CYS Investments, Inc.
Form 10-Q
July 27, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
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 001-33740

CYS Investments, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland | 20-4072657 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| 500 Totten Pond Road, 6th Floor, Waltham, Massachusetts | 02451 |
| (Address of principal executive offices) | (Zip Code) |

(617) 639-0440
(Registrant’s telephone number, including area code)

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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or a an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. Check one:

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |
| | Emerging growth company ¨ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | July 27, 2017 |
| --- | --- |
| Common Stock ($0.01 par value) | 151,751,482 |

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PART II. OTHER INFORMATION

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PART I. Financial Information
Item 1. Financial Statements
CYS INVESTMENTS, INC.
CONSOLIDATED BALANCE SHEETS
(dollars and shares in thousands)

| | June 30, 2017 | December 31, 2016* |
|---|---|---|
| | (Unaudited) | |
| Assets: | | |
| Cash and cash equivalents | $1,264 | $1,260 |
| Investments in securities, at fair value: | | |
| Agency mortgage-backed securities (including pledged assets of $9,834,904 and $10,233,165, respectively) | 11,705,696 | 12,599,045 |
| U.S. Treasury securities (including pledged assets of $24,841 and $44,469, respectively) | 24,841 | 49,686 |
| Receivable for securities sold and principal repayments | 689 | 409,849 |
| Receivable for cash pledged as collateral | — | 600 |
| Interest receivable | 32,340 | 31,825 |
| Derivative assets, at fair value | 92,520 | 142,556 |
| Other investments | 8,028 | 8,028 |
| Other assets | 4,038 | 2,419 |
| Total assets | $11,869,416 | $13,245,268 |
| Liabilities and stockholders' equity: | | |
| Liabilities: | | |
| Repurchase agreements | $9,370,845 | $9,691,544 |
| Payable for securities purchased | 817,597 | 1,881,963 |
| Payable for cash received as collateral | 64,402 | 91,503 |
| Accrued interest payable | 28,810 | 27,908 |
| Accrued expenses and other liabilities | 3,045 | 6,170 |
| Dividends payable | 42,342 | 4,410 |
| Derivative liabilities, at fair value | 6,725 | 6,051 |
| Total liabilities | $10,333,766 | $11,709,549 |
| Stockholders' equity: | | |
| Preferred Stock, $0.01 par value, 50,000 shares authorized: | | |
| 7.75% Series A Cumulative Redeemable Preferred Stock, (3,000 shares issued and outstanding, respectively, $75,000 in aggregate liquidation preference) | $72,369 | $72,369 |
| 7.50% Series B Cumulative Redeemable Preferred Stock, (8,000 shares issued and outstanding, respectively, $200,000 in aggregate liquidation preference) | 193,531 | 193,531 |
| Common Stock, $0.01 par value, 500,000 shares authorized (151,731 and 151,435 shares issued and outstanding, respectively) | 1,517 | 1,514 |
| Additional paid in capital | 1,946,856 | 1,944,908 |
| Retained earnings (accumulated deficit) | (678,623) | (676,603) |
| Total stockholders' equity | $1,535,650 | $1,535,719 |
| Total liabilities and stockholders' equity | $11,869,416 | $13,245,268 |

* Derived from audited consolidated financial statements.
See Notes to consolidated financial statements (unaudited).

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CYS INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(dollars in thousands, except per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Interest income: | | | | |
| Agency RMBS | $77,027 | $74,176 | $150,254 | $155,499 |
| Other | 61 | 681 | 147 | 809 |
| Total interest income | 77,088 | 74,857 | 150,401 | 156,308 |
| Interest expense: | | | | |
| Repurchase agreements | 26,182 | 16,910 | 47,403 | 32,797 |
| FHLBC Advances | — | 1,777 | — | 3,835 |
| Total interest expense | 26,182 | 18,687 | 47,403 | 36,632 |
| Net interest income | 50,906 | 56,170 | 102,998 | 119,676 |
| Other income (loss): | | | | |
| Net realized gain (loss) on investments | (19,831) | 36,359 | (85,875) | 37,561 |
| Net unrealized gain (loss) on investments | 51,299 | 28,915 | 114,777 | 191,201 |
| Net unrealized gain (loss) on FHLBC Advances | — | (448) | — | (1,299) |
| Other income | 39 | 387 | 86 | 850 |
| Net realized and unrealized gain (loss) on investments, FHLBC Advances and other income | 31,507 | 65,213 | 28,988 | 228,313 |
| Swap and cap interest expense | (8,434) | (14,779) | (16,761) | (33,177) |
| Net realized and unrealized gain (loss) on derivative instruments | (18,324) | (44,535) | (19,336) | (185,059) |
| Net gain (loss) on derivative instruments | (26,758) | (59,314) | (36,097) | (218,236) |
| Total other income (loss) | 4,749 | 5,899 | (7,109) | 10,077 |
| Expenses: | | | | |
| Compensation and benefits | 3,004 | 3,565 | 6,780 | 7,430 |
| General, administrative and other | 2,426 | 2,294 | 4,864 | 4,782 |
| Total expenses | 5,430 | 5,859 | 11,644 | 12,212 |
| Net income (loss) | $50,225 | $56,210 | $84,245 | $117,541 |
| Dividends on preferred stock | (5,203) | (5,203) | (10,406) | (10,406) |
| Net income (loss) available to common stockholders | $45,022 | $51,007 | $73,839 | $107,135 |
| Net income (loss) per common share basic & diluted | $0.30 | $0.34 | $0.49 | $0.71 |
| Dividends declared per common share | $0.25 | $0.25 | $0.50 | $0.51 |

See Notes to consolidated financial statements (unaudited).

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CYS INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)
(dollars in thousands)

| | Cumulative Redeemable Preferred Stock | | | | | |
|---|---|---|---|---|---|---|
| | Series A | Series B | Common Stock Par Value | Additional Paid-in Capital | Retained Earnings (Accumulated Deficit) | Total |
| Balance, December 31, 2015 | $72,369 | $193,531 | $1,517 | $1,946,419 | $(519,222) | $1,694,614 |
| Net income (loss) | — | — | — | — | 117,541 | 117,541 |
| Issuance of common stock | — | — | 4 | (4) | — | — |
| Amortization of share based compensation | — | — | — | 2,023 | — | 2,023 |
| Repurchase of common stock | — | — | (7) | (5,508) | — | (5,515) |
| Preferred dividends | — | — | — | — | (10,406) | (10,406) |
| Common dividends | — | — | — | — | (77,248) | (77,248) |
| Balance, June 30, 2016 | $72,369 | $193,531 | $1,514 | $1,942,930 | $(489,335) | $1,721,009 |
| | | | | | | |
| Balance, December 31, 2016 | $72,369 | $193,531 | $1,514 | $1,944,908 | $(676,603) | $1,535,719 |
| Net income (loss) | — | — | — | — | 84,245 | 84,245 |
| Issuance of common stock | — | — | 3 | 11 | — | 14 |
| Amortization of share-based compensation | — | — | — | 2,284 | — | 2,284 |
| Repurchase of common stock | — | — | — | (347) | — | (347) |
| Preferred dividends | — | — | — | — | (10,406) | (10,406) |
| Common dividends | — | — | — | — | (75,859) | (75,859) |
| Balance, June 30, 2017 | $72,369 | $193,531 | $1,517 | $1,946,856 | $(678,623) | $1,535,650 |

See Notes to consolidated financial statements (unaudited).

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CYS INVESTMENTS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(dollars in thousands)

| | Six Months Ended June 30, | |
|---|---|---|
| | 2017 | 2016 |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 84,245 | $ 117,541 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Amortization of share-based compensation | 2,284 | 2,023 |
| Amortization of premiums and discounts on investment securities | 27,104 | 38,457 |
| Amortization of premiums on interest rate cap contracts | 8,750 | 8,750 |
| Net realized (gain) loss on investments | 85,875 | (37,561) |
| Net unrealized (gain) loss on investments | (114,777) | (191,201) |
| Net unrealized (gain) loss on derivative instruments | 41,960 | 148,883 |
| Net unrealized (gain) loss on FHLBC Advances | — | 1,299 |
| Change in assets and liabilities: | | |
| Interest receivable | (515) | 2,103 |
| Other assets | (1,619) | (574) |
| Accrued interest payable | 902 | (12,281) |
| Accrued expenses and other liabilities | (3,125) | 774 |
| Net cash provided by (used in) operating activities | 131,084 | 78,213 |
| Cash flows from investing activities: | | |
| Purchase of available-for-sale investment securities | (4,494,384) | (7,253,953) |
| Proceeds from sale of available-for-sale investment securities | 4,778,107 | 6,842,804 |
| Proceeds from sale of other investments | — | 19,000 |
| Proceeds from paydowns of available-for-sale investment securities | 636,269 | 865,015 |
| Change in assets and liabilities: | | |
| Receivable for securities sold and principal repayments | 409,160 | 1,083,337 |
| Receivable for cash pledged as collateral | 600 | (75,558) |
| Payable for securities purchased | (1,064,366) | (823,355) |
| Payable for cash received as collateral | (27,101) | (13,708) |
| Net cash provided by (used in) investing activities | 238,285 | 643,582 |
| Cash flows from financing activities: | | |
| Proceeds from repurchase agreements | 70,517,981 | 49,667,326 |
| Repayments of repurchase agreements | (70,838,680) | (48,805,601) |
| Proceeds from FHLBC Advances | — | 2,175,000 |
| Repayments of FHLBC Advances | — | (3,700,000) |
| Net proceeds from issuance of common shares | 14 | — |
| Net payments from repurchase of common stock | (347) | (5,515) |
| Dividends paid | (48,333) | (49,805) |
| Net cash provided by (used in) financing activities | (369,365) | (718,595) |
| Net increase (decrease) in cash and cash equivalents | 4 | 3,200 |
| Cash and cash equivalents - Beginning of period | 1,260 | 9,982 |
| Cash and cash equivalents - End of period | $ 1,264 | $ 13,182 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid (excluding interest paid on interest rate swaps) | $ 45,924 | $ 37,549 |
| Net interest paid on interest rate swaps | $ 8,587 | $ 35,789 |

| | | |
|---|---|---|
| Income taxes paid | $ 1,499 | $ — |
| Supplemental disclosures of non-cash flow information: | | |
| Dividends declared, not paid | $ 42,342 | $ 42,259 |

See Notes to consolidated financial statements (unaudited).

CYS INVESTMENTS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2017

These footnotes to our accompanying unaudited consolidated financial statements in this interim report should be read in conjunction with the footnotes to our Annual Report on Form 10-K, filed with the SEC on February 17, 2017 (the "2016 Annual Report").

1. ORGANIZATION

CYS Investments, Inc. (the "Company", "we", "us" or "our") was formed as a Maryland corporation on January 3, 2006, and commenced operations on February 10, 2006. The Company has elected to be taxed and intends to continue to qualify as a real estate investment trust ("REIT") and is required to comply with the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), with respect thereto. The Company primarily invests in residential mortgage-backed securities that are issued and the principal and interest of which are guaranteed by a federally chartered corporation ("Agency RMBS"), such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or an agency of the U.S. government such as the Government National Mortgage Association ("Ginnie Mae"), and debt securities issued by the United States Department of Treasury ("U.S. Treasuries"). The Company's investment guidelines provide that the Company may also purchase collateralized mortgage obligations issued by a government agency or government-sponsored entity that are collateralized by Agency RMBS ("CMOs"), or securities issued by a government sponsored entity that are not backed by collateral but, in the case of government agencies, are backed by the full faith and credit of the U.S. government, and, in the case of government sponsored entities, are backed by the integrity and creditworthiness of the issuer ("U.S. Agency Debentures").

The Company’s common stock, Series A Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series A Preferred Stock"), and Series B Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series B Preferred Stock"), trade on the New York Stock Exchange under the symbols "CYS," "CYS PrA" and "CYS PrB," respectively.

In March 2015, our wholly-owned captive insurance subsidiary, CYS Insurance Services, LLC ("CYS Insurance"), was granted membership in the Federal Home Loan Bank ("FHLB") system, specifically in the FHLB of Cincinnati ("FHLBC"). Membership in the FHLBC obligated CYS Insurance to purchase FHLBC membership stock and activity stock, the latter being a percentage of the advances it obtained from the FHLBC. CYS Insurance sought both short-term advances ("Short-term FHLBC Advances") and long-term advances ("Long-term FHLBC Advances"), and collectively with Short-term FHLBC Advances ("FHLBC Advances") from the FHLBC. On January 12, 2016, the Federal Housing Finance Agency ("FHFA") issued a final rule (the "Final Rule") amending its regulations governing FHLBC Membership criteria for captive insurance companies. Under this Final Rule, which became effective on February 19, 2016, CYS Insurance's membership in the FHLBC was required to be terminated within one year of the effective date, it was not permitted to secure any new advances, and all FHLBC Advances were required to be repaid no later than February 19, 2017. The Company repaid all outstanding FHLBC Advances prior to September 30, 2016, and CYS Insurance's membership in the FHLBC was terminated on February 19, 2017.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and the instructions to the Securities and Exchange Commission ("SEC") Form 10-Q and Article 10, Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The unaudited consolidated financial statements should be read in conjunction with the Company’s audited financial statements as of and for the year ended December 31, 2016, included in the 2016 Annual Report. The results for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year.

The unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries. All intercompany balances and transactions have been eliminated. The unaudited consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make a number of estimates and assumptions that affect the amounts reported in the unaudited consolidated financial statements and accompanying footnotes. Actual results could differ from these estimates and the differences may be material.

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Reclassification

Prior to January 1, 2016, FHLBC Advances were presented and disclosed separately on the consolidated balance sheet and interest expense on all FHLBC Advances was reported in the aggregate with interest expense on repurchase agreements. Effective January 1, 2016, FHLBC Advances are presented on the balance sheet and disclosed in the aggregate, while interest expense on FHLBC Advances is reported separately from interest expense on repurchase agreements. Prior periods have been reclassified to conform to the current period presentation.

Cash and Cash Equivalents

Cash and cash equivalents represent cash held in banks, cash on hand, and liquid investments with original maturities of three months or less. We may have bank balances in excess of federally insured amounts; however, we deposit our cash and cash equivalents with high credit-quality institutions to minimize credit risk exposure. We have not experienced, and do not expect, any losses on our cash or cash equivalents.

Investments in Securities

The Company's investment securities are accounted for in accordance with the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") 320-Investments-Debt and Equity Securities. These investments meet the requirements to be classified as available-for-sale under ASC 320. Therefore, our investment securities are recorded at fair market value on the consolidated balance sheets. The Company has chosen to make a fair value election pursuant to ASC 825-Financial Instruments for its securities. Electing the fair value option requires the Company to record changes in the fair value of investments in the Consolidated Statement of Operations as a component of net unrealized gain (loss) on investments, which in management's view more appropriately reflects the results of operations for a particular reporting period as all securities activities will be recorded in a similar manner. The Company records its security purchase and sale transactions, including forward settling transactions, on a trade date basis. Realized gains and losses on securities transactions are recorded on an identified cost basis.

Agency RMBS

The Company's investments in Agency RMBS consist of pass-through certificates backed by fixed-rate, monthly-reset adjustable-rate loans ("ARMs") and Hybrid ARMs, the principal and interest of which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Hybrid ARMs have interest rates that have an initial fixed period (typically three, five, seven or 10 years) and thereafter reset at regular intervals in a manner similar to ARMs.

Forward Settling Transactions

The Company engages in forward settling transactions to purchase or sell certain securities. Agency RMBS may include forward contracts for Agency RMBS purchases or sales of specified pools on a to-be-announced basis ("TBA Securities") that meet the regular-way scope exception in ASC 815-Derivatives and Hedging ("ASC 815"), and are recorded on a trade date basis to the extent it is probable that we will take or make timely physical delivery of the related securities. The Company maintains security positions such that sufficiently liquid assets will be available to make payment on the settlement date for securities purchased. The Agency RMBS purchased at the forward settlement date are typically priced at a discount to securities for settlement in the current month. Securities purchased on a forward settling basis are carried at fair value and begin earning interest on the settlement date. Gains or losses may occur on these transactions due to changes in market conditions or the failure of counterparties to perform under the contract.

Investment and Derivative Valuation

The Company has a pricing committee responsible for establishing valuation policies and procedures, and reviewing and approving valuations during monthly pricing meetings. The pricing committee is composed of individuals from the finance and investment teams and other members of senior management. See Note 7, Fair Value Measurements, for additional details related to the fair value of the Company's assets and liabilities.

Interest Income

We record interest income and expense on an accrual basis. We accrue interest income based on the outstanding principal amount of the settled securities in our portfolio and their contractual terms. We amortize premiums and discounts using the effective interest method as prepayments occur, and this net amortization is either a reduction of or accretive to interest income from Agency RMBS in the accompanying Consolidated Statements of Operations. The Company does not estimate prepayments when calculating the yield to maturity on Agency RMBS.

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Other Investments

CYS Insurance was a member of the FHLBC. As a condition of its membership in the FHLBC, CYS Insurance was required to maintain FHLBC stock, both for membership and for the level of advances from the FHLBC to CYS Insurance. The Company accounted for its investment in FHLBC stock as a cost method investment in "Other investments" in the accompanying consolidated balance sheets in accordance with ASC 325, Investments - Other. The Company periodically evaluated FHLBC stock for impairment in accordance with ASC 320-Investments-Debt and Equity Securities. Also included in other investments is a net investment in real estate that is recorded at fair value, inclusive of $3.7 million of corresponding mortgage debt, with changes in estimated fair value recognized in the accompanying Consolidated Statements of Operations.

Repurchase Agreements and FHLBC Advances

Prior to the Final Rule effective as of February 19, 2016, which precluded the Company from securing new FHLBC Advances, we entered into FHLBC Advances, some of which had an initial maturity of more than one year that were collateralized by the Company's Agency RMBS and U.S. Treasuries (collectively, "Debt Securities"). The Company chose to make a fair value election pursuant to ASC 825-Financial Instruments for FHLBC Advances with initial terms greater than one year and, therefore, this debt was recorded at fair market value in the accompanying consolidated balance sheets. The unpaid principal balance of FHLBC Advances with initial maturities less than one year generally approximated fair value due to the short-term nature of the instruments. We priced FHLBC Advances with an initial maturity greater than one year daily through a pricing service that used a discounted cash flow model to value the debt, and we periodically validated the prices we received through this process. Changes in the fair market value were recorded in current period earnings in the accompanying Consolidated Statements of Operations as a component of net unrealized gain (loss) on FHLBC Advances. Electing the fair value option permitted the Company to record changes in the fair value of FHLBC Advances along with that of our investments in the Consolidated Statements of Operations which, in management’s view, more appropriately reflect the results of operations for a particular reporting period as all income producing assets and liabilities are recognized in a consistent manner.

Borrowings under repurchase agreements ("repo borrowings") are, and FHLBC Advances were, collateralized by the Company’s Debt Securities. The Company’s repo borrowing counterparties are institutional dealers in fixed income securities and large financial institutions, and CYS Insurance's counterparty for FHLBC Advances was the FHLBC. Collateral pledged on repo borrowings is valued daily, and collateral that was pledged on FHLBC Advances was valued periodically, and our counterparties may require posting of additional collateral when the fair value of pledged collateral declines. Repo borrowing counterparties have, and the FHLBC had, the right to sell or repledge collateral pledged under repo borrowings and FHLBC Advances.

We account for our repo borrowings as short-term indebtedness under ASC 470-Debt; accordingly, these short-term instruments are reflected in our financial statements at their amortized cost, which approximates fair value due to their short-term nature.

Derivative Instruments

Included in Derivative Instruments are interest rate swaps and interest rate caps and TBA Derivatives (defined below). The Company uses interest rate swaps and caps (a "swap" or "cap", respectively) to economically hedge a portion of its exposure to market risks, including interest rate and extension risk. The objective of our risk management strategy is to reduce fluctuations in stockholders’ equity over a range of interest rate scenarios. In particular, we attempt to manage the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates.

During the term of a swap or cap, the Company makes and/or receives periodic payments and records unrealized gains or losses as a result of marking the swap or cap to fair value. We report the periodic payments and amortization of premiums on cap contracts under swap and cap interest expense in the accompanying Consolidated Statements of Operations. When the Company terminates a swap or cap, we record a realized gain or loss equal to the difference between the proceeds from (or the cost of) closing the transaction and the Company's cost basis in the contract, if any. Swaps involve a risk that interest rates will move contrary to the Company’s expectations, thereby increasing the Company’s payment obligation.

The Company's swaps and caps may be subject to a master netting arrangement ("MNA"), pursuant to which the Company may be exposed to credit loss in the event of non-performance by the counterparty to the swap or cap, limited to the fair value of collateral posted in excess of the fair value of the contract in a net liability position and the shortage of the fair value of collateral posted for the contract in a net asset position. As of June 30, 2017 and December 31, 2016, the Company did not anticipate non-performance by any counterparty. Should interest rates move contrary to the Company's expectations, the Company may not achieve the anticipated benefits of the interest rate swap or cap and may realize a loss.

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While the Company's derivative agreements generally permit netting or setting-off derivative assets and liabilities with the counterparty, the Company reports derivative assets and liabilities on a gross basis in the accompanying consolidated balance sheets. Derivatives are accounted for in accordance with ASC 815 which requires recognition of all derivatives as either assets or liabilities at fair value in the accompanying consolidated balance sheets with changes in fair value recognized in the accompanying Consolidated Statements of Operations in "Net realized and unrealized gain (loss) on derivative instruments". Cash receipts and payments related to derivative instruments are classified in the accompanying Consolidated Statements of Cash Flows in accordance with GAAP in both the operating and investing activities sections.

The Company enters into TBA dollar roll transactions whereby the Company is not contractually obligated to accept delivery on the settlement date ("TBA Derivatives"). TBA Derivatives are accounted for as a series of derivative transactions. The fair value of TBA Derivatives is based on similar methods used to value Agency RMBS with gains and losses recorded in Net realized and unrealized gains (losses) on derivative instruments in the accompanying Consolidated Statements of Operations. TBA Derivative transactions involve moving the settlement of a TBA contract out to a later date by entering into an offsetting short 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. The Company records such pair offs on a gross basis such that there is a sale of the original TBA Derivative and a subsequent purchase of a new TBA Derivative.

None of the Company's derivatives have been designated as hedging instruments for accounting purposes. Effective January 1, 2016, the Company recognized all TBAs that do not qualify for the regular-way scope exception under ASC 815 as derivatives.

Income Taxes

The Company has elected to be treated as a REIT under the Code. The Company will generally not be subject to federal income tax to the extent that it distributes 90% of its taxable income, after application of available tax attributes, within the time limits prescribed by the Code and as long as it satisfies the ongoing REIT requirements including meeting certain asset, income and stock ownership tests.

Leases

The Company occupies leased office space. The Company’s lease is accounted for in accordance with ASC 840-Leases, and is classified as an operating lease. Rent expense is amortized on a straight-line basis over the lease term and is included in "General, administrative and other expense" in the accompanying Consolidated Statements of Operations.

Stock-based compensation

The Company applies the provisions of ASC 718-Compensation-Stock Compensation, with regard to its equity incentive plans. ASC 718 covers a wide range of share-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights and employee stock purchase plans. ASC 718 requires that compensation costs relating to stock-based payment transactions be recognized in the consolidated financial statements. Compensation costs related to restricted common shares issued are measured at their estimated fair value at the grant date, and are amortized and expensed over the vesting period on a straight-line basis.

Earnings Per Share ("EPS")

The Company computes basic EPS using the two-class method by dividing net income (loss), after adjusting for the impact of unvested stock awards deemed to be participating securities, by the weighted-average number of common shares outstanding, calculated excluding unvested stock awards. The Company computes diluted EPS by dividing net income (loss), after adjusting for the impact of unvested stock awards deemed to be participating securities, by the weighted-average number of common shares outstanding, calculated excluding unvested stock awards, giving effect to common stock options and warrants, if they are not anti-dilutive. See Note 9, Earnings Per Share for EPS computations.

Recent Accounting Pronouncements

The following table provides a brief description of recent accounting pronouncements that could potentially impact the Company's unaudited consolidated financial statements:

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| Accounting Standard | Description | Required Date of Adoption | Anticipated Effect on the Financial Statements |
|---|---|---|---|
| ASU 2017-09 Compensation - Stock Compensation (Topic 718); Scope of Modification Accounting | On May 10, 2017, the FASB issued ASU 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718, (Compensation - Stock Compensation). Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. | Effective for annual reporting periods, including interim periods within those annual reporting periods, beginning after December 15, 2017.<br><br>Early adoption is permitted, including adoption in any interim period. | Not expected to have a significant impact on the consolidated financial statements. |
| ASU 2017-05 Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets | On February 22, 2017, the FASB issued ASU 2017-05, which clarifies the scope of the Board's recently established guidance on nonfinancial asset derecognition (ASC 610-20) as well as the accounting for partial sales of nonfinancial assets. The ASU conforms the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard (ASC 606, as amended).<br><br>The FASB issued the ASU in response to stakeholder feedback indicating that (1) the meaning of the term "in-substance nonfinancial asset" is unclear because the Board's new revenue standard does not define it and (2) the scope of the guidance on nonfinancial assets is confusing and complex and does not specify how a partial sales transaction should be accounted for or which model entities should apply. | January 1, 2018. The effective date of the new guidance aligns with the requirements in the new revenue standard. If the entity decides to early adopt the ASU's guidance, it must also early adopt ASC 606-Revenue from Contracts with Customers (and vice versa). | Not expected to have a significant impact on the consolidated financial statements. |

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| Accounting Standard | Description | Required Date of Adoption | Anticipated Effect on the Financial Statements |
|---|---|---|---|
| ASU 2017-01 Business Combinations (Topic 805) Clarifying the Definition of a Business | On January 5, 2017, the FASB issued ASU 2017-01 to clarify the definition of a business in ASC 805. The FASB issued the ASU in response to stakeholder feedback that the definition of a business in ASC 805 is being applied too broadly. In addition, stakeholders said that analyzing transactions under the current definition is difficult and costly. Concerns about the definition of a business were among the primary issues raised in connection with the Financial Accounting Foundation’s post-implementation review report on FASB Statement No. 141(R), Business Combinations (codified in ASC 805). The amendments in the ASU are intended to make application of the guidance more consistent and cost-efficient. Real estate is less likely to be a "business" which will lead to more capitalization of transaction costs-vs-expensing. | January 1, 2018 (early adoption permitted). | Not expected to have a significant impact on the consolidated financial statements. |
| ASU 2016-15 Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15") (a consensus of the Emerging Issues Task Force) | On August 26, 2016, the FASB issued ASU 2016-15, which amends ASC 230, Statement of Cash Flows ("ASC 230), to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. ASC 230 lacks consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows. This has led to diversity in practice and, in certain circumstances, financial statement restatements. Consequently, the FASB issued ASU 2016-15 with the intent of reducing diversity in practice with respect to certain types of cash flows. | January 1, 2018 (early adoption is permitted). Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively if retrospective application would be impracticable. | Not expected to have a significant impact on the consolidated financial statements. |
| ASU 2016-02 Leases (Topic 842) | The amendments require lessees to recognize a right-of-use asset and a liability to make lease payments in the balance sheets for most leases. The accounting for lessors is largely unchanged. | January 1, 2019 (early adoption permitted). | Not expected to have a significant impact on the consolidated financial statements. |
| ASU 2016-01 Financial Instruments - Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and | The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. | January 1, 2018 (early adoption permitted for a provision related to presentation of instrument-specific credit risk of liabilities accounted for under the | Not expected to have a significant impact on the consolidated financial statements. |

| | |
|---|---|
| Financial Liabilities | fair value option). |

3. INVESTMENTS IN SECURITIES

The available-for-sale portfolio consisted of the following as of June 30, 2017 and December 31, 2016 (in thousands):

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June 30, 2017

| Asset Type | Amortized Cost | Gross Unrealized Loss | Gross Unrealized Gain | Fair Value |
|---|---|---|---|---|
| Fannie Mae Certificates | | | | |
| Fixed Rate | $8,986,881 | $(21,649 ) | $ 41,581 | $9,006,813 |
| ARMs | 243,346 | (1,303 ) | 1,413 | 243,456 |
| Total Fannie Mae | 9,230,227 | (22,952 ) | 42,994 | 9,250,269 |
| Freddie Mac Certificates | | | | |
| Fixed Rate | 2,355,189 | (11,091 ) | 11,281 | 2,355,379 |
| ARMs | 67,314 | (147 ) | 482 | 67,649 |
| Total Freddie Mac | 2,422,503 | (11,238 ) | 11,763 | 2,423,028 |
| Ginnie Mae Certificates | | | | |
| Fixed Rate | 1,745 | (51 ) | — | 1,694 |
| ARMs | 30,304 | — | 401 | 30,705 |
| Ginnie Mae Certificates - ARMs | 32,049 | (51 ) | 401 | 32,399 |
| Total Agency RMBS | 11,684,779 | (34,241 ) | 55,158 | 11,705,696 |
| U.S. Treasuries | 24,984 | (143 ) | — | 24,841 |
| Total | $11,709,763 | $(34,384 ) | $ 55,158 | $11,730,537 |

December 31, 2016

| Asset Type | Amortized Cost | Gross Unrealized Loss | Gross Unrealized Gain | Fair Value |
|---|---|---|---|---|
| Fannie Mae Certificates | | | | |
| Fixed Rate | $9,505,262 | $(81,783 ) | $ 36,622 | $9,460,101 |
| ARMs | 301,029 | (2,668 ) | 1,571 | 299,932 |
| Total Fannie Mae | 9,806,291 | (84,451 ) | 38,193 | 9,760,033 |
| Freddie Mac Certificates | | | | |
| Fixed Rate | 2,799,604 | (55,624 ) | 7,659 | 2,751,639 |
| ARMs | 50,641 | (514 ) | 606 | 50,733 |
| Total Freddie Mac | 2,850,245 | (56,138 ) | 8,265 | 2,802,372 |
| Ginnie Mae Certificates | | | | |
| Fixed Rate | 1,856 | (54 ) | — | 1,802 |
| ARMs | 34,390 | — | 448 | 34,838 |
| Total Ginnie Mae | 36,246 | (54 ) | 448 | 36,640 |
| Total Agency RMBS | 12,692,782 | (140,643 ) | 46,906 | 12,599,045 |
| U.S. Treasuries | 49,952 | (266 ) | — | 49,686 |
| Total | $12,742,734 | $(140,909) | $ 46,906 | $12,648,731 |

The following table presents the gross unrealized loss and fair values of our available-for-sale investments by length of time that such securities have been in a continuous unrealized loss position as of June 30, 2017 and December 31, 2016 (in thousands):

| | Unrealized loss positions | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | Greater than 12 months | | Total | |
| As of | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| June 30, 2017 | $4,711,452 | $(34,384 ) | $ — | $ — | $4,711,452 | $(34,384 ) |
| December 31, 2016 | 9,264,265 | (140,909 ) | — | — | 9,264,265 | (140,909 ) |

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The following table summarizes the Company’s available-for-sale investments as of June 30, 2017 and December 31, 2016, according to their estimated remaining weighted-average maturity classifications:

| | June 30, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| | Fair Value | Amortized Cost | Fair Value | Amortized Cost |
| Less than one year | $24,841 | $24,984 | $— | $— |
| Greater than one year through five years | 6,877,266 | 6,849,276 | 3,765,037 | 3,744,614 |
| Greater than five years through ten years | 4,828,430 | 4,835,503 | 8,864,309 | 8,978,537 |
| Greater than ten years | — | — | 19,385 | 19,583 |
| Total | $11,730,537 | $11,709,763 | $12,648,731 | $12,742,734 |

The following table summarizes our net realized gain (loss) from the sale of available-for-sale investments for the three months ended June 30, 2017 and 2016 (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Available-for-sale investments, at cost | $1,265,490 | $5,408,055 | $4,863,982 | $6,805,243 |
| Proceeds from sale of available-for-sale investments | 1,245,659 | 5,444,414 | 4,778,107 | 6,842,804 |
| Net realized gain (loss) on sale of available-for-sale investments | $(19,831) | $36,359 | (85,875) | 37,561 |
| | | | | |
| Gross gain on sale of available-for-sale investments | $2,270 | $36,743 | 10,873 | 42,126 |
| Gross (loss) on sale of available-for-sale investments | (22,101) | (384) | (96,748) | (4,565) |
| Net realized gain (loss) on sale of available-for-sale investments | $(19,831) | $36,359 | $(85,875) | $37,561 |

The components of the carrying value of available-for-sale securities at June 30, 2017 and December 31, 2016 are presented below. A premium purchase price is generally due to the average coupon interest rates on these investments being higher than prevailing market rates; similarly, a discount purchase price is generally due to the average coupon interest rate on these investments being lower than prevailing market rates.

| (in thousands) | June 30, 2017 | December 31, 2016 |
|---|---|---|
| Principal balance | $11,341,310 | $12,285,204 |
| Unamortized premium | 368,542 | 458,709 |
| Unamortized discount | (89) | (1,179) |
| Gross unrealized gains | 55,158 | 46,906 |
| Gross unrealized losses | (34,384) | (140,909) |
| Fair value | $11,730,537 | $12,648,731 |

As of June 30, 2017, the weighted-average coupon interest rate on the Company's Agency RMBS and U.S. Treasuries was 3.46% and 0.63%, respectively. As of December 31, 2016, the weighted-average coupon interest rate on the Company's Agency RMBS and U.S. Treasuries was 3.37% and 0.63%, respectively. Actual maturities of Agency RMBS are generally shorter than their stated contractual maturities (which range up to 30 years), because they are affected by the contractual lives of the underlying mortgages, periodic payments and principal prepayments.

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Credit Risk

The Company believes it has minimal exposure to credit losses on its Debt Securities at June 30, 2017 and December 31, 2016. Principal and interest payments on Agency RMBS are guaranteed by Freddie Mac and Fannie Mae, while principal and interest payments on Ginnie Mae RMBS and U.S. Treasuries are backed by the full faith and credit of the U.S. government. Since September 2008, both Freddie Mac and Fannie Mae have operated in the conservatorship of the U.S. government. As of June 30, 2017, S&P maintained its AA+ rating for the U.S. government, while Fitch and Moody's rated the U.S. government AAA and Aaa, respectively. Since Fannie Mae and Freddie Mac are in U.S. government conservatorship, the implied credit ratings of Agency RMBS are similarly rated.

4. DERIVATIVE INSTRUMENTS

The Company enters into swaps and caps as part of its efforts to manage its interest rate exposure. The Company had the following activity in interest rate swap and cap transactions during the three and six months ended June 30, 2017 and 2016 (in thousands):

| June 30, 2017 | | | June 30, 2016 | | |
|---|---|---|---|---|---|
| Trade Date | Transaction | Notional | Trade Date | Transaction | Notional |
| April 2017 | Terminated | (500,000 ) | January 2016 | Terminated | $(500,000 ) |
| April 2017 | Opened | 500,000 | May 2016 | Terminated | (2,200,000 ) |
| May 2017 | Terminated | (500,000 ) | May 2016 | Opened | 1,700,000 |
| May 2017 | Opened | 500,000 | Net Decrease | | $(1,000,000) |
| June 2017 | Opened | 100,000 | | | |
| Net Increase | | $100,000 | | | |

As of June 30, 2017 and December 31, 2016, the Company had pledged Debt Securities with a fair value of $58.1 million and $72.5 million, respectively, as collateral on swaps and caps. As of June 30, 2017 and December 31, 2016, the Company had no cash pledged as collateral on swaps and caps. As of June 30, 2017, the Company had Agency RMBS and U.S. Treasuries of $9.1 million and cash of $64.4 million pledged to it as collateral for its derivative instruments. As of December 31, 2016, the Company had Agency RMBS and U.S. Treasuries of $33.0 million and cash of $90.8 million pledged to it as collateral for its derivative instruments. The table below summarizes information about our derivative and other hedging instrument assets and liabilities as of June 30, 2017 and December 31, 2016 (in thousands):

| | | June 30, 2017 | | December 31, 2016 | |
|---|---|---|---|---|---|
| Derivative and Other Hedging Instruments - Assets | Consolidated Balance Sheets | Notional | Fair Value | Notional | Fair Value |
| Interest Rate Swaps | Derivative assets, at fair value | $5,550,000 | $64,513 | $6,450,000 | $80,608 |
| Interest Rate Caps | Derivative assets, at fair value | 2,500,000 | 27,731 | 2,500,000 | 42,532 |
| TBA Derivatives | Derivative assets, at fair value | 255,600 | 276 | 2,417,000 | 19,416 |
| Total derivative assets at fair value | | $8,305,600 | $92,520 | $11,367,000 | $142,556 |
| Derivative and Other Hedging Instruments - Liabilities | Consolidated Balance Sheets | Notional | Fair Value | Notional | Fair Value |
| Interest Rate Swaps | Derivative liabilities, at fair value | $1,000,000 | $(883 ) | $— | $— |
| Interest Rate Caps | Derivative liabilities, at fair value | — | — | — | — |
| TBA Derivatives | Derivative liabilities, at fair value | 1,486,850 | (5,842 ) | 1,870,000 | (6,051 ) |
| Total derivative liabilities at fair value | | $2,486,850 | $(6,725 ) | $1,870,000 | $(6,051 ) |

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The average notional value of the Company's TBA Derivatives during the three and six months ended June 30, 2017 was $1.7 billion and $1.6 billion, respectively. The average notional value of the Company's TBA Derivatives during the three and six months ended June 30, 2016 was $1.1 billion and $1.3 billion, respectively. The average notional value of the Company's swaps and caps during the three and six months ended June 30, 2017 was $9.0 billion. The average notional value of the Company's swaps and caps during the three and six months ended June 30, 2016 was $9.7 billion and $9.9 billion, respectively.
The following table presents information about the net realized and unrealized gain (loss) on swap, cap and TBA Derivatives for the three and six months ended June 30, 2017 and 2016 (in thousands):

| | | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|---|
| Derivative Instrument Type | Location of Gain (Loss) on Derivative Instruments | 2017 | 2016 | 2017 | 2016 |
| Interest rate swaps and caps | Swap and cap interest expense | $(8,434) | $(14,779) | $(16,761) | $(33,177) |
| Interest rate swaps, caps and TBA Derivatives | Net realized and unrealized gain (loss) on derivative instruments | (18,324) | (44,535) | (19,336) | (185,059) |
| Interest rate swaps, caps and TBA Derivatives | Net gain (loss) on derivative instruments | $(26,758) | $(59,314) | $(36,097) | $(218,236) |

The swap and cap notional was $9.1 billion at June 30, 2017 compared to $9.0 billion at December 31, 2016, and respectively 97% and 92% of our repo borrowings at June 30, 2017 and December 31, 2016.

5. REPURCHASE AGREEMENTS AND FHLBC ADVANCES

The Company leverages its Debt Securities portfolio primarily through repo borrowings. Each of the Company's repo borrowings bears interest at a rate based on a spread above or below the London Interbank Offered Rate ("LIBOR"). While repo borrowings are the Company's principal source of borrowings, the Company may issue long-term debt (i.e., debt with an initial term greater than one year) to diversify credit sources and to manage interest rate and duration risk.
Certain information with respect to the Company’s repo borrowings outstanding at the balance sheet dates is summarized in the table below.

| (in thousands) | June 30, 2017 | December 31, 2016 |
|---|---|---|
| Outstanding repurchase agreements | $9,370,845 | $9,691,544 |
| Interest accrued thereon | $17,649 | $16,170 |
| Weighted-average borrowing rate | 1.23% | 0.89% |
| Weighted-average remaining maturity (in days) | 79.9 | 53.3 |
| Fair value of pledged collateral[(1)] | $9,798,063 | $10,198,641 |

(1) Collateral for repo borrowings consists of Agency RMBS and U.S. Treasuries.

The following table presents the remaining contractual maturity of repo borrowings by collateral type as of June 30, 2017 and December 31, 2016 (in thousands):

| | Remaining contractual maturity | | | |
|---|---|---|---|---|
| June 30, 2017 | Up to 30 days | 30-90 days | Greater than 90 days | Total |
| Agency RMBS | $3,399,706 | $3,114,492 | $2,856,647 | $9,370,845 |
| Total | $3,399,706 | $3,114,492 | $2,856,647 | $9,370,845 |
| | | | | |
| December 31, 2016 | | | | |
| Agency RMBS | $4,113,286 | $3,694,937 | $1,883,321 | $9,691,544 |

| | | | | |
|---|---|---|---|---|
| Total | $4,113,286 | $3,694,937 | $1,883,321 | $9,691,544 |

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At June 30, 2017 and December 31, 2016, our amount at risk with any individual counterparty related to our repo borrowings was less than 2.2% and 2.6% of stockholders' equity, respectively. The amount at risk is defined as the excess of the fair value of the securities, including accrued interest, and cash, pledged to secure the repurchase agreement, over the amount of the repurchase agreement liability adjusted for accrued interest.

Prior to the issuance of the Final Rule, pursuant to the FHLBC terms and conditions of membership and applicable credit policies, CYS Insurance was able to obtain FHLBC Advances, secured by eligible collateral, including, but not limited to, residential mortgage-backed securities. As a direct result of the Final Rule, all FHLBC Advances were required to be repaid on or before February 19, 2017. The Company repaid all of its remaining FHLBC Advances prior to September 30, 2016.

6. PLEDGED ASSETS

Assets Pledged to Counterparties

The following tables summarize our assets pledged as collateral under repo borrowings, and derivative instruments by type, including securities pledged related to securities purchased or sold but not yet settled, as of June 30, 2017 and December 31, 2016 (in thousands):

June 30, 2017

| Asset Type | Repurchase Agreements | Derivative Instruments* | Forward Settling Trades (TBAs) | Total |
|---|---|---|---|---|
| Agency RMBS - fair value | $9,798,173 | $ 34,751 | $ 1,980 | $9,834,904 |
| U.S. Treasuries - fair value | 301 | 26,126 | — | 26,427 |
| Accrued interest on pledged securities | 27,233 | 91 | 10 | 27,334 |
| Cash | — | — | — | — |
| Total | $9,825,707 | $ 60,968 | $ 1,990 | $9,888,665 |

December 31, 2016

| Asset Type | Repurchase Agreements | Derivative Instruments* | Forward Settling Trades (TBAs) | Total |
|---|---|---|---|---|
| Agency RMBS - fair value | $10,197,244 | $ 33,311 | $ 2,610 | $10,233,165 |
| U.S. Treasuries - fair value | 1,398 | 45,730 | — | 47,128 |
| Accrued interest on pledged securities | 27,730 | 87 | 7 | 27,824 |
| Cash | — | 600 | — | 600 |
| Total | $10,226,372 | $ 79,728 | $ 2,617 | $10,308,717 |

* Includes amounts related to TBA Derivatives.

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Assets Pledged from Counterparties

If the estimated fair value of our investment securities pledged as collateral increases due to changes in interest rates or other factors, we may require counterparties to return collateral to us, which may be in the form of identical or similar securities, or cash. As of June 30, 2017 and December 31, 2016, we had assets pledged to us as collateral under our repurchase agreements, derivative agreements and TBAs as summarized in the tables below (in thousands):

June 30, 2017

| Asset Type | Repurchase Agreements | Derivative Instruments* | Forward Settling Trades (TBAs) | Total |
|---|---|---|---|---|
| Agency RMBS - fair value | $— | $ — | $ — | $— |
| U.S. Treasuries - fair value | 411 | 9,115 | — | 9,526 |
| Accrued interest on pledged securities | 2 | 38 | — | 40 |
| Cash | — | 64,402 | — | 64,402 |
| Total | $413 | $ 73,555 | $ — | $73,968 |

December 31, 2016

| Asset Type | Repurchase Agreements | Derivative Instruments* | Forward Settling Trades (TBAs) | Total |
|---|---|---|---|---|
| Agency RMBS - fair value | $— | $ 3,016 | $ 1,293 | $4,309 |
| U.S. Treasuries - fair value | — | 29,937 | — | 29,937 |
| Accrued interest on pledged securities | — | 1,788 | 4 | 1,792 |
| Cash | — | 90,779 | 724 | 91,503 |
| Total | $— | $ 125,520 | $ 2,021 | $127,541 |

* Includes amounts related to TBA Derivatives.

Cash collateral received is not restricted as to use and is recognized in "Cash and cash equivalents" with a corresponding amount recognized in "Payable for cash received as collateral" in the accompanying consolidated balance sheets. The Company's collateral received in the form of securities from counterparties is disclosed in Note 4, Derivative Instruments.

The Company’s Master Repurchase Agreements ("MRAs"), Master Securities Forward Transaction Agreements ("MSFTA") and ISDA Master Agreements ("ISDAs", and together with MRAs, the “Master Agreements”) generally provide (unless specified otherwise) that the Company may sell, pledge, rehypothecate, assign, invest, use, commingle, dispose of, or otherwise use in its business any posted collateral it holds, free from any claim or right of any nature whatsoever of the counterparty. MSFTAs govern the considerations and factors surrounding the settlement of certain forward settling transactions, TBAs and secured borrowing transactions by and between the Company and our counterparties. As of June 30, 2017, $9.5 million of assets were pledged to the Company under the Master Agreements, of which $1.6 million were repledged by the Company to other counterparties at June 30, 2017. As of December 31, 2016, $34.2 million of assets were pledged to the Company under the Master Agreements, of which $2.7 million were repledged by the Company to other counterparties at December 31, 2016. Since title to these assets remain with the counterparty under the Master Agreements, these assets are not reflected in the accompanying consolidated balance sheets.

Offsetting Assets and Liabilities

Certain of our repo borrowings and derivative transactions are governed by underlying agreements that generally provide for a right of offset under MNAs (or similar agreements), including in the event of default or in the event of bankruptcy of either party to the transactions. Under GAAP, if the Company has a contractual right of offset, the Company may offset the related asset and liability and report the net amount in the accompanying consolidated balance sheets. However, the Company reports amounts subject to its MRAs and ISDAs in the consolidated balance sheets on a gross basis without regard to such rights of offset.

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At June 30, 2017 and December 31, 2016, the Company's derivative assets and liabilities (by type) are as follows (in thousands):

| June 30, 2017 | Assets | Liabilities |
|---|---|---|
| Interest rate swap contracts | $64,513 | $ 883 |
| Interest rate cap contracts | 27,731 | — |
| TBA derivatives | 276 | 5,842 |
| Total derivative assets and liabilities | 92,520 | 6,725 |
| Derivatives not subject to a Master Netting Agreement | 61,620 | 455 |
| Total assets and liabilities subject to a Master Netting Agreement | $30,900 | $ 6,270 |

| December 31, 2016 | Assets | Liabilities |
|---|---|---|
| Interest rate swap contracts | $80,608 | $ — |
| Interest rate cap contracts | 42,532 | — |
| TBA derivatives | 19,416 | 6,051 |
| Total derivative assets and liabilities | 142,556 | 6,051 |
| Derivatives not subject to a Master Netting Agreement | 75,033 | — |
| Total assets and liabilities subject to a Master Netting Agreement | $67,523 | $ 6,051 |

Below are summaries of the Company's assets and liabilities subject to offsetting provisions (in thousands):

| Assets | | | Gross Amounts Not Offset in the Consolidated Balance Sheets | | |
|---|---|---|---|---|---|
| As of | Description | Amount of Assets Presented in the Consolidated Balance Sheets | Instruments Available for Offset | Collateral Received(1) | Net Amount(2) |
| June 30, 2017 | Derivative assets | $ 30,900 | $704 | $ 26,452 | $ 3,744 |
| December 31, 2016 | Derivative assets | 67,523 | 3,145 | 49,801 | 14,577 |

| Liabilities | | | Gross Amounts Not Offset in the Consolidated Balance Sheets | | |
|---|---|---|---|---|---|
| As of | Description | Amount of Liabilities Presented in the Consolidated Balance Sheets | Instruments Available for Offset | Collateral Pledged(1) | Net Amount(2) |
| June 30, 2017 | Derivative liabilities | $ 6,270 | $ 704 | $ 5,566 | $ — |
| June 30, 2017 | Repurchase agreements and FHLBC Advances | 9,370,845 | — | 9,370,845 | — |
| December 31, 2016 | Derivative liabilities | 6,051 | 3,145 | 2,906 | — |
| December 31, 2016 | | 9,691,544 | — | 9,691,544 | — |

Repurchase agreements and FHLBC Advances

(1) Collateral consists of Agency RMBS, U.S. Treasuries and Cash and cash equivalents. Excess collateral pledged is not shown for financial reporting purposes.
(2) Net amount represents the net amount receivable from (in the case of assets) and payable to (in the case of liabilities) the counterparty in the event of default.

## 7. FAIR VALUE MEASUREMENTS

The Company’s valuation techniques are based on observable and unobservable inputs. ASC 820 establishes a fair value hierarchy that prioritizes and ranks the level of market price observability used in measuring financial instruments. Market price observability is affected by a number of factors, including the type of financial instrument, the characteristics specific to the financial instrument, and the state of the marketplace, including the existence and transparency of transactions between market participants. Financial instruments with readily available quoted prices in active markets generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Financial instruments measured and reported at fair value are classified and disclosed based on the observability of inputs used in the determination, as follows:

Level 1: Generally includes only unadjusted quoted prices that are available in active markets for identical financial instruments as of the reporting date.

Level 2: Pricing inputs include quoted prices in active markets for similar instruments, quoted prices in less active or inactive markets for identical or similar instruments where multiple price quotes can be obtained, and other observable inputs, such as interest rates and yield curves.

Level 3: Pricing inputs are unobservable for the financial instruments and include situations where there is little, if any, market activity for the financial instrument. These inputs require significant judgment or estimation by management when determining fair value and generally represent anything that does not meet the criteria of Levels 1 and 2.

The estimated value of each asset reported at fair value using Level 3 inputs is approved by an internal committee composed of members of senior management, including our Chief Executive Officer, Chief Financial Officer, and other senior officers.

Excluded from the tables below are short-term financial instruments carried in our unaudited consolidated financial statements at cost basis, which is deemed to approximate fair value, primarily due to the short duration of these instruments, including cash and cash equivalents, receivables, payables, and repo borrowings with initial terms of one year or less.

Agency RMBS and U.S. Treasuries are generally valued based on prices provided by third-party pricing services, as derived from such services' pricing models. Inputs to the models may include, but are not limited to, reported trades, executable bid and ask prices, broker quotations, prices or yields of securities with similar characteristics, prepayment rates, benchmark curves or information pertaining to the issuer, as well as industry and economic events. The pricing services may also use a matrix approach, which considers information regarding securities with similar characteristics to determine the valuation for a security.

All valuations we receive from third-party pricing services or broker quotes are non-binding. The pricing committee reviews all prices. To date, the Company has not adjusted any of the prices received from third-party pricing services or brokers. Our pricing review includes comparisons of similar market transactions, alternative third-party pricing services and broker quotes, or comparisons to a pricing model. To ensure proper classification within the fair value hierarchy in ASC 820, the Company reviews the third-party pricing services' methodologies periodically to understand whether observable or unobservable inputs are being used.

We generally value swaps and caps using prices provided by broker quotations. Such broker quotations are based on the present value of fixed and projected floating rate cash flows over the term of the swap contract. Future cash flows are discounted to present value using swap rates provided by electronic data services or by brokers.

"Other investments" is comprised of our investment in FHLBC stock and our net investment in a real estate asset at fair value, inclusive of the corresponding $3.7 million and $3.8 million of mortgage debt at June 30, 2017 and December 31, 2016, respectively. Investment in real estate is considered to be a Level 3 asset to which we periodically apply valuation techniques and/or impairment analysis.

The following tables provide a summary of the Company’s assets and liabilities that are measured at fair value on a recurring basis, as of June 30, 2017 and December 31, 2016 (in thousands):

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| June 30, 2017 | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Agency RMBS | $— | $11,705,696 | $— | $11,705,696 |
| U.S. Treasuries | 24,841 | — | — | 24,841 |
| Derivative assets | — | 92,520 | — | 92,520 |
| Other investments | — | — | 8,028 | 8,028 |
| Total | $24,841 | $11,798,216 | $8,028 | $11,831,085 |
| Liabilities | | | | |
| Derivative liabilities | — | 6,725 | — | 6,725 |
| Total | $— | $6,725 | $— | $6,725 |

| December 31, 2016 | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Agency RMBS | $— | $12,599,045 | $— | $12,599,045 |
| U.S. Treasuries | 49,686 | — | — | 49,686 |
| Derivative assets | — | 142,556 | — | 142,556 |
| Other investments | — | — | 8,028 | 8,028 |
| Total | $49,686 | $12,741,601 | $8,028 | $12,799,315 |
| Liabilities | | | | |
| FHLBC Advances | — | — | — | — |
| Derivative liabilities | — | 6,051 | — | 6,051 |
| Total | $— | $6,051 | $— | $6,051 |

The table below presents a reconciliation of changes in Other investments classified as Level 3 and measured at fair value on a recurring basis in the accompanying consolidated balance sheets for the three months ended June 30, 2017 and 2016.

Level 3 Fair Value Reconciliation

| (In thousands) | Three and Six Months Ended June 30, | |
|---|---|---|
| Other investments | 2017 | 2016 |
| Beginning balance Level 3 assets | $8,028 | $8,028 |
| Change in net unrealized gain (loss) | — | — |
| Gross purchases | — | — |
| Gross sales | — | — |
| Net gain (loss) on sales | — | — |
| Transfers into (out of) Level 3 | — | — |
| Ending balance Level 3 assets | $8,028 | $8,028 |

The fair value of our net investment in a real estate asset is primarily derived internally, and is based on inputs observed from sales transactions of similar assets. We also rely on available industry information about capitalization rates and expected trends in rents and occupancy in determining estimates of the fair value of real estate. The significant unobservable input used in the fair value measurement of our net investment in real estate is the capitalization rate, which the Company estimated to be between 4.0% and 4.9% at June 30, 2017 and December 31, 2016.

8. STOCKHOLDERS' EQUITY

The Company has authorized 500,000,000 shares of common stock having a par value of $0.01 per share. As of June 30, 2017 and December 31, 2016, the Company had issued and outstanding 151,731,146 and 151,434,917 shares

of common stock, respectively.
The Company has authorized 50,000,000 shares of preferred stock having a par value of $0.01 per share. As of June 30, 2017 and December 31, 2016, 3,000,000 shares of 7.75% Series A Cumulative Redeemable Preferred Stock ($25.00

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liquidation preference) were issued and outstanding. As of June 30, 2017 and December 31, 2016, 8,000,000 shares of 7.50% Series B Cumulative Redeemable Preferred Stock ($25.00 liquidation preference) were issued and outstanding. The Series A Preferred Stock and Series B Preferred Stock are not redeemable before August 3, 2017 and April 30, 2018, respectively, except under circumstances where it is necessary to preserve the Company's qualification as a REIT, for federal income tax purposes, or the occurrence of a change of control. On or after August 3, 2017 and April 30, 2018, the Company may, at its option, redeem any or all of the shares of the Series A Preferred Stock and Series B Preferred Stock, respectively, at $25.00 per share plus any accumulated and unpaid dividends to, but not including, the respective redemption date. The Series A Preferred Stock and Series B Preferred Stock have no stated maturity, and are not subject to a sinking fund requirement or mandatory redemption.

Equity Offerings

On May 22, 2017, the Company filed an automatically effective shelf registration statement on Form S-3 with the SEC (the "Registration Statement"). The Company may offer and sell, from time to time, shares of common stock, preferred stock and debt securities in one or more offerings pursuant to the prospectus that is a part of the registration statement. As of June 30, 2017, the Company had not issued any shares of common stock, preferred stock or debt securities under the Registration Statement.

Dividend Reinvestment and Direct Stock Purchase Plan ("DSPP")

The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of common stock by reinvesting some or all cash dividends received on shares of common stock. Stockholders may also make optional cash purchases of shares of common stock subject to certain limitations detailed in the respective plan prospectus. For the six months ended June 30, 2017 the Company issued 1,618 shares for net proceeds of $14 thousand. For the six months ended June 30, 2016 the Company did not issue any shares under the DSPP. As of June 30, 2017 and December 31, 2016, there were approximately 4.1 million shares available for issuance under the DSPP.

Share Repurchase Program

On November 15, 2012, the Company announced that its Board of Directors authorized the repurchase of shares of the Company’s common stock having an aggregate value of up to $250 million. Pursuant to this program, through July 20, 2014, the Company repurchased approximately $115.7 million in aggregate value of its shares of common stock on the open market. On July 21, 2014, the Company announced that its Board of Directors authorized the repurchase of shares of the Company's common stock having an aggregate value of up to $250 million, which included approximately $134.3 million available for repurchase under the November 2012 authorization. Subsequently, during 2014 we repurchased 172,549 shares at a weighted-average purchase price of $8.88 per share, for an aggregate purchase price of approximately $1.5 million. For the year ended December 31, 2015, the Company repurchased 10,559,493 shares at a weighted-average purchase price of $8.28 per share for an aggregate purchase price of approximately $87.7 million. For the year ended December 31, 2016, the Company repurchased 673,166 shares at a weighted-average purchase price of $7.85 per share for an aggregate purchase price of approximately $5.3 million. Accordingly, the Company was authorized to repurchase shares of its common stock of approximately $155.5 million as of December 31, 2016.

For the six months ended June 30, 2017, we did not repurchase any shares of the Company's common stock. For the six months ended June 30, 2016, we repurchased 673,166 shares of the Company's common stock at a weighted-average purchase price of $7.85, for an aggregate purchase price of approximately $5.3 million. Accordingly, the Company was authorized to repurchase shares of its common stock of approximately $155.5 million as of June 30, 2017 and June 30, 2016.

Restricted Stock Awards

For the six months ended June 30, 2017 and 2016, the Company granted 339,132 and 357,349 shares of restricted stock, respectively, to certain of its directors, officers and employees.

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9. EARNINGS PER SHARE

Components of the computation of basic and diluted earnings per share ("EPS") are as follows (in thousands except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net income (loss) | $50,225 | $56,210 | $84,245 | $117,541 |
| Less dividends on preferred shares | (5,203) | (5,203) | (10,406) | (10,406) |
| Net income (loss) available to common stockholders | 45,022 | 51,007 | 73,839 | 107,135 |
| Less dividends paid: | | | | |
| Common shares | (37,700) | (37,587) | (75,394) | (76,713) |
| Unvested shares | (232) | (262) | (465) | (534) |
| Undistributed earnings (loss) | 7,090 | 13,158 | (2,020) | 29,888 |
| Basic weighted-average shares outstanding: | | | | |
| Common shares | 150,800 | 150,405 | 150,691 | 150,591 |
| Basic earnings (loss) per common share: | | | | |
| Distributed earnings | $0.25 | $0.25 | $0.50 | $0.51 |
| Undistributed earnings (loss) | 0.05 | 0.09 | (0.01) | 0.20 |
| Basic earnings (loss) per common share | $0.30 | $0.34 | $0.49 | $0.71 |
| Diluted weighted-average shares outstanding: | | | | |
| Common shares | 150,800 | 150,405 | 150,691 | 150,591 |
| Net effect of dilutive stock options [1] | — | — | — | — |
| | 150,800 | 150,405 | 150,691 | 150,591 |
| Diluted earnings (loss) per common share: | | | | |
| Distributed earnings | $0.25 | $0.25 | $0.50 | $0.51 |
| Undistributed earnings | 0.05 | 0.09 | (0.01) | 0.20 |
| Diluted earnings (loss) per common share | $0.30 | $0.34 | $0.49 | $0.71 |

(1) For the three and six months ended June 30, 2017 and 2016, the Company had no stock options outstanding.

10. COMMITMENTS AND CONTINGENCIES

The Company enters into certain agreements that contain a variety of indemnifications, principally with broker-dealers. As of June 30, 2017 and December 31, 2016, no claims have been asserted against the Company under these indemnification agreements. Accordingly, the Company has no liabilities recorded for these agreements as of June 30, 2017 and December 31, 2016.

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The Company occupied leased office space for which the term expired on June 30, 2016. In September 2015, the Company entered into a new lease agreement with a commencement date of January 1, 2016, and an estimated rent commencement date of July 1, 2016 (the "New Lease"). The New Lease has an initial term of 84 months from the rent commencement date. All leases have been classified as operating leases. The Company’s aggregate future minimum lease payments total approximately $2.3 million.  The following table details the lease payments (in thousands):

| Years Ending December 31, | Lease Commitments |
|---|---|
| 2017 (remaining) | $ 179 |
| 2018 | 363 |
| 2019 | 373 |
| 2020 | 383 |
| 2021 | 393 |
| Thereafter | 606 |
| | $ 2,297 |

11. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through July 27, 2017, the date these financial statements were issued, and determined that no events have occurred that would require adjustments to or disclosures in the accompanying unaudited consolidated financial statements.

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

CYS Investments, Inc. (the "Company", "we", "us", or "our") is a specialty finance company created with the objective of achieving consistent risk-adjusted investment income. Management’s Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to provide the reader of the Company’s unaudited consolidated financial statements and accompanying notes with a narrative of management's perspective on the business underlying those financial statements and its financial condition and results of operations during the periods presented. The Company’s MD&A is comprised of the following sections:

- Forward-Looking Statements,
- Executive Overview,
- Trends and Recent Market Activity,
- Financial Condition,
- Results of Operations,
- Off-Balance Sheet Arrangements,
- Liquidity and Capital Resources,
- Quantitative and Qualitative Disclosures about Short-Term Borrowings, and
- Inflation

The following information should be read in conjunction with our unaudited consolidated financial statements and accompanying notes included in Item 1 of this Quarterly Report on SEC Form 10-Q ("Quarterly Report"), as well as our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed on February 17, 2017 (the "2016 Annual Report").

Forward Looking Statements

When used in this Quarterly Report, in future filings with the 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," "may," "will," "anticipate," "estimate," "plan," "continue," "intend," "should,” or the negative of these words and 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 Quarterly Report include, but are not limited to, statements about the following:

- the effect of movements in interest rates on our assets, liabilities, and hedging instruments, and our net income;
- our investment, financing and hedging strategies;
- the effect of U.S. government and foreign central bank actions on interest rates and the housing and credit markets, government sponsored entities and the economy;
- the effect of actual or proposed actions of the U.S. Federal Reserve (the "Fed"), the Federal Housing Finance Agency (the "FHFA") and the Fed Open Market Committee (the "FOMC") with respect to monetary policy, interest rates, inflation, unemployment or reducing the purchase of assets by the Fed;
- the effect of regulations that prevent or restrict the use of Agency RMBS or U.S. Treasuries as collateral for borrowings;
- the supply and availability of Agency RMBS;
- the effect of increased prepayment rates on the value of our assets;
- our ability to convert our assets into cash and cash equivalents or extend the financing terms related to our assets;
- the effect of widening credit spreads or shifts in the yield curve on the value of our assets and investment strategy;
- the types of indebtedness we may incur;
- our ability to achieve anticipated benefits from interest rate swaps and caps;
- our ability to quantify risks based on historical experience;

- our ability to be taxed as a real estate investment trust ("REIT") and to maintain an exemption from registration under the Investment Company Act of 1940, as amended (the "Investment Company Act");
- the tax limitations of capital loss carryforwards;
- our assessment of counterparty risk and/or the rise of counterparty defaults;
- our ability to meet short-term liquidity requirements with our cash flow from operations and borrowings;
- the effect of rising interest rates on unemployment, inflation and mortgage supply and demand;
- our liquidity;
- changes in our investment guidelines and the composition of our investment portfolio;

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- our asset valuation policies; and
- our dividend distribution policy.

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. The following factors could cause actual results to vary from our forward-looking statements:

- the factors referenced in this Quarterly Report;
- changes in our investment, financing and hedging strategies;
- the liquidity of our portfolio and our ability to borrow to finance our assets;
- the adequacy of our cash flow from operations and borrowings to meet our short- and long-term liquidity requirements;
- unanticipated changes in our industry, interest rates, the credit markets, the general economy or the real estate market;
- changes in interest rates and the market value of our Agency RMBS;
- changes in the prepayment rates on the mortgage loans underlying our Agency RMBS;
- actions by the U.S. government or the Fed that impact the value of our Agency RMBS, interest rates or the economy;
- changes in regulations affecting our business;
- changes in the U.S. government's credit rating or ability to pay its debts;
- our ability to maintain our qualification as a REIT for federal income tax purposes;
- our ability to maintain our exemption from registration under the Investment Company Act and the availability of such exemption in the future; and
- risks associated with investing in real estate assets, including changes in business conditions and the general economy.

These and other risks, uncertainties and factors, including those described elsewhere in this Quarterly Report, and in the Company's 2016 Annual Report, which has been filed with the Securities and Exchange Commission, 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.

Executive Overview

We seek to achieve our objective of earning consistent risk-adjusted investment income by investing on a leveraged basis primarily in Agency RMBS. These investments consist of residential mortgage pass-through securities for which the principal and interest payments are guaranteed by a government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or by a U.S. government agency, such as the Government National Mortgage Association ("Ginnie Mae") (collectively referred to as "GSEs" and each a "GSE"). We also may invest in debt securities issued by the United States Department of Treasury ("U.S. Treasuries"), collateralized mortgage obligations issued by a government agency or GSE that are collateralized by Agency RMBS ("CMOs"), or securities issued by a GSE that are not backed by collateral but, in the case of government agencies, are backed by the full faith and credit of the U.S. government, and, in the case of GSEs, are backed by the integrity and creditworthiness of the issuer ("U.S. Agency Debentures").

We commenced operations in February 2006, and completed our initial public offering in June of 2009. Our common stock, our 7.75% Series A Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series A Preferred Stock"), and our 7.50% Series B Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series B Preferred Stock"), trade on the New York Stock Exchange under the symbols "CYS," "CYS PrA" and "CYS PrB," respectively.

We earn income from our investment portfolio which, as of June 30, 2017, was comprised principally of the Company's Agency RMBS and U.S. Treasuries (collectively, the "Debt Securities"). We finance our investments primarily through borrowings under repurchase agreements ("repo borrowings"), and, prior to the effective date of the Final Rule (as defined below) on February 19, 2016, FHLBC Advances (see further discussion below). Our economic net interest income, a non-GAAP measure, described in "Results of Operations" below, is generated primarily from the net spread, or difference, between the interest income we earn on our investment portfolio and the cost of our borrowings and hedging activities. The amount of economic net interest income we earn on our investments depends in part on our ability to control our financing costs, which comprise a significant portion of our operating expenses. Economic interest expense is comprised of interest expense, as computed in accordance with GAAP, plus swap and cap interest expense used to hedge our cost of funds, a component of net gain (loss) on derivative instruments in the Company's Consolidated Statements of Operations. The Company uses interest rate swaps to manage its exposure to changes in interest rates on its interest bearing liabilities by economically hedging cash flows associated with these borrowings. Presenting the contractual interest payments on interest rate swaps and caps with the interest paid on interest-bearing liabilities reflects the total contractual interest payments. This presentation depicts the economic cost of our financing strategy. Although we leverage our portfolio investments in Debt Securities to seek to enhance our potential returns, leverage also may exacerbate losses.

While we use hedging to attempt to manage some of our interest rate risk, we do not hedge all of our exposure to changes in interest rates. Our investments vary in interest rate and maturity compared with the rates and duration of the hedges we employ. As a result, it is not possible to insulate our portfolio from all potential negative consequences associated with changes in interest rates in a manner that will allow us to achieve attractive spreads on our portfolio. Consequently, changes in interest rates, particularly short-term interest rates, may significantly affect our net income.

In addition to investing in issued pools of Agency RMBS, we regularly utilize forward settling transactions to purchase and sell certain securities, including forward settling purchases and sales of Agency RMBS where the pool is "to-be-announced" ("TBA"). Pursuant to a TBA, we agree to purchase or sell for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not specifically identified until shortly before the TBA settlement date. TBA securities that meet the regular-way securities scope exception from derivative accounting under ASC 815 - Derivatives and Hedging, are recorded on the trade date utilizing information associated with the specified terms of the transaction. TBAs are carried at fair value and begin earning interest on the settlement date. At times, the Company may enter into TBA contracts without having the contractual obligation to accept or make delivery ("TBA Derivatives") as a means of investing in and financing Agency RMBS via "dollar roll" transactions. TBA dollar roll transactions are accounted for as a series of derivative transactions. For other forward settling transactions, we agree to purchase or sell, for future delivery, Agency RMBS. However, unlike TBA Derivatives, these forward settling transactions reference an identified Agency RMBS.

In March 2015, our captive insurance subsidiary, CYS Insurance Services, LLC ("CYS Insurance"), was granted membership in the FHLBC and commenced obtaining FHLBC Advances from the FHLBC in the form of secured borrowings. Membership in the FHLBC permitted CYS Insurance to access a variety of products and services offered by the FHLBC, and obligated CYS Insurance to purchase FHLBC membership and activity stock, the latter being a percentage of the advances it obtained from the FHLBC. As with our repo borrowings, if the value of any assets pledged to the FHLBC as collateral for advances decreased, the FHLBC could require posting of additional collateral. On January 12, 2016, the FHFA issued a final rule (the "Final Rule") amending its regulations governing FHLBC Membership criteria for captive insurance companies. The Final Rule defines "insurance company" to exclude "captive insurers". Under this Final Rule, which became effective on February 19, 2016, CYS Insurance's membership in the FHLBC was required to terminate within one year of the effective date and it was not permitted to secure any new advances. In response to this action, the Company repaid all of its outstanding FHLBC Advances prior to September of 2016. CYS Insurance's membership in the FHLBC was terminated on February 19, 2017.

We have elected to be treated as a REIT for U.S. federal income tax purposes, and have complied with, and intend to continue to comply with, the provisions of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"), with respect thereto. Accordingly, we generally do not expect to be subject to federal income tax on our REIT taxable income that we currently distribute to our stockholders if certain asset, income and ownership tests and recordkeeping requirements are fulfilled. Even if we maintain our qualification as a REIT, we may be subject to federal, state and local taxes on our income.

Trends and Recent Market Activity

Overview

The second quarter of 2017 ("Second Quarter") presented global political and financial news that was similar to 2016 but resulted in comparatively diminished market reactions in the Second Quarter. In 2017, the elections in France had the potential for significant changes to the structure of the European Union (the "EU"), potentially even more significant than the United Kingdom's vote to exit in the EU in 2016 ("Brexit"). In both cases, markets reacted long before the elections and the U.S. bond markets had the task of pricing for the growth and inflation effects of the elections' ultimate outcomes. In 2017, however, markets had the advantage of learning from the Brexit vote and recognized that the implications may not be as severe as previously thought. Specifically, in the Second Quarter, the yield on the 10-year U.S. Treasury traded in a 29 basis points ("bps") range, as compared to the second quarter of 2016 where it traded in a 48 bps range. This is in line with recent market trends where volatility has been steadily dropping, equity prices slowly moving higher, and interest rates trading within a narrower range than recent prior quarters. The expectation of more muted market reactions seems likely to continue until and

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unless there is a meaningful shift in underlying global economic conditions or to the structure of global financial institutions. In the Second Quarter, equity markets continued to advance incrementally and only down shifted briefly in mid-May on potentially incriminating news relating to the Trump administration. Over much of the Second Quarter, the U.S. bond market dropped in yield. However, by the end of the quarter, as the markets reacted to modestly more hawkish comments by the European Central Bank and Bank of England, the 10-year U.S. Treasury yield moved slightly higher and closed the quarter with just a 9 bps decrease over the quarter.

In the U.S., the Fed continues its path of normalizing interest rate policy. Having raised the target federal funds rate (the "Fed Funds Rate") in March 2017, as generally expected, they raised again in June 2017. Additionally, they have begun to communicate how the Fed intends to slow their large scale asset purchases and ultimately reduce the size of the Fed's balance sheet. In the Fed's May minutes, the FOMC proposed a plan under which it might set a gradually increasing set of monthly caps, or limits, on the amount of U.S. Treasuries and agency securities that may be reinvested. FOMC Chair Janet Yellen further detailed the committee plans for balance sheet tapering in the June 2017 meeting. Thus, reinvestment levels should be reduced predictably over time. Markets appeared to take the balance sheet normalization news in stride as it was clear the process should be extremely gradual and transparent in nature. With the Fed slowly raising short-term interest rates and volatility in long-term rates greatly diminished, the latter half of the Second Quarter was characterized by a slowly flattening yield curve. The 2s-10s U.S. Treasury spread fell 22 bps from the beginning of the quarter, ending the Second Quarter at 92 bps.

While the 10-year U.S. Treasury yield fell 9 bps to 2.30% during the Second Quarter, the 5-year U.S. Treasury yield dropped 3 bps to 1.89%. Correspondingly, the prices of Agency RMBS increased marginally. For example, the price of 30-year FNMA 3.5% Agency RMBS increased from $102.36 on March 31, 2017 to $102.67 at June 30, 2017, while the price of 15-year FNMA 3.0% Agency RMBS increased from $102.55 on March 31, 2017 to $102.61 on June 30, 2017. On the financing side of our business, we continued to benefit from an abundance of cash in government money market funds which seeks short-term government collateral and repo. This supply dynamic has moderated repo rates.

Over the past four quarters, interest rates have steadily risen while we have produced an attractive 13.4% total shareholder return, compared to the Aggregate Bond Index of (0.31%). Notably, despite three separate 25 bps Fed rate hikes, financing costs have only risen approximately 55 bps and the yield on the 10-year U.S. Treasury has risen 83 bps. While some may believe these are bearish conditions for our industry, we have navigated through this environment and been able to increase our interest spread net of hedge by 14 bps.

Looking forward, markets will be watching carefully for clues about who the Trump administration might nominate as the next Fed Chairperson, as well as several other important posts on the FOMC. Chair Yellen's term is set to expire in February 2018. Discussions surrounding the debt ceiling, fiscal stimulus programs, tax reform, budget/fiscal policy and trade policy changes will also continue to impact markets.

Government Activity

We cannot be certain if any housing and/or mortgage-related legislation will emerge from, or be approved by Congress in the next six to twelve months, and, if so, what the effect of any such legislation may be on our business.

Recent CYS Activity in Response to These Trends

In response to the conditions in and changes to the environment described above, we continue to monitor, reposition, and actively manage our investment portfolio, the structure of our borrowings and our hedge positions. During the first quarter of 2017 (the "First Quarter") we continued to sell lower yielding, and purchase higher yielding, Agency RMBS resulting in an increase in the average yield and simultaneous decrease in the weighted average amortized cost of our Debt Securities portfolio, which we continued to benefit from this activity throughout the Second Quarter and expect to continue benefiting from this portfolio repositioning in future quarters. During the Second Quarter, we moderately reduced our 15-year Agency RMBS holdings and increased our 30-year Agency RMBS holdings. We experienced a 0.6% decline in the weighted average 1-month prepayment speeds during the Second Quarter to 7.5% from 8.1% in the First Quarter. The decline in prepayment speeds, coupled with additional portfolio repositioning resulted in a 15 bps increase in the average yield on Debt Securities during the Second Quarter to 2.86% from 2.71% in the First Quarter.

During the Second Quarter we also took advantage of the decline in swap rates and opportunistically repositioned a portion of our hedge portfolio by replacing an existing $1 billion in notional amount of shorter dated swaps maturing in less than six months with an equal amount of 7-year, cancelable-in-one-year, swaps. We also incrementally added $100 million notional of 10-year swaps. We continued to benefit from an increase in 3-month LIBOR during the Second Quarter, resulting in a 13 bps increase in the receive-leg of our swaps. In addition, during the Second Quarter, 3-month LIBOR exceeded the cap rate of 1.25%

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on two of our interest rate caps, making them cash flow positive. Two additional caps are expected to begin cash-flowing in the third quarter of 2017 when the respective rates are scheduled to reset. After repositioning and increasing the duration and size of our hedge portfolio, we experienced an 8 bps decrease in the net swap and cap pay rate during the Second Quarter to 41 bps from 49 bps in the First Quarter.

Financial Condition

Our Agency RMBS were purchased at a net premium to their face value generally due to the average interest rates on these investments being higher than the prevailing market rates at the time of purchase. Inclusive of TBA Derivatives, as of June 30, 2017 and December 31, 2016, we had approximately $403.3 million and $452.3 million, respectively, of net unamortized premium included in the cost basis of our investments. TBA Agency RMBS, including those accounted for as derivatives, are included in the table below on a gross basis. Our Debt Securities portfolio, including TBA Derivatives, consisted of the following:

| (dollars in thousands) | | | | Weighted-Average | | | |
|---|---|---|---|---|---|---|---|
| Coupon | Face Value | Fair Value | Amortized Cost Basis per Face Value | Loan Balance (1) | Loan Age (in months)(1) | 3 Month CPR(1)(2) | Duration(3) |
| June 30, 2017 | | | | | | | |
| 15-Year Agency Mortgage-Backed Securities | | | | | | | |
| 2.5% | $345,631 | $347,745 | $102.51 | $183 | 8 | 3.2% | 4.24 |
| 3.0% | 2,633,493 | 2,705,292 | 102.45 | 272 | 24 | 7.9 | 3.23 |
| TBA 3.0% * | 256,200 | 262,953 | 102.93 | n/a | n/a | n/a | 3.27 |
| 3.5% | 640,603 | 667,784 | 102.65 | 204 | 61 | 13.5 | 2.68 |
| 4.0% | 94,007 | 98,859 | 100.99 | 168 | 76 | 18.5 | 2.49 |
| 4.5% | 12,641 | 13,399 | 102.13 | 242 | 89 | 12.6 | 1.85 |
| Subtotal | 3,982,575 | 4,096,032 | 102.48 | 249 | 30 | 8.8 | 3.21 |
| 20-Year Agency Mortgage-Backed Securities | | | | | | | |
| 4.5% | 35,368 | 38,034 | 102.61 | 205 | 83 | 13.9 | 2.32 |
| 30-Year Agency Mortgage-Backed Securities | | | | | | | |
| 3.0% | 1,671 | 1,694 | 104.45 | 132 | 49 | 17.5 | 5.25 |
| 3.5% | 4,334,591 | 4,457,596 | 103.04 | 333 | 9 | 4.5 | 4.61 |
| TBA 3.5%* | 693,050 | 711,630 | 103.03 | n/a | n/a | n/a | 4.23 |
| 4.0% | 2,084,400 | 2,197,885 | 104.94 | 294 | 21 | 9.0 | 3.10 |
| TBA 4.0%* | 582,000 | 611,546 | 105.50 | n/a | n/a | n/a | 3.12 |
| 4.5% | 101,715 | 110,041 | 106.55 | 281 | 74 | 17.8 | 2.49 |
| Subtotal | 7,797,427 | 8,090,392 | 103.77 | 319 | 14 | 6.2 | 4.04 |
| Agency RMBS Hybrid ARMs | | | | | | | |
| 3.0%(5) | 332,190 | 341,811 | 102.64 | 315 | 44 | 19.5 | 2.07 |
| Subtotal Agency RMBS | 12,147,560 | 12,566,269 | 103.32 | 294 | 21 | 7.5 | 3.71 |
| U.S. Treasuries | | | | | | | |
| 0.6% | 25,000 | 24,841 | 99.94 | n/a | n/a | n/a | 0.99 |
| Total | $12,172,560 | $12,591,110 | $103.31 | $294 | 21 | 7.5% | 3.70 |

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| (dollars in thousands) | | | | Weighted-Average | | | |
|---|---|---|---|---|---|---|---|
| Coupon | Face Value | Fair Value | Amortized Cost Basis per Face Value | Loan Balance (1) | Loan Age (in months)(1) | 3 Month CPR(1)(2) | Duration(3) |
| December 31, 2016 | | | | | | | |
| 15-Year Agency RMBS | | | | | | | |
| 2.5% | $1,046,887 | $1,049,504 | $102.78 | $276 | 4 | 5.4% | 3.94 |
| TBA 2.5%(4)* | (400,000) | (400,633) | 99.73 | n/a | n/a | n/a | 3.75 |
| 3.0% | 2,540,786 | 2,610,678 | 102.68 | $263 | 27 | 13.0 | 3.03 |
| TBA 3.0%* | 200,000 | 205,174 | 102.86 | n/a | n/a | n/a | 2.83 |
| 3.5% | 813,323 | 849,549 | 102.98 | 215 | 52 | 14.6 | 2.52 |
| 4.0% | 108,173 | 114,207 | 101.03 | 167 | 70 | 14.7 | 2.27 |
| 4.5% | 14,439 | 15,256 | 102.23 | 240 | 83 | 19.3 | 1.79 |
| Subtotal | 4,323,608 | 4,443,735 | 103.00 | 255 | 27 | 12.4 | 3.05 |
| 20-Year Agency RMBS | | | | | | | |
| 4.5% | 39,328 | 42,348 | 102.66 | 209 | 77 | 19.6 | 2.16 |
| 30-Year Agency RMBS | | | | | | | |
| 3.0% | 1,776 | 1,802 | 104.51 | 130 | 43 | 0.2 | 4.69 |
| 3.5% | 4,934,357 | 5,062,330 | 104.48 | 338 | 8 | 9.5 | 4.48 |
| TBA 3.5%* | 383,000 | 392,293 | 102.58 | n/a | n/a | n/a | 4.10 |
| 4.0% | 1,247,116 | 1,314,969 | 104.93 | 244 | 30 | 22.0 | 3.30 |
| TBA 4.0%* | 500,000 | 524,869 | 104.50 | n/a | n/a | n/a | 2.95 |
| 4.5% | 113,274 | 122,361 | 106.63 | 282 | 68 | 21.7 | 2.32 |
| Subtotal | 7,179,523 | 7,418,624 | 104.34 | 319 | 13 | 13.1 | 4.12 |
| Agency RMBS Hybrid ARMs | | | | | | | |
| 2.8%(5) | 375,745 | 385,502 | 102.74 | 322 | 30 | 21.3 | 2.16 |
| Subtotal Agency RMBS | 11,918,204 | 12,290,209 | 103.80 | 293 | 20 | 13.1 | 3.66 |
| U.S. Treasuries | | | | | | | |
| 0.6% | 50,000 | 49,686 | 99.90 | n/a | n/a | n/a | 1.48 |
| Total | $11,968,204 | $12,339,895 | $103.78 | $293 | 20 | 13.1% | 3.66 |

(1) TBAs are excluded from this calculation as they do not have a defined weighted-average loan balance or age until mortgages have been assigned to the pool.

(2) The Constant Prepayment Rate ("CPR") represents the 3-month CPR of the Company's Agency RMBS held at June 30, 2017 and December 31, 2016. The CPR experienced by the Company during the period may differ. Securities with no prepayment history are excluded from this calculation.

(3) Duration measures the market price volatility of financial instruments as interest rates change, using Dollar Value of One Basis Point, or "DV01", methodology. We generally calculate duration using various third-party financial models and empirical data. Different models and methodologies can produce different estimates of duration for the same securities. Duration estimates in the table are calculated utilizing Yield Book® software and may reflect adjustments based on our judgment.

(4) Includes $400.6 million of forward settling transactions at December 31, 2016.

(5) Coupon represents the weighted-average coupon of Agency Hybrid ARMs.

* Includes TBA Derivatives with a fair value of $0.9 billion and $(308.8) million at June 30, 2017 and December 31, 2016, respectively.

In July 2017, the monthly weighted-average experienced CPR of the Company's Debt Securities increased to 10.0% from 8.3% in June 2017.

Hedging Instruments

The Company utilizes interest rate swap and cap contracts (a "swap" or "cap", respectively) to hedge the interest rate risk associated with the financing of our Debt Securities portfolio. As of June 30, 2017, the Company held swaps with an aggregate notional of approximately $6.6 billion, a weighted-average fixed rate of 1.48%, and a weighted-average maturity of 3.6 years. This compares with interest rate swaps with a notional amount of $6.5 billion, a weighted-average fixed rate of 1.23%, and a

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weighted-average maturity of 3.0 years at December 31, 2016. The receive rate on the Company's swaps is the 3-month LIBOR. At June 30, 2017, the Company held caps with a notional of $2.5 billion, a weighted-average cap rate of 1.28%, and a weighted-average maturity of 2.5 years. This compares with interest rate caps with a notional amount of $2.5 billion, a weighted-average fixed rate of 1.28%, and a weighted-average maturity of 3.0 years at December 31, 2016.

Below is a summary of our interest rate swaps and caps as of June 30, 2017 and December 31, 2016:

| | | | Weighted-Average | | | |
|---|---|---|---|---|---|---|
| June 30, 2017 | Number of Contracts | Notional (000's) | Rate | Maturity | Duration | Fair Value (000's) |
| Interest Rate Swaps | 19 | $6,550,000 | 1.48% | February 2021 | (2.82) | $63,630 |
| Interest Rate Caps | 5 | 2,500,000 | 1.28% | January 2020 | (1.94) | 27,731 |
| | 24 | $9,050,000 | 1.43% | October 2020 | (2.57) | $91,361 |
| December 31, 2016 | | | | | | |
| Interest Rate Swaps | 17 | $6,450,000 | 1.23% | January 2020 | (2.72) | $80,608 |
| Interest Rate Caps | 5 | 2,500,000 | 1.28% | January 2020 | (1.94) | 42,532 |
| | 22 | $8,950,000 | 1.24% | January 2020 | (2.50) | $123,140 |

Our swap and cap notional was $9.05 billion and $8.95 billion at June 30, 2017 and December 31, 2016, respectively, resulting in a hedge ratio of 97% at June 30, 2017, compared to 92% at December 31, 2016.

The Company does not consider TBA Derivatives to be hedging instruments.

Liabilities

We finance our assets through repo borrowings, and prior to the February 19, 2016 effective date of the Final Rule, FHLBC Advances. Repo borrowings and FHLBC Advances are secured by our assets and generally bear interest rates that have historically moved in close relationship to LIBOR. At June 30, 2017 and December 31, 2016, we had liabilities pursuant to repo borrowings with 35 counterparties which are summarized below (dollars in thousands):

| June 30, 2017 | | | Weighted-Average | | |
|---|---|---|---|---|---|
| Original Days to Maturity by Collateral Type | Repo Borrowings Outstanding | Percentage of Total | Interest Rate | Remaining Days to Maturity | Original Days to Maturity |
| Agency RMBS | | | | | |
| ≤ 30 Days | $1,671,694 | 18% | 1.35% | 13 | 24 |
| > 30 to ≤ 60 Days | 874,678 | 9% | 1.28% | 19 | 41 |
| > 60 Days | 6,824,473 | 73% | 1.20% | 104 | 178 |
| Subtotal | $9,370,845 | 100% | 1.23% | 80 | 138 |

| December 31, 2016 | | | Weighted-Average | | |
|---|---|---|---|---|---|
| Original Days to Maturity by Collateral Type | Repo Borrowings Outstanding | Percentage of Total | Interest Rate | Remaining Days to Maturity | Original Days to Maturity |
| Agency RMBS | | | | | |
| ≤ 30 Days | $651,032 | 7% | 0.83% | 5 | 11 |
| > 30 to ≤ 60 Days | 1,135,428 | 12% | 0.89% | 16 | 45 |
| > 60 Days | 7,905,084 | 81% | 0.90% | 63 | 139 |
| Total | $9,691,544 | 100% | 0.89% | 53 | 119 |

In addition, as of June 30, 2017 and December 31, 2016, we had an aggregate payable for securities purchased, a portion of which will be financed through repo borrowings, as summarized below (in thousands).

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June 30, 2017

| Settle Date | Face Value | Payable |
|---|---|---|
| July 2017 | $511,692 | $532,832 |
| August 2017 | 75,000 | 76,870 |
| September 2017 | 200,000 | 207,895 |
| | $786,692 | $817,597 |

December 31, 2016

| Settle Date | Face Value | Payable |
|---|---|---|
| January 2017 | $1,376,248 | $1,418,658 |
| February 2017 | 450,045 | 463,305 |
| | $1,826,293 | $1,881,963 |

Summary Financial Data

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands, except per share data) | 2017 | 2016 | 2017 | 2016 |
| Income Statement Data: | | | | |
| Interest income | $77,088 | $74,857 | $150,401 | $156,308 |
| Interest expense | 26,182 | 18,687 | 47,403 | 36,632 |
| Net interest income | 50,906 | 56,170 | 102,998 | 119,676 |
| Other income (loss): | | | | |
| Net realized and unrealized gain (loss) on investments, FHLBC Advances and other income | 31,507 | 65,213 | 28,988 | 228,313 |
| Net gain (loss) on derivative instruments | (26,758) | (59,314) | (36,097) | (218,236) |
| Total other income (loss) | 4,749 | 5,899 | (7,109) | 10,077 |
| Expenses: | | | | |
| Compensation and benefits | 3,004 | 3,565 | 6,780 | 7,430 |
| General, administrative and other | 2,426 | 2,294 | 4,864 | 4,782 |
| Total expenses | 5,430 | 5,859 | 11,644 | 12,212 |
| Net income (loss) | $50,225 | $56,210 | $84,245 | $117,541 |
| Dividends on preferred stock | (5,203) | (5,203) | (10,406) | (10,406) |
| Net income (loss) available to common stockholders | $45,022 | $51,007 | $73,839 | $107,135 |
| Net income (loss) per common share basic & diluted | $0.30 | $0.34 | $0.49 | $0.71 |
| Dividends per common share | $0.25 | $0.25 | $0.50 | $0.51 |
| | | | | |
| Key Balance Sheet Metrics | | | | |
| Average settled Debt Securities [1] | $10,796,064 | $11,887,351 | $10,841,813 | $11,913,005 |
| Average total Debt Securities [2] | $12,479,401 | $13,230,800 | $12,484,228 | $13,097,446 |
| Average repurchase agreements and FHLBC Advances [3] | $9,276,572 | $10,412,784 | $9,306,968 | $10,473,530 |
| Average Debt Securities liabilities [4] | $10,959,909 | $11,756,233 | $10,949,383 | $11,657,971 |
| Average stockholders' equity [5] | $1,550,906 | $1,725,879 | $1,547,562 | $1,722,046 |
| Average common shares outstanding [6] | 151,729 | 151,452 | 151,651 | 151,620 |
| Leverage ratio (at period end) [7] | 7.20:1 | 6.91:1 | 7.20:1 | 6.91:1 |
| Hedge Ratio [8] | 97% | 91% | 97% | 91% |
| Book value per common share (at period end) [9] | $8.31 | $9.55 | $8.31 | $9.55 |

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| (dollars in thousands, except per share data) | Three Months Ended June 30, 2017 | Three Months Ended June 30, 2016 | Six Months Ended June 30, 2017 | Six Months Ended June 30, 2016 |
|---|---|---|---|---|
| Weighted-average amortized cost of Agency RMBS and U.S. Treasuries (10) | $103.31 | $103.42 | $103.31 | $103.42 |
| Key Performance Metrics* | | | | |
| Average yield on settled Debt Securities (11) | 2.86 % | 2.52 % | 2.77 % | 2.62 % |
| Average yield on total Debt Securities including Drop Income (12) | 2.75 % | 2.50 % | 2.70 % | 2.61 % |
| Average cost of funds (13) | 1.13 % | 0.72 % | 1.02 % | 0.70 % |
| Average cost of funds and hedge (14) | 1.49 % | 1.29 % | 1.38 % | 1.33 % |
| Adjusted average cost of funds and hedge (15) | 1.26 % | 1.14 % | 1.17 % | 1.20 % |
| Interest rate spread net of hedge (16) | 1.37 % | 1.23 % | 1.39 % | 1.29 % |
| Interest rate spread net of hedge including Drop Income (17) | 1.49 % | 1.36 % | 1.53 % | 1.41 % |
| Operating expense ratio (18) | 1.40 % | 1.36 % | 1.50 % | 1.42 % |
| Total stockholder return on common equity (19) | 3.63 % | 3.59 % | 5.76 % | 7.48% |
| CPR (weighted-average experienced 1-month) (20) | 7.5 % | 12.9 % | 7.8 % | 10.2% |

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(1) The average settled Debt Securities is calculated by averaging the month end cost basis of settled Debt Securities during the period.

(2) The average total Debt Securities is calculated by averaging the month end cost basis of total Debt Securities and all TBA contracts during the period.

(3) The average repurchase agreements and FHLBC Advances are calculated by averaging the month-end repurchase agreements and FHLBC Advances balances during the period.

(4) The average Debt Securities liabilities are calculated by adding the average month-end repurchase agreements and FHLBC Advances balances plus average unsettled Debt Securities (inclusive of TBA Derivatives) during the period.

(5) The average stockholders' equity is calculated by averaging the month-end stockholders' equity during the period.

(6) The average common shares outstanding are calculated by averaging the daily common shares outstanding during the period.

(7) The leverage ratio is calculated by dividing (i) the Company's repurchase agreements and FHLBC Advances balance plus payable for securities purchased minus receivable for securities sold plus the net TBA Derivatives positions by (ii) stockholders' equity.

(8) The Hedge ratio for the period is calculated by dividing Interest Rate Swaps and Interest Rate Caps notional amount by total repurchase agreements.

(9) Book value per common share is calculated by dividing total stockholders' equity less the liquidation value of preferred stock at period end by common shares outstanding at period end.

(10) The weighted-average amortized cost of Agency RMBS and U.S. Treasuries is calculated using the weighted-average amortized cost by security divided by the current face at period end.

(11) The average yield on settled Debt Securities for the period is calculated by dividing total interest income by average settled Debt Securities.

(12) The average yield on total Debt Securities including Drop Income for the period is calculated by dividing total interest income plus Drop Income by average total Debt Securities. Drop Income was $8.7 million and $8.0 million for the three months ended June 30, 2017 and 2016, respectively. Drop Income was $18.1 million and $14.3 million for the six months ended June 30, 2017 and 2016, respectively. Drop Income is a component of our net realized and unrealized gain (loss) on investments and net realized and unrealized gain (loss) on derivative instruments in the accompanying unaudited Consolidated Statements of Operations. Drop

Income is the difference between the spot price and the forward settlement price for the same security on trade date. This difference is also the economic equivalent of the assumed net interest margin (yield minus financing costs) of the bond from trade date to settlement date. We derive Drop Income through utilization of forward settling transactions.

(13) The average cost of funds for the period is calculated by dividing repurchase agreement and FHLBC Advances interest expense by average repurchase agreements and FHLBC Advances for the period.

(14) The average cost of funds and hedge for the period is calculated by dividing repurchase agreement, FHLBC Advances and swap and cap interest expense by average repurchase agreements and FHLBC Advances.

(15) The adjusted average cost of funds and hedge for the period is calculated by dividing repurchase agreement, FHLBC Advances and swap and cap interest expense by average Debt Securities liabilities.

(16) The interest rate spread net of hedge for the period is calculated by subtracting average cost of funds and hedge from average yield on settled Debt Securities.

(17) The interest rate spread net of hedge including Drop Income for the period is calculated by subtracting adjusted average cost of funds and hedge from average yield on total Debt Securities including Drop Income.

(18) The operating expense ratio for the period is calculated by dividing operating expenses by average stockholders' equity.

(19) The total stockholder return on common equity is calculated as the change in book value plus dividend distributions on common stock divided by book value at the beginning of the period.

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(20) The CPR represents the weighted-average 1-month CPR of the Company's Agency RMBS during the period.
* All percentages are annualized except total stockholder return on common equity.

Core Earnings

"Core Earnings" represents a non-GAAP financial measure and is defined as net income (loss) available to common stockholders excluding net realized and unrealized gain (loss) on investments and derivative instruments and net unrealized gain (loss) on FHLBC Advances. Management uses Core Earnings to evaluate the effective yield of the portfolio after operating expenses. The Company believes that providing users of the Company's financial information with such measures, in addition to the related GAAP measures, gives investors greater transparency and insight into the information used by the Company's management in its financial and operational decision-making.

The primary limitation associated with Core Earnings as a measure of our financial performance over any period is that it excludes the effects of net realized and unrealized gain (loss) on investments and derivative instruments, and net unrealized gain (loss) on FHLBC Advances. In addition, our presentation of Core Earnings may not be comparable to similarly-titled measures used by other companies, which may employ different calculations. As a result, Core Earnings should not be considered a substitute for our GAAP net income (loss) as a measure of our financial performance or any measure of our liquidity under GAAP.

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| Non-GAAP Reconciliation: | 2017 | 2016 | 2017 | 2016 |
| Net income (loss) available to common stockholders | $45,022 | $51,007 | $ 73,839 | $ 107,135 |
| Net realized (gain) loss on investments | 19,831 | (36,359 ) | 85,875 | (37,561 ) |
| Net unrealized (gain) loss on investments | (51,299 ) | (28,915 ) | (114,777 ) | (191,201 ) |
| Net realized and unrealized (gain) loss on derivative instruments | 18,324 | 44,535 | 19,336 | 185,059 |
| Net unrealized (gain) loss on FHLBC Advances | — | 448 | — | 1,299 |
| Core Earnings | $31,878 | $30,716 | $ 64,273 | $ 64,731 |

Results of Operations

Our Economic Net Interest Income, a non-GAAP measure, is generated primarily from the net spread, or difference, between the interest income we earn on our investment portfolio and the cost of our borrowings and hedging activities. The amount of Economic Net Interest Income we earn on our investments depends in part on our ability to control our financing costs, which comprise a significant portion of our operating expenses. Economic Interest Expense consists of interest expense, as computed in accordance with GAAP, plus swap and cap interest expense used to hedge our cost of funds, a component of net gain (loss) on derivative instruments in the Company's Consolidated Statements of Operations. The Company uses interest rate swaps to manage its exposure to changes in interest rates on its interest bearing liabilities by economically hedging cash flows associated with these borrowings. Presenting the contractual interest payments on interest rate swaps and caps with the interest paid on interest-bearing liabilities reflects the Company's total contractual interest payments. Economic Interest Expense depicts the economic cost of our financing strategy. We present the non-GAAP measures Economic Interest Expense, and Economic Net Interest Income to provide an economic measure of our interest income net of borrowing and hedge expense, and economic interest expense, which management uses to evaluate the Company's investments portfolio. We believe that providing users of our financial information with such measures in addition to the related GAAP measures gives users additional transparency into the information used by our management in its financial and operational decision-making, and that it is meaningful information to consider in addition to the related GAAP measure as these measures reflects the net economic interest income earned and cost of financing and hedging our investment portfolio.

The following table provides GAAP measures of interest expense and net interest income and details with respect to reconciling these line items on a non-GAAP basis for each respective period.

| | Three Months Ended June 30, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ Change | % Change |
| Total interest expense | $26,182 | $18,687 | $7,495 | 40.1 % |
| Swap and cap interest expense | 8,434 | 14,779 | (6,345 ) | (42.9)% |
| Economic interest expense | $34,616 | $33,466 | $1,150 | 3.4 % |
| | | | | |
| Net interest income | $50,906 | $56,170 | $(5,264) | (9.4 )% |
| Swap and cap interest expense | 8,434 | 14,779 | (6,345 ) | (42.9)% |
| Economic net interest income | $42,472 | $41,391 | $1,081 | 2.6 % |

| | Six Months Ended June 30, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ Change | % Change |
| Total interest expense | $47,403 | $36,632 | $10,771 | 29.4 % |
| Swap and cap interest expense | 16,761 | 33,177 | (16,416 ) | (49.5)% |
| Economic interest expense | $64,164 | $69,809 | $(5,645 ) | (8.1 )% |
| | | | | |
| Net interest income | $102,998 | $119,676 | $(16,678) | (13.9)% |
| Swap and cap interest expense | 16,761 | 33,177 | (16,416 ) | (49.5)% |
| Economic net interest income | $86,237 | $86,499 | $(262 ) | (0.3 )% |

Three Months Ended June 30, 2017 Compared to the Three Months Ended June 30, 2016

Net Income (Loss)

Net income available to common stockholders decreased $6.0 million to $45.0 million for the three months ended June 30, 2017, compared to net income of $51.0 million for the three months ended June 30, 2016 (the "Second Quarter of 2016"), primarily due to (i) a $33.8 million decrease in net realized and unrealized gain on investments and (ii) a $7.5 million increase in total interest expense, offset by (i) a $26.2 million decrease in net realized and unrealized loss on derivative instruments, (ii) a $6.4 million decrease in swap and cap interest expense, and (iii) a $2.2 million increase in total interest income. The major components that make up the net decrease in net income available to common stockholders during the Second Quarter as compared to the Second Quarter of 2016 are described in more detail below.

Interest Income and Asset Yield

Our principal source of income is interest income that we earn on our investment securities portfolio. Interest income, which consists primarily of interest income on Debt Securities, increased by $2.2 million to $77.1 million for the Second Quarter, as compared to $74.9 million for the Second Quarter of 2016. Our interest income increased as a result of an increase in the average yield on settled Debt Securities to 2.86% at June 30, 2017 from 2.52% at June 30, 2016, offset by a decrease in average settled Debt Securities to $10.8 billion in the Second Quarter from $11.9 billion in the Second Quarter of 2016, as further illustrated below (in thousands):

| Change in Size | | Change in Yield | | Change in Size & Yield | |
|---|---|---|---|---|---|
| Change in average settled | $(1,091,287) | Change in average yield | 0.34 % | Change in average settled | $(1,091,287) |
| Q2 2016 average annualized yield | 2.52 % | Q2 2016 average settled | $11,887,351 | Change in average yield | 0.34 % |
| Quarterly change | $(6,872 ) | Quarterly change | $10,023 | Quarterly change | $(920 ) |
| | | | | Total change | $2,231 |

The increase in the average yield during the Second Quarter as compared to the Second Quarter of 2016 largely resulted from a decrease in prepayment speeds. The Second Quarter weighted-average experienced CPR decreased to 7.5% compared to 12.9% for the Second Quarter of 2016 . Amortization expense decreased by $10.0 million to $12.6 million during the Second Quarter from $22.6 million in the Second Quarter of 2016 as a direct result of the decrease in CPR, coupled with a decrease in the average settled Debt Securities.

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Economic Interest Expense and Cost of Funds

Economic interest expense for the Second Quarter, which consists of interest expense from repo borrowings, swap and cap contracts, and FHLBC Advances (solely as it relates to the Second Quarter of 2016), increased $1.1 million to $34.6 million from $33.5 million for the three months ended June 30, 2016. Interest expense from repo borrowings and FHLBC Advances increased by $7.5 million to $26.2 million for the Second Quarter from $18.7 million for the Second Quarter of 2016 due to a higher cost of funds, largely resulting from three separate 25 bps Fed rate hikes during the comparable period. As a result, our weighted-average cost of funds rose to 1.13% in the Second Quarter from 0.72% in the Second Quarter of 2016. The net increase in interest expense was partially offset by a decrease in our average repo borrowings and FHLBC Advances to $9.3 billion for the Second Quarter from $10.4 billion for the Second Quarter of 2016. The decrease in average repo borrowings and FHLBC Advances was consistent with the decrease in average settled Debt Securities during the Second Quarter as compared to the Second Quarter of 2016.

The table below illustrates the result of changes to the average amount of repurchase agreements and FHLBC Advances outstanding and the related rates on interest expense during the three months ended June 30, 2017 and 2016 (in thousands):

| Change in Size | | Change in Rate | | Change in Size & Yield | |
|---|---|---|---|---|---|
| Change in average outstanding | $(1,136,212) | Change in average rate | 0.41 % | Change in average outstanding | $(1,136,212) |
| 2016 average rate | 0.72 % | 2016 average outstanding | $10,412,784 | Change in average rate | 0.41 % |
| Quarterly change | $(2,039) | Quarterly change | $10,702 | Quarterly change | $(1,168) |
| | | | | Total change | $7,495 |

Swap and cap interest expense decreased by $6.4 million to $8.4 million in the Second Quarter, compared to $14.8 million in the Second Quarter of 2016. The decrease in swap and cap interest expense was primarily attributable to an increase in 3-month LIBOR, the receive leg of our swaps, combined with a decrease in the average aggregate swap and cap notional by $0.7 billion to $9.0 billion in the Second Quarter from $9.7 billion in the Second Quarter of 2016. 3-month LIBOR increased to 1.30% at June 30, 2017 from 0.65% at June 30, 2016, driving the decrease in the weighted-average swap and cap net pay rate to 0.38% in the Second Quarter from 0.61% in the Second Quarter of 2016, as further illustrated in the table below (in thousands):

| Change in Size | | Change in Swap and Cap Net Pay Rate | | Change in Size & Rate | |
|---|---|---|---|---|---|
| Change in average notional outstanding | $(725,000) | Change in average rate | (0.23)% | Change in average notional outstanding | $(725,000) |
| 2016 average rate | 0.61 % | 2016 average notional outstanding | $9,700,000 | Change in average rate | (0.23)% |
| Quarterly change | $(1,104) | Quarterly change | $(5,664) | Quarterly change | $423 |
| | | | | Total change | $(6,345) |

Our annualized weighted-average cost of funds including hedge was 1.49% for the Second Quarter, as compared to 1.29% for the Second Quarter of 2016. The increase in the weighted average cost of funds including hedge is largely attributable to the increase in cost of funds, partially offset by the decrease in the swap and cap net pay rate, as further described above. The components of our cost of funds and hedging are (i) rates on our repo borrowings and FHLBC Advances ("Total Outstanding Borrowings"), (ii) rates on our swaps and caps, (iii) the size of our Total Outstanding Borrowings, and (iv) the total notional amount of our swaps and caps.

Economic Net Interest Income

Our economic net interest income for the Second Quarter was $42.5 million, and our interest rate spread, net of hedge, was 1.37%, compared to economic net interest income of $41.4 million and an interest rate spread, net of hedge, of 1.23% for the Second Quarter of 2016. The increase in our economic net interest income was principally due to the $6.3 million decrease in swap and cap interest expense and $2.2 million increase in total interest income, offset by the $7.5 million increase in interest expense further described above. While our economic net interest income is influenced significantly by the size of our portfolio and overall interest rate levels, we believe our interest rate spread

net of hedge is an important performance indicator.
Other Income (Loss)
For the Second Quarter, our total other income (loss) was $4.7 million compared to $5.9 million for the Second Quarter of 2016. The key components contributing to the change in total other income (loss) are discussed in more detail below.

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Net Realized and Unrealized Gain (Loss) on Investments and Drop Income

During the Second Quarter, our net realized and unrealized gain (loss) on investments decreased by $33.8 million to a net gain of $31.5 million, compared to a net gain of $65.3 million for the Second Quarter of 2016 in response to a smaller decrease in bond yields and corresponding decrease in the price of Agency RMBS during the Second Quarter as compared to the Second Quarter of 2016. To illustrate, during the Second Quarter, the 10-year U.S. Treasury yield decreased by 9 bps, ending the quarter at 2.30% compared to a 30 bps decrease during the Second Quarter of 2016, or 1.47% as of June 30, 2016. During the Second Quarter, the price of a 15-year 3.0% Agency RMBS increased $0.06 to $102.61, and during the Second Quarter of 2016, the price increased $0.34 to $104.86. Furthermore, during the Second Quarter, the price of a 30-year 3.5% Agency RMBS increased $0.31 to $102.67, and during the Second Quarter of 2016, the price increased $0.63 to $105.55.

During the three months ended June 30, 2017 and 2016, we generated Drop Income of approximately $8.7 million and $8.0 million, respectively. The higher Drop Income during the Second Quarter was primarily due to higher volumes of forward settling transactions from which we derive Drop Income. During the Second Quarter, the average gross balance in the combined TBA Securities and TBA Derivatives portfolio was $1.7 billion, a $0.4 billion increase compared to the average gross balance of $1.3 billion for the Second Quarter of 2016. Drop Income is a component of our net realized and unrealized gain (loss) on investments and our net realized and unrealized gain (loss) on derivative instruments in the accompanying unaudited Consolidated Statements of Operations and is therefore excluded from Core Earnings. Drop Income is the difference between the spot price and the forward settlement price for the same Agency RMBS on the trade date. This difference is also the economic equivalent of the assumed interest rate spread net of hedge (yield less financing costs) of the Agency RMBS from trade date to settlement date. The Company derives Drop Income through utilization of forward settling transactions of Agency RMBS.

Net Gain (Loss) on Derivative Instruments

Net gain (loss) on derivative instruments is comprised of net swap and cap interest expense and net realized and unrealized gain (loss) on derivative instruments. Net realized and unrealized gain (loss) on derivative instruments was $(18.3) million (comprised of $(28.4) million net realized and unrealized loss on swap and cap contracts, and $10.1 million net realized and unrealized gain on TBA Derivatives) in the Second Quarter, compared to $(44.5) million (comprised of $(51.0) million net realized and unrealized loss on swap and cap contracts, and $6.5 million net realized and unrealized gain on TBA Derivatives) for the Second Quarter of 2016. As previously noted, during the Second Quarter we repositioned a portion of the hedge portfolio by terminating and replacing swaps with a $1 billion notional and short remaining life with an equal amount of 7-year, cancelable-in-one-year, swaps, in addition to incrementally adding $100 million notional of 10-year swaps. Terminating the aforementioned hedges resulted in a realized gain of $1.8 million during the Second Quarter. The change in net realized and unrealized gain (loss) on derivative instruments for the Second Quarter and comparable prior year period were mainly due to a decrease in swap rates. During the Second Quarter, the 5-year and 7-year swap rates decreased by 9 bps and 11 bps, respectively, while they decreased 19 bps and 24 bps, respectively, during the Second Quarter of 2016.

Swap and cap interest expense decreased by $6.4 million in the Second Quarter to $8.4 million from $14.8 million in the Second Quarter of 2016 as further described above.

Operating Expenses

Operating expenses declined to $5.4 million in the Second Quarter from $5.9 million in the Second Quarter of 2016, largely resulting from a $0.5 million decrease in the incentive compensation accrual.

Six Months Ended June 30, 2017 Compared to the Six Months Ended June 30, 2016

Net Income (Loss)

Net income available to common stockholders decreased $33.3 million to $73.8 million for the six months ended June 30, 2017, compared to net income of $107.1 million for the six months ended June 30, 2016. The decrease in net income during the six months ended June 30, 2017 is primarily attributable to a $123.4 million increase in net realized loss on investments, a $76.4 million decrease in net unrealized gain on investments, a $10.8 million increase in interest expense and a $5.9 million decrease in interest income, partially offset by a $165.8 million decrease in net realized and unrealized loss on derivative instruments and a $16.4 million decrease in swap and cap interest expense. Details regarding each of the aforementioned components that make up the net decrease in net income available to common stockholders follow.

Interest Income and Asset Yield

Interest income decreased by $5.9 million to $150.4 million for the six months ended June 30, 2017, as compared to $156.3 million for the six months ended June 30, 2016. The decrease is largely due to a decrease in average settled Debt Securities during the six months ended June 30, 2017, offset by an increase in the yield on our investments, as further illustrated below (in thousands):

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| Change in Size | | Change in Yield | | Change in Size & Yield | |
|---|---|---|---|---|---|
| Change in average settled | $(1,071,192) | Change in average yield | 0.15 % | Change in average settled | $(1,071,192) |
| 2016 average yield | 2.62 % | 2016 average settled | $11,913,005 | Change in average yield | 0.15 % |
| Change | $(14,055) | Change | $8,953 | Change | $(805) |
| | | | | Total change | $(5,907) |

Our average settled Debt Securities for the six months ended June 30, 2017 was $10.8 billion, compared to $11.9 billion for the six months ended June 30, 2016. Our annualized yield on average settled Debt Securities for the six months ended June 30, 2017 was 2.77%, as compared to 2.62% for the six months ended June 30, 2016. The increase in our yield was primarily attributable to an $11.4 million decrease in amortization expense to $27.1 million for the six months ended June 30, 2017 from $38.5 million in the six months ended June 30, 2016, coupled with a decline in average settled Debt Securities. The decline in amortization is attributed to the decline in the annualized rate of portfolio prepayments to 7.8% for the six months ended June 30, 2017 from 10.2% in the comparable prior year period.

Economic Interest Expense and Cost of Funds

Economic interest expense, which consists of interest expense from repo borrowings, interest rate swaps and caps, and prior to September 30, 2016, FHLBC Advances, decreased $5.6 million to $64.2 million for the six months ended June 30, 2017, from $69.8 million for the six months ended June 30, 2016.

Interest expense from Total Outstanding Borrowings increased $10.8 million to $47.4 million for the six months ended June 30, 2017 from $36.6 million for the six months ended June 30, 2016 mostly due to an increase in the cost of funds that resulted from three separate 25 bps Fed rate hikes during the comparable period. Our weighted-average cost of funds rose to 1.02% during the six months ended June 30, 2017 from 0.70% for the six months ended June 30, 2016. Our average Total Outstanding Borrowings decreased to $9.3 billion for the six months ended June 30, 2017 from $10.5 billion for the six months ended June 30, 2016, consistent with the decrease in the settled Debt Securities portfolio for the comparable prior year period. The table below illustrates the impact on interest expense resulting from changes to Total Outstanding Borrowings and financing rates during the six months ended June 30, 2017 and 2016 (in thousands):

| Change in Size | | Change in Rate | | Change in Size & Yield | |
|---|---|---|---|---|---|
| Change in average outstanding | $(1,166,562) | Change in average rate | 0.32 % | Change in average outstanding | $(1,166,562) |
| 2016 average rate | 0.70 % | 2016 average outstanding | $10,473,530 | Change in average rate | 0.32 % |
| Change | $(4,081) | Change | $16,713 | Change | $(1,861) |
| | | | | Total change | $10,771 |

Swap and cap interest expense decreased by approximately $16.4 million, to $16.8 million during the six months ended June 30, 2017 from $33.2 million during the six months ended June 30, 2016. The decrease in swap and cap interest expense is largely attributable to the increase in 3-month LIBOR, the receive-leg of our swaps, which increased to 1.30% at June 30, 2017 from 0.65% at June 30, 2016. In addition, the $0.9 billion decrease in the average aggregate swap and cap notional to $9.0 billion for the six months ended June 30, 2017, from $9.9 billion for the six months ended June 30, 2016, contributed to the decrease in swap and cap interest expense. The increase in 3-month LIBOR resulted in a 30 bps decrease in the average swap and cap net pay rate to 0.37% during the six months ended June 30, 2017 from 0.67% during the comparable prior year period. The impact of the decrease in the swap and cap net pay rate and notional on swap and cap interest expense are further illustrated in the table below (in thousands):

| Change in Size | | Change in Swap and Cap Net Pay Rate | | Change in Size & Rate | |
|---|---|---|---|---|---|
| Change in average notional outstanding | $(914,285) | Change in average rate | (0.30)% | Change in average notional outstanding | $(914,285) |
| 2016 average rate | 0.67 % | 2016 average notional outstanding | $9,878,571 | Change in average rate | (0.30)% |

| | | | | | |
|---|---|---|---|---|---|
| Change | $(3,070 ) | Change | $(14,707 ) | Change | $1,361 |
| | | | | Total change | $(16,416 ) |

Our annualized weighted-average cost of funds, including hedges was 1.38% for the six months ended June 30, 2017 as compared to 1.33% for the six months ended June 30, 2016.

Economic Net Interest Income

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Our economic net interest income for the six months ended June 30, 2017 was $86.2 million, and our interest rate spread net of hedge, was 1.39% compared to economic net interest income of $86.5 million and interest rate spread net of hedge of 1.29% for the six months ended June 30, 2016. The decrease in economic net interest income was principally due to the $5.9 million decrease in total interest income and $10.8 million increase in total interest expense, largely offset by the $16.4 million decrease in swap and cap interest expense further described above.

Other Income (Loss)

For the six months ended June 30, 2017, our total other income (loss) was $(7.1) million compared to $10.1 million for the six months ended June 30, 2016. The key components contributing to the change in total other income (loss) are discussed in more detail below.

Net Realized and Unrealized Gain (Loss) on Investments and Drop Income

Net realized and unrealized gain on investments decreased by $199.9 million to a net gain of $28.9 million for the six months ended June 30, 2017, compared to a net gain of $228.8 million for the six months ended June 30, 2016. This change was driven by changes in bond yields, resulting in a less significant increase in the prices of our Agency RMBS for the six months ended June 30, 2017, as compared to a more significant increase in the prices of our Agency RMBS for the six months ended June 30, 2016. During the six months ended June 30, 2017 and 2016, the yield on the 10-year U.S. Treasury declined by 14 bps and 80 bps, respectively. During the six months ended June 30, 2017, the price of a 30-year 3.5% Agency RMBS increased $0.34 to $102.67, and during the six months ended June 30, 2016, the price for the same security increased $2.32 to $105.55. In addition, during the six months ended June 30, 2017, the price of a 15-year 3.0% Agency RMBS increased $0.13 to $102.61, and during the six months ended June 30, 2016, the price increased $1.78 to $104.86.

During the six months ended June 30, 2017 and 2016, we generated Drop Income of approximately $18.1 million and $14.3 million, respectively. The increase in Drop Income during the six months ended June 30, 2017, as compared to the comparable prior year period was primarily attributable to higher volumes of forward settling transactions from which we derive Drop Income. During the six months ended June 30, 2017, the average gross balance in the combined TBA Securities and TBA Derivatives portfolio was $1.5 billion, a $0.3 billion increase compared to the average gross balance of $1.2 billion for the six months ended June 30, 2016.

Net unrealized gain (loss) on FHLBC Advances

We had no FHLBC Advances outstanding during the six months ended June 30, 2017. During the six months ended June 30, 2016, the Company repaid $1.5 billion of the $2.1 billion in FHLBC Advances outstanding at December 31, 2015. We had $350.0 million of FHLBC Advances with an initial maturity greater than one year and a weighted-average maturity of 0.6 years at June 30, 2016. For the six months ended June 30, 2016 the net unrealized loss on FHLBC Advances was $(1.3) million. The unrealized loss was due to pricing FHLBC Advances with an initial term greater than one year at par due to an expectation to repay the outstanding balance by August 2016.

Net Gain (Loss) on Derivative Instruments

Net gain (loss) on derivative instruments is comprised of net realized and unrealized gain (loss) on swaps and caps and TBA Derivatives. Net realized and unrealized gain (loss) on derivative instruments was $(19.3) million (comprised of $(21.2) million net realized and unrealized loss on swap and cap contracts, and $1.9 million net realized and unrealized gain on TBA Derivatives) for the six months ended June 30, 2017, compared to a loss of $(185.1) million (comprised of $(199.0) million net realized and unrealized loss on swap and cap contracts, and $13.9 million net realized and unrealized gain on TBA Derivatives) for the six months ended June 30, 2016. The change in net realized and unrealized gain (loss) on derivative instruments for the six months ended June 30, 2017 and 2016 was primarily due to changes in interest rates during the six months ended June 30, 2017, resulting in a decrease in the value of our derivative instruments. To illustrate, during the six months ended June 30, 2017 and 2016, 5-year swap rates decreased by 2 bps and 76 bps, respectively. The decrease in swap and cap notional described above also contributed to the change in net realized and unrealized loss on swaps and caps during the comparative period.

Operating Expenses

Operating expenses decreased to $11.6 million in the six months ended June 30, 2017 from $12.2 million for the six months ended June 30, 2016. Included in the six months ended June 30, 2017 operating expenses is approximately

$0.6 million of non-recurring accelerated restricted stock and other compensation expenses due to the retirement of our prior Chief Financial Officer and Treasurer. The net decrease in compensation expense is mainly due to a decrease in the incentive compensation accrual.

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Contractual Obligations and Commitments

The following table summarizes the principal balances related to our repo borrowings, the related interest expense thereon, and our office lease at June 30, 2017 (in thousands):

| June 30, 2017 | Within One Year | One to Three Years | Three to Five Years | Thereafter | Total |
|---|---|---|---|---|---|
| Repurchase agreements | $9,370,845 | $ — | $ — | $ — | $9,370,845 |
| Interest expense on repurchase agreements based on rates at June 30, 2017 | 43,879 | — | — | — | 43,879 |
| Long-term operating lease obligation | 357 | 746 | 786 | 408 | 2,297 |
| Total | $9,415,081 | $ 746 | $ 786 | $ 408 | $9,417,021 |

At June 30, 2017 and December 31, 2016, we held the following interest rate swap and cap contracts (in thousands):

As of June 30, 2017

| Interest Rate Swaps | Weighted-Average | | | | |
|---|---|---|---|---|---|
| Expiration Year | Fixed Pay Rate | Receive Rate | Net Pay Rate | Notional Amount | Fair Value |
| 2018 | 1.00% | 1.18% | (0.18)% | 1,500,000 | 4,037 |
| 2020 | 1.45% | 1.16% | 0.29% | 1,750,000 | 18,251 |
| 2021 | 1.21% | 1.18% | 0.03% | 1,700,000 | 39,725 |
| 2022 | 1.98% | 1.17% | 0.81% | 500,000 | (455 ) |
| 2024* | 2.42% | 1.17% | 1.25% | $1,000,000 | $894 |
| 2027 | 2.16% | 1.27% | 0.89% | $100,000 | $1,178 |
| Total | 1.48% | 1.17% | 0.31% | $6,550,000 | $63,630 |

| Interest Rate Caps | Weighted-Average | | | | |
|---|---|---|---|---|---|
| Expiration Year | Cap Rate | Receive Rate | Net Cap Pay Rate | Notional Amount | Fair Value |
| 2019 | 1.34% | —% | 1.34% | $800,000 | $4,937 |
| 2020 | 1.25% | 0.91% | 0.34% | 1,700,000 | 22,794 |
| Total | 1.28% | 0.62% | 0.66% | $2,500,000 | $27,731 |

* Includes 7-year swaps with a notional value of $500 million, $250 million, and $250 million, cancelable on April 19, 2018, May 19, 2018 and May 21, 2018, respectively.

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As of December 31, 2016

| Interest Rate Swaps | Weighted-Average | | | | |
|---|---|---|---|---|---|
| Expiration Year | Fixed Pay Rate | Receive Rate | Net Pay Rate | Notional Amount | Fair Value |
| 2017 | 0.82% | 0.94% | (0.12)% | $ 1,000,000 | $ 2,316 |
| 2018 | 1.00% | 0.91% | 0.09% | 1,500,000 | 4,359 |
| 2020 | 1.45% | 0.86% | 0.59% | 1,750,000 | 23,474 |
| 2021 | 1.21% | 0.89% | 0.32% | 1,700,000 | 48,931 |
| 2022 | 1.98% | 0.88% | 1.10% | 500,000 | 1,528 |
| Total | 1.23% | 0.89% | 0.34% | $ 6,450,000 | $ 80,608 |

| Interest Rate Caps | Weighted-Average | | | Notional | Fair |
|---|---|---|---|---|---|
| Expiration Year | Cap Rate | Receive Rate | Net Cap Pay Rate | Amount | Value |
| 2019 | 1.34% | —% | 1.34% | $ 800,000 | $ 8,051 |
| 2020 | 1.25% | —% | 1.25% | 1,700,000 | 34,481 |
| Total | 1.28% | —% | 1.28% | $ 2,500,000 | $ 42,532 |

We enter into certain agreements that contain a variety of indemnification obligations, principally with our brokers and counterparties for interest rate swap contracts and repo borrowings. We have not incurred any costs to defend a lawsuit or settle claims related to these indemnification obligations. The maximum potential future payment amount we could be required to pay under these indemnification obligations cannot be reasonably estimated. Accordingly, no liabilities have been recognized for these agreements as of June 30, 2017 and December 31, 2016. In addition, as of June 30, 2017 and December 31, 2016, we had $0.8 billion and $1.9 billion of payable for securities purchased, respectively, a portion of which either will be or was financed through repo borrowings.

Off-Balance Sheet Arrangements

As of June 30, 2017 and December 31, 2016, we had no relationships with any significant unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of June 30, 2017 and December 31, 2016, other than as discussed in the accompanying consolidated financial statements, we had not guaranteed obligations of unconsolidated entities, entered into commitments or had any intent to provide funding to any such entities.

We may seek to obtain other sources of financing depending on market conditions. We may finance the acquisition of Agency RMBS by entering into TBA dollar roll transactions in which we would sell a TBA contract for current month settlement and simultaneously purchase a similar TBA contract for a forward settlement date. Prior to the forward settlement date, we may choose to roll the position 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. The discount is the difference between the spot price and the forward settlement price for the same Agency RMBS on trade date and is referred to by the Company as Drop Income. This difference is also the economic equivalent of the assumed net interest spread (yield less financing costs) of the Agency RMBS from trade date to settlement date. Consequently, dollar roll transactions accounted for as TBA Derivatives, whereby the Company is not contractually obligated to accept delivery on the settlement date ("TBA Derivatives") 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.

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Liquidity and Capital Resources

Our primary sources of funds are repo borrowings, monthly principal and interest payments on our investment portfolio, asset sales, equity and debt offerings, and prior to the effective date of the Final Rule on January 19, 2016, which precluded us from securing new advances, FHLBC Advances. Because the level of our borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our balance sheet is significantly less important than the potential liquidity available under our borrowing arrangements. We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, maintenance of any margin requirements and the payment of cash dividends as required for our continued qualification as a REIT. To qualify as a REIT, we must distribute annually at least 90% of our net taxable income. To the extent that we annually distribute all of our net taxable income in a timely manner, we will generally not be subject to federal and state income taxes. We currently expect to distribute all or substantially all of our taxable income in a timely manner so that we are not subject to federal and state income tax. This distribution requirement limits our ability to retain earnings and thereby replenish or increase capital from operations.

As of June 30, 2017 and December 31, 2016, we had approximately $1.1 billion and $0.9 billion, respectively, in Agency RMBS, U.S. Treasuries, and cash and cash equivalents available to satisfy future margin calls. We have consistently maintained sufficient liquidity to meet margin calls, and have historically satisfied all margin calls, although no assurance can be given that we will be able to satisfy margin calls in the future. During the six months ended June 30, 2017, we maintained an average liquidity level of 61%. Our liquidity level was never less than 53% of stockholders' equity during the six months ended June 30, 2017. The following table presents our unencumbered liquid assets as a percentage of stockholders' equity for the periods presented:

| | Carrying Value as of | |
|---|---|---|
| Unencumbered Liquid Assets | June 30, 2017 | December 31, 2016 |
| Cash and cash equivalents | $1,264 | $1,260 |
| U.S. Treasuries | 7,940 | 32,494 |
| Agency RMBS | 1,056,513 | 903,548 |
| Total liquid assets | $1,065,717 | $937,302 |
| Unencumbered liquid assets as % of total stockholders' equity | 69.4 % | 61.0 % |

During the Second Quarter we had average repo borrowings outstanding of $9.3 billion with an average cost of funds of 1.13%, and during the Second Quarter of 2016 we had average repo borrowings and FHLBC Advances of $10.4 billion with an average cost of funds of 0.72%.  At June 30, 2017, repo borrowing financing was generally stable but at higher rates relative to the Second Quarter of 2016 as a direct result of three separate 25 bps Fed rate hikes during the comparable period. Repo borrowing rates were between 1.02% and 1.38% for 30-90 day repo borrowings during the Second Quarter as compared to 0.55% and 0.84% in the Second Quarter of 2016.

We diversify our funding across multiple counterparties and by counterparty region to limit our exposure to counterparty credit risk. As of June 30, 2017 and December 31, 2016, we had access to 51 and 50 counterparties, respectively, subject to certain conditions, located throughout North America, Europe and Asia. At June 30, 2017 and December 31, 2016 we had no FHLBC Advances outstanding. As of June 30, 2017 and December 31, 2016, repo borrowings with any individual counterparty were less than 6.6% and 7.1% of the Total Outstanding Borrowings, respectively. The table below includes a summary of our outstanding repo borrowings by number of counterparties and region as of June 30, 2017 and December 31, 2016:

| | June 30, 2017 | |
|---|---|---|
| Counterparty Region | Number of Counterparties | Percent of Total Outstanding Borrowings |
| North America | 21 | 53.8% |
| Europe | 8 | 25.3% |
| Asia | 6 | 20.9% |
| | 35 | 100.0% |

| | December 31, 2016 | |
|---|---|---|
| Counterparty Region | Number of Counterparties | Percent of Total Outstanding Borrowings |
| North America | 22 | 60.4% |
| Europe | 8 | 22.8% |
| Asia | 5 | 16.8% |
| | 35 | 100.0% |

Our repurchase agreements contain standard provisions and covenants as set forth in the standard master repurchase agreement published by the Securities Industry and Financial Markets Association. Our repurchase agreements generally require us to transfer additional securities to the counterparty if the value of the securities then held by the counterparty in the margin account falls below specified levels and contain events of default in cases where we or the counterparty breaches our respective obligations under the agreement.

The credit arrangement pursuant to which CYS Insurance maintained FHLBC Advances (the "FHLBC Arrangement") involved observance by CYS Insurance of the rules of FHLBC membership, subject to the FHLBC's credit policy, and was governed by the terms and conditions of a blanket security agreement, and the consent and guaranty of the Company. The FHLBC Arrangement required CYS Insurance to transfer additional securities to the FHLBC if the value of the securities then held by the FHLBC fell below specified levels, and contained events of default in cases where we or the FHLBC breached our respective obligations under the FHLBC Arrangement. An event of default or termination event under the FHLBC Arrangement would have given the FHLBC the option to terminate all FHLBC Advances existing with us and make any amount due by us to the FHLBC immediately payable.

We receive margin calls from our repurchase agreement counterparties in the ordinary course of business, similar to other special finance entities. We receive two types of margin calls under our repurchase agreements. The first type, which are known as "factor calls," are margin calls that occur each month and relate to the timing difference between the reduction of principal balances of our Agency RMBS due to monthly principal payments on the underlying mortgages, and the receipt of the corresponding cash. The second type of margin call we may receive is a "valuation call", which occurs due to market and interest rate movements. Both factor and valuation margin calls occur if the total value of our assets pledged as collateral to our counterparty drops beyond a threshold level, typically between $100,000 and $500,000 (although no such minimum applied under the FHLBC Arrangement). Both types of margin calls require a dollar for dollar restoration of the margin shortfall. Conversely, we may initiate margin calls to our counterparties when the value of our assets pledged as collateral with a counterparty increases above the threshold level, thereby increasing our liquidity. All unrestricted cash plus any unpledged securities, are available to satisfy margin calls.

Our collateral is generally valued on the basis of prices provided by recognized bond market sources agreed to by the parties. Inputs to the models used by pricing sources may include, but are not necessarily limited to, reported trades, executable bid and asked prices, broker quotations, prices or yields of securities with similar characteristics, benchmark curves or information pertaining to the issuer, as well as industry and economic events. Our master repurchase agreements contain mostly standard provisions for the valuation of collateral. These agreements typically provide that both the repurchase seller (the borrower) and the repurchase buyer (the lender) value the collateral on a daily basis. Each party uses prices that it obtains from generally recognized pricing sources, or the most recent closing bid quotation from such a source. If the buyer, or the seller, as the case may be, determines that additional collateral is required, it may call for the delivery of such collateral. Under certain of our repurchase agreements, in limited circumstances, such as when a pricing source is not available, our lenders have the right to determine the value of the collateral we have provided to secure our repo borrowings. In instances where we have agreed to permit our lenders to make a determination of the value of such collateral, such lenders are expected to act reasonably and in good faith in making such valuation determinations.

We also pledge collateral for our interest rate swaps, caps, and forward purchase transactions. We will receive margin calls on these transactions when the value of the swap, cap or forward purchase transaction declines or when the value of any collateral pledged falls below a particular threshold level. All unrestricted cash and cash equivalents, plus any unpledged Agency RMBS or U.S. Treasuries, are available to satisfy margin calls.

An event of default or termination event under the standard master repurchase agreement would give our counterparty the option to terminate all repurchase transactions existing with us and make any amount due by us to the counterparty immediately payable.

For our short-term (less than one year) and long-term (more than one year) liquidity and capital resource requirements, we rely on the cash flow from operations, primarily monthly principal and interest payments to be received on our Agency RMBS. During the six months ended June 30, 2017 and 2016, we recorded $636.3 million and $865.0 million of principal repayments, respectively, and received $149.9 million and $158.4 million of interest payments, respectively. We held cash and cash equivalents of $1.3 million at June 30, 2017 and December 31, 2016. For the six months ended June 30, 2017 and 2016, net cash provided by operating activities was $131.1 million and $78.2 million, respectively. For the six months ended June 30, 2017 and 2016, net cash provided by (used in) investing activities was $238.3 million and $643.6 million, respectively. For the six months ended June 30, 2017 and 2016, net cash provided by (used in) financing activities was $(369.4) million and $(718.6) million, respectively.

Based on our current portfolio, leverage and available borrowing capacity, we believe that our cash flow from operations and the utilization of borrowings will be sufficient to enable us to meet anticipated short-term liquidity requirements such as funding our investment activities, distributions to stockholders and general corporate expenses. However, an increase in prepayment rates substantially above our expectations may cause a temporary liquidity shortfall due to the timing of margin calls and the actual receipt of cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may be required to sell Agency RMBS in our portfolio or issue debt or equity securities, subject to market conditions. If required, the sale of Agency RMBS at prices lower than their amortized cost would result in realized losses. We believe that we have additional capacity through repurchase agreements to leverage our equity further should the need for additional short-term liquidity arise.

Our investment portfolio is comprised principally of highly-liquid Agency RMBS and U.S. Treasuries. We regularly monitor the creditworthiness of the U.S. government and the GSEs. While the U.S. government has had its credit rating downgraded in recent years by one of the credit rating agencies, we believe it remains one of the most secure creditors in the world as of June 30, 2017.

We may increase our capital resources by obtaining long-term credit facilities or making public or private offerings of equity or debt securities. Such capital transactions will depend on market conditions for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations. On May 22, 2017, we filed an automatically effective shelf registration statement on Form S-3 with the SEC. We may offer and sell, from time to time, shares of common stock, preferred stock and debt securities in one or more offerings pursuant to the prospectus that is a part of the registration statement. As of June 30, 2017, we had not issued any shares of common stock, preferred stock or debt securities under the prospectus.

Our Direct Share Purchase Program ("DSPP") is another vehicle we may use to raise capital, through which stockholders may purchase additional shares of common stock by reinvesting some or all of the cash dividends received on shares of common stock. Stockholders may also make optional cash purchases of shares of common stock subject to certain limitations detailed in the plan prospectus. For the six months ended June 30, 2017, the Company issued 1,618 shares for net proceeds of $14 thousand. We did not issue any shares under the DSPP during the six months ended June 30, 2016. As of June 30, 2017 and December 31, 2016, there were approximately 4.1 million shares available for issuance under the DSPP.

For the six months ended June 30, 2017, we did not repurchase any shares of the Company's common stock. Accordingly, the Company was authorized to repurchase shares of its common stock approximating $155.5 million as of June 30, 2017 pursuant to its stock repurchase program. For the six months ended June 30, 2016, we repurchased 673,166 shares of the Company's common stock at a weighted-average purchase price of $7.85 per share, for an aggregate purchase price of approximately $5.3 million. Accordingly, the Company was authorized to repurchase shares of its common stock approximating $155.5 million as of June 30, 2016.

Quantitative and Qualitative Disclosures about Short-Term Borrowings

The following table is a summary of quantitative data about our repo borrowings and FHLBC Advances with initial maturities less than one year during the three and six months ended June 30, 2017 and 2016:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2017 | 2016 | 2017 | 2016 |
| Outstanding at period end | $9,371 | $10,075 | $9,371 | $10,075 |
| Weighted-average rate at period end | 1.23 % | 0.65 % | 1.23 % | 0.65 % |
| Average outstanding during period [(1)] | $9,277 | $10,025 | $9,307 | $10,070 |
| Weighted-average rate during period | 1.13 % | 0.69 % | 1.02 % | 0.67 % |

| | | | | |
|---|---|---|---|---|
| Largest month end balance during period | $ 9,376 | $ 10,363 | $ 9,692 | $ 10,663 |

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(1) Calculated based on the average month end balance of repurchase agreements and FHLBC Advances with initial maturities less than one year.

The Company's borrowing rates were higher in the three and six months ended June 30, 2017 than in the corresponding three and six months ended June 30, 2016 due primarily to three separate 25 bps Fed rate hikes between June 30,

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2016 and June 30, 2017. Overall, we continue to experience a stable financing environment. During the six months ended June 30, 2016 we replaced $1.45 billion of FHLBC Advances with repo borrowings from existing counterparties. From quarter to quarter, fluctuations occur in repo borrowings and FHLBC Advances that are fairly tightly correlated with the expansion and contraction of our investment portfolio. Though it varies by quarter, we generally maintain leverage between 6.4:1 and 7.2:1.

At June 30, 2017 and December 31, 2016, our amount at risk with any individual counterparty related to our repo borrowings was less than 2.2% and 2.6% of stockholders' equity, respectively.

Inflation

Our assets and liabilities are sensitive to interest rate and other related factors to a greater degree 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 dividend distributions are determined by our Board of Directors based in large part on our REIT taxable income as calculated according to the requirements of the Internal Revenue Code. In each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As of June 30, 2017 and December 31, 2016, the primary component of our market risk was interest rate risk, as described below. We do not seek to completely avoid risk because we believe that certain risks can be estimated based on historic experience. Accordingly, we manage these risks in an effort to earn the commensurate compensation required to take them and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

We are subject to interest rate risk in connection with our investments in Debt Securities and our related debt obligations, which are generally repo borrowings and, prior to the February 19, 2016 effective date of the Final Rule, FHLBC Advances, of limited duration that are periodically refinanced at current market rates. We seek to manage this risk through utilization of derivative contracts, primarily interest rate swap and cap contracts.

Effect on Net Interest Income. We fund our investments in long-term Agency RMBS collateralized by ARMs, Hybrid ARMs and fixed rate mortgage loans with short-term repo borrowings and, prior to the February 19, 2016 effective date of the Final Rule, FHLBC Advances. During periods of rising interest rates, the borrowing costs associated with Agency RMBS tend to increase while the income earned on such Agency RMBS (during the fixed rate component of such securities) may remain substantially unchanged, assuming a static portfolio. This results in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses.

We are a party to interest rate swap and cap contracts as of June 30, 2017 and December 31, 2016, described in detail under Item 2. "Management’s Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations and Commitments" in this Quarterly Report.

Hedging techniques are partly based on assumed levels of prepayments of our Agency RMBS. If prepayments are slower or faster than assumed, the life of the Agency RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions.

Effect on Fair Value. Another component of interest rate risk is the effect changes in interest rates will have on the fair value of our assets, liabilities, and derivative instruments, which is discussed in further detail below.

We assess our interest rate risk primarily by estimating the duration of our assets and liabilities. Duration, in its simplest form, measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using third-party financial models and empirical data. Different models and methodologies can produce different durations for the same securities.

Extension Risk

We have generally structured our swaps to expire in conjunction with the estimated weighted-average life of the fixed period of the mortgages underlying our Agency RMBS portfolio. However, in a rising interest rate environment, the weighted-average life of the fixed rate mortgages underlying our Agency RMBS could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the term of the hedging instrument while the income earned on the remaining Agency RMBS would remain fixed for a period of time. This situation may also cause the market value of our Agency RMBS to decline with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to realize losses.

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Interest Rate Cap Risk

Both ARMs and Hybrid ARMs that collateralize our Agency RMBS are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, the interest costs on our borrowings could increase without limitation by caps while the interest rate or yield on our Agency RMBS would be fixed or effectively be limited by caps. This problem will be magnified to the extent that we acquire Agency RMBS that are collateralized by Hybrid ARMs that are not fully indexed. In addition, the underlying mortgages may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash on our Agency RMBS than we need in order to pay the interest cost on our related borrowings. These factors could result in a decrease in our net income or cause a net loss during periods of rising interest rates, which could have an adverse effect on our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk

We intend to fund a substantial portion of our acquisitions of Agency RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and repricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and repricing terms of the Agency RMBS. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our Agency RMBS and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Therefore, our cost of funds would likely rise or fall faster than the rate of earnings on our assets. During periods of changing interest rates, such interest rate mismatches could adversely affect our financial condition, cash flows and results of operations. To manage interest rate mismatches, we may utilize the hedging strategies discussed above.

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results reflected herein.

Prepayment Risk

Prepayments are the full or partial repayment of principal prior to the original contractual maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates for existing Agency RMBS generally increase when prevailing mortgage interest rates fall. Additionally, the majority of our Agency RMBS were purchased at a premium. The prepayment of such Agency RMBS at a rate faster than anticipated would result in amortization of any remaining unamortized premium faster than expected, which could adversely affect our financial condition and results of operations.

Effect on Fair Value and Net Income

Another component of interest rate risk is the effect that changes in interest rates will have on the fair value of our assets and our net income exclusive of the effect on fair value. We face the risk that the fair value of our assets and net interest income will increase or decrease at different rates than that of our liabilities, including our hedging instruments.

The following sensitivity analysis table estimates the impact of our interest rate-sensitive investments and repo borrowing liabilities on our net income, fair value of our assets, and change in stockholders' equity, exclusive of the effect of changes in fair value on our net income, at June 30, 2017 and December 31, 2016, assuming a static portfolio and an instantaneous increase and decrease in rates of 25, 50 and 75 bps, except as further described in the footnotes to the following table:

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June 30, 2017

| Interest Rate Change (bps) | Projected Change in Net Income [1] | | | Projected Change in the Fair Value of Our Investments [1] | | Projected Change in Stockholders' Equity | |
|---|---|---|---|---|---|---|---|
| - 75 | 21.07 | % | (2)(3) | 0.72 | % | 5.97 | % |
| - 50 | 16.86 | % | (2)(3) | 0.61 | % | 5.03 | % |
| - 25 | 8.43 | % | (2)(3) | 0.37 | % | 3.05 | % |
| + 25 | (11.05 | )% | (2) | (0.49 | )% | (4.02 | )% |
| + 50 | (18.26 | )% | (2) | (1.08 | )% | (8.91 | )% |
| + 75 | (32.12 | )% | (2) | (1.75 | )% | (14.50 | )% |

December 31, 2016

| Interest Rate Change (bps) | Projected Change in Net Income [1] | | | Projected Change in the Fair Value of Our Investments [1] | | Projected Change in Stockholders' Equity | |
|---|---|---|---|---|---|---|---|
| - 75 | 19.81 | % | (2)(3) | 0.71 | % | 5.78 | % |
| - 50 | 16.23 | % | (2)(3) | 0.63 | % | 5.13 | % |
| - 25 | 12.20 | % | (2)(3) | 0.38 | % | 3.10 | % |
| + 25 | (10.08 | )% | (2) | (0.47 | )% | (3.83 | )% |
| + 50 | (20.16 | )% | (2) | (1.01 | )% | (8.22 | )% |
| + 75 | (30.24 | )% | (2) | (1.63 | )% | (13.21 | )% |

(1) Projected changes in the table are calculated utilizing Yield Book® software and may reflect adjustments based on our judgment.

(2) Immediate impact estimated over 12 month period.

(3) Given the historically low level of interest rates at June 30, 2017 and December 31, 2016, we reduced 3-month LIBOR and our repo borrowing rates by 20, 40 and 50 bps and by 10, 20 and 30 bps for the 25, 50, and 75 bps down net income scenarios, respectively. All other interest rate-sensitive instruments were calculated in accordance with the table.

While the tables above reflect the estimated immediate impact of interest rate increases and decreases on a static portfolio, we rebalance our portfolio periodically either to take advantage of, or minimize the impact of, changes in interest rates. Generally, our interest rate swaps reset in the quarter following rate changes. The impact of changing interest rates on fair value and net income can change significantly when interest rates change beyond 75 bps from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 75 bps. In addition, other factors impact the fair value of and net income from our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, when actual interest rates change, the change in the fair value of our assets and our net income will likely differ from that shown above, and such difference may be material and adverse for our stockholders.

Risk Management

Our board of directors exercises its oversight of risk management in many ways, including overseeing our senior management's risk-related responsibilities, including reviewing management policies and performance against these policies and related benchmarks.

As part of our risk management process, we actively manage the interest rate, liquidity, prepayment and counterparty risks associated with our Agency RMBS portfolio. This process includes monitoring various stress test scenarios on our portfolio. We seek to manage our interest rate risk exposure by entering into various hedging instruments in order to minimize our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs. We seek to manage our liquidity risks by monitoring our liquidity position on a daily basis and maintaining a prudent level of leverage based on current market conditions and various other factors, including the health of the financial institutions that lend to us under repurchase agreements. We seek to manage our counterparty risk by (i) diversifying our exposure across a broad number of counterparties, (ii) limiting our exposure to any one counterparty, and (iii) monitoring the financial stability of our counterparties.

## Item 4. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2017. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2017, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

There have been no changes in our internal controls over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## PART II. Other Information

### Item 1. Legal Proceedings

The Company and its subsidiaries are not currently subject to any material legal proceedings other than ordinary, routine litigation incidental to the business.

### Item 1A. Risk Factors

There were no material changes during the period covered by this Quarterly Report to the risk factors previously disclosed in our 2016 Annual Report. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operations.

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

Issuer Purchases of Equity Securities

The following table summarizes the Company's purchases of shares of its common stock during the six months ended June 30, 2017 (dollars in thousands except per share data):

| Period | Total Number of Shares Purchased [(1)] | Average Price Paid Per Share [(1)] | Dollar Value of Shares That May Yet Be Purchased [(1)] |
|---|---|---|---|
| January 1, 2017 - January 31, 2017 | — | $ — | $ 155,502 |
| February 1, 2017 - February 28, 2017 [(2)] | — | — | 155,502 |
| March 1, 2017 - March 31, 2017 | — | — | 155,502 |
| April 1, 2017 - April 30, 2017 | — | — | 155,502 |
| May 1, 2017 - May 31, 2017 | — | — | 155,502 |
| June 1, 2017 - June 30, 2017 | — | — | 155,502 |
| Total | — | $ — | |

(1) The Company repurchases shares of its common stock in open-market transactions pursuant to its share repurchase program, which was authorized by its board of directors and publicly announced on July 21, 2014. Pursuant to this authority, the Company may repurchase shares of its common stock up to $250 million in aggregate value. Since July 21, 2014, the Company has repurchased approximately $94.5 million in aggregate value of its common stock, and accordingly, the Company was authorized to repurchase shares with an aggregate value of $155.5 million as of June 30, 2017.

(2) Excludes 44,521 shares purchased during February 2017 at a weighted-average price per share of $7.80 to satisfy withholding obligations on the vesting of restricted shares. The price paid per share was the then closing price of our common stock on the New York Stock Exchange. These 44,521 shares are not included in "Dollar Value of Shares That May Yet Be Purchased".

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) Exhibits.

| Exhibit Number | Description of Exhibit |
|---|---|
| 3.1[1] | Articles of Amendment and Restatement of CYS Investments, Inc. |
| 3.2[2] | Articles of Amendment to the Articles of Amendment and Restatement |
| 3.3[2] | Articles of Amendment to the Articles of Amendment and Restatement |
| 3.4[3] | Articles of Amendment to the Articles of Amendment and Restatement |
| 3.5[4] | Articles Supplementary of 7.75% Series A Cumulative Redeemable Preferred Stock |
| 3.6[5] | Articles Supplementary of 7.50% Series B Cumulative Redeemable Preferred Stock |
| 3.7[6] | Amended and Restated Bylaws of CYS Investments, Inc. |
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002 |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002 |
| 32.1** | 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 |
| 32.2** | 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 |
| Exhibit 101.INS XBRL | Instance Document (7) |
| Exhibit 101.SCH XBRL | Taxonomy Extension Schema Document (7) |
| Exhibit 101.CAL XBRL | Taxonomy Extension Calculation Linkbase Document (7) |
| Exhibit 101.DEF XBRL | Additional Taxonomy Extension Definition Linkbase Document Created (7) |
| Exhibit 101.LAB XBRL | Taxonomy Extension Label Linkbase Document (7) |
| Exhibit 101.PRE XBRL | Taxonomy Extension Presentation Linkbase Document (7) |

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* Filed herewith.

** Furnished herewith.

(1) Incorporated by reference to the Registrant’s Registration Statement on Form S-11 filed with the Securities and Exchange Commission (File No. 333-142236).

(2) Incorporated by reference to the Registrant’s Form 10-K filed with the Securities and Exchange Commission on February 10, 2010.

(3) Incorporated by reference to the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on September 1, 2011.

(4) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 2, 2012.

(5) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 29, 2013.

(6) Incorporated by reference to the Registrant’s Form 10-K filed with the Securities and Exchange Commission on February 10, 2012.

(7) Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at June 30, 2017 (Unaudited) and December 31, 2016 (Derived from the audited balance sheet at December 31, 2016); (ii) Consolidated Statements of Operations (Unaudited) for the three and six months ended June 30, 2017 and 2016; (iii) Consolidated Statements of Stockholders' Equity (Unaudited) for the six months ended June 30, 2017 and 2016; (iv) Consolidated Statements of Cash Flows (Unaudited) for the six months ended June 30, 2017 and 2016; and (v) Notes to Consolidated Financial Statements (Unaudited).

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SIGNATURES

Pursuant to the requirements 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.

CYS INVESTMENTS, INC.
Dated: July 27, 2017 BY: /s/ JACK DECICCO
Jack DeCicco, CPA
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
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