Armour Residential REIT, Inc.
Form 10-K
February 27, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2013
OR
o 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 001-34766

ARMOUR RESIDENTIAL REIT, INC.
(Exact name of registrant as specified in its charter)

Maryland	26-1908763
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3001 Ocean Drive, Suite 201, Vero Beach, FL 32963
(Address of principal executive offices)(zip code)

(772) 617-4340
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on which registered
Preferred Stock, 8.250% Series A Cumulative Redeemable	New York Stock Exchange
Preferred Stock, 7.875% Series B Cumulative Redeemable	New York Stock Exchange
Common Stock, $0.001 par value	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES o NO x

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 twelve 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 o

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 twelve months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x   Accelerated filer o   Non-accelerated filer o   Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

On June 30, 2013, the aggregate value of the registrant's common stock held by non-affiliates of the registrant was approximately $1,701,980,000, based on the closing sales price of our common stock on such date as reported on the NYSE.

The number of outstanding shares of the Registrant's common stock as of February 25, 2014 was 357,621,939.

Documents Incorporated By Reference

Certain portions of the registrant's definitive proxy statement pursuant to Regulation 14A of the Securities Exchange Act of 1934 for its 2014 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

Item 1. Business

References to “we,” “us,” “our,” "ARMOUR" or the “Company” are to ARMOUR Residential REIT, Inc. References to "ARRM" are to ARMOUR Residential Management LLC, a Delaware limited liability company. References to “Enterprise” are to Enterprise Acquisition Corp., which was a wholly-owned subsidiary of ARMOUR dissolved in December 2013.

Our Company

We are a Maryland corporation formed to invest in and manage a leveraged portfolio of residential mortgage backed securities (“MBS”). The securities we invest in are issued or guaranteed by a United States (“U.S.”) Government-sponsored entity (“GSE”), such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), or guaranteed by the Government National Mortgage Administration (Ginnie Mae) (collectively, “Agency Securities”). Our securities portfolio consists primarily of Agency Securities backed by fixed rate home loans. From time to time, a portion of our assets may be invested in Agency Securities backed by hybrid adjustable rate and adjustable rate home loans as well as unsecured notes and bonds issued by U.S. Government-sponsored entities (“Agency Debt”), U.S. Treasuries and money market instruments, subject to certain income tests we must satisfy for our qualification as a real estate investment trust (“REIT”). Our charter permits us to invest in Agency Securities and Non-Agency Securities. As of December 31, 2013 and December 31, 2012, Agency Securities account for 100% of our securities portfolio. It is expected that the percentage will continue to be 100% or close thereto.

We are externally managed by ARRM, pursuant to a management agreement (the “Management Agreement”), which was most recently amended on February 25, 2014. ARRM is an investment advisor registered with the Securities and Exchange Commission (“SEC”). ARRM is also the external manager of JAVELIN Mortgage Investment Corp. (“JAVELIN”), a publicly traded REIT, which invests in and manages a leveraged portfolio of Agency Securities and Non-Agency Securities. Our executive officers also serve as the executive officers of JAVELIN.

We seek attractive long-term investment returns by investing our equity capital and borrowed funds in our targeted asset class of Agency Securities. We earn returns on the spread between the yield on our assets and our costs, including the interest cost of the funds we borrow, after giving effect to our hedges. We identify and acquire Agency Securities, finance our acquisitions with borrowings under a series of short-term repurchase agreements at the most competitive interest rates available to us and then cost-effectively hedge our interest rate and other risks based on our entire portfolio of assets, liabilities and derivatives and our management’s view of the market. Successful implementation of this approach requires us to address interest rate risk, maintain adequate liquidity and effectively hedge interest rate risks. We believe that the residential mortgage market will undergo significant changes in the coming years as the role of GSEs, such as Fannie Mae and Freddie Mac, is diminished, which we expect will create attractive investment opportunities for us. We execute our business plan in a manner consistent with our intention of qualifying as a REIT under the Internal Revenue Code, (the “Code”) and to avoid regulation as an investment company under the Investment Company Act of 1940 (the “1940 Act”).

We have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code including meeting certain asset, income and stock ownership tests.

Our Subsidiary - Enterprise Acquisition Corp.

Enterprise was a Delaware blank check company incorporated on July 9, 2007, in order to serve as a vehicle for the acquisition of one or more operating businesses.

On July 29, 2009, Enterprise entered into an Agreement and Plan of Merger (the "Merger Agreement"), with ARMOUR and ARMOUR Merger Sub Corp., a Delaware corporation and a wholly-owned subsidiary of ARMOUR, ("Merger Sub Corp."). The Merger Agreement provided for two primary transactions: (i) the merger of Merger Sub Corp. with and into Enterprise with Enterprise surviving the merger and becoming a wholly-owned subsidiary of ARMOUR and (ii) ARMOUR becoming the new publicly-traded corporation of which the holders of Enterprise securities became security holders of ARMOUR. A summary of these transactions is as follows:

- On November 5, 2009, the stockholders of Enterprise approved certain proposals to: (i) amend Enterprise's amended and restated certificate of incorporation to allow for a business combination with ARMOUR and (ii) adopt the Merger Agreement and approve the merger of Merger Sub Corp. with and into Enterprise, which we refer to as the Business Combination.

• On November 6, 2009, Merger Sub Corp. merged with and into Enterprise pursuant to the Merger Agreement. In connection with the closing, the holders of Enterprise common stock and warrants became holders of the securities of ARMOUR after the Business Combination.

On December 27, 2013, Enterprise filed a Certificate of Dissolution with the Secretary of State of the State of Delaware to effectuate the dissolution of Enterprise. At the time of filing, Enterprise had no operations and its assets were nominal.

Our Strategies

Our primary goal is to acquire Agency Securities, finance our acquisitions in the capital markets, use targeted leverage ratios and employ risk management in an effort to provide an attractive risk adjusted return on stockholders' equity. We seek to achieve this goal through the thoughtful and opportunistic application of our asset acquisition, leverage and interest rate management strategies.

Our Assets

Since our formation, our assets have been invested in Agency Securities or money market instruments, primarily deposits at federally chartered banks.

Our Borrowings

We borrow against our Agency Securities using repurchase agreements. Our borrowings generally have maturities that may range from one month or less, up to one year, although occasionally we may enter into longer dated borrowing agreements to more closely match the rate adjustment period of our Agency Securities. Our total repurchase indebtedness was approximately $13.2 billion at December 31, 2013, and had a weighted average maturity of 45 days. Depending on market conditions, we may enter into additional repurchase arrangements with similar maturities or a committed borrowing facility. Our borrowings are generally between six and ten times the amount of our stockholders' equity, but we are not limited to that range. The level of our borrowings may vary periodically depending on market conditions. In addition, certain of our master repurchase agreements ("MRAs") and master swap agreements contain a restriction that prohibits our leverage from exceeding twelve times our stockholders' equity as well as termination events in the case of significant reductions in equity capital.

Despite recent credit market developments and prevailing trends, we believe Agency Securities will continue to be eligible for financing in the repurchase agreement market.

Our Hedging

Our hedging strategies are designed to reduce the impact on our earnings caused by the potential adverse effects of changes in interest rates on our assets and liabilities. Subject to complying with REIT requirements, we use hedging techniques to limit the risk of adverse changes in interest rates on the value of our assets as well as the differences between the interest rate adjustments on our assets and borrowings. These techniques primarily consist of entering into interest rate swap contracts and swaptions and purchasing or selling Eurodollar Futures Contracts ("Futures Contracts") and may also include entering into interest rate cap or floor agreements, purchasing put and call options on securities or securities underlying Futures Contracts, or entering into forward rate agreements. Although we are not legally limited to our use of hedging, we intend to limit our use of derivative instruments to only those techniques described above and to enter into derivative transactions only with counterparties that we believe have a strong credit rating to help limit the risk of counterparty default or insolvency. These transactions are not entered into for speculative purposes. In addition, since we have not elected to use cash flow hedge accounting, earnings reported in accordance with generally accepted accounting principles in the U.S. (“GAAP”) will fluctuate even in situations where our derivatives are operating as intended. As a result of this mark-to-market accounting treatment, our results of operations are likely to fluctuate far more than if we were to designate our derivative activities as cash flow hedges. Comparisons with companies that use cash flow hedge accounting for all or part of their derivative activities may not be meaningful.

Our Manager

We are externally managed by ARRM, pursuant to the Management Agreement (see Note 14 to the consolidated financial statements). All of our executive officers are also employees of ARRM. ARRM manages our day-to-day operations, subject to the direction and oversight of the Board of Directors (“Board”). The Management Agreement expires on June 18, 2022 and is thereafter automatically renewed for an additional 5 year term unless terminated under certain circumstances. Either party must provide 180 days prior written notice of any such termination. ARRM is entitled to receive a termination fee from us under certain circumstances.

Pursuant to the Management Agreement, ARRM is entitled to receive a management fee payable monthly in arrears. Currently, the monthly management fee is 1/12th of the sum of (a) 1.5% of gross equity raised up to $1.0 billion plus (b) 0.75% of gross equity raised in excess of $1.0 billion. The cost of repurchased stock and dividends representing returns of capital for tax purposes, reduce the amount of gross equity raised used to calculate the monthly management fee. As of December 31, 2013, the effective management fee was 1.026% based on gross equity raised. ARRM is entitled to receive a monthly management fee regardless of the performance of our securities portfolio. Accordingly, the payment of our monthly management fee may not decline in the event of a decline in our earnings and may cause us to incur losses. We incurred $28.1 million, $19.5 million and $6.9 million, respectively, in management fees for the years ended December 31, 2013, 2012 and 2011, respectively.

We are required to take actions as may be reasonably required to permit and enable ARRM to carry out its duties and obligations. We are also responsible for any costs and expenses that ARRM incurred solely on behalf of ARMOUR or its subsidiary other than the various overhead expenses specified in the terms of the Management Agreement. For the year ended December 31, 2013, we reimbursed ARRM $1.5 million for other expenses incurred on our behalf. We also reimbursed $1.1 million of compensation expense during the year ended December 31, 2013, related to restricted shares for ARRM employees (see Note 10 to the consolidated financial statements). For the year ended December 31, 2012, we reimbursed ARRM $0.05 million for other expenses incurred on our behalf. For the year ended December 31, 2011, we did not reimburse ARRM for any expenses.

Pursuant to a Sub-Management Agreement between ARMOUR, ARRM and Staton Bell Blank Check LLC (“SBBC”), ARRM is responsible for the monthly payment of a sub-management fee to SBBC in an amount equal to 25% of the monthly management fee earned by ARRM, net of expenses. On November 6, 2014, SBBC has the option of terminating the Sub-Management Agreement. If the Sub-Management Agreement is terminated, we would be required to make a final payment to SBBC in the amount of 6.16 times the annualized rate of the sub-management fee for the prior three months. Thereafter, we will be entitled to receive the sub-management fee or, at the option of ARRM, reimbursement of the final payment by ARRM. The payments from ARRM to SBBC for the three months preceding December 31, 2013 totaled $1.4 million. If the Sub-Management Agreement had been terminated on December 31, 2013, the payment due from ARMOUR would have been $35.4 million.

Other Activities

If, when applicable, ARRM and the Board determine that additional funding is required, we may raise such funds through equity offerings (including preferred equity), unsecured debt securities, convertible securities (including warrants, preferred equity and debt) or the retention of cash flow (subject to provisions in the Code concerning taxability of undistributed REIT taxable income) or a combination of these methods.

In the event that ARRM determines the need to raise additional equity capital, we have the authority, without stockholder approval, to issue additional stock in any manner and on such terms and for such consideration as we deem appropriate, at any time.

In December 2012, our Board authorized a stock repurchase program of up to $100.0 million of outstanding shares of our common stock outstanding (the “Repurchase Program”). Under the Repurchase Program, shares may be purchased in the open market, including block trades, through privately negotiated transactions, or pursuant to a trading plan separately adopted in the future. The timing, manner, price and amount of any repurchases will be at our discretion, subject to the requirements of the Securities Exchange Act of 1934 and related rules. We are not required to repurchase any shares under the Repurchase Program and it may be modified, suspended or terminated at any time for any reason. We do not intend to purchase shares from our Board or other affiliates. Under Maryland law, such repurchased shares are treated as authorized but unissued. As of December 31, 2013, there was $27.3 million remaining under the Repurchase Program.

Real Estate Investment Trust Requirements

We have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code, including meeting certain asset, income and stock ownership tests.

As a REIT, we will generally not be subject to federal income tax on the REIT taxable income that we currently distribute to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to federal income tax at regular corporate rates. Even if we qualify as a REIT for federal income tax purposes, we may still be subject to some federal, state and local taxes on our income.

Distributions

As required in order to maintain our qualification as a REIT for U.S. federal income tax purposes, we intend to distribute with respect to each year at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. To satisfy the requirements to qualify as a REIT and generally not be subject to U.S. federal income and excise tax, we intend to continue to make regular cash distributions of all or substantially all of our taxable income to holders of our stock out of assets legally available for such purposes. We are not restricted from using the proceeds of equity or debt offerings to pay dividends, but we do not intend to do so. The timing and amount of any dividends we pay to holders of our stock will be at the discretion of our Board and will depend upon various factors, including our earnings and financial condition, maintenance of REIT status, applicable provisions of the Maryland General Corporation Law (“MGCL”) and such other factors as our Board deems relevant. Dividends in excess of REIT taxable income for the year (including taxable income carried forward from the previous year) will generally not be taxable to common stockholders.

Investment Company Act of 1940 Exclusion

We conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940 (the “1940 Act”). We rely on the exclusion provided by Section 3(c)(5)(C) of the 1940 Act as interpreted by the staff of the SEC. To qualify for this exclusion we must invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" or "qualifying real estate interests" and at least 80% of our assets in qualifying real estate interests and "real estate related assets." In satisfying this 55% requirement we treat agency mortgage backed securities issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool ("whole pool" securities) as qualifying real estate interests. We currently treat agency mortgage backed securities in which we hold less than all of the certificates issued by the pool ("partial pool" securities) as real estate related assets.

There can be no assurance that the laws and regulations governing the 1940 Act status of REIT’s, including guidance and interpretations from the SEC staff regarding the Section 3(c)(5)(C) exclusion, will not change in a manner that adversely affects our operations or business. For example, we may be required at times to adopt less efficient methods of financing certain of our mortgage related investments and we may be precluded from acquiring certain types of higher yielding securities. The net effect of these factors would be to lower our net interest income. If we fail to qualify for an exclusion from registration as an investment company or an exclusion from the definition of an investment company, our ability to use leverage would be substantially reduced. Our business will be materially and adversely affected if we fail to qualify for an exclusion from regulation under the 1940 Act.

Compliance with NYSE Corporate Governance Standards

We comply with the corporate governance standards of the New York Stock Exchange (“NYSE”). Our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are comprised entirely of independent directors and a majority of our directors are “independent” in accordance with the rules of the NYSE.

Competition

Our success depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring Agency Securities, we compete with mortgage REITs, mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, other lenders, governmental bodies and other entities. Many of these organizations have greater financial resources and access to lower costs of capital than we do. In addition, there are numerous mortgage REITs with similar asset acquisition objectives, including Agency Securities and others may be organized in the future. The effect of the existence of additional REITs may be to increase competition for the available supply of mortgage assets suitable for purchase.

Employees

We are managed by ARRM pursuant to the Management Agreement between us and ARRM. We do not have any employees. As of December 31, 2013, ARRM had 19 full-time employees.

Facilities

Our principal offices are located at:

ARMOUR Residential REIT, Inc.
3001 Ocean Drive, Suite 201
Vero Beach, FL 32963

Phone Number

Our phone number is (772) 617-4340.

Website

Our website is www.armourreit.com. Our investor relations website can be found under the "Investor Relations" tab at www.armourreit.com. We make available on our website under "SEC filings," free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC. We also make available on our website, our corporate governance documents, including our code of business conduct and ethics. Any amendments or waivers thereto will be provided on our website within four business days following the date of the amendment or waiver.

Available Information

We are required to file Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q with the SEC on a regular basis and are required to disclose certain material events (e.g., changes in corporate control; acquisitions or dispositions of a significant amount of assets other than in the ordinary course of business and bankruptcy) in a current report on Form 8-K. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The SEC's Internet website is located at http://www.sec.gov.

Item 1A. Risk Factors

An investment in our securities involves a high degree of risk. You should consider carefully the material risks described below together with the other information contained in this Annual Report on Form 10-K, before making a decision to invest in our securities. If any of the following events occur, our business, financial condition and operating results may be materially adversely affected. In that event, the trading price of our securities could decline and you could lose all or part of your investment. This Annual Report on Form 10-K also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks described below.

Risks Related to Our Business

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

The payments we receive on the Agency Securities in which we invest depend upon a steady stream of payments by borrowers on the underlying mortgages and the fulfillment of guarantees by GSEs. Ginnie Mae is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the U.S. Fannie Mae and Freddie Mac are GSEs, but their guarantees are not backed by the full faith and credit of the U.S Government.

In response to the deteriorating financial condition of Fannie Mae and Freddie Mac and the credit market disruption beginning in 2007, Congress and the U.S. Treasury undertook a series of actions to stabilize these GSEs and the financial markets, generally. The Housing and Economic Recovery Act of 2008 was signed into law on July 30, 2008, and established the Federal Housing Finance Agency ("FHFA"), with enhanced regulatory authority over, among other things, the business activities of Fannie Mae and Freddie Mac and the size of their portfolio holdings. On September 7, 2008, FHFA placed Fannie Mae and Freddie Mac into federal conservatorship and, together with the U.S. Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and Agency Securities. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the stockholders, the directors and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

Those efforts resulted in significant U.S. Government financial support and increased control of the GSEs. As part of the conservatorship agreement, the U.S. Treasury committed to support the positive net worth of Fannie Mae and Freddie Mac with preferred stock purchases as necessary, through the beginning of 2013. In 2013, Fannie Mae's bailout was capped at $125.0 billion and Freddie Mac's was limited to $149.0 billion. The preferred stock purchase agreements, as amended, also require the reduction of Fannie Mae's and Freddie Mac's mortgage and Agency Securities portfolios (they must be reduced by at least 15 percent each year until their respective mortgage assets reach $250 billion, which is projected to be 2018). Under these agreements, each GSE is required to pay to the U.S. Treasury a quarterly dividend equal to 10 percent of the total amount drawn under their respective agreements. In 2012, the U.S. Treasury announced that that the payments would be replaced by a quarterly sweep of every dollar of profit that each GSE earned in the future.

The U.S. Federal Reserve (the "Fed") announced in November 2008 a program of large-scale purchases of Agency Securities in an attempt to lower longer-term interest rates and contribute to an overall easing of adverse financial conditions. In total, $1.25 trillion in Agency Securities were purchased between January 2009 and March 2010, when the purchase phase of the program was completed. In addition, while the Fed program of Agency Securities purchases terminated in 2010, the Fed reported that through October 30, 2013, it held approximately $1.4 trillion of Agency Securities. Subject to specified investment guidelines, the portfolios of Agency Securities purchased through the programs established by the U.S. Treasury and the Fed may be held to maturity and, based on mortgage market conditions, adjustments may be made to these portfolios. This flexibility may adversely affect the pricing and availability of Agency Securities that we seek to acquire during the remaining term of these portfolios.

There can be no assurance that the U.S. Government's intervention in Fannie Mae and Freddie Mac will be adequate for the longer-term viability of these GSEs. These uncertainties lead to questions about the availability of and trading market for, Agency Securities. Accordingly, if these government actions are inadequate and the GSEs defaulted on their guaranteed obligations, suffered losses or ceased to exist, the value of our Agency Securities and our business, operations and financial condition could be materially and adversely affected.

We cannot predict the impact, if any, on our earnings or cash available for distribution to our stockholders of the FHFA's proposed revisions to Fannie Mae's, Freddie Mac's and Ginnie Mae's existing infrastructures to align the standards and practices of the three entities.

On February 21, 2012, the FHFA released its Strategic Plan for Enterprise Conservatorships, which set forth three goals for the next phase of the Fannie Mae and Freddie Mac conservatorships. These three goals are to (i) build a new infrastructure for the secondary mortgage market, (ii) gradually contract Fannie Mae and Freddie Mac's presence in the marketplace while simplifying and shrinking their operations, and (iii) maintain foreclosure prevention activities and credit availability for new and refinanced mortgages. On October 4, 2012, the FHFA released its white paper entitled Building a New Infrastructure for the Secondary Mortgage Market, which proposes a new infrastructure for Fannie Mae and Freddie Mac that has two basic goals.

The first such goal is to replace the current, outdated infrastructures of Fannie Mae and Freddie Mac with a common, more efficient infrastructure that aligns the standards and practices of the two entities, beginning with core functions performed by both entities such as issuance, master servicing, bond administration, collateral management and data integration. The second goal is to establish an operating framework for Fannie Mae and Freddie Mac that is consistent with the progress of housing finance reform and encourages and accommodates the increased participation of private capital in assuming credit risk associated with the secondary mortgage market.

The FHFA recognizes that there are a number of impediments to their goals which may or may not be surmountable, such as the absence of any significant secondary mortgage market mechanisms beyond Fannie Mae, Freddie Mac and Ginnie Mae, and that their proposals are in the formative stages. As a result, it is unclear if the proposals will be enacted. If such proposals are enacted, it is unclear how closely what is enacted will resemble the proposals from the FHFA White Paper or what the effects of the enactment will be in terms of our net asset value, earnings or cash available for distribution to our stockholders.

We could be negatively affected in a number of ways depending on the manner in which related events unfold for Fannie Mae and Freddie Mac. We rely on our Agency Securities as collateral for our financings under our repurchase agreements. Any decline in their value or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on our Agency Securities on acceptable terms or at all, or to maintain our compliance with the terms of any financing transactions.

Further, the current support provided by the U.S. Treasury to Fannie Mae and Freddie Mac and any additional support it may provide in the future, could have the effect of lowering the interest rates we expect to receive from Agency Securities, thereby tightening the spread between the interest we earn on our Agency Securities and the cost of financing those assets. A reduction in the supply of Agency Securities could also negatively affect the pricing of Agency Securities, by reducing the spread between the interest we earn on our portfolio of Agency Securities and our cost of financing that portfolio.

Separate legislation has been introduced in both houses of the U.S. Congress, which would, among other things, wind down Fannie Mae and Freddie Mac, and we could be materially adversely affected if these proposed laws were enacted.

On June 25, 2013, a bipartisan group of U.S. Senators introduced a draft bill titled, "Housing Finance Reform and Taxpayer Protection Act of 2013," which may serve as a catalyst for congressional discussion on the reform of Fannie Mae and Freddie Mac, to the U.S. Senate. Also, on July 11, 2013, members of the House Committee on Financial Services introduced a draft bill titled, "Protecting American Taxpayers and Homeowners Act" to the U.S. House of Representatives. Both bills call for the winding down of Fannie Mae and Freddie Mac and seek to increase the opportunities for private capital to participate in, and consequently bear the risk of loss in connection with, government-guaranteed MBS. While both bills have had support in their respective house of Congress, the momentum to reform and possibly eliminate Fannie Mae and Freddie Mac has been slowed somewhat by the fact that the GSEs are now turning considerable profits and have paid back the $188 billion in aggregate financial support they received from the U.S. Treasury.

The passage of any new legislation affecting Fannie Mae and Freddie Mac may create market uncertainty and reduce the actual or perceived credit quality of securities issued or guaranteed by the U.S. Government through a new or existing successor entity to Fannie Mae and Freddie Mac. If Fannie Mae and Freddie Mac were reformed or wound down, it is unclear what effect, if any, this would have on the value of the existing Fannie Mae and Freddie Mac Agency Securities. It is also possible that the above-referenced proposed legislation, if made law, could adversely impact the market for securities issued or guaranteed by the U.S. Government and the spreads at which they trade. The foregoing could materially adversely affect the pricing, supply, liquidity and value of the Agency Securities in which we invest and otherwise materially adversely affect our business, operations and financial condition.

We cannot predict the impact of the Fed’s third quantitative easing program ("QE3”) on the prices and liquidity of Agency Securities or other securities in which we invest, although the Fed action could increase the prices of our target assets and reduce the spread on our investments.

The Fed announced on December 18, 2013 that it will keep the target range for the Federal Funds Rate between zero and 0.25% for at least as long as the unemployment rate remains above 6.5%, inflation between one and two years ahead is projected to be no more than 0.5% above the Fed’s 2% longer-run goal, and longer-term inflation expectations continue to be well anchored. The Fed expects these measures to put downward pressure on long-term interest rates. Also at its December 18, 2013 and January 29, 2014 meetings, the Fed announced as part of the QE3 that it would trim its monthly U.S. Treasury Securities and Agency Securities purchases to $75.0 billion and $65.0 billion, respectively, for January and February 2014, down from $85.0 billion during 2013. While the Fed hopes that QE3 will expedite an economic recovery, stabilize prices, reduce unemployment and improve business and household spending, we cannot predict the impact of these programs or any future actions by the Fed on the prices and liquidity of Agency Securities or other securities in which we invest, although the Fed action could increase the prices of our target assets and reduce the spread on our investments.

Certain actions by the Fed could cause a flattening of the yield curve, which could materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders.

On September 21, 2011, the Fed announced “Operation Twist,” which is a program by which it intended to purchase, by the end of June 2012, $400 billion of U.S. Treasury Securities with remaining maturities between 6 and 30 years and sell an equal amount of U.S. Treasury Securities with remaining maturities of three years or less. On June 20, 2012, the Fed announced that it would extend “Operation Twist” through 2012 by purchasing and selling an additional $267 billion of such securities. On December 12, 2012, the Fed announced that it would continue purchasing U.S. Treasury Securities into 2013 initially at a pace of $45.0 billion per month. On December 18, 2013, the Fed announced it would reduce its monthly purchases of U.S. Treasury Securities in 2014 to $40.0 billion and monthly purchases of Agency Securities to $35.0 billion. The effect of this purchasing program could be a flattening in the yield curve, which could result in increased prepayment rates due to lower long-term interest rates and a narrowing of our net interest margin. Consequently, future securities purchase programs by the Fed could materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders.

The downgrade of the U.S. Government's or certain European countries' credit ratings and future downgrades of the U.S. Government's or certain European countries' credit ratings may materially adversely affect our business, financial condition and results of operations.

On August 5, 2011, Standard & Poor's Corporation downgraded the U.S. Government's credit rating from AAA to AA+ and on August 8, 2011, Fannie Mae and Freddie Mac's credit ratings were downgraded from AAA to AA+. Standard & Poor's Corporation reaffirmed those ratings in 2012 and in 2013. Because Fannie Mae and Freddie Mac are in conservatorship of the U.S. Government, the U.S. Government's credit rating downgrade and Fannie Mae and Freddie Mac's credit rating downgrades will impact the credit risk associated with Agency Securities and, therefore, may decrease the value of the Agency Securities in our portfolio.

Other actions of the U.S. Government, including the U.S. Congress, the Fed, the U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing or reforming the financial markets, or market response to those actions, may not achieve the intended effect or benefit our business and may adversely affect our business.

In response to the financial issues affecting the banking system and financial markets and going concern threats to commercial banks, investment banks and other financial institutions, the Emergency Economic Stabilization Act ("EESA"), was enacted by the U.S. Congress in 2008. There can be no assurance that the EESA or any other U.S. Government actions will have a beneficial impact on the financial markets. To the extent the markets do not respond favorably to any such actions by the U.S. Government or such actions do not function as intended, our business may not receive the anticipated positive impact from the legislation and such result may have broad adverse market implications.

In July 2010, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), in part to impose significant investment restrictions and capital requirements on banking entities and other organizations that are significant to U.S. financial markets. For instance, the Dodd-Frank Act will impose significant restrictions on the proprietary trading activities of certain banking entities and subject other systemically significant organizations regulated by the Fed to increased capital requirements and quantitative limits for engaging in such activities. The Dodd-Frank Act also seeks to reform the asset-backed securitization market (including the Agency Securities market) by requiring the retention of a portion of the credit risk inherent in the pool of securitized assets and by imposing additional registration and disclosure requirements. Certain of the new requirements and restrictions exempt Agency Securities; other government issued or guaranteed securities, or other securities. Nonetheless, the Dodd-Frank Act also imposes significant regulatory restrictions on the origination of residential mortgage loans. While the full impact of the Dodd-Frank Act cannot be assessed until implementing regulations are released, the Dodd-Frank Act's extensive requirements may have a significant effect on the financial markets and may affect the availability or terms of financing from our lender counterparties and the availability or terms of Agency Securities, both of which may have an adverse effect on our business.

In addition, the U.S. Government, the Fed, the U.S. Treasury and other governmental and regulatory bodies have taken or are continuing to consider taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur or what affect, if any, such actions could have on our business, results of operations and financial condition.

The increasing number of proposed U.S. federal, state and local laws and regulations may affect certain mortgage related assets in which we intend to invest and could increase our cost of doing business.

Legislation has been proposed which, among other provisions, could hinder the ability of a servicer to foreclose promptly on defaulted mortgage loans or would permit limited assignee liability for certain violations in the mortgage loan origination process. For example, the Dodd-Frank Act permits borrowers to assert certain defenses to foreclosure against an assignee for certain violations in the mortgage loan origination process. We cannot predict whether or in what form the U.S. Congress, the various state and local legislatures or the various federal, state or local regulatory agencies may enact legislation affecting our business. We will evaluate the potential impact of any initiatives which, if enacted, could affect our practices and results of operations. We are unable to predict whether the U.S. federal, state or local authorities will enact laws, rules or regulations that will require changes in our practices in the future and any such changes could adversely affect our cost of doing business and profitability.

Mortgage loan modification programs and future legislative action may adversely affect the value of and the returns on, the Agency Securities in which we invest.

The U.S. Government, through the Fed, the Federal Housing Administration (“FHA”) and the Federal Deposit Insurance Corporation, has implemented a number of federal programs designed to assist homeowners, including the Home Affordable Modification Program (“HAMP”), which provides homeowners with assistance in avoiding residential mortgage loan foreclosures, the Hope for Homeowners Program (“H4H Program”), which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans in order to avoid residential mortgage loan foreclosures and the Home Affordable Refinance Program (“HARP”), which allows borrowers who are current on their mortgage payments to refinance and reduce their monthly mortgage payments at loan to value ratios up to 125% without new mortgage insurance. HAMP, the H4H Program and other loss mitigation programs may involve among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or to extend the payment terms of the loans. Especially with Non-Agency Securities, a significant number of loan modifications with respect to a given security, including, but not limited to, those related to principal forgiveness and coupon reduction, could negatively impact the realized yields and cash flows on such security. These loan modification programs, future legislative or regulatory actions, including possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of and the returns on, our Agency Securities.

In October 2011, the FHFA announced changes to HARP to expand access to refinancing for qualified individuals and families whose homes have lost value, including increasing the HARP loan to value ratio above 125%. However, this would only apply to mortgages guaranteed by the GSEs. There are many challenging issues to this proposal, notably the question as to whether a loan with a loan to value ratio of 125% qualifies as a mortgage or an unsecured consumer loan. The chances of this initiative’s success have created additional uncertainty in the Agency Securities market, particularly with respect to possible increases in prepayment rates.

On January 4, 2012, the Fed issued a white paper outlining additional ideas with regard to refinancings and loan modifications. In an effort to continue to provide meaningful solutions to the housing crisis, effective June 1, 2012, the Obama administration expanded the population of homeowners that may be eligible for HAMP. It is likely that loan modifications would result in increased prepayments on some Agency Securities. These loan modification programs, as well as future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

Continued adverse developments in the global capital markets, including defaults, credit losses and liquidity concerns, as well as mergers, acquisitions or bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency Securities on a leveraged basis, on favorable terms, or at all, which could adversely affect our profitability.

We rely on the availability of financing to acquire Agency Securities on a leveraged basis. Institutions from which we obtain financing may have invested in or financed assets that declined in value as a result of the downturn in financial markets, particularly in Europe and the residential mortgage market, causing these institutions to suffer losses. If these conditions persist, these institutions may be forced to exit the repurchase market, become insolvent or further tighten their lending standards or increase the amount of equity capital or the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount required to obtain financing. Under such circumstances, it could be more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

While the overall financing environment has improved, further credit losses or mergers, acquisitions, or bankruptcies of investment banks and commercial banks that have historically acted as repurchase agreement counterparties may occur. This would result in a fewer number of potential repurchase agreement counterparties operating in the market and could potentially impact the pricing and availability of financing for our business.

Volatile market conditions for mortgages and mortgage related assets as well as the broader financial markets may adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage related assets, including MBS, as well as the broader financial markets and the economy generally. Beginning in 2007, significant adverse changes in financial market conditions resulted in a deleveraging of the entire global financial system and the forced sale of large quantities of mortgage related and other financial assets. Over the past several years, concerns over economic recession, inflation, geopolitical issues, unemployment, the availability and cost of financing, the mortgage market and a declining real estate market contributed to increased volatility and diminished expectations for the economy and markets. In particular, the residential mortgage market in the U.S. experienced a variety of difficulties and changed economic conditions, including defaults, credit losses and liquidity concerns. Certain commercial banks, investment banks and insurance companies announced extensive losses from exposure to the residential mortgage market. These factors impacted investor perception of the risk associated with RMBS, real estate related securities and various other asset classes in which we may invest. As a result, values for RMBS, real estate related securities and various other asset classes in which we may invest experienced volatility. Any decline in the value of our investments, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Increased volatility and deterioration in the broader residential mortgage and MBS markets may adversely affect the performance and market value of our investments.

Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency Securities in which we invest.

During the past few years, the residential mortgage market in the U.S. experienced a variety of difficulties and changed economic conditions that adversely affected the performance and market value of the Agency Securities in which we invest. Although the overall residential mortgage market has improved, Agency Securities that originated in 2006 and 2007 have experienced a higher and earlier than expected rate of delinquencies. Additionally, other earlier vintages of Agency Securities may not perform as expected. As a result, the market for these securities may be adversely affected.

Conditions within the market over the past several years were driven primarily by:

- delinquencies across a broad scope of mortgage loans that include subprime mortgage loans, Alt-A mortgage loans; and prime mortgage loans;
- declining housing prices and flattening of property values;
- resetting adjustable rate mortgages (“ARMs”) that result in increased mortgage payments; and
- constrained ability by borrowers to refinance or sell their properties.

While we primarily invest in Agency Securities, rising levels of delinquencies could negatively affect the value of our Agency Securities or create market uncertainty about their true value. At the same time, market uncertainty about residential mortgages in general could depress the market for Agency Securities, making it more difficult for us to sell Agency Securities we own on favorable terms or at all.

Changes in the underwriting standards by Freddie Mac or Fannie Mae could have an adverse impact on the Agency Securities in which we may invest or make it more difficult to acquire attractive Non-Agency Securities.

In April 2010, Freddie Mac and Fannie Mae announced tighter underwriting guidelines for ARMs and hybrid interest-only ARMs in particular. Specifically, Freddie Mac announced that it would no longer purchase interest-only mortgages and Fannie Mae changed its eligibility criteria for purchasing and securitizing ARMs to protect consumers from potentially dramatic payment increases. Our targeted assets include adjustable-rate mortgages and hybrid ARMs. Tighter underwriting standards by Freddie Mac or Fannie Mae could reduce the supply of ARMs, resulting in a reduction in the availability of the asset class.

We may not be able to operate our business or implement our operating policies and strategies successfully.

The results of our operations depend on many factors, including, without limitation, the availability of opportunities for the acquisition of attractively priced Agency Securities, the level and volatility of interest rates, readily accessible funding in the financial markets and our ability to cost-effectively hedge risks as well as overall economic conditions. We may not be able to maintain any agreements with our lenders on favorable terms or at all. Furthermore, we may not be able to operate our business successfully or implement our operating policies and strategies as described in this Annual Report on Form 10-K, which could result in the loss of some or all of your investment.

Market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our portfolio.

Our success depends to a significant degree on our ability to analyze the relationship of changing interest rates and prepayments of the mortgages that underlie our Agency Securities. Changes in interest rates and prepayments affect the market price of the Agency Securities that we purchase and any Agency Securities that we hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our portfolio. In conducting our analysis, we depend on industry-accepted assumptions with respect to the relationship between interest rates and prepayments under normal market conditions. If the dislocation in the residential mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to assess the market value of our portfolio would be significantly affected and could materially adversely affect our financial position and results of operations.

Competition may prevent us from acquiring Agency Securities at favorable yields and that would harm our results of operations.

Our net income largely depends on our ability to acquire Agency Securities at favorable spreads over our borrowing costs. In acquiring Agency Securities, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase Agency Securities, many of which have greater financial resources than we do. Additionally, many of our competitors are not subject to REIT tax compliance or required to maintain an exemption from the Act. As a result, we may not be able to acquire sufficient Agency Securities at favorable spreads over our borrowing costs, which would harm our results of operations.

We may not be able to acquire investments at favorable prices.

We may not be able to acquire Agency Securities at favorable prices. As a result, we may not be able to acquire enough Agency Securities in order to remain fully invested, or we may have to pay more for Agency Securities than we would expect. In either case, the return that we earn on our stockholders' equity may be reduced.

Changes in interest rates may adversely affect the results of our operations and our financial position.

Interest rates are highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, all of which are beyond our control. Our success depends to a significant degree on our ability to analyze the relationship changing interest rates may have on our results of operations and financial position in general and the impact such rate changes may have on critical elements underlying Agency Securities and other investments' values and borrowings in particular, as follows:

- changes in interest rates may inversely affect the fair value of our assets, which are primarily Agency Securities; When interest rates rise, the value of fixed rate Agency Securities generally declines, when interest rates fall, the value of fixed rate Agency Securities generally increase;
- changes in interest rates may inversely affect levels of prepayments on mortgages. Typically, as interest rates rise, prepayments on the underlying mortgages tend to slow; conversely, as interest rates fall, prepayments on the underlying mortgages tend to accelerate. The effect that rising or falling interest rates on these prepayments affects the price of Agency Securities and the effect can be particularly pronounced with fixed rate Agency Securities; and
- changes in interest rates may create mismatches between our assets, primarily Agency Securities and our borrowings used to fund our purchases of those assets. The risk of these mismatches may be pronounced in that, should rates increase, interest rate caps on our hybrid adjustable rate and adjustable rate MBS would limit the income stream on these investments while our borrowings would not be subject to similar restrictions.

Interest rate fluctuations will also cause variations in the yield curve, which may reduce our net income. The relationship between short-term and longer-term interest rates is often referred to as the "yield curve." If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because our assets may bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income and the market value of our Agency Security assets. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested in Agency Securities, the spread between the yields of the new investments and available borrowing rates may decline, which would likely decrease our net income. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve inversion), in which event our borrowing costs may exceed our interest income and we could incur significant operating losses. This risk and the variables created by changing interest rates discussed above are integral to our business and our investment strategies. We will seek to mitigate these risks to the degree achievable through the active formulation and execution of our hedging strategies.

Because we invest in fixed rate securities, an increase in interest rates may adversely affect our book value.

Increases in interest rates may negatively affect the market value of our Agency Securities. Any fixed rate securities we invest in generally will be more negatively affected by these increases than adjustable rate securities. In accordance with accounting rules, we are required to reduce our stockholders' equity, or book value, by the amount of any decrease in the market value of our mortgage related assets. We are required to evaluate our securities on a quarterly basis to determine their fair value by using third-party pricing services or third-party bid price indications provided by dealers who make markets in these securities. If the fair value of a security is not available from a third-party price service or dealer, we would estimate the fair value of the security using a variety of methods including, but not limited to, discounted cash flow analysis, matrix pricing, option-adjusted spread models and fundamental analysis. Aggregate characteristics taken into consideration include, but are not limited to, type of collateral, index, margin, periodic cap, lifetime cap, underwriting standards, age and delinquency experience. However, the fair value reflects estimates and may not be indicative of the amounts we would receive in a current market exchange. If we are required by GAAP to reduce the value of one or more Agency Securities on our balance sheet then our stockholders' equity would be correspondingly reduced. Reductions in stockholders' equity decrease the amounts we may borrow to purchase additional securities, which could restrict our ability to increase our net income.

Interest rate mismatches between our Agency Securities and our borrowings used to fund our purchases of these securities may reduce our income during periods of changing interest rates.

We fund our fixed rate Agency Securities with short-term borrowings. As a result, an increase in short-term interest rates would likely cause an increase in our borrowing costs, resulting in a decrease in net income or a net loss. In addition, we fund most of our investments in adjustable rate Agency Securities with borrowings that have interest rates that adjust more frequently than the interest rate indices and repricing terms of our Agency Securities. Accordingly, if short-term interest rates increase, our borrowing costs may increase faster than the interest rates on our adjustable rate securities adjust. As a result, in a period of rising interest rates, we could experience a decrease in net income or a net loss.

Our investment strategy focuses in part on the acquisition of adjustable rate Agency Securities. This means that their interest rates may vary over time based upon changes in an identified short-term interest rate index. In most cases, the interest rate indices and repricing terms of the Agency Securities that we acquire and our borrowings will not be identical, thereby potentially creating an interest rate mismatch between our investments and our borrowings. While the historical spread between relevant short-term interest rate indices has been relatively stable, there have been periods when the spread between these indices was volatile. During periods of changing interest rates, these interest rate index mismatches could reduce our net income or produce a net loss and adversely affect our dividends and the market price of our stock.

Changes in prepayment rates may adversely affect our profitability.

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

We may purchase securities or loans that have a higher interest rate than the then prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire the security or loan. In accordance with GAAP, we amortize this premium over the expected term of the security or loan based on our prepayment assumptions. If a security or loan is prepaid in whole or in part at a faster than expected rate, however, we must expense all or a part of the remaining unamortized portion of the premium that was paid at the time of the purchase, which will adversely affect our profitability.

We also may purchase securities or loans that have a lower interest rate than the then prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire the security or loan. We accrete this discount over the expected term of the security or loan based on our prepayment assumptions. If a security or loan is prepaid at a slower than expected rate, however, we must accrete the remaining portion of the discount at a slower than expected rate. This will extend the expected life of investment portfolio and result in a lower than expected yield on securities and loans purchased at a discount to par.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayments can also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage as part of a physical relocation or when borrowers default on their mortgages and the

mortgages are prepaid from the proceeds of a foreclosure sale of the property. Fannie Mae and Freddie Mac will generally, among other conditions, purchase mortgages that are 120 days or more delinquent from MBS trusts when the cost of guaranteed payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the nonperforming loans in their portfolios. Consequently, prepayment rates also may be affected by conditions in the housing and financial markets, which may result in increased delinquencies on mortgage loans, the government-sponsored entities, cost of capital, general economic conditions and the relative interest rates on fixed and adjustable rate loans, which could lead to an acceleration of the payment of the related principal. Additionally, changes in the GSEs' decisions as to when to repurchase delinquent loans can materially impact prepayment rates.
In addition, the introduction of relatively recent government programs, such as the U.S. Treasury’s HAMP program, increases the availability of mortgage credit to a large number of homeowners in the United States, which we expect impacts the prepayment rates for the entire mortgage securities market, but primarily for Fannie Mae and Freddie Mac Agency Securities. These new programs, along with any new additional programs or changes to existing programs, can cause uncertainty around the

magnitude of changes in prepayment speeds. To the extent that actual prepayment speeds differ from our expectations, it could adversely affect our operating results.

Interest rate caps on our adjustable rate Agency Securities may reduce our income or cause us to suffer a loss during periods of rising interest rates.

The mortgage loans underlying our adjustable rate securities typically will be subject to periodic and lifetime interest rate caps. Additionally, we may invest in ARMs, with an initial rate that will provide us with a lower than market interest rate initially, which may accordingly have lower interest rate caps than ARMs without such initial rates. Periodic interest rate caps limit the amount an interest rate can increase during a given period. Lifetime interest rate caps limit the amount an interest rate can increase through maturity of a mortgage loan. If these interest rate caps apply to the mortgage loans underlying our adjustable rate securities, the interest distributions made on the related securities will be similarly impacted. Our borrowings may not be subject to similar interest rate caps. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while caps would limit the interest distributions on our adjustable rate Agency Securities. Further, some of the mortgage loans underlying our adjustable rate Agency Securities may be subject to periodic payment caps that result in a portion of the interest on those loans being deferred and added to the principal outstanding. As a result, we could receive less interest distributions on adjustable rate Agency Securities than we need to pay interest on our related borrowings. These, factors could lower our net interest income, cause us to suffer a net loss or cause us to incur additional borrowings to fund interest payments during periods of rising interest rates or sell our investments at a loss.

Mitigating against interest rate exposure may adversely affect our earnings and our interest rate risk mitigation transactions may fail to protect us from the losses that they were designed to offset.

Subject to complying with REIT tax requirements, we employ techniques that limit the adverse effects of rising interest rates on a portion of our short-term repurchase agreements and on a portion of the value of our assets. In general, our interest rate mitigation strategy depends on our view of our entire portfolio, consisting of assets, liabilities and derivative instruments, in light of prevailing market conditions. We could misjudge the condition of our portfolio or the market. Our interest rate risk mitigation activity will vary in scope based on the level and volatility of interest rates and principal repayments, the type of securities held and other changing market conditions. Our actual interest rate risk mitigation decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated strategy. These techniques may include entering into interest rate swap contracts, purchasing or selling Futures Contracts, or interest rate cap or floor agreements, swaptions, purchasing put and call options on securities or securities underlying Futures Contracts, or entering into forward rate agreements.

Because a mortgage borrower typically has no restrictions on when a loan may be paid off, either partially or in full, there are no perfect interest rate risk mitigation strategies and interest rate mitigation may fail to protect us from loss. Alternatively, we may fail to properly assess a risk to our portfolio or may fail to recognize a risk entirely leaving us exposed to losses without the benefit of any offsetting interest rate mitigation activities. The derivative instruments we select may not have the effect of reducing our interest rate risk. The nature and timing of interest rate risk mitigation transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could actually increase our risk and losses. In addition, interest rate risk mitigation activities could result in losses if the event against which we mitigate does not occur.

We may not be able to execute desired interest risk mitigation transactions at favorable prices.

We will continue to execute derivative instrument transactions to manage many, but not all, of the risks inherent in our portfolio. This strategy will potentially help us reduce our exposure to significant changes in interest rates but entails significant costs and other risks. These derivative instruments may not be attractively priced in the marketplace and may not be available to us given our financial condition in the future or as a result of other factors. Additionally, we may not successfully implement our business strategy, we may expose ourselves to additional risks and we could suffer significant losses.

Our use of derivative instruments may expose us to counterparty and termination risks.

We enter into transactions to hedge interest rate risks associated with our business with counterparties that have a high-quality credit rating and with futures exchanges. If counterparties, or the exchange, cannot perform under the terms of our Futures Contracts, for example, we would not receive payments due under that agreement and may lose any unrealized gain associated with the Futures Contract and the mitigated liability would cease to be mitigated by the Futures Contract. We may also be at risk for any collateral we have pledged to secure our obligations under the Futures Contract if the counterparty became insolvent or filed for bankruptcy. Similarly, if a counterparty to a cap agreement fails to perform under the terms of the agreement, in addition to not receiving payments due under that agreement that would offset our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement. Our derivative instrument agreements generally require our counterparties to post collateral in certain events, generally related to their credit condition, to provide us some protection against their potential failure to perform. We, in turn, are subject to similar requirements. In addition, some of our derivative instrument agreements contain various termination events related to, among other items, our REIT status, equity levels and performance under related agreements which could cause the agreement to terminate at prevailing market levels, resulting in either a payment by us to the counterparty or by the counterparty to us. A termination event could also require us to realize taxable income or loss.

We have not elected to use cash flow hedge accounting.

We record derivative and hedge transactions in accordance with GAAP, specifically according to the Accounting Standards Codification Topic No. 815 "Derivatives and Hedging." Under these standards, we have not elected to use cash flow hedge accounting for a number of reasons, including if we use instruments that do not meet the definition of a derivative (such as short sales), we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or our instruments are not highly effective. Since we have not elected to use cash flow hedge accounting, earnings reported in accordance with GAAP will fluctuate even in situations where our derivatives are operating as intended. As a result of this mark-to-market accounting treatment, our results of operations are likely to fluctuate far more than if we were to designate our derivative activities as cash flow hedges. Comparisons with companies that use cash flow hedge accounting for all or part of their derivative activities may not be meaningful.

The adoption of derivatives legislation by Congress could have an adverse impact on our ability to hedge risks associated with our business.

The Dodd−Frank Act regulates derivative transactions, which include certain instruments used in our risk management activities. Under the Dodd−Frank Act, most swaps will be required to be cleared through a registered clearing facility and traded on a designated exchange or swap execution facility. There are some exceptions to these requirements for entities that use swaps to hedge or mitigate commercial risk. However, we do not currently anticipate qualifying for an exception. Among the other provisions of the Dodd−Frank Act that may affect derivative transactions are those relating to establishment of capital and margin requirements for certain derivative participants; establishment of business conduct standards, recordkeeping and reporting requirements; and imposition of position limits. Although the Dodd−Frank Act includes significant new provisions regarding the regulation of derivatives, the impact of those requirements will not be known definitively until regulations have been adopted by the SEC and the U.S. Commodity Futures Trading Commission (the "CFTC"). The new legislation and any new regulations could increase the operational and transactional cost of derivatives contracts and affect the number and/or creditworthiness of available hedge counterparties to us. We have established an account with a futures commission merchant for this purpose. To date, we have not entered into any cleared interest rate swap contracts.

Risks Related to Debt Financing

There is no assurance that our current financing arrangements will remain in place.

AVM, L.P. ("AVM"), is a securities broker dealer with which we contract with for administering clearing and settlement services for our securities and derivative transactions, as well as assistance with financing transaction services such as repurchase financing. AVM also assists us with the management of margin arrangements between us and our lenders for each of our repurchase agreements and they are beneficial in addressing the potential scarcity of repurchase funding. Nonetheless, we depend on borrowings to fund our acquisitions of Agency Securities and reach our target leverage ratio. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. We have entered into MRA's establishing the general terms and conditions of borrowings, if any, made by lenders. There can be no assurance that these agreements will remain in place and, even if in place, the amount and definitive terms under which we would be able to borrow.

Continued adverse developments in the residential and commercial mortgage markets could make it more difficult for us to borrow money to finance our acquisition of Agency Securities.

Institutions from which we seek to obtain financing may also originate and hold residential and commercial mortgage loans and may have suffered financial difficulties as a result of the market conditions described above. Further, even lenders that do not originate and hold mortgage loans may have suffered losses related to their lending and other financial relationships with the institutions that do so as part of their businesses. As a result, institutions that originate and hold loans and other lenders that have been indirectly affected by losses in the mortgage market may become insolvent or tighten their lending standards which could result in the following:

- our lenders may not be able to obtain financing to fund our borrowings;
- our lenders may require us to enter into restrictive covenants relating to our operations;
- we may not be able to fund acquisitions of sufficient Agency Securities to reach our target leverage ratio; and
- we may become dependent on one or a few lenders for all of our financing.

We may incur increased borrowing costs related to repurchase agreements which could harm our results of operations.

Our borrowing costs under repurchase agreements that we have arranged generally are adjustable and relate to short-term interest rates, such as the Fed Funds and London Interbank Offered Rate. The price of these borrowings may vary depending upon a number of factors, including, without limitation:

- the movement of interest rates;
- the availability of financing in the market, including the financial stability of lenders; and
- the value and liquidity of our Agency Securities.

As of December 31, 2013, the weighted average margin requirement under all our repurchase agreements was approximately 5.0% (weighted by borrowing amount).

Most of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, our results of operations may be harmed and we may have losses.

We leverage our portfolio investments in Agency Securities, which may adversely affect our return on our investments and may reduce cash available for distribution to our stockholders.

We leverage our portfolio investments in Agency Securities through borrowings under repurchase agreements. Leverage can enhance our potential returns but can also exacerbate losses. The percentage of leverage will vary depending on our investment strategy, ability to obtain these financing facilities and the lender's estimate of the stability of the portfolio investments' cash flow. Our return on our investments and cash available for distribution to our stockholders may be reduced if market conditions cause the cost of our financing to increase relative to the income that can be derived from the assets acquired, which could adversely affect the price of our stock. In addition, our debt service payments will reduce cash flow available for distributions to stockholders. We may not be able to meet our debt service obligations. To the extent that we cannot meet our debt service obligations, we risk the loss of some or all of our assets to sale to satisfy our debt obligations.

Our leverage strategy increases the risks of our operations, which could reduce our net income and the amount available for distributions or cause us to suffer a loss.

We generally seek to borrow (on a recourse basis) between six and ten times the amount of our stockholders' equity, although we are not limited to those ranges. We incur this leverage by borrowing against a substantial portion of the market value of our Agency Securities. The amount of leverage, however, is not expressly limited and will depend on our and our lenders' estimate of the stability of our portfolio's cash flow and our ability to service and repay additional debt. We may not be able to meet our debt service obligations and, to the extent we cannot, we may be forced to liquidate our assets at disadvantageous prices and you could lose some or all of your investment.

This leverage, which is fundamental to our investment strategy, also creates significant risks. For example:

- our borrowings are secured by our Agency Securities, generally under repurchase agreements. A decline in the market value of the Agency Securities used to secure these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell Agency Securities under adverse market conditions. If these sales are made at prices lower than the carrying value of the Agency Securities, we would experience losses;
- certain lenders may require us to remain in compliance with all provisions of other material contracts, including other financing agreements. As a result, a default under one financing agreement could cause us to be in default

under other financing agreements. If that occurs, our access to capital would be significantly impeded, which could materially and adversely affect our ability to operate our business;

- to the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be negatively affected, which would jeopardize our qualification as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and would decrease our overall profitability and distributions to our stockholders; and
- certain of our MRA's contain a restriction that prohibits our leverage from exceeding twelve times our stockholders' equity.

If we experience losses as a result of our leverage policy, such losses would reduce the amounts available for distribution to our stockholders. Because the assets that we expect to acquire may experience periods of illiquidity, we may be prevented from selling our Agency Securities at opportune times and prices.

We bear the risk of being unable to dispose of our Agency Securities at advantageous times and prices or in a timely manner because Agency Securities may experience periods of illiquidity. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale. As a result, the illiquidity of Agency Securities may harm our results of operations and could cause us to suffer a loss and reduce our distributions.

Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or a lender file for bankruptcy.

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and to take possession of and liquidate our collateral under the repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that a lender files for bankruptcy. Thus, our use of repurchase agreements will expose our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

Risks Related to Our Corporate Structure

Maintenance of our exclusion from the 1940 Act will impose limits on our business.

We conduct our business so as not to become regulated as an investment company under the 1940 Act. If we were to fall within the definition of investment company, we would be unable to conduct our business as described in this Annual Report on Form 10-K. Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the 1940 Act also defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of GSEs and cash items) on an unconsolidated basis. Excluded from the term "investment securities," among other things, in Section 3(a)(1)(C) of the 1940 Act, as defined above, are GSEs and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exclusion from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act.

We rely on the exclusion from the definition of "investment company" provided by Section 3(c)(5)(C) of the 1940 Act. To qualify for the exclusion, we make investments so that at least 55% of the assets we own consist of "qualifying assets" and so that at least 80% of the assets we own consist of qualifying assets and other real estate related assets. We generally expect that our investments in our target assets will be treated as either qualifying assets or real estate related assets under Section 3(c)(5)(C) of the 1940 Act in a manner consistent with SEC staff no-action letters. Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency Securities that are considered the functional equivalent of mortgage loans for purposes of the 1940 Act. The SEC staff has not issued guidance with respect to whole pool non-Agency Securities. Accordingly, based on our own judgment and analysis of the SEC's pronouncements with respect to agency whole pool certificates, we may also treat non-Agency Securities issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool as qualifying assets. We invest at least 55% of our assets in whole pool Agency and non-Agency Securities that constitute qualifying assets in accordance with SEC staff guidance and at least 80% of our assets in qualifying assets plus other real estate related assets. Other real estate related assets would consist primarily of Agency and

Non-Agency Securities that are not whole pools, such as collateralized mortgage obligations ("CMOs") and commercial mortgage backed securities. As a result of the foregoing restrictions, we are limited in our ability to make or dispose of certain investments. To the extent that the SEC staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. These restrictions could also result in our holding assets we might wish to sell or selling assets we might wish to hold. Although we monitor our portfolio for compliance with the Section 3(c)(5)(C) exclusion periodically and prior to each acquisition and disposition, there can be no assurance that we will be able to maintain this exclusion.

To the extent that we elect in the future to conduct our operations through majority-owned subsidiaries, such business will be conducted in such a manner as to ensure that we do not meet the definition of investment company under either Section 3(a)(1)(A) or Section 3(a)(1)(C) of the 1940 Act, because less than 40% of the value of our total assets on an unconsolidated basis would consist of investment securities. We intend to monitor our portfolio periodically to insure compliance with the 40% test. In such case, we would be a holding company which conducts business exclusively through majority-owned subsidiaries and we would be engaged in the non-investment company business of our subsidiaries.

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

Recently adopted rules under the Dodd-Frank Act establish a comprehensive new regulatory framework for derivative contracts commonly referred to as swaps. Under these recently adopted rules, any investment fund that trades in swaps may be considered a “commodity pool,” which would cause its directors to be regulated as “commodity pool operators” ("CPOs"). Under the new rules, which became effective on October 12, 2012 for those who became CPOs solely because of their use of swaps, CPOs must register with the National Futures Association (the "NFA"), which requires compliance with NFA's rules, and are subject to regulation by the CFTC including with respect to disclosure, reporting, recordkeeping and business conduct.

Our hedging strategies are designed to reduce the impact on our earnings caused by the potential adverse effects of changes in interest rates on our target assets and liabilities. Subject to complying with REIT requirements, we use hedging techniques to limit the risk of adverse changes in interest rates on the value of our target assets as well as the differences between the interest rate adjustments on our target assets and borrowings. These techniques primarily consist of entering into interest rate swap contracts and purchasing or selling Futures Contracts and may also include entering into interest rate cap or floor agreements, purchasing put and call options on securities or securities underlying Futures Contracts, or entering into forward rate agreements. Although we are not legally limited to our use of hedging, we limit our use of derivative instruments to only those techniques described above and enter into derivative transactions only with counterparties that we believe have a strong credit rating to help limit the risk of counterparty default or insolvency. These transactions are not entered into for speculative purposes. We do not use these instruments for the purpose of trading in commodity interests, and we do not consider our company or its operations to be a commodity pool as to which CPO regulation or compliance is required.

We, along with numerous other mortgage REITs, submitted a no-action letter request to the CFTC seeking exemptive relief for our directors from CPO registration under these new rules. On December 7, 2012, the CFTC staff issued a no-action letter (CFTC Staff Letter 12-44) to provide exemptive relief to mortgage REITs that perfect the use of the relief set forth in the no-action letter. On December 11, 2012, we submitted our claim to perfect the use of CFTC Staff Letter 12-44. Therefore, at this time, our directors do not intend to register as CPOs with the NFA. To comply with CFTC Staff Letter 12-44, we are restricted to operating within certain parameters discussed in the no-action letter. For example, the exemptive relief limits our ability to enter into interest rate hedging transactions if the amount of income we receive from such hedges will exceed five percent of our gross income or the initial margin and premiums for such hedges will exceed five percent of the fair market value of our total target assets.

The CFTC has substantial enforcement power with respect to violations of the laws over which it has jurisdiction, including their anti-fraud and anti-manipulation provisions. Among other things, the CFTC may suspend or revoke the registration of a person who fails to comply, prohibit such a person from trading or doing business with registered entities, impose civil money penalties, require restitution and seek fines or imprisonment for criminal violations. Additionally, a private right of action exists against those who violate the laws over which the CFTC has jurisdiction or who willfully aid, abet, counsel, induce or procure a violation of those laws. In the event we fail to maintain exemptive relief from the CFTC on this matter and our directors fail to comply with the regulatory requirements of these new rules, we may be subject to significant fines, penalties and other civil or governmental actions or proceedings, any of which could have a materially adverse effect on our business, financial condition and results of operations.

We are highly dependent on information and communications systems. System failures, security breaches or cyber-attacks of networks or systems could significantly disrupt our business and negatively affect the market price of our common stock and our ability to distributions dividends.

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

We rely on sophisticated information technology systems, networks and infrastructure in managing our day-to-day operations. Despite cyber-security measures already in place, our information technology systems, networks and infrastructure may be vulnerable to deliberate attacks or unintentional events that could interrupt or interfere with their functionality or the confidentiality of our information. Our inability to effectively utilize our information technology systems, networks and infrastructure, and protect our information could adversely affect our business.

Loss of the 1940 Act exclusion would adversely affect us, the market price of shares of our stock and our ability to distribute dividends.

As described above, we conduct our operations so as not to become required to register as an investment company under the 1940 Act based on current laws, regulations and guidance. Although we monitor our portfolio, we may not be able to maintain exclusion under the 1940 Act. If we were to fail to qualify for this exclusion in the future, we could be required to restructure our activities or the activities of our subsidiaries, if any, including effecting sales of assets in a manner that, or at a time when we would not otherwise choose, which could negatively affect the value of our stock, the sustainability of our business model and our ability to make distributions. The sale could occur during adverse market conditions and we could be forced to accept a price below that which we believe is appropriate.

On August 31, 2011, the SEC issued a concept release requesting comments to a number of matters relating to the Section 3(c)(5)(C) exclusion from the 1940 Act, including the nature of assets that qualify for purposes of the exclusion and whether mortgage related REIT's should be regulated as investment companies. There can be no assurance that the laws and regulations governing the 1940 Act status of REIT's, including guidance and interpretations from the SEC and its staff regarding the Section 3(c)(5)(C) exclusion, will not change in a manner that adversely affects our operations or business. As a result of this release, the SEC or its staff may issue new interpretations of the Section 3(c)(5)(C) exclusion causing us to change the way we conduct our business, including changes that may adversely affect our ability to achieve our investment objective. We may be required at times to adopt less efficient methods of financing certain of our mortgage related investments and we may be precluded from acquiring certain types of higher yielding securities. The net effect of these factors would be to lower our net interest income. If we fail to qualify for an exclusion from registration as an investment company or an exclusion from the definition of an investment company, our ability to use leverage would be substantially reduced. Our business will be materially and adversely affected if we fail to qualify for an exclusion from regulation under the 1940 Act.

We have not established a minimum dividend payment level and there are no guarentees of our ability to pay dividends in the future.

We expect to continue to make regular cash distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Code. However, we have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by the risk factors described in this report. Future distributions are made at the discretion of our Board and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time. There are no guarantees of our ability to pay dividends in the future. In addition, some of our distributions may include a return of capital.

Although we have no intention to do so, we may use proceeds from equity and debt offerings and other financings to fund distributions, which will decrease the amount of capital available for purchasing our target assets.

We presently have no intention of using the proceeds of any offering of our equity or debt or other financings to fund distributions to stockholders. However, there are no restrictions in our charter or in any agreement to which we are a party that prohibits us from doing so. In the event that we elect to fund any distribution to our stockholders from sources other than our earnings, the amount of capital available to us to purchase our target assets would decrease, which could have an adverse effect on our overall financial results and performance.

We are subject to financial reporting and other requirements for which our accounting, internal audit and other management systems and resources may not be adequately prepared.

We are subject to reporting and other obligations under the Securities Act and the Exchange Act, including the requirements of Section 404 of the Sarbanes-Oxley Act. These reporting and other obligations, may place significant demands on our management, administrative, operational, internal audit and accounting resources and cause us to incur significant expenses. We may need to upgrade our systems or create new systems; implement additional financial and management controls, reporting systems and procedures; expand or outsource our internal audit function; and hire additional accounting, internal audit and finance staff. If we are unable to accomplish these objectives in a timely and effective fashion, our ability to comply with the financial reporting requirements and other rules that apply to reporting companies could be impaired. Any failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price.

Future issuances or sales of stocks could cause our share price to decline.

Sales of substantial numbers of our stock in the public market, or the perception that such sales might occur, could adversely affect the market price of our stock. In addition, the sale of these shares could impair our ability to raise capital through a sale of additional equity securities.

Other issuances of our stock could have an adverse effect on the market price of our stock. In addition, future issuances of our stock may be dilutive to existing stockholders.

Provisions of Maryland law and other provisions of our organizational documents may limit the ability of a third-party to acquire control of the company.

Certain provisions of the MGCL may have the effect of delaying, deferring or preventing a transaction or a change in control of the company that might involve a premium price for holders of our common stock or otherwise be in their best interests. Additionally, our charter and bylaws contain other provisions that may delay or prevent a change of control of the company.

If we have a class of equity securities registered under the Securities Exchange Act and meet certain other requirements, Title 3, Subtitle 8 of the MGCL permits us without stockholder approval and regardless of what is currently provided in our charter or bylaws, to elect to be subject to statutory provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control of the company that might involve a premium price for holders of our common stock or otherwise be in their best interest. Pursuant to Title 3, Subtitle 8 of the MGCL, once we meet the applicable requirements, our charter provides that our Board will have the exclusive power to fill vacancies on our Board. As a result, unless all of the directorships are vacant, our stockholders will not be able to fill vacancies with nominees of their own choosing. We may elect to opt in to additional provisions of Title 3, Subtitle 8 of the MGCL without stockholder approval at any time that we have a class of equity securities registered under the Securities Exchange Act and satisfy certain other requirements.

Risks Related to Our Management and Conflicts of Interest

We depend on ARRM and particularly key personnel including Mr. Ulm and Mr. Zimmer. The loss of those key personnel could severely and detrimentally affect our operations.

As an externally managed company, we depend on the diligence, experience and skill of ARRM for the selection, acquisition, structuring, hedging and monitoring of our MBS and associated borrowings. We depend on the efforts and expertise of our operating officers to manage our day-to-day operations and strategic business direction. If any of our key personnel were to leave the Company, locating individuals with specialized industry knowledge and skills similar to that of our key personnel may not be possible or could take months. Because we have no employees, the loss of Mr. Ulm and Mr. Zimmer could harm our business, financial condition, cash flow and results of operations.

Messrs. Ulm and Zimmer have a long-term relationship with AVM and we have a contract with AVM to administer clearing and settlement services for our securities and derivative transactions. We have also entered into a second contract with AVM to assist us with financing transaction services such as repurchase financings and managing the margin arrangement between us and our lenders for each of our repurchase agreements. We rely on AVM for these aspects of our business so our executive officers can focus on our daily operations and strategic direction. Further, as our business expands, we will be increasingly dependent on AVM to provide us with timely, effective services. In the future, as we expand our staff, we may absorb internally some or all of the services provided by AVM. Until we elect to move those services in-house, we will remain dependent on AVM or other third-parties that provide similar services. If we are unable to maintain a relationship with AVM or are unable to establish a successful relationship with other third-parties providing similar services at comparable pricing, we may have to reduce or delay our operations and/or increase our expenditures and undertake the repurchase agreement and trading and administrative activities on our own, which could have a material adverse effect on our business operations and financial condition. However, we believe that the breadth and scope of ARRM's experience will enable them to fill any needs created by discontinuing a relationship with AVM.

There are conflicts of interest in our relationship with ARRM and its affiliates, which could result in decisions that are not in the best interests of our stockholders.

We are subject to conflicts of interest arising out of our relationship with JAVELIN, ARRM and their affiliates. Each of our executive officers and certain of our non-independent directors is also an employee or affiliated with JAVELIN and ARRM and they will not be exclusively dedicated to our business. Each of Mr. Ulm and Mr. Zimmer is a Co-Managing Member of ARRM and stockholder of JAVELIN.

In addition, Daniel C. Staton and Marc H. Bell, two of our directors, are joint owners of SBBC, which, in consideration for services to be provided to ARRM under a Sub-Management Agreement is entitled to receive a percentage of the net management fee earned by ARRM from us and JAVELIN. As a result, the Management Agreement with ARRM may create a conflict of interest and its terms, including fees payable to ARRM, may not be as favorable to us as if they had been negotiated with an unaffiliated third-party. In addition, we may choose not to enforce, or to enforce less vigorously, our rights under the Management Agreement because of our desire to maintain our ongoing relationship with ARRM. ARRM maintains a contractual and fiduciary relationship with us. The Management Agreement with ARRM does not prevent ARRM and its affiliates from engaging in additional management or investment opportunities some of which will compete with us. ARRM and its affiliates may engage in additional management or investment opportunities that have overlapping objectives with ours and may thus face conflicts in the allocation of investment opportunities to these other investments. Such allocation is at the discretion of ARRM and there is no guarantee that this allocation would be made in the best interest of our stockholders. We are not entitled to receive preferential treatment as compared with the treatment given by ARRM or its affiliates to any investment company, fund or advisory account other than any fund or advisory account which contains only funds invested by ARRM (and not of any of its clients or customers) or its officers and directors. Additionally, the ability of ARRM and its respective officers and employees to engage in other business activities, including their activities related to JAVELIN, may reduce the time spent managing our activities.

We compete with current and future investment entities affiliated with ARRM.

There are conflicts of interest in allocating investment opportunities among us and other funds, investment vehicles and ventures managed by ARRM. There is a significant overlap in the assets and investment strategies of us and JAVELIN. Although ARRM may dedicate certain trading and investment personnel to serve us only, in most cases the same trading and investment personnel may provide services to both entities. ARRM and its affiliates may in the future form additional funds or sponsor additional investment vehicles and ventures that have overlapping objectives with us and therefore may compete with us for investment opportunities and ARRM resources. ARRM has an allocation policy that addresses the manner in which investment opportunities are allocated among the various entities and strategies for which they provide investment management services. However, we cannot assure you that ARRM will always allocate every investment opportunity in a manner that is advantageous for us; indeed, we may expect that the allocation of investment opportunities will at times result in our receiving only a portion of, or none of, certain investment opportunities.

Resolution of potential conflicts of interest in allocation of investment opportunities.

In allocating investment opportunities among us and any other funds or accounts managed by them, ARRM's personnel are guided by the principles that they will treat all entities fairly and equitably, they will not arbitrarily distinguish among entities and they will not favor one entity over another.

In allocating a specific investment opportunity among us and JAVELIN, ARRM will make a determination, exercising their judgment in good faith, as to whether the opportunity is appropriate for each entity. Factors in making such a determination may include an evaluation of each entity's liquidity, overall investment strategy and objectives, the composition of the existing portfolio, the size or amount of the available opportunity, the characteristics of the securities involved, the liquidity of the markets in which the securities trade, the risks involved, and other factors relating to the entity and the investment opportunity. ARRM is not required to provide every opportunity to each entity.

If ARRM determines that an investment opportunity is appropriate for both us and JAVELIN, then ARRM will allocate that opportunity in a manner that they determine, exercising their judgment in good faith, to be fair and equitable, taking into consideration all allocations among us and JAVELIN taken as a whole. ARRM has broad discretion in making that determination, and in amending that determination over time.

In the future, ARRM may adopt additional conflicts on interest resolution policies and procedures designed to support the equitable allocation and to prevent the preferential allocation of investment opportunities among entities with overlapping investment objectives.

If ARRM ceases to be our investment manager, financial institutions providing any financing arrangements to us may not provide future financing to us.

Financial institutions that finance our investments may require that ARRM continue to act in such capacity. If ARRM ceases to be our manager, it may constitute an event of default and the financial institution providing the arrangement may have acceleration rights with respect to outstanding borrowings and termination rights with respect to our ability to finance our future investments with that institution. If we are unable to obtain financing for our accelerated borrowings and for our future investments under such circumstances, it is likely that we would be materially and adversely affected.

ARRM's failure to make investments on favorable terms that satisfy our investment strategy and otherwise generate attractive risk adjusted returns initially and consistently from time to time in the future would materially and adversely affect us.

Our ability to achieve our investment objective depends on ARRM's personnel and their ability to make investments on favorable terms that satisfy our investment strategy and otherwise generate attractive risk adjusted returns initially and consistently from time to time in the future. Accomplishing this result is also a function of ARRM's ability to execute our financing strategy on favorable terms.

The manner of determining the management fee may not provide sufficient incentive to ARRM to maximize risk adjusted returns on our investment portfolio since it is based on our gross equity raised and not on our performance.

ARRM is entitled to receive a monthly management fee that is based on the total of all gross equity raised (see Note 14 to the consolidated financial statements), as measured as of the date of determination (i.e., each month), regardless of our performance. Accordingly, the possibility exists that significant management fees could be payable to ARRM for a given month despite the fact that we could experience a net loss during that month. ARRM's entitlement to such significant nonperformance-based compensation may not provide sufficient incentive to ARRM to devote its time and effort to source and maximize risk adjusted returns on our investment portfolio, which could, in turn, adversely affect our ability to pay dividends to our stockholders and the market price of our common stock. Further, the management fee structure gives ARRM the incentive to maximize gross equity raised by the issuance of new equity securities or the retention of existing equity, regardless of the effect of these actions on existing stockholders. In other words, the management fee structure will reward ARRM primarily based on the size of our equity and not on our financial returns to stockholders.

The termination of the Management Agreement may be difficult and costly, which may adversely affect our inclination to end our relationship with ARRM.

Termination of the Management Agreement with ARRM without cause may be difficult and costly. The term "cause" is limited to those circumstances described in the Management Agreement with ARRM. We may not terminate the Management Agreement during the New Initial Term, as defined therein, except for cause or in connection with a Corporate Event, as defined therein. Upon a termination by us without cause, which shall include a Corporate Event, the Management Agreement provides that we will pay ARRM a termination payment equal to the greater of (a) the base management fee as calculated immediately prior to the effective date of the termination of the Management Agreement pursuant to Section 10.2 of the Management Agreement for the remainder of the then current term, or (b) three times the base management fee paid to ARRM in the preceding twelve-month period before such termination, calculated as of the effective date of the termination. This provision increases the effective cost to us of electing to terminate the Management Agreement, thereby adversely affecting our inclination to end our relationship with ARRM, even if we believe ARRM's performance is not satisfactory.

ARRM may terminate the Management Agreement at any time and for any reason upon 180 days prior notice. If the Management Agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Additionally, following the initial term, the Management Agreement will automatically renew for successive five-year renewal terms unless either we or ARRM give advance notice to the other of our intent not to renew the agreement prior to the expiration of the initial term or any renewal term. However, our right to give such a notice of non-renewal is limited and requires our independent directors to agree that certain conditions are met.

ARRM's liability is limited under the Management Agreement and we have agreed to indemnify ARRM and its affiliates against certain liabilities. As a result, we could experience poor performance or losses for which ARRM would not be liable.

The Management Agreement limits the liability of ARRM and any directors and officers of ARRM for money damages, except for liability resulting from actual receipt of an improper benefit or profit in money, property or services, or a final judgment based upon a finding of active and deliberate dishonesty by the director or officer that was material to the cause of action adjudicated.

Pursuant to the Management Agreement, ARRM will not assume any responsibility other than to render the services called for there under and will not be responsible for any action of our Board in following or declining to follow its advice or recommendations. ARRM and its affiliates, directors, officers, stockholders, equity holders, employees, representatives and agents and any affiliates thereof, will not be liable to us, our stockholders, any subsidiary of ours, the stockholders of any subsidiary of ours, our Board, any issuer of mortgage securities, any credit-party, any counterparty under any agreement, or any other person for any acts or omissions, errors of judgment or mistakes of law by ARRM or its affiliates, directors, officers, stockholders, equity holders, employees, representatives or agents, or any affiliates thereof, under or in connection with the Management Agreement, except if ARRM was grossly negligent, acted with reckless disregard or engaged in willful misconduct or fraud while discharging its duties under the Management Agreement. We have agreed to indemnify ARRM and its affiliates, directors, officers, stockholders, equity holders, employees, representatives and agents and any affiliates thereof, with respect to all expenses, losses, costs, damages, liabilities, demands, charges and claims of any nature, actual or threatened (including reasonable attorneys' fees), arising from or in respect of any acts or omissions, errors of judgment or mistakes of law (or any alleged acts or omissions, errors of judgment or mistakes of law) performed or made while acting in any capacity contemplated under the Management Agreement or pursuant to any underwriting or similar agreement to which ARRM is a party that is related to our activities, unless ARRM was grossly negligent, acted with reckless disregard or engaged in willful misconduct or fraud while discharging its duties under the Management Agreement. As a result, we could experience poor performance or losses for which ARRM would not be liable.

In addition, our articles of incorporation provide that no director or officer of ours shall be personally liable to us or our stockholders for money damages. Furthermore, our articles of incorporation permit and our by-laws require, us to indemnify, pay or reimburse any present or former director or officer of ours who is made or threatened to be made a party to a proceeding by reason of his or her service to us in such capacity. Officers and directors of ours who are also officers and board members of ARRM will therefore benefit from the exculpation and indemnification provisions of our articles of incorporation and by-laws and accordingly may not be liable to us in such circumstances.

The Management Agreement was not negotiated on an arm's-length basis and the terms, including fees payable, may not be as favorable to us as if they were negotiated with an unaffiliated third-party.

The Management Agreement that we entered into with ARRM was negotiated between related parties, and we did not have the benefit of arm's-length negotiations of the type normally conducted with an unaffiliated third-party. The terms of the Management Agreement, including fees payable, may not reflect the terms that we may have received if it were negotiated with an unrelated third-party. In addition, we may choose not to enforce, or to enforce less vigorously, our rights under the Management Agreement because of our desire to maintain our ongoing relationship with ARRM.

Members of our management team have competing duties to other entities, which could result in decisions that are not in the best interests of our stockholders.

Our executive officers and the employees of ARRM do not spend all of their time managing our activities and our investment portfolio. Our executive officers and the employees of ARRM allocate some, or a material portion, of their time to other businesses and activities. For example, each of our executive officers is also an officer of JAVELIN and an employee of ARRM. None of these individuals is required to devote a specific amount of time to our affairs. As a result of these overlapping responsibilities, there may be conflicts of interest among and reduced time commitments from our officers and the officers and employees of JAVELIN and ARRM when making investment decisions on behalf of ARMOUR. Accordingly, we will compete with JAVELIN and ARRM, and their existing activities, other ventures and possibly other entities in the future for the time and attention of these officers.

In the future, we may enter, or ARRM may cause us to enter, into additional transactions with ARRM or its affiliates. In particular, we may purchase, or ARRM may cause us to purchase, assets from ARRM or its affiliates or make co-purchases alongside ARRM or its affiliates. These transactions may not be the result of arm's length negotiations and may involve conflicts between our interests and the interests of ARRM and/or its affiliates in obtaining favorable terms and conditions.

Federal Income Tax Risks

Rapid changes in the values of our target assets may make it more difficult for us to maintain our qualification as a REIT or our exemption from the 1940 Act.

If the market value or income potential of our Agency Securities declines as a result of increased interest rates, prepayment rates, general market conditions, government actions or other factors, we may need to increase certain types of our assets and income or liquidate our non-qualifying assets to maintain our REIT qualifications or our exemption from the 1940 Act. If the decline in real estate asset values or income occurs quickly, this may be especially difficult to accomplish. We may have to make decisions that we otherwise would not make absent the REIT and the 1940 Act considerations.

Our qualification as a REIT subjects us to a broad array of financial and operating parameters that may influence our business and investment decisions and limit our flexibility in reacting to market developments.

In order to qualify and maintain our qualification as a REIT, we must, among other things, ensure that:

- that at least 75% of our gross income each year is derived from certain real estate related sources;
- that at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets at the end of each calendar quarter;
- that the remainder of our investment in securities generally cannot include more than 10% of the outstanding voting securities of any one issuer, or more than 10% of the total value of the outstanding securities of any one issuer; and
- that no more than 5% of the value of our assets can consist of securities of any one issuer.

If we fail to comply with these requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences. If we fail to qualify as a REIT, we will be subject to federal income tax as a regular corporation and may face substantial tax liability.

Qualification as a REIT involves the satisfaction of numerous requirements (some on an annual or quarterly basis) established under highly technical and complex provisions of the Code for which only a limited number of judicial or administrative interpretations exist. We believe we currently satisfy all the requirements of a REIT. However, the determination that we satisfy all REIT requirements requires an analysis of various factual matters and circumstances that may not be totally within our control. We have not requested and do not intend to request, a ruling from the Internal Revenue Service ("IRS'), that we qualify as a REIT. Accordingly, we are not certain we will be able to qualify and remain qualified as a REIT for federal income tax purposes. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, the U.S. Congress or the IRS might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effect, which could make it more difficult or impossible for us to qualify as a REIT.

If we fail to qualify as a REIT in any tax year, then:

- we would be taxed as a regular domestic corporation, which, among other things, means that we would be unable to deduct distributions to stockholders in computing taxable income and would be subject to federal income tax on our taxable income at regular corporate rates;
- any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders and could force us to liquidate assets at inopportune times, causing lower income or higher losses than would result if these assets were not liquidated; and
- unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification and thus, our cash available for distribution to our stockholders would be reduced for each of the years during which we do not qualify as a REIT.

REIT distribution requirements could adversely affect our ability to execute our business plan.

We generally must distribute annually at least 90% of our taxable income, subject to certain adjustments and excluding any net capital gain, in order for federal corporate income tax not to apply to earnings that we distribute. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a non-deductible 4% excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than 85% of our taxable income. We intend to make distributions to our stockholders to comply with the REIT requirements of the Code.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, we may be required to accrue income from MBS and other types of debt securities or interests in debt securities before we receive any payments of interest or principal on such assets. We may also acquire discounted debt investments that are subsequently modified by agreement with the borrower. If such arrangements constitute "significant modifications" of such debt under the applicable Treasury regulations, the modified debt may be considered to have been reissued to us in a debt-for-debt exchange with the borrower, with gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification.

As a result, we may find it difficult or impossible to meet distribution requirements in certain circumstances. In particular, where we experience differences in timing between the recognition of taxable income and the actual receipt of cash, the requirement to distribute a substantial portion of our taxable income could cause us to: (i) sell assets in adverse market conditions, (ii) borrow on unfavorable terms, (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt, in order to comply with REIT requirements, or (iv) make taxable distributions of our capital stock or debt securities. These alternatives could increase our costs or reduce our equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

Even if we qualify and remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we qualify and remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through a taxable REIT subsidiary ("TRS") or other subsidiary corporations that will be subject to corporate level income tax at regular rates. In addition, if we lend money to a TRS, the TRS may be unable to deduct all or a portion of the interest paid to us, which could result in an even higher corporate level tax liability. Any of these taxes would decrease cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to forgo otherwise attractive opportunities.

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. In addition, in certain cases, the modification of a debt instrument or, potentially, an increase in the value of a debt instrument that we acquired at a significant discount, could result in the conversion of the instrument from a qualifying real estate asset to a wholly or partially non-qualifying asset that must be contributed to a TRS or disposed of in order for us to qualify or maintain our qualification as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets, including certain mortgage loans and certain kinds of MBS. The remainder of our investment in securities (other than government securities, TRSs and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities, TRSs and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our investment portfolio otherwise attractive investments. For example, in certain cases, the modification of a debt instrument or, potentially, an increase in the value of a debt instrument that we acquired at a significant discount, could result in the conversion of the instrument from a qualifying real estate asset to a wholly or partially non-qualifying asset that must be liquidated in order for us to qualify or maintain our qualification as a REIT. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

The failure of assets subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.

In order to finance some of our assets that we hold or acquire, we may enter into repurchase agreements, including with persons who sell us those assets. Under a repurchase agreement, we will nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase those sold assets. Although the tax treatment of repurchase transactions is unclear, we take the position that we are treated for U.S. federal income tax purposes as the owner of those assets that are the subject of any such repurchase agreement notwithstanding that we may transfer record ownership of those assets to the counterparty during the term of any such agreement. Because we enter into repurchase agreements the tax treatment of which is unclear, the IRS could assert, particularly in respect of our repurchase agreements with persons who sell us the assets that we wish to finance by way of repurchase agreements, that we did not own those assets during the term of the repurchase agreements, in which case we could fail to qualify as a REIT.

Our capital loss carry forward for tax purposes may expire before we can fully use it to offset otherwise taxable income or gains.
For U.S. federal income tax purposes, we have incurred a net capital loss during our taxable year ending on December 31, 2013. Such net capital loss may be carried forward for five taxable years and generally used to offset taxable net capital gains realized during the carry forward period. As of December 31, 2013, our capital loss carry forward for U.S. federal income tax purposes, is equal to $579.3 million. Any capital loss carry forward that we have not used to offset otherwise taxable net capital gains will expire after the end of such five-year period, and will no longer be available to us. Our capital loss carry forward may expire before we can fully use it because, for example, we do not generate enough taxable net capital gains during that period. In the absence of offsetting net capital loss carry forward amounts, we will be required to make timely distributions of future net capital gains realized, or alternatively, pay U.S. federal income tax on such realized net capital gains not distributed.

We may be required to report taxable income for certain investments in excess of the economic income we ultimately realize from them.

We may acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectability rather than current market interest rates. The amount of such discount will nevertheless generally be treated as “market discount” for federal income tax purposes. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made. If we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions. Some of the debt instruments that we acquire may have been issued with original issue discount. We are required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such debt instruments will be made. If such debt instruments or MBS turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year that uncollectability is provable.

In addition, we may acquire debt instruments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding instrument are “significant modifications” under the applicable Treasury regulations, the modified instrument is considered to have been reissued to us in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified instrument exceeds our adjusted tax basis in the unmodified instrument, even if the value of the instrument or the payment expectations have not changed. Following such a taxable modification, we would hold the modified loan with a cost basis equal to its principal amount for federal tax purposes.

Finally, in the event that any debt instruments acquired by us are delinquent as to mandatory principal and interest payments, or in the event payments with respect to a particular instrument are not made when due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectability. Similarly, we may be required to accrue interest income with respect to debt instruments at its stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

Distributions to tax-exempt investors may be classified as unrelated business taxable income.

Neither ordinary nor capital gain distributions with respect to our common stock nor gain from the sale of common stock should generally constitute unrelated business taxable income to a tax-exempt investor. However, there are certain exceptions to this rule, including: (i) part of the income and gain recognized by certain qualified employee pension trusts with respect to our common stock may be treated as unrelated business taxable income if shares of our common stock are predominantly held by qualified employee pension trusts, and we are required to rely on a special look-through rule for purposes of meeting one of the REIT ownership tests, and we are not operated in a manner to avoid treatment of such income or gain as unrelated business taxable income; (ii) part of the income and gain recognized by a tax-exempt investor with respect to our common stock would constitute unrelated business taxable income if the investor incurs debt in order to acquire the common stock; (iii) part or all of the income or gain recognized with respect to our common stock by social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal services plans which are exempt from federal income taxation under the Code may be treated as unrelated business taxable income; and (iv) to the extent that we are (or a part of us, or a disregarded subsidiary of ours, is) a “taxable mortgage pool,” or if we hold residual interests in a real estate mortgage investment conduit ("REMIC"), a portion of the distributions paid to a tax-exempt stockholder that is allocable to excess inclusion income may be treated as unrelated business taxable income.

The “taxable mortgage pool” rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.

Securitizations could result in the creation of taxable mortgage pools for federal income tax purposes. As a REIT, so long as we own 100% of the equity interests in a taxable mortgage pool, we generally would not be adversely affected by the characterization of the securitization as a taxable mortgage pool. Certain categories of stockholders, however, such as foreign stockholders eligible for treaty or other benefits, stockholders with net operating losses and certain tax-exempt stockholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their distribution income from us that is attributable to the taxable mortgage pool. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we will reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax. Moreover, we would be precluded from selling equity interests in these securitizations to outside investors, or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

We may incur excess inclusion income that would increase the tax liability of our stockholders or the Company.

In general, dividend income that a tax-exempt entity receives from us should not constitute unrelated business taxable income as defined in Section 512 of the Code. If we realize excess inclusion income and allocate it to stockholders, however, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Code. If the stockholder is foreign, it would generally be subject to U.S. federal income tax withholding on this income without reduction pursuant to any otherwise applicable income tax treaty. U.S. stockholders would not be able to offset such income with their operating losses. If our stock is held in record name by "disqualified organizations" (generally government entities and certain tax-exempt investors, such as certain state pension plans and charitable remainder trusts, that are not subject to the tax on unrelated business taxable income), the Company must pay tax at the highest corporate rate on any excess inclusion income attributable to such disqualified organization investors. That tax would reduce our taxable REIT income.

We generally structure our borrowing arrangements in a manner designed to avoid generating significant amounts of excess inclusion income. However, excess inclusion income could result if we held a residual interest in a REMIC. Excess inclusion income also may be generated if we were to issue debt obligations with two or more maturities and the terms of the payments on these obligations bore a relationship to the payments that we received on our MBS securing those debt obligations. For example, we may engage in non-REMIC CMO securitizations. We also enter into various repurchase agreements that have differing maturity dates and afford the lender the right to sell any pledged mortgage securities if we default on our obligations. These transactions may give rise to excess inclusion income that requires allocation among our stockholders. We may invest in equity securities of other REITs and it is possible that we might receive excess inclusion income from those investments. Some types of entities, including, without limitation, voluntarily employee benefit associations and entities that have borrowed funds to acquire their shares of our stock, may be required to treat a portion of or all of the dividends they receive from us as unrelated business taxable income.

To the extent we invest in construction loans, we may fail to qualify as a REIT if the IRS successfully challenges our estimates of the fair market value of land improvements that will secure those loans.

We may invest in construction loans, the interest from which will be qualifying income for purposes of the REIT income tests, provided that the loan value of the real property securing the construction loan is equal to or greater than the highest outstanding principal amount of the construction loan during any taxable year. For purposes of construction loans, the loan value of the real property is the fair market value of the land plus the reasonably estimated cost of the improvements or developments (other than personal property), which will secure the loan and which are to be constructed from the proceeds of the loan. There can be no assurance that the IRS would not successfully challenge our estimate of the loan value of the real property and our treatment of the construction loans for purposes of the REIT income and assets tests, which may cause us to fail to qualify as a REIT.

Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.

To qualify as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as dealer property or inventory.

The tax on prohibited transactions limits our ability to engage in transactions, including certain methods of securitizing mortgage loans, which would be treated as prohibited transactions for federal income tax purposes.

Net income that we derive from a prohibited transaction is subject to a 100% tax. The term “prohibited transaction” generally includes a sale or other disposition of property (including mortgage loans, but other than foreclosure property, as discussed below) that is held primarily for sale to customers in the ordinary course of a trade or business by us or by a borrower that has issued a shared appreciation mortgage or similar debt instrument to us. We might be subject to this tax if we were to dispose of or securitize loans in a manner that was treated as a prohibited transaction for federal income tax purposes.

We conduct our operations so that no asset that we own (or are treated as owning) will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having been in the ordinary course of our business. As a result, we may choose not to engage in certain sales of loans at the REIT level, and may limit the structures we utilize for our securitization transactions, even though the sales or structures might otherwise be beneficial to us. In addition, whether property is held “primarily for sale to customers in the ordinary course of a trade or business” depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We structure our activities to avoid prohibited transaction characterization.

Complying with REIT requirements may force us to borrow to make distributions to our stockholders.

As a REIT, we must distribute at least 90% of our annual REIT taxable income (excluding net capital gains) to our stockholders. From time to time, we may generate taxable income greater than our net income for financial reporting purposes from, among other things, the non-taxable unrealized changes in the value of our derivatives, or our taxable income may be greater than our cash flow available for distribution to our stockholders. If we do not have other funds available in these situations, we may be unable to distribute 90% of our taxable income as required by the REIT rules. Thus, we could be required to borrow funds, sell a portion of our assets at disadvantageous prices or find another alternative source of funds. These alternatives could increase our costs or reduce our equity and reduce amounts available to invest in Agency Securities.

Employee Retirement Income Security Act (“ERISA”) Tax Risks

Plans should consider ERISA risks of investing in our common stock.

Investment in our common stock may not be appropriate for a pension, profit-sharing, employee benefit, or retirement plan, considering the plan’s particular circumstances, under the fiduciary standards of ERISA, or other applicable similar laws including standards with respect to prudence, diversification and delegation of control and the prohibited transaction provisions of ERISA, the Code and any applicable similar laws.

ERISA and Section 4975 of the Code prohibit certain transactions that involve (i) certain pension, profit-sharing, employee benefit, or retirement plans or individual retirement accounts and (ii) any person who is a “party in interest” or “disqualified person” with respect to such plan. Consequently, the fiduciary of a plan contemplating an investment in our common stock should consider whether its company, any other person associated with the issuance of its common stock or any affiliate of the foregoing is or may become a “party in interest” or “disqualified person” with respect to the plan and, if so, whether an exemption from such prohibited transaction rules is applicable.

ERISA may limit our ability to attract capital from Benefit Plan Investors.

It is unlikely that we will qualify as an operating company for purposes of ERISA. Consequently, in order to avoid our assets being deemed to include so-called “plan assets” under ERISA, we will initially limit equity ownership in us by Benefit Plan Investors to less than 25% of the value of each class or series of capital stock issued by us and to prohibit transfers of our common stock to Benefit Plan Investors. Our charter prohibits Benefit Plan Investors from holding any interest in any shares of our capital stock that are not publicly traded. These restrictions on investments in us by Benefit Plan Investors (and certain similar investors) may adversely affect the ability of our stockholders to transfer their shares of our common stock and our ability to attract private equity capital in the future.

Risks Related to Our Common Stock

The performance of our common stock correlates to the performance of our REIT investments, which may be speculative and aggressive compared to other types of investments.

The investments we make in accordance with our investment objectives may result in a greater amount of risk as compared to alternative investment options, including relatively higher risk of volatility or loss of principal. Our investments may be speculative and aggressive, and therefore an investment in our common stock may not be suitable for someone with lower risk tolerance.

One of the factors that investors may consider in deciding whether to buy or sell shares of our common stock is our distribution rate as a percentage of the trading price of our common stock relative to market interest rates. If the market price of our common stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and capital market conditions are likely to affect adversely the market price of our common stock. For instance, if market rates rise without an increase in our distribution rate, the market price of our common stock could decrease as potential investors may require a higher distribution yield on our common stock or seek other securities paying higher distributions or interest. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby reducing cash flow and our ability to service our indebtedness and pay distributions.

Future offerings of debt securities, which would rank senior to our common stock upon our liquidation, and future offerings of equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common stock.

In the future, we may raise capital through the issuance of debt or equity securities. Upon liquidation, holders of our debt securities and preferred stock, if any, and lenders with respect to other borrowings will be entitled to our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Additional series of preferred stock, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to pay dividends to the holders of our common stock. Sales of substantial amounts of our common stock (including shares of our common stock issued pursuant to our Incentive Plan, or the perception that these sales could occur, could have a material adverse effect on the price of our common stock. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us.

There are significant restrictions on ownership of our common stock.

In order for us to maintain our qualification as a REIT under the Code, not more than 50% in value of the issued and outstanding shares of our capital stock may be owned, actually or constructively, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year (other than our first year as a REIT). This test is known as the “5/50 test.” Attribution rules in the Code apply to determine if any individual actually or constructively owns our capital stock for purposes of this requirement, including, without limitation, a rule that deems, in certain cases, a certain holder of a warrant or option to purchase stock as owning the shares underlying such warrant or option and a rule that treats shares owned (or treated as owned, including shares underlying warrants) by entities in which an individual has a direct or indirect interest as if they were owned by such individual. Additionally, at least 100 persons must beneficially own our capital stock during at least 335 days of each taxable year (other than our first year as a REIT). While we believe that we meet the 5/50 test, no assurance can be given that we will continue to meet this test.

Our charter prohibits beneficial or constructive ownership by any person of more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock or all classes of our capital stock. Additionally, our charter prohibits beneficial or constructive ownership of our stock that would otherwise result in our failure to qualify as a REIT. In each case, such prohibition includes a prohibition on owning warrants or options to purchase stock if ownership of the underlying stock would cause the holder or beneficial owner to exceed the prohibited thresholds. The ownership rules in our charter are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be owned by one individual or entity. As a result, these ownership rules could cause an individual or entity to unintentionally own shares beneficially or constructively in excess of our ownership limits. Any attempt to own or transfer shares of our common or preferred stock, in excess of our ownership limits without the consent of our board of directors shall be void, and will result in the shares being transferred to a charitable trust. These provisions may inhibit market activity and the resulting opportunity for our stockholders to receive a premium for their shares that might otherwise exist if any person were to attempt to assemble a block of shares of our stock in excess of the number of shares permitted under our charter and which may be in the best interests of our stockholders. We may grant waivers from the 9.8% charter restriction for holders where, based on representations, covenants and agreements received from certain equity holders, we determine that such waivers would not jeopardize our status as a REIT.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We do not own or lease any real estate or other physical properties. Pursuant to the Management Agreement, ARRM maintains our executive offices at 3001 Ocean Drive, Suite 201, Vero Beach, Florida 32963. We consider our current office space adequate for our current operations.

Item 3. Legal Proceedings

Our company and ARRM are not currently subject to any legal proceedings, as described in Item 103 of Regulation S-K.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our Series A Preferred Stock, Series B Preferred Stock and our common stock are currently listed on the NYSE under the symbols “ARR-PA,” "ARR-PB" and "ARR," respectively. Our warrants expired on November 7, 2013 and were listed on the NYSE MKT LLC. As of February 25, 2014, the per share price of our common stock as reported on the NYSE was $4.32.

The following table sets forth the range of high and low closing prices for our stock for the periods indicated as reported by the NYSE.

Quarter ended	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Warrants	
	High	Low	High	Low	High	Low	High	Low
December 31, 2013 (1)	$23.20	$20.89	$21.72	$19.80	$4.45	$3.68	—	—
September 30, 2013	$25.23	$21.13	$24.28	$20.03	$4.69	$3.78	$0.01	—
June 30, 2013	$26.09	$24.08	$25.50	$23.30	$6.50	$4.29	$0.03	$0.01
March 31, 2013 (2)	$26.07	$25.46	$25.04	$24.80	$7.18	$6.24	$0.05	$0.03
December 31, 2012	$25.54	$24.73	—	—	$7.70	$6.09	$0.03	$0.02
September 30, 2012	$25.85	$25.26	—	—	$7.75	$7.22	$0.03	$0.03
June 30, 2012 (3)	$25.35	$24.60	—	—	$7.11	$6.72	$0.02	$0.02
March 31, 2012	—	—	—	—	$7.21	$6.63	$0.03	$0.01

(1) For the Warrants this is for the period from October 1, 2013 through November 1, 2013 which was the final trading day determined by the NYSE MKT LLC. The Warrants expired in accordance with the original terms on November 7, 2013.
(2) For the Series B Preferred Stock this is for the period commencing February 13, 2013(date of issuance) through March 31, 2013.
(3) For the Series A Preferred Stock this is for the period commencing June 7, 2012 (date of issuance) through June 30, 2012.

Holders of Common Equity

As of February 25, 2014, we had 160 stockholders of record of our outstanding common stock. We believe that there are more beneficial owners of shares of our common stock.

Dividend Policy

We intend to continue to make regular cash distributions to holders of shares of common stock. Future dividends will be at the discretion of the Board and will depend on our earnings and financial condition, maintenance of our REIT qualification, restrictions on making distributions under MGCL and such other factors as our Board deems relevant. Dividends cannot be paid on our common stock unless we have paid full cumulative dividends on both classes of our preferred stock. For the year ended December 31, 2013, we have paid full cumulative dividends on our Series A Preferred Stock and our Series B Preferred Stock.

For historical information on the frequency and amount of cash dividends paid to the holders of shares of our common stock, see the heading titled, "Stockholders' Equity - Dividends" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K.

Total dividend payments to common stockholders were $292.6 million and dividend payments to preferred stockholders were $14.2 million, respectively, for the year ended December 31, 2013. Our estimated REIT taxable income available to pay dividends was $240.4 million for the year ended December 31, 2013. We also carried forward from the year ended December 31, 2012, undistributed REIT taxable income of $10.4 million. Our REIT taxable income and dividend requirements are determined on an annual basis. Dividends in excess of REIT taxable income for the year (including taxable income carried forward from the previous year) will generally not be taxable to common stockholders.

Stock Repurchase Program

The following table presents information regarding our common stock repurchases made during the three months ended December 31, 2013.

	Total Number of Shares Purchased (1)	Per Share Price (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Maximum Number of Shares That May Yet Be Purchased Under the Publicly Announced Plans or Programs (4)
December 11, 2013 through December 31, 2013	13,375,400	$3.89	13,375,400	NA

(1) All shares were repurchased pursuant to a stock repurchase program ("Repurchase Program") (see Note 3 to the consolidated financial statements).
(2) Weighted average price.
(3) In December 2012, our Board authorized a Repurchase Program of up to $100.0 million of our common stock outstanding.
(4) As of December 31, 2013, there is $27.3 million remaining under the Repurchase Program.

Performance Graph

The following graph compares the stockholder’s cumulative total return, assuming $100 invested at December 31, 2009, with all reinvestment of dividends, such as if such amounts had been invested in: (i) our common stock; (ii) the stocks included in the Standard and Poor’s 500 Stock Index (“S&P 500”) and (iii) the stocks included in the NAREIT Mortgage REIT Index.

Index	Period Ending 12/31/09	12/31/10	12/30/11	12/31/12	12/31/13
FTSE NAREIT Mortgage Total Return Index	$100.00	$122.60	$119.63	$143.43	$140.62
S&P 500 Total Return Index	$100.00	$115.06	$117.49	$136.30	$180.44
ARMOUR Residential REIT	$100.00	$115.66	$126.36	$137.17	$99.68

The information in the performance graph and table has been obtained from sources believed to be reliable, but neither its accuracy nor its completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future performance.

Item 6. Selected Financial Data

The following table sets forth selected historical financial information derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K for the years listed. The following data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements including the notes thereto, included elsewhere in this Annual Report on Form 10-K.

	December 31, 2013 (in thousands)	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009
Balance Sheet Data:					
Agency Securities, available for sale, at fair value	$14,648,178	$19,096,562	$5,393,675	$1,161,851	$118,649
Repurchase agreements	$13,151,504	$18,366,095	$5,335,962	$971,676	$46,389
Stockholders' Equity	$1,901,228	$2,307,775	$626,606	$108,709	$21,491
Statement of Operations Data:					
Interest Income	$505,443	$388,994	$117,638	$12,161	$446
Interest Expense	(83,218)	(61,195)	(11,856)	(1,207)	(13)
Net Interest Income	$422,225	$327,799	$105,782	$10,954	433
Total Other Loss	(572,128)	(80,143)	(105,462)	(2,885)	—
Expenses	(37,151)	(25,374)	(9,711)	(1,683)	(2,027)
Income tax benefit (expense)	10	24	(51)	151	394
Net Income (Loss)	$(187,044)	$222,306	$(9,442)	$6,537	$(1,149)
Dividends declared on preferred stock	(14,213)	(1,964)	—	—	—
Net Income (loss) available (related) to common stockholders	$(201,257)	$220,342	$(9,442)	$6,537	$(1,149)
Earnings (Loss) per share – common stock, Basic	$(0.55)	$0.99	$(0.15)	$1.12	$(0.11)
Earnings (Loss) per share- common stock, Diluted	$(0.55)	$0.98	$(0.15)	$1.12	$(0.11)
Weighted average shares outstanding- Basic	362,830	223,627	61,421	5,855	20,460
Weighted average shares outstanding- Diluted	362,830	224,263	61,421	5,855	20,460
Cash dividends paid per common share	$0.81	$1.20	$1.41	$1.52	$0.13
Key Portfolio Statistics *					

Average Agency Securities (1)	$19,593,311	$14,270,813	$3,927,434	$369,193	$10,670
Average Repurchase Agreements (2)	$19,106,669	$12,922,455	$3,902,680	$362,183	$5,532
Average Portfolio Yield (3)	2.58 %	2.73 %	3.00 %	3.29 %	4.59 %
Average Cost of Funds (4)	1.19 %	0.96 %	0.94 %	0.45 %	0.72 %
Interest Rate Spread (5)	1.39 %	1.76 %	2.05 %	2.85 %	3.87 %
Return on Equity (6)	(9.8)%	9.6 %	(2.0)%	6.0 %	(5.3)%
Average Annual Portfolio Repayment Rate (7)	10.0 %	11.9 %	13.2 %	13.0 %	8.6 %
Debt to Stockholders' Equity (8)	6.92:1	7.96:1	8.52:1	8.94:1	2.16:1

*All percentages represent daily weighted averages annualized.

(1) Our daily average investment in Agency Securities was calculated by dividing the sum of our daily Agency Securities investments during the year by the number of days in the period.
(2) Our daily average balance outstanding under our repurchase agreements was calculated by dividing the sum of our daily outstanding balances under our repurchase agreements during the year by the number of days in the period.
(3) Our average portfolio yield was calculated by dividing our interest income by our average Agency Securities.
(4) Our average cost of funds was calculated by dividing our total interest expense (including derivatives) by our average repurchase agreement borrowings.
(5) Our interest rate spread was calculated by subtracting our average cost of funds from our average portfolio yield.
(6) Our return on equity was calculated by dividing net income (loss) by equity.
(7) Our average annual portfolio repayment rate is calculated by taking the actual CPR for a month and averaging it with the other CPRs from the same year.
(8) Our debt-to-equity ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by total stockholders’ equity at period end.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report.

References to “we,” “us,” “our,” “ARMOUR” or the “Company” are to ARMOUR Residential REIT, Inc. References to “ARR are to ARMOUR Residential Management LLC, a Delaware limited liability company.

Overview

We are a Maryland corporation formed to invest in and manage a leveraged portfolio of residential mortgage backed securities (“MBS”). The securities we invest in are issued or guaranteed by a United States (“U.S.”) Government-sponsored entity (“GSE”), such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), or guaranteed by the Government National Mortgage Administration (Ginnie Mae) (collectively, “Agency Securities”). Our securities portfolio consists primarily of Agency Securities backed by fixed rate home loans. From time to time, a portion of our assets may be invested in Agency Securities backed by hybrid adjustable rate and adjustable rate home loans as well as unsecured notes and bonds issued by U.S. Government-sponsored entities (“Agency Debt”), U.S. Treasuries and money market instruments, subject to certain income tests we must satisfy for our qualification as a real estate investment trust (“REIT”). Our charter permits us to invest in Agency Securities and Non-Agency Securities. As of December 31, 2013, and December 31, 2012, Agency Securities account for 100% of our securities portfolio.It is expected that the percentage will continue to be 100% or close thereto.

We are externally managed by ARRM, pursuant to a management agreement (the “Management Agreement”), which was most recently amended on February 25, 2014. ARRM is an investment advisor registered with the Securities and

Exchange Commission (“SEC”). ARRM is also the external manager of JAVELIN Mortgage Investment Corp. (“JAVELIN”), a publicly traded REIT, which invests in and manages a leveraged portfolio of Agency Securities and Non-Agency Securities. Our executive officers also serve as the executive officers of JAVELIN.

We seek attractive long-term investment returns by investing our equity capital and borrowed funds in our targeted asset class of Agency Securities. We earn returns on the spread between the yield on our assets and our costs, including the interest cost of the funds we borrow, after giving effect to our hedges. We identify and acquire Agency Securities, finance our acquisitions with borrowings under a series of short-term repurchase agreements at the most competitive interest rates available to us and then cost-effectively hedge our interest rate and other risks based on our entire portfolio of assets, liabilities and derivatives and our management’s view of the market. Successful implementation of this approach requires us to address interest rate risk, maintain adequate liquidity and effectively hedge interest rate risks. We believe that the residential mortgage market will undergo significant changes in the coming years as the role of GSEs, such as Fannie Mae and Freddie Mac, is diminished, which we expect will create attractive investment opportunities for us. We execute our business plan in a manner consistent with our intention of qualifying as a REIT under the Internal Revenue Code, (the “Code”) and avoid regulation as an investment company under the Investment Company Act of 1940 (the “1940 Act”).

We have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code including meeting certain asset, income and stock ownership tests.

Factors that Affect our Results of Operations and Financial Condition

Our results of operations and financial condition are affected by various factors, many of which are beyond our control, including, among other things, our net interest spread, the market value of our assets and the supply of, and demand for, such assets. We invest in financial assets and markets. Recent events, such as those discussed below, can affect our business in ways that are difficult to predict and may produce results outside of typical operating variances. Our net interest income varies primarily as a result of changes in interest rates, borrowing costs and prepayment speeds, the behavior of which involves various risks and uncertainties. Prepayment rates, as reflected by the rate of principal pay downs and interest rates vary according to the type of investment, conditions in financial markets, government actions, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment rates on our Agency Securities purchased at a premium increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. Because changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to manage interest rate risks and prepayment risks effectively while maintaining our status as a REIT.

For any period during which changes in the interest rates earned on our assets do not coincide with interest rate changes on our borrowings, such assets will tend to reprice more slowly than the corresponding liabilities. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net interest income. With the maturities of our assets generally of longer term than those of our liabilities, interest rate increases will tend to decrease our net interest income and the market value of our assets (and therefore our book value). Such rate increases could possibly result in operating losses or adversely affect our ability to make distributions to our stockholders.

Prepayments on Agency Securities and the underlying mortgage loans may be influenced by changes in market interest rates and a variety of economic and geographic factors, policy decisions by regulators, as well as other factors beyond our control. Consequently, prepayment rates cannot be predicted with certainty. To the extent we hold Agency Securities acquired at a premium or discount to par, or face value, changes in prepayment rates may impact our anticipated yield. In periods of declining interest rates, prepayments on our Agency Securities will likely increase. If we are unable to reinvest the proceeds of such prepayments at comparable yields, our net interest income may decline. The recent climate of government intervention in the mortgage markets significantly increases the risk associated with prepayments.

While we use strategies to economically hedge some of our interest rate risk, we do not hedge all of our exposure to changes in interest rates and prepayment rates, as there are practical limitations on our ability to insulate our securities portfolio from all potential negative consequences associated with changes in short-term interest rates in a manner that will allow us to seek attractive net spreads on our securities portfolio. Also, since we have not elected to use cash flow hedge accounting, earnings reported in accordance with generally accepted accounting principles in the U.S. (“GAAP”) will fluctuate even in situations where our derivatives are operating as intended. As a result of this mark-to-market accounting treatment, our results of operations are likely to fluctuate far more than if we were to designate our derivative activities as cash flow hedges. Comparisons with companies that use cash flow hedge accounting for all or part of their derivative activities may not be meaningful. For these and other reasons more fully described under the section captioned “Derivative Instruments” below, no assurance can be given that our derivatives will have the desired beneficial impact on our results of operations or financial condition.

In addition to the use of derivatives to hedge interest rate risk, a variety of other factors relating to our business may also impact our financial condition and operating performance; these factors include,

- our degree of leverage;
- our access to funding and borrowing capacity;
- the REIT requirements under the Code; and
- the requirements to qualify for an exclusion under the 1940 Act and other regulatory and accounting policies related to our business.

For a discussion of additional risks relating to our business see “Risk Factors” in Item 1A.

Our Manager

We are externally managed by ARRM, pursuant to the Management Agreement (see Note 14 to the consolidated financial statements). All of our executive officers are also employees of ARRM. ARRM manages our day-to-day operations, subject to the direction and oversight of the Board of Directors (“Board”). The Management Agreement expires June 18, 2022 and is thereafter automatically renewed for an additional 5 year term unless terminated under certain circumstances. Either party must provide 180 days prior written notice of any such termination. ARRM is entitled to receive a termination fee from us under certain circumstances.

Pursuant to the Management Agreement, ARRM is entitled to receive a management fee payable monthly in arrears. Currently, the monthly management fee is 1/12th of the sum of (a) 1.5% of gross equity raised up to $1.0 billion plus (b) 0.75% of gross equity raised in excess of $1.0 billion. The cost of repurchased stock reduces the amount of gross equity raised used to calculate the monthly management fee. As of December 31, 2013, the effective management fee was 1.026% based on gross equity raised. ARRM is entitled to receive a monthly management fee regardless of the performance of our securities portfolio. Accordingly, the payment of our monthly management fee may not decline in the event of a decline in our earnings and may cause us to incur losses. We incurred $28.1 million, $19.5 million and $6.9 million, respectively, in management fees for the years ended December 31, 2013, 2012 and 2011.

We are required to take actions as may be reasonably required to permit and enable ARRM to carry out its duties and obligations. We are also responsible for any costs and expenses that ARRM incurred solely on behalf of ARMOUR or its subsidiary other than the various overhead expenses specified in the terms of the Management Agreement. For the year ended December 31, 2013, we reimbursed ARRM $1.5 million for other expenses incurred on our behalf and $1.1 million of compensation expense related to restricted shares of common stock for ARRM employees (see Note 10 to the consolidated financial statements). For the year ended December 31, 2012 we reimbursed ARRM $0.05 million for other expenses incurred on our behalf. For the year ended December 31, 2011, we did not reimburse ARRM for any expenses.

Pursuant to a Sub-Management Agreement between ARMOUR, ARRM and Staton Bell Blank Check LLC ("SBBC"), ARRM is responsible for the payment of a monthly sub-management fee to SBBC in an amount equal to 25% of the monthly management fee earned by ARRM, net of expenses. On November 6, 2014, SBBC has the option of terminating the Sub-Management Agreement. If the Sub-Management Agreement is terminated, we would be required to make a final payment to SBBC in the amount of 6.16 times the annualized rate of the sub-management fee for the prior three months. Thereafter, we will be entitled to receive the sub-management fee or, at the option of ARRM, reimbursement of the final payment by ARRM. The payments from ARRM to SBBC for the three months preceding December 31, 2013 totaled $1,438 thousand. If the Sub-Management Agreement had been terminated on December 31, 2013, the payment due from ARMOUR would have been $35.4 million.

For a discussion of additional risks relating to our business, see “Risk Factors“in Item 1A.

Market and Interest Rate Trends and the Effect on our Portfolio

Developments at Fannie Mae and Freddie Mac

Payments on the principal and interest on the Agency Securities in which we invest are guaranteed by Fannie Mae and Freddie Mac. Because of the guarantee and the underwriting standards associated with mortgages underlying Agency Securities, Agency Securities historically have had high stability in value and been considered to present low credit risk.

In February 2011, the U.S. Treasury along with the U.S. Department of Housing and Urban Development released a report entitled, “Reforming America’s Housing Finance Market” to the U.S. Congress outlining recommendations for reforming the U.S. housing system, specifically Fannie Mae and Freddie Mac and transforming the U.S. Government’s involvement in the housing market. It is unclear how future legislation may impact the housing finance market and the investing environment for Agency Securities as the method of reform is undecided and has not yet been defined by the regulators. Without U.S. Government support for residential mortgages, we may not be able to execute our current business model in an efficient manner.

In March 2011, the U.S. Treasury announced that it would begin the orderly wind down of Agency Securities it had purchased from Fannie Mae, Freddie Mac and Ginnie Mae to stabilize the housing market, with sales up to $10.0 billion per month, subject to market conditions. We are unable to predict the timing or manner in which the U.S. Treasury or the U.S. Federal Reserve (“the Fed”) will liquidate their holdings or make further interventions in the Agency Securities markets, or what impact, if any, such action could have on the Agency Securities market, the Agency Securities we hold, our business, results of operations and financial condition.

On June 25, 2013, a bipartisan group of U.S. senators introduced a draft bill titled, "Housing Finance Reform and Taxpayer Protection Act of 2013" to the U.S. Senate, which would wind down Fannie Mae and Freddie Mac over a period of five years and replace the public securitization market used by the GSEs with a public-private alternative market. On July 11, 2013, members of the U.S. House Committee on Financial Services introduced a similar draft bill titled, "Protecting American Taxpayers and Homeowners Act" to the U.S. House of Representatives. While distinguishable in some respects from the Senate version, the House bill would also eliminate Fannie Mae and Freddie Mac and seek to increase the opportunities for private capital to participate in, and consequently bear the risk of loss in connection with, government-guaranteed MBS.

The passage of any new legislation affecting Fannie Mae and Freddie Mac may create market uncertainty and reduce the actual or perceived credit quality of securities issued or guaranteed by the U.S. Government through a new or existing successor entity to Fannie Mae and Freddie Mac. If Fannie Mae and Freddie Mac were reformed or wound down, it is unclear what effect, if any, this would have on the value of the existing Fannie Mae and Freddie Mac Agency Securities. It is also possible that the above-referenced proposed legislation, if made law, could adversely impact the market for securities issued or guaranteed by the U.S. Government and the spreads at which they trade. The foregoing could materially adversely affect the pricing, supply, liquidity and value of the Agency Securities in which we invest and otherwise materially adversely affect our business, operations and financial condition.

We cannot predict whether or when new actions may occur, the timing and pace of current actions already implemented, or what impact if any, such actions, or future actions, could have on our business, results of operations and financial condition.

U.S. Government Mortgage Related Securities Market Intervention

In September 2012, the Fed announced a third quantitative easing program, popularly referred to as “QE3,” to purchase an additional $40.0 billion of Agency Securities per month until the unemployment rate and other economic indicators improved. QE3 plus its existing investment programs grew the Fed’s U.S. Treasury Securities and Agency Securities holdings by approximately $85.0 billion per month at least through the end of 2013.

At its December 18, 2013, and January 29, 2014, meetings, the Fed decided to trim its monthly Agency Securities purchases to $35.0 billion and $30.0 billion, respectively, for January and February 2014, down from $40.0 billion in 2013. Longer term U.S. Treasury Securities purchases were trimmed a pace of $40.0 billion and $35.0 billion per month, respectively, for January and February 2014, down from $45.0 billion in 2013. These actions were to keep in place its highly accommodative stance of monetary policy. As part of that policy, the Fed announced that it would keep the target range for the Federal Funds Rate between zero and 0.25% for at least as long as the unemployment rate remains above 6.5%, inflation between one and two years ahead was projected to be no more than 0.5% above the Fed’s 2% longer-run goal, and longer-term inflation expectations continued to be well anchored.

Reduced purchase levels by the Fed may result in lower over all demand and therefore lower prices for Agency Securities. Lower Agency Securities prices will reduce our book value and the amounts that we can borrow under repurchase agreements.

Financial Regulatory Reform Bill and Other Government Activity

We believe that we conduct our business in a manner that allows us to avoid being regulated as an investment company pursuant to the exclusion provided by Section 3(c)(5)(C) of the 1940 Act for entities that are primarily engaged in the business of purchasing or otherwise acquiring “mortgages and other liens on and interests in real estate.” On August 31, 2011, the SEC issued a concept release (No. IC-29778; File No. SW7-34-11, Companies Engaged in the Business of Acquiring Mortgages and Mortgage Related Instruments) pursuant to which it is reviewing whether certain companies that invest in MBS and rely on the exclusion from registration under Section 3(c)(5)(C) of the 1940 Act (such as us) should continue to be allowed to rely on such exclusion from registration. If we fail to continue to qualify for this exclusion from registration as an investment company, or the SEC determines that companies that invest in MBS are no longer able to rely on this exclusion, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as planned, or we may be required to register as an investment company under the 1940 Act, either of which could negatively affect the value of shares of our stock and our ability to make distributions to our stockholders.

Certain programs initiated by the U.S. Government, through the Federal Housing Finance Agency (“FHFA”) and the Federal Deposit Insurance Corporation (“FDIC”), to provide homeowners with assistance in avoiding residential mortgage loan foreclosures are currently in effect. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. While the effect of these programs has not been as extensive as originally expected, the effect of such programs for holders of Agency Securities could be that such holders would experience changes in the anticipated yields of their Agency Securities due to (i) increased prepayment rates and/or (ii) lower interest and principal payments.

In March 2009, the Home Affordable Modification Program (“HAMP”) was introduced to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. HAMP is designed to help at risk homeowners, both those who are in default and those who are at imminent risk of default, by providing the borrower with affordable and sustainable monthly payments.

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. The Dodd-Frank Act is extensive, complicated and comprehensive legislation that impacts practically all aspects of banking, and a significant overhaul of many aspects of the regulation of the financial services industry. Although many provisions remain subject to further rulemaking, the Dodd-Frank Act implements numerous and far-reaching changes that affect financial companies, including our company, and other banks and institutions which are important to our business model. Certain notable rules are, among other things:

- Requiring regulation and oversight of large, systemically important financial institutions by establishing an interagency council on systemic risk and implementation of heightened prudential standards and regulation by the Board of Governors of the Fed for systemically important financial institutions (including nonbank financial companies), as well as the implementation of the FDIC resolution procedures for liquidation of large financial companies to avoid market disruption;

- Applying the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, savings and loan holding companies and systemically important nonbank financial companies;
- Limiting the Fed's emergency authority to lend to nondepository institutions to facilities with broad-based eligibility, and authorizing the FDIC to establish an emergency financial stabilization fund for solvent depository institutions and their holding companies, subject to the approval of Congress, the Secretary of the U.S. Treasury and the Fed;
- Creating regimes for regulation of over-the-counter derivatives and non-admitted property and casualty insurers and reinsurers;
- Implementing regulation of hedge fund and private equity advisers by requiring such advisers to register with the SEC;
- Providing for the implementation of corporate governance provisions for all public companies concerning proxy access and executive compensation; and
- Reforming regulation of credit rating agencies.

Many of the provisions of the Dodd-Frank Act, including certain provisions described above are subject to further study, rulemaking, and the discretion of regulatory bodies. As the hundreds of regulations called for by the Dodd-Frank Act are promulgated, we will continue to evaluate the impact of any such regulations. It is unclear how this legislation may impact the borrowing environment, investing environment for Agency Securities and interest rate swap contracts as much of the bill's implementation has not yet been defined by the regulators.

In addition, in 2010, the Group of Governors and Heads of Supervisors of the Basel Committee on Banking Supervision, the oversight body of the Basel Committee, published its "calibrated" capital standards for major banking institutions ("Basel III"). Under these standards, when fully phased in on January 1, 2019, banking institutions will be required to maintain heightened Tier 1 common equity, Tier 1 capital and total capital ratios, as well as maintaining a "capital conservation buffer." Beginning with the Tier 1 common equity and Tier 1 capital ratio requirements, Basel III will be phased in incrementally between January 1, 2013 and January 1, 2019. The final package of Basel III reforms were approved by the Group of Twenty Finance Ministers and Central Bank Governors in November 2010 and are subject to individual adoption by member nations, including the U.S.

In October 2011, the FHFA announced changes to the Home Affordable Refinance Program ("HARP") to expand access to refinancing for qualified individuals and families whose homes have lost value, including increasing the HARP loan to value ratio above 125%. However, this would only apply to mortgages guaranteed by the GSEs. There are many challenging issues to this proposal, notably the question as to whether a loan with a loan to value ratio of 125% qualifies as a mortgage or an unsecured consumer loan. The chances of this initiative's success have created additional uncertainty in the Agency Securities market, particularly with respect to possible increases in prepayment rates.

On January 4, 2012, the Fed issued a white paper outlining additional ideas with regard to refinancings and loan modifications. It is likely that loan modifications would result in increased prepayments on some Agency Securities. These loan modification programs, as well as future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

In an effort to continue to provide meaningful solutions to the housing crisis, effective June 1, 2012, the Obama administration expanded the population of homeowners that may be eligible for HAMP.

On September 28, 2012, the United Kingdom Financial Services Authority ("FSA") released the results of its review of the process for setting the London Interbank Offered Rate ("LIBOR") interest rate for various currencies and maturities ("Wheatley Review"). Some of our derivative positions use various maturities of U.S. dollar LIBOR. Our borrowings in the repurchase market have also historically tracked these LIBOR rates. The Wheatley Review found, among other things, that potential conflicts of interests coupled with insufficient oversight and accountability resulted in some reported LIBOR rates that did not reflect the true cost of inter-bank borrowings they were meant to represent.

The Wheatley Review also proposes a number of remedial actions, including:

- New statutory authority for the FSA to supervise and regulate the LIBOR setting process;
- Establishing a new independent oversight body to administer the LIBOR setting process;
- Eliminating LIBOR rates for certain currencies and maturities where markets are not sufficiently deep and liquid;
- Ceasing immediate reporting of rates submitted by individual participating banks; and
- Establishing controls to ensure that submitted rates represent actual transactions.

In April 2013, all the recommendations of the Wheatley Review came into force through the Financial Services Act of 2012. In this new regulatory framework, the Financial Conduct Authority (“FCA") and the Prudential Regulation Authority (“PRA”) have replaced the FSA, the Bank of England has overall responsibility for financial stability, and a new Financial Policy Committee (“FPC”) was created to assist the Bank in achieving its financial stability objective. Additionally, in September 2013, the European Commission proposed draft legislation that will enhance the robustness and reliability of benchmarks like LIBOR, facilitate the prevention and detection of their manipulation and clarify responsibility for and the supervision of benchmarks.

Our derivative and repurchase borrowings are conducted in U.S. dollars for maturities with historically deep and liquid markets. To date, implementation of the Wheatley Review recommendations have not had a material impact on the reported levels of LIBOR rates relevant to our derivative or repurchase borrowings.

On July 2, 2013, the Fed, in coordination with the FDIC and the Office of the Comptroller of the Currency (the "OCC"), approved a final rule that enhances bank regulatory capital requirements and implements certain elements of the Basel III capital reforms in the U.S. On July 9, 2013, the OCC approved the final rule and the FDIC approved the final rule as an interim rule. The final rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent and a common equity tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets that will apply to all supervised U.S. financial institutions. The final rule also raises the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all U.S. banking organizations. The final rule will continue to apply existing risk-based capital standards with respect to residential loans, including a 50 percent risk weight for safely underwritten first-lien mortgages that are not past due. "Advanced approaches banking organizations," those with $250 billion or more in total consolidated assets or $10 billion or more in foreign exposures, will be required to comply with the final rule starting on January 1, 2014. Other banking organizations will be required to comply with the final rule starting January 1, 2015.

On July 9, 2013, the Fed, the FDIC, and the OCC proposed a rule to change the leverage ratio standards for the largest U.S. banking organizations. Under the proposed rule, bank-holding companies with more than $700 billion in consolidated total assets or $10 trillion in assets under custody would be required to maintain a tier 1 capital leverage buffer of at least 5 percent, which is 2 percent above the minimum supplementary leverage ratio requirement of 3 percent adopted by these three agencies in their Basel III capital reform rules on July 2, 2013. In addition to the leverage buffer, the proposed rule would require insured depository institutions of such large bank-holding companies to meet a 6 percent supplementary leverage ratio to be considered "well capitalized." The proposed rule would apply starting January 1, 2018. Adoption of these rules may increase cost and reduce availability of repurchase funding provided by institutions subject to the rules.

Credit Market Disruption and Current Conditions

The residential housing and mortgage markets in the U.S. have experienced a variety of difficulties and changed economic conditions including loan defaults, credit losses and decreased liquidity. These conditions have resulted in volatility in the value of the Agency Securities we purchase and an increase in the average collateral requirements under our repurchase agreements we have obtained. While these markets have recovered significantly, further increased volatility and deterioration in the broader residential mortgage and residential mortgage backed securities (“RMBS”) markets may adversely affect the performance and market value of the Agency Securities and other high quality RMBS.

Short-term Interest Rates and Funding Costs

In December 2008, the Fed stated that it was adopting a policy of “quantitative easing” and would target keeping the Federal Funds Rate between 0.00% and 0.25%. To date, the Fed has maintained that target range. Our funding costs, which traditionally have tracked the 30-day LIBOR have generally benefited by this easing of monetary policy, although to a somewhat lesser extent. Because of continued uncertainty in the credit markets and U.S. economic conditions, we expect that interest rates are likely to experience continued volatility, which will likely affect our financial results since our cost of funds is largely dependent on short-term rates.

Historically, 30-day LIBOR has closely tracked movements in the Federal Funds Rate and the Effective Federal Funds Rate. The Effective Federal Funds Rate can differ from the Federal Funds Rate in that the Effective index represents the volume weighted average of interest rates at which depository institutions lend balances at the Fed to other depository institutions overnight (actual transactions, rather than target rate).

Our borrowings in the repurchase market have also historically closely tracked the Federal Funds Rate and LIBOR. Traditionally, a lower Federal Funds Rate has indicated a time of increased net interest margin and higher asset values. However, for the past several years, LIBOR and repurchase market rates have varied greatly and often have been significantly higher than the target and the Effective Federal Funds Rate. The difference between 30-day LIBOR and the Effective Federal Funds Rate has also been quite volatile, with the spread alternately returning to more normal levels and then widening out again. The continued volatility in these rates and divergence from the historical relationship among these rates could negatively impact our ability to manage our securities portfolio. If this were to occur, our net interest margin and the value of our securities portfolio might suffer as a result.

The following table shows 30-day LIBOR as compared to the Effective Federal Funds Rate at the quarterly periods presented.

Quarter ended	30-Day LIBOR		Effective Federal Funds Rate	
December 31, 2013	0.17	%	0.07	%
September 30, 2013	0.18	%	0.06	%
June 30, 2013	0.19	%	0.07	%
March 31, 2013	0.20	%	0.09	%
December 31, 2012	0.21	%	0.09	%
September 30, 2012	0.21	%	0.09	%
June 30, 2012	0.25	%	0.09	%
March 31, 2012	0.24	%	0.09	%
December 31, 2011	0.30	%	0.04	%
September 30, 2011	0.24	%	0.06	%
June 30, 2011	0.19	%	0.07	%
March 31, 2011	0.24	%	0.10	%

Results of Operations

As a result of our equity raising efforts, through February 2013, our earnings as reported in prior year consolidated financial statements, particularly on a per share basis, may not be indicative of a full run-rate. Some period over period comparisons in the discussion below may not be meaningful.

Net Income (Loss) Summary

Our primary source of income is the interest income we earn on our securities portfolio. Our net loss for the year ended December 31, 2013 available to common stockholders was $(201.3) million, or $(0.55) per basic and diluted weighted average common share. These results compare to net income of $220.3 million available to common stockholders or $0.99 per basic and $0.98 per diluted weighted average common share for the year ended December 31, 2012 and a net loss of $(9.4) million related to common stockholders or $(0.15) per basic and diluted common share for the year ended December 31, 2011. The main factors for the 2013 declines over 2012 were the declines in security purchases and our reduction in leverage which generated capital losses and an other than temporary impairment on our Agency Securities, as well as our capital raising that increased preferred and common shares outstanding. The main factors for the 2012 increase over 2011, were the increased equity capital resources and the continued implementation of our investment strategy, in addition to changes in value from our derivatives and increased management fees.

As of December 31, 2013 and December 31, 2012, our Agency Securities portfolio was carried at a net premium to par value with a weighted average amortized cost of 102.57% and 105.24% respectively, due to the average interest rates on these securities being higher than prevailing market rates.

The following table presents the components of the yield earned on our securities portfolio for the quarterly periods presented.

Quarter Ended	Asset Yield	Cost of Funds	Net Interest Margin	Interest Expense on Repurchase Agreements
December 31, 2013	2.98 %	1.38 %	1.60 %	0.43 %
September 30, 2013	2.60 %	1.36 %	1.24 %	0.41 %
June 30, 2013	2.52 %	1.14 %	1.38 %	0.43 %
March 31, 2013	2.33 %	0.98 %	1.35 %	0.46 %
December 31, 2012	2.47 %	0.92 %	1.55 %	0.48 %
September 30, 2012	2.70 %	0.89 %	1.82 %	0.45 %
June 30, 2012	2.97 %	0.82 %	2.15 %	0.39 %
March 31, 2012	3.04 %	0.81 %	2.23 %	0.34 %
December 31, 2011	2.60 %	0.98 %	1.62 %	0.35 %
September 30, 2011	3.11 %	0.93 %	2.18 %	0.27 %
June 30, 2011	3.35 %	0.99 %	2.36 %	0.28 %
March 31, 2011	3.20 %	0.80 %	2.40 %	0.33 %

The yield on our assets is most significantly affected by the rate of repayments on our Agency Securities. Our rate of portfolio repayment for the quarter ended December 31, 2013, was 4.8% on a constant prepayment basis compared to 14.1% for the quarter ended December 31, 2012.

Our repurchase agreements are secured by our Agency Securities and bear interest at rates that have historically moved in close relationship to the Federal Funds Rate and LIBOR. The Federal Funds Rate was 0.07% and LIBOR was 0.17% at December 31, 2013. During the years ended December 31, 2013, 2012 and 2011, we realized losses of $135.9 million, $63.0 million and $25.0 million, respectively related to our derivatives. We increased our total interest rate swap contracts aggregate notional balance from $8.7 billion at December 31, 2012 to $10.2 billion at December 31, 2013. Our interest rate swap contracts had a weighted average swap rate of 1.5% and a weighted average term of 69 months at December 31, 2013. We increased our total interest rate swaptions notional balance from $1.1 billion at December 31, 2012 to $5.8 billion at December 31, 2013. Our swaptions had an underlying weighted average swap rate of 2.9% and a weighted average term of 8 months at December 31, 2013. Our total Eurodollar Futures Contracts (“Futures Contracts”) notional amount decreased from $102.0 million at December 31, 2012 to $55.0 million at December 31, 2013 due to the maturity of contracts. Our Futures Contracts had a weighted average swap equivalent rate of 2.0% and weighted average term of 13 months as of December 31, 2013. Unrealized gains (losses) on derivatives totaled $544.6 million, $(58.8) million and $(97.1) million, respectively, for the years ended December 31, 2013, 2012 and 2011. The gain for the year ended December 31, 2013 represents the changes in fair value resulting from sharp increases in long-term interest rates experienced during the year. The losses for the years ended December 31, 2012 and December 31, 2011 were the result of more gradual and sustained declines of interest rates during those periods.

Net Interest Income

Our net interest income for the years ended December 31, 2013, 2012 and 2011 was $422.2 million, $327.8 million, and $105.8 million, respectively. The continued growth of our net interest income from year to year is due to the completion of equity raises. The proceeds from these equity raises were initially invested in Agency Securities, creating a larger investment portfolio able to generate increasing levels of interest income. Beginning in March 2013, we reduced our portfolio and leverage to limit our exposure to increased volatility in the market. As of December 31, 2013 and December 31, 2012, our securities portfolio consisted of $14.6 billion and $19.1 billion of Agency Securities, respectively.

Gains and Losses on Sale of Agency Securities

During the years ended December 31, 2013, 2012 and 2011 we sold $15.0 billion, $4.1 billion and $1.6 billion of Agency Securities, resulting in a realized (loss) gain of $(593.5) million, $40.6 million and $16.6 million, respectively. During the second and third quarter of 2013, our Agency Securities experienced significant price declines as a result of disruptive volatility in the markets for Agency Securities, mortgages and U.S. Treasury Securities. The sale of $15.0 billion of our Agency Securities, intended to limit our exposure to further price volatility, which occurred primarily in the third and fourth quarter of 2013, triggered the realization of $(593.5) million of losses. These losses have been reflected in other comprehensive income. The $40.6 million gain in 2012 includes $1.1 million of losses due to the bankruptcy of a counterparty to a repurchase agreement. In addition, due to the bankruptcy, we also recorded $1.0 million of other income resulting from the non-performance of the counterparty on the related repurchase agreement for the year ended December 31, 2012.

Other Than Temporary Impairment of Agency Securities

We evaluated our Agency Securities with unrealized losses as of December 31, 2013 and December 31, 2012, to determine whether there was any an other than temporary impairment. The decline in value of our Agency Securities is solely due to market conditions and not the credit quality of the assets. All of our Agency Securities are issued and guaranteed by GSEs. The GSEs have a rating of AA+. As of those dates, we also considered whether we intended to sell Agency Securities and whether it was more likely than not that we could meet our liquidity requirements and contractual obligations without selling Agency Securities. Anticipating portfolio repositioning sales in the first quarter of 2014 (see Note 16, to the consolidated financial statements), we concluded that the December 31, 2013 unrealized losses on our 25-year and 30-year fixed rate Agency Securities represented an other than temporary impairment. Accordingly, we recognized losses totaling $401.5 million in our 2013 consolidated statements of operations, thereby establishing a new cost basis for Agency Securities with aggregate fair value of $6.8 billion as of December 31, 2013. We determined that at December 31, 2013, there was no other than temporary impairment of our other Agency Securities, which are primarily 20-year and 15-year fixed rate securities. We previously determined that at December 31, 2012, there was no other than temporary impairment. Through February 25, 2014, we have sold $5.5 billion of our 25-year fixed rate and 30-year fixed rate Agency Securities, leaving $1.3 billion of 30-year fixed rate Agency Securities to be sold. We recovered approximately $69.4 million of other than temporary impairment loss recognized at December 31, 2013. For tax purposes, the sales generated capital losses of approximately $447.1 million, which will be available to offset future capital gains through 2019. Through February 25, 2014, we have purchased $3.7 billion of 15-year fixed-rate Agency Securities. These sales and purchases are intended to reduce the interest rate risk of our Agency Securities portfolio.

The clearing regulations adopted under the Dodd-Frank Act have increased the initial margin requirements for most types of interest rate swap contracts. For example, the estimated initial margin for new, cleared 10-year interest rate swap contracts is between 2.75% and 3.00% of the notional amount of the swap. This compares to the average initial margin of 0.64% of notional amount on our current 10-year interest rate swap contracts. Because initial margin payments are not accessible until the swap matures, the increased initial margin on new cleared interest rate swap contracts would create a heightened liquidity consideration for us. As a result, we are currently reducing our exposure to 30-year fixed rate Agency Securities, and increasing our purchases of Agency Securities with shorter final maturities. This will allow us to manage the interest rate risk created by the differing maturity profiles of our assets and the liabilities with shorter tenor interest rate swap contracts and Futures Contracts that have smaller initial margin requirements. We began repositioning our portfolio in the first quarter of 2014 and expect to continue into the second quarter of 2014.

Gains and Losses on U.S. Treasury Securities

For the year ended December 31, 2013, we sold short $2.8 billion of U.S Treasury Securities acquired under reverse repurchase agreements. We had purchases of $2.8 billion of U.S. Treasury Securities resulting in a gain of $14.2 million for the year ended December 31, 2013. During the years ended December 31, 2012 and December 31, 2011, we did not sell or purchase any U.S. Treasury Securities.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. During the years ended December 31, 2013, 2012 and 2011, other comprehensive income (loss) totaled $(421.0) million, $181.8 million and $53.0 million, respectively, reflecting net unrealized gains or losses on available for sale Agency Securities net of amounts reclassified upon sale. The 2013 other comprehensive loss resulted from significant price declines in our Agency Securities. The increase in other comprehensive income for 2012 compared to 2011, resulted primarily from the increase in the size of our portfolio.

Expenses

Our total expenses for the years ended December 31, 2013, 2012 and 2011 were $37.2 million, $25.4 million and $9.7 million, respectively. The increase in expenses from year to year is primarily due to two factors. The first factor is due to increased management fees. Our total management fee expense for the year ended December 31, 2013, was $28.1 million as compared to $19.5 million and $6.9 million, respectively, for the years ended December 31, 2012 and 2011. Management fees are determined based on gross equity raised. Therefore, our management fee increases when we raise capital and declines when we repurchase previously issued stock. However, because the management fee rate decreased to 0.75% per annum for gross equity raised in excess of $1.0 billion pursuant to the Management Agreement, the effective average management fee rate has generally declined over time. The second factor is an increase in professional fees and operating costs to support our current securities portfolio. We had a combined increase in these fees and cost of $1.9 million from December 31, 2012 to December 31, 2013 and $1.7 million from the year ended December 31, 2011 to December 31, 2012.

Taxable Income

We have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code, including meeting certain asset, income and stock ownership tests.

The following table reconciles our GAAP net income (loss) to estimated REIT taxable income for the years presented.

	For the Years Ended		
	December 31, 2013	December 31, 2012	December 31, 2011
	(in thousands)		
GAAP net income (loss)	$(187,044)	$222,306	$(9,442)
Book to tax differences:			
Unrealized (gain) loss on derivatives	(544,643)	58,774	97,087
Other than temporary impairment of Agency Securities	401,541	—	—
Net capital losses	579,322	—	—
Amortization of deferred hedging costs	(2,030)	—	—
Realized loss on interest rate contracts	(6,716)	—	—
Other	18	94	76
Estimated taxable income	$240,448	$281,174	$87,721

The aggregate tax basis of our assets and liabilities is greater than our total Stockholders' Equity at December 31, 2013 by approximately $146.2 million, or approximately $0.41 per common share (based on the 357,613,485 common shares then outstanding).

We are required and intend to timely distribute substantially all of our REIT taxable income in order to maintain our REIT status under the Code. Total dividend payments to stockholders were $306.8 million, $271.5 million and $87.3 million for the years ended December 31, 2013, 2012 and 2011, respectively. Our estimated REIT taxable income available to pay dividends was $240.4 million, $281.2 million and $87.7 million for the years ended December 31, 2013, 2012 and 2011 respectively. We carried forward from the year ended December 31, 2012, undistributed REIT taxable income of $10.4 million. Our REIT taxable income and dividend requirements are determined on an annual basis. Dividends in excess of REIT taxable income for the year (including taxable income carried forward from the previous year) will generally not be taxable to common stockholders.

Net capital losses realized in 2013 will be available to offset future capital gains realized through 2018.

Our management is responsible for determining whether tax positions taken by us are more likely than not to be sustained on their merits. We have no material unrecognized tax benefits or material uncertain tax positions.

Financial Condition

Agency Securities

We typically purchase Agency Securities at premium prices. The premium price paid over par value on those assets is expensed as the underlying mortgages experience repayment or prepayment. The lower the constant prepayment rate, the lower the amount of amortization expense for a particular period. Accordingly, the yield on an asset and earnings, are higher. If prepayment rates increase, the amount of amortization expense for a particular period will go up. These increased prepayment rates would act to decrease the yield on an asset and would decrease earnings.

The tables below summarize certain characteristics of our Agency Securities as of December 31, 2013 and December 31, 2012. (dollars in thousands)

Agency Securities:

As of	Principal Amount	Net Unamortized Premium	Amortized Cost	Amortized Cost divided by Principal	Fair Value	Fair Value divided by Principal	Weighted Average Coupon
December 31, 2013	$14,467,220	$371,438	$14,838,658	102.57 %	$14,648,178	101.25 %	3.52 %
December 31, 2012	$17,925,998	$940,000	$18,865,998	105.24 %	$19,096,562	106.53 %	3.52 %

Adjustable and Hybrid Adjustable Rate Agency Securities:

As of	Principal Amount (in thousands)	Weighted Average Coupon	Weighted Average Months to Reset	Percentage of Total Agency Securities
December 31, 2013	$208,216	3.95 %	16	1.4 %
December 31, 2012	$2,037,778	3.69 %	66	11.4 %

Fixed Rate Agency Securities:

As of	Principal Amount (in thousands)	Weighted Average Coupon	Weighted Average Months to Maturity	Percentage of Total Agency Securities
December 31, 2013	$14,259,004	3.52 %	270	98.6 %
December 31, 2012	$15,888,220	3.52 %	276	88.6 %

The following table shows the average principal repayment rate for those securities which have settled for the quarterly periods presented.

Quarter ended	Average Quarterly Principal Repayment Rate	
December 31, 2013	4.8	%
September 30, 2013	8.8	%
June 30, 2013	10.8	%
March 31, 2013	15.7	%
December 31, 2012	14.1	%
September 30, 2012	13.0	%
June 30, 2012	9.1	%
March 31, 2012	11.4	%
December 31, 2011	19.3	%
September 30, 2011	12.4	%
June 30, 2011	9.3	%
March 31, 2011	11.7	%

As of December 31, 2013 and December 31, 2012 our Agency Securities in our securities portfolio consisted of approximately $14.6 billion and $19.1 billion, respectively, in market value of Agency Securities with initial fixed-interest rate periods of three, five, seven, ten, fifteen, twenty, twenty-five and thirty years.

Our net income (loss) is primarily a function of the difference between the yield on our assets and the financing cost of owning those assets. Since we tend to purchase Agency Securities at a premium to par, the main item that can affect the yield on our Agency Securities after they are purchased is the rate at which the mortgage borrowers repay the loan. While the scheduled repayments, which are the principal portion of the homeowners' regular monthly payments, are fairly predictable, the unscheduled repayments, which are generally refinancing of the mortgage but can also result from repurchases of delinquent, defaulted, or modified loans, are less so. Being able to accurately estimate and manage these repayment rates is a critical portion of the management of our securities portfolio, not only for estimating current yield but also for considering the rate of reinvestment of those proceeds into new securities, the yields which those new securities may add to our securities portfolio and our hedging strategy.

As of December 31, 2013 and December 31, 2012, the adjustable and hybrid adjustable rate mortgage loans underlying our Agency Securities have fixed-interest rates for an average period of approximately 16 months and 66 months, respectively, after which time the interest rates reset and become adjustable. After a reset date, interest rates on our adjustable and hybrid adjustable Agency Securities float based on spreads over various indices, typically LIBOR or the one-year Constant Maturity Treasury rate. These interest rates are subject to caps that limit the amount the applicable interest rate can increase during any year, known as an annual cap and through the maturity of the security, known as a lifetime cap.

We evaluated our Agency Securities with unrealized losses as of December 31, 2013 and December 31, 2012, to determine whether there was any an other than temporary impairment. The decline in value of our Agency Securities is solely due to market conditions and not the credit quality of the assets. All of our Agency Securities are issued and guaranteed by GSEs. The GSEs have a rating of AA+. As of those dates, we also considered whether we intended to sell Agency Securities and whether it was more likely than not that we could meet our liquidity requirements and contractual obligations without selling Agency Securities. Anticipating portfolio repositioning sales in the first quarter of 2014 (see Note 16, "Subsequent Events" for additional information), we concluded that the December 31, 2013 unrealized losses on our 25-year and 30-year fixed rate Agency Securities represented an other than temporary impairment. Accordingly, we recognized losses totaling $401.5 million in our 2013 consolidated statements of operations, thereby establishing a new cost basis for those Agency Securities with aggregate fair value of $6.8 billion as of December 31, 2013. We determined that at December 31, 2013, there was no other than temporary impairment of our other Agency Securities, which are primarily 20-year and 15-year fixed rate securities. We previously determined that at December 31, 2012, there was no other than temporary impairment.

Liabilities

We have entered into repurchase agreements to finance most of our Agency Securities. Our repurchase agreements are secured by our Agency Securities and bear interest at rates that have historically moved in close relationship to the Federal Funds Rate and LIBOR. We have established borrowing relationships with several investment banking firms and other lenders, 27 of which we had done repurchase trades with as of December 31, 2013 and 26 of which we had done repurchases trades with as of December 31, 2012. We had outstanding balances under our repurchase agreements as of December 31, 2013 and December 31, 2012 of $13.2 billion and $18.4 billion, respectively.

Derivative Instruments

We generally hedge our interest rate risk as we deem prudent in light of market conditions and the associated costs with counterparties that have a high quality credit rating and with futures exchanges. We generally pay a fixed rate and receive a floating rate with the objective of fixing a portion of our borrowing costs and hedging the change in our book value to some degree. The floating rate we receive is generally the Federal Funds Rate or LIBOR. While our policies do not contain specific requirements as to the percentages or amount of interest rate risk that we are required to hedge, we maintain an overall target of hedging at least 40% of our non-adjustable rate mortgages. As of December 31, 2013, the notional value of our derivatives was 110.69% of the fair market value of our non-adjustable rate mortgages. For interest rate risk mitigation purposes, we consider Agency Securities to be adjustable rate mortgages (“ARMs”) if their interest rate is either currently subject to adjustment according to prevailing rates or if they are within 18 months of the period where such adjustments will occur. No assurance can be given that our derivatives will have the desired beneficial impact on our results of operations or financial condition. We have not elected cash flow hedge accounting treatment as allowed by GAAP. Since we do not designate our derivative activities as cash flow hedges, realized as well as unrealized gains/losses from these transactions will impact our earnings.

Use of derivative instruments may fail to protect or could adversely affect us because, among other things:

- available derivatives may not correspond directly with the interest rate risk for which protection is sought (e.g., the difference in interest rate movements for long-term U. S. Treasury Securities compared to Agency Securities);
- the duration of the derivatives may not match the duration of the related liability;
- the counterparty to a derivative agreement with us may default on its obligation to pay or not perform under the terms of the agreement and the collateral posted may not be sufficient to protect against any consequent loss;
- we may lose collateral we have pledged to secure our obligations under a derivative agreement if the associated counterparty becomes insolvent or files for bankruptcy;
- we may experience a termination event under one or more of our derivative agreements related to our REIT status, equity levels and performance, which could result in a payout to the associated counterparty and a taxable loss to us;
- the credit-quality of the party owing money on the derivatives may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives may be adjusted from time to time in accordance with GAAP to reflect changes in fair value; downward adjustments, or “mark-to-market losses,” would reduce our net income or increase any net loss.

As of December 31, 2013 and December 31, 2012, we had interest rate swap contracts with an aggregate notional balance of $10.2 billion and $8.7 billion, respectively. As of December 31, 2013 and December 31, 2012, we had entered into interest rate swaptions with an aggregate notional balance of $5.8 billion and $1.1 billion, respectively. In addition, as of December 31, 2013 and December 31, 2012, we had purchased or sold Futures Contracts with an aggregate notional balance of $55.0 million and $102.0 million, respectively. Futures Contracts are traded on the Chicago Mercantile Exchange (“CME”). Counterparty risk of interest rate swap contracts, interest rate swaptions and Futures Contracts are limited to some degree because of daily mark-to-market and collateral requirements. In addition, substantial credit support for the Futures Contracts is provided by the CME. These derivative transactions are designed to lock in some funding costs for financing activities associated with our assets in such a way as to help assure the realization of attractive net interest margins and to vary inversely in value with our Agency Securities. Such contracts are based on assumptions about prepayments which, if not realized, will cause results to differ from expectations.

Although we attempt to structure our derivatives to offset the changes in asset prices, they are not perfectly correlated and depend on the corresponding durations and sections of the yield curve that moves to offset each other. We recognized net gains of $408.7 million for the year ended December 31, 2013 and losses of $(121.8) million and $(122.1) million for the years ended December 31, 2012 and December 31, 2011, respectively, related to our derivatives. For the year ended December 31, 2013, the net unrealized change in the fair value of our Agency Securities decreased by $(1,416.1) million, compared to an increase of $222.4 million and an increase of $69.6 million for the years ended December 31, 2012 and December 31, 2011, respectively.

As required by the Dodd-Frank Act, the Commodity Futures Trading Commission has adopted rules requiring certain interest rate swap contracts to be cleared through a derivatives clearing organization. We are required to clear certain new interest rate swap contracts as of June 2013. Cleared interest rate swaps may have higher margin requirements than un-cleared interest rate swaps previously had. We have established an account with a futures commission merchant for this purpose. To date, we have not entered into any cleared interest rate swap contracts.

Contractual Obligations and Commitments

We had the following contractual obligations as of December 31, 2013:

Obligations	Payments Due By Period (in thousands) Total	Less Than 1 Year	2-3 Years	4-5 Years	Greater Than 5 Years
Repurchase Agreements (1)	$13,151,504	$13,151,504	$—	$—	$—
Related Party Fees (2)	197,907	28,272	56,545	56,545	56,545
Board of Directors fees (3)	6,818	974	1,948	1,948	1,948
Total	$13,356,229	$13,180,750	$58,493	$58,493	$58,493

(1) Excludes interest on Repurchase Agreements.
(2) Represents fees to be paid to ARRM under the terms of the Management Agreement (Refer to Note 14 to our consolidated financial statements).
(3) Represents fees to be paid to the Board of Directors.

We had contractual commitments under our derivatives as of December 31, 2013. We had interest rate swap contracts with an aggregate notional balance of $10.2 billion, a weighted average swap rate of 1.5% and a weighted average term of 69 months as of December 31, 2013. We had interest rate swaptions with an aggregate notional balance of $5.8 billion, a weighted average swap rate of 2.9% and a weighted average term of 8 months as of December 31, 2013. Our total Futures Contracts notional amount at December 31, 2013, was $55.0 million, with a weighted average swap equivalent rate of 2.0% and weighted average term of 13 months.

Liquidity and Capital Resources

During the year ended December 31, 2013, we issued 65,066,841 shares of common stock and raised additional net proceeds of approximately $438.6 million. During the year ended December 31, 2013, we issued 175,000 shares of 8.250% Series A Cumulative Preferred Stock (“Series A Preferred Stock”) and issued 5,650,000 shares of 7.875% Series B Cumulative Preferred Stock (“Series B Preferred Stock”) for a combined net proceeds of approximately $140.9 million. As a result, we were able to acquire additional assets, arrange additional repurchase agreement funding and increase economies of scale. During the year ended December 31, 2013, we repurchased 16,771,003 shares of our outstanding common stock under our stock repurchase program (the “Repurchase Program”) for an aggregate of $72.7 million. At times, we purchased assets for forward settlement up to 90 days in the future to minimize purchase prices. Our management fee expense also increased in absolute terms under the provisions of the Management Agreement. However, pursuant to the Management Agreement, the average effective management fee rate declined because the management fee rate stepped down as the amounts of equity raised exceeded $1.0 billion.

As of December 31, 2013, we financed our securities portfolio with approximately $13.2 billion of borrowings under repurchase agreements. Our leverage ratio as of December 31, 2013, was 6.92 to 1. As of December 31, 2013, our liquidity totaled $1.2 billion, consisting of $496.5 million of cash and cash equivalents plus $656.8 million of unpledged Agency Securities (including securities received as collateral). Our primary sources of funds are borrowings under repurchase arrangements, monthly principal and interest payments on our Agency Securities and cash generated from our operating results. Other sources of funds may include proceeds from equity and debt offerings and asset sales. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. 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 our potential liquidity available under our borrowing arrangements.

In addition to the repurchase agreement financing discussed above, at certain times we have entered into reverse repurchase agreements with certain of our repurchase agreement counterparties. Under a typical reverse repurchase agreement, we purchase U.S. Treasury Securities from a borrower in exchange for cash and agree to sell the same securities back in the future. We then sell such U.S. Treasury Securities to third-parties and recognize a liability to return the securities to the original borrower. Reverse repurchase agreement receivables and repurchase agreement liabilities are presented net when they meet certain criteria, including being with the same counterparty, being governed by the same master repurchase agreement, settlement through the same brokerage or clearing account and maturing on the same day. The practical effect of these transactions is to replace a portion of our repurchase agreement financing of our Agency Securities in our securities portfolio with short positions in U.S. Treasury Securities. We believe that this helps to reduce interest rate risk, and therefore counterparty credit and liquidity risk. At December 31, 2013 and December 31, 2012, we did not have any reverse repurchase agreements outstanding.

Both parties to the repurchase and reverse repurchase transactions have the right to make daily margin calls based on changes in the value of the collateral obtained and/or pledged.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on repurchase borrowings, reacquisition of securities to be returned to borrowers and the payment of cash dividends as required for continued qualification as a REIT.

Our primary uses of cash are to purchase Agency Securities, pay interest and principal on our borrowings, fund our operations and pay dividends. During the year ended December 31, 2013, we purchased $15.0 billion of Agency Securities using proceeds from equity raises, repurchase agreements and principal repayments. During the year ended December 31, 2013, we received cash of $3.1 billion from prepayments and scheduled principal payments on our Agency Securities. We received net proceeds of $438.6 million from common equity issuances, including our common stock dividend reinvestment and stock purchase plan ("common stock DRIP") and $4.4 million of proceeds from the issuance of 175,000 shares of Series A Preferred Stock and $136.6 million of proceeds from the issuance of 5,650,000 shares of Series B Preferred Stock during the year ended December 31, 2013. We had a net cash decrease from our repurchase agreements of $5.2 billion for the year ended December 31, 2013 and made cash interest payments of approximately $226.5 million on our liabilities for the year ended December 31, 2013. Part of funding our operations includes providing margin cash to offset liability balances on our derivatives. We recovered $229.6 million of cash collateral posted with counterparties and increased our liability by $387.8 million for cash collateral held as of December 31, 2013.

We have continued to pursue additional lending counterparties in order to help increase our financial flexibility and ability to withstand periods of contracting liquidity in the credit markets.

Repurchase Agreements

The following table represents the contractual repricing regarding our repurchase agreements to finance Agency Security purchases as of December 31, 2013 and December 31, 2012.

	December 31, 2013	December 31, 2012
	(in thousands)	
Within 30 days	$3,990,434	$7,771,444
31 days to 60 days	7,098,298	7,840,268
61 days to 90 days	1,226,694	2,699,706
Greater than 90 days	836,078	54,677
Total	$13,151,504	$18,366,095

The following table represents the Master Repurchase Agreements ("MRAs") and other information regarding our repurchase agreements to finance Agency Security purchases as of December 31, 2013 and December 31, 2012.

	December 31, 2013		December 31, 2012	
Number of MRAs	35		33	
Number of counterparties with repurchase agreements outstanding	27		26	
Weighted average maturity in days	45		34	
Weighted average contractual rate	0.42	%	0.49	%
Haircut for repurchase agreements (1)	5.0	%	4.8	%

(1) The Haircut represents the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount.

Declines in the value of our Agency Securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event under the standard MRA would give our counterparty the option to terminate all repurchase transactions existing with us and require any amount due to be payable immediately.

The residential mortgage market in the U.S. continues to experience difficult economic conditions including:

- increased volatility of many financial assets, including Agency Securities and other high-quality RMBS assets;
- increased volatility and deterioration in the broader residential mortgage and RMBS markets; and
- significant disruption in financing of RMBS.

While conditions have improved, should there be a reoccurrence of difficulties in the residential mortgage market, our lenders may be forced to exit the repurchase market, become insolvent or further tighten lending standards or increase the amount of required equity capital or haircut, any of which could make it more difficult or costly for us to obtain financing.

Financial sector volatility can also lead to increased demand and prices for high quality debt securities, including Agency Securities. While increased prices may increase the value of our Agency Securities, higher values may also reduce the return on reinvestment of capital, thereby lowering our future profitability.

The following graph represents the month-end outstanding balances of our repurchase agreements (before the effect of netting reverse repurchase agreements), which finance most of our Agency Securities. Our repurchase agreements balance will fluctuate based on our change in capital, leverage targets and the market prices of our assets. Over time, the level of our repurchase agreement financing has grown in conjunction with the growth of Agency Securities in our securities portfolio, which in turn has been the result of successful equity capital raising efforts. In 2013, declining security values and our decision to reduce leverage resulted in a substantial decline in our repurchase agreements. The balance of repurchase agreements outstanding will fluctuate within any given month based on changes in the market value of the particular Agency Security pledged as collateral (including the effects of principal paydowns) and the level and timing of investment and reinvestment activity.

Effects of Margin Requirements, Leverage and Credit Spreads

Our Agency Securities have values that fluctuate according to market conditions and, as discussed above, the market value of our Agency Securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase agreement decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a margin call, which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities, our lenders have full discretion to determine the value of the Agency Securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled principal repayments are announced monthly.

We experience margin calls in the ordinary course of our business and under certain conditions, such as during a period of declining market value for Agency Securities and we may experience margin calls as frequently as daily. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our liquidity. The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase as a result of a yield curve shift or for another reason or if credit spreads widen, the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline and we may experience margin calls. We will use our liquidity to meet such margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls. If our haircuts increase, our liquidity will proportionately decrease. If we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness. In addition, certain of our MRAs contain a restriction that prohibits our leverage from exceeding twelve times our stockholders' equity as well as termination events in the case of significant reductions in equity capital.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls but that also allows us to be substantially invested in Agency Securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to involuntarily liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

We generally seek to borrow (on a recourse basis) between six and ten times the amount of our total stockholders' equity. At December 31, 2013 and December 31, 2012, our total net borrowings were approximately $13.2 billion and $18.4 billion (excluding accrued interest), respectively. As of December 31, 2013 and December 31, 2012 we had a leverage ratio of approximately 6.92:1 and 7.96:1, respectively.

Forward-Looking Statements Regarding Liquidity

Based on our current portfolio, leverage rate and available borrowing arrangements, we believe that our cash flow from operations and our ability to make timely portfolio adjustments, will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements such as to fund our investment activities, meet our financing obligations, pay fees under the Management Agreement and fund our distributions to stockholders and pay general corporate expenses.

We may increase our capital resources by obtaining long-term credit facilities or making public or private offerings of equity or debt securities, including classes of preferred stock, common stock and senior or subordinated notes to meet our long-term (greater than one year) liquidity. Such financing will depend on market conditions for capital raises and for the investment of any proceeds and there can be no assurances that we will successfully obtain any such financing.

Stockholders' Equity

Dividends

The following tables present our common stock dividend transactions for the years ended December 31, 2013, 2012 and 2011.

December 31, 2013

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2013	January 30, 2013	$0.08	$24.8
February 15, 2013	February 27, 2013	$0.08	$24.8
March 15, 2013	March 27, 2013	$0.08	$30.2
April 15, 2013	April 29, 2013	$0.07	$26.3
May 15, 2013	May 30, 2013	$0.07	$26.3
June 14, 2013	June 27, 2013	$0.07	$26.1
July 15, 2013	July 30, 2013	$0.07	$26.1
August 15, 2013	August 29, 2013	$0.07	$26.1
September 16, 2013	September 27, 2013	$0.07	$26.1
October 15, 2013	October 28, 2013	$0.05	$18.6
November 15, 2013	November 27, 2013	$0.05	$18.6
December 16, 2013	December 27, 2013	$0.05	$18.6

December 31, 2012

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2012	January 30, 2012	$0.11	$11.6
February 15, 2012	February 28, 2012	$0.11	$15.3
March 15, 2012	March 29, 2012	$0.11	$19.9
April 16, 2012	April 27, 2012	$0.10	$17.8
May 15, 2012	May 30, 2012	$0.10	$18.1
June 15, 2012	June 28, 2012	$0.10	$18.6
July 16, 2012	July 30, 2012	$0.10	$23.5
August 15, 2012	August 30, 2012	$0.10	$30.0
September 14, 2012	September 27, 2012	$0.10	$31.0
October 15, 2012	October 30, 2012	$0.09	$27.9
November 15, 2012	November 29, 2012	$0.09	$27.9
December 14, 2012	December 28, 2012	$0.09	$27.9

December 31, 2011

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2011	January 28, 2011	$0.12	$2.0
February 15, 2011	February 25, 2011	$0.12	$3.9
March 15, 2011	March 30, 2011	$0.12	$3.9
April 15, 2011	April 28, 2011	$0.12	$5.9
May 15, 2011	May 27, 2011	$0.12	$5.9
June 15, 2011	June 29, 2011	$0.12	$8.3
July 15, 2011	July 28, 2011	$0.12	$9.1
August 15, 2011	August 30, 2011	$0.12	$9.1
September 15, 2011	September 29, 2011	$0.12	$10.1
October 15, 2011	October 28, 2011	$0.11	$9.4
November 15, 2011	November 29, 2011	$0.11	$9.4
December 15, 2011	December 29, 2011	$0.11	$10.3

The following table presents our Series A Preferred Stock dividend transactions for the year ended December 31, 2013 and December 31, 2012. There were no Series A Preferred Stock dividend transactions for the year ended December 31, 2011.

December 31, 2013

Record Date	Payment Date	Rate per Series A Preferred share	Aggregate amount paid to holders of record (in millions)
January 15, 2013	January 28, 2013	$0.17	$0.3576
February 15, 2013	February 26, 2013	$0.17	$0.3748
March 15, 2013	March 26, 2013	$0.17	$0.3748
April 15, 2013	April 29, 2013	$0.17	$0.3748
May 15, 2013	May 27, 2013	$0.17	$0.3748
June 14, 2013	June 27, 2013	$0.17	$0.3748
July 15, 2013	July 29, 2013	$0.17	$0.3748
August 15, 2013	August 27, 2013	$0.17	$0.3748
September 15, 2013	September 27, 2013	$0.17	$0.3748
October 15, 2013	October 28, 2013	$0.17	$0.3748
November 15, 2013	November 27, 2013	$0.17	$0.3748
December 15, 2013	December 27, 2013	$0.17	$0.3748

December 31, 2012

Record Date	Payment Date	Rate per Series A Preferred share	Aggregate amount paid to holders of record (in millions)
July 13, 2012 (1)	July 27, 2012	$0.29	$0.4011
August 15, 2012	August 27, 2012	$0.17	$0.2717
September 14, 2012	September 27, 2012	$0.17	$0.2915
October 15, 2012	October 29, 2012	$0.17	$0.3152
November 15, 2012	November 27, 2012	$0.17	$0.3395
December 14, 2012	December 27, 2012	$0.17	$0.3446

(1) This amount included $0.2 million paid to holders of record on July 13, 2012 for the period of June 7, 2012 through June 30, 2012.

The following table presents our Series B Preferred Stock dividend transactions for the year ended December 31, 2013. There were no Series B Preferred Stock dividend transactions for the years ended December 31, 2012 and 2011, respectively.

Record Date	Payment Date	Rate per Series B Preferred share	Aggregate amount paid to holders of record (in millions)
March 15, 2013	March 26, 2013	$0.25	$1.3905
April 15, 2013	April 29, 2013	$0.16	$0.9269
May 15, 2013	May 27, 2013	$0.16	$0.9269
June 14, 2013	June 27, 2013	$0.16	$0.9269
July 15, 2013	July 29, 2013	$0.16	$0.9269
August 15, 2013	August 27, 2013	$0.16	$0.9269
September 15, 2013	September 27, 2013	$0.16	$0.9269
October 15, 2013	October 28, 2013	$0.16	$0.9269
November 15, 2013	November 27, 2013	$0.16	$0.9269
December 15, 2013	December 27, 2013	$0.16	$0.9269

Equity Capital Raising Activities

The following tables present our equity transactions for the years ended December 31, 2013, 2012 and 2011.

December 31, 2013

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Series A Preferred equity distribution agreements	January 2, 2013 to January 30, 2013	174,961	$25.51	(1)	$4.4
Common stock dividend reinvestment program	January 25, 2013 to December 27, 2013	66,841	$4.83	(1)	$0.2
Series B Preferred initial offering	February 12, 2013	5,650,000	$25.00		$136.6
Common stock follow-on public offering	February 20, 2013	65,000,000	$6.75		$438.4

(1) Weighted average price

December 31, 2012

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Follow-on public offering	January 13, 2012	10,350,000	$6.80		$70.1
Follow-on public offering	February 8, 2012	29,900,000	$6.80		$203.0
Equity distribution agreement	February 29, 2012	1,287,570	$7.06		$8.9
Follow-on public offering	March 14, 2012	35,650,000	$6.72		$239.2
Issuance of Series A Preferred Stock	June 7, 2012	1,400,000	$25.00		$33.8
Follow-on public offering	July 13, 2012	46,000,000	$7.06		$324.5
Follow-on public offering	August 8, 2012	63,250,000	$7.30		$461.4
Common equity distribution agreements	January 18, 2012 to September 11, 2012	19,750,000	$7.14	(1)	$138.2
Preferred equity distribution agreements	July 16, 2012 to December 27, 2012	605,611	$25.54	(1)	$15.0
Dividend Reinvestment and Stock Purchase Plan	January 25, 2012 to December 28, 2012	7,286,404	$7.28	(1)	$52.9

(1) Weighted average price

December 31, 2011

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Follow-on public offering	January 26, 2011	6,900,000	$7.55		$49.0
Follow-on public offering	February 8, 2011	8,912,500	$7.60		$64.0
Equity distribution agreement	February 18, 2011 to September 30, 2011	5,212,430	$7.39	(1)	$37.5
Follow-on public offering	April 13, 2011	17,000,000	$7.40		$121.1
Follow-on public offering	June 6, 2011	18,400,000	$7.40		$131.0
Follow-on public offering	December 13, 2011	9,200,000	$6.80		$62.4
Dividend Reinvestment and Stock Purchase Plan	April 25, 2011 to December 29, 2011	13,352,181	$7.25	(1)	$96.8

(1) Weighted average price

Common Stock Repurchases

The following tables present our common stock repurchases for the year ended December 31, 2013. We did not have any common stock repurchases in the years ended December 31, 2012 and 2011.

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Cost (in millions)
Repurchased common shares	May 15, 2013 to May 17, 2013	3,395,603	$5.94	(1)	$20.3
Repurchased common shares	December 11, 2013 to December 31, 2013	13,375,400	$3.89	(1)	$52.4

(1) Weighted average price

As of December 31, 2013, there was $27.3 million left under our Repurchase Program.

Off-Balance Sheet Arrangements

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As of December 31, 2013 and December 31, 2012, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Furthermore, as of December 31, 2013 and December 31, 2012, we had not guaranteed any obligations of any unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

Critical Accounting Policies

Our financial statements are prepared in conformity with GAAP. In preparing the financial statements, management is required to make various judgments, estimates and assumptions that affect the reported amounts. Changes in these estimates and assumptions could have a material effect on our financial statements. The following is a summary of our policies most affected by management’s judgments, estimates and assumptions.

Revenue Recognition: Interest income is earned and recognized based on the unpaid principal amount of the Agency Securities and their contractual terms. Premiums and discounts associated with the purchase of Agency Securities are amortized or accreted into interest income over the actual lives of the securities.

Fair Value of Agency Securities: We invest in Agency Securities representing interests in or obligations backed by pools of single-family fixed rate, hybrid adjustable rate and adjustable rate mortgage loans. The authoritative literature requires us to classify our investments as either trading, available for sale or held to maturity securities. Management determines the appropriate classifications of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. We currently classify all of our Agency Securities as available for sale. Agency Securities classified as available for sale are reported at their estimated fair values with unrealized gains and losses excluded from earnings and reported as part of the consolidated statements of comprehensive income (loss). We utilize a third-party pricing service to value our securities portfolio. The pricing service incorporates common market pricing methods including a spread measurement to the Treasury yield curve as well as underlying characteristics of the particular security including coupon, periodic and life caps, rate reset period and expected life of the security.

Security purchase and sale transactions, including purchase of when issued securities, are recorded on the trade date. Gains or losses realized from the sale of securities are included in income and are determined using the specific identification method.

Impairment of Assets: We evaluate Agency Securities for other than temporary impairment at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. We consider an impairment to be other than temporary if we (1) have the intent to sell the Agency Securities, (2) believe it is more likely than not that we will be required to sell the securities before recovery (for example, because of liquidity requirements or contractual obligations) or (3) a credit loss exists. Impairment losses recognized establish a new cost basis for the related Agency Securities.

Repurchase Agreements: We finance the acquisition of our Agency Securities through the use of repurchase agreements. Our repurchase agreements are secured by our Agency Securities and bear interest rates that have historically moved in close relationship to the Federal Funds Rate and LIBOR. Under these repurchase agreements, we sell Agency Securities to a lender and agree to repurchase the same Agency Securities in the future for a price that is higher than the original sales price. The difference between the sales price that we receive and the repurchase price that we pay represents interest paid to the lender. A repurchase agreement operates as a financing arrangement under which we pledge our Agency Securities as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then prevailing interest rate. The repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

In addition to the repurchase agreement financing discussed above, at certain times we have entered into reverse repurchase agreements with certain of our repurchase agreement counterparties. Under a typical reverse repurchase agreement, we purchase U.S. Treasury Securities from a borrower in exchange for cash and agree to sell the same securities in the future in exchange for a price that is higher than the original purchase price. The difference between the purchase price originally paid and the sale price represents interest received from the borrower. Reverse repurchase agreement receivables and repurchase agreement liabilities are presented net when they meet certain criteria, including being with the same counterparty, being governed by the same master repurchase agreement, settlement through the same brokerage or clearing account and maturing on the same day. At December 31, 2013 and December 31, 2012, we did not have any reverse repurchase agreements outstanding.

Obligations to Return Securities Received as Collateral, at Fair Value: At certain times, we also sell to third-parties the U.S. Treasury Securities received as collateral for reverse repurchase agreements and recognize the resulting obligation to return said U.S. Treasury Securities as a liability on our consolidated balance sheet. Interest is recorded on the repurchase agreements, reverse repurchase agreements and U.S. Treasury Securities on an accrual basis and presented as net interest expense. Both parties to the transaction have the right to make daily margin calls based on changes in the fair value of the collateral received and/or pledged. We did not have any obligations to return securities as collateral at December 31, 2013 or December 31, 2012.

Derivative Instruments: We account for derivative instruments in accordance with GAAP, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for derivative activities. The guidance requires that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

We do not designate our derivative activities as cash flow hedges for GAAP purposes, which, among other factors, would require us to match the pricing dates of both derivative transactions and repurchase agreements. Operational issues and credit market volatility make such matching impractical for us. Since we have not elected cash flow hedge accounting treatment, our operating results may suffer because losses on the derivative instruments may not be offset by a changes in the fair value or cash flows of the related hedged transaction. Consequently, any declines in the hedged interest rates would result in a charge to earnings. We will continue to designate derivative transactions as hedges for tax purposes and any unrealized gains or losses should not affect our distributable net taxable income.

Inflation

Virtually all of our assets and liabilities are interest rate-sensitive in nature. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and any distributions we may make will be determined by our Board based in part on our REIT taxable income as calculated according to the requirements of the Code; in each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

Subsequent Events

See Note 16 to the consolidated financial statements.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains various "forward-looking statements." Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology such as "believes," "expects," "may," "will," "would," "could," "should," "seeks," "approximately," "intends," "p "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases. All forward-looking statements may be impacted by a number of risks and uncertainties, including statements regarding the following subjects:

- our business and investment strategy;
- our anticipated results of operations;
- statements about future dividends;

- our ability to obtain financing arrangements;
- our understanding of our competition and ability to compete effectively;
- market, industry and economic trends; and
- interest rates.

The forward-looking statements in this report 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. You should carefully consider these risks before you make an investment decision with respect to our stock, along with the following factors that could cause actual results to vary from our forward-looking statements:

- the factors referenced in this report, including those set forth under the section captioned “Risk Factors;”

- the impact of the federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government and the Fed system;
- the possible material adverse effect on our business if the U.S. Congress passed legislation reforming or winding down Fannie Mae or Freddie Mac;
- mortgage loan modification programs and future legislative action;
- the impact of the continued delay or failure of the U.S. Government in reaching an agreement on the national debt ceiling;
- availability, terms and deployment of capital;
- changes in economic conditions generally;
- changes in interest rates, interest rate spreads and the yield curve or prepayment rates;
- general volatility of the financial markets, including markets for mortgage securities;
- inflation or deflation;
- availability of suitable investment opportunities;
- the degree and nature of our competition, including competition for Agency Securities from the U.S. Treasury;
- changes in our business and investment strategy;
- our dependence on ARRM and ability to find a suitable replacement if ARRM were to terminate their management relationship with us;
- the existence of conflicts of interest in our relationship with ARRM, certain of our directors and our officers, which could result in decisions that are not in the best interest of our stockholders;
- changes in personnel at ARRM or the availability of qualified personnel at ARRM;
- limitations imposed on our business by our status as a REIT under the Code;
- changes in GAAP, including interpretations thereof; and
- changes in applicable laws and regulations.

We cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on forward-looking statements, which apply only as of the date of this report. We do not intend and disclaim any duty or obligation to update or revise any industry information or forward-looking statements set forth in this report to reflect new information, future events or otherwise, except as required under the U.S. Federal securities laws.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We seek to manage our risks related to the credit-quality of our assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk adjusted returns through ownership of our capital stock. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate, Cap and Mismatch Risk

A portion of our securities portfolio consists of hybrid adjustable rate and adjustable rate Agency Securities. Hybrid mortgages are ARMs that have a fixed-interest rate for an initial period of time (typically three years or greater) and then convert to an adjustable rate for the remaining loan term. Our debt obligations are generally repurchase agreements of limited duration that are periodically refinanced at current market rates.

ARMs are typically subject to periodic and lifetime interest rate caps that limit the amount the interest rate can change during any given period. ARMs are also typically subject to a minimum interest rate payable. Our borrowings are not subject to similar restrictions. Hence, in a period of increasing interest rates, interest rates on our borrowings could increase without limitation, while the interest rates on our mortgage related assets could be limited. This exposure would be magnified to the extent we acquire fixed rate Agency Securities or ARMs that are not fully indexed. Furthermore, some ARMs may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would negatively impact our liquidity, net income and our ability to make distributions to stockholders.

We fund the purchase of a substantial portion of our ARMs with borrowings that have interest rates based on indices and repricing terms similar to, but of shorter maturities than, the interest rate indices and repricing terms of our mortgage assets. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. During periods of changing interest rates, such interest rate mismatches could negatively impact our net interest income, dividend yield and the market price of our stock.

Most of our adjustable rate assets are based on the one-year constant maturity treasury rate and the one-year LIBOR rate and our debt obligations are generally based on LIBOR. These indices generally move in the same direction, but there can be no assurance that this will continue to occur.

Our ARMs and borrowings reset at various different dates for the specific asset or obligation. In general, the repricing of our debt obligations occurs more quickly than on our assets. Therefore, on average, our cost of funds may rise or fall more quickly than our earnings rate on our assets.

Furthermore, our net income may vary somewhat as the spread between one-month interest rates, the typical term for our repurchase agreements and six-month and twelve-month interest rates, the typical reset term of ARMs, varies.

Prepayment Risk

As we receive repayments of principal on our Agency Securities from prepayments and scheduled payments, premiums paid on such securities are amortized against interest income and discounts are accreted to interest income as realized. Premiums arise when we acquire Agency Securities at prices in excess of the principal balance of the mortgage loans underlying such Agency Securities. Conversely, discounts arise when we acquire Agency Securities at prices below the principal balance of the mortgage loans underlying such Agency Securities. As of December 31, 2013, all of our Agency Securities were purchased at a premium.

Interest Rate Risk and Effect on Market Value Risk

Another component of interest rate risk is the effect changes in interest rates will have on the market value of our Agency Securities. We face the risk that the market value of our Agency Securities will increase or decrease at different rates than that of our liabilities, including our derivative instruments and obligations to return securities received as collateral.

We primarily assess our interest rate risk by estimating the effective duration of our assets and the effective duration of our liabilities and by estimating the time difference between the interest rate adjustment of our assets and the interest rate adjustment of our liabilities. Effective duration essentially measures the market price volatility of financial instruments as interest rates change. We generally estimate effective duration using various financial models and empirical data. Different models and methodologies can produce different effective duration estimates for the same securities.

The sensitivity analysis tables presented below reflect the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, at December 31, 2013 and December 31, 2012, assuming a static portfolio. It assumes that the spread between the interest rates on Agency Securities and long-term U.S. Treasury Securities remains constant. Actual interest rate movements over time will likely be different, and such differences may be material. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on ARRM's expectations. The analysis presented utilized assumptions, models and estimates of the manager based on ARRM's judgment and experience.

As of December 31, 2013

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value Including Derivatives
1.00%	2.29%	(0.71)%

0.50%	0.01%	(0.44)%
(0.50)%	6.65%	0.54%
(1.00)%	5.35%	1.08%

As of December 31, 2012

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value Including Derivatives
1.00%	4.90%	(0.99)%
0.50%	12.81%	(0.60)%
(0.50)%	(6.38)%	(1.31)%
(1.00)%	(41.89)%	(2.17)%

While the tables above reflect the estimated immediate impact of interest rate increases and decreases on a static securities portfolio, we rebalance our securities portfolio from time to time either to seek to take advantage of or reduce the impact of changes in interest rates. It is important to note that the impact of changing interest rates on market value and net interest income can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the market value of our assets could increase significantly when interest rates change beyond amounts shown in the table above. In addition, other factors impact the market value of and net interest income from our interest rate-sensitive investments and derivative instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, interest income would likely differ from that shown above and such difference might be material and adverse to our stockholders.

The above tables quantify the potential changes in net interest income and securities portfolio value, which includes the value of our derivatives, should interest rates immediately change. Given the low level of interest rates at December 31, 2013 and December 31, 2012, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Due to the presence of this floor, it is anticipated that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level; however, because prepayments speeds are unaffected by this floor, it is expected that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization and the reinvestment of such prepaid principal in lower yielding assets. As a result, the presence of this floor limits the positive impact of any interest rate decrease on our funding costs. Therefore, at some point, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

Market Value Risk

All of our Agency Securities are classified as available for sale assets. As such, they are reflected at fair value with the periodic adjustment to fair value (that is not considered to be an other than temporary impairment) reported as part of “Accumulated other comprehensive income (loss)” that is included in the stockholders’ equity section of our consolidated balance sheets. The market value of our assets can fluctuate due to changes in interest rates and other factors. Weakness in the mortgage market may adversely affect the performance and market value of our investments. This could negatively impact our book value. Furthermore, if our lenders are unwilling or unable to provide additional financing, we could be forced to sell our Agency Securities at an inopportune time when prices are depressed. The principal and interest payments on our Agency Securities are guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae.

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity Agency Securities with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our ARMs. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from Agency Securities.

Item 8. Financial Statements and Supplementary Data

Reference is made to the Index to Financial Statements that appears on page F-1 of this Annual Report on Form 10-K. The Report of Independent Registered Public Accounting Firm, the Financial Statements and the Notes to the Financial Statements, listed in the Index to Financial Statements, which appear beginning on page F-2 of this Annual Report on Form 10-K, are incorporated by reference to this Item 8.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Co-Chief Executive Officers ("Co-CEOs") and Chief Financial Officer ("CFO") participated in an evaluation by our management of the effectiveness of our 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")) as of the end of our fiscal year that ended on December 31, 2013. Based on their participation in that evaluation, our Co-CEOs and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2013 to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that information required to be disclosed in our reports filed or furnished under the Exchange Act, is accumulated and communicated to our management, including our Co-CEOs and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Internal Control Over Financial Reporting

Our Co-CEOs and CFO also participated in an evaluation by our management of any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2013. That evaluation did not identify any changes during the quarter ended December 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management Report On Internal Control Over Financial Reporting

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

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. As a result, even systems determined to be effective can provide only reasonable assurance regarding the preparation and presentation of financial statements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

There have been no changes in our internal controls over financial reporting that occurred during the year ended December 31, 2013, that have materially affected, or are reasonably likely to affect our internal control over financial reporting.

Management assessed the effectiveness of the Company’s internal control over financial reporting for the year ended December 31, 2013. Management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control-Integrated Framework (1992) when making this assessment.

Based on management’s assessment, management believes that, as of December 31, 2013, the Company’s internal control over financial reporting was effective. The Company’s independent registered public accounting firm, Deloitte & Touche LLP, has issued its attestation report on the Company’s internal control over financial reporting. This report appears on page F-3 of this Annual Report on Form 10-K.

Item 9B. Other Information

On February 25, 2014, the Company entered into a Third Amended and Restated Management Agreement with ARRM. The purpose of the Third Amended and Restated Management Agreement is to clarify, among other things, that (i) Gross Equity

Raised, as defined in Section 1.15 of the Third Amended and Restated Agreement, which is used to calculate ARRM's compensation, excludes: (a) the value of securities repurchased by the Company, and (b) dividends paid by the Company to the extent that such dividends are deemed a return of capital for tax purposes; (ii) a Corporate Event, as defined in Section 10.21 of the Third Amended and Restated Management Agreement, will be deemed a termination without cause, entitling ARRM to a termination fee, as described below, pursuant to Section 10.4 of the Third Amended and Restated Management Agreement, if such a Corporate Event occurs during the term of the Third Amended and Restated Management Agreement; and (iii) upon a termination of the Third Amended and Restated Management Agreement by us without cause, the Third Amended and Restated Management Agreement provides that we shall pay ARRM a termination fee equal to the greater of (a) the base management fee as calculated immediately prior to the effective date of the termination of the Third Amended and Restated Management Agreement pursuant to Section 10.2 of the Third Amended and Restated Management Agreement for the remainder of the then current term, or (b) three times the base management fee paid to ARRM in the preceding twelve-month period before such termination, calculated as of the effective date of the termination.

Part III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 of this Annual Report on Form 10-K will be contained in and is hereby incorporated by reference to, the proxy statement for our 2014 annual meeting of stockholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report.

Item 11. Executive Compensation

The information required by Item 11 of this Annual Report on Form 10-K will be contained in and is hereby incorporated by reference to, the proxy statement for our 2014 annual meeting of stockholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 of this Annual Report on Form 10-K will be contained in and is hereby incorporated by reference to, the proxy statement for our 2014 annual meeting of stockholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 of this Annual Report on Form 10-K will be contained in and is hereby incorporated by reference to, the proxy statement for our 2014 annual meeting of stockholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report.

Item 14. Principal Accounting Fees and Services

The information required by Item 14 of this Annual Report on Form 10-K will be contained in and is hereby incorporated by reference to, the proxy statement for our 2014 annual meeting of stockholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report.

Part IV

Item 15. Exhibits, Financial Statement Schedules

(1) Financial Statements

See Item 8 – Financial Statements and Supplementary Data.

(2) Financial Statement Schedules

All supplemental schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule, or because the required information is included in the consolidated financial statements or notes thereto.

(3) Exhibits

See Exhibit Index.

EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.4 to ARMOUR's Current Report on Form 8-K filed with the SEC on November 12, 2009)
3.2	Articles of amendment to Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on August 8, 2011)
3.3	Articles of amendment to Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on December 1, 2011)
3.4	Articles Supplementary of 8.250% Series A Cumulative Redeemable Preferred Stock (Incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on June 6, 2012)
3.5	Articles Supplementary Classifying 6,000,000 shares of ARMOUR Residential REIT, Inc.'s preferred stock into additional shares of Series A Cumulative Redeemable Preferred Stock (Incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on July 13, 2012)
3.6	Articles Supplementary Classifying 2,000,000 shares of ARMOUR Residential REIT, Inc.'s preferred stock into additional shares of Series A Cumulative Redeemable Preferred Stock (Incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on July 27, 2012)
3.7	Articles of Amendment to the Charter of ARMOUR Residential REIT, Inc. (Incorporated by reference to Exhibit 3.3 to ARMOUR's Quarterly Report on Form 10-Q filed with the SEC on November 1, 2012)
3.8	Articles Supplementary of 7.875% Series B Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on February 12, 2013)
3.9	Amended Bylaws (Incorporated by reference to Exhibit 3.5 to ARMOUR's Current Report on Form 8-K filed with the SEC on November 12, 2009)
4.1	Specimen Common Stock Certificate of ARMOUR Residential REIT, Inc. (incorporated by reference to Exhibit 4.2 of ARMOUR's Registration Statement on Form S-4 (Reg. No. 333-160870))
4.2	Specimen 8.250% Series A Cumulative Redeemable Preferred Stock Certificate of ARMOUR Residential REIT, Inc. (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement of Form 8-A (Reg. No. 001-34766) filed with the SEC on June 7, 2012)
4.3	Specimen 7.875% Series B Cumulative Redeemable Preferred Stock Certificate of ARMOUR Residential REIT, Inc. (incorporated by reference to Exhibit 4.2 of ARMOUR's Registration Statement on Form 8-A (Reg. No. 001-34766) filed with the SEC on February 12, 2013)
10.1	ARMOUR Residential REIT, Inc. Amended and Restated 2009 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to ARMOUR's Registration Statement on Form S-8 filed with the SEC on July 22, 2011) †††
10.2	Second Amended and Restated Management Agreement, dated June 18, 2012, between ARMOUR and ARRM (Incorporated by reference to Exhibit 10.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on June 22, 2012)
10.3	Third Amended and Restated Management Agreement, dated February 25, 2014, between ARMOUR and ARRM †
10.4	Sub-Management Agreement, dated November 6, 2009, by and between Staton Bell Blank Check LLC and ARMOUR Residential Management, LLC (Incorporated by reference to Exhibit 4.4 to ARMOUR's Current Report on Form 8-K filed with the SEC on November 12, 2009)
10.5	Distribution Agreement, dated February 18, 2011, by and among the Company, Ladenburg Thalmann & Co. Inc. and JMP Securities LLC (Incorporated by reference to Exhibit 1.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on February 18, 2011)
10.6	

	Equity Distribution Agreement, dated October 11, 2011, by and among the Company, Deutsche Bank Securities Inc., JMP Securities LLC and Ladenburg Thalmann & Co. Inc. (Incorporated by reference to Exhibit 1.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on October 12, 2011)
10.7	At Market Issuance Sales Agreement, dated July 13, 2012, among ARMOUR Residential REIT, Inc., ARMOUR Residential Management LLC and MLV & Co. LLC.(Incorporated by reference to Exhibit 1.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on July 13, 2012)
10.8	Equity Distribution Agreement, dated July 27, 2012, among ARMOUR Residential REIT, Inc., ARMOUR Residential Management LLC and Citadel Securities LLC.(Incorporated by reference to Exhibit 1.1 to ARMOUR's Current Report on Form 8-K filed with the SEC on July 27, 2012)
12.1	Statement of computation of ratio of earnings to fixed charges and ratio of earnings to combined fixed charges and preferred stock dividends †
23.1	Consent of Deloitte & Touche LLP †
31.1	Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a) †
31.2	Certification of Chief Executive Officer Pursuant to SEC Rule 13a-14(a)/15d-14(a) †
31.3	Certification of Chief Financial Officer Pursuant to SEC Rule 13a14(a)/15d-14(a) †

32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. §1350 ††
32.2	Certification of Chief Executive Officer Pursuant to 18 U.S.C. §1350 ††
32.3	Certification of Chief Financial Officer Pursuant to 18 U.S.C. §1350 ††
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

† Filed herewith.
†† Furnished herewith.
††† Management contract or compensatory plan, contract or arrangement.

Index to Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
ARMOUR Residential REIT, Inc.

We have audited the accompanying consolidated balance sheets of ARMOUR Residential REIT, Inc. and subsidiary (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ARMOUR Residential REIT, Inc. and subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2014 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP
Certified Public Accountants

Miami, Florida
February 26, 2014

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
ARMOUR Residential REIT, Inc.

We have audited the internal control over financial reporting of ARMOUR Residential REIT, Inc. and subsidiary (the "Company") as of December 31, 2013, based on the criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013 of the Company and our report dated February 26, 2014 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP
Certified Public Accountants

Miami, Florida
February 26, 2014

ARMOUR Residential REIT, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	December 31, 2013	December 31, 2012
Assets		
Cash and cash equivalents	$496,478	$771,282
Cash collateral posted	35,917	265,552
Agency Securities, available for sale, at fair value (including pledged securities of $13,832,482 and $18,578,690)	14,648,178	19,096,562
Receivable for unsettled sales	—	668,244
Derivatives, at fair value	508,988	5,367
Principal payments receivable	70	16,037
Accrued interest receivable	42,034	55,430
Prepaid and other assets	852	404
Total Assets	$15,732,517	$20,878,878
Liabilities and Stockholders' Equity		
Liabilities:		
Repurchase agreements	$13,151,504	$18,366,095
Cash collateral held	387,845	—
Payable for unsettled purchases	159,159	—
Derivatives, at fair value	102,795	190,540
Accrued interest payable	6,629	10,064
Accounts payable and other accrued expenses	23,357	4,395
Dividends payable	—	9
Total Liabilities	$13,831,289	$18,571,103
Commitments and contingencies (Note 9)		
Stockholders' Equity:		
Preferred stock, $0.001 par value, 50,000 shares authorized;		
8.250% Series A Cumulative Preferred Stock; 2,181 shares and 2,006 shares issued and outstanding at December 31, 2013 and December 31, 2012	$2	$2
7.875% Series B Cumulative Preferred Stock; 5,650 shares and none issued and outstanding at December 31, 2013 and December 31, 2012	6	—
Common stock, $0.001 par value, 1,000,000 shares authorized, 357,613 shares and 309,013 shares issued and outstanding at December 31, 2013 and December 31, 2012	358	309
Additional paid-in capital	2,734,480	2,226,198
Accumulated deficit	(643,138)	(149,298)
Accumulated other comprehensive income (loss)	(190,480)	230,564
Total Stockholders' Equity	$1,901,228	$2,307,775
Total Liabilities and Stockholders' Equity	$15,732,517	$20,878,878

See notes to consolidated financial statements

ARMOUR Residential REIT, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	For the Years Ended December 31, 2013	December 31, 2012	December 31, 2011
Interest income, net of amortization of premium on Agency Securities	$505,443	$388,994	$117,638
Interest expense	(83,218)	(61,195)	(11,856)
Net interest income	$422,225	$327,799	$105,782
Other Income (Loss):			
Realized gain (loss) on sale of Agency Securities (reclassified from Other comprehensive income (loss))	(593,498)	40,627	16,631
Other than temporary impairment of Agency Securities (reclassified from Other comprehensive income (loss); no amounts remaining in Accumulated other comprehensive income (loss))	(401,541)	—	—
Gain on short sale of U.S. Treasury Securities	14,176	—	—
Other income	—	1,043	—
Subtotal	$(980,863)	41,670	16,631
Realized loss on derivatives (1)	(135,908)	(63,039)	(25,006)
Unrealized gain (loss) on derivatives	544,643	(58,774)	(97,087)
Subtotal	$408,735	$(121,813)	$(122,093)
Total Other Loss	$(572,128)	$(80,143)	$(105,462)
Expenses:			
Management fee	28,141	19,459	6,858
Professional fees	3,311	2,009	1,387
Insurance	543	291	213
Compensation	3,047	1,838	543
Other	2,109	1,777	710
Total expenses	$37,151	$25,374	$9,711
Income (loss) before taxes	(187,054)	222,282	(9,391)
Income tax benefit (expense)	10	24	(51)
Net Income (Loss)	$(187,044)	$222,306	$(9,442)
Dividends declared on preferred stock	(14,213)	(1,964)	—
Net Income (Loss) available (related) to common stockholders	$(201,257)	$220,342	$(9,442)
Net income (loss) available (related) per share to common stockholders:			
Basic	$(0.55)	$0.99	$(0.15)
Diluted	$(0.55)	$0.98	$(0.15)
Weighted average common shares outstanding:			
Basic	362,830	223,627	61,421
Diluted	362,830	224,263	61,421

(1) Interest expense related to our interest rate swap contracts is recorded in realized losses on derivatives on the consolidated statements of operations. For additional information, see Note 8 to the consolidated financial statements.

See notes to consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the Years Ended December 31, 2013	December 31, 2012	December 31, 2011
Net Income (Loss)	$(187,044)	$222,306	$(9,442)
Other comprehensive income (loss):			
Reclassification adjustment for realized (gain) loss on sale of available for sale Agency Securities	593,498	(40,627)	(16,631)
Reclassification adjustment for other than temporary impairment of available for sale Agency Securities	401,541	—	—
Net unrealized gain (loss) on available for sale Agency Securities	(1,416,083)	222,443	69,608
Other comprehensive income (loss)	$(421,044)	$181,816	$52,977
Comprehensive Income (Loss)	$(608,088)	$404,122	$43,535

See notes to consolidated financial statements

ARMOUR Residential REIT, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Preferred Stock						Common Stock						
	Series A Shares	Series A Par Amount	Series A Additional Paid-In Capital	Series B Shares	Series B Par Amount	Series B Additional Paid-In Capital	Shares	Par Amount	Additional Paid-In Capital	Total Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2011	—	—	—	—	—	—	16,442	16	116,748	116,748	(3,826)	(4,229)	108,709
Common dividends declared	—	—	—	—	—	—	—	—	—	—	(87,610)	—	(87,610
Issuance of common stock, net	—	—	—	—	—	—	78,977	78	561,748	561,748	—	—	561,826
Stock based compensation, net of withholding requirements	—	—	—	—	—	—	18	1	145	145	—	—	146
Net loss	—	—	—	—	—	—	—	—	—	—	(9,442)	—	(9,442
Other comprehensive income	—	—	—	—	—	—	—	—	—	—	—	52,977	52,977
Balance, December 31, 2011	—	—	—	$ —	$ —	—	95,437	$95	$678,641	$678,641	$(100,878)	$48,748	$626,606
Series A Preferred dividends declared	—	—	—	—	—	—	—	—	—	—	(1,964)	—	(1,964
Common dividends declared	—	—	—	—	—	—	—	—	—	—	(268,762)	—	(268,762
Issuance of Series A Preferred stock, net	2,006	2	48,792	—	—	—	—	—	—	48,792	—	—	48,794
Issuance of common stock, net	—	—	—	—	—	—	213,473	213	1,498,025	1,498,025	—	—	1,498,238
Stock based compensation, net of withholding requirements	—	—	—	—	—	—	103	1	740	740	—	—	741
Net income	—	—	—	—	—	—	—	—	—	—	222,306	—	222,306

Other comprehensive income	—	—	—	—	—	—	—	—	—	—	—	181,816	181,816
Balance, December 31, 2012	2,006	$2	48,792	—	$ —	$ —	309,013	$309	$2,177,406	$2,226,198	$(149,298)	$230,564	$2,307,77
Series A Preferred dividends declared	—	—	—	—	—	—	—	—	—	—	(4,480)	—	(4,480
Series B Preferred dividends declared	—	—	—	—	—	—	—	—	—	—	(9,733)	—	(9,733
Common stock dividends declared	—	—	—	—	—	—	—	—	—	—	(292,583)	—	(292,583
Issuance of Series A Preferred stock, net	175	—	4,380	—	—	—	—	—	—	4,380	—	—	4,380
Issuance of Series B Preferred stock, net	—	—	—	5,650	6	136,547	—	—	—	136,547	—	—	136,553
Issuance of common stock, net	—	—	—	—	—	—	65,067	65	438,517	438,517	—	—	438,582
Stock based compensation, net of withholding requirements	—	—	—	—	—	—	304	1	1,515	1,515	—	—	1,516
Common stock repurchased	—	—	—	—	—	—	(16,771)	(17)	(72,677)	(72,677)	—	—	(72,694
Net loss	—	—	—	—	—	—	—	—	—	—	(187,044)	—	(187,044
Other comprehensive loss	—	—	—	—	—	—	—	—	—	—	—	(421,044)	(421,044
Balance, December 31, 2013	2,181	$2	53,172	5,650	$6	$136,547	357,613	$358	$2,544,761	$2,734,480	$(643,138)	$(190,480)	$1,901,22

See notes to consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Years Ended December 31, 2013	December 31, 2012	December 31, 2011
Cash Flows From Operating Activities:			
Net income (loss)	$(187,044)	$222,306	$(9,442)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Net amortization of premium on Agency Securities	157,645	123,896	34,807
Realized (gain) loss on sale of Agency Securities	593,498	(40,627)	(16,631)
Other than temporary impairment of Agency Securities	401,541	—	—
Gain on short sale of U.S. Treasury Securities	(14,176)	—	—
Stock based compensation	1,516	741	146
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	13,411	(36,855)	(14,744)
(Increase) decrease in prepaid and other assets	(448)	(236)	374
(Increase) decrease in derivatives, at fair value	(591,366)	63,446	119,145
Increase (decrease) in accrued interest payable	(3,435)	7,910	1,925
Increase (decrease) in accounts payable and other accrued expenses	(704)	3,100	2,492
Net cash provided by operating activities	$370,438	$343,681	$118,072
Cash Flows From Investing Activities:			
Purchases of Agency Securities	(15,029,408)	(20,493,773)	(6,677,723)
Principal repayments of Agency Securities	3,135,502	2,629,142	834,947
Proceeds from sales of Agency Securities	15,611,917	3,853,612	1,245,438
Disbursements on reverse repurchase agreements	(11,239,305)	—	—
Receipts from reverse repurchase agreements	11,239,305	—	—
(Increase) decrease in cash collateral	617,480	(118,353)	(142,518)
Net cash provided by (used in) investing activities	$4,335,491	$(14,129,372)	$(4,739,856)
Cash Flows From Financing Activities:			
Issuance of Series A Preferred stock, net of expenses	4,380	48,772	—
Issuance of Series B Preferred stock, net of expenses	136,553	—	—
Issuance of common stock, net of expenses	438,566	1,498,233	561,822
Proceeds from repurchase agreements	122,761,377	127,326,357	39,069,778
Principal repayments on repurchase agreements	(127,975,968)	(114,297,294)	(34,705,492)
Proceeds from sales of U.S. Treasury Securities	2,789,560	—	—
Purchases of U.S. Treasury Securities	(2,775,384)	—	—
Series A Preferred stock dividends paid	(4,480)	(1,964)	—
Series B Preferred stock dividends paid	(9,733)	—	—
Common stock dividends paid	(292,592)	(269,503)	(87,296)
Common stock repurchased	(53,012)	—	—
Net cash provided by (used in) financing activities	$(4,980,733)	$14,304,601	$4,838,812
Net increase (decrease) in cash	$(274,804)	$518,910	$217,028
Cash and cash equivalents - beginning of year	771,282	252,372	35,344
Cash and cash equivalents - end of year	$496,478	$771,282	$252,372
Supplemental Disclosure:			

Cash paid during the period for interest	$226,549	$85,139	$9,024
Non-Cash Investing and Financing Activities:			
Receivable for unsettled sales	$—	$668,244	$382,931
Payable for unsettled purchases	$159,159	$—	$117,885
Net unrealized gain (loss) on available for sale Agency Securities	$(1,416,083)	$222,443	$69,608
Amounts receivable for issuance of preferred stock	$—	$22	$—
Amounts receivable for issuance of common stock	$16	$5	$4
Amounts payable for common stock repurchased	$(19,682)	$—	$—
Common dividends declared, to be paid in subsequent period	$—	$—	$643

See notes to consolidated financial statements.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

Note 1 - Basis of Presentation

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles in the U.S. (“GAAP”). The consolidated financial statements include the accounts of ARMOUR Residential REIT, Inc. and its subsidiary. All intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the accompanying consolidated financial statements include the valuation of Agency Securities (as defined below) and derivative instruments.

Note 2 - Organization and Nature of Business Operations

References to “we,” “us,” “our,” "ARMOUR" or the “Company” are to ARMOUR Residential REIT, Inc. References to "ARRM" are to ARMOUR Residential Management LLC, a Delaware limited liability company. References to “Enterprise” are to Enterprise Acquisition Corp., which was a wholly-owned subsidiary of ARMOUR dissolved in December 2013.

We are an externally managed Maryland corporation organized in 2008, managed by ARRM (see Note 14, “Related Party Transactions” for additional discussion), an investment advisor registered with the Securities and Exchange Commission. We invest in residential mortgage backed securities issued or guaranteed by a United States (“U.S.”) Government-sponsored entity (“GSE”), such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) or guaranteed by the Government National Mortgage Administration (Ginnie Mae) (collectively, "Agency Securities"). As of December 31, 2013 and December 31, 2012, Agency Securities accounted for 100% of our securities portfolio. It is expected that the percentage will continue to be 100% or close thereto. Our securities portfolio consists primarily of Agency Securities backed by fixed rate home loans. From time to time, a portion of our assets may be invested in Agency Securities backed by hybrid adjustable rate and adjustable rate home loans as well as unsecured notes and bonds issued by GSEs (“Agency Debt”), U.S. Treasuries and money market instruments, subject to certain income tests we must satisfy for our qualification as a real estate investment trust (“REIT”). On December 1, 2011, our stockholders approved an amendment to our charter to alter our investment asset class restriction in response to potential changes in Agency Securities to include Non-Agency Securities as well as Agency Securities in our investment asset class restriction. While we remain committed to investing in Agency Securities for so long as an adequate supply and pricing exists, we believe it is prudent for us to have the flexibility to invest in Non-Agency Securities and respond to changes in GSE policy.

We have elected to be taxed as a REIT under the Internal Revenue Code (“the Code”). Our qualification as a REIT depends on our ability to meet, on a continuing basis, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the concentration of ownership of our capital stock. We believe that we are organized in conformity with the requirements for qualification as a REIT under the Code and our manner of operations enables us to meet the requirements for taxation as a REIT for federal income tax purposes.

As a REIT, we will generally not be subject to federal income tax on the REIT taxable income that we currently distribute to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to federal income tax at regular corporate rates. Even if we qualify as a

REIT for federal income tax purposes, we may still be subject to some federal, state and local taxes on our income.

Note 3 - Summary of Significant Accounting Policies

Cash and cash equivalents

Cash and cash equivalents includes cash on deposit with financial institutions and investments in high quality overnight money market funds, all of which have original maturities of three months or less, at the time of purchase. We may maintain deposits in federally insured financial institutions in excess of federally insured limits. However, management believes we are not exposed to significant credit risk due to the financial position and creditworthiness of the depository institutions in which those deposits are held.

ARMOUR Residential REIT, Inc. and Subsidiary
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Cash Collateral Posted/Held

The following table presents information related to margin collateral posted (held) for Agency Securities, interest rate swap contracts and Eurodollar Futures Contracts ("Futures Contracts") which are included in cash collateral on the accompanying consolidated balance sheets as of December 31, 2013 and December 31, 2012.

December 31, 2013

	Assets at Fair Value (1) (in thousands)	Liabilities at Fair Value (1)
Agency Securities	$13,547	$(53,845)
Interest rate swap contracts	20,771	(334,000)
Futures Contracts	1,599	—
Totals	$35,917	$(387,845)

(1) See Note 5, "Fair Value of Financial Instruments" for additional discussion.

December 31, 2012

	Assets at Fair Value (1) (in thousands)	Liabilities at Fair Value (1)
Interest rate swap contracts	$261,364	$—
Futures Contracts	4,188	—
Totals	$265,552	$—

(1) See Note 5, "Fair Value of Financial Instruments" for additional discussion.

Agency Securities, at Fair Value

We generally intend to hold most of our Agency Securities for extended periods of time. We may, from time to time, sell any of our Agency Securities as part of the overall management of our securities portfolio. Management determines the appropriate classifications of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. As of December 31, 2013 and December 31, 2012, all of our Agency Securities were classified as available for sale securities. Agency Securities classified as available for sale are reported at their estimated fair values with unrealized gains and losses excluded from earnings and reported as part of the consolidated statements of comprehensive income (loss).

We evaluate Agency Securities for other than temporary impairment at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. We consider an impairment to be other than temporary if we (1) have the intent to sell the Agency Securities, (2) believe it is more likely than not that we will be required to sell the securities before recovery (for example, because of liquidity requirements or contractual obligations) or (3) a credit loss exists. Impairment losses recognized establish a new cost basis for the related Agency Securities.

Accrued Interest Receivable and Payable

Accrued interest receivable includes interest accrued between payment dates on Agency Securities. Accrued interest payable includes interest payable on our repurchase agreements.

Repurchase Agreements

We finance the acquisition of our Agency Securities through the use of repurchase agreements. Our repurchase agreements are secured by our Agency Securities and bear interest rates that have historically moved in close relationship to the Federal Funds Rate and the London Interbank Offered Rate ("LIBOR"). Under these repurchase agreements, we sell Agency Securities to a lender and agree to repurchase the same Agency Securities in the future for a price that is higher than the original sales price. The difference between the sales price that we receive and the repurchase price that we pay represents interest paid to the lender. A repurchase agreement operates as a financing arrangement under which we pledge our Agency Securities as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then prevailing interest rate. The repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

In addition to the repurchase agreement financing discussed above, at certain times we have entered into reverse repurchase agreements with certain of our repurchase agreement counterparties. Under a typical reverse repurchase agreement, we purchase U.S. Treasury Securities from a borrower in exchange for cash and agree to sell the same securities in the future in exchange for a price that is higher than the original purchase price. The difference between the purchase price originally paid and the sale price represents interest received from the borrower. Reverse repurchase agreement receivables and repurchase agreement liabilities are presented net when they meet certain criteria, including being with the same counterparty, being governed by the same master repurchase agreement ("MRA"), settlement through the same brokerage or clearing account and maturing on the same day. At December 31, 2013 and December 31, 2012, we did not have any reverse repurchase agreements outstanding.

Obligations to Return Securities Received as Collateral, at Fair Value

At certain times, we also sell to third-parties the U.S. Treasury Securities received as collateral for reverse repurchase agreements and recognize the resulting obligation to return said U.S. Treasury Securities as a liability on our consolidated balance sheets. Interest is recorded on the repurchase agreements, reverse repurchase agreements and U.S. Treasury Securities on an accrual basis and presented as net interest expense. Both parties to the transaction have the right to make daily margin calls based on changes in the fair value of the collateral received and/or pledged. We did not have any obligations to return securities as collateral at December 31, 2013 or December 31, 2012.

Derivatives, at Fair Value

We recognize all derivatives as either assets or liabilities at fair value on our consolidated balance sheets. We have not elected cash flow hedge accounting treatment as allowed by GAAP, all changes in the fair values of our derivatives are reflected in our consolidated statements of operations. Accordingly, our operating results may reflect greater volatility than otherwise would be the case, because gains or losses on derivatives may not be offset by changes in the fair value or cash flows of the transaction within the same accounting period or ever. Consequently, any declines in the fair value of our derivatives result in a charge to earnings. We will continue to designate derivatives as hedges for tax purposes and any unrealized derivative gains or losses would not affect our distributable net taxable income.

Credit Risk

We have limited our exposure to credit losses on our securities portfolio of Agency Securities. The payment of principal and interest on the Freddie Mac and Fannie Mae Agency Securities are guaranteed by those respective agencies and the payment of principal and interest on the Ginnie Mae Agency Securities are backed by the full faith and credit of the U.S. Government.

In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. Government. On August 5, 2011, Standard & Poor’s Corporation downgraded the U.S. Government’s credit rating from AAA to AA+ and on August 8, 2011, Fannie Mae and Freddie Mac’s credit ratings were downgraded from AAA to AA+. Fannie Mae and Freddie Mac remain in conservatorship of the U.S. Government. There can be no assurances as to how or when the U.S. Government will end these conservatorships or how the future profitability of Fannie Mae and Freddie Mac and any future credit rating actions may impact the credit risk associated with Agency Securities and, therefore, the value of the Agency Securities in our securities portfolio.

Market Risk

Weakness in the mortgage market may adversely affect the performance and market value of our investments. This could negatively impact our book value. Furthermore, if our lenders are unwilling or unable to provide additional financing, we could be forced to sell our Agency Securities at an inopportune time when prices are depressed.

Preferred Stock

At December 31, 2013, we were authorized to issue up to 50,000,000 shares of preferred stock, par value $0.001 per share, with such designations, voting and other rights and preferences as may be determined from time to time by our Board of Directors (“Board”) or a committee thereof.

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Series A Cumulative Preferred Shares ("Series A Preferred Stock")

On June 6, 2012, we filed with the Maryland State Department of Assessments and Taxation to designate 1,610,000 shares of the 50,000,000 authorized preferred stock as 8.250% Series A Preferred Stock with the powers, designations, preferences and other rights as set forth therein. On July 13, 2012, we entered into an At Market Issuance Sales Agreement with MLV & Co. LLC, as our agent, to offer and sell, from time to time, up to 6,000,000 shares of Series A Preferred Stock. On July 27, 2012, we entered into an Equity Distribution Agreement with Citadel Securities LLC, as our agent, to offer and sell, from time to time, up to 2,000,000 shares of Series A Preferred Stock. At December 31, 2013 there were 9,610,000 shares designated as Series A Preferred Stock.

We had 2,181,000 shares of Series A Preferred Stock issued and outstanding at December 31, 2013 and 2,006,000 shares of Series A Preferred Stock issued and outstanding at December 31, 2012. Our Series A Preferred Stock has a par value $0.001 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends. The Series A Preferred Stock is entitled to a dividend at a rate of 8.250% per year based on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends exclusively at our option commencing on June 7, 2017 (subject to our right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve our qualification as a REIT). The Series A Preferred Stock is senior to our common stock and therefore in the event of liquidation, dissolution or winding up, the Series A Preferred Stock will receive a liquidation preference of $25.00 per share plus accumulated and unpaid dividends before distributions are paid to holders of our common stock, with no right or claim to any of our remaining assets thereafter. The Series A Preferred Stock generally does not have voting rights except if we fail to pay dividends on the Series A Preferred Stock for eighteen months, whether or not consecutive. Under such circumstances, the Series A Preferred Stock will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set aside for payment. The Series A Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless repurchased or redeemed by us or converted into our common stock in connection with a change of control by the holders of Series A Preferred Stock.

Series B Cumulative Preferred Shares (”Series B Preferred Stock”)

On February 11, 2013, we filed with the Maryland State Department of Assessments and Taxation to designate 6,210,000 shares of the 50,000,000 authorized preferred stock as 7.875% Series B Preferred Stock with the powers, designations, preferences and other rights as set forth therein.

We had 5,650,000 shares of Series B Preferred Stock issued and outstanding at December 31, 2013 and none issued and outstanding at December 31, 2012. Our Series B Preferred Stock has a par value of $0.001 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends. The Series B Preferred Stock is entitled to a dividend at a rate of 7.875% per year based on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series B Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends exclusively at our option commencing on February 12, 2018 (subject to our right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve our qualification as a REIT). The Series B Preferred Stock is senior to our common stock and rank on parity with the Series A Preferred Stock. In the event of liquidation, dissolution or winding up, the Series B Preferred Stock will receive a liquidation preference of $25.00 per share plus accumulated and unpaid dividends before distributions are paid to holders of our common stock, with no right or claim to any of our remaining assets thereafter. The Series B Preferred Stock generally does not have voting rights except if we fail to pay dividends on the Series B Preferred Stock for eighteen months, whether or not consecutive. Under such circumstances, the Series B Preferred Stock will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set aside for payment. The Series B Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless repurchased or redeemed by us or converted into our common stock in connection with a change of control by the holders of Series B Preferred Stock.

Common Stock

Common Stock and Warrants

At December 31, 2013, we were authorized to issue up to 1,000,000,000 shares of common stock, par value $0.001 per share, with such designations, voting and other rights and preferences as may be determined from time to time by our Board. We had 357,613,485 shares of common stock issued and outstanding at December 31, 2013 and 309,013,984 shares of common stock issued and outstanding at December 31, 2012. We had outstanding warrants whereby their holders had the right to purchase 32,500,000 shares of common stock at December 31, 2012. These warrants were exercisable at $11.00 per share and expired unexercised on November 7, 2013 in accordance with their original terms. The warrants were listed on the NYSE MKT LLC which determined that November 1, 2013, was the final trading day for the warrants.

ARMOUR Residential REIT, Inc. and Subsidiary
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Common Stock Repurchased

On December 17, 2012, we announced that our Board had authorized a stock repurchase program of up to $100.0 million of shares of our common stock outstanding (the "Repurchase Program"). Under the Repurchase Program shares may be purchased in the open market, including block trades, through privately negotiated transactions, or pursuant to a trading plan separately adopted in the future. The timing, manner, price and amount of any repurchases will be at our discretion, subject to the requirements of the Securities Exchange Act of 1934, as amended, and related rules. We are not required to repurchase any shares under the Repurchase Program and it may be modified, suspended or terminated at any time for any reason. We do not intend to purchase shares from our Board or other affiliates. Under Maryland law, such repurchased shares are treated as authorized but unissued. As of December 31, 2013, we repurchased 16,771,003 shares of our common stock under the Repurchase Program for an aggregate cost of $72.7 million. As of December 31, 2013, there was $27.3 million left under our Repurchase Program.

Revenue Recognition

Interest income is earned and recognized based on the unpaid principal amount of the Agency Securities and their contractual terms. Premiums and discounts associated with the purchase of Agency Securities are amortized or accreted into interest income over the actual lives of the securities, reflecting actual prepayments as they occur.

Comprehensive Income (Loss)

Comprehensive income (loss) refers to changes in equity during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Note 4 - Recent Accounting Pronouncements

In January 2013, the Financial Accounting Standards Board ("FASB") issued ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, Balance Sheet (Topic 210). This update to ASU 2011-11 addressed implementation issues and applied to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with ASC 210-20-45 or ASC 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The guidance was effective January 1, 2013 and was applied retrospectively. This guidance did not affect the presentation of Derivatives, at fair value on our consolidated balance sheets and therefore, did not affect our consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, Comprehensive Income (Topic 220). This update to ASU 2011-12 addressed improving the reporting of reclassifications out of accumulated other comprehensive income by requiring reporting of the effect of significant reclassifications out of accumulated other comprehensive income if the amount being reclassified is required under GAAP to be classified in its entirety to net income. For amounts not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about these amounts. The update did not change the current requirements for reporting net income or other comprehensive income and resulted in additional disclosure but had no significant effect on our consolidated financial statements. The guidance was effective for reporting periods beginning after

December 15, 2012 and was applied prospectively.

In July 2013, the FASB issued ASU 2013-10, Derivatives and Hedging (Topic 815), Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (a consensus of the FASB Emerging Issues Task Force). Because we do not currently use hedge accounting for our derivative positions this addition to Topic 815 does not affect our consolidated financial statements.

Note 5 - Fair Value of Financial Instruments

Our valuation techniques for financial instruments are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from third-party sources, while unobservable inputs reflect management’s market assumptions. The Accounting Standards Codification Topic No. 820 “Fair Value Measurement” classifies these inputs into the following hierarchy:

Level 1 Inputs - Quoted prices for identical instruments in active markets.

Level 2 Inputs - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs - Prices determined using significant unobservable inputs. Unobservable inputs may be used in situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period). Unobservable inputs reflect management's assumptions about the factors that market participants would use in pricing an asset or liability, and would be based on the best information available.

The following describes the valuation methodologies used for our assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy. Any transfers between levels are assumed to occur at the beginning of the reporting period.

Cash - Cash and cash equivalents includes cash on deposit with financial institutions and investments in high quality overnight money market funds, all of which have maturities of three months or less, at the time of purchase. The carrying amount of cash is deemed to be its fair value. Our cash balances are classified as Level 1. Cash balances posted to or held by counterparties as collateral are classified as Level 2.

Agency Securities Available for Sale - Fair value for the Agency Securities in our securities portfolio is based on obtaining a valuation for each Agency Security from third-party pricing services and/or dealer quotes. The third-party pricing services use common market pricing methods that may include pricing models that may incorporate such factors as coupons, prepayment speeds, spread to the Treasury curves and interest rate swap curves, duration, periodic and life caps and credit enhancement. If the fair value of an Agency Security is not available from the third-party pricing services or such data appears unreliable, we obtain valuations from up to three dealers who make markets in similar Agency Securities. In general, the dealers incorporate common market pricing methods, including a spread measurement to the Treasury curve or interest rate swap curve as well as underlying characteristics of the particular Agency Security including coupon, periodic and life caps, collateral type, rate reset period and seasoning or age of the Agency Security. Management reviews pricing used to ensure that current market conditions are properly reflected. This review includes, but is not limited to, comparisons of similar market transactions or alternative third-party pricing services, dealer quotes and comparisons to a third-party pricing model. Fair values obtained from the third-party pricing services for similar instruments are classified as Level 2 securities if the inputs to the pricing methods used are consistent with the Level 2 definition. If quoted prices for a security are not reasonably available from the third-party pricing service, but dealer quotes are, the security will be classified as a Level 2 security. If neither is available, management will determine the fair value based on characteristics of the security that we receive from the issuer and based on available market information received from dealers and classify it as a Level 3 security. At December 31, 2013 and December 31, 2012, all of our Agency Security fair values were based solely on third-party pricing services and dealer quotes and therefore were classified as Level 2.

Repurchase Agreements - The fair value of repurchase agreements reflects the present value of the contractual cash flows discounted at the estimated LIBOR based market interest rates at the valuation date for repurchase agreements with a term equivalent to the remaining term to interest rate repricing, which may be at maturity, of our repurchase agreements. The fair value of the repurchase agreements approximates their carrying amount due to the short-term nature of these financial instruments. Our repurchase agreements are classified as Level 2.

Derivative Transactions - Our Futures Contracts are traded on the Chicago Mercantile Exchange ("CME") and are classified as Level 1. The fair values of our interest rate swap contracts and interest rate swaptions are valued using third-party pricing services that incorporates common market pricing methods that may include current interest rate curves, forward interest rate curves and market spreads to interest rate curves. Management compares pricing used to dealer quotes to ensure that the current market conditions are properly reflected. The fair values of our interest rate swap contracts and our interest rate swaptions are classified as Level 2.

ARMOUR Residential REIT, Inc. and Subsidiary
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The following tables provide a summary of our assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2013 and December 31, 2012.

	Quoted Prices in Active Markets for Identical Assets (Level 1) (in thousands)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2013
Assets at Fair Value:				
Agency Securities, available for sale	$—	$14,648,178	$—	$14,648,178
Derivatives	$—	$508,988	$—	$508,988
Liabilities at Fair Value:				
Derivatives	$1,503	$101,292	$—	$102,795

There were no transfers of assets or liabilities between Levels of the fair value hierarchy during the year ended December 31, 2013.

	Quoted Prices in Active Markets for Identical Assets (Level 1) (in thousands)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2012
Assets at Fair Value:				
Agency Securities, available for sale	$—	$19,096,562	$—	$19,096,562
Derivatives	$—	$5,367	$—	$5,367
Liabilities at Fair Value:				
Derivatives	$3,919	$186,621	$—	$190,540

There were no transfers of assets or liabilities between Levels of the fair value hierarchy during the year ended December 31, 2012.

ARMOUR Residential REIT, Inc. and Subsidiary
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The following tables provide a summary of the carrying values and fair values of our financial assets and liabilities not carried at fair value but for which fair value is required to be disclosed as of December 31, 2013 and December 31, 2012.

	December 31, 2013		Fair Value Measurements using:			
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
	(in thousands)					
Financial Assets:						
Cash and cash equivalents	$496,478	$496,478	$496,478	$—	496,478	$—
Cash collateral posted	$35,917	$35,917	$—	$35,917	35,917	$—
Principal payments receivable	$70	$70	$—	$70	70	$—
Accrued interest receivable	$42,034	$42,034	$—	$42,034	42,034	$—
Financial Liabilities:						
Repurchase agreements	$13,151,504	$13,151,504	$—	$13,151,504	13,151,504	$—
Cash collateral held	$387,845	$387,845	$—	$387,845	387,845	$—
Payable for unsettled purchases	$159,159	$159,159	$—	$159,159	159,159	$—
Accrued interest payable	$6,629	$6,629	$—	$6,629	6,629	$—

	December 31, 2012		Fair Value Measurements using:		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)				
Financial Assets:					
Cash and cash equivalents	$771,282	$771,282	$771,282	$—	$—
Cash collateral posted	$265,552	$265,552	$—	$265,552	$—
Receivable for unsettled sales	$668,244	$668,244	$—	$668,244	$—
Principal payments receivable	$16,037	$16,037	$—	$16,037	$—
Accrued interest receivable	$55,430	$55,430	$—	$55,430	$—
Financial Liabilities:					
Repurchase agreements	$18,366,095	$18,366,095	$—	$18,366,095	$—
Accrued interest payable	$10,064	$10,064	$—	$10,064	$—

Note 6 - Agency Securities, Available for Sale

All of our Agency Securities are classified as available for sale and, as such, are reported at their estimated fair value and changes in fair value reported as part of the statements of comprehensive income. As of December 31, 2013 and December 31, 2012, investments in Agency Securities accounted for 100% of our securities portfolio.

We evaluated our Agency Securities with unrealized losses as of December 31, 2013 and December 31, 2012, to determine whether there was any an other than temporary impairment. The decline in value of our Agency Securities is solely due to market conditions and not the credit quality of the assets. All of our Agency Securities are issued and guaranteed by GSEs. The GSEs have a rating of AA+. As of those dates, we also considered whether we intended to sell Agency Securities and whether it was more likely than not that we could meet our liquidity requirements and contractual obligations without selling Agency Securities. Anticipating portfolio repositioning sales in the first quarter of 2014 (see Note 16, "Subsequent Events" for additional discussion), we concluded that the December 31, 2013 unrealized losses on our 25-year and 30-year fixed rate Agency Securities represented an other than temporary impairment. Accordingly, we recognized losses totaling $401.5 million in our 2013 consolidated statements of operations, thereby establishing a new cost basis for those Agency Securities with aggregate fair value of $6.8 billion as of December 31, 2013. We determined that at December 31, 2013, there was no other than temporary impairment of our other Agency Securities, which are primarily 20-year and 15-year fixed rate securities. We previously determined that at December 31, 2012, there was no other than temporary impairment.

As of December 31, 2013, we had the following Agency Securities in an unrealized gain or loss position as presented below. The components of the carrying value of our Agency Securities as of December 31, 2013 are also presented below.

December 31, 2013	Fannie Mae	Freddie Mac	Ginnie Mae	Total Agency Securities
	(in thousands)			
Principal Amount	$10,700,322	$3,627,871	$139,027	$14,467,220
Net unamortized premium	227,771	136,714	6,953	371,438
Amortized cost	$10,928,093	$3,764,585	$145,980	$14,838,658
Unrealized gains	3,512	2,684	1,152	7,348
Unrealized losses	(124,825)	(72,939)	(64)	(197,828)
Fair value	$10,806,780	$3,694,330	$147,068	$14,648,178

December 31, 2013	Adjustable and Hybrid Adjustable Rate	Fixed Rate	Total Agency Securities
	(in thousands)		
Principal Amount	$208,216	$14,259,004	$14,467,220
Net unamortized premium	9,888	361,550	371,438
Amortized cost	$218,104	$14,620,554	$14,838,658
Unrealized gains	2,731	4,617	7,348
Unrealized losses	(141)	(197,687)	(197,828)
Fair value	$220,694	$14,427,484	$14,648,178

We apply trade date accounting. Included in the above tables are unsettled purchases with an aggregate cost of $159.2 million and estimated fair value of $158.8 million at December 31, 2013.

As of December 31, 2012, we had the following securities in an unrealized gain or loss position as presented below. The components of the carrying value of our Agency Securities as of December 31, 2012 are also presented below.

December 31, 2012	Fannie Mae	Freddie Mac	Ginnie Mae	Total Agency Securities
	(in thousands)			
Principal Amount	$12,328,493	$5,305,071	$292,434	$17,925,998
Net unamortized premium	641,833	284,739	13,428	940,000
Amortized cost	$12,970,326	$5,589,810	$305,862	$18,865,998
Unrealized gains	169,227	66,904	6,466	242,597
Unrealized losses	(9,815)	(2,170)	(48)	(12,033)
Fair value	$13,129,738	$5,654,544	$312,280	$19,096,562

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December 31, 2012	Adjustable and Hybrid Adjustable Rate (in thousands)	Fixed Rate	Total Agency Securities
Principal Amount	$2,037,778	$15,888,220	$17,925,998
Net unamortized premium	84,255	855,745	940,000
Amortized cost	$2,122,033	$16,743,965	$18,865,998
Unrealized gains	36,758	205,839	242,597
Unrealized losses	(222)	(11,811)	(12,033)
Fair value	$2,158,569	$16,937,993	$19,096,562

We apply trade date accounting. We did not have unsettled purchases at December 31, 2012.

Actual maturities of Agency Securities are generally shorter than stated contractual maturities because actual maturities of Agency Securities are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal.

The following table summarizes the weighted average lives of our Agency Securities as of December 31, 2013 and December 31, 2012.

	December 31, 2013 (in thousands)		December 31, 2012	
Weighted Average Life of all Agency Securities	Fair Value	Amortized Cost	Fair Value	Amortized Cost
Less than one year	$2	$2	$2,647	$2,593
Greater than or equal to one year and less than three years	20,289	20,127	8,618,862	8,476,157
Greater than or equal to three years and less than five years	3,809,418	3,837,530	9,681,538	9,592,001
Greater than or equal to five years	10,818,469	10,980,999	793,515	795,247
Total Agency Securities	$14,648,178	$14,838,658	$19,096,562	$18,865,998

We use a third-party model to calculate the weighted average lives of our Agency Securities. Weighted average life is calculated based on expectations for estimated prepayments for the underlying mortgage loans of our Agency Securities. These estimated prepayments are based on assumptions such as interest rates, current and future home prices, housing policy and borrower incentives. The weighted average lives of our Agency Securities as of December 31, 2013 and December 31, 2012 in the table above are based upon market factors, assumptions, models and estimates from the third-party model and also incorporate management’s judgment and experience. The actual weighted average lives of our Agency Securities could be longer or shorter than estimated.

The following table presents the unrealized losses and estimated fair value of our Agency Securities by length of time that such securities have been in a continuous unrealized loss position as of December 31, 2013 and December 31, 2012.

	Unrealized Loss Position For: (in thousands)					
	Less than 12 months		12 Months or More		Total	
As of	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized

		Losses		Losses		Losses
December 31, 2013	$7,175,317	$(197,536)	$17,737	$(292)	$7,193,054	$(197,828)
December 31, 2012	$1,521,052	$(12,030)	$836	$(3)	$1,521,888	$(12,033)

During the years ended December 31, 2013, 2012 and 2011 we sold $15.0 billion, $4.1 billion, $1.6 billion of Agency Securities resulting in a realized (loss) gain of $(593.5) million, $40.6 million and $16.6 million, respectively. The $40.6 million in 2012 includes $1.1 million of losses due to the bankruptcy of a counterparty to a repurchase agreement. In addition, due to the bankruptcy we also recorded $1.0 million of other income resulting from the non-performance of the counterparty on the related repurchase agreement for the year ended December 31, 2012.

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Note 7 - Repurchase Agreements

The following table represents the contractual repricing regarding our repurchase agreements to finance Agency Security purchases as of December 31, 2013 and December 31, 2012.

	December 31, 2013	December 31, 2012
	(in thousands)	
Within 30 days	$3,990,434	$7,771,444
31 days to 60 days	7,098,298	7,840,268
61 days to 90 days	1,226,694	2,699,706
Greater than 90 days	836,078	54,677
Total	$13,151,504	$18,366,095

The following table represents the MRAs and other information regarding our repurchase agreements to finance Agency Security purchases as of December 31, 2013 and December 31, 2012.

	December 31, 2013	December 31, 2012
Number of MRAs	35	33
Number of counterparties with repurchase agreements outstanding	27	26
Weighted average maturity in days	45	34
Weighted average contractual rate	0.42 %	0.49 %
Haircut for repurchase agreements (1)	5.0 %	4.8 %

(1) The Haircut represents the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount.

For the year ended December 31, 2013, we sold short $2.8 billion of U.S. Treasury Securities acquired under reverse repurchase agreements. We had purchases of $2.8 billion of U.S. Treasury Securities resulting in a gain of $14.2 million for the year ended December 31, 2013. During the years ended December 31, 2012 and December 31, 2011 we did not sell or purchase any U.S. Treasury Securities.

Note 8 - Derivatives

We enter into transactions to manage our interest rate risk exposure. These transactions include entering into interest rate swap contracts and interest rate swaptions as well as purchasing or selling Futures Contracts. These transactions are designed to lock in funding costs for repurchase agreements associated with our assets in such a way to help assure the realization of net interest margins. Such transactions are based on assumptions about prepayments which, if not realized, will cause transaction results to differ from expectations. Our derivatives are carried on our consolidated balance sheets, as assets or as liabilities at their fair value. We do not designate our derivatives as cash flow hedges and as such, we recognize changes in the fair value of these derivatives through earnings.

We have agreements with our swap (including swaption) counterparties that provide for the posting of collateral based on the fair values of our interest rate swap contracts. Through this margin process, either we or our swap counterparty may be required to pledge cash or Agency Securities as collateral. Collateral requirements vary by counterparty and change over time based on the market value, notional amount and remaining term of the contracts. Certain interest rate swap contracts provide for cross collateralization and cross default with repurchase agreements and other contracts with the same counterparty.

Interest rate swaptions generally provide us the option to enter into an interest rate swap agreement at a certain point of time in the future with a predetermined notional amount, stated term and stated rate of interest in the fixed leg and interest rate index on the floating leg.

Our Futures Contracts are traded on the CME which requires the use of daily mark-to-market collateral and the CME provides substantial credit support. The collateral requirements of the CME require us to pledge assets under a bi-lateral margin arrangement, including either cash or Agency Securities and these requirements may vary and change over time based on the

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market value, notional amount and remaining term of the Futures Contracts. In the event we are unable to meet a margin call under one of our Futures Contracts, the counterparty to such agreement may have the option to terminate or close-out all of the outstanding Futures Contracts with us. In addition, any close-out amount due to the counterparty upon termination of the counterparty's transactions would be immediately payable by us pursuant to the applicable agreement.

The following tables present information about interest rate swap contracts, interest rate swaptions and Futures Contracts which are included in derivatives on the accompanying consolidated balance sheets as of December 31, 2013 and December 31, 2012.

December 31, 2013

	Notional Amount	Assets at Fair Value (1)	Liabilities at Fair Value (1)
	(in thousands)		
Interest rate swap contracts	$10,220,000	$397,219	$(101,292)
Interest rate swaptions	5,750,000	111,769	—
Futures Contracts	55,000	—	(1,503)
Totals	$16,025,000	$508,988	$(102,795)

(1) See Note 5, "Fair Value of Financial Instruments" for additional discussion.

December 31, 2012

	Notional Amount	Assets at Fair Value (1)	Liabilities at Fair Value (1)
	(in thousands)		
Interest rate swap contracts	$8,670,000	$1,718	$(186,621)
Interest rate swaptions	1,050,000	3,649	—
Futures Contracts	102,000	—	(3,919)
Totals	$9,822,000	$5,367	$(190,540)

(1) See Note 5, "Fair Value of Financial Instruments" for additional discussion.

We apply trade date accounting. We did not have unsettled purchases or sales of derivatives at December 31, 2013 or December 31, 2012.

The following tables present information about interest rate swap contracts, interest rate swaptions and Futures Contracts and the potential effects of netting if we were to offset the assets and liabilities of these financial instruments on the accompanying consolidated balance sheets. Currently we present these financial instruments at their gross amounts and they are included in derivatives, at fair value on the accompanying consolidated balance sheets as of December 31, 2013.

December 31, 2013

		Gross Amounts Not Offset in the Consolidated Balance Sheet		
Assets	Gross Amounts of Assets Presented in the Consolidated Balance Sheet (in thousands)	Financial Instruments	Cash Collateral Held (1)	Net Amount

Interest rate swap contracts	$397,219	$(101,292)	$(313,229)	$(17,302)
Interest rate swaptions	111,769	—	—	111,769
Totals	$508,988	$(101,292)	$(313,229)	$94,467

(1) This is net of $20.8 million of cash collateral posted and $334.0 million of cash collateral held.

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December 31, 2013		Gross Amounts Not Offset in the Consolidated Balance Sheet		
Liabilities	Gross Amounts of Liabilities Presented in the Consolidated Balance Sheet (in thousands)	Financial Instruments	Cash Collateral Posted	Net Amount
Interest rate swap contracts	$(101,292)	$101,292	$—	$—
Futures Contracts	(1,503)	—	1,599	96
Totals	$(102,795)	$101,292	$1,599	$96

The following tables present information about interest rate swap contracts, interest rate swaptions and Futures Contracts and the potential effects of netting if we were to offset the assets and liabilities of these financial instruments on the accompanying consolidated balance sheets. Currently we present these financial instruments at their gross amounts and they are included in derivatives, at fair value on the accompanying consolidated balance sheets as of December 31, 2012.

December 31, 2012		Gross Amounts Not Offset in the Consolidated Balance Sheet		
Assets	Gross Amounts of Assets Presented in the Consolidated Balance Sheet (in thousands)	Financial Instruments	Cash Collateral Held (1)	Net Amount
Interest rate swap contracts	$1,718	$(1,718)	$—	$—
Interest rate swaptions	3,649	—	—	$3,649
Totals	$5,367	$(1,718)	$—	$3,649

December 31, 2012		Gross Amounts Not Offset in the Consolidated Balance Sheet		
Liabilities	Gross Amounts of Liabilities Presented in the Consolidated Balance Sheet (in thousands)	Financial Instruments	Cash Collateral Posted	Net Amount
Interest rate swap contracts	$(186,621)	$1,718	$261,364	$76,461
Futures Contracts	(3,919)	—	4,188	269
Totals	$(190,540)	$1,718	$265,552	$76,730

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The following table represents the location and information regarding our derivatives which are included in Other Income (Loss) in the accompanying consolidated statements of operations for the years presented.

		Income (Loss) Recognized (in thousands) For the Years Ended		
Derivatives	Location on consolidated statements of operations	December 31, 2013	December 31, 2012	December 31, 2011
Interest rate swap contracts:				
Realized gain (loss)	Realized loss on derivatives	$25,686	$—	$(239)
Interest income	Realized loss on derivatives	17,180	8,882	1,457
Interest expense	Realized loss on derivatives	(158,465)	(69,479)	(25,017)
Changes in fair value	Unrealized gain (loss) on derivatives	499,193	(39,278)	(94,428)
		$383,594	$(99,875)	$(118,227)
Interest rate swaptions:				
Realized loss	Realized loss on derivatives	(17,778)	—	—
Changes in fair value	Unrealized gain (loss) on derivatives	43,034	(20,869)	—
		$25,256	$(20,869)	$—
Futures Contracts:				
Realized loss	Realized loss on derivatives	(2,531)	(2,442)	(1,207)
Changes in fair value	Unrealized gain (loss) on derivatives	2,416	1,373	(2,659)
		$(115)	$(1,069)	$(3,866)
Totals		$408,735	$(121,813)	$(122,093)

Note 9 - Commitments and Contingencies

Management Agreement with ARRM

As discussed in Note 14 “Related Party Transactions,” we are externally managed by ARRM pursuant to a management agreement, (the “Management Agreement”), which was most recently amended on February 25, 2014. The Management Agreement entitles ARRM to receive a management fee payable monthly in arrears. Currently, the monthly management fee is 1/12th of the sum of (a) 1.5% of gross equity raised up to $1.0 billion plus (b) 0.75% of gross equity raised in excess of $1.0 billion. The cost of repurchased stock reduces the amount of gross equity raised used to calculate the monthly management fee. As of December 31, 2013, the effective management fee was 1.026% based on gross equity raised. The ARRM monthly management fee is not calculated based on the performance of our assets. Accordingly, the payment of our monthly management fee may not decline in the event of a decline in our earnings and may cause us to incur losses. We are also obligated to reimburse certain expenses incurred by ARMOUR. ARRM is further entitled to receive a termination fee from us under certain circumstances.

Pursuant to a Sub-Management Agreement between ARMOUR, ARRM and Staton Bell Blank Check LLC (“SBBC”), ARRM is responsible for the monthly payment of a sub-management fee to SBBC in an amount equal to 25% of the monthly management fee earned by ARRM, net of expenses. On November 6, 2014, SBBC has the option of terminating the Sub-Management Agreement. If the Sub-Management Agreement is terminated, we would be required to make a final payment to SBBC in the amount of 6.16 times the annualized rate of the sub-management fee for the prior three months. Thereafter, we will be entitled to receive the sub-management fee or, at the option of ARRM, reimbursement of the final payment by ARRM. The payments from ARRM to SBBC for the three months preceding December 31, 2013 totaled $1.4 million. If the Sub-Management Agreement had been terminated on December 31, 2013, the payment due from ARMOUR would have been $35.4 million.

Indemnifications and Litigation

We enter into certain contracts that contain a variety of indemnifications, principally with ARRM and underwriters, against third-party claims for errors and omissions in connection with their services to us. We have not incurred any costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the estimated fair value of these agreements, as well as the maximum amount attributable to past events, is minimal. Accordingly, we have no liabilities recorded for these agreements as of December 31, 2013 and December 31, 2012.

We are not party to any pending, threatened or contemplated litigation

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Note 10 - Stock Based Compensation

We adopted the 2009 Stock Incentive Plan (the "Plan") to attract, retain and reward directors and other persons who provide services to us in the course of operations. The Plan authorizes the Board to grant awards including common stock, restricted shares of common stock ("Restricted Shares"), stock options, performance shares, performance units, stock appreciation rights and other equity and cash-based awards (collectively "Awards"), subject to terms as provided in the Plan.

On May 12, 2010, the Board allocated up to 250,000 shares to be available under the Plan. In considering such allocation, the Board considered the size of the Plan relative to our capital base and our current and potential future performance and capitalization. On July 18, 2011, our stockholders approved an amendment to the Plan to increase the number of shares issuable thereunder from 250,000 shares to 2,000,000 shares and the Plan was amended accordingly. During the year ended December 31, 2013, we awarded a total of 1,278,195 Restricted Shares to ARRM for its employees. Of these awards, 150,208 shares vesting in 2017 were awarded subject to stockholder approval by June 30, 2017 of an increase to the number of shares issuable under the Plan.

Transactions related to Restricted Shares for the years ended December 31, 2013 and December 31, 2012 are summarized below:

	December 31, 2013		December 31, 2012	
	Number of Awards	Weighted Average Grant Date Fair Value per Award	Number of Awards	Weighted Average Grant Date Fair Value per Award
Unvested Awards Outstanding beginning of period	628,367	$7.28	153,980	$7.91
Granted	1,127,987	6.78	655,524	7.13
Vested	(424,754)	7.13	(181,137)	7.29
Forfeited	(2,490)	7.69	—	—
Unvested Awards Outstanding end of period	1,329,110	$6.94	628,367	$7.28

As of December 31, 2013, there was approximately $7.1 million of unearned non-cash stock-based compensation related to the Awards (based on the December 31, 2013 stock price), that we expect to recognize as an expense over the remaining average service period of 2.8 years.

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Note 11 - Stockholders' Equity

Dividends

The following tables present our common stock dividend transactions for the years ended December 31, 2013, 2012 and 2011.

December 31, 2013

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2013	January 30, 2013	$0.08	$24.8
February 15, 2013	February 27, 2013	$0.08	$24.8
March 15, 2013	March 27, 2013	$0.08	$30.2
April 15, 2013	April 29, 2013	$0.07	$26.3
May 15, 2013	May 30, 2013	$0.07	$26.3
June 14, 2013	June 27, 2013	$0.07	$26.1
July 15, 2013	July 30, 2013	$0.07	$26.1
August 15, 2013	August 29, 2013	$0.07	$26.1
September 16, 2013	September 27, 2013	$0.07	$26.1
October 15, 2013	October 28, 2013	$0.05	$18.6
November 15, 2013	November 27, 2013	$0.05	$18.6
December 16, 2013	December 27, 2013	$0.05	$18.6

December 31, 2012

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2012	January 30, 2012	$0.11	$11.6
February 15, 2012	February 28, 2012	$0.11	$15.3
March 15, 2012	March 29, 2012	$0.11	$19.9
April 16, 2012	April 27, 2012	$0.10	$17.8
May 15, 2012	May 30, 2012	$0.10	$18.1
June 15, 2012	June 28, 2012	$0.10	$18.6
July 16, 2012	July 30, 2012	$0.10	$23.5
August 15, 2012	August 30, 2012	$0.10	$30.0
September 14, 2012	September 27, 2012	$0.10	$31.0
October 15, 2012	October 30, 2012	$0.09	$27.9
November 15, 2012	November 29, 2012	$0.09	$27.9
December 14, 2012	December 28, 2012	$0.09	$27.9

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December 31, 2011

Record Date	Payment Date	Rate per common share	Aggregate amount paid to holders of record (in millions)
January 15, 2011	January 28, 2011	$0.12	$2.0
February 15, 2011	February 25, 2011	$0.12	$3.9
March 15, 2011	March 30, 2011	$0.12	$3.9
April 15, 2011	April 28, 2011	$0.12	$5.9
May 15, 2011	May 27, 2011	$0.12	$5.9
June 15, 2011	June 29, 2011	$0.12	$8.3
July 15, 2011	July 28, 2011	$0.12	$9.1
August 15, 2011	August 30, 2011	$0.12	$9.1
September 15, 2011	September 29, 2011	$0.12	$10.1
October 15, 2011	October 28, 2011	$0.11	$9.4
November 15, 2011	November 29, 2011	$0.11	$9.4
December 15, 2011	December 29, 2011	$0.11	$10.3

The following table presents our Series A Preferred Stock dividend transactions for the year ended December 31, 2013 and December 31, 2012. There were no Series A Preferred Stock dividend transactions for the year ended December 31, 2011.

December 31, 2013

Record Date	Payment Date	Rate per Series A Preferred share	Aggregate amount paid to holders of record (in millions)
January 15, 2013	January 28, 2013	$0.17	$0.3576
February 15, 2013	February 26, 2013	$0.17	$0.3748
March 15, 2013	March 26, 2013	$0.17	$0.3748
April 15, 2013	April 29, 2013	$0.17	$0.3748
May 15, 2013	May 27, 2013	$0.17	$0.3748
June 14, 2013	June 27, 2013	$0.17	$0.3748
July 15, 2013	July 29, 2013	$0.17	$0.3748
August 15, 2013	August 27, 2013	$0.17	$0.3748
September 15, 2013	September 27, 2013	$0.17	$0.3748
October 15, 2013	October 28, 2013	$0.17	$0.3748
November 15, 2013	November 27, 2013	$0.17	$0.3748
December 15, 2013	December 27, 2013	$0.17	$0.3748

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December 31, 2012

Record Date	Payment Date	Rate per Series A Preferred share	Aggregate amount paid to holders of record (in millions)
July 13, 2012 (1)	July 27, 2012	$0.29	$0.4011
August 15, 2012	August 27, 2012	$0.17	$0.2717
September 14, 2012	September 27, 2012	$0.17	$0.2915
October 15, 2012	October 29, 2012	$0.17	$0.3152
November 15, 2012	November 27, 2012	$0.17	$0.3395
December 14, 2012	December 27, 2012	$0.17	$0.3446

(1) This amount included $0.2 million paid to holders of record on July 13, 2012 for the period of June 7, 2012 through June 30, 2012.

The following table presents our Series B Preferred Stock dividend transactions for the year ended December 31, 2013. There were no Series B Preferred Stock dividend transactions for the years ended December 31, 2012 and 2011, respectively.

Record Date	Payment Date	Rate per Series B Preferred share	Aggregate amount paid to holders of record (in millions)
March 15, 2013	March 26, 2013	$0.25	$1.3905
April 15, 2013	April 29, 2013	$0.16	$0.9269
May 15, 2013	May 27, 2013	$0.16	$0.9269
June 14, 2013	June 27, 2013	$0.16	$0.9269
July 15, 2013	July 29, 2013	$0.16	$0.9269
August 15, 2013	August 27, 2013	$0.16	$0.9269
September 15, 2013	September 27, 2013	$0.16	$0.9269
October 15, 2013	October 28, 2013	$0.16	$0.9269
November 15, 2013	November 27, 2013	$0.16	$0.9269
December 15, 2013	December 27, 2013	$0.16	$0.9269

Equity Capital Raising Activities

The following tables present our equity transactions for the years ended December 31, 2013, 2012 and 2011.

December 31, 2013

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Series A Preferred equity distribution agreements	January 2, 2013 to January 30, 2013	174,961	$25.51	(1)	$4.4
Common stock dividend reinvestment program	January 25, 2013 to December 27, 2013	66,841	$4.83	(1)	$0.2
	February 12, 2013	5,650,000	$25.00		$136.6

Series B Preferred initial offering				
Common stock follow-on public offering	February 20, 2013	65,000,000	$6.75	$438.4

(1) Weighted average price

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December 31, 2012

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Follow-on public offering	January 13, 2012	10,350,000	$6.80		$70.1
Follow-on public offering	February 8, 2012	29,900,000	$6.80		$203.0
Equity distribution agreement	February 29, 2012	1,287,570	$7.06		$8.9
Follow-on public offering	March 14, 2012	35,650,000	$6.72		$239.2
Issuance of Series A Preferred Stock	June 7, 2012	1,400,000	$25.00		$33.8
Follow-on public offering	July 13, 2012	46,000,000	$7.06		$324.5
Follow-on public offering	August 8, 2012	63,250,000	$7.30		$461.4
Common equity distribution agreements	January 18, 2012 to September 11, 2012	19,750,000	$7.14	(1)	$138.2
Preferred equity distribution agreements	July 16, 2012 to December 27, 2012	605,611	$25.54	(1)	$15.0
Dividend Reinvestment and Stock Purchase Plan	January 25, 2012 to December 28, 2012	7,286,404	$7.28	(1)	$52.9

(1) Weighted average price

December 31, 2011

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Proceeds (in millions)
Follow-on public offering	January 26, 2011	6,900,000	$7.55		$49.0
Follow-on public offering	February 8, 2011	8,912,500	$7.60		$64.0
Equity distribution agreement	February 18, 2011 to September 30, 2011	5,212,430	$7.39	(1)	$37.5
Follow-on public offering	April 13, 2011	17,000,000	$7.40		$121.1
Follow-on public offering	June 6, 2011	18,400,000	$7.40		$131.0
Follow-on public offering	December 13, 2011	9,200,000	$6.80		$62.4
Dividend Reinvestment and Stock Purchase Plan	April 25, 2011 to December 29, 2011	13,352,181	$7.25	(1)	$96.8

(1) Weighted average price

Common Stock Repurchases

The following tables present our common stock repurchases for the year ended December 31, 2013. We did not have any common stock repurchases in the years ended December 31, 2012 and 2011.

Transaction Type	Completion Date	Number of Shares	Per Share price		Net Cost (in millions)
Repurchased common shares	May 15, 2013 to May 17, 2013	3,395,603	$5.94	(1)	$20.3
Repurchased common shares	December 11, 2013 to December 31, 2013	13,375,400	$3.89	(1)	$52.4

(1) Weighted average price

As of December 31, 2013, there was $27.3 million left under our Repurchase Program.

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Note 12 – Income (Loss) per Common Share

The following table presents a reconciliation of the net income (loss) and the shares used in calculating basic and diluted earnings per share for the years ended December 31, 2013, 2012 and 2011.

	For the Years Ended		
	December 31, 2013	December 31, 2012	December 31, 2011
	(in thousands)		
Net Income (Loss)	$(187,044)	$222,306	$(9,442)
Less: Preferred dividends	(14,213)	(1,964)	—
Net Income (Loss) available (related) to common stockholders	$(201,257)	$220,342	$(9,442)
Weighted average common shares outstanding - basic	362,830	223,627	61,421
Add: Effect of dilutive non-vested restricted stock unit awards, assumed vested	—	636	—
Weighted average common shares outstanding - diluted	362,830	224,263	61,421

We had 32,500,000 warrants outstanding and considered anti-dilutive as their exercise price exceeded the average stock price for the year ended December 31, 2013 until their expiration on November 7, 2013 and for the years ended December 31, 2012 and 2011.

Note 13 – Income Taxes

We have elected to be taxed as a REIT under the Code. We will generally not be subject to federal income tax to the extent that we distribute our taxable income to our stockholders and as long as we satisfy the ongoing REIT requirements under the Code including meeting certain asset, income and stock ownership tests.

The following table reconciles our GAAP net income to estimated REIT taxable income for the years presented.

	For the Years Ended		
	December 31, 2013	December 31, 2012	December 31, 2011
	(in thousands)		
GAAP net income (loss)	$(187,044)	$222,306	$(9,442)
Book to tax differences:			
Unrealized (gain) loss on derivatives	(544,643)	58,774	97,087
Other than temporary impairment of Agency Securities	401,541	—	—
Net capital losses	579,322	—	—
Amortization of deferred hedging costs	(2,030)	—	—
Realized loss on interest rate contracts	(6,716)	—	—
Other	18	94	76
Estimated taxable income	$240,448	$281,174	$87,721

The aggregate tax basis of our assets and liabilities is greater than our total Stockholders' Equity at December 31, 2013 by approximately $146.2 million, or approximately $0.41 per common share (based on the 357,613,485 common shares then outstanding).

We are required and intend to timely distribute substantially all of our REIT taxable income in order to maintain our REIT status under the Code. Total dividend payments to stockholders were $306.8 million, $271.5 million and $87.3 million for the years ended December 31, 2013, 2012 and 2011, respectively. Our estimated REIT taxable income available to pay dividends was $240.4 million, $281.2 million and $87.7 million for the years ended December 31, 2013, 2012 and 2011, respectively. We carried forward from the year ended December 31, 2012, undistributed REIT taxable income of $10.4 million. Our REIT taxable income and dividend requirements are determined on an annual basis. Dividends in excess of REIT taxable income for the year (including taxable income carried forward from the previous year) will generally not be taxable to common stockholders.

Net capital losses realized in 2013 will be available to offset future capital gains realized through 2018.

We have elected to treat Enterprise as a taxable REIT subsidiary, which is a tax paying entity for income tax purposes and it is taxed separately from ARMOUR. Because Enterprise is inactive, its taxes are nominal.On December 27, 2013, Enterprise filed a Certificate of Dissolution with the Secretary of State of the State of Delaware to effectuate the dissolution of Enterprise. At the time of filing, Enterprise had no operations and its assets were nominal.

Our management is responsible for determining whether tax positions taken by us are more likely than not to be sustained on their merits. We have no material unrecognized tax benefits or material uncertain tax positions.

Note 14 - Related Party Transactions

We are externally managed by ARRM pursuant to the Management Agreement. All of our executive officers are also employees of ARRM. ARRM manages our day-to-day operations, subject to the direction and oversight of the Board. The Management Agreement expires on June 18, 2022 and is thereafter automatically renewed for an additional term of 5 years unless terminated under certain circumstances. Either party must provide 180 days prior written notice of any such termination.

Under the terms of the Management Agreement, ARRM is responsible for costs incident to the performance of its duties, such as compensation of its employees and various overhead expenses. ARRM is responsible for the following primary roles:

- Advising us with respect to, arranging for and managing the acquisition, financing, management and disposition of, elements of our investment portfolio;
- Evaluating the duration risk and prepayment risk within the investment portfolio and arranging borrowing and hedging strategies;
- Coordinating capital raising activities;
- Advising us on the formulation and implementation of operating strategies and policies, arranging for the acquisition of assets, monitoring the performance of those assets and providing administrative and managerial services in connection with our day-to-day operations; and
- Providing executive and administrative personnel, office space and other appropriate services required in rendering management services to us.

In accordance with the Management Agreement, we incurred $28.1 million, $19.5 million and $6.9 million respectively in management fees for the years ended December 31, 2013, 2012 and 2011.

We are required to take actions as may be reasonably required to permit and enable ARRM to carry out its duties and obligations. We are also responsible for any costs and expenses that ARRM incurred solely on behalf of ARMOUR or its subsidiary other than the various overhead expenses specified in the terms of the Management Agreement. For the year ended December 31, 2013, we reimbursed ARRM $1.5 million for other expenses incurred on our behalf. We also reimbursed $1.1 million of compensation expense during the year ended December 31, 2013, related to Restricted

Shares for ARRM employees (see Note 10, “Stock Based Compensation” for additional discussion). For the year ended December 31, 2012 we reimbursed ARRM $0.05 million for other expenses incurred on our behalf. For the year ended December 31, 2011, we did not reimburse ARRM for any expenses.

See Note 9, "Commitments and Contingencies" for discussion of the Sub-Management Agreement.

Note 15 - Interest Rate Risk

Our primary market risk is interest rate risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned and the interest expense incurred in connection with the liabilities, by affecting the spread between the interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of Agency Securities and our ability to realize gains from the sale of these assets. A decline in the value of the Agency Securities pledged as collateral for borrowings under repurchase agreements could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels.

Note 16 – Subsequent Events

On January 27, 2014, cash dividends of $0.17 per outstanding share of Series A Preferred Stock, or $0.4 million in the aggregate, and $0.16 per outstanding share of Series B Preferred Stock, or $0.9 million in the aggregate,was paid to holders of record on January 15, 2014.

On January 30, 2014, a cash dividend of $0.05 per outstanding common share, or $17.9 million in the aggregate, was paid to holders of record on January 15, 2014.

Through February 25, 2014, we have sold $5.5 billion of our 25-year fixed rate and 30-year fixed rate Agency Securities, leaving $1.3 billion of 30-year fixed rate Agency Securities to be sold. We recovered approximately $69.4 million of other than temporary impairment loss recognized at December 31, 2013. For tax purposes, the sales generated capital losses of approximately $447.1 million, which will be available to offset future capital gains through 2019. Through February 25, 2014, we have purchased $3.7 billion of 15-year fixed-rate Agency Securities. These sales and purchases are intended to reduce the interest rate risk of our Agency Securities portfolio.

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Note 17- Quarterly Financial Data (unaudited)

The following tables are a comparative breakdown of our unaudited quarterly financial results for the immediately preceding eight quarters.

	Quarters Ended			
	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	(in thousands, except per share amounts)			
Interest income, net of premium amortization	$130,637	$141,159	$112,418	$121,229
Interest expense	(25,475)	(23,595)	(17,899)	(16,249)
Net interest income	$105,162	$117,564	$94,519	$104,980
Realized gain (loss) on sale of Agency Securities (reclassified from Other comprehensive income (loss))	18,514	20,876	(300,960)	(331,929)
Other than temporary impairment of Agency Securities	—	—	—	(401,541)
Gain on short sale of U.S. Treasury Securities	—	(21,078)	35,255	—
Realized loss on derivatives (1)	(29,053)	(38,858)	(37,262)	(30,735)
Unrealized gain (loss) on derivatives	16,301	412,183	(11,821)	127,980
Expenses	(8,634)	(9,302)	(9,684)	(9,531)
Income tax benefit (expense)	—	—	10	—
Net income (loss)	$102,290	$481,385	$(229,943)	$(540,776)
Dividends declared on preferred stock	(2,497)	(3,905)	(3,905)	(3,906)
Net income (loss) available (related) to common stockholders	$99,793	$477,480	$(233,848)	$(544,682)
Net income (loss) available (related) per share to common stockholders – Basic	0.30	1.28	(0.63)	(1.47)
Net income (loss) available (related) per share to common stockholders – Diluted	0.29	1.28	(0.63)	(1.47)
Dividends declared per common share	0.24	0.21	0.21	0.15
Weighted average common shares outstanding – Basic	337,935	372,591	370,818	369,543
Weighted average common shares outstanding – Diluted	339,722	374,135	372,256	369,543

(1) Interest expense related to our interest rate swap contracts is recorded in realized loss on derivatives on the consolidated statements of operations.

	Quarters Ended			
	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(in thousands, except per share amounts)			
Interest income, net of premium amortization	$62,763	$86,204	$116,693	$123,334
Interest expense	(6,929)	(11,106)	(19,222)	(23,938)
Net interest income	55,834	75,098	97,471	99,396
Realized gain (loss) on sale of Agency Securities (reclassified from Other comprehensive income (loss))	6,316	(1,268)	15,062	20,517

Other income	—	1,043	—	—
Realized loss on derivatives (1)	(9,741)	(12,400)	(18,914)	(21,984)
Unrealized gain (loss) on derivatives	17,614	(70,394)	(31,486)	25,492
Expenses	(4,831)	(5,683)	(7,188)	(7,672)
Income tax benefit (expense)	32	(3)	(3)	(2)
Net income (loss)	$65,224	$(13,607)	$54,942	$115,747
Dividends declared on preferred stock	—	(160)	(804)	(1,000)
Net income (loss) available (related) to common stockholders	$65,224	$(13,767)	$54,138	$114,747
Net income (loss) available (related) per share to common stockholders – Basic	0.48	(0.08)	0.20	0.37
Net income (loss) available (related) per share to common stockholders – Diluted	0.48	(0.08)	0.20	0.37
Dividends declared per common share	0.33	0.30	0.30	0.27
Weighted average common share outstanding – Basic	134,903	180,773	269,325	309,005
Weighted average common share outstanding – Diluted	134,903	180,773	270,010	309,648

(1) Interest expense related to our interest rate swap contracts is recorded in realized loss on derivatives on the consolidated statements of operations.

SIGNATURES

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

Date: February 26, 2014

ARMOUR RESIDENTIAL REIT, INC.

/s/ James R. Mountain
James R. Mountain
Chief Financial Officer, Duly Authorized Officer and
Principal Financial and Accounting Officer

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

Signature	Title	Date
/s/ Scott J. Ulm Scott J. Ulm	Co-Chief Executive Officer, Chief Investment Officer, Head of Risk Management and Co-Vice Chairman (Principal Executive Officer)	February 26, 2014
/s/ Jeffrey J. Zimmer Jeffrey J. Zimmer	Co-Chief Executive Officer, President, Co-Vice Chairman and Secretary	February 26, 2014
/s/ James R. Mountain James R. Mountain	Chief Financial Officer (Principal Financial and Accounting Officer)	February 26, 2014
/s/ Daniel C. Staton Daniel C. Staton	Chairman	February 25, 2014
/s/ Marc H. Bell Marc H. Bell	Director	February 25, 2014
/s/ Thomas K. Guba Thomas K. Guba	Director	February 26, 2014
/s/ Stewart J. Paperin Stewart J. Paperin	Director	February 25, 2014
/s/ John P. Hollihan, III John P. Hollihan, III	Director	February 25, 2014
/s/ Robert C. Hain Robert C. Hain	Director	February 25, 2014
/s/ Carolyn Downey Carolyn Downey	Director	February 25, 2014