade is an investment security purchase or sale transaction that is expected to settle within the period of time following the trade date that is prevalent or traditional for that specific type of security. Any amounts payable or receivable for unsettled security trades are recorded as "sold securities receivable" or "purchased securities payable" in the consolidated balance sheets.

***Interest Income Recognition for Investments in Agency MBS***

On January 1, 2016, the Company elected to change its accounting policy for recognizing interest income on its investments in agency MBS classified as trading securities by amortizing purchase premiums (or accreting purchase discounts) as an adjustment to interest income in accordance with the "interest method" permitted by GAAP. Prior to January 1, 2016, interest income from trading agency MBS was reported based upon each security's stated coupon rate (referred to by the Company as the "coupon rate method").

The interest method is applied at the individual security level based upon each security's effective interest rate. The Company calculates each security's effective interest rate at the time of purchase by solving for the discount rate that equates the present value of that security's remaining contractual cash flows (assuming no principal prepayments) to its purchase price. Because each security's effective interest rate does not reflect an estimate of future prepayments, the Company refers to this manner of applying the interest method as the "contractual effective interest method." When applying the contractual effective interest method to its investments in agency MBS, as principal prepayments occur, a proportional amount of the unamortized premium or discount is recognized in interest income such that the effective interest rate on the remaining security balance is unaffected.

The Company believes that the application of the contractual effective interest method, relative to the coupon rate method, to its investments in trading agency MBS results in a reported interest income measure that better reflects the economic yield of its investments, including a better reflection of the economic effect of principal prepayments in the period in which those prepayments occur. In addition, the Company believes that this change in accounting policy enhances the comparability of its reported periodic financial results to those of its peers.

The Company retrospectively applied this change in accounting policy to all historical periods. Because the Company accounts for its investments in trading agency MBS on its consolidated balance sheets at fair value with all periodic changes in fair value reflected in the Company's net income, this change in accounting policy did not have an effect on the Company's historical consolidated balance sheets, net income, or comprehensive income. The change in accounting policy did, however, result in a reclassification between reported "gain (loss) on trading investments, net" and interest income on the Company's historical consolidated statements of comprehensive income. As the Company's agency MBS have generally been acquired at a premium to par value, historical reported interest income was reduced by periodic premium amortization, while periodic investment gains (losses) reported as a component of "gain (loss) on trading investments, net" were increased (decreased) by an equal and offsetting amount. The following table presents the effect of the Company's retrospective application of the change in accounting policy to the fiscal years ended December 31, 2015 and 2014:

| | Year Ended December 31, | |
|---|---|---|
| | **2015** | **2014** |
| Interest income: agency mortgage-backed securities: | | |
| As previously reported | $ 139,244 | $ 97,900 |
| Retrospective adjustment | (33,330) | (17,970) |
| As revised | $ 105,914 | $ 79,930 |
| Gain (loss) on trading investments, net: | | |
| As previously reported | $ (64,388) | $ 84,152 |
| Retrospective adjustment | 33,330 | 17,970 |
| As revised | $ (31,058) | $ 102,122 |
| Effect to previously reported net income (loss) | $ — | $ — |

***Interest Income Recognition for Investments in Private-Label MBS***

The Company's investments in private-label MBS were generally acquired at significant discounts to their par values due in large part to an expectation that the Company will be unable to collect all of the contractual cash flows of the securities. Investments in private-label MBS acquired prior to 2015 were classified as available-for-sale. The Company has elected to classify its investments in private-label MBS acquired in 2015 or later as trading securities. Interest income from investments in private-label MBS is recognized using a prospective level-yield methodology which is based upon each security's effective interest rate. The amount of periodic interest income recognized is determined by applying the security's effective interest rate to its amortized cost basis or reference amount. At the time of acquisition, the security's effective interest rate is calculated by solving for the single discount rate that equates the present value of the Company's best estimate of the amount and timing of the cash flows expected to be collected from the security to its purchase price. To prepare its best estimate of cash flows expected to be collected, the Company develops a number of assumptions about the future performance of the pool of mortgage loans that serve as collateral for its investment, including assumptions about the timing and amount of prepayments and credit losses.

In each subsequent quarterly reporting period, the amount and timing of cash flows expected to be collected from the security are re-estimated based upon current information and events. The following table provides a description of how periodic changes in the estimate of cash flows expected to be collected affect interest income recognition prospectively for investments in private-label MBS that are classified as available-for-sale and trading securities, respectively:

| | Effect on Interest Income Recognition for Investments in Private-Label MBS Classified as: | |
|---|---|---|
| **Scenario:** | **Available-for-Sale** | **Trading** |
| **A positive change in cash flows occurs.**<br><br>Actual cash flows exceed prior estimates and/or a positive change occurs in the estimate of expected remaining cash flows. | If the positive change in cash flows is deemed significant, a revised effective interest rate is calculated and applied prospectively such that the positive change is recognized as incremental interest income over the remaining life of the security. This revised effective interest rate is also used in subsequent periods to determine if any declines in the fair value of that security are other-than-temporary. | A revised effective interest rate is calculated and applied prospectively such that the positive change in cash flows is recognized as incremental interest income over the remaining life of the security. |
| **An adverse change in cash flows occurs.**<br><br>Actual cash flows fall short of prior estimates and/or an adverse change occurs in the estimate of expected remaining cash flows. | The security's effective interest rate is unaffected. If an adverse change in cash flows occurs for a security that is impaired (that is, its fair value is less than its amortized cost basis), the impairment is considered other-than-temporary due to the occurrence of a credit loss. If a credit loss occurs, the Company writes-down the amortized cost basis of the security to an amount equal to the present value of cash flows expected to be collected, discounted at the security's existing effective interest rate, and recognizes a corresponding other-than-temporary impairment charge in earnings as a component of "investment gain (loss), net." | The amount of periodic interest income recognized over the remaining life of the security will be reduced accordingly. Specifically, if an adverse change in cash flows occurs for a security that is impaired (that is, its fair value is less than its reference amount), the reference amount to which the security's existing effective interest rate will be prospectively applied will be reduced to the present value of cash flows expected to be collected, discounted at the security's existing effective interest rate. If an adverse change in cash flows occurs for a security that is not impaired, the security's effective interest rate will be reduced accordingly and applied on a prospective basis. |

***Other Comprehensive Income***

Comprehensive income includes net income as currently reported by the Company on the consolidated statements of comprehensive income adjusted for other comprehensive income. Other comprehensive income for the Company represents periodic unrealized holding gains and losses related to the Company's investments in MBS classified as available-for-sale. Accumulated unrealized holding gains and losses for available-for-sale MBS are reclassified into net income as a component of "investment gain (loss), net" upon (i) sale or realization, or (ii) the occurrence of an other-than-temporary impairment.

***Earnings Per Share***

Basic earnings per share includes no dilution and is computed by dividing net income or loss applicable to common stock by the weighted-average number of common shares outstanding for the respective period. Diluted earnings per share includes the impact of dilutive securities such as unvested shares of restricted stock and performance share units. The following tables present the computations of basic and diluted earnings (loss) per share for the periods indicated:

| | Year Ended December 31, | | |
|---|---|---|---|
| **(Shares in thousands)** | **2016** | **2015** | **2014** |
| Basic weighted-average shares outstanding | 23,051 | 23,002 | 20,043 |
| Performance share units and unvested restricted stock | — | — | 354 |
| Diluted weighted-average shares outstanding | 23,051 | 23,002 | 20,397 |
| Net (loss) income | $ (41,347) | $ (69,403) | $ 7,753 |
| Basic (loss) earnings per common share | $ (1.79) | $ (3.02) | $ 0.39 |
| Diluted (loss) earnings per common share | $ (1.79) | $ (3.02) | $ 0.38 |

The diluted loss per share for the years ended December 31, 2016 and 2015 did not include the antidilutive effect of 150,996 and 86,372 shares, respectively, of unvested shares of restricted stock and performance share units.

***Other Significant Accounting Policies***

The Company's other significant accounting policies are described in the following notes:

| | |
|---|---|
| Investments in agency MBS, subsequent measurement | Note 4 |
| Investments in private-label MBS, subsequent measurement | Note 5 |
| Borrowings | Note 6 |
| To-be-announced agency MBS transactions, including "dollar rolls" | Note 7 |
| Derivative instruments | Note 7 |
| Balance sheet offsetting | Note 8 |
| Fair value measurements | Note 9 |
| Income taxes | Note 10 |
| Stock-based compensation | Note 13 |

***Recent Accounting Pronouncements***

The following table provides a brief description of recently issued accounting pronouncements and their actual or expected effect on the Company's consolidated financial statements:

| Standard | Description | Date of Adoption | Effect on the Consolidated Financial Statements |
|---|---|---|---|
| **Recently Adopted Accounting Guidance** | | | |
| ASU No. 2015-02, *Amendments to the Consolidation Analysis (Topic 810)* | This amendment makes targeted changes to the current consolidation guidance and ends the deferral granted to investment companies from applying variable interest entity guidance. | January 1, 2016 | This amendment did not have an impact on the Company's consolidated financial statements. |
| ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs (Subtopic 835-30)* | This amendment requires debt issuance costs to be presented in the balance sheet as a direct reduction from the associated debt liability rather than as a separate asset. | January 1, 2016 | The adoption of this amendment resulted in an immaterial reclassification of unamortized debt issuance costs from the line item "other assets" to the line item "long-term debt" on the Company's consolidated balance sheets. |
| **Recently Issued Accounting Guidance Not Yet Adopted** | | | |
| ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606)* | This amendment defers the effective date of ASU No. 2014-09 for all entities by one year.<br><br>ASU No. 2014-09 requires entities to recognize revenue to depict the transfer of promised goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue recognition with respect to financial instruments is not within the scope of ASU No. 2014-09. | January 1, 2018 | The Company does not expect that the adoption of ASU No. 2015-14 will have a material impact on its consolidated financial statements. |

| Standard | Description | Date of Adoption | Effect on the Consolidated Financial Statements |
|---|---|---|---|
| ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)* | This amendment makes targeted changes to certain aspects of guidance applicable to financial assets and financial liabilities. The amendment primarily affects accounting for certain equity investments, financial liabilities measured under the fair value option, and certain financial instrument presentation and disclosure requirements. Accounting for investments in debt securities and financial liabilities not measured under the fair value option is largely unaffected by this amendment. | January 1, 2018 | The Company is currently evaluating the impact of this amendment on its consolidated financial statements. |
| ASU No. 2016-02, *Leases (Topic 842)* | This amendment replaces the existing lease accounting model with a revised model. The primary change effectuated by the revised lease accounting model is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. | January 1, 2018 | The Company is currently evaluating the impact of this amendment on its consolidated financial statements. |
| ASU No. 2016-07, *Simplifying the Transition to the Equity Method of Accounting (Topic 323)* | This amendment eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. | January 1, 2017 | The Company does not expect that the adoption of ASU No. 2016-07 will have a material impact on its consolidated financial statements. |

| Standard | Description | Date of Adoption | Effect on the Consolidated Financial Statements |
|---|---|---|---|
| ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting (Topic 718)* | This amendment was issued with the objective of simplifying several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. | January 1, 2017 | The Company is currently evaluating the impact of this amendment on its consolidated financial statements. |
| ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 606)* | The amendments in this update require financial assets measured at amortized cost as well as available-for-sale debt securities to be measured for impairment on the basis of the net amount expected to be collected. Credit losses are to be recognized through an allowance for credit losses, which differs from the direct write-down of the amortized cost basis currently required for other-than-temporary impairments of investments in debt securities. This update also makes substantial changes to the manner in which interest income is to be recognized for financial assets acquired with a more-than-insignificant amount of credit deterioration since origination.<br><br>This update will not affect the accounting for investments in debt securities that are classified as trading securities. | January 1, 2019 | A prospective transition approach is required for investments in debt securities for which an other-than-temporary impairment had been recognized before the effective date of the update. Accordingly, the effect of the adoption of this update on the Company's consolidated financial statements will depend, in large part, on the extent to which the Company holds available-for-sale debt securities as of January 1, 2019 (if any) for which other-than-temporary impairments had been previously recognized. As of December 31, 2016, the Company does not hold any investment securities designated as available-for-sale. |
| ASU No. 2016-15, *Statement of Cash Flows (Topic 230)* | This amendment was issued to reduce diversity in practice with respect to eight various statement of cash flow reporting issues for which existing GAAP is either unclear or does not provide specific guidance. | January 1, 2018 | The Company does not expect that the adoption of ASU No. 2016-15 will have a material impact on the classification of cash inflows or outflows within its consolidated statement of cash flows. |

**Note 4. Investments in Agency MBS**

The Company’s investments in agency MBS are reported in the accompanying consolidated balance sheets at fair value. As of December 31, 2016, all of the Company’s investments in agency MBS are classified as trading securities. The following table provides the fair value of the Company’s available-for-sale and trading investments in agency MBS as of the dates indicated:

| | Fair Value as of | |
|---|---|---|
| | December 31, 2016 | December 31, 2015 |
| Agency MBS classified as: | | |
| Available-for-sale | $ — | $ 26 |
| Trading | 3,911,375 | 3,865,290 |
| Total | $ 3,911,375 | $ 3,865,316 |

Substantially all of the Company's investments in agency MBS represent undivided (or "pass-through") beneficial interests in specified pools of fixed-rate mortgage loans. As of December 31, 2016, the Company's portfolio of investments in agency MBS also includes investments in inverse interest-only agency MBS with an aggregate fair value of $1,923. The Company's investments in inverse interest-only agency MBS represent beneficial interests in a portion of the interest cash flows of an underlying pool of pass-through agency MBS collateralized by adjustable-rate mortgage loans.

All periodic changes in the fair value of trading agency MBS that are not attributed to interest income are recognized as a component of "investment loss, net" in the accompanying consolidated statements of comprehensive income. The following table provides additional information about the gains and losses recognized as a component of "investment gain loss, net" in the Company's consolidated statements of comprehensive income for the periods indicated with respect to investments in agency MBS classified as trading securities:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Net (losses) gains recognized in earnings for: | | | |
| Agency MBS still held at period end | $ (62,363) | $ (26,543) | $ 100,596 |
| Agency MBS sold during the period | 21,714 | (4,465) | 1,526 |
| Total | $ (40,649) | $ (31,008) | $ 102,122 |

The Company also invests in and finances fixed-rate agency MBS on a generic pool basis through sequential series of to-be-announced security transactions commonly referred to as "dollar rolls." Dollar rolls are accounted for as a sequential series of derivative instruments. Refer to "Note 7. Derivative Instruments" for further information about dollar rolls.

**Note 5. Investments in Private-Label MBS**

The Company's investments in private-label MBS are reported in the accompanying consolidated balance sheets at fair value. Investments in private-label MBS acquired prior to 2015 were classified as available-for-sale. The Company has elected to classify its investments in private-label MBS acquired in 2015 or later as trading securities. The following table provides the fair value of the Company's available-for-sale and trading investments in private-label MBS as of the dates indicated:

| | Fair Value as of | |
|---|---|---|
| | December 31, 2016 | December 31, 2015 |
| Private-label MBS classified as: | | |
| Available-for-sale | $ — | $ 127,536 |
| Trading | 1,266 | 3,017 |
| Total | $ 1,266 | $ 130,553 |

During the years ended December 31, 2016 and 2015, the private-label MBS portfolio consisted primarily of "re-REMIC" securities. The Company's investments in re-REMIC securities represent "mezzanine" interests in underlying, re-securitized senior class MBS issued by private-label Real Estate Mortgage Investment Conduit ("REMIC") securitization trusts. The senior class REMIC securities that serve as collateral to the Company's investments in re-REMIC securities represent beneficial interests in pools of prime or Alt-A residential mortgage loan collateral that hold the first right to cash flows and absorb credit losses only after their respective subordinate REMIC classes have been fully extinguished. The majority of the trusts that issued the Company's investments in re-REMIC securities employ a "sequential" principal repayment structure, while a minority of the issuing trusts employ a "pro-rata" principal repayment structure. Accordingly, the majority of the Company's mezzanine class re-REMIC securities are not entitled to receive principal repayments until the principal balance of the senior interest in the respective collateral group has been reduced to zero. Principal shortfalls are allocated on a "reverse sequential" basis. Accordingly, any principal shortfalls on the underlying senior class REMIC securities are first absorbed by the Company's mezzanine class re-REMIC securities, to the extent of their respective principal balance, prior to being allocated to the senior interest in the respective collateral pool. Periodic interest accrues on each re-REMIC security's outstanding principal balance at its contractual coupon rate.

The prime and Alt-A residential mortgage loans that serve as collateral to the underlying REMIC securitization trusts of the Company's private-label MBS had the following weighted average characteristics, based on face value, as of the dates indicated:

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Original loan-to-value | 59% | 66% |
| Original FICO score | 726 | 723 |
| Three-month voluntary prepayment rate (annualized) | 1.3% | 6.1% |
| Three-month default rate (annualized) | 7.4% | 4.7% |
| Three-month loss severity rate (1) | 96.5% | 36.9% |
| Three-month credit loss rate (annualized) (2) | 7.1% | 1.7% |

(1) Represents a "loss-given-default" rate. Private-label MBS collateral pools which experienced no defaults within the three-month historical period are excluded from the loss severity rate calculation.

(2) Calculated as the three-month default rate multiplied by the three-month loss severity rate.

***Available-for-Sale Private-Label MBS***

Periodic changes in the fair value of the Company's available-for-sale private-label MBS that are not attributed to interest income or other-than-temporary impairments represent unrealized holding gains and losses. Unrealized holding gains and losses are accumulated in other comprehensive income until the securities are sold. As of December 31, 2016, the Company had no available-for-sale private-label MBS. The following table provides gross unrealized gains and losses accumulated in other comprehensive income for the Company's investments in available-for-sale private-label MBS as of December 31, 2015:

| December 31, 2015 | | | | | |
|---|---|---|---|---|---|
| Unpaid Principal Balance | Net Discounts | Amortized Cost Basis | Unrealized | | Fair Value |
| | | | Gains | Losses | |
| $ 164,555 | $ (52,620) | $ 111,935 | $ 15,601 | $ — | $ 127,536 |

Upon the sale of available-for-sale private-label MBS, any gains or losses accumulated in other comprehensive income are recognized in earnings as a component of "investment gain (loss), net." The Company uses the specific identification method to determine the realized gain or loss that is recognized in earnings upon the sale of an available-for-sale private-label MBS.

The following table presents the results of sales of available-for-sale private-label MBS for the periods indicated:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Proceeds from sales | $ 113,983 | $ 130,138 | $ 86,318 |
| Gross realized gains | 5,819 | 18,145 | 17,397 |
| Gross realized losses | 1,042 | 420 | 140 |

*Accretable Yield*

The excess of the Company's estimate of undiscounted future cash flows expected to be collected over the security's amortized cost basis represents that security's accretable yield. The accretable yield is expected to be recognized as interest income over the remaining life of the security on a level-yield basis. The difference between undiscounted future contractual cash flows and undiscounted future expected cash flows represents the non-accretable difference. Based on actual payments received and/or changes in the estimate of future cash flows expected to be collected, the accretable yield and the non-accretable difference can change over time. Actual cash collections that exceed prior estimates and/or positive changes in the Company's periodic estimate of expected future cash flows result in a reclassification of non-accretable difference to accretable yield. Conversely, actual cash collections that fall short of prior estimates and/or adverse changes in the Company's periodic estimate of expected future cash flows result in a reclassification of accretable yield to non-accretable difference.

The following table presents the changes in the accretable yield solely for available-for-sale private-label MBS for the periods indicated:

| | Year Ended December 31, 2016 | Year Ended December 31, 2015 |
|---|---|---|
| Beginning balance | $ 85,052 | $ 202,108 |
| Accretion | (6,744) | (15,218) |
| Reclassifications, net | (11,853) | (6,202) |
| Eliminations in consolidation | (3,515) | — |
| Sales | (62,940) | (95,636) |
| Ending balance | $ — | $ 85,052 |

*Other-than-Temporary Impairments*

The Company evaluates available-for-sale MBS for other-than-temporary impairment on a quarterly basis. When the fair value of an available-for-sale security is less than its amortized cost at the quarterly reporting date, the security is considered impaired. Impairments determined to be other-than-temporary are recognized as a direct write-down to the security's amortized cost basis with a corresponding charge recognized in earnings as a component of "investment gain (loss), net." An impairment is considered other-than-temporary when (i) the Company intends to sell the impaired security, (ii) the Company more-likely-than not will be required to sell the impaired security prior to the recovery of its amortized cost basis, or (iii) a credit loss exists. A credit loss exists when the present value of the Company's estimate of the cash flows expected to be collected from the security, discounted at the security's existing effective interest rate, is less than the security's amortized cost basis.

If the Company intends to sell an impaired security or it more-likely-than-not will be required to sell an impaired security before recovery of its amortized cost basis, the Company writes-down the amortized cost basis of the security to an amount equal to the security's fair value and recognizes a corresponding other-than-temporary impairment charge in earnings as a component of "investment gain (loss), net." If a credit loss exists for an impaired security that the Company does not intend to sell nor will it likely be required to sell prior to recovery, the Company writes-down the amortized cost basis of the security to an amount equal to the present value of cash flows expected to be collected, discounted at the security's existing effective interest rate, and recognizes a corresponding other-than-temporary impairment charge in earnings as a component of "investment gain (loss), net."

For the years ended December 31, 2016 and 2015, the Company recorded credit related other-than-temporary impairment charges of $1,737 and $2,417, respectively, as a component of "investment loss, net" on the consolidated statements of comprehensive income on certain available-for-sale private-label MBS. The following table presents a summary of cumulative credit related other-than-temporary impairment charges recognized on the available-for-sale private-label MBS held as of the dates indicated:

| | Year Ended December 31, 2016 | Year Ended December 31, 2015 |
|---|---|---|
| Cumulative credit related other-than-temporary impairments, beginning balance | $ 14,017 | $ 18,903 |
| Additions for: | | |
| Securities for which other-than-temporary impairments have not previously occurred | 1,737 | 2,417 |
| Securities with previously recognized other-than-temporary impairments | — | — |
| Reductions for sold or matured securities | (15,754) | (7,303) |
| Cumulative credit related other-than-temporary impairments, ending balance | $ — | $ 14,017 |

***Trading Private-Label MBS***

Periodic changes in the fair value of investments in trading private-label MBS that are not attributable to interest income are recognized as a component of "investment gain (loss), net" in the Company's consolidated statements of comprehensive income. The following table provides additional information about the gains and losses recognized as a component of "investment loss, net" for the periods indicated with respect to investments in private-label MBS classified as trading securities:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Net losses recognized in earnings for: | | | |
| Private-label MBS still held at period end | $ (379) | $ (50) | $ — |
| Private-label MBS sold during the period | (221) | — | — |
| Total | $ (600) | $ (50) | $ — |

**Note 6. Borrowings**

***Repurchase Agreements***

The Company finances the purchase of MBS through repurchase agreements, which are accounted for as collateralized borrowing arrangements. In a repurchase transaction, the Company sells MBS to a counterparty under a master repurchase agreement in exchange for cash and concurrently agrees to repurchase the same security at a future date in an amount equal to the cash initially exchanged plus an agreed-upon amount of interest. MBS sold under agreements to repurchase remain on the Company's consolidated balance sheets because the Company maintains effective control over such securities throughout the duration of the arrangement. Throughout the contractual term of a repurchase agreement, the Company recognizes a "repurchase agreement" liability on its consolidated balance sheets to reflect the obligation to repay to the counterparty the proceeds received upon the initial transfer of the MBS. The difference between the proceeds received by the Company upon the initial transfer of the MBS and the contractually agreed-upon repurchase price is recognized as interest expense over the term of the repurchase arrangement on a level-yield basis.

Amounts borrowed pursuant to repurchase agreements are equal in value to a specified percentage of the fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral throughout the term of the repurchase agreement. The counterparty to the repurchase agreements may require that the Company pledge additional securities or cash as additional collateral to secure borrowings when the value of the collateral declines.

As of December 31, 2016 and 2015, the Company had no amount at risk with a single repurchase agreement counterparty or lender greater than 10% of equity. The following table provides information regarding the Company's outstanding repurchase agreement borrowings as of the dates indicated:

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Pledged with agency MBS: | | |
| Repurchase agreements outstanding | $ 3,649,102 | $ 2,797,561 |
| Agency MBS collateral, at fair value | 3,851,269 | 2,946,684 |
| Net amount (1) | 202,167 | 149,123 |
| Weighted-average rate | 0.96% | 0.61% |
| Weighted-average term to maturity | 19.3 days | 12.8 days |
| Pledged with private-label MBS: | | |
| Repurchase agreements outstanding | $ — | $ 37,219 |
| Private-label MBS collateral, at fair value | — | 70,511 |
| Net amount (1) | — | 33,292 |
| Weighted-average rate | — | 2.42% |
| Weighted-average term to maturity | — | 16.9 days |
| Total MBS: | | |
| Repurchase agreements outstanding | $ 3,649,102 | $ 2,834,780 |
| MBS collateral, at fair value | 3,851,269 | 3,017,195 |
| Net amount (1) | 202,167 | 182,415 |
| Weighted-average rate | 0.96% | 0.64% |
| Weighted-average term to maturity | 19.3 days | 12.8 days |

(1) Net amount represents the value of collateral in excess of corresponding repurchase obligation. The amount of collateral at-risk is limited to the outstanding repurchase obligation and not the entire collateral balance.

The following table provides information regarding the Company's outstanding repurchase agreement borrowings during the years ended December 31, 2016 and 2015:

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Weighted-average outstanding balance | $ 3,391,465 | $ 3,390,402 |
| Weighted-average rate | 0.70% | 0.42% |

***Federal Home Loan Bank Advances***

In September 2015, the Company's wholly-owned captive insurance subsidiary, Key Bridge Insurance, LLC ("Key Bridge"), was granted membership to the Federal Home Loan Bank of Cincinnati ("FHLBC"). The FHLBC, like each of the 11 regional Federal Home Loan Banks (collectively, the "FHLB"), is a cooperative that provides its member financial institutions with a number of financial products and services, including short and long-term secured borrowings that are known as "advances." FHLBC advances may be collateralized by a number of real estate related assets, including agency MBS. As a member of the FHLBC, Key Bridge is required to acquire membership stock as well as activity-based stock (the amount of which is based upon a percentage of the dollar amount of its outstanding advances) in the FHLBC. As of December 31, 2016 and 2015, Key Bridge held $2 and $15,740 of capital stock in the FHLBC, respectively, which is included in "other assets" in the accompanying consolidated balance sheets. Similar to a repurchase agreement borrowing, the Company pledged agency MBS as collateral to secure the advance to Key Bridge, the amount of which is equal to a specified percentage of the fair value of the pledged collateral. The Company retained beneficial ownership of the pledged collateral throughout the term of the advance arrangement. The FHLBC held the right to require that the Company pledge additional collateral to secure borrowings when the value of the collateral declined.

On January 12, 2016, the regulator of the FHLB system, the Federal Housing Finance Agency ("FHFA"), released a final rule that amends regulations governing FHLB membership, including an amendment which prevents captive insurance companies from being eligible for FHLB membership. Under the terms of the final rule, Key Bridge is required to terminate its membership and repay its existing advances within one year following the final rule's effective date of February 19, 2016. In addition, Key Bridge is prohibited from obtaining new advances during the one-year transition period. During the first quarter of 2016, the Company repaid all of its outstanding FHLBC advances, funded primarily through proceeds obtained from traditional repurchase agreement financing arrangements.

The following table provides information regarding the Company's outstanding FHLB advances as of the date indicated:

| | December 31, 2015 |
|---|---|
| Pledged with agency MBS: | |
| FHLB advances outstanding | $ 786,900 |
| Agency MBS collateral, at fair value | 805,163 |
| Net amount (1) | 18,263 |
| Weighted-average rate | 0.36% |
| Weighted-average term to maturity | 11.6 days |

(1) Net amount represents the value of collateral in excess of corresponding FHLB advance. The amount of collateral at-risk is limited to the outstanding FHLB advance and not the entire collateral balance.

***Long-Term Debt***

As of December 31, 2016 and 2015, the Company had $73,656 and $73,433, respectively, of outstanding long-term debentures, net of unamortized debt issuance costs of $1,644 and $1,867, respectively. The Company's long-term debentures consisted of the following as of the dates indicated:

| | **December 31, 2016** | | | **December 31, 2015** | | |
|---|---|---|---|---|---|---|
| | **Senior Notes Due 2025** | **Senior Notes Due 2023** | **Trust Preferred Debt** | **Senior Notes Due 2025** | **Senior Notes Due 2023** | **Trust Preferred Debt** |
| Outstanding Principal | $ 35,300 | $ 25,000 | $ 15,000 | $ 35,300 | $ 25,000 | $ 15,000 |
| Annual Interest Rate | 6.75% | 6.625% | LIBOR+ 2.25 - 3.00 % | 6.75% | 6.625% | LIBOR+ 2.25 - 3.00 % |
| Interest Payment Frequency | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly | Quarterly |
| Weighted-Average Interest Rate | 6.75% | 6.625% | 3.63% | 6.75% | 6.625% | 3.07% |
| Maturity | March 15, 2025 | May 1, 2023 | 2033 - 2035 | March 15, 2025 | May 1, 2023 | 2033 - 2035 |
| Early Redemption Date | March 15, 2018 | May 1, 2016 | 2008 - 2010 | March 15, 2018 | May 1, 2016 | 2008 - 2010 |

On March 18, 2015, the Company completed a public offering of $35,300 of 6.75% senior notes due in 2025 and received net proceeds of $34,063 after payment of underwriting discounts, commissions, and expenses.

The Senior Notes due 2023 and the Senior Notes due 2025 are publicly traded on the New York Stock Exchange under the ticker symbols "AIW" and "AIC," respectively. The Senior Notes due 2023 and Senior Notes due 2025 may be redeemed in whole or in part at any time and from time to time at the Company's option on or after May 1, 2016 and March 15, 2018, respectively, at a redemption price equal to the principal amount plus accrued and unpaid interest. The indenture governing these Senior Notes contains certain covenants, including limitations on the Company's ability to merge or consolidate with other entities or sell or otherwise dispose of all or substantially all of the Company's assets.

**Note 7. Derivative Instruments**

In the normal course of its operations, the Company is a party to financial instruments that are accounted for as derivative instruments. Derivative instruments are recorded at fair value as either "derivative assets" or "derivative liabilities" in the consolidated balance sheets, with all periodic changes in fair value reflected as a component of "investment gain (loss), net" in the consolidated statements of comprehensive income. Cash receipts or payments related to derivative instruments are classified as investing activities within the consolidated statements of cash flows.

***Types and Uses of Derivative Instruments***

*Interest Rate Derivatives*

Most of the Company's derivative instruments are interest rate derivatives that are intended to economically hedge changes, attributable to changes in benchmark interest rates, in certain MBS fair values and future interest cash flows on the Company's short-term financing arrangements. Interest rate derivatives include centrally cleared interest rate swaps as well as exchange-traded instruments, such as Eurodollar futures, interest rate swap futures, U.S. Treasury note futures, and options on futures. While the Company uses its interest rate derivatives to economically hedge a portion of its interest rate risk, it has not designated such contracts as hedging instruments for financial reporting purposes.

The Company exchanges collateral with the counterparties to its interest rate derivative instruments at least on a daily basis based upon daily changes in fair value (also known as "variation margin") as measured by the central clearinghouse through which those derivatives are cleared. In addition, the central clearinghouse requires market participants to deposit and maintain an "initial margin" amount which is determined by the clearinghouse and is generally intended to be set at a level sufficient to protect the clearinghouse from the maximum estimated single-day price movement in that market participant's contracts. Receivables recognized for the right to reclaim cash initial and variation margin posted in respect of interest rate derivative instruments are included in the line item "deposits, net" in the accompanying consolidated balance sheets. In its consolidated balance sheets, the Company has elected to offset any payables recognized for the obligation to return cash variation margin received from an interest rate derivative instrument counterparty against receivables recognized for the right to reclaim cash initial margin posted by the Company to that same counterparty.

*To-Be-Announced Agency MBS Transactions, Including "Dollar Rolls"*

In addition to interest rate derivatives that are used for interest rate risk management, the Company is a party to derivative instruments that economically serve as investments, such as forward contracts to purchase fixed-rate "pass-through" agency MBS on a non-specified pool basis, which are known as to-be-announced ("TBA") contracts. A TBA contract is a forward contract for the purchase or sale of a fixed-rate agency MBS at a predetermined price, face amount, issuer, coupon, and stated maturity for settlement on an agreed upon future date. The specific agency MBS that will be delivered to satisfy the TBA trade is not known at the inception of the trade. The Company accounts for TBA contracts as derivative instruments because the Company cannot assert that it is probable at inception and throughout the term of an individual TBA contract that its settlement will result in physical delivery of the underlying agency MBS, or the individual TBA contract will not settle in the shortest time period possible.

The Company's agency MBS investment portfolio includes net purchase (or "net long") positions in TBA securities, which are primarily the result of executing sequential series of "dollar roll" transactions. The Company executes dollar roll transactions as a means of investing in and financing non-specified fixed-rate agency MBS. Such transactions involve effectively delaying (or "rolling") the settlement of a forward purchase of a TBA agency MBS by entering into an offsetting sale prior to the settlement date, net settling the "paired-off" positions in cash, and contemporaneously entering another forward purchase of a TBA agency MBS of the same characteristics for a later settlement date. TBA securities purchased for a forward settlement month are generally priced at a discount relative to TBA securities sold for settlement in the current month. This discount, often referred to as the dollar roll "price drop," reflects compensation for the net interest income (interest income less financing costs) that is foregone as a result of relinquishing beneficial ownership of the MBS for the duration of the dollar roll (also known as "dollar roll income"). By executing a sequential series of dollar roll transactions, the Company is able to create the economic experience of investing in an agency MBS, financed with a repurchase agreement, over a period of time. Forward purchases and sales of TBA securities are accounted for as derivative instruments in the Company's financial statements. Accordingly, dollar roll income is recognized as a component of "investment gains (losses), net" along with all other periodic changes in the fair value of TBA commitments.

In addition to transacting in net long positions in TBA securities for investment purposes, the Company may also, from time to time, transact in net sale (or "net short") positions in TBA securities for the purpose of economically hedging a portion of the sensitivity of the fair value of the Company's investments in agency MBS to changes in interest rates.

Cash collateral posted by the Company with respect to TBA transactions is included in the line item "deposits, net" in the accompanying consolidated balance sheets.

In addition to TBA transactions, the Company may, from time to time, enter into commitments to purchase or sell specified agency MBS that do not qualify as regular-way security trades. Such commitments are also accounted for as derivative instruments.

***Derivative Instrument Population and Fair Value***

The following table presents the fair value of the Company's derivative instruments as of the dates indicated:

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | Assets | Liabilities | Assets | Liabilities |
| Interest rate swaps | $ 63,315 | $ (1,949) | $ 6,153 | $ — |
| 10-year U.S. Treasury note futures | — | — | 6,813 | — |
| Options on 10-year U.S. Treasury note futures | 4,289 | (3,906) | — | — |
| Put options on Eurodollar futures | — | — | 25 | — |
| TBA commitments | 7,285 | (3,699) | — | (553) |
| Total | $ 74,889 | $ (9,554) | $ 12,991 | $ (553) |

*Interest Rate Swaps*

The Company's interest rate swap agreements represent agreements to make semiannual interest payments based upon a fixed interest rate and receive quarterly variable interest payments based upon the prevailing three-month LIBOR on the date of reset.

The following table presents information about the Company's interest rate swap agreements that were in effect as of December 31, 2016:

| | | Weighted-average: | | | |
|---|---|---|---|---|---|
| | **Notional Amount** | **Fixed Pay Rate** | **Variable Receive Rate** | **Remaining Life (Years)** | **Fair Value** |
| Years to maturity: | | | | | |
| Less than 3 years | $ 1,375,000 | 1.10% | 0.97% | 1.7 | $ 6,470 |
| 3 to less than 7 years | 350,000 | 1.84% | 1.00% | 3.7 | (769) |
| 7 to 10 years | 1,600,000 | 1.93% | 0.96% | 9.2 | 50,511 |
| Total / weighted-average | $ 3,325,000 | 1.58% | 0.97% | 5.5 | $ 56,212 |

The following table presents information about the Company's forward-starting interest rate swap agreements that had yet to take effect as of December 31, 2016:

| | | Weighted-average: | | |
|---|---|---|---|---|
| | **Notional Amount** | **Fixed Pay Rate** | **Term After Effective Date (Years)** | **Fair Value** |
| Effective in September / October 2017 | $ 375,000 | 1.13% | 2.0 | $ 5,154 |

The following table presents information about the Company's interest rate swap agreements as of December 31, 2015, all of which were in effect as of that date:

| | | Weighted-average: | | | |
|---|---|---|---|---|---|
| | **Notional Amount** | **Fixed Pay Rate** | **Variable Receive Rate** | **Remaining Life (Years)** | **Fair Value** |
| Years to maturity: | | | | | |
| Less than 3 years | $ 750,000 | 1.04% | 0.49% | 1.9 | $ 1,166 |
| 3 to less than 7 years | — | — | — | — | — |
| 7 to 10 years | 750,000 | 2.12% | 0.43% | 9.9 | 4,987 |
| Total / weighted-average | $ 1,500,000 | 1.58% | 0.46% | 5.9 | $ 6,153 |

*Options on 10-year U.S. Treasury Note Futures*

The Company has purchased and sold exchange-traded options on U.S. Treasury note futures contracts as of December 31, 2016 with the objective of hedging a portion of the interest rate sensitivity of the Company's agency MBS portfolio. As of December 31, 2016, the Company holds put options which provide the Company with the right to sell 10-year U.S. Treasury note futures to a counterparty with an equivalent notional amount of $1,650,000 that were struck at a weighted average strike price that equates to a 10-year U.S. Treasury rate of approximately 2.77%. In addition, the Company has sold, or written, call options that provide a counterparty with the option to buy 10-year U.S. Treasury note futures from the Company with an equivalent notional amount of $1,000,000 that were struck at a weighted average strike price per contract that equates to a 10-year U.S. Treasury rate of approximately 2.24%. In order to limit its exposure on the sold call options from a significant decline in long-term interest rates, the Company also purchased contracts that provide the Company with the option to buy 10-year U.S. Treasury note futures from a counterparty with an equivalent notional amount of $1,000,000 as of December 31, 2016 that were struck at a weighted average strike price per contract that equates to a 10-year U.S. Treasury rate of approximately 2.12%. The options may be exercised at any time prior to their expiry, which occurs in the first quarter of 2017, and, if exercised, will be net settled in cash. Information about the Company's outstanding put and call options on 10-year U.S. Treasury note futures contracts as of December 31, 2016 is as follows:

| | Notional Amount Long/(Short) | Weighted-average Strike Price | Implied Strike Rate (1) | Net Fair Value |
|---|---|---|---|---|
| Purchased put options: | | | | |
| January 2017 expiration | $ 950,000 | 120.8 | 2.87% | $ 539 |
| February 2017 expiration | 700,000 | 122.6 | 2.64% | 3,281 |
| Total / weighted average for purchased put options | $ 1,650,000 | 121.6 | 2.77% | $ 3,820 |
| Sold call options: | | | | |
| January 2017 expiration | $ (100,000) | 126.0 | 2.25% | $ (141) |
| February 2017 expiration | (900,000) | 126.0 | 2.24% | (3,765) |
| Total / weighted average for sold call options | $ (1,000,000) | 126.0 | 2.24% | $ (3,906) |
| Purchased call options: | | | | |
| January 2017 expiration | $ 1,000,000 | 127.1 | 2.12% | $ 469 |
| | | | | $ 383 |

(1) The implied strike rate is estimated based upon the weighted average strike price per contract and the price of an equivalent 10-year U.S. Treasury note futures contract.

*10-year U.S. Treasury Note Futures*

The Company's 10-year U.S. Treasury note futures held as of December 31, 2015 were short positions with an aggregate notional amount of $1,335,000 that matured in March 2016. Upon the maturity date of these futures contracts, the Company had the option to either net settle each contract in cash in an amount equal to the difference between the then-current fair value of the underlying 10-year U.S. Treasury note and the contractual sale price inherent to the futures contract, or to physically settle the contract by delivering the underlying 10-year U.S. Treasury note. The Company elected to net settle these contracts in cash.

*TBA Commitments*

The following tables present information about the Company's TBA commitments as of the dates indicated:

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Notional Amount: Purchase (Sale) Commitment | Contractual Forward Price | Market Price | Fair Value |
| Dollar roll positions: | | | | |
| 3.0% coupon purchase commitments | $ 725,000 | $ 718,887 | $ 720,027 | $ 1,140 |
| 3.5% coupon purchase commitments | 25,000 | 25,586 | 25,613 | 27 |
| 3.5% coupon sale commitments | (25,000) | (25,602) | (25,613) | (11) |
| Total dollar roll positions, net | 725,000 | 718,871 | 720,027 | 1,156 |
| TBA commitments serving as economic hedges: | | | | |
| 3.5% coupon purchase commitments | 600,000 | 608,601 | 614,719 | 6,118 |
| 3.5% coupon sale commitments | (600,000) | (611,031) | (614,719) | (3,688) |
| Total economic hedges, net | - | (2,430) | - | 2,430 |
| Total TBA commitments, net | $ 725,000 | $ 716,441 | $ 720,027 | $ 3,586 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Notional Amount: Purchase (Sale) Commitment | Contractual Forward Price | Market Price | Fair Value |
| Dollar roll positions: | | | | |
| 3.5% coupon purchase commitments | $ 275,000 | $ 283,928 | $ 283,469 | $ (459) |
| 4.0% coupon purchase commitments | 100,000 | 105,883 | 105,789 | (94) |
| Total TBA commitments, net | $ 375,000 | $ 389,811 | $ 389,258 | $ (553) |

***Derivative Instrument Gains and Losses***

The following table provides information about the derivative gains and losses recognized within the periods indicated:

| | For the Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Interest rate derivatives: | | |
| Interest rate swaps: | | |
| Net interest expense (1) | $ (17,825) | $ (1,282) |
| Unrealized gains, net | 57,206 | 7,419 |
| Losses realized upon early termination | (300) | — |
| Total interest rate swap gains, net | 39,081 | 6,137 |
| Eurodollar futures, net | — | (59,908) |
| U.S. Treasury note futures, net | (63,235) | 10,344 |
| Options on U.S. Treasury note futures, net | 2,063 | — |
| 10-year interest rate swap futures and other, net | (25) | (63,000) |
| Total interest rate derivative losses, net | (22,116) | (106,427) |
| TBA and specified agency MBS commitments: | | |
| TBA dollar roll income (2) | 19,261 | 6,743 |
| Other losses on agency MBS commitments, net | (28,805) | (5,059) |
| Total (losses) gains on agency MBS commitments, net | (9,544) | 1,684 |
| Total derivative losses, net | $ (31,660) | $ (104,743) |

(1) Represents the periodic net interest settlement incurred during the period (often referred to as "net interest carry").

(2) Represents the price discount of forward-settling TBA purchases relative to a contemporaneously executed "spot" TBA sale, which economically equates to net interest income that is earned ratably over the period beginning on the settlement date of the sale and ending on the settlement date of the forward-settling purchase.

***Derivative Instrument Activity***

The following tables summarize the volume of activity, in terms of notional amount, related to derivative instruments for the periods indicated:

| | For the Year Ended December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Beginning of Period | Additions | Scheduled Settlements | Early Terminations | End of Period |
| Interest rate swaps | $ 1,500,000 | $ 2,575,000 | $ — | $ (375,000) | $ 3,700,000 |
| 10-year U.S. Treasury note futures | 1,335,000 | 1,482,500 | (2,230,000) | (587,500) | — |
| Purchased put options on 10-year U.S. Treasury note futures | — | 11,214,500 | (9,564,500) | — | 1,650,000 |
| Sold call options on 10-year U.S. Treasury note futures | — | 3,450,000 | (2,450,000) | — | 1,000,000 |
| Purchased call options on 10-year U.S. Treasury note futures | — | 2,620,000 | (1,620,000) | — | 1,000,000 |
| Put options on Eurodollar futures | 4,000,000 | — | (4,000,000) | — | — |
| Commitments to purchase (sell) MBS, net | 375,000 | 9,850,441 | (9,500,441) | — | 725,000 |

| | For the Year Ended December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Beginning of Period | Additions | Scheduled Settlements | Early Terminations | End of Period |
| Eurodollar futures | $ 41,090,000 | $ 11,841,000 | $ (7,235,000) | $ (45,696,000) | $ — |
| 10-year interest rate swap futures | 1,145,000 | 2,685,000 | (3,130,000) | (700,000) | — |
| Interest rate swaps | — | 1,500,000 | — | — | 1,500,000 |
| 2-year U.S. Treasury note futures | — | 350,000 | (350,000) | — | — |
| 10-year U.S. Treasury note futures | — | 3,020,000 | (1,510,000) | (175,000) | 1,335,000 |
| Put options on Eurodollar futures | — | 6,000,000 | (2,000,000) | — | 4,000,000 |
| Commitments to purchase (sell) MBS, net | 200,000 | 2,782,544 | (2,607,544) | — | 375,000 |

***Cash Collateral Posted and Received for Derivative Instruments***

The following table presents information about the cash collateral posted and received by the Company in respect of its derivative instruments, which is included in the line item "deposits, net" in the accompanying consolidated balance sheets, for the dates indicated:

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Cash collateral posted for: | | |
| Interest rate swaps | $ 65,728 | $ 17,434 |
| Options on U.S. Treasury note futures | 5,314 | — |
| U.S. Treasury note futures | — | 11,197 |
| TBA commitments | 1,474 | 798 |
| Total cash collateral posted | 72,516 | 29,429 |
| Cash collateral received for interest rate swaps | (61,367) | — |
| Total cash collateral posted, net | $ 11,149 | $ 29,429 |

**Note 8. Offsetting of Financial Assets and Liabilities**

The agreements that govern certain of the Company's derivative instruments and collateralized short-term financing arrangements provide for a right of setoff in the event of default or bankruptcy with respect to either party to such transactions. The Company presents derivative assets and liabilities as well as collateralized short-term financing arrangements on a gross basis. In its consolidated balance sheets, the Company has elected to offset any payables recognized for the obligation to return cash variation margin received from an interest rate derivative instrument counterparty against receivables recognized for the right to reclaim cash initial margin posted by the Company to that same counterparty; the net receivable due from interest rate derivative instrument counterparties is reflected in the line item "deposits, net" in the accompanying consolidated balance sheets.

The following tables present information, as of the dates indicated, about the Company's derivative instruments, short-term borrowing arrangements, and associated collateral, including those subject to master netting (or similar) arrangements:

| | As of December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Gross Amount Recognized | Amount Offset in the Consolidated Balance Sheets | Net Amount Presented in the Consolidated Balance Sheets | Gross Amount Not Offset in the Consolidated Balance Sheets | | Net Amount |
| | | | | Financial Instruments (1) | Cash Collateral (2) | |
| Assets: | | | | | | |
| Derivative instruments: | | | | | | |
| Options on U.S. Treasury note futures | $ 4,289 | $ — | $ 4,289 | $ (3,906) | $ — | $ 383 |
| Interest rate swaps | 63,315 | — | 63,315 | (1,949) | (61,366) | — |
| TBA commitments | 7,285 | — | 7,285 | — | — | 7,285 |
| Total derivative instruments | 74,889 | — | 74,889 | (5,855) | (61,366) | 7,668 |
| Deposits, net | 72,516 | (61,367) | 11,149 | — | — | 11,149 |
| Total assets | $ 147,405 | $ (61,367) | $ 86,038 | $ (5,855) | $ (61,366) | $ 18,817 |
| Liabilities: | | | | | | |
| Derivative instruments: | | | | | | |
| Options on U.S. Treasury note futures | $ 3,906 | $ — | $ 3,906 | $ (3,906) | $ — | $ — |
| Interest rate swaps | 1,949 | — | 1,949 | (1,949) | — | — |
| TBA commitments | 3,699 | — | 3,699 | — | (1,474) | 2,225 |
| Total derivative instruments | 9,554 | — | 9,554 | (5,855) | (1,474) | 2,225 |
| Deposits, net | 61,367 | (61,367) | — | — | — | — |
| Repurchase agreements | 3,649,102 | — | 3,649,102 | (3,649,102) | — | — |
| Total liabilities | $ 3,720,023 | $ (61,367) | $ 3,658,656 | $ (3,654,957) | $ (1,474) | $ 2,225 |

| | As of December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Gross Amount Recognized | Amount Offset in the Consolidated Balance Sheets | Net Amount Presented in the Consolidated Balance Sheets | Gross Amount Not Offset in the Consolidated Balance Sheets | | Net Amount |
| | | | | Financial Instruments (1) | Cash Collateral (2) | |
| Assets: | | | | | | |
| Derivative instruments: | | | | | | |
| Interest rate swaps | $ 6,153 | $ — | $ 6,153 | $ — | $ — | $ 6,153 |
| 10-year U.S. Treasury note futures | 6,813 | — | 6,813 | — | — | 6,813 |
| Put options on Eurodollar futures | 25 | — | 25 | — | — | 25 |
| Total derivative instruments | 12,991 | — | 12,991 | — | — | 12,991 |
| Total assets | $ 12,991 | $ — | $ 12,991 | $ — | $ — | $ 12,991 |
| Liabilities: | | | | | | |
| Derivative instruments: | | | | | | |
| TBA commitments | $ 553 | $ — | $ 553 | $ — | $ (387) | $ 166 |
| Total derivative instruments | 553 | — | 553 | — | (387) | 166 |
| Repurchase agreements | 2,834,780 | — | 2,834,780 | (2,834,780) | — | — |
| Federal Home Loan Bank advances | 786,900 | — | 786,900 | (786,900) | — | — |
| Total liabilities | $ 3,622,233 | $ — | $ 3,622,233 | $ (3,621,680) | $ (387) | $ 166 |

(1) Does not include the fair value amount of financial instrument collateral pledged in respect of repurchase agreements or Federal Home Loan Bank advances that exceeds the associated liability presented in the consolidated balance sheets.

(2) Does not include the amount of cash collateral pledged in respect of derivative instruments that exceeds the associated derivative liability presented in the consolidated balance sheets.

**Note 9. Fair Value Measurements**

***Fair Value of Financial Instruments***

The accounting principles related to fair value measurements define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial Accounting Standards Board Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, giving the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3) as described below:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that are accessible by the Company at the measurement date;

Level 2 Inputs - Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and

Level 3 Inputs - Unobservable inputs for the asset or liability, including significant judgments made by the Company about the assumptions that a market participant would use.

The Company measures the fair value of the following assets and liabilities:

*Mortgage-backed securities*

*Agency MBS* - The Company's investments in agency MBS are classified within Level 2 of the fair value hierarchy. Inputs to fair value measurements of the Company's investments in agency MBS include price estimates obtained from third-party pricing services. In determining fair value, third-party pricing services use a market approach. The inputs used in the fair value measurements performed by the third-party pricing services are based upon readily observable transactions for securities with similar characteristics (such as issuer/guarantor, coupon rate, stated maturity, and collateral pool characteristics) occurring on the measurement date. The Company makes inquiries of the third party pricing sources to understand the significant inputs and assumptions used to determine prices. The Company reviews the various third-party fair value estimates and performs procedures to validate their reasonableness, including comparison to recent trading activity for similar securities and an overall review for consistency with market conditions observed as of the measurement date.

*Private-label MBS* - The Company's investments in private-label MBS are classified within Level 3 of the fair value hierarchy as private-label MBS trade infrequently and, therefore, the measurement of their fair value requires the use of significant unobservable inputs. In determining fair value, the Company primarily uses an income approach as well as market approaches. The Company utilizes present value techniques based on the estimated future cash flows of the instrument taking into consideration various assumptions derived by management based on their observations of assumptions used by market participants. These assumptions are corroborated by evidence such as historical collateral performance data, evaluation of historical collateral performance data for other securities with comparable or similar risk characteristics, and observed completed or pending transactions in similar instruments, when available. The significant inputs to the Company's valuation process include collateral default, loss severity, prepayment, and discount rates (i.e., the rate of return demanded by market participants as of the measurement date). In general, significant increases (decreases) in default, loss severity, or discount rate assumptions, in isolation, would result in a significantly lower (higher) fair value measurement. However, significant increases (decreases) in prepayment rate assumptions, in isolation, may result in a significantly higher (lower) fair value measurement depending upon the instrument's specific characteristics and the overall payment structure of the issuing securitization vehicle. It is difficult to generalize the interrelationships between these significant inputs as the actual results could differ considerably on an individual security basis. Therefore, each significant input is closely analyzed to ascertain its reasonableness for the Company's purposes of fair value measurement.

Measuring fair value is inherently subjective given the volatile and sometimes illiquid markets for these private-label MBS and requires management to make a number of judgments about the assumptions that a market participant would use, including assumptions about the timing and amount of future cash flows as well as the rate of return required by market participants. The assumptions the Company applies are specific to each security. Although the Company relies on its internal calculations to estimate the fair value of these private-label MBS, the Company considers indications of value from actual sales of similar private-label MBS to assist in the valuation process and to calibrate the Company's models.

*Derivative instruments*

*Exchange-traded derivative instruments* - Exchange-traded derivative instruments, which include Eurodollar futures, U.S. Treasury note futures, interest rate swap futures, and options on futures, are classified within Level 1 of the fair value hierarchy as they are measured using quoted prices for identical instruments in liquid markets.

*Centrally cleared interest rate swaps* - Centrally cleared interest rate swaps are classified within Level 2 of the fair value hierarchy. The fair values of centrally cleared interest rate swaps are measured using the daily valuations reported by the clearinghouse through which the instrument was cleared. In performing its end-of-day valuations, the clearinghouse constructs forward interest rate curves (for example, three-month LIBOR forward rates) from its specific observations of that day's trading activity. The clearinghouse uses the applicable forward interest rate curve to develop a market-based forecast of future remaining contractually required cash flows for each interest rate swap. Each market-based cash flow forecast is then discounted using the overnight index swap rate curve (sourced from the Federal Reserve Bank of New York) to determine a net present value amount which represents the instrument's fair value. The Company reviews the valuations reported by the clearinghouse on an ongoing basis and performs procedures using readily available market data to independently verify their reasonableness.

*Forward-settling purchases and sales of TBA securities* - Forward-settling purchases and sales of TBA securities are classified within Level 2 of the fair value hierarchy. The fair value of each forward-settling TBA contract is measured using broker or dealer quotations, which are based upon readily observable transaction prices occurring on the measurement date for forward-settling contracts to buy or sell TBA securities with the same guarantor, contractual maturity, and coupon rate for delivery on the same forward settlement date as the contract under measurement.

*Other*

*Long-term debt* - As of December 31, 2016 and 2015, the carrying value of the Company's long-term debt was $73,656 and $73,433, respectively, net of unamortized debt issuance costs, and consists of Senior Notes and trust preferred debt issued by the Company. The Company's estimate of the fair value of long-term debt is $66,489 and $59,130 as of December 31, 2016 and 2015, respectively. The Company's Senior Notes, which are publicly traded on the New York Stock Exchange, are classified within Level 1 of the fair value hierarchy. Trust preferred debt is classified within Level 2 of the fair value hierarchy as the fair value is estimated based on the quoted prices of the Company's publicly traded Senior Notes.

*FHLBC capital stock* - FHLBC capital stock is initially purchased at par and may only be transferred back to the FHLBC or to another FHLBC member, subject to approval by the FHLBC, also at par. Due to the restrictions placed on transferability, it is not practical to determine the fair value of FHLBC capital stock. The par value and carrying amount of the FHLBC capital stock included in the line item "other assets" on the Company's consolidated balance sheets is $2 and $15,740 as of December 31, 2016 and 2015, respectively.

*Investments in equity securities of non-public companies and investment funds* - As of December 31, 2016 and 2015, the Company had investments in equity securities and investment funds with a carrying amount of $1,918 and $1,558, respectively, which are included in the line item "other assets" in the accompanying consolidated balance sheets. As of December 31, 2016, $533 of these investments represent securities for which the Company elected the "fair value option" at the time that the securities were initially recognized on the Company's consolidated balance sheets; the Company measures the fair value of these securities on a recurring basis, recognizing the periodic change in fair value in earnings. The remaining $1,385 in investments in equity securities of non-public companies and investment funds as of December 31, 2016, and the entire population of such securities as of December 31, 2015, were measured at cost, net of impairments. The Company's estimate of the fair value of investments in equity securities and investment funds is $6,034 and $5,989 as of December 31, 2016 and 2015, respectively. Investments in equity securities and investment funds are classified within Level 3 of the fair value hierarchy. The fair values of the Company's investments in equity securities and investment funds are not readily determinable. Accordingly, for its investments in equity securities, the Company estimates fair value by estimating the enterprise value of the investee and then waterfalls the enterprise value over the investee's securities in the order of their preference relative to one another. To estimate the enterprise value of the investee, the Company uses traditional valuation methodologies, including the consideration of recent investments in, or tender offers for, the equity securities of the investee. For its investments in investment funds, the Company estimates fair value based upon the investee's net asset value per share.

*Financial assets and liabilities for which carrying value approximates fair value* - Cash and cash equivalents, deposits, net, receivables, repurchase agreements, FHLB advances, payables, and other assets and liabilities are reflected in the consolidated balance sheets at their cost, which, due to the short-term nature of these instruments and their limited inherent credit risk, approximates fair value.

***Fair Value Hierarchy***

*Financial Instruments Measured at Fair Value on a Recurring Basis*

The following tables set forth financial instruments measured at fair value by level within the fair value hierarchy as of December 31, 2016 and 2015. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| MBS | | | | |
| Trading: | | | | |
| Agency MBS | $ 3,911,375 | $ — | $ 3,911,375 | $ — |
| Private-label MBS | 1,266 | — | — | 1,266 |
| Total MBS | 3,912,641 | — | 3,911,375 | 1,266 |
| Derivative assets | 74,889 | 4,289 | 70,600 | — |
| Derivative liabilities | (9,554) | (3,906) | (5,648) | — |
| Other assets | 533 | — | — | 533 |
| Total | $ 3,978,509 | $ 383 | $ 3,976,327 | $ 1,799 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| MBS | | | | |
| Trading: | | | | |
| Agency MBS | $ 3,865,290 | $ — | $ 3,865,290 | $ — |
| Private-label MBS | 3,017 | — | — | 3,017 |
| Total trading | 3,868,307 | — | 3,865,290 | 3,017 |
| Available-for-sale: | | | | |
| Agency MBS | 26 | — | 26 | — |
| Private-label MBS | 127,536 | — | — | 127,536 |
| Total available-for-sale | 127,562 | — | 26 | 127,536 |
| Total MBS | 3,995,869 | — | 3,865,316 | 130,553 |
| Derivative assets | 12,991 | 6,838 | 6,153 | — |
| Derivative liabilities | (553) | — | (553) | — |
| Total | $ 4,008,307 | $ 6,838 | $ 3,870,916 | $ 130,553 |

There were no transfers of financial instruments into or out of Levels 1, 2 or 3 during the years ended December 31, 2016 and 2015.

*Level 3 Financial Assets and Liabilities*

The following table provides information about the significant unobservable inputs used to measure the fair value of the Company's private-label MBS as of the dates indicated:

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | Weighted-average (1) | Range | Weighted-average (1) | Range |
| Discount rate | 6.50% | 6.50 - 6.50 % | 5.57% | 5.50 - 10.00 % |
| Default rate | 2.25% | 2.25 - 2.25 % | 2.78% | 1.45 - 6.20 % |
| Loss severity rate | 45.00% | 45.00 - 45.00 % | 45.84% | 35.00 - 65.00 % |
| Total prepayment rate (including defaults) | 10.25% | 10.25 - 10.25 % | 11.02% | 7.75 - 17.70 % |

(1) Based on face value.

The table below sets forth an attribution of the change in the fair value of the Company's Level 3 investments that are measured at fair value on a recurring basis for the periods indicated:

| | Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Beginning balance | $ 130,553 | $ 267,649 |
| Total net gains (losses) | | |
| Included in investment loss, net | 2,973 | 15,776 |
| Included in other comprehensive income | (15,601) | (31,937) |
| Purchases | 5,357 | 2,870 |
| Sales | (124,962) | (130,138) |
| Payments, net | (4,431) | (9,009) |
| Accretion of discount | 7,910 | 15,342 |
| Ending balance | $ 1,799 | $ 130,553 |
| Net unrealized gains (losses) included in earnings for the period for Level 3 assets still held at the reporting date | $ (465) | $ (2,468) |

**Note 10. Income Taxes**

Arlington Asset is subject to taxation as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended (the "Code"). As of December 31, 2016, the Company had net operating loss ("NOL") carry-forwards of $95,725 that can be used to offset future taxable ordinary income. The Company's NOL carry-forwards begin to expire in 2027. As of December 31, 2016, the Company had net capital loss ("NCL") carry-forwards of $310,897 that can be used to offset future capital gains. The scheduled expirations of the Company's NCL carry-forwards are $136,840 in 2019, $102,927 in 2020 and $71,130 in 2021. The Company is subject to federal alternative minimum tax ("AMT") and state and local taxes on its taxable income and gains that are not offset by its NOL and NCL carry-forwards.

Income taxes are provided for using the asset and liability method. Deferred tax assets and liabilities reflect the impact of temporary differences between the carrying amount of assets and liabilities pursuant to the application of GAAP and their respective tax bases and are stated at tax rates expected to be in effect when the taxes are actually paid or recovered. Deferred tax assets are also recorded for net operating loss carry-forwards, net capital loss carry-forwards and any tax credit carry-forwards. Deferred tax assets and liabilities consisted of the following as of dates indicated:

| | 2016 | 2015 |
|---|---|---|
| Net operating loss carry-forward | $ 37,238 | $ 41,660 |
| Net unrealized losses on investments and derivatives | 19,108 | 24,677 |
| AMT credit | 8,427 | 8,195 |
| Stock-based compensation | 2,426 | 2,004 |
| Deferred net losses on designated derivatives | 1,386 | 8,066 |
| Other, net | 208 | (34) |
| Capital loss carry-forward | 120,939 | 93,625 |
| Valuation allowance on capital loss carry-forward | (116,300) | (80,663) |
| Deferred tax assets, net | $ 73,432 | $ 97,530 |

The provision for income taxes from operations consists of the following for the years ended December 31, 2016, 2015 and 2014:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Federal | $ 23,163 | $ 32,613 | $ 40,298 |
| State | 4,224 | 5,948 | 7,349 |
| Total income tax provision | $ 27,387 | $ 38,561 | $ 47,647 |
| Current | $ 232 | $ 970 | $ 796 |
| Deferred | 27,155 | 37,591 | 46,851 |
| Total income tax provision | $ 27,387 | $ 38,561 | $ 47,647 |

The provision for income taxes results in effective tax rates that differ from the federal statutory rates. The reconciliation of the Company and its subsidiaries' income tax attributable to net income computed at federal statutory rates to the provision for income taxes for the years ended December 31, 2016, 2015, and 2014 were as follows:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Federal income tax at statutory rate | $ (4,886) | $ (10,795) | $ 19,390 |
| State income taxes, net of federal benefit | (544) | (1,203) | 2,161 |
| Expiration of capital loss carry-forward | — | — | 4,668 |
| Losses on available-for sale MBS acquired prior to 2012 | (2,838) | (3,987) | (1,178) |
| Tax character adjustments | — | (1,934) | (1,656) |
| Other, net | 18 | 45 | 34 |
| Valuation allowance | 35,637 | 56,435 | 24,228 |
| Total income tax provision | $ 27,387 | $ 38,561 | $ 47,647 |

A valuation allowance is provided against the deferred tax asset if, based on the Company's evaluation, it is more-likely-than-not that some or all of the deferred tax assets will not be realized. All available evidence, both positive and negative, is considered to determine whether a valuation allowance for deferred tax assets is needed. Items considered in determining our valuation allowance include expectations of future earnings of the appropriate tax character, recent historical financial results, tax planning strategies, the length of statutory carry-forward periods and the expected timing of the reversal of temporary differences. As of December 31, 2016 and 2015, the Company provided a valuation allowance against the portion of its NCL carry-forwards for which the Company believes it is more likely than not that the benefits will not be realized prior to expiration. During the years ended December 31, 2016, 2015 and 2014, the Company recorded an increase to its valuation allowance of $35,637, $56,435 and $24,228, respectively. The increase in the valuation allowance was primarily due to the increase in the NCL carry-forwards from net capital losses generated during those periods primarily as a result of unrealized and realized net capital losses from certain of its derivative hedging instruments.

The Company recognizes uncertain tax positions in the financial statements only when it is more-likely-than-not that the position will be sustained upon examination by the relevant taxing authority based on the technical merits of the position. A position that meets this standard is measured at the largest amount of benefit that will more-likely-than-not be realized upon settlement. A liability is established for differences between positions taken in a tax return and the financial statements. As of December 31, 2016 and 2015, the Company assessed the need for recording a provision for any uncertain tax position and has made the determination that such provision is not necessary.

The Company is subject to examination by the IRS and state and local authorities in jurisdictions where the Company has significant business operations. The Company's federal tax returns for 2013 and forward remain subject to examination by the IRS. As of December 31, 2016, there are no on-going examinations.

**Note 11. Commitments and Contingencies**

***Contractual Obligations***

The Company has contractual obligations to make future payments in connection with long-term debt and non-cancelable lease agreements. The following table sets forth these contractual obligations by fiscal year:

| | 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Long-term debt maturities | $ — | $ — | $ — | $ — | $ — | $ 75,300 | $ 75,300 |
| Minimum rental commitments | 458 | 471 | 483 | 497 | — | — | 1,909 |
| | $ 458 | $ 471 | $ 483 | $ 497 | $ — | $ 75,300 | $ 77,209 |

**Note 12. Shareholders' Equity**

The Company has authorized share capital of 450,000,000 shares of Class A common stock, par value $0.01 per share; 100,000,000 shares of Class B common stock, par value $0.01 per share; and 25,000,000 shares of undesignated preferred stock. Holders of the Class A and Class B common stock are entitled to one vote and three votes per share, respectively, on all matters voted upon by the shareholders. Shares of Class B common stock are convertible into shares of Class A common stock on a one-for-one basis at the option of the Company in certain circumstances including either (i) upon sale or other transfer, or (ii) at the time the holder of such shares of Class B common stock ceases to be employed by the Company. The Company's Board of Directors has the authority, without further action by the shareholders, to issue preferred stock in one or more series and to fix the terms and rights of the preferred stock.

***Conversion of Class B Common Stock to Class A Common Stock***

On October 28, 2016, the Company entered into exchange agreements with each of the Company's Executive Chairman and Chief Executive Officer to exchange all of their shares of Class B common stock for shares of the Company's Class A common stock.

During the years ended December 31, 2016 and 2015, holders of the Company's Class B common stock converted an aggregate of 81,960 and 3,653 shares of Class B common stock into 81,960 and 3,653 shares of Class A common stock, respectively.

As of the filing of this Annual Report on Form 10-K, all remaining shares of Class B common stock had been exchanged for shares of the Company's Class A common stock.

***Equity Distribution Agreements***

On May 24, 2013, we entered into separate equity distribution agreements (the "Equity Distribution Agreements") with each of RBC Capital Markets, LLC, JMP Securities LLC, Ladenburg Thalmann & Co. Inc. and MLV & Co. LLC (the "Equity Sales Agents"), pursuant to which we may offer and sell, from time to time, up to 1,750,000 shares of the Company's Class A common stock. Pursuant to the Equity Distribution Agreements, shares of our common stock may be offered and sold through the Equity Sales Agents in transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, including sales made directly on the NYSE or sales made to or through a market maker other than on an exchange or, subject to the terms of a written notice from the Company, in privately negotiated transactions.

During the year ended December 31, 2016, we issued 595,342 shares of Class A common stock at a weighted average public offering price of $16.57 per share for proceeds of $9,675, net of underwriting discounts and commissions. As of December 31, 2016, we had 1,154,658 shares of Class A common stock available for sale under the Equity Distribution Agreements.

***Equity Offerings***

During the year ended December 31, 2014, the Company completed public offerings as follows:

| Closing date of the offering | | March 28, 2014 | | September 8, 2014 |
|---|---|---|---|---|
| Shares sold to public | | 2,750,000 | | 2,750,000 |
| Shares sold pursuant to the underwriter over-allotment | | 312,500 | | 412,500 |
| Total shares of Class A common stock | | 3,062,500 | | 3,162,500 |
| Public offering price per share | $ | 27.40 | $ | 27.61 |
| Net proceeds (1) | $ | 81,669 | $ | 85,214 |

(1) Net of underwriting discounts and commissions and expenses.

***Share Repurchases***

The Company's Board of Directors authorized a share repurchase program pursuant to which the Company may repurchase up to 2,000,000 shares of its Class A common stock (the "Repurchase Program"). Repurchases under the Repurchase Program may be made from time to time on the open market and in private transactions at management's discretion in accordance with applicable federal securities laws. The timing of repurchases and the exact number of shares of Class A common stock to be repurchased will depend upon market conditions and other factors. The Repurchase Program is funded using the Company's cash on hand and cash generated from operations. The Repurchase Program has no expiration date and may be suspended or terminated at any time without prior notice.

During the year ended December 31, 2015, the Company repurchased 48,695 shares of its Class A common stock at an average price of $12.15 per share for a total cost of $593. As of December 31, 2016, 1,951,305 shares of Class A common stock remain available for repurchases under the Repurchase Program.

***Shareholder Rights Agreement***

The Board of Directors adopted and the Company's shareholders approved a shareholder rights agreement ("Rights Plan"). Under the terms of the Rights Plan, in general, if a person or group acquires or commences a tender or exchange offer for beneficial ownership of 4.9% or more of the outstanding shares of our Class A common stock upon a determination by our Board of Directors (an "Acquiring Person"), all of our other Class A and Class B common shareholders will have the right to purchase securities from us at a discount to such securities' fair market value, thus causing substantial dilution to the Acquiring Person.

The Board of Directors adopted the Rights Plan in an effort to protect against a possible limitation on the Company's ability to use its NOL carry-forwards, NCL carry-forwards, and built-in losses under Sections 382 and 383 of the Code. The Company's ability to use its NOLs, NCLs and built-in losses would be limited if it experienced an "ownership change" under Section 382 of the Code. In general, an "ownership change" would occur if there is a cumulative change in the ownership of the Company's common stock of more than 50% by one or more "5% shareholders" during a three-year period. The Rights Plan was adopted to dissuade any person or group from acquiring 4.9% or more of the Company's outstanding Class A common stock, each, an Acquiring Person, without the approval of the Board of Directors and triggering an "ownership change" as defined by Section 382.

The Rights Plan and any outstanding rights will expire at the earliest of (i) June 4, 2019, (ii) the time at which the rights are redeemed or exchanged pursuant to the Rights Plan, (iii) the repeal of Section 382 and 383 of the Code or any successor statute if the Board of Directors determines that the Rights Plan is no longer necessary for the preservation of the applicable tax benefits, and (iv) the beginning of a taxable year to which the Board of Directors determines that no applicable tax benefits may be carried forward.

***Dividends***

Pursuant to the Company's variable dividend policy, the Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. The Company's dividend payments, if any, may vary significantly from quarter to quarter. The Board of Directors has approved and the Company has declared and paid the following dividends in 2016:

| Quarter Ended | | Dividend Amount | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|---|
| December 31 | $ | 0.625 | December 16 | December 30 | January 31, 2017 |
| September 30 | | 0.625 | September 15 | September 30 | October 31 |
| June 30 | | 0.625 | June 17 | June 30 | July 29 |
| March 31 | | 0.625 | March 15 | March 31 | April 29 |

The Board of Directors approved and the Company declared and paid the following dividends for 2015:

| Quarter Ended | Dividend Amount | Declaration Date | Record Date | Pay Date |
|---|---|---|---|---|
| December 31 | $ 0.625 | December 17 | December 31 | January 29, 2016 |
| September 30 | 0.625 | September 17 | September 30 | October 30 |
| June 30 | 0.875 | June 17 | June 30 | July 31 |
| March 31 | 0.875 | March 10 | March 31 | April 30 |

**Note 13. Long-Term Incentive Plan**

The Company provides its employees and its non-employee directors with long-term incentive compensation in the form of stock-based awards. On April 7, 2014, the Board of Directors adopted the Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (the "2014 Plan"), which was approved by the Company's shareholders and became effective on July 15, 2014.

Under the 2014 Plan, a maximum number of 2,000,000 shares of Class A common stock of the Company, subject to adjustment as set forth in the 2014 Plan, were authorized for issuance and may be issued to employees, directors, consultants and advisors of the Company and its affiliates. As of December 31, 2016, 1,861,983 shares remained available for issuance under the 2014 Plan. The 2014 Plan replaced the Arlington Asset Investment Corp. 2011 Long-Term Incentive Plan (the "2011 Plan"). No additional grants will be made under the 2011 Plan. However, previous grants under the 2011 Plan will remain in effect subject to the terms of the 2011 Plan and the applicable award agreement, and shares of Class A common stock may be issued under the 2011 Plan. The shares of Class A common stock to be issued under the 2011 Plan are subject to the achievement of performance measures and/or vesting. As of December 31, 2016, 269,283 shares remained available for issuance under the 2011 Plan.

Under the 2014 Plan, the Compensation Committee of the Company's Board of Directors may grant restricted stock, restricted stock units ("RSUs"), performance stock units ("PSUs"), stock options, stock appreciation rights ("SARs") and/or other stock-based awards. However, no participant may be granted (i) stock options or SARs during any twelve-month period covering more than 300,000 shares or (ii) restricted stock, RSUs, PSUs and/or other stock-based awards denominated in shares that are intended to qualify as performance based compensation under Section 162(m) that permit the participant to earn more than 300,000 shares for each twelve months in the vesting or period on which performance is measured ("Performance Period"). These share limits are subject to adjustment in the event of any merger, reorganization, consolidation, recapitalization, stock dividend, stock split, reverse stock split, spin-off, extraordinary cash dividend or similar transaction or other change in corporate structure affecting the share. In addition, during any calendar year no participant may be granted performance awards that are denominated in cash and that are intended to qualify as performance based compensation under Section 162(m) under which more than $10,000 may be earned for each twelve months in the Performance Period. Each of the individual award limits described in this paragraph will be multiplied by two during the first calendar year in which the participant commences employment with the Company and its affiliates. The 2014 Plan will terminate on the tenth anniversary of its effective date unless sooner terminated by the Board of Directors.

Stock-based compensation costs are initially measured at the estimated fair value of the awards on the grant date developed using appropriate valuation methodologies, as adjusted for estimates of future award forfeitures. Valuation methodologies used and subsequent expense recognition is dependent upon each award's service and performance conditions.

Excess tax benefits from the tax deduction of stock-based awards exceeding the stock-based compensation recorded in accordance with GAAP are recorded as an increase to additional paid-in capital. Conversely, if the tax deduction of stock-based awards is less than the stock-based compensation recorded in accordance with GAAP, it is recorded as a decrease to additional paid-in capital to the extent of previously accumulated excess tax benefits recorded in additional paid-in capital with any remaining amount recorded as additional income tax provision. The gross windfall tax benefit is presented in the consolidated statements of cash flows as financing cash inflows.

*Performance Stock Unit Awards*

Compensation costs for PSUs subject to nonmarket-based performance conditions (i.e. performance not predicated on changes in the Company's stock price) are measured at the closing stock price on the dates of grant, adjusted for the probability of achieving certain benchmarks included in the performance metrics. These initial cost estimates are recognized as expense over the requisite performance periods, as adjusted for changes in estimated, and ultimately actual, performance and forfeitures. Compensation costs for components of PSUs subject to market-based performance conditions (i.e. performance predicated on changes in the Company's stock price) are measured at the dates of grant using a Monte Carlo simulation model which incorporates into the valuation the inherent uncertainty regarding the achievement of the market-based performance metrics. These initial valuation amounts are recognized as expense over the requisite performance periods, subject only to adjustments for changes in estimated, and ultimately actual, forfeitures.

The Company has granted performance stock units to executive officers of the Company that are convertible into shares of Class A common stock following the applicable performance periods. The performance goals established by the Compensation Committee are based on (i) the compound annualized growth in the Company's book value per share ( i.e., book value change with such adjustments as determined and approved by the Compensation Committee plus dividends on a reinvested basis) during the applicable performance period ("Book Value PSUs'), and (ii) the compound annualized total shareholder return ( i.e., share price change plus dividends on a reinvested basis) during the applicable performance period ("TSR PSUs").

The Compensation Committee of the Board of Directors of the Company approved the following PSU grants for the periods indicated:

| | December 31, 2016 | December 31, 2015 | December 31, 2014 |
|---|---|---|---|
| Book Value PSUs granted | 71,926 | 45,054 | 35,126 |
| Book Value PSU grant date fair value per share | $ 12.93 | $ 19.56 | $ 27.26 |
| TSR PSUs granted | 80,173 | 58,169 | 35,593 |
| TSR PSU grant date fair value per share | $ 11.60 | $ 15.15 | $ 26.90 |

For the Company's Book Value PSUs, the grant date fair value per share is based on the close price on the date of grant. For the Company's TSR PSUs, the grant date fair value per share is based on a Monte Carlo simulation model. The following assumptions, determined as of the date of grant, were used in the Monte Carlo simulation model to measure the grant date fair value per share of the Company's TSR PSUs for the periods indicated:

| | TSR PSUs Granted in: 2016 | TSR PSUs Granted in: 2015 | TSR PSUs Granted in: 2014 |
|---|---|---|---|
| Closing stock price on date of grant | $ 12.93 | $ 19.56 | $ 27.26 |
| Beginning average stock price on date of grant (1) | $ 13.40 | $ 20.82 | $ 27.68 |
| Expected volatility (2) | 24.78% | 21.72% | 31.03% |
| Dividend yield (3) | 0.00% | 0.00% | 0.00% |
| Risk-free rate (4) | 0.71% | 1.08% | 0.90% |

(1) Based upon the 30 trading days prior to and including the date of grant.
(2) Based upon the most recent three-year volatility as of the date of grant.
(3) Dividend equivalents are accrued during the performance period and deemed reinvested in additional stock units, which are to be paid out at the end of the performance period to the extent the underlying PSU is earned. Applying dividend yield assumption of 0.00% in the Monte Carlo simulation is mathematically equivalent to reinvesting dividends on a continuous basis and including the value of the dividends in the final payout.
(4) Based upon the yield of a U.S. Treasury bond with a three-year maturity as of the date of grant.

The vesting of the PSUs is subject to both continued employment under the terms of the award agreement and the achievement of the Company performance goals established by the Compensation Committee. For PSU awards granted during the three years ended December 31, 2016, the Compensation Committee established a three-year performance period. The actual number of shares of Class A common stock that will be issued to each participant at the end of the applicable performance period will vary between 0% and 250% of the number of PSUs granted, depending on performance results. If the minimum threshold level of performance goals is not achieved, no PSUs are earned. To the extent the performance results are between the minimum threshold level and maximum level of performance goals, between 50% to 250% of the number of PSUs granted are earned.

PSUs do not have any voting rights. No dividends are paid on outstanding PSUs during the applicable performance period. Instead, dividend equivalents are accrued on outstanding PSUs during the applicable performance period, deemed invested in shares of Class A common stock and are paid out in shares of Class A common stock at the end of the performance period to the extent that the underlying PSUs vest. Upon settlement, vested PSUs are converted into shares of the Company's Class A common stock on a one-for-one basis.

For the years ended December 31, 2016, 2015, and 2014, the Company recognized $1,266, $(560) and $2,457, respectively, of compensation expense related to PSU awards. For the year ended December 31, 2015, the compensation expense included a reversal of $1,474 of expense recognized in prior periods due to a reduction in the number of PSUs expected to vest based on deterioration in performance metrics. As of December 31, 2016 and 2015, the Company had unrecognized compensation expense related to PSU awards of $3,591 and $2,697, respectively. The unrecognized compensation expense as of December 31, 2016 is expected to be recognized over a weighted average period of 2.2 years. For the years ended December 31, 2015 and 2014, the intrinsic value of PSU awards that vested was $716 and $2,447, respectively. There were no PSU awards that vested for the year ended December 31, 2016.

*Employee Restricted Stock Awards*

Compensation costs for restricted stock awards subject only to service conditions are measured at the closing stock price on the dates of grant and are recognized as expense on a straight-line basis over the requisite service periods for the awards, as adjusted for changes in estimated, and ultimately actual, forfeitures.

The Company grants restricted common shares to employees that vest ratably over a three-year period or cliff-vest after two to four years based on continued employment over these specified periods. A summary of these unvested restricted stock awards is presented below:

| | Number of Shares | Weighted-average Grant-date Fair Value | Weighted-average Remaining Vested Period |
|---|---|---|---|
| Share Balance as of December 31, 2013 | 57,673 | $ 25.71 | 2.0 |
| Granted | 84,602 | 26.84 | — |
| Forfeitures | — | — | — |
| Vestitures | (25,163) | 25.64 | — |
| Share Balance as of December 31, 2014 | 117,112 | 26.54 | 1.9 |
| Granted | 58,000 | 14.35 | — |
| Forfeitures | (6,668) | 26.34 | — |
| Vestitures | (36,669) | 25.63 | — |
| Share Balance as of December 31, 2015 | 131,775 | 21.44 | 2.0 |
| Granted | 73,457 | 14.67 | — |
| Forfeitures | — | — | — |
| Vestitures | (43,341) | 21.04 | — |
| Share Balance as of December 31, 2016 | 161,891 | 18.47 | 1.4 |

For the years ended December 31, 2016, 2015, and 2014, the Company recognized $1,197, $1,207 and $927, respectively, of compensation expense related to restricted stock awards. As of December 31, 2016 and 2015, the Company had unrecognized compensation expense related to restricted stock awards of $1,512 and $1,631, respectively. The unrecognized compensation expense as of December 31, 2016 is expected to be recognized over a weighted average period of 1.4 years. For the years ended December 31, 2016, 2015 and 2014, the intrinsic value of restricted stock awards that vested were $630, $646 and $681, respectively.

In addition, as part of the Company's satisfaction of incentive compensation earned for past service under the Company's variable compensation programs, employees may receive restricted Class A common stock in lieu of cash payments. These restricted Class A common stock shares are issued to an irrevocable trust and are not returnable to the Company. No such shares were issued in 2016, 2015 and 2014. As of December 31, 2016 and 2015, the Company had 9,155 vested shares of the undistributed restricted stock issued to the trust.

*Director Restricted Stock Units*

Compensation costs for RSU awards subject only to service conditions are measured at the closing stock price on the dates of grant and are recognized as expense on a straight-line basis over the requisite service periods for the awards, as adjusted for changes in estimated, and ultimately actual, forfeitures. Compensation costs for RSUs that do not require future service conditions are expensed immediately.

The Company's non-employee directors are compensated in both cash and RSUs. RSUs awarded under the Company's 2014 Plan vest immediately on the award grant date and are convertible into shares of Class A common stock. For RSUs granted under the Company's 2014 Plan and 2011 Plan, the RSUs are convertible into shares of Class A common stock at the later of the date the non-employee director ceases to be a member of the Company's Board or the first anniversary of the grant date. For RSUs granted under prior long-term incentive plans, the RSUs are convertible into shares of Class A common stock one year after the non-employee director ceases to be a member of the Company's Board. The RSUs do not have any voting rights but are entitled to cash dividend equivalent payments. As of December 31, 2016, the Company had 185,424 RSUs outstanding. A summary of the RSUs grants is presented below for the periods indicated:

| | December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| RSUs granted | 37,007 | 25,506 | 15,521 |
| Grant date fair value | $ 13.78 | $ 20.78 | $ 27.70 |

The grant date fair value is based on the closing price of the Class A common stock on the New York Stock Exchange on the date of grant. For the years ended December 31, 2016, 2015 and 2014, the Company recognized $511, $496 and $430, respectively, of director fees related to these RSUs.

**Note 14. Financial Instruments with Off-Balance-Sheet Risk and Credit Risk**

As of December 31, 2016, the Company did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities ("VIEs"), established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. The Company's economic interests held in unconsolidated VIEs are limited in nature to those of a passive holder of MBS issued by securitization trusts; the Company was not involved in the design or creation of the securitization trusts which issued its investments in MBS. As of December 31, 2016, the Company had not consolidated for financial reporting purposes any securitization trusts as the Company does not have the power to direct the activities that most significantly impact the economic performance of such entities. Further, as of December 31, 2016, the Company had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

**Note 15. Quarterly Data (Unaudited)**

The following tables set forth selected information for each of the fiscal quarters during the years ended December 31, 2016 and 2015. The selected quarterly data is derived from unaudited financial statements of the Company and has been prepared on the same basis as the annual, audited financial statements to include, in the opinion of management, all adjustments (consisting of only normal recurring adjustments) necessary for fair statement of the results for such periods.

The sum of quarterly earnings per share amounts may not equal full year earnings per share amounts due to differing average outstanding shares amounts for the respective periods.

| | Fiscal Year 2016 | | | | |
|---|---|---|---|---|---|
| | Total Year | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
| Interest income | $ 105,336 | $ 24,577 | $ 25,654 | $ 26,351 | $ 28,754 |
| Interest expense | 29,222 | 8,436 | 7,390 | 6,703 | 6,693 |
| Net interest income | 76,114 | 16,141 | 18,264 | 19,648 | 22,061 |
| Investment (loss) gain, net | (69,318) | (31,203) | 20,722 | (8,947) | (49,890) |
| General and administrative expenses | 20,756 | 4,119 | 4,630 | 7,672 | 4,335 |
| (Loss) income before income taxes | (13,960) | (19,181) | 34,356 | 3,029 | (32,164) |
| Income tax provision (benefit) | 27,387 | 22,255 | 15,543 | (9,865) | (546) |
| Net (loss) income | $ (41,347) | $ (41,436) | $ 18,813 | $ 12,894 | $ (31,618) |
| Basic (loss) earnings per share | $ (1.79) | $ (1.79) | $ 0.82 | $ 0.56 | $ (1.38) |
| Diluted (loss) earnings per share | $ (1.79) | $ (1.79) | $ 0.81 | $ 0.56 | $ (1.38) |

| | Fiscal Year 2015 | | | | |
|---|---|---|---|---|---|
| | Total Year | Fourth Quarter | Third Quarter | Second Quarter | First Quarter |
| Interest income | $ 121,263 | $ 31,228 | $ 31,239 | $ 28,286 | $ 30,510 |
| Interest expense | 18,889 | 5,421 | 5,165 | 4,575 | 3,728 |
| Net interest income | 102,374 | 25,807 | 26,074 | 23,711 | 26,782 |
| Investment (loss) gain, net | (118,429) | 1,653 | (59,757) | (7,518) | (52,807) |
| General and administrative expenses | 14,787 | 3,974 | 3,450 | 3,945 | 3,418 |
| (Loss) income before income taxes | (30,842) | 23,486 | (37,133) | 12,248 | (29,443) |
| Income tax provision | 38,561 | 4,675 | 15,497 | 5,647 | 12,742 |
| Net (loss) income | $ (69,403) | $ 18,811 | $ (52,630) | $ 6,601 | $ (42,185) |
| Basic (loss) earnings per share | $ (3.02) | $ 0.82 | $ (2.29) | $ 0.29 | $ (1.84) |
| Diluted (loss) earnings per share | $ (3.02) | $ 0.82 | $ (2.29) | $ 0.29 | $ (1.84) |

**Exhibit 12.01**

**Arlington Asset Investment Corp.**
**Computation of Ratio of Earnings to Fixed Charges**
**(dollars in thousands)**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2016 | 2015 | 2014 | 2013 | 2012 |
| Pre-tax (loss) income from continuing operations adjusted to exclude income or loss from equity investees | $ (14,512) | $ (32,403) | $ 55,189 | $ 14,253 | $ 30,788 |
| Distributed income of equity investees | 809 | 1,628 | 413 | 90 | 384 |
| Fixed charges: | | | | | |
| Interest expense and amortization of debt discount and premium on all indebtedness | 29,222 | 18,889 | 11,391 | 8,529 | 4,965 |
| Rentals | 87 | 92 | 83 | 81 | 88 |
| Total fixed charges | $ 29,309 | $ 18,981 | $ 11,474 | $ 8,610 | $ 5,053 |
| Pre-tax income (loss) from continuing operations adjusted to exclude income or loss from equity investees plus fixed charges and distributed income of equity investees | $ 15,606 | $ (11,794) | $ 67,076 | $ 22,953 | $ 36,225 |
| Ratio of earnings to fixed charges | (A) | (A) | 5.8 | 2.7 | 7.2 |

(A) For the years ended December 31, 2016 and 2015, the ratio coverage in the period was less than 1:1. The Company would have had to generate additional earnings of $13,703 and $30,775, respectively, to achieve coverage of 1:1 in those periods.

Exhibit 21.01

## List of Significant Subsidiaries of the Registrant

| Name | State of Incorporation |
| --- | --- |
| Key Bridge Insurance, LLC | Tennessee |
| Rosslyn REIT Trust | Maryland |

**Exhibit 23.01**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-104475, 333-174669 and 333-197442) and Form S-3 (Nos. 333-193478 and 333-215384) of Arlington Asset Investment Corp. of our report dated February 21, 2017 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Annual Report on Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP

McLean, Virginia

February 21, 2017

**Exhibit 31.01**

**CERTIFICATION**

I, J. Rock Tonkel, Jr., certify that:

1. I have reviewed this Annual Report on Form 10-K of Arlington Asset 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(s) 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:

   (a) 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;

   (b) 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;

   (c) 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

   (d) 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(s) 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 (or persons performing the equivalent functions):

   (a) 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

   (b) 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.

February 21, 2017

/s/ J. ROCK TONKEL, JR.
**J. Rock Tonkel, Jr.**
**President and Chief Executive Officer**

**CERTIFICATION**

I, Richard E. Konzmann, certify that:

1. I have reviewed this Annual Report on Form 10-K of Arlington Asset 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(s) 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:

    (a) 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;

    (b) 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;

    (c) 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

    (d) 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(s) 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 (or persons performing the equivalent functions):

    (a) 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

    (b) 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.

February 21, 2017

/s/ RICHARD E. KONZMANN

**Richard E. Konzmann**
**Executive Vice President,**
**Chief Financial Officer, and Treasurer**
**(Principal Financial and Accounting Officer)**

**Exhibit 32.01**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Arlington Asset Investment Corp. (the Company) for the year ended December 31, 2016, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, J. Rock Tonkel, Jr., Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 21, 2017

/s/ J. ROCK TONKEL, JR.
**J. Rock Tonkel, Jr.**
**President and Chief Executive Officer**

**Exhibit 32.02**

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Arlington Asset Investment Corp. (the Company) for the year ended December 31, 2016, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Richard E. Konzmann, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 21, 2017

/s/ RICHARD E. KONZMANN
**Richard E. Konzmann**
**Executive Vice President,**
**Chief Financial Officer, and Treasurer**
**(Principal Financial and Accounting Officer)**