

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

ANNALY CAPITAL MANAGEMENT INC  
Form 10-K  
February 26, 2009

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2008

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.

(Exact Name of Registrant as Specified in its Charter)

MARYLAND  
(State or other jurisdiction of  
incorporation of organization)

22-3479661  
(I.R.S. Employer  
Identification Number)

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

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

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

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

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

None.

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

--

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

--

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

1

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

Yes X No  
-- --

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

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

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

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

-- --

At June 30, 2008, the aggregate market value of the voting stock held by non-affiliates of the Registrant was \$8,306,036,131.

The number of shares of the Registrant's Common Stock outstanding on February 25, 2009 was 544,290,086.

Documents Incorporated by Reference

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2008. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

2

ANNALY CAPITAL MANAGEMENT, INC.  
2008 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS

PART I

# Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- ITEM 1. BUSINESS
- ITEM 1A. RISK FACTORS
- ITEM 1B. UNRESOLVED STAFF COMMENTS
- ITEM 2. PROPERTIES
- ITEM 3. LEGAL PROCEEDINGS
- ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

## PART II

- ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES
- ITEM 6. SELECTED FINANCIAL DATA
- ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
- ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
- ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
- ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE
- ITEM 9A. CONTROLS AND PROCEDURES
- ITEM 9B. OTHER INFORMATION

## PART III

- ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE
- ITEM 11. EXECUTIVE COMPENSATION
- ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS
- ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE
- ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

## PART IV

- ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES
- EXHIBIT INDEX
- FINANCIAL STATEMENTS
- SIGNATURES

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

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

- o changes in interest rates,
- o changes in the yield curve,
- o changes in prepayment rates,
- o the availability of mortgage-backed securities and other securities for purchase,
- o the availability of financing,
- o changes in the market value of our assets,
- o changes in business conditions and the general economy,
- o changes in government regulations affecting our business,
- o our ability to maintain our qualification as a REIT for federal income tax purposes,
- o risks associated with the investment advisory business of our wholly owned subsidiaries, including:
  - o the removal by clients of assets managed,
  - o their regulatory requirements, and
  - o competition in the investment advisory business and
- o risks associated with the broker-dealer business of our subsidiary.

For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, please see the information under the caption "Risk Factors" described in this Form 10-K. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

ii

### PART I

#### ITEM 1. BUSINESS

-----

# Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

## THE COMPANY

### Background

Annaly Capital Management, Inc. owns, manages, and finances a portfolio of investment securities, including mortgage pass-through certificates, collateralized mortgage obligations (or CMOs), agency callable debentures, and other securities representing interests in or obligations backed by pools of mortgage loans. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our investment securities and the cost of borrowings to finance our acquisition of investment securities. We are a Maryland corporation that commenced operations on February 18, 1997. We are self-advised and self-managed.

We acquired Fixed Income Discount Advisory Company (or FIDAC) on June 4, 2004 and Merganser Capital Management, Inc. (or Merganser) on October 31, 2008. Both are registered investment advisors and are taxable REIT subsidiaries. FIDAC and Merganser manage a number of investment vehicles and separate accounts for which they earn fee income. Our subsidiary, RCap Securities Inc. (or RCap), which will operate as a broker-dealer, was granted membership in the Financial Industry Regulatory Authority (or FINRA) in January 2009. RCap is a taxable REIT subsidiary.

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

As used herein, "Annaly," the "Company," "we," "our" and similar terms refer to Annaly Capital Management, Inc., unless the context indicates otherwise.

### Assets

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

The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation ("S&P") or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including but without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

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

1

To date, all of the mortgage-backed securities that we have acquired have been agency mortgage-backed securities which, although not rated, carry an implied "AAA" rating. Agency mortgage-backed securities are mortgage-backed securities for which a government agency or federally chartered corporation, such as the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac"), the Federal National Mortgage Association ("FNMA" or "Fannie Mae"), or the Government National Mortgage Association ("GNMA" or "Ginnie Mae"), guarantees payments of principal or interest on the securities. Agency mortgage-backed securities consist of agency pass-through certificates and CMOs issued or guaranteed by an agency. Pass-through certificates provide for a pass-through of the monthly interest and principal payments made by the borrowers on the underlying mortgage loans. CMOs divide a pool of mortgage loans into multiple tranches with different principal and interest payment characteristics.

At December 31, 2008, approximately 28% of our investment securities were adjustable-rate pass-through certificates, approximately 64% of our investment securities were fixed-rate pass-through certificates or CMOs, and approximately 8% of our investment securities were CMO floaters. Our adjustable-rate pass-through certificates are backed by adjustable-rate mortgage loans and have coupon rates which adjust over time, subject to interest rate caps and lag periods, in conjunction with changes in short-term interest rates. Our fixed-rate pass-through certificates are backed by fixed-rate mortgage loans and have coupon rates which do not adjust over time. CMO floaters are tranches of mortgage-backed securities where the interest rate adjusts in conjunction with changes in short-term interest rates. CMO floaters may be backed by fixed-rate mortgage loans or, less often, by adjustable-rate mortgage loans. In this Form 10-K, except where the context indicates otherwise, we use the term "adjustable-rate securities" or "adjustable-rate investment securities" to refer to adjustable-rate pass-through certificates, CMO floaters, and Agency debentures. At December 31, 2008, the weighted average yield on our portfolio of earning assets was 5.03% and the weighted average term to next rate adjustment on adjustable rate securities was 36 months.

We may also invest in Federal Home Loan Bank ("FHLB"), FHLMC, and FNMA debentures. We refer to the mortgage-backed securities and agency debentures collectively as "Investment Securities." We intend to continue to invest in adjustable-rate pass-through certificates, fixed-rate mortgage-backed securities, CMO floaters, and Agency debentures. We may also invest on a limited basis in mortgage derivative securities such as interest rate swaps, and other derivative securities which include securities representing the right to receive interest only or a disproportionately large amount of interest as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics. We have not and will not invest in real estate mortgage investment conduit ("REMIC") residuals and other CMO residuals.

Borrowings

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

We attempt to structure our borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, correspond generally to the interest rate adjustment indices and periods of our adjustable-rate investment securities. However, periodic rate adjustments on our borrowings are generally more frequent than rate adjustments on our investment securities. At December 31, 2008, the weighted average cost of funds for all of our borrowings was 4.08%, with the effect of swaps, the weighted average original term to maturity was 287 days, and the weighted average term to next rate adjustment of these borrowings was 238 days.

We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from time to time depending upon market conditions and other factors that our management deems relevant. For purposes of calculating this ratio, our equity is equal to the value of our investment portfolio on a mark-to-market basis, less the book value of our obligations under repurchase agreements and other collateralized borrowings. At December 31, 2008, our ratio of debt-to-equity was 6.4:1.

### Hedging

To the extent consistent with our election to qualify as a REIT, we enter into hedging transactions to attempt to protect our investment securities and related borrowings against the effects of major interest rate changes. This hedging would be used to mitigate declines in the market value of our investment securities during periods of increasing or decreasing interest rates and to limit or cap the interest rates on our borrowings. These transactions would be entered into solely for the purpose of hedging interest rate or prepayment risk and not for speculative purposes. In connection with our interest rate risk management strategy, we hedge a portion of our interest rate risk by entering into derivative financial instrument contracts. As of December 31, 2008, we had \$17.6 billion in interest rate swaps, which in effect modify the cash flows on repurchase agreements.

2

### Compliance with REIT and Investment Company Requirements

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

### Executive Officers of the Company

The following table sets forth certain information as of February 25, 2009 concerning our executive officers:

Name ----	Age ---	Position held with the Compa -----
Michael A.J. Farrell	57	Chairman of the Board, Chief Executive Officer
Wellington J. Denahan-Norris	45	Vice Chairman of the Board, Chief Investment Operating Officer
Kathryn F. Fagan	42	Chief Financial Officer and Treasurer

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

R. Nicholas Singh	49	Executive Vice President, General Counsel, Se Compliance Officer
James P. Fortescue	35	Managing Director and Head of Liabilities
Kristopher Konrad	34	Managing Director and Co-Head Portfolio Mana
Rose-Marie Lyght	35	Managing Director and Co-Head Portfolio Mana
Jeremy Diamond	45	Managing Director
Ronald Kazel	41	Managing Director

Mr. Farrell and Ms. Denahan-Norris have an average of 25 years experience in the investment banking and investment management industries where, in various capacities, they have each managed portfolios of mortgage-backed securities, arranged collateralized borrowings and utilized hedging techniques to mitigate interest rate and other risk within fixed-income portfolios. Ms. Fagan is a certified public accountant and, prior to becoming our Chief Financial Officer and Treasurer, served as Chief Financial Officer and Controller of a publicly owned savings and loan association. Mr. Singh joined Annaly in February 2005. Prior to that, he was a partner in the law firm of McKee Nelson LLP. Mr. Fortescue joined Annaly in 1997. Mr. Konrad joined Annaly in 1997. Ms. Lyght joined Annaly in April 1999. Mr. Diamond joined Annaly in March 2002. Mr. Kazel joined Annaly in December 2001. We and our subsidiaries had 65 full-time employees at December 31, 2008.

### Distributions

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

3

## BUSINESS STRATEGY

### General

Our principal business objective is to generate income for distribution to our stockholders, primarily from the net cash flows on our investment securities. Our net cash flows result primarily from the difference between the interest income on our investment securities and borrowing costs of our repurchase agreements and from dividends we receive from our taxable REIT subsidiaries. To achieve our business objective and generate dividend yields, our strategy is:

- |X| to purchase mortgage-backed securities, the majority of which we expect to have adjustable interest rates based on changes in short-term market interest rates;
- |X| to acquire mortgage-backed securities that we believe:
  - we have the necessary expertise to evaluate and manage;
  - we can readily finance;



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- are consistent with our balance sheet guidelines and risk management objectives; and
  - provide attractive investment returns in a range of scenarios;
- [X] to finance purchases of mortgage-backed securities with the proceeds of equity offerings and, to the extent permitted by our capital investment policy, to utilize leverage to increase potential returns to stockholders through borrowings;
- [X] to attempt to structure our borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-backed securities;
- [X] to seek to minimize prepayment risk by structuring a diversified portfolio with a variety of prepayment characteristics and through other means; and
- [X] to issue new equity or debt and increase the size of our balance sheet when opportunities in the market for mortgage-backed securities are likely to allow growth in earnings per share.

We believe we are able to obtain cost efficiencies through our facilities-sharing arrangement with FIDAC and RCap and by virtue of our management's experience in managing portfolios of mortgage-backed securities and arranging collateralized borrowings. We will strive to become even more cost-efficient over time by:

- [X] seeking to raise additional capital from time to time in order to increase our ability to invest in mortgage-backed securities;
- [X] striving to lower our effective borrowing costs by seeking direct funding with collateralized lenders, rather than using financial intermediaries, and investigating the possibility of using commercial paper and medium term note programs;
- [X] improving the efficiency of our balance sheet structure by investigating the issuance of uncollateralized subordinated debt, preferred stock and other forms of capital; and
- [X] utilizing information technology in our business, including improving our ability to monitor the performance of our investment securities and to lower our operating costs.

4

### Mortgage-Backed Securities

#### General

To date, all of the mortgage-backed securities that we have acquired have been agency mortgage-backed securities which, although not rated, carry an implied "AAA" rating. Agency mortgage-backed securities are mortgage-backed securities where a government agency or federally chartered corporation, such as FHLMC, FNMA or GNMA, guarantees payments of principal or interest on the securities. Agency mortgage-backed securities consist of agency pass-through certificates and CMOs issued or guaranteed by an agency.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Even though to date we have only acquired mortgage backed securities with an implied "AAA" rating, under our capital investment policy, we have the ability to acquire securities of lower quality. Under our policy, at least 75% of our total assets must be high quality mortgage-backed securities and short-term investments. High quality securities are securities (1) that are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) that are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) that are unrated or whose ratings have not been updated but that our management determines are of comparable quality to rated high quality mortgage-backed securities.

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

Our allocation of investments among the permitted investment types may vary from time-to-time based on the evaluation by our board of directors of economic and market trends and our perception of the relative values available from these types of investments, except that in no event will our investments that are not high quality exceed 25% of our total assets.

We intend to acquire only those mortgage-backed securities that we believe we have the necessary expertise to evaluate and manage, that are consistent with our balance sheet guidelines and risk management objectives and that we believe we can readily finance. Since we generally hold the mortgage-backed securities we acquire until maturity, we generally do not seek to acquire assets whose investment returns are attractive in only a limited range of scenarios. We believe that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, we seek to acquire mortgage-backed securities which we believe will provide acceptable returns over a broad range of interest rate and prepayment scenarios.

At December 31, 2008, our mortgage-backed securities consisted of pass-through certificates and collateralized mortgage obligations issued or guaranteed by FHLMC, FNMA or GNMA. We have not, and will not, invest in REMIC residuals and other CMO residuals.

### Recent Developments

Recently, the government passed the Housing and Economic Recovery Act of 2008. Fannie Mae and Freddie Mac have recently been placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. 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

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

operate Fannie Mae and Freddie Mac with all the powers of the shareholders, 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.

5

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Department of Treasury and FHFA have entered into preferred stock purchase agreements between the U.S. Department of Treasury and Fannie Mae and Freddie Mac pursuant to which the U.S. Department of Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Department of Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the U.S. Department of Treasury has initiated a temporary program to purchase RMBS issued by Fannie Mae and Freddie Mac.

### Description of Mortgage-Backed Securities

The mortgage-backed securities that we acquire provide funds for mortgage loans made primarily to residential homeowners. Our securities generally represent interests in pools of mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and other mortgage lenders. These pools of mortgage loans are assembled for sale to investors (like us) by various government, government-related and private organizations.

Mortgage-backed securities differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, mortgage-backed securities provide for a monthly payment, which consists of both interest and principal. In effect, these payments are a "pass-through" of the monthly interest and principal payments made by the individual borrower on the mortgage loans, net of any fees paid to the issuer or guarantor of the securities. Additional payments result from prepayments of principal upon the sale, refinancing or foreclosure of the underlying residential property, net of fees or costs which may be incurred. Some mortgage-backed securities, such as securities issued by GNMA, are described as "modified pass-through." These securities entitle the holder to receive all interest and principal payments owed on the mortgage pool, net of certain fees, regardless of whether the mortgagors actually make mortgage payments when due.

The investment characteristics of pass-through mortgage-backed securities differ from those of traditional fixed-income securities. The major differences include the payment of interest and principal on the mortgage-backed securities on a more frequent schedule, as described above, and the possibility that principal may be prepaid at any time due to prepayments on the underlying mortgage loans or other assets. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities.

Various factors affect the rate at which mortgage prepayments occur, including changes in interest rates, general economic conditions, the age of the mortgage loan, the location of the property and other social and demographic conditions. Generally prepayments on mortgage-backed securities increase during periods of falling mortgage interest rates and decrease during periods of rising

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

mortgage interest rates. We may reinvest prepayments at a yield that is higher or lower than the yield on the prepaid investment, thus affecting the weighted average yield of our investments.

To the extent mortgage-backed securities are purchased at a premium, faster than expected prepayments result in a faster than expected amortization of the premium paid. Conversely, if these securities were purchased at a discount, faster than expected prepayments accelerate our recognition of income.

CMOs may allow for shifting of prepayment risk from slower-paying tranches to faster-paying tranches. This is in contrast to mortgage pass-through certificates where all investors share equally in all payments, including all prepayments, on the underlying mortgages.

6

### FHLMC Certificates

FHLMC is a privately-owned government-sponsored enterprise created pursuant to an Act of Congress on July 24, 1970. The principal activity of FHLMC currently consists of the purchase of mortgage loans or participation interests in mortgage loans and the resale of the loans and participations in the form of guaranteed mortgage-backed securities. FHLMC guarantees to each holder of FHLMC certificates the timely payment of interest at the applicable pass-through rate and ultimate collection of all principal on the holder's pro rata share of the unpaid principal balance of the related mortgage loans, but does not guarantee the timely payment of scheduled principal of the underlying mortgage loans. The obligations of FHLMC under its guarantees are solely those of FHLMC and are not backed by the full faith and credit of the United States. If FHLMC were unable to satisfy these obligations, distributions to holders of FHLMC certificates would consist solely of payments and other recoveries on the underlying mortgage loans and, accordingly, defaults and delinquencies on the underlying mortgage loans would adversely affect monthly distributions to holders of FHLMC certificates.

FHLMC certificates may be backed by pools of single-family mortgage loans or multi-family mortgage loans. These underlying mortgage loans may have original terms to maturity of up to 40 years. FHLMC certificates may be issued under cash programs (composed of mortgage loans purchased from a number of sellers) or guarantor programs (composed of mortgage loans acquired from one seller in exchange for certificates representing interests in the mortgage loans purchased).

FHLMC certificates may pay interest at a fixed rate or an adjustable rate. The interest rate paid on adjustable-rate FHLMC certificates ("FHLMC ARMs") adjusts periodically within 60 days prior to the month in which the interest rates on the underlying mortgage loans adjust. The interest rates paid on certificates issued under FHLMC's standard ARM programs adjust in relation to the Treasury index. Other specified indices used in FHLMC ARM programs include the 11th District Cost of Funds Index published by the Federal Home Loan Bank of San Francisco, LIBOR and other indices. Interest rates paid on fully-indexed FHLMC ARM certificates equal the applicable index rate plus a specified number of basis points. The majority of series of FHLMC ARM certificates issued to date have evidenced pools of mortgage loans with monthly, semi-annual or annual interest adjustments. Adjustments in the interest rates paid are generally limited to an annual increase or decrease of either 100 or 200 basis points and to a lifetime cap of 500 or 600 basis points over the initial interest rate. Certain FHLMC programs include mortgage loans which allow the borrower to convert the adjustable mortgage interest rate to a fixed rate. Adjustable-rate mortgages which are converted into fixed-rate mortgage loans are repurchased by FHLMC or by the seller of the loan to FHLMC at the unpaid principal balance of

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

the loan plus accrued interest to the due date of the last adjustable rate interest payment.

### FNMA Certificates

FNMA is a privately-owned, federally-chartered corporation organized and existing under the Federal National Mortgage Association Charter Act. FNMA provides funds to the mortgage market primarily by purchasing home mortgage loans from local lenders, thereby replenishing their funds for additional lending. FNMA guarantees to the registered holder of a FNMA certificate that it will distribute amounts representing scheduled principal and interest on the mortgage loans in the pool underlying the FNMA certificate, whether or not received, and the full principal amount of any such mortgage loan foreclosed or otherwise finally liquidated, whether or not the principal amount is actually received. The obligations of FNMA under its guarantees are solely those of FNMA and are not backed by the full faith and credit of the United States. If FNMA were unable to satisfy its obligations, distributions to holders of FNMA certificates would consist solely of payments and other recoveries on the underlying mortgage loans and, accordingly, defaults and delinquencies on the underlying mortgage loans would adversely affect monthly distributions to holders of FNMA.

FNMA certificates may be backed by pools of single-family or multi-family mortgage loans. The original term to maturity of any such mortgage loan generally does not exceed 40 years. FNMA certificates may pay interest at a fixed rate or an adjustable rate. Each series of FNMA ARM certificates bears an initial interest rate and margin tied to an index based on all loans in the related pool, less a fixed percentage representing servicing compensation and FNMA's guarantee fee. The specified index used in different series has included the Treasury Index, the 11th District Cost of Funds Index published by the Federal Home Loan Bank of San Francisco, LIBOR and other indices. Interest rates paid on fully-indexed FNMA ARM certificates equal the applicable index rate plus a specified number of basis points. The majority of series of FNMA ARM certificates issued to date have evidenced pools of mortgage loans with monthly, semi-annual or annual interest rate adjustments. Adjustments in the interest rates paid are generally limited to an annual increase or decrease of either 100 or 200 basis points and to a lifetime cap of 500 or 600 basis points over the initial interest rate. Certain FNMA programs include mortgage loans which allow the borrower to convert the adjustable mortgage interest rate of the ARM to a fixed rate. Adjustable-rate mortgages which are converted into fixed-rate mortgage loans are repurchased by FNMA or by the seller of the loans to FNMA at the unpaid principal of the loan plus accrued interest to the due date of the last adjustable rate interest payment. Adjustments to the interest rates on FNMA ARM certificates are typically subject to lifetime caps and periodic rate or payment caps.

7

### GNMA Certificates

GNMA is a wholly owned corporate instrumentality of the United States within the Department of Housing and Urban Development ("HUD"). The National Housing Act of 1934 authorizes GNMA to guarantee the timely payment of the principal of and interest on certificates which represent an interest in a pool of mortgages insured by the Federal Housing Administration ("FHA") or partially guaranteed by the Department of Veterans Affairs and other loans eligible for inclusion in mortgage pools underlying GNMA certificates. Section 306(g) of the Housing Act provides that the full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty by GNMA.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

At present, most GNMA certificates are backed by single-family mortgage loans. The interest rate paid on GNMA certificates may be a fixed rate or an adjustable rate. The interest rate on GNMA certificates issued under GNMA's standard ARM program adjusts annually in relation to the Treasury index. Adjustments in the interest rate are generally limited to an annual increase or decrease of 100 basis points and to a lifetime cap of 500 basis points over the initial coupon rate.

### Single-Family and Multi-Family Privately-Issued Certificates

Single-family and multi-family privately-issued certificates are pass-through certificates that are not issued by one of the agencies and that are backed by a pool of conventional single-family or multi-family mortgage loans. These certificates are issued by originators of, investors in, and other owners of mortgage loans, including savings and loan associations, savings banks, commercial banks, mortgage banks, investment banks and special purpose "conduit" subsidiaries of these institutions.

While agency pass-through certificates are backed by the express obligation or guarantee of one of the agencies, as described above, privately-issued certificates are generally covered by one or more forms of private (i.e., non-governmental) credit enhancements. These credit enhancements provide an extra layer of loss coverage in the event that losses are incurred upon foreclosure sales or other liquidations of underlying mortgaged properties in amounts that exceed the equity holder's equity interest in the property. Forms of credit enhancements include limited issuer guarantees, reserve funds, private mortgage guaranty pool insurance, over-collateralization and subordination.

Subordination is a form of credit enhancement frequently used and involves the issuance of classes of senior and subordinated mortgage-backed securities. These classes are structured into a hierarchy to allocate losses on the underlying mortgage loans and also for defining priority of rights to payment of principal and interest. Typically, one or more classes of senior securities are created which are rated in one of the two highest rating levels by one or more nationally recognized rating agencies and which are supported by one or more classes of mezzanine securities and subordinated securities that bear losses on the underlying loans prior to the classes of senior securities. Mezzanine securities, as used in this Form 10-K, refers to classes that are rated below the two highest levels, but no lower than a single "B" rating under the S&P rating system (or comparable level under other rating systems) and are supported by one or more classes of subordinated securities which bear realized losses prior to the classes of mezzanine securities. Subordinated securities, as used in this Form 10-K, refers to any class that bears the "first loss" from losses from underlying mortgage loans or that is rated below a single "B" level (or, if unrated, we deem it to be below that level). In some cases, only classes of senior securities and subordinated securities are issued. By adjusting the priority of interest and principal payments on each class of a given series of senior-subordinated mortgage-backed securities, issuers are able to create classes of mortgage-backed securities with varying degrees of credit exposure, prepayment exposure and potential total return, tailored to meet the needs of sophisticated institutional investors.

8

### Collateralized Mortgage Obligations and Multi-Class Pass-Through Securities

We may also invest in CMOs and multi-class pass-through securities. CMOs are debt obligations issued by special purpose entities that are secured by mortgage loans or mortgage-backed certificates, including, in many cases,

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

certificates issued by government and government-related guarantors, including, GNMA, FNMA and FHLMC, together with certain funds and other collateral. Multi-class pass-through securities are equity interests in a trust composed of mortgage loans or other mortgage-backed securities. Payments of principal and interest on underlying collateral provide the funds to pay debt service on the CMO or make scheduled distributions on the multi-class pass-through securities. CMOs and multi-class pass-through securities may be issued by agencies or instrumentalities of the U.S. Government or by private organizations. The discussion of CMOs in the following paragraphs is similarly applicable to multi-class pass-through securities.

In a CMO, a series of bonds or certificates is issued in multiple classes. Each class of CMOs, often referred to as a "tranche," is issued at a specific coupon rate (which, as discussed below, may be an adjustable rate subject to a cap) and has a stated maturity or final distribution date. Principal prepayments on collateral underlying a CMO may cause it to be retired substantially earlier than the stated maturity or final distribution date. Interest is paid or accrues on all classes of a CMO on a monthly, quarterly or semi-annual basis. The principal and interest on underlying mortgages may be allocated among the several classes of a series of a CMO in many ways. In a common structure, payments of principal, including any principal prepayments, on the underlying mortgages are applied to the classes of the series of a CMO in the order of their respective stated maturities or final distribution dates, so that no payment of principal will be made on any class of a CMO until all other classes having an earlier stated maturity or final distribution date have been paid in full.

Other types of CMO issues include classes such as parallel pay CMOs, some of which, such as planned amortization class CMOs ("PAC bonds"), provide protection against prepayment uncertainty. Parallel pay CMOs are structured to provide payments of principal on certain payment dates to more than one class. These simultaneous payments are taken into account in calculating the stated maturity date or final distribution date of each class which, as with other CMO structures, must be retired by its stated maturity date or final distribution date but may be retired earlier. PAC bonds generally require payment of a specified amount of principal on each payment date so long as prepayment speeds on the underlying collateral fall within a specified range.

Other types of CMO issues include targeted amortization class CMOs (or TAC bonds), which are similar to PAC bonds. While PAC bonds maintain their amortization schedule within a specified range of prepayment speeds, TAC bonds are generally targeted to a narrow range of prepayment speeds or a specified prepayment speed. TAC bonds can provide protection against prepayment uncertainty since cash flows generated from higher prepayments of the underlying mortgage-related assets are applied to the various other pass-through tranches so as to allow the TAC bonds to maintain their amortization schedule.

A CMO may be subject to the issuer's right to redeem the CMO prior to its stated maturity date, which may diminish the anticipated return on our investment. Privately-issued CMOs are supported by private credit enhancements similar to those used for privately-issued certificates and are often issued as senior-subordinated mortgage-backed securities. We will only acquire CMOs or multi-class pass-through certificates that constitute debt obligations or beneficial ownership in grantor trusts holding mortgage loans, or regular interests in REMICs, or that otherwise constitute qualified REIT real estate assets under the Internal Revenue Code (provided that we have obtained a favorable opinion of our tax advisor or a ruling from the IRS to that effect).

### Adjustable-Rate Mortgage Pass-Through Certificates and Floating Rate Mortgage-Backed Securities

Some of the mortgage pass-through certificates we acquire are

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

adjustable-rate mortgage pass-through certificates. This means that their interest rates may vary over time based upon changes in an objective index, such as:

- o LIBOR or the London Interbank Offered Rate. The interest rate that banks in London offer for deposits in London of U.S. dollars.
- o Treasury Index. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

9

- o CD Rate. The weekly average of secondary market interest rates on six-month negotiable certificates of deposit, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. The underlying mortgages for adjustable-rate mortgage pass-through certificates are adjustable-rate mortgage loans ("ARMs").

We also acquire CMO floaters. One or more tranches of a CMO may have coupon rates that reset periodically at a specified increment over an index such as LIBOR. These adjustable-rate tranches are sometime known as CMO floaters and may be backed by fixed or adjustable-rate mortgages.

There are two main categories of indices for adjustable-rate mortgage pass-through certificates and floaters: (1) those based on U.S. Treasury securities, and (2) those derived from calculated measures such as a cost of funds index or a moving average of mortgage rates. Commonly utilized indices include the one-year Treasury note rate, the three-month Treasury bill rate, the six-month Treasury bill rate, rates on long-term Treasury securities, the 11th District Federal Home Loan Bank Costs of Funds Index, the National Median Cost of Funds Index, one-month or three-month LIBOR, the prime rate of a specific bank, or commercial paper rates. Some indices, such as the one-year Treasury rate, closely mirror changes in market interest rate levels. Others, such as the 11th District Home Loan Bank Cost of Funds Index, tend to lag changes in market interest rate levels. We seek to diversify our investments in adjustable-rate mortgage pass-through certificates and floaters among a variety of indices and reset periods so that we are not at any one time unduly exposed to the risk of interest rate fluctuations. In selecting adjustable-rate mortgage pass-through certificates and floaters for investment, we will also consider the liquidity of the market for the different mortgage-backed securities.

We believe that adjustable-rate mortgage pass-through certificates and floaters are particularly well-suited to our investment objective of high current income, consistent with modest volatility of net asset value, because the value of adjustable-rate mortgage pass-through certificates and floaters generally remains relatively stable as compared to traditional fixed-rate debt securities paying comparable rates of interest. While the value of adjustable-rate mortgage pass-through certificates and floaters, like other debt securities, generally varies inversely with changes in market interest rates (increasing in value during periods of declining interest rates and decreasing in value during periods of increasing interest rates), the value of adjustable-rate mortgage pass-through certificates and floaters should generally be more resistant to price swings than other debt securities because the interest rates on these securities move with market interest rates.

Accordingly, as interest rates change, the value of our shares should be more stable than the value of funds which invest primarily in securities backed by fixed-rate mortgages or in other non-mortgage-backed debt securities, which



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

do not provide for adjustment in the interest rates in response to changes in market interest rates.

Adjustable-rate mortgage pass-through certificates and floaters typically have caps, which limit the maximum amount by which the interest rate may be increased or decreased at periodic intervals or over the life of the security. To the extent that interest rates rise faster than the allowable caps on the adjustable-rate mortgage pass-through certificates and floaters, these securities will behave more like fixed-rate securities. Consequently, interest rate increases in excess of caps can be expected to cause these securities to behave more like traditional debt securities than adjustable-rate securities and, accordingly, to decline in value to a greater extent than would be the case in the absence of these caps.

Adjustable-rate mortgage pass-through certificates and floaters, like other mortgage-backed securities, differ from conventional bonds in that principal is to be paid back over the life of the security rather than at maturity. As a result, we receive monthly scheduled payments of principal and interest on these securities and may receive unscheduled principal payments representing prepayments on the underlying mortgages. When we reinvest the payments and any unscheduled prepayments we receive, we may receive a rate of interest on the reinvestment which is lower than the rate on the existing security. For this reason, adjustable-rate mortgage pass-through certificates and floaters are less effective than longer-term debt securities as a means of "locking in" longer-term interest rates. Accordingly, adjustable-rate mortgage pass-through certificates and floaters, while generally having less risk of price decline during periods of rapidly rising interest rates than fixed-rate mortgage-backed securities of comparable maturities, have less potential for capital appreciation than fixed-rate securities during periods of declining interest rates.

10

As in the case of fixed-rate mortgage-backed securities, to the extent these securities are purchased at a premium, faster than expected prepayments would accelerate our amortization of the premium. Conversely, if these securities were purchased at a discount, faster than expected prepayments would accelerate our recognition of income.

As in the case of fixed-rate CMOs, floating-rate CMOs may allow for shifting of prepayment risk from slower-paying tranches to faster-paying tranches. This is in contrast to mortgage pass-through certificates where all investors share equally in all payments, including all prepayments, on the underlying mortgages.

### Other Floating Rate Instruments

We may also invest in structured floating-rate notes issued or guaranteed by government agencies, such as FNMA and FHLMC. These instruments are typically structured to reflect an interest rate arbitrage (i.e., the difference between the agency's cost of funds and the income stream from specified assets of the agency) and their reset formulas may provide more attractive returns than other floating rate instruments. The indices used to determine resets are the same as those described above.

### Mortgage Loans

As of December 31, 2008, we have not invested directly in mortgage loans, but we may from time-to-time invest a small percentage of our assets directly in single-family, multi-family or commercial mortgage loans. We expect that the majority of these mortgage loans would be ARM pass-through

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

certificates. The interest rate on an ARM pass-through certificate is typically tied to an index (such as LIBOR or the interest rate on Treasury bills), and is adjustable periodically at specified intervals. These mortgage loans are typically subject to lifetime interest rate caps and periodic interest rate or payment caps. The acquisition of mortgage loans generally involves credit risk. We may obtain credit enhancement to mitigate this risk; however, there can be no assurances that we will be able to obtain credit enhancement or that credit enhancement would mitigate the credit risk of the underlying mortgage loans.

### Capital Investment Policy

#### Asset Acquisitions

Our capital investment policy provides that at least 75% of our total assets will be comprised of high quality mortgage-backed securities and short-term investments. The remainder of our assets (comprising not more than 25% of total assets), may consist of mortgage-backed securities and other qualified REIT real estate assets which are unrated or rated less than high quality but which are at least "investment grade" (rated "BBB" or better) or, if not rated, are determined by us to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

Our capital investment policy requires that we structure our portfolio to maintain a minimum weighted average rating (including our deemed comparable ratings for unrated mortgage-backed securities) of our mortgage-backed securities of at least single "A" under the S&P rating system and at the comparable level under the other rating systems. To date, all of the mortgage-backed securities we have acquired have been pass-through certificates or CMOs issued or guaranteed by FHLMC, FNMA or GNMA which, although not rated, have an implied "AAA" rating.

We intend to acquire only those mortgage-backed securities that we believe we have the necessary expertise to evaluate and manage, that we can readily finance and that are consistent with our balance sheet guidelines and risk management objectives. Since we expect to hold our mortgage-backed securities until maturity, we generally do not seek to acquire assets whose investment returns are only attractive in a limited range of scenarios. We believe that future interest rates and mortgage prepayment rates are very difficult to predict and, as a result, we seek to acquire mortgage-backed securities which we believe provide acceptable returns over a broad range of interest rate and prepayment scenarios.

11

Among the asset choices available to us, our policy is to acquire those mortgage-backed securities which we believe generate the highest returns on capital invested, after consideration of the following:

- |X| the amount and nature of anticipated cash flows from the asset;
- |X| our ability to pledge the asset to secure collateralized borrowings;
- |X| the increase in our capital requirement determined by our capital

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

investment policy resulting from the purchase and financing of the asset; and

the costs of financing, hedging and managing the asset.

Prior to acquisition, we assess potential returns on capital employed over the life of the asset and in a variety of interest rate, yield spread, financing cost, credit loss and prepayment scenarios.

We also give consideration to balance sheet management and risk diversification issues. We deem a specific asset which we are evaluating for potential acquisition as more or less valuable to the extent it serves to increase or decrease certain interest rate or prepayment risks which may exist in the balance sheet, to diversify or concentrate credit risk, and to meet the cash flow and liquidity objectives our management may establish for our balance sheet from time-to-time. Accordingly, an important part of the asset evaluation process is a simulation, using risk management models, of the addition of a potential asset and our associated borrowings and hedges to the balance sheet and an assessment of the impact this potential asset acquisition would have on the risks in and returns generated by our balance sheet as a whole over a variety of scenarios.

We focus primarily on the acquisition of adjustable-rate mortgage-backed securities, including floaters. We have, however, purchased a significant amount of fixed-rate mortgage-backed securities and may continue to do so in the future if, in our view, the potential returns on capital invested, after hedging and all other costs, would exceed the returns available from other assets or if the purchase of these assets would serve to reduce or diversify the risks of our balance sheet.

We may purchase the stock of mortgage REITs or similar companies when we believe that these purchases would yield attractive returns on capital employed. When the stock market valuations of these companies are low in relation to the market value of their assets, these stock purchases can be a way for us to acquire an interest in a pool of mortgage-backed securities at an attractive price. We do not, however, presently intend to invest in the securities of other issuers for the purpose of exercising control or to underwrite securities of other issuers.

We may acquire newly issued mortgage-backed securities, and also may seek to expand our capital base in order to further increase our ability to acquire new assets, when the potential returns from new investments appears attractive relative to the return expectations of stockholders. We may in the future acquire mortgage-backed securities by offering our debt or equity securities in exchange for the mortgage-backed securities.

We generally intend to hold mortgage-backed securities for extended periods. In addition, the REIT provisions of the Internal Revenue Code limit in certain respects our ability to sell mortgage-backed securities. We may decide however to sell assets from time to time, for a number of reasons, including our desire to dispose of an asset as to which credit risk concerns have arisen, to reduce interest rate risk, to substitute one type of mortgage-backed security for another, to improve yield or to maintain compliance with the 55% requirement under the Investment Company Act, or generally to re-structure the balance sheet when we deem advisable. Our board of directors has not adopted any policy that would restrict management's authority to determine the timing of sales or the selection of mortgage-backed securities to be sold.

We do not invest in REMIC residuals or other CMO residuals.

As a requirement for maintaining REIT status, we will distribute to stockholders aggregate dividends equaling at least 90% of our REIT taxable

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

income (determined without regard to the deduction for dividends paid and by excluding any net capital gain) for each taxable year. We will make additional distributions of capital when the return expectations of the stockholders appear to exceed returns potentially available to us through making new investments in mortgage-backed securities. Subject to the limitations of applicable securities and state corporation laws, we can distribute capital by making purchases of our own capital stock or through paying down or repurchasing any outstanding uncollateralized debt obligations.

12

Our asset acquisition strategy may change over time as market conditions change and as we evolve.

### Credit Risk Management

We have not taken on credit risk to date, but may do so in the future. In that event, we will review credit risk and other risk of loss associated with each investment and determine the appropriate allocation of capital to apply to the investment under our capital investment policy. Our management will monitor the overall portfolio risk and determine appropriate levels of provision for loss.

### Capital and Leverage

We expect generally to maintain a debt-to-equity ratio of between 8:1 and 12:1, although the ratio may vary from time-to-time depending upon market conditions and other factors our management deems relevant, including the composition of our balance sheet, haircut levels required by lenders, the market value of the mortgage-backed securities in our portfolio and "excess capital cushion" percentages (as described below) set by our board of directors from time to time. For purposes of calculating this ratio, our equity (or capital base) is equal to the value of our investment portfolio on a mark-to-market basis less the book value of our obligations under repurchase agreements and other collateralized borrowings. For the calculation of this ratio, equity includes the Series B Cumulative Convertible Preferred Stock, which is not included in equity under Generally Accepted Accounting Principles.

Our goal is to strike a balance between the under-utilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce our ability to meet our obligations during adverse market conditions. Our capital investment policy limits our ability to acquire additional assets during times when our debt-to-equity ratio exceeds 12:1. At December 31, 2008, our ratio of debt-to-equity was 6.4:1. Our capital base represents the approximate liquidation value of our investments and approximates the market value of assets that we can pledge or sell to meet over-collateralization requirements for our borrowings. The unpledged portion of our capital base is available for us to pledge or sell as necessary to maintain over-collateralization levels for our borrowings.

We are prohibited from acquiring additional assets during periods when our capital base is less than the minimum amount required under our capital investment policy, except as may be necessary to maintain REIT status or our exemption from the Investment Company Act of 1940, as amended (the "Investment Company Act"). In addition, when our capital base falls below our risk-managed capital requirement, our management is required to submit to our board of directors a plan for bringing our capital base into compliance with our capital investment policy guidelines. We anticipate that in most circumstances we can achieve this goal without overt management action through the natural process of mortgage principal repayments. We anticipate that our capital base is likely to

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

exceed our risk-managed capital requirement during periods following new equity offerings and during periods of falling interest rates and that our capital base could fall below the risk-managed capital requirement during periods of rising interest rates.

The first component of our capital requirements is the current aggregate over-collateralization amount or "haircut" the lenders require us to hold as capital. The haircut for each mortgage-backed security is determined by our lenders based on the risk characteristics and liquidity of the asset. Should the market value of our pledged assets decline, we will be required to deliver additional collateral to our lenders to maintain a constant over-collateralization level on our borrowings.

The second component of our capital requirement is the "excess capital cushion." This is an amount of capital in excess of the haircuts required by our lenders. We maintain the excess capital cushion to meet the demands of our lenders for additional collateral should the market value of our mortgage-backed securities decline. The aggregate excess capital cushion equals the sum of liquidity cushion amounts assigned under our capital investment policy to each of our mortgage-backed securities. We assign excess capital cushions to each mortgage-backed security based on our assessment of the mortgage-backed security's market price volatility, credit risk, liquidity and attractiveness for use as collateral by lenders. The process of assigning excess capital cushions relies on our management's ability to identify and weigh the relative importance of these and other factors. In assigning excess capital cushions, we also give consideration to hedges associated with the mortgage-backed security and any effect such hedges may have on reducing net market price volatility, concentration or diversification of credit and other risks in the balance sheet as a whole and the net cash flows that we can expect from the interaction of the various components of our balance sheet.

13

Our capital investment policy stipulates that at least 25% of the capital base maintained to satisfy the excess capital cushion must be invested in AAA-rated adjustable-rate mortgage-backed securities or assets with similar or better liquidity characteristics.

A substantial portion of our borrowings are short-term or variable-rate borrowings. Our borrowings are implemented primarily through repurchase agreements, but in the future may also be obtained through loan agreements, lines of credit, dollar-roll agreements (an agreement to sell a security for delivery on a specified future date and a simultaneous agreement to repurchase the same or a substantially similar security on a specified future date) and other credit facilities with institutional lenders and issuance of debt securities such as commercial paper, medium-term notes, CMOs and senior or subordinated notes. We enter into financing transactions only with institutions that we believe are sound credit risks and follow other internal policies designed to limit our credit and other exposure to financing institutions.

We expect to continue to use repurchase agreements as our principal financing device to leverage our mortgage-backed securities portfolio. We anticipate that, upon repayment of each borrowing under a repurchase agreement, we will use the collateral immediately for borrowing under a new repurchase agreement. At present, we have entered into uncommitted facilities with 30 lenders for borrowings in the form of repurchase agreements. We have not at the present time entered into any commitment agreements under which the lender would be required to enter into new repurchase agreements during a specified period of time, nor do we presently plan to have liquidity facilities with commercial banks. We may, however, enter into such commitment agreements in the future. We enter into repurchase agreements primarily with national broker-dealers,

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

commercial banks and other lenders which typically offer this type of financing. We enter into collateralized borrowings only with financial institutions meeting credit standards approved by our board of directors, and we monitor the financial condition of these institutions on a regular basis.

A repurchase agreement, although structured as a sale and repurchase obligation, acts as a financing under which we effectively pledge our mortgage-backed securities as collateral to secure a short-term loan. Generally, the other party to the agreement makes the loan in an amount equal to a percentage of the market value of the pledged collateral. At the maturity of the repurchase agreement, we are required to repay the loan and correspondingly receive back our collateral. While used as collateral, the mortgage-backed securities continue to pay principal and interest which are for our benefit. In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the Bankruptcy Code, the effect of which, among other things, would be to allow the creditor under the agreement to avoid the automatic stay provisions of the Bankruptcy Code and to foreclose on the collateral without delay. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur.

Substantially all of our borrowing agreements require us to deposit additional collateral in the event the market value of existing collateral declines, which may require us to sell assets to reduce our borrowings. We have designed our liquidity management policy to maintain a cushion of equity sufficient to provide required liquidity to respond to the effects under our borrowing arrangements of interest rate movements and changes in market value of our mortgage-backed securities, as described above. However, a major disruption of the repurchase or other market that we rely on for short-term borrowings would have a material adverse effect on us unless we were able to arrange alternative sources of financing on comparable terms.

Our articles of incorporation and bylaws do not limit our ability to incur borrowings, whether secured or unsecured.

14

### Interest Rate Risk Management

To the extent consistent with our election to qualify as a REIT, we follow an interest rate risk management program intended to protect our portfolio of mortgage-backed securities and related debt against the effects of major interest rate changes. Specifically, our interest rate risk management program is formulated with the intent to offset the potential adverse effects resulting from rate adjustment limitations on our mortgage-backed securities and the differences between interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-backed securities and related borrowings.

Our interest rate risk management program encompasses a number of procedures, including the following:

|X| we attempt to structure our borrowings to have interest rate

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-backed securities; and

- |X| we attempt to structure our borrowing agreements relating to adjustable-rate mortgage-backed securities to have a range of different maturities and interest rate adjustment periods (although substantially all will be less than one year).

We adjust the average maturity adjustment periods of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due and are renewed. Through use of these procedures, we attempt to minimize the differences between the interest rate adjustment periods of our mortgage-backed securities and related borrowings that may occur.

We purchase from time-to-time interest rate swaps. We may enter into interest rate collars, interest rate caps or floors, and purchase interest-only mortgage-backed securities and similar instruments to attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings on our assets during a period of rising interest rates or to mitigate prepayment risk. We may hedge as much of the interest rate risk as our management determines is in our best interests, given the cost of the hedging transactions and the need to maintain our status as a REIT. This determination may result in our electing to bear a level of interest rate or prepayment risk that could otherwise be hedged when management believes, based on all relevant facts, that bearing the risk is advisable.

We seek to build a balance sheet and undertake an interest rate risk management program which is likely to generate positive earnings and maintain an equity liquidation value sufficient to maintain operations given a variety of potentially adverse circumstances. Accordingly, our interest rate risk management program addresses both income preservation, as discussed above, and capital preservation concerns. For capital preservation, we monitor our "duration." This is the expected percentage change in market value of our assets that would be caused by a 1% change in short and long-term interest rates. To monitor weighted average duration and the related risks of fluctuations in the liquidation value of our equity, we model the impact of various economic scenarios on the market value of our mortgage-backed securities and liabilities. At December 31, 2008, we estimate that the duration of our assets was 2.00 years and giving effect to the swap transactions, our weighted average duration was 1.21 years. We believe that our interest rate risk management program will allow us to maintain operations throughout a wide variety of potentially adverse circumstances. Nevertheless, in order to further preserve our capital base (and lower our duration) during periods when we believe a trend of rapidly rising interest rates has been established, we may decide to increase hedging activities or to sell assets. Each of these actions may lower our earnings and dividends in the short term to further our objective of maintaining attractive levels of earnings and dividends over the long term.

We may elect to conduct a portion of our hedging operations through one or more subsidiary corporations, each of which we would elect to treat as a "taxable REIT subsidiary." To comply with the asset tests applicable to us as a REIT, we could own 100% of the voting stock of such subsidiary, provided that the value of the stock that we own in all such taxable REIT subsidiaries does not exceed 25% of the value of our total assets at the close of any calendar quarter. A taxable subsidiary, such as FIDAC, Merganser, and RCap, would not elect REIT status and would distribute any net profit after taxes to us. Any dividend income we receive from the taxable subsidiaries (combined with all other income generated from our assets, other than qualified REIT real estate assets) must not exceed 25% of our gross income.

We believe that we have developed a cost-effective asset/liability management program to provide a level of protection against interest rate and prepayment risks. However, no strategy can completely insulate us from interest rate changes and prepayment risks. Further, as noted above, the federal income tax requirements that we must satisfy to qualify as a REIT limit our ability to hedge our interest rate and prepayment risks. We monitor carefully, and may have to limit, our asset/liability management program to assure that we do not realize excessive hedging income, or hold hedging assets having excess value in relation to total assets, which could result in our disqualification as a REIT, the payment of a penalty tax for failure to satisfy certain REIT tests under the Internal Revenue Code, provided the failure was for reasonable cause. In addition, asset/liability management involves transaction costs which increase dramatically as the period covered by the hedging protection increases. Therefore, we may be unable to hedge effectively our interest rate and prepayment risks.

#### Prepayment Risk Management

We seek to minimize the effects of faster or slower than anticipated prepayment rates through structuring a diversified portfolio with a variety of prepayment characteristics, investing in mortgage-backed securities with prepayment prohibitions and penalties, investing in certain mortgage-backed security structures which have prepayment protections, and balancing assets purchased at a premium with assets purchased at a discount. We monitor prepayment risk through periodic review of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net balance sheet market value.

#### Future Revisions in Policies and Strategies

Our board of directors has established the investment policies and operating policies and strategies set forth in this Form 10-K. The board of directors has the power to modify or waive these policies and strategies without the consent of the stockholders to the extent that the board of directors determines that the modification or waiver is in the best interests of our stockholders. Among other factors, developments in the market which affect our policies and strategies or which change our assessment of the market may cause our board of directors to revise our policies and strategies.

#### Potential Acquisitions, Strategic Alliances and Other Investments

From time-to-time we have explored possible transactions to enhance our operations and growth, including entering into new businesses, acquisitions of other businesses or assets, investments in other entities, joint venture arrangements, or strategic alliances. We are entering into the broker-dealer business during the first quarter of January 2009, through our subsidiary RCap, which was granted membership in FINRA in January 2009. On October 31, 2008 we consummated our acquisition of Merganser which is a registered investment advisor. In October 2008 we acquired approximately 11.7 million shares of common stock of Chimera Investment Corporation, or Chimera, for approximately \$26.3 million. During 2007 we acquired approximately 3.6 million shares of Chimera common stock for approximately \$54.3 million in connection with Chimera's initial public offering on November 21, 2007. Chimera is a publicly traded, specialty finance company that invests in residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. Chimera is externally managed by FIDAC and intends to elect and qualify to be taxed as a REIT for federal income tax purposes. We also own an investment fund.



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

We may, from time-to-time, continue to explore possible new businesses, acquisitions, investments, joint venture arrangements and strategic alliances which may enhance our operations and assist our and our subsidiaries' growth.

### Dividend Reinvestment and Share Purchase Plan

We have adopted a dividend reinvestment and share purchase plan. Under the dividend reinvestment feature of the plan, existing shareholders can reinvest their dividends in additional shares of our common stock. Under the share purchase feature of the plan, new and existing shareholders can purchase shares of our common stock. We have an effective shelf registration statement on Form S-3 which registered 100,000,000 shares that could be issued under the plan. We still sell shares covered by this registration statement under the plan.

16

### At the Market Sales Programs

We have entered into an ATM Equity Offeringsm Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated (or Merrill Lynch), relating to the sale of shares of our common stock from time to time through Merrill Lynch. We have also entered into a ATM Equity Sales Agreement with UBS Securities LLC (or UBS Securities), relating to the sale of shares of our common stock from time to time through UBS Securities. Under these agreements, sales of the shares, if any, will be made by means of ordinary brokers' transaction of the New York Stock Exchange at market prices.

### Legal Proceedings

From time-to-time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial statements.

### Employees

As of December 31, 2008, we and our subsidiaries had 65 full time employees. None of our employees are subject to any collective bargaining agreements. We believe we have good relations with our employees.

### Available Information

Our investor relations website is [www.annaly.com](http://www.annaly.com). We make available on this website under "Financial Reports and 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.

### COMPETITION

We believe that our principal competition in the acquisition and holding of the types of mortgage-backed securities we purchase are financial institutions such as banks, savings and loans, life insurance companies, institutional investors such as mutual funds and pension funds, and certain other mortgage REITs. Some of our competitors have greater financial resources and access to capital than we do. Our competitors, as well as additional competitors which may emerge in the future, may increase the competition for the acquisition of mortgage-backed securities, which in turn may result in higher prices and lower yields on assets.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

### ITEM 1A. RISK FACTORS

-----

An investment in our stock involves a number of risks. Before making an investment decision, you should carefully consider all of the risks described in this Form 10-K. If any of the risks discussed in this Form 10-K actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the trading price of our stock could decline significantly and you may lose all or part of your investment.

#### Risks Related to Our Business

An increase in the interest payments on our borrowings relative to the interest we earn on our investment securities may adversely affect our profitability

We earn money based upon the spread between the interest payments we earn on our investment securities and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our investment securities, our profitability may be adversely affected.

The interest payments on our borrowings may increase relative to the interest we earn on our adjustable-rate investment securities for various reasons discussed in this section.

17

Differences in timing of interest rate adjustments on our investment securities and our borrowings may adversely affect our profitability

We rely primarily on short-term borrowings to acquire investment securities with long-term maturities. Accordingly, if short-term interest rates increase, this may adversely affect our profitability.

Most of the investment securities we acquire are adjustable-rate securities. This means that their interest rates may vary over time based upon changes in an objective index, such as:

- o LIBOR. The interest rate that banks in London offer for deposits in London of U.S. dollars.
- o Treasury Rate. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.
- o CD Rate. The weekly average of secondary market interest rates on six-month negotiable certificates of deposit, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. On December 31, 2008, approximately 28% of our investment securities were adjustable-rate securities.

The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate investment securities. For example, on December 31, 2008, our adjustable-rate investment securities had a weighted average term to next rate adjustment of 36 months, while our borrowings had a weighted average term to next rate adjustment of 238 days. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

investment securities.

Interest rate caps on our investment securities may adversely affect our profitability

Our adjustable-rate investment securities are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through maturity of an investment security. Our borrowings are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, we could experience a decrease in net income or experience a net loss because the interest rates on our borrowings could increase without limitation while the interest rates on our adjustable-rate investment securities would be limited by caps.

Because we acquire fixed-rate securities, an increase in interest rates may adversely affect our profitability

In a period of rising interest rates, our interest payments could increase while the interest we earn on our fixed-rate mortgage-backed securities would not change. This would adversely affect our profitability. On December 31, 2008, approximately 64% of our investment securities were fixed-rate securities.

An increase in prepayment rates may adversely affect our profitability

The mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans at rates that are faster than expected, this results in prepayments that are faster than expected on the mortgage-backed securities. These faster than expected prepayments may adversely affect our profitability.

We often purchase mortgage-backed securities that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we must pay a premium over the market value to acquire the security. In accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. If the mortgage-backed security is prepaid in whole or in part prior to its maturity date, however, we must expense all or a part of the remaining unamortized portion of the premium that was prepaid at the time of the prepayment. This adversely affects our profitability.

18

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

We may seek to reduce prepayment risk by acquiring mortgage-backed securities at a discount. If a discounted security is prepaid in whole or in part prior to its maturity date, we will earn income equal to the amount of the remaining discount. This will improve our profitability if the discounted securities are prepaid faster than expected.

We also can acquire mortgage-backed securities that are less affected by prepayments. For example, we can acquire CMOs, a type of mortgage-backed security. CMOs divide a pool of mortgage loans into multiple tranches that allow for shifting of prepayment risks from slower-paying tranches to faster-paying tranches. This is in contrast to pass-through or pay-through mortgage-backed

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

securities, where all investors share equally in all payments, including all prepayments. As discussed below, the Investment Company Act of 1940 imposes restrictions on our purchase of CMOs. As of December 31, 2008, approximately 24% of our mortgage-backed securities were CMOs and approximately 76% of our mortgage-backed securities were pass-through or pay-through securities.

While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

An increase in interest rates may adversely affect our book value

Increases in interest rates may negatively affect the market value of our investment securities. Our fixed-rate securities, generally, are more negatively affected by these increases. In accordance with accounting rules, we reduce our book value by the amount of any decrease in the market value of our investment securities.

Failure to procure funding on favorable terms, or at all, would adversely affect our results and may, in turn, negatively affect the market price of shares of our common stock.

The current dislocation and weakness in the broader mortgage markets could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. If one or more major market participants fails or otherwise experiences a major liquidity crisis, as was the case for Bear Stearns & Co. in March 2008 and Lehman Brothers Holdings Inc. in September 2008, it could negatively impact the marketability of all fixed income securities, including Agency RMBS, and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if any of our potential lenders or any of our lenders are unwilling or unable to provide us with financing, we could be forced to sell our assets at an inopportune time when prices are depressed.

Since June 30, 2008, there have been increased market concerns about Freddie Mac and Fannie Mae's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. Recently, the government passed the Housing and Economic Recovery Act of 2008. Fannie Mae and Freddie Mac have recently been placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. 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 shareholders, 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.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Department of Treasury and FHFA have entered into preferred stock purchase agreements between the U.S. Department of Treasury and Fannie Mae and Freddie Mac pursuant to which the U.S. Department of Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Department of Treasury has established a new secured lending credit

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the U.S. Department of Treasury has initiated a temporary program to purchase RMBS issued by Fannie Mae and Freddie Mac. Given the highly fluid and evolving nature of these events, it is unclear how our business will be impacted. Based upon the further activity of the U.S. government or market response to developments at Fannie Mae or Freddie Mac, our business could be adversely impacted.

19

Our strategy involves significant leverage

We seek to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although our ratio may at times be above or below this amount. We incur this leverage by borrowing against a substantial portion of the market value of our investment securities. By incurring this leverage, we can enhance our returns. Nevertheless, this leverage, which is fundamental to our investment strategy, also creates significant risks.

- o Our leverage may cause substantial losses

Because of our significant leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

- o short-term interest rates increase;
  - o the market value of our investment securities decreases;
  - o interest rate volatility increases; or
  - o the availability of financing in the market decreases.
- o Our leverage may cause margin calls and defaults and force us to sell assets under adverse market conditions

Because of our leverage, a decline in the value of our investment securities may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. Our fixed-rate mortgage-backed securities generally are more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate securities.

If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. This could force us to sell our investment securities under adverse market conditions. Additionally, in the event of our bankruptcy, our borrowings, which are generally made under repurchase agreements, may qualify for special treatment under the Bankruptcy Code. This special treatment would allow the lenders under these agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under these agreements without delay.

- o Liquidation of collateral may jeopardize our REIT status

To continue to qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our investment securities, we may be unable to comply with these requirements, ultimately jeopardizing our status as a REIT and our failure to qualify as a REIT will have adverse tax consequences.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- o We may exceed our target leverage ratios

We seek to maintain a ratio of debt-to-equity of between 8:1 and 12:1. However, we are not required to stay within this leverage ratio. If we exceed this ratio, the adverse impact on our financial condition and results of operations from the types of risks described in this section would likely be more severe.

20

- o We may not be able to achieve our optimal leverage

We use leverage as a strategy to increase the return to our investors. However, we may not be able to achieve our desired leverage for any of the following reasons:

- o we determine that the leverage would expose us to excessive risk;
  - o our lenders do not make funding available to us at acceptable rates; or
  - o our lenders require that we provide additional collateral to cover our borrowings.
- o We may incur increased borrowing costs which would adversely affect our profitability

Currently, all of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, it would adversely affect our profitability.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon:

- o the movement of interest rates;
- o the availability of financing in the market; or
- o the value and liquidity of our investment securities.

If we are unable to renew our borrowings at favorable rates, our profitability may be adversely affected

Since we rely primarily on short-term borrowings, our ability to achieve our investment objectives depends not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace on a continuous basis our maturing short-term borrowings. If we are not able to renew or replace maturing borrowings, we would have to sell our assets under possibly adverse market conditions.

Our hedging strategies expose us to risks

Our policies permit us to enter into interest rate swaps, caps and floors and other derivative transactions to help us mitigate our interest rate and prepayment risks described above. We have used interest rate swaps and interest rate caps to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- o Our hedging strategies may not be successful in mitigating the risks associated with interest rates

We cannot assure you that our use of derivatives will offset the risks related to changes in interest rates. It is likely that there will be periods in the future during which we will incur losses on our derivative financial instruments that will not be fully offset by gains on our portfolio. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could significantly increase our risk and lead to material losses. In addition, hedging strategies involve transaction and other costs. Our hedging strategy and the derivatives that we use may not adequately offset the risk of interest rate volatility or that our hedging transactions may not result in losses.

- o Our use of derivatives may expose us to counterparty risks

We enter into interest rate swap and cap agreements to hedge risks associated with movements in interest rates. If a swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligations under the interest rate swap if the counterparty becomes insolvent or files for bankruptcy. Similarly, if a cap counterparty fails to perform under the terms of the cap agreement, in addition to not receiving payments due under that agreement that would off-sets our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement.

21

We may face risks of investing in inverse floating rate securities

We may invest in inverse floaters. The returns on inverse floaters are inversely related to changes in an interest rate. Generally, income on inverse floaters will decrease when interest rates increase and increase when interest rates decrease. Investments in inverse floaters may subject us to the risks of reduced or eliminated interest payments and losses of principal. In addition, certain indexed securities and inverse floaters may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages our investment in such securities. As a result, the market value of such securities will generally be more volatile than that of fixed rate securities.

Our investment strategy may involve credit risk

We may incur losses if there are payment defaults under our investment securities.

To date, all of our mortgage-backed securities have been agency certificates and agency debentures which, although not rated, carry an implied "AAA" rating. Agency certificates are mortgage pass-through certificates where Freddie Mac, Fannie Mae or Ginnie Mae guarantees payments of principal or interest on the certificates. Agency debentures are debt instruments issued by Freddie Mac, Fannie Mae, or the FHLB.

Even though we have only acquired "AAA" securities so far, pursuant to our capital investment policy, we have the ability to acquire securities of

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

lower credit quality. Under our policy:

- o 75% of our investments must have a "AA" or higher rating by S&P, an equivalent rating by a similar nationally recognized rating organization or our management must determine that the investments are of comparable credit quality to investments with these ratings;
- o the remaining 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation ("S&P") or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivate securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics; and
- o we seek to have a minimum weighted average rating for our portfolio of at least "A" by S&P.

If we acquire securities of lower credit quality, we may incur losses if there are defaults under those securities or if the rating agencies downgrade the credit quality of those securities.

There can be no assurance that the actions of the U.S. government, Federal Reserve and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, or market response to those actions, will achieve the intended effect, our business may not benefit from these actions and further government or market developments could adversely impact us.

In response to the financial issues affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, the Emergency Economic Stabilization Act of 2008, or EESA, was recently enacted. The EESA provides the U.S. Secretary of the Treasury with the authority to establish a Troubled Asset Relief Program, or TARP, to purchase from financial institutions up to \$700 billion of equity or preferred securities, residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, as well as any other financial instrument that the U.S. Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, upon transmittal of such determination, in writing, to the appropriate committees of the U.S. Congress. The EESA also provides for a program that would allow companies to insure their troubled assets.

22

In addition, the U.S. Government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. There can be no assurance that the EESA or other policy initiatives will have a beneficial impact on the financial markets, including current extreme levels of volatility. We cannot predict



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

whether or when such actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition.

We have not established a minimum dividend payment level

We intend to pay quarterly dividends and to make 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 enables us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described in this section. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time.

Because of competition, we may not be able to acquire mortgage-backed securities at favorable yields

Our net income depends, in large part, on our ability to acquire mortgage-backed securities at favorable spreads over our borrowing costs. In acquiring mortgage-backed 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 mortgage-backed securities, many of which have greater financial resources than us. As a result, in the future, we may not be able to acquire sufficient mortgage-backed securities at favorable spreads over our borrowing costs.

We are dependent on our key personnel

We are dependent on the efforts of our key officers and employees, including Michael A. J. Farrell, our Chairman of the board of directors, Chief Executive Officer and President, Wellington J. Denahan-Norris, our Vice Chairman, Chief Operating Officer and Chief Investment Officer, and Kathryn F. Fagan, our Chief Financial Officer and Treasurer. The loss of any of their services could have an adverse effect on our operations. Although we have employment agreements with each of them, we cannot assure you they will remain employed with us.

We and our shareholders are subject to certain tax risks

- o Our failure to qualify as a REIT would have adverse tax consequences

We believe that since 1997 we have qualified for taxation as a REIT for federal income tax purposes. We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service (or IRS) might make changes to the tax laws and regulations, and the courts might issue new rulings that make it more difficult or impossible for us to remain qualified as a REIT.

If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and would therefore have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our securities. In addition, the tax law would no longer require us to make distributions to our stockholders.

A REIT that fails the quarterly asset tests for one or more quarters will not lose its REIT status as a result of such failure if either (i) the failure is regarded as a de minimis failure under standards set out in the Internal Revenue Code, or (ii) the failure is greater than a de minimis failure but is attributable to reasonable cause and not willful neglect. In the case of a greater than de minimis failure, however, the REIT must pay a tax and must remedy the failure within 6 months of the close of the quarter in which the failure was identified. In addition, the Internal Revenue Code provides relief for failures of other tests imposed as a condition of REIT qualification, as long as the failures are attributable to reasonable cause and not willful neglect. A REIT would be required to pay a penalty of \$50,000, however, in the case of each failure.

- o We have certain distribution requirements

As a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). The required distribution limits the amount we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement.

- o We are also subject to other tax liabilities

Even if we qualify as a REIT, we may be subject to certain federal, state and local taxes on our income and property. Any of these taxes would reduce our operating cash flow.

- o Limits on ownership of our common stock could have adverse consequences to you and could limit your opportunity to receive a premium on our stock

To maintain our qualification as a REIT for federal income tax purposes, not more than 50% in value of the outstanding shares of our capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal tax laws to include certain entities). Primarily to facilitate maintenance of our qualification as a REIT for federal income tax purposes, our charter will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of our common stock and will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of any class or

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

series of our preferred stock. Our board of directors, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons who would not be treated as "individuals" for purposes of the federal tax laws if it is satisfied, based upon information required to be provided by the party seeking the waiver and upon an opinion of counsel satisfactory to the board of directors, that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for federal income tax purposes.

The ownership limit may have the effect of delaying, deferring or preventing a change in control and, therefore, could adversely affect our shareholders' ability to realize a premium over the then-prevailing market price for our common stock in connection with a change in control.

- o A REIT cannot invest more than 25% of its total assets in the stock or securities of one or more taxable REIT subsidiaries; therefore, our taxable subsidiaries cannot constitute more than 25% of our total assets

24

A taxable REIT subsidiary is a corporation, other than a REIT or a qualified REIT subsidiary, in which a REIT owns stock and which elects taxable REIT subsidiary status. The term also includes a corporate subsidiary in which the taxable REIT subsidiary owns more than a 35% interest. A REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary may earn income that would not be qualifying income if earned directly by the parent REIT. Overall, at the close of any calendar quarter, no more than 25% of the value of a REIT's assets may consist of stock or securities of one or more taxable REIT subsidiaries.

The stock and securities of our taxable REIT subsidiaries are expected to represent less than 25% of the value of our total assets. Furthermore, we intend to monitor the value of our investments in the stock and securities of our taxable REIT subsidiaries to ensure compliance with the above-described 25% limitation. We cannot assure you, however, that we will always be able to comply with the 25% limitation so as to maintain REIT status.

- o Taxable REIT subsidiaries are subject to tax at the regular corporate rates, are not required to distribute dividends, and the amount of dividends a taxable REIT subsidiary can pay to its parent REIT may be limited by REIT gross income tests

A taxable REIT subsidiary must pay income tax at regular corporate rates on any income that it earns. Our taxable REIT subsidiaries will pay corporate income tax on their taxable income, and their after-tax net income will be available for distribution to us. Such income, however, is not required to be distributed.

Moreover, the annual gross income tests that must be satisfied to ensure REIT qualification may limit the amount of dividends that we can receive from our taxable REIT subsidiaries and still maintain our REIT status. Generally, not more than 25% of our gross income can be derived from non-real estate related sources, such as dividends from a taxable REIT subsidiary. If, for any taxable year, the dividends we received from our taxable REIT subsidiaries, when added to our other items of non-real estate related income, represented more than 25% of our total gross income for the year, we could be denied REIT status, unless we

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

were able to demonstrate, among other things, that our failure of the gross income test was due to reasonable cause and not willful neglect.

The limitations imposed by the REIT gross income tests may impede our ability to distribute assets from our taxable REIT subsidiaries to us in the form of dividends. Certain asset transfers may, therefore, have to be structured as purchase and sale transactions upon which our taxable REIT subsidiaries recognize taxable gain.

- o If interest accrues on indebtedness owed by a taxable REIT subsidiary to its parent REIT at a rate in excess of a commercially reasonable rate, or if transactions between a REIT and a taxable REIT subsidiary are entered into on other than arm's-length terms, the REIT may be subject to a penalty tax

If interest accrues on an indebtedness owed by a taxable REIT subsidiary to its parent REIT at a rate in excess of a commercially reasonable rate, the REIT is subject to tax at a rate of 100% on the excess of (i) interest payments made by a taxable REIT subsidiary to its parent REIT over (ii) the amount of interest that would have been payable had interest accrued on the indebtedness at a commercially reasonable rate. A tax at a rate of 100% is also imposed on any transaction between a taxable REIT subsidiary and its parent REIT to the extent the transaction gives rise to deductions to the taxable REIT subsidiary that are in excess of the deductions that would have been allowable had the transaction been entered into on arm's-length terms. We will scrutinize all of our transactions with our taxable REIT subsidiaries in an effort to ensure that we do not become subject to these taxes. We may not be able to avoid application of these taxes.

### Risks of Ownership of Our Common Stock

- o Issuances of large amounts of our stock could cause the market price of our common stock to decline

As of February 25, 2009, 544,290,086 shares of our common stock were outstanding. If we issue a significant number of shares of common stock or securities convertible into common stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock.

25

- o We may change our policies without stockholder approval

Our board of directors and management determine all of our policies, including our investment, financing and distribution policies. They may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or distributions.

- o Our governing documents and Maryland law impose limitations on the acquisition of our common stock and changes in control that could make it more difficult for a third party to acquire us

#### Maryland Business Combination Act

-----

The Maryland General Corporation Law establishes special requirements for "business combinations" between a Maryland corporation and "interested

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

stockholders" unless exemptions are applicable. An interested stockholder is any person who beneficially owns 10% or more of the voting power of our then-outstanding voting stock. Among other things, the law prohibits for a period of five years a merger and other similar transactions between us and an interested stockholder unless the board of directors approved the transaction prior to the party's becoming an interested stockholder. The five-year period runs from the most recent date on which the interested stockholder became an interested stockholder. The law also requires a super majority stockholder vote for such transactions after the end of the five-year period. This means that the transaction must be approved by at least:

- o 80% of the votes entitled to be cast by holders of outstanding voting shares; and
- o two-thirds of the votes entitled to be cast by holders of outstanding voting shares other than shares held by the interested stockholder or an affiliate of the interested stockholder with whom the business combination is to be effected.

As permitted by the Maryland General Corporation Law, we have elected not to be governed by the Maryland business combination statute. We made this election by opting out of this statute in our articles of incorporation. If, however, we amend our articles of incorporation to opt back in to the statute, the business combination statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests.

### Maryland Control Share Acquisition Act

-----

Maryland law provides that "control shares" of a Maryland corporation acquired in a "control share acquisition" have no voting rights except to the extent approved by a vote of the stockholders. Two-thirds of the shares eligible to vote must vote in favor of granting the "control shares" voting rights. "Control shares" are shares of stock that, taken together with all other shares of stock the acquirer previously acquired, would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power:

- o One-tenth or more but less than one third of all voting power;
- o One-third or more but less than a majority of all voting power; or
- o A majority or more of all voting power.

Control shares do not include shares of stock the acquiring person is entitled to vote as a result of having previously obtained stockholder approval. A "control share acquisition" means the acquisition of control shares, subject to certain exceptions.

If a person who has made (or proposes to make) a control share acquisition satisfies certain conditions (including agreeing to pay expenses), he may compel our board of directors to call a special meeting of stockholders to consider the voting rights of the shares. If such a person makes no request for a meeting, we have the option to present the question at any stockholders' meeting.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

If voting rights are not approved at a meeting of stockholders then, subject to certain conditions and limitations, we may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value. We will determine the fair value of the shares, without regard to voting rights, as of the date of either:

- o the last control share acquisition; or
- o the meeting where stockholders considered and did not approve voting rights of the control shares.

If voting rights for control shares are approved at a stockholders' meeting and the acquirer becomes entitled to vote a majority of the shares of stock entitled to vote, all other stockholders may obtain rights as objecting stockholders and, thereunder, exercise appraisal rights. This means that you would be able to force us to redeem your stock for fair value. Under Maryland law, the fair value may not be less than the highest price per share paid in the control share acquisition. Furthermore, certain limitations otherwise applicable to the exercise of dissenters' rights would not apply in the context of a control share acquisition. The control share acquisition statute would not apply to shares acquired in a merger, consolidation or share exchange if we were a party to the transaction. The control share acquisition statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests.

### Regulatory Risks

- o Loss of Investment Company Act exemption would adversely affect us

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act. If we fail to qualify for this exemption, our ability to use leverage would be substantially reduced, and we would be unable to conduct our business as described in this Form 10-K.

We rely on the exclusion provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) as interpreted by the staff of the SEC, requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" (or Qualifying Real Estate Assets) and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act. If the SEC determines that any of these securities are not qualifying interests in real estate or real estate related assets, adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exceptions, we could be required to restructure our activities or sell certain of our assets. We may be required at times to adopt less efficient methods of financing certain of our mortgage assets and we may be precluded from acquiring certain types of higher yielding mortgage assets. The net effect of these factors will be to lower our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption.

- o Compliance with proposed and recently enacted changes in securities laws and regulations increase our costs

The Sarbanes-Oxley Act of 2002 and rules and regulations promulgated by the SEC and the New York Stock Exchange have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. We believe

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

that these rules and regulations will make it more costly for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified members of management and our board of directors, particularly to serve on our audit committee.

27

### ITEM 1B. UNRESOLVED STAFF COMMENTS

-----

None.

### ITEM 2. PROPERTIES

-----

Our executive and administrative office is located at 1211 Avenue of the Americas, Suite 2902 New York, New York 10036, telephone 212-696-0100. This office is leased under a non-cancelable lease expiring December 31, 2009.

### ITEM 3. LEGAL PROCEEDINGS

-----

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on our consolidated financial statements.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

-----

We did not submit any matters to a vote of our stockholders during the fourth quarter of 2008.

28

## PART II

-----

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

-----

Our common stock began trading publicly on October 8, 1997 and is traded on the New York Stock Exchange under the trading symbol "NLY". As of February 25, 2009, we had 544,290,086 shares of common stock issued and outstanding which were held by approximately 290,409 beneficial holders.

The following table sets forth, for the periods indicated, the high, low, and closing sales prices per share of our common stock as reported on the New York Stock Exchange composite tape and the cash dividends declared per share of our common stock.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	Stock Prices		
	High	Low	Clos
First Quarter ended March 31, 2008	\$21.00	\$14.16	\$15.
Second Quarter ended June 30, 2008	\$17.95	\$15.51	\$15.
Third Quarter ended September 30, 2008	\$17.00	\$12.92	\$13.
Fourth Quarter ended December 31, 2008	\$16.12	\$11.21	\$15.
	High	Low	Clos
First Quarter ended March 31, 2007	\$15.48	\$13.54	\$15.
Second Quarter ended June 30, 2007	\$16.20	\$13.83	\$14.
Third Quarter ended September 30, 2007	\$16.42	\$13.03	\$15.
Fourth Quarter ended December 31, 2007	\$18.18	\$15.25	\$18.

	Common Dividends Declared Per Share
First Quarter ended March 31, 2008	\$0.48
Second Quarter ended June 30, 2008	\$0.55
Third Quarter ended September 30, 2008	\$0.55
Fourth Quarter ended December 31, 2008	\$0.50
First Quarter ended March 31, 2007	\$0.20
Second Quarter ended June 30, 2007	\$0.24
Third Quarter ended September 30, 2007	\$0.26
Fourth Quarter ended December 31, 2007	\$0.34

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors." All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of issuance of our preferred stock through December 31, 2008, we have paid full cumulative dividends on our preferred stock.

29

### EQUITY COMPENSATION PLAN INFORMATION

We have adopted a long term stock incentive plan for executive officers, key employees and nonemployee directors (the "Incentive Plan"). The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including incentive stock options as defined under Section 422 of the Code ("ISOs") and options not so qualified ("NQSOs"). The Incentive Plan authorizes the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the outstanding shares of our common stock up to a ceiling of 8,932,921 shares. For a description of our Incentive Plan, see Note 11 to the Financial Statements.



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

The following table provides information as of December 31, 2008 concerning shares of our common stock authorized for issuance under our existing Incentive Plan.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of se remaining ava future issua Incentive Plan previously
Equity compensation plans approved by security holders	5,180,164	\$15.87	
Equity compensation plans not approved by security holders	-	-	
<b>Total</b>	<b>5,180,164</b>	<b>\$15.87</b>	

(1) The Incentive Plan authorizes the granting of options or other awards for an aggregate of the 500,000 or 9.5% of the outstanding shares on a fully diluted basis of our common stock up to a total of 8,932,921 shares.

30

### ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are derived from our audited financial statements for the years ended December 31, 2008, 2007, 2006, 2005, and 2004. The selected financial data should be read in conjunction with the more detailed information contained in the Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

SELECTED FINANCIAL DATA  
(dollars in thousands, except for per share data)

	For the Year Ended December 31, 2008	For the Year Ended December 31, 2007	For Dec
<b>Statement of Operations Data</b>			
Interest income	\$3,115,428	\$2,355,447	
Interest expense	1,888,912	1,926,465	
Net interest income	1,226,516	428,982	
<b>Other (loss) income:</b>			
Investment advisory and service fees	27,891	22,028	
Gain (loss) on sale of investment securities	10,713	19,062	
Gain on termination of interest rate swaps	-	2,096	
Income from trading securities	9,695	19,147	
Dividend income from available-for-sale equity securities	2,713	91	

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Loss on other-than-temporarily impaired securities	(31,834)	(1,189)
Unrealized loss on interest rate swaps	(768,268)	-
	-----	-----
Total other (loss) income	(749,090)	61,235
	-----	-----
Expenses:		
Distribution fees	1,589	3,647
General and administrative expenses	103,622	62,666
	-----	-----
Total Expenses	105,211	66,313
	-----	-----
Impairment of intangible for customer relationships	-	-
	-----	-----
Income before income taxes	372,215	423,904
Income taxes	25,977	8,870
	-----	-----
Income (loss) before minority interest	346,238	415,034
Minority interest	58	650
	-----	-----
Net income (loss)	346,180	414,384
Dividends on preferred stock	21,177	21,493
	-----	-----
Net income available (loss related) to common shareholders	\$325,003	\$392,891
	=====	=====
Basic net income (loss) per average common share	\$0.64	\$1.32
Diluted net income (loss) per average common share	\$0.64	\$1.31
Dividends declared per common share	\$2.08	\$1.04
Dividends declared per preferred Series A share	\$1.97	\$1.97
Dividends declared per preferred Series B share	\$1.50	\$1.50

31

Balance Sheet Data	December 31, 2008	December 31, 2007	Decem 20
Mortgage-Backed Securities, at fair value	\$55,046,995	\$52,879,528	\$30,
Agency Debentures, at fair value	598,945	253,915	
Total assets	57,597,615	53,903,514	30,
Repurchase agreements	46,674,885	46,046,560	27,
Total liabilities	50,318,301	48,585,536	28,
Stockholders' equity	7,183,272	5,204,938	2,
Number of common shares outstanding	541,475,366	401,822,703	205,
	For the Year Ended	For the Year Ended	For t E
Other Data	December 31, 2008	December 31, 2007	Dece 2

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Average total assets	\$58,540,508	\$41,834,831	\$23,
Average investment securities	55,962,519	40,800,148	23,
Average borrowings	50,270,226	37,967,215	21,
Average equity	6,679,431	3,710,821	2,
Yield on average interest earning assets	5.57%		5.77%
Cost of funds on average interest bearing liabilities	3.76%		5.07%
Interest rate spread	1.81%		0.70%

### Financial Ratios

Net interest margin (net interest income/average total assets)	2.10%		1.03%
G&A expense as a percentage of average total assets	0.18%		0.15%
G&A expense as a percentage of average equity	1.55%		1.69%
Return on average total assets	0.59%		0.99%
Return on average equity	5.18%		11.17%

32

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

#### RESULTS OF OPERATIONS

##### Overview

We are a REIT that owns and manages a portfolio of principally mortgage-backed securities. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our investment securities and the costs of borrowing to finance our acquisition of investment securities and from dividends we receive from our taxable REIT subsidiaries. FIDAC and Merganser are our wholly-owned taxable REIT subsidiaries that are registered investment advisors that generate advisory and service fee income. RCap is our wholly-owned broker dealer taxable REIT subsidiary which we expect to generate fee income.

We are primarily engaged in the business of investing, on a leveraged basis, in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans (collectively, "Mortgage-Backed Securities"). We also invest in Federal Home Loan Bank ("FHLB"), Federal Home Loan Mortgage Corporation ("FHLMC"), and Federal National Mortgage Association ("FNMA") debentures. The Mortgage-Backed Securities and agency debentures are collectively referred to herein as "Investment Securities."

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

The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation ("S&P") or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

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

We have elected to be taxed as a REIT for federal income tax purposes. Pursuant to the current federal tax regulations, one of the requirements of maintaining our status as a REIT is that we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain) to our stockholders, subject to certain adjustments.

The results of our operations are affected by various factors, many of which are beyond our control. Our results of operations primarily depend on, among other things, our net interest income, the market value of our assets and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, 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 speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Mortgage-Backed Securities portfolio increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. The CPR on our Mortgage-Backed Securities portfolio averaged 13% ,15% and 17% for the years ended December 31, 2008, 2007 and 2006, respectively. Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

33

The table below provides quarterly information regarding our average balances, interest income, yield on assets, average repurchase agreement balances, interest expense, cost of funds, net interest income and net interest rate spreads for the quarterly periods presented.

	Average Investment Securities Held (1)	Total Interest Income	Yield on Average Investment Securities	Average Balance of Repurchase Agreements	Interest Expense	Average Cost of Funds
Quarter Ended December 31, 2008	\$53,838,665	\$740,282	5.50%	\$47,581,332	\$450,805	3.79%
Quarter Ended September 30, 2008	\$57,694,277	\$810,659	5.62%	\$51,740,645	\$458,250	3.54%

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

June 30, 2008	\$56,197,550	\$773,359	5.50%	\$50,359,825	\$442,251	3.51%
Quarter Ended						
March 31, 2008	\$56,119,584	\$791,128	5.64%	\$51,399,101	\$537,606	4.18%

(1) Does not reflect unrealized gains/(losses).

The following table presents the CPR experienced on our Mortgage-Backed Securities portfolio, on an annualized basis, for the quarterly periods presented.

Quarter Ended	CPR
-----	---
December 31, 2008	10%
September 30, 2008	11%
June 30, 2008	16%
March 31, 2008	15%

We believe that the CPR in future periods will depend, in part, on changes in and the level of market interest rates across the yield curve, with higher CPRs expected during periods of declining interest rates and lower CPRs expected during periods of rising interest rates.

We continue to explore alternative business strategies, alternative investments and other strategic initiatives to complement our core business strategy of investing, on a leveraged basis, in high quality Investment Securities. No assurance, however, can be provided that any such strategic initiative will or will not be implemented in the future.

For the purposes of computing ratios relating to equity measures, throughout this report, equity includes Series B preferred stock, which has been treated under accounting principles generally accepted in the United States, or GAAP,, as temporary equity.

### Recent Developments

The liquidity crisis which commenced in August 2007 escalated throughout 2008. During this period of market dislocation, fiscal and monetary policymakers have established new liquidity facilities for primary dealers and commercial banks, reduced short-term interest rates, and passed legislation that is intended to address the challenges of mortgage borrowers and lenders. This legislation, the Housing and Economic Recovery Act of 2008, seeks to forestall home foreclosures for distressed borrowers and assist communities with foreclosure problems. Although these aggressive steps are intended to protect and support the US housing and mortgage market, we continue to operate under very difficult market conditions.

Subsequent to June 30, 2008, there were increased market concerns about Freddie Mac and Fannie Mae's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. In September 2008 Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. 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 shareholders, 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

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

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.

34

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Department of Treasury and FHFA have entered into preferred stock purchase agreements between the U.S. Department of Treasury and Fannie Mae and Freddie Mac pursuant to which the U.S. Department of Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Department of Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the U.S. Department of Treasury has initiated a temporary program to purchase RMBS issued by Fannie Mae and Freddie Mac. Given the highly fluid and evolving nature of these events, it is unclear how our business will be impacted. Based upon the further activity of the U.S. government or market response to developments at Fannie Mae or Freddie Mac, our business could be adversely impacted.

The Emergency Economic Stabilization Act of 2008, or EESA, was recently enacted. The EESA provides the U.S. Secretary of the Treasury with the authority to establish a Troubled Asset Relief Program, or TARP, to purchase from financial institutions up to \$700 billion of equity or preferred securities, residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, as well as any other financial instrument that the U.S. Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, upon transmittal of such determination, in writing, to the appropriate committees of the U.S. Congress. The EESA also provides for a program that would allow companies to insure their troubled assets.

In addition, the U.S. Government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. There can be no assurance that the EESA or other policy initiatives will have a beneficial impact on the financial markets, including current extreme levels of volatility. We cannot predict whether or when such actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition.

The liquidity crisis could adversely affect one or more of our lenders and could cause one or more of our lenders to be unwilling or unable to provide us with additional financing. This could potentially increase our financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including government mortgage securities, and this could negatively impact the value of the securities in our portfolio, thus reducing its net book value. Furthermore, if many of our lenders are unwilling or unable to provide us with additional financing, we could be forced to sell our Investment Securities at an inopportune time when prices are depressed. Even with the current situation in the sub-prime mortgage sector we do not anticipate having difficulty converting our assets to cash or extending financing terms, due to the fact that our investment securities have an actual or implied "AAA" rating and principal payment is guaranteed.

Critical Accounting Policies

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Management's discussion and analysis of financial condition and results of operations is based on the amounts reported in our financial statements. These 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.

35

**Fair Value of Investment Securities:** All assets classified as available-for-sale are reported at fair value, based on market prices. Although we generally intend to hold most of our Investment Securities until maturity, we may, from time to time, sell any of our Investment Securities as part of our overall management of our portfolio. Accordingly, we are required to classify all of our Investment Securities as available-for-sale. Our policy is to obtain fair values from independent sources. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Investments with unrealized losses are not considered other-than-temporarily impaired if the Company has the ability and intent to hold the investments for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the cost of the investments. Unrealized losses on Investment Securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to factors other than temporary, are recognized in income and the cost basis of the Investment Securities is adjusted.

**Interest Income:** Interest income is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, Wall Street consensus prepayment speeds, and current market conditions. If our estimate of prepayments is incorrect, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

**Derivative Financial Instruments/Hedging Activity :** Prior to the fourth quarter of 2008, we designated interest rate swaps as cash flow hedges, whereby the swaps were recorded at fair value on the balance sheet as assets and liabilities with any changes in fair value recorded in accumulated other comprehensive income. In a cash flow hedge, a swap would exactly match the pricing date of the relevant repurchase agreement. Through the end of the third quarter 2008, we continued to be able to match the swaps with the repurchase agreements therefore entering into effective hedge transactions. However, due to the volatility of the credit markets, it is no longer practical to match the pricing dates of both the swaps and the repurchase agreements.

As a result, we voluntarily discontinued hedge accounting in the fourth quarter of 2008 through a combination of de-designating previously defined hedge relationships and not designating new contracts as cash flow hedges. The

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

de-designation of cash flow hedges was done in accordance with Derivatives Implementation Group (DIG) Issue Nos. G3, G17, G18 & G20, which generally require that the net derivative gain or loss related to the discontinued cash flow hedge should continue to be reported in accumulated other comprehensive income, unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. As such we continue to hold repurchase agreements in excess of swap contracts and have no indication that interest payments on the hedged repurchase agreements are in jeopardy of discontinuing. Therefore, the deferred losses related to these derivatives that have been de-designated were not recognized immediately and are expected to be reclassified into earnings during the contractual terms of the swap agreements starting as of October 1, 2008. Changes in the unrealized gains or losses on the interest rate swaps subsequent to September 30, 2008 will be reflected in our income statement.

**Repurchase Agreements:** We finance the acquisition of our Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

36

**Income Taxes:** We have elected to be taxed as a REIT and intend to comply with the provisions of the Internal Revenue Code of 1986, as amended (or the Code), with respect thereto. Accordingly, we will not be subjected to federal income tax to the extent of our distributions to shareholders and as long as certain asset, income and stock ownership tests are met. We, FIDAC, Merganser, and RCap have made a joint election to treat FIDAC, Merganser, and RCap as taxable REIT subsidiaries. As such, FIDAC, Merganser, and RCap are taxable as a domestic C corporations and subject to federal and state and local income taxes based upon their taxable income.

**Impairment of Goodwill and Intangibles:** The Company's acquisitions of FIDAC and Merganser were accounted for using the purchase method. The cost of FIDAC and Merganser were allocated to the assets acquired, including identifiable intangible assets and the liabilities assumed, based on their estimated fair values at the date of acquisition. The excess of cost over the fair value of the net assets acquired was recognized as goodwill. Goodwill and finite-lived intangible assets are periodically reviewed for potential impairment. This evaluation requires significant judgment.

### Recent Accounting Pronouncements:

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - including an amendment of FASB Statement No. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS 159 was effective for us commencing January 1, 2008.

In April 2007, the FASB issued FASB Staff Position FIN 39-1 ("FSP FIN 39-1") which modifies FASB Interpretation No. 39, Offsetting of Amounts relating to Certain Contracts ("FIN 39"). FSP FIN 39-1 addresses whether a reporting entity that is party to a master netting arrangement can offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments that have been offset under the same master netting arrangement in accordance with FIN 39. Upon adoption of this



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

guidance, a reporting entity is permitted to change its accounting policy to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. This guidance was effective for us on January 1, 2008. The implementation did not have an effect on our financial statements.

In February 2008, FASB issued FASB Staff Position No. FAS 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions, ("FSP FAS 140-3"). FSP FAS 140-3 addresses whether transactions where assets purchased from a particular counterparty and financed through a repurchase agreement with the same counterparty can be considered and accounted for as separate transactions, or are required to be considered "linked" transactions and may be considered derivatives under SFAS 133 Accounting for Derivative Instruments and Hedging Activities. FSP FAS 140-3 requires purchases and subsequent financing through repurchase agreements be considered linked transactions unless all of the following conditions apply: (1) the initial purchase and the use of repurchase agreements to finance the purchase are not contractually contingent upon each other; (2) the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed; (3) the financial assets are readily obtainable in the market; and (4) the financial instrument and the repurchase agreement are not coterminous. This FSP is effective for us on January 1, 2009. We are currently evaluating FSP FAS 140-3 but do not expect its application to have a significant impact on our financial reporting.

In March 2008, the FASB issued SFAS No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities, and an amendment of FASB Statement No. 133. SFAS 161 attempts to improve the transparency of financial reporting by providing additional information about how derivative and hedging activities affect an entity's financial position, financial performance and cash flows. This statement changes the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosure about (1) how and why an entity uses derivative instruments, (2) how derivative instruments and related hedged items are accounted for under SFAS Statement 133 and its related interpretations, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. To meet these objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This disclosure framework is intended to better convey the purpose of derivative use in terms of the risks that an entity is intending to manage. SFAS 161 is effective for us on January 1, 2009. We expect that adoption of SFAS 161 will increase footnote disclosure to comply with the disclosure requirements for financial statements issued after January 1, 2009.

37

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (the valuation of which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 was adopted by us on January 1, 2008. SFAS 157 did not have an impact on the manner in which we estimate fair value, but it required additional disclosure, which is included in Note 6.

On October 10, 2008, FASB issued FASB Staff Position (FSP) 157-3,

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ("FSP 157-3"), in response to the deterioration of the credit markets. This FSP provides guidance clarifying how SFAS 157 should be applied when valuing securities in markets that are not active. The guidance provides an illustrative example that applies the objectives and framework of SFAS 157, utilizing management's internal cash flow and discount rate assumptions when relevant observable data does not exist. It further clarifies how observable market information and market quotes should be considered when measuring fair value in an inactive market. It reaffirms the notion of fair value as an exit price as of the measurement date and that fair value analysis is a transactional process and should not be broadly applied to a group of assets. FSP 157-3 is effective upon issuance including prior periods for which financial statements have not been issued. FSP 157-3 does not have a material effect on the fair value of our assets as we intend to continue to hold assets that can be valued via level 1 and level 2 criteria, as defined under SFAS No. 157.

### Results of Operations:

#### Net Income Summary

For the year ended December 31, 2008, our net income was \$346.2 million or \$0.64 basic income per average share related to common shareholders, as compared to \$414.4 million net income or \$1.32 basic net income per average share for the year ended December 31, 2007. For the year ended December 31, 2006, our net income was \$93.8 million or \$0.44 basic net income per average share related to common shareholders. Net income per average share decreased by \$0.68 per average share available to common shareholders and total net income decreased \$68.2 million for the year ended December 31, 2008, when compared to the year ended December 31, 2007. We attribute the decrease in total net income for the year ended December 31, 2008 from the year ended December 31, 2007 primarily to recording of unrealized losses related to interest rate swaps in the fourth quarter of 2008. An unrealized loss of \$768.3 million was recorded in the income statement for the year ended December 31, 2008, as the result of de-designation of cash flow hedges. Prior to the fourth quarter of 2008, we recorded changes in the fair values in our interest rate swaps in the Accumulated Other Comprehensive Income in our Statement of Financial Condition. Net interest income increased by \$797.5 million for the year ended December 31, 2008, as compared to the year ended December 31, 2007, due to the increase in interest earning assets from the deployment of additional capital we raised in 2008 and the improved interest rate spread. For the year ended December 31, 2008, net gain on sale of Mortgage-Backed Securities was \$10.7 million, as compared to a net gain of \$19.1 million for the year ended December 31, 2007. The loss on other-than-temporarily impaired securities totaled \$31.8 million for the year ended December 31, 2008, as compared to \$1.2 million for the year ended December 31, 2007. During the year ended December 31, 2008, our general and administrative expenses increased to \$103.6 million, as compared to \$62.7 million for the year ended December 31, 2007.

We attribute the increase in total net income for the year ended December 31, 2007 compared to the year ended December 31, 2006 primarily to the increase in net interest income, gains on the sale of securities, a reduction in losses on other-than temporarily impaired securities, the increased asset base, and the increase in interest rate spread. The interest rate spread increased from 0.38% for the year ended December 31, 2006 to 0.70% for the year ended December 31, 2007. For the year ended December 31, 2007, net gain on sale of Mortgage-Backed Securities was \$19.1 million, as compared to a net loss of \$3.9 million in 2006. The table below presents the net income (loss) summary for the years ended December 31, 2008, 2007, and 2006.

# Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

## Net Income (Loss) Summary (dollars in thousands, except for per share data)

	Year Dec
Interest income	\$3
Interest expense	1
Net interest income	1
Other (loss) income:	
Investment advisory and service fees	
Gain (loss) on sale of investment securities	
Gain on termination of interest rate swaps	
Income from trading securities	
Dividend income from available-for-sale equity securities	
Loss on other-than-temporarily impaired securities	
Unrealized loss on interest rate swaps	
Total other (loss) income	
Expenses:	
Distribution fees	
General and administrative expenses	
Total expenses	
Impairment of intangible for customer relationships	
Income before income taxes and minority interest	
Income taxes	
Income before minority interest	
Minority interest	
Net Income	
Dividends on preferred stock	
Net income available to common shareholders	
Weighted average number of basic common shares outstanding	507
Weighted average number of diluted common shares outstanding	507
Basic net income per average common share	
Diluted net income per average common share	

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Average total assets

Average equity

Return on average total assets

Return on average equity

### Interest Income and Average Earning Asset Yield

We had average earning assets of \$56.0 billion for the year ended December 31, 2008. We had average earning assets of \$40.8 billion for the year ended December 31, 2007. We had average earning assets of \$23.0 billion for the year ended December 31, 2006. Our primary source of income is interest income. Our interest income was \$3.1 billion for the year ended December 31, 2008, \$2.4 billion for the year ended December 31, 2007, and \$1.2 billion for the year ended December 31, 2006. The yield on average investment securities was 5.57%, 5.77%, and 5.31% for the respective years. The prepayment speeds decreased to an average of 10% CPR for the year ended December 31, 2008 from an average of 15% CPR for the year ended December 31, 2007.

39

### Interest Expense and the Cost of Funds

Our largest expense is the cost of borrowed funds. We had average borrowed funds of \$50.3 billion and total interest expense of \$1.9 billion for the year ended December 31, 2008. We had average borrowed funds of \$38.0 billion and total interest expense of \$1.9 billion for the year ended December 31, 2007. We had average borrowed funds of \$21.4 billion and total interest expense of \$1.1 billion for the year ended December 31, 2006. Our average cost of funds was 3.76% for the year ended December 31, 2008 and 5.07% for the year ended December 31, 2007 and 4.93 % for the year ended December 31, 2006. The cost of funds rate decreased by 131 basis points and the average borrowed funds increased by \$12.3 billion for the year ended December 31, 2008 when compared to the year ended December 31, 2007. Interest expense for the year ended December 31, 2008 decreased by \$37.6 million over the prior year due to the substantial decrease in the average cost of funds rate. The cost of funds rate increased by 14 basis points and the average borrowed funds increased by \$16.6 billion for the year ended December 31, 2007 when compared to the year ended December 31, 2006. Interest expense for the year ended December 31, 2007 increased by \$871.5 million over the previous year due to the substantial increase in the average borrowed funds and the increase in the average cost of funds rate. Since a substantial portion of our repurchase agreements are short term, changes in market rates are directly reflected in our interest expense. Our average cost of funds was 1.08% above average one-month LIBOR and 0.70% above average six-month LIBOR for the year ended December 31, 2008. Our average cost of funds was 0.12% below average one-month LIBOR and 0.12% below average six-month LIBOR for the year ended December 31, 2007. Our average cost of funds was 0.10% below average one-month LIBOR and 0.28% below average six-month LIBOR for the year ended December 31, 2006.

The table below shows our average borrowed funds and average cost of funds as compared to average one-month and average six-month LIBOR for the years ended December 31, 2008, 2007, 2006, 2005, and 2004 and the four quarters in 2008.

#### Average Cost of Funds

-----  
(Ratios for the four quarters in 2008 have been annualized, dollars in thousands)

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One- Month LIBOR
For the Year Ended December 31, 2008	\$50,270,226	\$1,888,912	3.76%	2.68%
For the Year Ended December 31, 2007	\$37,967,215	\$1,926,465	5.07%	5.19%
For the Year Ended December 31, 2006	\$21,399,130	\$1,055,013	4.93%	5.03%
For the Year Ended December 31, 2005	\$17,408,828	\$568,560	3.27%	3.33%
For the Year Ended December 31, 2004	\$15,483,118	\$270,116	1.74%	1.50%
For the Quarter Ended December 31, 2008	\$47,581,332	\$450,805	3.79%	2.23%
For the Quarter Ended September 30, 2008	\$51,740,645	\$458,250	3.54%	2.62%
For the Quarter Ended June 30, 2008	\$50,359,825	\$442,251	3.51%	2.59%
For the Quarter Ended March 31, 2008	\$51,399,101	\$537,606	4.18%	3.31%

40

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$1.2 billion for the year ended December 31, 2008 and \$429.0 million for the year ended December 31, 2007 and \$166.9 million for the year ended December 31, 2006. Our net interest income increased for the year ended December 31, 2008, as compared to the year ended December 31, 2007, because of the increased average asset base in 2008 and the increased interest rate spread. Our net interest income increased for the year ended December 31, 2007 as compared to the year ended December 31, 2006 by \$262.1 million because of the increased average asset base for 2007. In 2008 average assets increased because of the deployment of additional capital. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.81% for the year ended December 31, 2008 as compared to 0.70% for the year ended December 31, 2007 and 0.38% for the year ended December 31, 2006. This 111 basis point increase in interest rate spread for 2008 over the spread for 2007 was the result in the decrease in the average cost of funds of 131 basis points, which was only partially offset by a decrease in average yield on average interest earning assets of 20 basis points.

The table below shows our interest income by average Investment Securities held, total interest income, yield on average interest earning assets, average balance of repurchase agreements, interest expense, average cost of funds, net interest income, and net interest rate spread for the years ended December 31, 2008, 2007, 2006, 2005, and 2004 and the four quarters in 2008.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

### Net Interest Income

(Ratios for the four quarters in 2008 have been annualized, dollars in thousands)

	Average Investment Securities Held	Total Interest Income	Yield on Average Interest Earning Assets	Average Balance of Repurchase Agreements	Interest Expense	Average Cost of Funds	Net Interest Income
For the Year Ended December 31, 2008	\$55,962,519	\$3,115,428	5.57%	\$50,270,226	\$1,888,912	3.76%	\$1,226,
For the Year Ended December 31, 2007	\$40,800,148	\$2,355,447	5.77%	\$37,967,215	\$1,926,465	5.07%	\$428,
For the Year Ended December 31, 2006	\$23,029,195	\$1,221,882	5.31%	\$21,399,130	\$1,055,013	4.93%	\$166,
For the Year Ended December 31, 2005	\$18,543,749	\$705,046	3.80%	\$17,408,827	\$568,560	3.27%	\$136,
For the Year Ended December 31, 2004	\$16,399,184	\$532,328	3.25%	\$15,483,118	\$270,116	1.74%	\$262,
For the Quarter Ended December 31, 2008	\$53,838,665	\$740,282	5.50%	\$47,581,332	\$450,805	3.79%	\$289,
For the Quarter Ended September 30, 2008	\$57,694,277	\$810,659	5.62%	\$51,740,645	\$458,250	3.54%	\$352,
For the Quarter Ended June 30, 2008	\$56,197,550	\$773,359	5.50%	\$50,359,825	\$442,251	3.51%	\$331,
For the Quarter Ended March 31, 2008	\$56,119,584	\$791,128	5.64%	\$51,399,101	\$537,606	4.18%	\$253,

### Investment Advisory and Service Fees

FIDAC and Merganser are registered investment advisors specializing in managing fixed income securities. At December 31, 2008, FIDAC and Merganser had under management approximately \$7.0 billion in net assets and \$15.3 billion in gross assets, compared to \$3.1 billion in net assets and \$15.4 billion in gross assets at December 31, 2007. Net investment advisory and service fees for the years ended December 31, 2008, 2007, and 2006 totaled \$26.3 million, \$18.4 million, and \$18.9 million, respectively, net of fees paid to third parties pursuant to distribution service agreements for facilitating and promoting distribution of shares or units to FIDAC's clients. Gross assets under management will vary from time to time because of changes in the amount of net assets FIDAC and Merganser manage as well as changes in the amount of leverage used by the various funds and accounts FIDAC manages.

41

### Gains and Losses on Sales of Investment Securities and Interest Rate Swaps

For the year ended December 31, 2008, we sold Investment Securities with a carrying value of \$15.2 billion for aggregate net gain of \$10.7 million. For the year ended December 31, 2007, we sold investment securities with a aggregate historical amortized value of \$4.9 billion for a net gain of \$19.1 million. In addition, for the year ended December 31, 2007, we had a \$2.1 million gain on the termination of interest rate swaps with a notional amount of \$900 million. For the year ended December 31, 2006, we sold investment

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

securities with an aggregate historical amortized value of \$3.2 billion for an aggregate loss of \$3.9 million. In addition, for the year ended December 31, 2006, we had a \$10.7 million gain on the termination of interest rate swaps with a notional amount of \$1.2 billion. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to move into new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

### Income from Trading Securities

Gross income from trading securities totaled \$9.7 million, \$19.1 million, and \$4.0 million for the year ended December 31, 2008, 2007 and 2006.

### Dividend Income from Available-For-Sale Equity Securities

Dividend income from our investment in Chimera totaled \$2.7 million for the year ended December 31, 2008 and \$91,000 for the year ended December 31, 2007. For the year 2006 we did not have an investment in available-for-sale equity securities.

### Loss on Other-Than-Temporarily Impaired Securities

At each quarter end, we review each of our securities to determine if an other-than-temporary impairment charge would be necessary. We will take these charges if we determine that we do not intend to hold securities that were in an unrealized loss position for a period of time, to maturity if necessary, sufficient for a forecasted market price recovery up to or beyond the cost of the investments. For the year ended December 31, 2008 the loss on other-than-temporarily impaired securities totaled \$31.8 million related to our equity investment in Chimera. For the years ended December 31, 2007 and 2006 the loss on other-than-temporarily impaired securities totaled \$1.2 million and \$52.3 million, respectively.

### Impairment of Goodwill and Intangibles

During the years ended December 31, 2008 and 2007, it was determined that there was no impairment of intangibles. The total impairment of intangible assets relating to customer relationships was \$2.5 million for the year ended December 31, 2006. There were no impairment charges related to goodwill during the years ended 2008, 2007, and 2006.

### General and Administrative Expenses

General and administrative (or G&A) expenses were \$103.6 million for the year ended December 31, 2008, \$62.7 million for the year ended December 31, 2007, and \$40.1 million for the year ended December 31, 2006. G&A expenses as a percentage of average total assets was 0.18%, 0.15%, and 0.17% for the years ended December 31, 2008, 2007, and 2006, respectively. The increase in G&A expenses of \$40.9 million for the year December 31, 2008 was primarily the result of increased compensation, directors and officers insurance and additional costs related to our subsidiaries. Staff increased from 34 at the end of 2006 to 39 at the end of 2007 and 65 at the end of 2008.

The table below shows our total G&A expenses as compared to average total assets and average equity for the years ended December 31, 2008, 2007, 2006, 2005, and 2004 and the four quarters in 2008.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

### G&A Expenses and Operating Expense Ratios

-----  
(ratios for the quarters have been annualized, dollars in thousands)

	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
For the Year Ended December 31, 2008	\$103,622	0.18%	1.55%
For the Year Ended December 31, 2007	\$62,666	0.15%	1.69%
For the Year Ended December 31, 2006	\$40,063	0.17%	2.00%
For the Year Ended December 31, 2005	\$26,278	0.14%	1.63%
For the Year Ended December 31, 2004	\$24,029	0.14%	1.55%
For the Quarter Ended December 31, 2008	\$26,957	0.18%	1.50%
For the Quarter Ended September 30, 2008	\$25,455	0.17%	1.40%
For the Quarter Ended June 30, 2008	\$27,215	0.18%	1.59%
For the Quarter Ended March 31, 2008	\$23,995	0.17%	1.64%

#### Net Income and Return on Average Equity

Our net income was \$346.2 million for the year ended December 31, 2008, net income was \$414.4 million for the year ended December 31, 2007, and net income was \$93.8 million for the year ended December 31, 2006. Our return on average equity was 5.18% for the year ended December 31, 2008, was 11.17% for the year ended December 31, 2007, and 4.68% for the year ended December 31, 2006. Net interest income increased by \$797.5 million for the year ended December 31, 2008, as compared to the year ended December 31, 2007, due to the increase in interest earning assets from the deployment of additional capital we raised in 2008 and the improved interest rate spread. Even with the increase in net interest income of \$797.5 million, net income for the year decreased by \$68.2 million. We attribute the decrease in total net income for the year ended December 31, 2008 from the year ended December 31, 2007 primarily to the de-designation of interest rate swaps as cash flow hedges in the fourth quarter of 2008, which resulted in an unrealized loss of \$768.3 million being recorded in the income statement for the year ended December 31, 2008. Prior to the fourth quarter of 2008 and the de-designation of cash flow hedges, we recorded these changes in the market values of interest rate swaps in the Statement of Financial Condition.

We attribute the increase in total net income for the year ended December 31, 2007 compared to the year ended December 31, 2006 primarily to the increase in net interest income, gains on the sale of securities, a reduction in losses on other-than temporarily impaired securities, the increased asset base, and the increase in interest rate spread.

The table below shows our net interest income, net investment advisory and service fees, gain (loss) on sale of Mortgage-Backed Securities and termination of interest rate swaps, loss on other-than-temporarily impaired securities, income from trading securities, G&A expenses, income taxes, impairment of intangibles for customer relationships, minority interest, each as a percentage of average equity, and the return on average equity for the years ended December 31, 2008, 2007, 2006, 2005, and 2004, and the four quarters in 2008.

#### Components of Return on Average Equity

-----  
(Ratios for the quarters have been annualized)



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	Net Interest Income /Average Equity	Net Investment Advisory and Service Fees /Average Equity	Gain/(Loss) on Sale of Mortgage-Backed Securities and Realized and Unrealized Gain / (Loss) Interest Rate Swaps /Average Equity	Loss on other-than-temporarily impaired securities/ Average Equity	Income from trading securities /Average Equity	Dividend income from available-for-sale equity securities	G&A Expenses/ Average Equity	Income Taxes/ Average Equity
For the Year Ended December 31, 2008	18.36%	0.39%	(11.34%)	(0.48%)	0.15%	0.04%	(1.55%)	(0.39%)
For the Year Ended December 31, 2007	11.56%	0.50%	0.57%	(0.03%)	0.52%	0.00%	(1.69%)	(0.24%)
For the Year Ended December 31, 2006	8.32%	0.94%	0.34%	(2.61%)	0.20%	-	(2.00%)	(0.38%)
For the Year Ended December 31, 2005	8.45%	1.71%	(3.30%)	(5.15%)	-	-	1.63%	0.67%
For the Year Ended December 31, 2004	16.92%	0.62%	0.34%	-	-	-	1.55%	0.29%
For the Quarter Ended December 31, 2008	16.06%	0.38%	(42.63%)	-	(0.11%)	0.03%	(1.50%)	(0.35%)
For the Quarter Ended September 30, 2008	19.52%	0.41%	(0.07%)	(1.76%)	0.42%	0.03%	(1.40%)	(0.42%)
For the Quarter Ended June 30, 2008	19.40%	0.35%	0.16%	-	0.13%	0.03%	(1.59%)	(0.44%)

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Quarter Ended March 31, 2008	17.38%	0.41%	0.64%	-	0.13%	0.06%	(1.64%)	(0.32%)
---------------------------------------	--------	-------	-------	---	-------	-------	---------	---------

43

### Financial Condition

#### Investment Securities, Available for Sale

All of our Mortgage-Backed Securities at December 31, 2008, 2007, and 2006 were adjustable-rate or fixed-rate mortgage-backed securities backed by single-family mortgage loans. All of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. All of our mortgage-backed securities were FHLMC, FNMA or GNMA mortgage pass-through certificates or CMOs, which carry an implied "AAA" rating. All of our agency debentures are callable and carry an implied "AAA" rating. We carry all of our earning assets at fair value.

We accrete discount balances as an increase in interest income over the life of discount investment securities and we amortize premium balances as a decrease in interest income over the life of premium investment securities. At December 31, 2008, 2007, and 2006 we had on our balance sheet a total of \$64.4 million, \$77.4 million and \$78.4 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of our investment securities acquired at a price below principal value) and a total of \$619.5 million, \$405.8 million and \$219.1 million, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our investment securities acquired at a price above principal value).

We received mortgage principal repayments of \$8.6 billion for the year ended December 31, 2008, \$6.8 billion for the year ended December 31, 2007, and \$5.1 billion for the year ended December 31, 2006. The average prepayment speed for the year ended December 31, 2008, 2007 and 2006 was 13%, 15%, and 17%, respectively. During the year ended December 31, 2008, the average CPR declined to 13% from 15% during the year ended December 31, 2007, due to a decline in refinancing activity. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Investment Securities at December 31, 2008, 2007, 2006, 2005, and 2004 and September 30, 2008, June 30, 2008, and March 31, 2008.

Investment Securities  
-----  
(dollars in thousands)

Amortized

Fair

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	Principal Amount	Net Premium	Amortized Cost	Cost/Principal Amount	Fair Value	Value/Principal Amount
At December 31, 2008	\$54,508,672	\$555,043	\$55,063,715	101.02%	\$55,645,940	102.88%
At December 31, 2007	\$52,569,598	\$328,376	\$52,897,974	100.62%	\$53,133,443	101.24%
At December 31, 2006	\$30,134,791	\$140,709	\$30,275,500	100.47%	\$30,217,009	100.27%
At December 31, 2005	\$15,915,801	\$220,637	\$16,136,438	101.39%	\$15,929,864	100.12%
At December 31, 2004	\$19,123,902	\$425,792	\$19,549,694	102.23%	\$19,428,895	101.55%
At September 30, 2008	\$55,211,123	\$525,394	\$55,736,517	100.95%	\$55,459,280	100.78%
At June 30, 2008	\$58,304,678	\$500,721	\$58,805,399	100.86%	\$58,749,300	100.55%
At March 31, 2008	\$56,006,707	\$383,334	\$56,390,041	100.68%	\$56,853,862	101.32%

44

The table below summarizes certain characteristics of our Investment Securities at December 31, 2008, 2007, 2006, 2005, and 2004 and September 30, 2008, June 30, 2008, and March 31, 2008. The index level for adjustable-rate Investment Securities is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

Adjustable-Rate Investment Security Characteristics

(dollars in thousands)

	Principal Amount	Weighted Average Coupon Rate	Weighted Average Term to Next Adjustment	Weighted Average Lifetime Cap	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investment Securities
At December 31, 2008	\$19,540,152	4.75%	36 months	10.00%	3.93%	35.85%
At December 31, 2007	\$15,331,447	5.90%	39 months	9.89%	5.63%	29.16%
At December 31, 2006	\$8,493,242	5.72%	19 months	9.76%	5.57%	28.18%
At December 31, 2005	\$9,699,133	4.76%	22 months	10.26%	4.74%	60.94%
At December 31, 2004	\$13,544,872	4.23%	24 months	10.12%	3.24%	70.83%
At September 30, 2008	\$19,310,012	5.27%	37 months	9.98%	4.65%	34.97%
At June 30, 2008	\$18,418,637	5.16%	36 months	9.89%	4.54%	31.59%
At March 31, 2008	\$17,487,518	5.19%	35 months	9.73%	4.40%	31.22%

Fixed-Rate Investment Security Characteristics

(dollars in thousands)

	Principal Amount	Weighted Average Coupon Rate	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investment Securities
At December 31, 2008	\$34,968,520	6.13%	5.84%	64.15%

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

At December 31, 2007	\$37,238,151	6.00%	5.80%	70.84%
At December 31, 2006	\$21,641,549	5.83%	5.65%	71.82%
At December 31, 2005	\$6,216,668	5.37%	4.60%	39.06%
At December 31, 2004	\$5,579,030	5.24%	3.89%	29.17%
At December 31, 2003	\$3,387,196	5.77%	4.29%	26.71%
-----				
At September 30, 2008	\$35,901,111	6.06%	5.82%	65.03%
At June 30, 2008	\$39,886,041	6.00%	5.70%	68.41%
At March 31, 2008	\$38,519,189	5.98%	5.80%	68.78%

At December 31, 2008 and 2007, we held Investment Securities with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

Adjustable-Rate Investment Securities by Index

December 31, 2008

	One- Month Libor	Six- Month Libor	Twelve Month Libor	12-Month Moving Average	11 Dis Cos Fu
	-----	-----	-----	-----	-----
Weighted Average Term to Next Adjustment	1 mo.	25 mo.	55 mo.	1 mo.	
Weighted Average Annual Period Cap	6.28%	1.95%	1.98%	0.00%	
Weighted Average Lifetime Cap at December 31, 2008	7.07%	10.87%	10.92%	8.86%	1
Investment Principal Value as Percentage of Investment Securities at December 31, 2008	8.11%	2.53%	19.32%	0.99%	

(1) Combination of indexes that account for less than 0.05% of total investment securities.

45

Adjustable-Rate Investment Securities by Index

December 31, 2007

	One- Month Libor	Six- Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	3-Year Treasury Index
	-----	-----	-----	-----	-----	-----	-----
Weighted Average Term to Next Adjustment	1 mo.	38 mo.	72 mo.	1 mo.	1 mo.	36 mo.	18 mo.
Weighted Average Annual Period Cap	6.48%	1.72%	2.00%	0.42%	0.00%	1.88%	2.07%

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Weighted Average Lifetime							
Cap at December 31, 2007	7.13%	11.25%	11.08%	9.15%	12.08%	10.73%	13.18%
Investment Principal Value as							
Percentage of Investment							
Securities at December 31, 2007	8.24%	1.89%	7.23%	0.67%	0.19%	3.39%	0.05%

(1) Combination of indexes that account for less than 0.05% of total investment securities.

### Reverse Repurchase Agreements

At December 31, 2008, we lent \$562.1 million to Chimera in an overnight reverse repurchase agreement. This amount is included at fair value in our Statement of Financial Condition. The interest rate at December 31, 2008 was an at the market rate of 1.43%. The average rate on all reverse repurchase agreements for the year was 2.99%. The collateral for this loan is mortgage-backed securities.

### Trading Securities and Trading Securities Sold, Not Yet Purchased

Trading securities and trading securities sold, not yet purchased, are included in the balance sheet as a result of consolidating the financial statements of an affiliated investment fund. The resulting realized and unrealized gains and losses are reflected in the statements of operations. There were no trading securities and trading securities sold, not yet purchased at December 31, 2008. The fair value of the trading securities was \$11.7 million and the trading securities sold, not yet purchased, was \$32.8 million at December 31, 2007.

### Receivable from Prime Broker on Equity Investment

The net assets of the investment fund are subject to English bankruptcy law, which governs the administration of Lehman Brothers International (Europe) (LBIE), as well as the law of New York, which governs the contractual documents. Until our contractual documents with LBIE are terminated, the value of the assets and liabilities in our account with LBIE will continue to fluctuate based on market movements. We do not intend to terminate these contractual documents until LBIE's administrators have clarified the consequences of us doing so. We have not received notice from LBIE's administrators that LBIE has terminated the documents. LBIE's administrators have advised us that they can provide us with no additional information about our account at this time. As a result, we have presented the market value of our account with LBIE as of September 15, 2008, which is the date of the last statement we received from LBIE on the account's assets and liabilities. We can provide no assurance, however, that we will recover all or any portion of these assets following completion of LBIE's administration (and any subsequent liquidation).

46

### Borrowings

To date, our debt has consisted entirely of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our balance sheet as repurchase agreements. At December 31, 2008, we had established uncommitted borrowing facilities in this market with 30 lenders in amounts which we believe are in excess of our needs. All of our Investment Securities are currently accepted as collateral for these borrowings. However, we limit our

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet.

For the year ended December 31, 2008, the term to maturity of our borrowings ranged from one day to three years. Additionally, we have entered into structured borrowings giving the counterparty the right to call the balance prior to maturity. The weighted average original term to maturity of our borrowings was 287 days at December 31, 2008. For the year ended December 31, 2007, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 286 days at December 31, 2007. For the year ended December 31, 2006, the term to maturity of our borrowings ranged from one day to three years, with a weighted average original term to maturity of 194 days at December 31, 2006.

At December 31, 2008, the weighted average cost of funds for all of our borrowings was 4.08%, with the effect of the interest rate swaps, and the weighted average term to next rate adjustment was 238 days. At December 31, 2007, the weighted average cost of funds for all of our borrowings 4.76% and the weighted average term to next rate adjustment was 234 days.

### Liquidity

Liquidity, which is our ability to turn non-cash assets into cash, allows us to purchase additional investment securities and to pledge additional assets to secure existing borrowings should the value of our pledged assets decline. Potential immediate sources of liquidity for us include cash balances and unused borrowing capacity. Unused borrowing capacity will vary over time as the market value of our investment securities varies. Our non-cash assets are largely actual or implied AAA assets, and accordingly, we have not had, nor do we anticipate having, difficulty in converting our assets to cash. Our balance sheet also generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should our needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, we believe that in most circumstances our investment securities could be sold to raise cash. The maintenance of liquidity is one of the goals of our capital investment policy. Under this policy, we limit asset growth in order to preserve unused borrowing capacity for liquidity management purposes.

Borrowings under our repurchase agreements increased by \$700 million to \$46.7 billion at December 31, 2008, from \$46.0 billion at December 31, 2007. Even though borrowing increased over the year, leverage declined from 8.7:1 to 6.4:1.

We anticipate that, upon repayment of each borrowing under a repurchase agreement, we will use the collateral immediately for borrowing under a new repurchase agreement. We have not at the present time entered into any commitment agreements under which the lender would be required to enter into new repurchase agreements during a specified period of time, nor do we presently plan to have liquidity facilities with commercial banks.

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties (i.e., lenders) in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (a "margin call"), which may take the form of additional securities or cash. Similarly, if the estimated fair value of investment securities increases due to changes in market interest rates or market factors, lenders may release collateral back to us. Specifically, margin calls result from a decline in the value of the our Mortgage-Backed Securities securing our repurchase agreements, prepayments on the mortgages securing such Mortgage-Backed Securities and to changes in the

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

estimated fair value of such Mortgage-Backed Securities generally due to principal reduction of such Mortgage-Backed Securities from scheduled amortization and resulting from changes in market interest rates and other market factors. Through December 31, 2008, we did not have any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should prepayment speeds on the mortgages underlying our Mortgage-Backed Securities and/or market interest rates suddenly increase, margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

47

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements, the non-cancelable office lease and employment agreements at December 31, 2008. The table does not include the effect of net interest rate payments under our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate, At December 31, 2008, the interest rate swaps had a negative fair value of \$1.1 billion.

	(dollars in thousands)			
	Within One Year	One to Three Years	Three to Five Years	More than Five Years
Contractual Obligations				
Repurchase agreements	\$40,195,726	\$2,930,000	\$2,049,159	\$1,500,000
Interest expense on repurchase agreements, based on rates at 12-31-08	367,979	395,150	183,269	196,000
Long-term operating lease obligations	532		-	
Employment contracts	36,645	-	-	
<b>Total</b>	<b>\$40,600,882</b>	<b>\$3,325,150</b>	<b>\$2,232,428</b>	<b>\$1,696,000</b>

### Stockholders' Equity

On May 13, 2008 we entered into an underwriting agreement pursuant to which we sold 69,000,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on May 19, 2008.

On January 23, 2008 we entered into an underwriting agreement pursuant to which we sold 58,650,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on January 29, 2008.

During the year ended December 31, 2008, we raised \$93.7 million by issuing 5.8 million shares through our Direct Purchase and Dividend Reinvestment Program.

On August 3, 2006, we entered into an ATM Equity Offering(sm) Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, relating to the sale of shares of our common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

ended December 31, 2008, 588,000 shares of our common stock were issued pursuant to this program, totaling \$11.5 million in net proceeds.

On August 3, 2006, we entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of our common stock from time to time through UBS Securities. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 3.8 million shares of our common stock were issued pursuant to this program, totaling \$60.3 million in net proceeds.

During the year ended December 31, 2008, 300,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$2.8 million.

On October 11, 2007, we entered into an underwriting agreement pursuant to which we sold 71,300,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$1.0 billion. This transaction settled on October 17, 2007.

On July 12, 2007, we entered into an underwriting agreement pursuant to which we sold 54,050,000 shares of our common stock for proceeds of \$720.8 million net of underwriting fees. This transaction settled on July 18, 2007.

48

On March 7, 2007, we entered into an underwriting agreement pursuant to which we sold 57,500,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$737.4 million. This transaction settled on March 13, 2007.

During the year ended December 31, 2007 we sold 4.5 million shares of our common stock, for net proceeds of \$66.2 million, under the ATM Equity Sales Agreement with Merrill. During the year ended December 31, 2007, we sold 1.1 million shares of our common stock for net proceeds of \$14.7 million under our Equity Shelf Program with UBS Securities, pursuant to which sales are made by means of ordinary brokers' transaction on the New York Stock Exchange.

During the year ended December 31, 2007, we raised \$116.5 million by issuing 8.0 million shares through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2007, 55,738 options were exercised under the Incentive Plan for an aggregate exercise price of \$576,000.

On August 16, 2006, we entered into an underwriting agreement pursuant to which we sold 40,825,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$476.7 million. This transaction settled on August 22, 2006.

On April 6, 2006, we entered into an underwriting agreement pursuant to which we sold 39,215,000 shares of our common stock for net proceeds following underwriting expenses of approximately \$437.7 million. On April 6, 2006, we entered into a second underwriting agreement pursuant to which we sold 4,600,000 shares of our 6% Series B Cumulative Convertible Preferred Stock for net proceeds following underwriting expenses of approximately \$111.5 million. Each of these transactions settled on April 12, 2006. The 6% Series B Cumulative Preferred Stock has been treated under GAAP as temporary equity. For the purpose of computing ratios relating to equity measures, the Series B Preferred Stock has been included in equity.

During the year ended December 31, 2006, 1,598,500 shares of the



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Company's common stock were issued through the ATM Programs and Equity Shelf Program with UBS Securities, totaling net proceeds of \$20.9 million. During the year ended December 31, 2006, 22,160 options were exercised under the long-term compensation plan for an aggregate exercise price of \$183,000.

### Unrealized Gains and Losses

With our "available-for-sale" accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders' equity under "Accumulated Other Comprehensive Income (Loss)." As a result of the de-designation of interest rate swaps as cash flow hedges during the quarter ended December 31, 2008, unrealized gains and losses in our interest rate swaps impact our GAAP income.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows unrealized gains and losses on the Investment Securities, available-for-sale equity securities and interest rate swaps in our portfolio prior to de-designation.

### Unrealized Gains and Losses

-----  
(dollars in thousands)

	At December 31,			
	2008	2007	2006	2005
Unrealized gain	\$785,087	\$379,348	\$112,596	\$ 5,027
Unrealized loss	(532,857)	(531,545)	(188,708)	(211,601)
Net Unrealized (loss) gain	\$252,230	(\$152,197)	(\$76,112)	(\$206,574)

49

Unrealized changes in the estimated net fair value of investment securities have one direct effect on our potential earnings and dividends: positive changes increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our capital investment policy. A very large negative change in the net fair value of our investment securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

### Leverage

Our debt-to-equity ratio at December 31, 2008, 2007 and 2006 was 6.4:1, 8.7:1 and 10.4:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

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

### Asset/Liability Management and Effect of Changes in Interest Rates

We continually review our asset/liability management strategy with respect to interest rate risk, mortgage prepayment risk, credit risk and the related issues of capital adequacy and liquidity. Our goal is to provide attractive risk-adjusted stockholder returns while maintaining what we believe is a strong balance sheet.

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, we have attempted to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in our portfolio of investment securities by entering into interest rate swaps. At December 31, 2008, we had entered into swap agreements with a total notional amount of \$17.6 billion. We agreed to pay a weighted average pay rate of 4.66% and receive a floating rate based on one month LIBOR. At December 31, 2007, we entered into swap agreements with a total notional amount of \$16.2 billion. We agreed to pay a weighted average pay rate of 5.03% and receive a floating rate based on one month LIBOR. We may enter into similar derivative transactions in the future by entering into interest rate collars, caps or floors or purchasing interest only securities.

Changes in interest rates may also affect the rate of mortgage principal prepayments and, as a result, prepayments on mortgage-backed securities. We seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets we purchase at a premium with assets we purchase at a discount. To date, the aggregate premium exceeds the aggregate discount on our mortgage-backed securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce our net income compared to what net income would be absent such prepayments.

### Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

### Capital Resources

At December 31, 2008, we had no material commitments for capital expenditures.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors drive our performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our dividends are based upon our net income as calculated for tax purposes; in each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

### Other Matters

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the years ended December 31, 2008 and 2007. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the years ended December 31, 2008 and 2007. Consequently, we met the REIT income and asset test. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, for the years ended of December 31, 2008, 2007, and 2006, we believe that we qualified as a REIT under the Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, or the Investment Company Act. If we were to become regulated as an investment company, then our use of leverage would be substantially reduced. The Investment Company Act exempts entities that are "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate" (qualifying interests). Under current interpretation of the staff of the SEC, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in qualifying interests and at least 80% of our assets in qualifying interests plus other real estate related assets. In addition, unless certain mortgage securities represent all the certificates issued with respect to an underlying pool of mortgages, the Mortgage-Backed Securities may be treated as securities separate from the underlying mortgage loans and, thus, may not be considered qualifying interests for purposes of the 55% requirement. We calculate that as of December 31, 2008 and December 31, 2007, we were in compliance with this requirement.

51

### ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

-----

#### MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risk to which we are exposed is interest rate risk, which is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of our Mortgage-Backed Securities and our ability to realize gains from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, caps, floors, inverse floaters and other interest rate exchange contracts, in order to limit the effects of interest rates on our operations. When we use these types of derivatives to hedge the risk of interest-earning assets or interest-bearing liabilities, we may be subject to certain risks, including the risk that losses on a hedge position will reduce the funds available for

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

payments to holders of securities and that the losses may exceed the amount we invested in the instruments.

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income, portfolio value should interest rates go up or down 25, 50 and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at December 31, 2008 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

Change in Interest Rate	Projected Percentage Change in Net Interest Income	Projected Perc Portfolio Valu Interest
-75 Basis Points	8.82%	1
-50 Basis Points	5.19%	1
-25 Basis Points	1.85%	1
Base Interest Rate	-	
+25 Basis Points	(3.68%)	0
+50 Basis Points	(7.62%)	0
+75 Basis Points	(11.57%)	(0

### ASSET AND LIABILITY MANAGEMENT

Asset and liability management is concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap", which is the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at December 31, 2008. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and does include the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially based on actual prepayment experience.

	Within 3 Months	4-12 Months	More than 1 Year to 3 Years	3 Year O
	(dollars in thousands)			
Rate Sensitive Assets:				
Investment Securities (Principal)	\$ 5,722,108	\$ 2,294,550	\$ 3,196,475	\$43,2
Cash Equivalents	909,353	-	-	
Reverse Repurchase Agreements	562,119			
Total Rate Sensitive Assets	7,193,580	2,294,550	3,196,475	43,2
Rate Sensitive Liabilities:				
Repurchase Agreements, with the effect of swaps	21,369,035	5,880,891	12,243,050	7,1
Interest rate sensitivity gap	(\$14,175,455)	(\$3,586,341)	(\$9,046,575)	\$36,1
Cumulative rate sensitivity gap	(\$14,175,455)	(\$17,761,796)	(\$26,808,371)	\$ 9,3
Cumulative interest rate sensitivity gap as a percentage of total rate-sensitive assets	(26%)	(33%)	(49%)	

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this report. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

#### ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements and the related notes, together with the Report of Independent Registered Public Accounting Firm thereon, are set forth on pages F-1 through F-22 of this Form 10-K.

#### ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND

##### FINANCIAL DISCLOSURE

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

None.

### ITEM 9A CONTROLS AND PROCEDURES

-----

Our management, including our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this annual report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is made known to our management, including our CEO and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms.

#### Management Report On Internal Control Over Financial Reporting

Dated: February 25, 2009

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

- o pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- o 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
- o provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

54

Based on management's assessment, the Company's management believes that, as of December 31, 2008, the Company's internal control over financial reporting was effective based on those criteria. There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended December 31, 2008 that have materially affected, or are reasonably likely to affect its internal control over financial reporting.

The Company's independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on the Company's internal control over financial reporting. This report appears on page F-1 of this annual report on Form 10-K.

### ITEM 9B. OTHER INFORMATION

-----

None.

### PART III

-----

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

-----

The information required by Item 10 as to our directors is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2008. The information regarding our executive officers required by Item 10 appears in Part I of this Form 10-K. The information required by Item 10 as to our compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2008.

We have adopted a Code of Business Conduct and Ethics within the meaning of Item 406(b) of Regulation S-K. This Code of Business Conduct and Ethics applies to our principal executive officer, principal financial officer and principal accounting officer. This Code of Business Conduct and Ethics is publicly available on our website at [www.annaly.com](http://www.annaly.com). If we make substantive amendments to this Code of Business Conduct and Ethics or grant any waiver, including any implicit waiver, we intend to disclose these events on our website.

### ITEM 11 EXECUTIVE COMPENSATION

-----

The information required by Item 11 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2008.

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

-----

The information required by Item 12 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

31, 2008.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR  
-----  
INDEPENDENCE  
-----

The information required by Item 13 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2008.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES  
-----

The information required by Item 14 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2008.

55

PART IV  
-----

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES.  
-----

(a) Documents filed as part of this report:

1. Financial Statements.
2. Schedules to Financial Statements:

All financial statement schedules not included have been omitted because they are either inapplicable or the information required is provided in our Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

3. Exhibits:

EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1	Articles of Amendment and Restatement of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on May 5, 1997).
3.2	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed with the Securities and Exchange Commission on June 12, 2002).
3.3	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on August 3, 2006).
3.4	Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- 3.3 to the Registrant's 8-A filed April 1, 2004).
- 3.5 Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's 8-K filed October 4, 2004).
- 3.6 Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's 8-K filed April 10, 2006).
- 3.7 Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
- 4.1 Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on September 17, 1997).
- 4.2 Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed with the Securities and Exchange Commission on December 5, 2001).
- 4.3 Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed with the SEC on April 1, 2004).
- 4.4 Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8K filed with the Securities and Exchange Commission on April 10, 2006).
- 10.1 Long-Term Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).\*

56

- 10.2 Form of Master Repurchase Agreement (incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
- 10.3 Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and Michael A.J. Farrell (incorporated by reference to Exhibit 10.3 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 1, 2006).
- 10.4 Amended and Restated Employment Agreement, dated as of February 25, 2008, between the Registrant and Wellington J. Denahan.\*
- 10.5 Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and Kathryn F. Fagan (incorporated by reference to Exhibit 10.5 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 1, 2006).
- 10.6 Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and James P. Fortescue (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 1, 2006).
- 10.7 Amended and Restated Employment Agreement, dated as of January 23, 2006, between the Registrant and Jeremy Diamond (incorporated by reference to Exhibit 10.7 for Diamond of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 1, 2006).
- 10.8 Amended and Restated Employment Agreement, dated as of January 23, 2006, between the Registrant and Ronald D. Kazel. Diamond (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 1, 2006).\*
- 10.9 Amended and Restated Employment Agreement, dated as of April 21, 2006, between the Registrant and Rose-Marie Lyght (incorporated by reference to Exhibit 10.9 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on May 9, 2006).\*
- 10.10 Amended and Restated Employment Agreement, effective as of June 4, 2006, between the Registrant and Rose-Marie Lyght (incorporated by reference to Exhibit 10.9 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on May 9, 2006).\*

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

- 2004, between the Registrant and Kristopher R. Konrad (incorporated by reference to Exhibit 10.11 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 10, 2005).\*
- 10.11 Amended and Restated Employment Agreement, dated January 23, 2006, between the Registrant and R. Nicholas Singh. Diamond (incorporated by reference to Exhibit 10.7 for Singh of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).\*
- 12.1 Computation of ratio of earnings to combined fixed charges and preferred stock dividends
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 31.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Exhibit Numbers 10.1 and 10.3-10.11 are management contracts or compensatory plans required to be filed as Exhibits to this Form 10-K.

57

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

FINANCIAL STATEMENTS

---

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007:

Consolidated Statements of Financial Condition

Consolidated Statements of Operations and Comprehensive Income (Loss)

Consolidated Statements of Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

58

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

To the Board of Directors and Stockholders of  
Annaly Capital Management, Inc.  
New York, New York

We have audited the accompanying consolidated statements of financial condition of Annaly Capital Management, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. We also have audited the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report On Internal Control Over Financial Reporting at Item 9A. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting 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 and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Annaly Capital Management, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Deloitte & Touche LLP  
New York, New York  
February 25, 2009

F-1

Part I  
Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
DECEMBER 31, 2008 AND 2007  
(dollars in thousands, except for share data)

ASSETS  
-----

Cash and cash equivalents  
Reverse repurchase agreements with affiliate  
Mortgage-Backed Securities, at fair value  
Agency debentures, at fair value  
Available for sale equity securities, at fair value  
Trading securities, at fair value  
Receivable for Mortgage-Backed Securities sold  
Accrued interest and dividends receivable  
Receivable from Prime Broker  
Receivable for advisory and service fees  
Intangible for customer relationships, net  
Goodwill  
Other assets

Total assets

LIABILITIES AND STOCKHOLDERS' EQUITY  
-----

Liabilities:

Repurchase agreements  
Payable for Investment Securities purchased  
Trading securities sold, not yet purchased, at fair value  
Accrued interest payable  
Dividends payable  
Accounts payable and other liabilities  
Interest rate swaps, at fair value

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Total liabilities

Minority interest in equity of consolidated affiliate

6.00% Series B Cumulative Convertible Preferred Stock:  
4,600,000 shares authorized 3,963,525 and 4,600,000 shares issued  
and outstanding respectively.

Commitments and contingencies (Note 13)

Stockholders' Equity:

7.875% Series A Cumulative Redeemable Preferred Stock:

7,412,500 shares authorized, issued and outstanding

Common stock: par value \$.01 per share; 987,987,500 shares

authorized, 541,475,366 and 401,822,703 issued and outstanding,  
respectively

Additional paid-in capital

Accumulated other comprehensive income (loss)

Accumulated deficit

Total stockholders' equity

Total liabilities, minority interest, Series B Cumulative Convertible  
Preferred Stock and stockholders' equity

See notes to consolidated financial statements.

F-2

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME  
YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006  
(dollars in thousands, except per share amounts)

Interest income  
Interest expense

Net interest income

Other (loss) income:

Investment advisory and service fees

Gain (loss) on sale of Investment Securities

Gain on termination of interest rate swaps

Income from trading securities

For

Dec

\$3

1

1

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Dividend income from available-for-sale equity securities	
Loss on other-than-temporarily impaired securities	
Unrealized loss on interest rate swaps	
Total other (loss) income	
Expenses:	
Distribution fees	
General and administrative expenses	
Total expenses	
Impairment of intangible for customer relationships	
Income before income taxes and minority interest	
Income taxes	
Income before minority interest	
Minority interest	
Net income	
Dividends on preferred stock	
Net income available to common shareholders	
Net income available per share to common shareholders:	
Basic	
Diluted	
Weighted average number of common shares outstanding:	
Basic	507
Diluted	507
Net income	
Other comprehensive gain (loss):	
Unrealized gain on available-for-sale securities	
Unrealized gain (loss) on interest rate swaps	
Reclassification adjustment for net loss (gains) included in net income	
Other comprehensive income (loss)	
Comprehensive income	
See notes to consolidated financial statements.	

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006  
(dollars in thousands, except per share data)

	Preferred Stock	Common Stock Par Value	Additional Paid-In Capital	Accumulated Deficit
BALANCE, DECEMBER 31, 2005	\$ 177,088	\$ 1,237	\$1,679,452	-
Net income	-	-	-	-
Other comprehensive income	-	-	-	-
Comprehensive income	-	-	-	-
Exercise of stock options	-	-	183	-
Option expense	-	-	1,285	-
Net proceeds from follow-on offerings	-	800	913,200	-
Net proceeds from equity shelf program	-	16	20,896	-
Preferred Series A dividends declared \$1.97 per share	-	-	-	-
Preferred Series B dividends declared \$1.08 per share	-	-	-	-
Common dividends declared, \$0.57 per share	-	-	-	-
<b>BALANCE, DECEMBER 31, 2006</b>	<b>177,088</b>	<b>2,053</b>	<b>2,615,016</b>	<b>-</b>
Net income	-	-	-	-
Other comprehensive loss	-	-	-	-
Comprehensive income	-	-	-	-
Exercise of stock options	-	-	576	-
Option and long-term compensation expense	-	-	1,355	-
Net proceeds from follow-on offerings	-	1,829	2,483,700	-
Net proceeds from ATM program	-	56	80,862	-
Net proceeds from direct purchase and dividend reinvestment	-	80	116,413	-
Preferred Series A dividends declared \$1.97 per share	-	-	-	-
Preferred Series B dividends declared \$1.50 per share	-	-	-	-
Common dividends declared, \$1.04 per share	-	-	-	-
<b>BALANCE, DECEMBER 31, 2007</b>	<b>177,088</b>	<b>4,018</b>	<b>5,297,922</b>	<b>-</b>
Net income	-	-	-	-
Other comprehensive income	-	-	-	-
Comprehensive income	-	-	-	-
Exercise of stock options	-	3	2,777	-
Option and long-term compensation expense	-	-	2,534	-
Conversion of Series B cumulative convertible Preferred Stock	-	13	15,411	-
Stock granted in acquisition	-	2	3,123	-
Net proceeds from follow-on offerings	-	1,277	2,146,266	-
Net proceeds from ATM program	-	44	71,788	-
Net proceeds from direct purchase and dividend reinvestment	-	58	93,617	-
Preferred Series A dividends declared \$1.97 per share	-	-	-	-
Preferred Series B dividends declared \$1.50 per share	-	-	-	-
Common dividends declared, \$2.08 per share	-	-	-	-
<b>BALANCE, DECEMBER 31, 2008</b>	<b>\$ 177,088</b>	<b>\$ 5,415</b>	<b>\$7,633,438</b>	<b>-</b>

See notes to consolidated financial statements

# Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

(dollars in thousands)

	For t E Decem 2 -----
Cash flows from operating activities:	
Net income	\$3
Adjustments to reconcile net income to net cash provided by operating activities:	
Amortization of Mortgage Backed Securities premiums and discounts, net	
Amortization of intangibles	
Amortization of trading securities premiums and discounts	
(Gain) loss on sale of Investment Securities	(
Gain on termination of interest rate swaps	
Stock option and long-term compensation expense	
Unrealized loss on interest rate swaps	7
Net realized gain on trading investments	(
Unrealized depreciation (appreciation) on trading investments	
Market value adjustment on long-term repurchase agreements	
Loss on other-than-temporarily impaired securities	
Impairment of intangibles	
Increase in accrued interest receivable	
Decrease (increase) in other assets	
Purchase of trading securities	(
Proceeds from sale of trading securities	(
Purchase of trading securities sold, not yet purchased	(
Proceeds from securities sold, not yet purchased	
Decrease (increase) in advisory and service fees receivable	
(Decrease) Increase in interest payable	(
(Decrease) Increase in accrued expenses and other liabilities	(
Receivable from Prime Broker	(
Reduction of net assets in the fund	(
	-----
Net cash provided by operating activities	1,1
	-----
Cash flows from investing activities:	
Purchase of Mortgage-Backed Securities	(25,2
Proceeds from sale of Investment Securities	15,4
Principal payments of Mortgage-Backed Securities	8,6
Purchase of agency debentures	(5
Purchase of equity securities	(
Purchase of reverse repurchase agreements	(5
Investment to purchase subsidiary	(
	-----
Net cash used in investing activities	(2,2
	-----
Cash flows from financing activities:	
Proceeds from repurchase agreements	434,0
Principal payments on repurchase agreements	(433,4
Proceeds from exercise of stock options	
Proceeds from termination of interest rate swaps	
Proceeds from direct purchase and dividend reinvestment	
Net proceeds from follow-on offerings	2,1
Net proceeds from preferred stock offering	
Net proceeds from ATM programs	
Minority interest	
Dividends paid	(9



## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Net cash provided by financing activities	1,9
Net increase in cash and cash equivalents	8
Cash and cash equivalents, beginning of period	1
Cash and cash equivalents, end of period	9
Supplemental disclosure of cash flow information:	
Interest paid	\$1,9
Taxes paid	\$
Noncash financing activities:	
Net change in unrealized loss on available-for-sale securities and interest rate swaps, net of reclassification adjustment	\$4
Dividends declared, not yet paid	\$2
Noncash investing activities:	
Receivable for Investment Securities Sold	\$
Payable for Investment Securities Purchased	\$2,0
See notes to consolidated financial statements.	

F-5

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Annaly Capital Management, Inc. ("Annaly" or the "Company") was incorporated in Maryland on November 25, 1996. The Company commenced its operations of purchasing and managing an investment portfolio of mortgage-backed securities on February 18, 1997, upon receipt of the net proceeds from the private placement of equity capital, and completed its initial public offering on October 14, 1997. The Company is a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Fixed Income Discount Advisory Company ("FIDAC") is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company. On June 27, 2006, the Company made a majority equity investment in an affiliated investment fund (the "Fund"), which is now wholly owned by the Company. During the third quarter of 2008, the Company formed RCap Securities Inc. ("RCap"). RCap was granted membership in the Financial Industry Regulatory Authority ("FINRA") on January 26, 2009, and will operate as broker-dealer. RCap is a wholly owned taxable REIT subsidiary of the Company. On October 31, 2008, the Company acquired Merganser Capital Management, Inc. ("Merganser"). Merganser is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company.

A summary of the Company's significant accounting policies follows:

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

The consolidated financial statements include the accounts of the Company, FIDAC, Merganser, RCap and the Fund. All intercompany balances and transactions have been eliminated. The minority shareholder's interest in the earnings of the Fund is reflected as minority interest in the consolidated financial statements.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand and cash held in money market funds on an overnight basis.

Reverse Repurchase Agreements - The Company may invest its daily available cash balances via reverse repurchase agreements to provide additional yield on its assets. These investments will typically be recorded as short term investments and will generally mature daily. Reverse repurchase agreements are recorded at cost and are collateralized by mortgage-backed securities pledged by the counterparty to the agreement.

Mortgage-Backed Securities and Agency Debentures - The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans, and certificates guaranteed by the Government National Mortgage Association ("GNMA") (collectively, "Mortgage-Backed Securities"). The Company also invests in agency debentures issued by Federal Home Loan Bank ("FHLB"), Federal Home Loan Mortgage Corporation ("FHLMC"), and Federal National Mortgage Association ("FNMA"). The Mortgage-Backed Securities and agency debentures are collectively referred to herein as "Investment Securities."

Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"), requires the Company to classify its Investment Securities as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Accordingly, the Company classifies all of its Investment Securities as available-for-sale. All assets classified as available-for-sale are reported at estimated fair value, based on market prices from independent sources, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity. The Company's investment in Chimera Investment Corporation ("Chimera") is accounted for as available-for-sale equity securities under the provisions of SFAS 115.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Based on the guidance provided by Financial Accounting Standards Board ("FASB") Staff Position Nos. FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary-Impairment and its Application to Certain Investments, consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on Investment Securities that are considered other than temporary, as measured by the amount of decline in fair value attributable to other-than-temporary factors, are recognized in income and the cost basis of the Investment Securities is adjusted. The loss on other-than-temporarily impaired securities was \$31.8 million, \$1.2 million and \$52.3 million during the years ended December 31, 2008, 2007 and 2006, respectively.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

SFAS No. 107, Disclosure About Fair Value of Financial Instruments, requires disclosure of the fair value of financial instruments for which it is practicable to estimate that value. The estimated fair value of Investment Securities, available-for-sale equity securities, trading securities, trading securities sold, not yet purchased, receivable from prime broker and interest rate swaps is equal to their carrying value presented in the consolidated statements of financial condition. The estimated fair value of cash and cash equivalents, reverse repurchase agreements, accrued interest and dividends receivable, receivable for securities sold, receivable for advisory and service fees, repurchase agreements with maturities shorter than one year, payable for Investment Securities purchased, dividends payable, accounts payable and other liabilities, and accrued interest payable, generally approximates cost as of December 31, 2008 due to the short term nature of these financial instruments. The estimated fair value of long term structured repurchase agreements is reflected in the Footnote 7 to the financial statements.

Interest income is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized into interest income over the projected lives of the securities using the interest method. The Company's policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus prepayment speeds, and current market conditions. Dividend income on available-for-sale equity securities is recorded on the ex-date on an accrual basis.

Investment Securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gains and losses on sales of Investment Securities are determined on the specific identification method.

Derivative Financial Instruments/Hedging Activity - Prior to the fourth quarter of 2008, the Company designated interest rate swaps as cash flow hedges, whereby the swaps were recorded at fair value on the balance sheet as assets and liabilities with any changes in fair value recorded in accumulated other comprehensive income ("OCI"). In a cash flow hedge, a swap would exactly match the pricing date of the relevant repurchase agreement. Through the end of the third quarter the Company continued to be able to effectively match the swaps with the repurchase agreements therefore entering into effective hedge transactions. However, due to the volatility of the credit markets, it is no longer practical to match the pricing dates of both the swaps and the repurchase agreements.

As a result, the Company voluntarily discontinued hedge accounting in the fourth quarter of 2008 through a combination of de-designating previously defined hedge relationships and not designating new contracts as cash flow hedges. The de-designation of cash flow hedges was done in accordance with SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and Derivatives Implementation Group "DIG" Issue Nos. G3, G17, G18 & G20, which generally requires that the net derivative gain or loss related to the discontinued cash flow hedge should continue to be reported in accumulated OCI, unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. The Company continues to hold repurchase agreements in excess of swap contracts and has no indication that interest payments on the hedged repurchase agreements are in jeopardy of discontinuing. Therefore, the deferred losses related to these derivatives that have been de-designated will not be recognized immediately and will remain in OCI. These losses are expected to be reclassified into earnings during the contractual terms of the swap agreements starting as of October 1, 2008. Changes in the unrealized gains or losses on the interest rate swaps subsequent to September 30, 2008 were reflected in the Company's statement of operations and comprehensive income.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Credit Risk - The Company has limited its exposure to credit losses on its portfolio of Investment Securities by only purchasing securities issued by FHLMC, FNMA, or GNMA and agency debentures issued by the FHLB, FHLMC and FNMA. The payment of principal and interest on the FHLMC, and FNMA Mortgage-Backed Securities are guaranteed by those respective agencies, and the payment of principal and interest on the GNMA Mortgage-Backed Securities are backed by the full faith and credit of the U.S. government. Principal and interest on agency debentures are guaranteed by the agency issuing the debenture. All of the Company's Investment Securities have an actual or implied "AAA" rating. The Company faces credit risk on the portions of its portfolio which are not Investment Securities.

F-7

Market Risk - The current situation in the mortgage sector and the current weakness in the broader mortgage market could adversely affect one or more of the Company's lenders and could cause one or more of the Company's lenders to be unwilling or unable to provide additional financing. This could potentially increase the Company's financing costs and reduce liquidity. If one or more major market participants fails, it could negatively impact the marketability of all fixed income securities, including government mortgage securities. This could negatively impact the value of the securities in the Company's portfolio, thus reducing its net book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its Investment Securities at an inopportune time when prices are depressed. Even with the current situation in the mortgage sector, the Company does not anticipate having difficulty converting its assets to cash or extending financing terms due to the fact that its Investment Securities have an actual or implied "AAA" rating and principal payment is guaranteed by FHLMC, FNMA, or GNMA.

Trading Securities and Trading Securities sold, not yet purchased - Trading securities and trading securities sold, not yet purchased, are presented in the consolidated statements of financial conditions as a result of consolidating the financial statements of the Fund, and are carried at fair value. The realized and unrealized gains and losses, as well as other income or loss from trading securities, are recorded in the income from trading securities balance in the accompanying consolidated statements of operations.

Trading securities sold, not yet purchased, represent obligations of the Fund to deliver the specified security at the contracted price, and thereby create a liability to purchase the security in the market at prevailing prices.

Repurchase Agreements - The Company finances the acquisition of its Investment Securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

Cumulative Convertible Preferred Stock- The Company classifies its Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock") on the consolidated statements of financial condition using the guidance in SEC Accounting Series Release No. 268, Presentation in Financial Statements of "Redeemable Preferred Stocks," and Emerging Issues Task Force ("EITF") Topic D-98, Classification and Measurement of Redeemable Securities. The Series B Preferred Stock contains fundamental change provisions that allow the holder to redeem the Series B Preferred Stock for cash if certain events occur. As redemption under these provisions is not solely within the Company's control, the Company has classified the Series B Preferred Stock as temporary equity in the accompanying consolidated statements of financial condition.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

The Company has analyzed whether the embedded conversion option should be bifurcated under the guidance in SFAS 133 and EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, and has determined that bifurcation is not necessary.

**Income Taxes** - The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), with respect thereto. Accordingly, the Company will not be subjected to federal income tax to the extent of its distributions to shareholders and as long as certain asset, income and stock ownership tests are met. The Company and each of its subsidiaries, FIDAC, Merganser, and RCap have made separate joint election to treat the subsidiaries as a taxable REIT subsidiary. As such, each of the taxable REIT subsidiaries are taxable as a domestic C corporation and subject to federal, state, and local income taxes based upon its taxable income. The affiliated investment fund is a partnership and the income and expense flow through to the Company.

**Use of Estimates** - The preparation of the consolidated 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.

F-8

**Goodwill and Intangible assets** - The Company's acquisitions of FIDAC and Merganser were accounted for using the purchase method. Under the purchase method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. In addition, the costs of FIDAC and Merganser were allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired was recognized as goodwill. Intangible assets are periodically (but not less frequently than annually) reviewed for potential impairment. Intangible assets with an estimated useful life are expected to amortize over a 10.5 year weighted average time period. During the years ended December 31, 2008 and 2007, there were no impairment losses. During the year ended December 31, 2006 the Company recognized \$2.5 million in impairment losses on intangible assets relating to customer relationships.

**Stock Based Compensation** - The Company accounts for its stock-based compensation in accordance with SFAS No. 123 (Revised 2004) - Share-Based Payment ("SFAS 123R"). SFAS 123R requires the Company to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The compensation cost should be reassessed based on the fair value of the equity instruments issued.

The Company recognizes compensation expense on a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award). The Company estimated fair value using the Black-Scholes valuation model.

**Recent Accounting Pronouncements** - In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - including an amendment of FASB Statement No. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

reporting date. SFAS 159 was effective for the Company commencing January 1, 2008. The Company did not elect the fair value option for any of its financial instruments.

In April 2007, the FASB issued FASB Staff Position FIN 39-1 ("FSP FIN 39-1") which modifies FASB Interpretation No. 39, Offsetting of Amounts relating to Certain Contracts ("FIN 39"). FSP FIN 39-1 addresses whether a reporting entity that is party to a master netting arrangement can offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments that have been offset under the same master netting arrangement in accordance with FIN 39. Upon adoption of this guidance, a reporting entity is permitted to change its accounting policy to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. This guidance was effective for the Company on January 1, 2008. The implementation did not have an effect on the financial statements of the Company.

In February 2008, FASB issued FASB Staff Position No. FAS 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions, ("FSP FAS 140-3"). FSP FAS 140-3 addresses whether transactions where assets purchased from a particular counterparty and financed through a repurchase agreement with the same counterparty can be considered and accounted for as separate transactions, or are required to be considered "linked" transactions and may be considered derivatives under SFAS 133. FSP FAS 140-3 requires purchases and subsequent financing through repurchase agreements be considered linked transactions unless all of the following conditions apply: (1) the initial purchase and the use of repurchase agreements to finance the purchase are not contractually contingent upon each other; (2) the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed; (3) the financial assets are readily obtainable in the market; and (4) the financial instrument and the repurchase agreement are not coterminous. This FSP is effective for the Company on January 1, 2009. The Company is currently evaluating FSP FAS 140-3 but does not expect its application to have a significant impact on its financial reporting.

In March 2008, the FASB issued SFAS No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities, and an amendment of FASB Statement No. 133. SFAS 161 attempts to improve the transparency of financial reporting by providing additional information about how derivative and hedging activities affect an entity's financial position, financial performance and cash flows. This statement changes the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosure about (1) how and why an entity uses derivative instruments, (2) how derivative instruments and related hedged items are accounted for under SFAS Statement 133 and its related interpretations, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. To meet these objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This disclosure framework is intended to better convey the purpose of derivative use in terms of the risks that an entity is intending to manage. SFAS 161 is effective for the Company on January 1, 2009. The Company expects that adoption of SFAS 161 will increase footnote disclosure to comply with the disclosure requirements for financial statements issued after January 1, 2009.

F-9

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category (the valuation of which require significant management judgment), including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS 157 was adopted by the Company on January 1, 2008. SFAS 157 did not have an impact on the manner in which the Company estimates fair value, but it requires additional disclosure, which is included in Note 5.

On October 10, 2008, FASB issued FASB Staff Position (FSP) 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ("FSP 157-3"), in response to the deterioration of the credit markets. This FSP provides guidance clarifying how SFAS 157 should be applied when valuing securities in markets that are not active. The guidance provides an illustrative example that applies the objectives and framework of SFAS 157, utilizing management's internal cash flow and discount rate assumptions when relevant observable data does not exist. It further clarifies how observable market information and market quotes should be considered when measuring fair value in an inactive market. It reaffirms the notion of fair value as an exit price as of the measurement date and that fair value analysis is a transactional process and should not be broadly applied to a group of assets. FSP 157-3 is effective upon issuance including prior periods for which financial statements have not been issued. FSP 157-3 does not have a material effect on the fair value of its assets as the Company intends to continue to hold assets that can be valued via level 1 and level 2 criteria, as defined under SFAS 157.

F-10

### 2. MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Mortgage-Backed Securities portfolio as of December 31, 2008 and 2007 which were carried at their fair value:

December 31, 2008	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government National Mortgage Association	Total Mortgage Backed Securities
	(dollars in thousands)			
Mortgage-Backed Securities, gross	\$19,898,430	\$32,749,123	\$1,259,118	\$53,906,666
Unamortized discount	(26,733)	(36,647)	(787)	(64,167)
Unamortized premium	212,354	381,433	25,694	619,481
Amortized cost	20,084,051	33,093,909	1,284,025	54,461,985
Gross unrealized gains	297,366	468,824	14,606	780,796
Gross unrealized losses	(71,195)	(123,443)	(1,148)	(195,786)
Estimated fair value	\$20,310,222	\$33,439,290	\$1,297,483	\$55,046,995
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

		(dollars in thousands)		
Adjustable rate	\$19,509,017	\$287,249	(\$178,599)	\$19,617,6
Fixed rate	34,952,968	493,547	(17,187)	35,429,3
Total	\$54,461,985	\$780,796	(\$195,786)	\$55,046,9

December 31, 2007	Federal Home Loan Mortgage Corporation	Federal National Mortgage Association	Government National Mortgage Association	Total Mortgage Backed Securitiz
-------------------	--	---	--	------------------------------------

	(dollars in thousands)			
Mortgage-Backed Securities, gross	\$19,789,792	\$32,155,740	\$367,066	\$52,312,5
Unamortized discount	(30,679)	(45,496)	(506)	(76,6
Unamortized premium	136,780	266,357	2,678	405,8
Amortized cost	19,895,893	32,376,601	369,238	52,641,7
Gross unrealized gains	141,248	224,795	2,229	368,2
Gross unrealized losses	(52,623)	(75,949)	(1,904)	(130,4

Estimated fair value	\$19,984,518	\$32,525,447	\$369,563	\$52,879,5
----------------------	--------------	--------------	-----------	------------

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Va
--	----------------	--------------------------	--------------------------	-------------------

	(dollars in thousands)			
Adjustable rate	\$15,361,031	\$96,310	(\$76,853)	\$15,380,4
Fixed rate	37,280,701	271,962	(53,623)	37,499,0
Total	\$52,641,732	\$368,272	(\$130,476)	\$52,879,5

F-11

Actual maturities of Mortgage-Backed Securities are generally shorter than stated contractual maturities because actual maturities of Mortgage-Backed Securities are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table summarizes the Company's Mortgage-Backed Securities on December 31, 2008 and 2007, according to their estimated weighted-average life classifications:

	December 31, 2008		Decem
Weighted-Average Life	Fair Value	Amortized Cost	Fair Value
	(dollars in thousands)		
Less than one year	\$ 4,147,646	\$ 4,181,282	\$ 324,



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Greater than one year and less than five years	37,494,312	37,102,706	35,772,
Greater than or equal to five years	13,405,037	13,177,997	16,782,
Total	\$55,046,995	\$54,461,985	\$52,879,

The weighted-average lives of the Mortgage-Backed Securities at December 31, 2008 and 2007 in the table above are based upon data provided through subscription-based financial information services, assuming constant principal prepayment rates to the reset date of each security. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loans, loan age, margin and volatility. The actual weighted average lives of the Mortgage-Backed Securities could be longer or shorter than estimated.

The following table presents the gross unrealized losses, and estimated fair value of the Company's Mortgage-Backed Securities by length of time that such securities have been in a continuous unrealized loss position at December 31, 2008 and December 31, 2007.

	Unrealized Loss Position For:				
	(dollars in thousands)				
	Less than 12 Months		12 Months or More		
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
December 31, 2008	\$4,631,897	(\$65,790)	\$4,267,448	(\$129,996)	\$8,899,3
December 31, 2007	\$7,593,443	(\$62,594)	\$5,340,667	(\$67,882)	\$12,934,1

The decline in value of these securities is solely due to market conditions and not the quality of the assets. All of the Mortgage-Backed Securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments. Also, the Company is guaranteed payment of the principal amount of the securities by the government agency which created them.

The adjustable rate Mortgage-Backed Securities are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every nine months) and lifetime caps. The weighted average lifetime cap was 10.0% at December 31, 2008 and 9.9% at December 31, 2007.

During the year ended December 31, 2008, the Company sold \$15.1 billion of Mortgage-Backed Securities, resulting in a realized gain of \$10.7 million. During the year ended December 31, 2007, the Company sold \$4.9 billion of Mortgage-Backed Securities, resulting in a realized gain of \$19.1 million.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

### 3. AVAILABLE FOR SALE EQUITY SECURITIES

All of the available-for-sale equity securities are shares of Chimera and are reported at fair value. The Company owns approximately 15.3 million shares of Chimera at a carrying value of \$52.8 million. Although the Company has the intent and ability to retain the investment in Chimera indefinitely, the Company determined based on the FSP FAS-115 that an other-than-temporarily impaired charge of \$31.8 million was appropriate in the third quarter of 2008 and is reflected in the income statement for the year ended of December 31, 2008. This determination is based on the extent of the decline in value of the Chimera shares combined with the current state of the mortgage and credit markets. At December 31, 2008, the investment in Chimera had an unrealized gain of \$4.0 million.

### 4. REVERSE REPURCHASE AGREEMENT

During the first quarter of 2008, the Company began using excess cash to do reverse repurchase agreements. At December 31, 2008, the Company had lent \$562.1 million to Chimera in an overnight reverse repurchase agreement. This amount is included at the principal amount which approximates fair value in the Company's Statement of Financial Condition. The interest rate at December 31, 2008 was an at the market rate of 1.43%. The average rate on all reverse repurchase agreements for the year was 2.99%. The collateral for this loan is mortgage-backed securities with a fair value of \$680.8million.

### 5. RECEIVABLE FROM PRIME BROKER

These net assets of the investment fund owned by the Company are subject to English bankruptcy law, which governs the administration of Lehman Brothers International (Europe) ("LBIE"), as well as the law of New York, which governs the contractual documents. Until the Company's contractual documents with LBIE are terminated, the value of the assets and liabilities in its account with LBIE will continue to fluctuate based on market movements. The Company does not intend to terminate these contractual documents until LBIE's administrators have clarified the consequences of doing so. The Company has not received notice from LBIE's administrators that LBIE has terminated the documents. LBIE's administrators have advised the Company that they can provide no additional information about the account at this time. As a result, the Company has recorded a receivable from LBIE based on the fair value of its account with LBIE as of September 15, 2008 of \$16.9 million, which is the date of the last statement it received from LBIE on the account's assets and liabilities. The Company can provide no assurance, however, that it will recover all or any portion of these assets following completion of LBIE's administration (and any subsequent liquidation).

### 6. FAIR VALUE MEASUREMENTS

SFAS 157 defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1- inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Level 3 - inputs to the valuation methodology are unobservable and significant to overall fair value.

Available for sale equity securities, trading securities, and trading securities sold, not yet purchased are valued based on quoted prices (unadjusted) in an active market. Investment Securities and interest rate swaps are valued using quoted prices for similar assets and dealer quotes. The dealer will 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 security including coupon, periodic and life caps, rate reset period and expected life of the security. Management reviews all prices used to ensure that current market conditions are represented. This review includes comparisons of similar market transactions and comparisons to a pricing model. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued as follows:

F-13

	Level 1	Level 2 (dollars in thousand)
-----		
Assets:		
Mortgage-Backed Securities	-	\$55,046,99
Agency debentures	-	598,94
Available for sale equity securities	\$52,795	
Liabilities:		
Interest rate swaps	-	1,102,28

The classification of assets and liabilities by level remains unchanged at December 31, 2008, when compared to the previous quarter.

### 7. REPURCHASE AGREEMENTS

The Company had outstanding \$46.7 billion and \$46.0 billion of repurchase agreements with weighted average borrowing rates of 4.08% and 4.76%, after giving effect to the Company's interest rate swaps, and weighted average remaining maturities of 238 days and 234 days as of December 31, 2008 and December 31, 2007, respectively. Investment Securities pledged as collateral under these repurchase agreements and interest rate swaps had an estimated fair value of \$51.8 billion at December 31, 2008 and \$48.3 billion at December 31, 2007.

At December 31, 2008 and 2007, the repurchase agreements had the following remaining maturities:

	December 31, 2008	December 31, 2007
	(dollars in thousands)	
-----		
Within 30 days	\$32,025,186	\$34,000,000
30 to 59 days	5,205,352	4,000,000
60 to 89 days	209,673	200,000
90 to 119 days	254,674	250,000
Over 120 days	8,980,000	6,000,000

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Total

\$46,674,885

\$46,

The Company did not have an amount at risk greater than 10% of the equity of the Company with any counterparty as of December 31, 2008 or December 31, 2007.

The Company has entered into repurchase agreements which provide the counterparty with the right to call the balance prior to maturity date. These repurchase agreements totaled \$8.1 billion and the fair value of the option to call was (\$574.3 million) at December 31, 2008. The repurchase agreements totaled \$6.4 billion and the fair value of the option to call was (\$176.7 million) at December 31, 2007. Management has determined that the call option is not required to be bifurcated under the provisions of SFAS 133 as it is deemed clearly and closely related to the debt instrument, therefore the fair value of the option is not recorded in the consolidated financial statements.

8. INTEREST RATE SWAPS

In connection with the Company's interest rate risk management strategy, the Company hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. As of December 31, 2008, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its Mortgage-Backed Securities pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

F-14

The Company's swaps are used to lock in the fixed rate related to a portion of its current and anticipated future 30-day term repurchase agreements.

The table below presents information about the Company's swaps outstanding at December 31, 2008 December 31, 2007.

	Notional Amount (dollars in thousands)	Weighted Average Pay Rate	Weighted Average Receive Rate
December 31, 2008	\$17,615,750	4.66%	1.18
December 31, 2007	\$16,243,500	5.03%	5.06

9. PREFERRED STOCK AND COMMON STOCK

(A) Common Stock Issuances

On May 13, 2008 the Company entered into an underwriting agreement pursuant to which it sold 69,000,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on May 19, 2008.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

On January 23, 2008 the Company entered into an underwriting agreement pursuant to which it sold 58,650,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$1.1 billion. This transaction settled on January 29, 2008.

During the year ended December 31, 2008, the Company raised \$93.7 million by issuing 5.8 million shares, through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2008, 300,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$2.8 million.

On August 3, 2006, the Company entered into an ATM Equity Offering(sm) Sales Agreement with Merrill Lynch & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, relating to the sale of shares of the Company's common stock from time to time through Merrill Lynch. Sales of the shares, if any, are made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 588,000 shares of the Company's common stock were issued pursuant to this program, totaling \$11.5 million in net proceeds.

On August 3, 2006, the Company entered into an ATM Equity Sales Agreement with UBS Securities LLC, relating to the sale of shares of the Company's common stock from time to time through UBS Securities. Sales of the shares, if any, will be made by means of ordinary brokers' transaction on the New York Stock Exchange. During the year ended December 31, 2008, 3.8 million shares of the Company's common stock were issued pursuant to this program, totaling \$60.3 million in net proceeds.

On October 11, 2007, the Company entered into an underwriting agreement pursuant to which it sold 71,300,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$1.0 billion. This transaction settled on October 17, 2007.

On July 12, 2007, the Company entered into an underwriting agreement pursuant to which it sold 54,050,000 shares of its common stock for proceeds of \$720.8 million net of underwriting fees. This transaction settled on July 18, 2007.

On March 7, 2007, the Company entered into an underwriting agreement pursuant to which it sold 57,500,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$737.4 million. This transaction settled on March 13, 2007.

F-15

During the year ended December 31, 2007, the Company raised \$116.5 million by issuing 8.0 million shares through the Direct Purchase and Dividend Reinvestment Program.

During the year ended December 31, 2007, 56,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of \$576,000.

During the year ended December 31, 2007, 4.5 million shares of the Company's common stock were issued pursuant to the Company's ATM Equity Offering(sm) Sales Agreement with Merrill Lynch, totaling \$66.2 million in net proceeds. During the year ended December 31, 2007, 1.1 million shares of its common stock were issued pursuant to the Company's ATM Equity Sales Agreement with UBS Securities, totaling \$14.7 million in net proceeds.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

On August 16, 2006, the Company entered into an underwriting agreement pursuant to which it sold 40,825,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$476.7 million. This transaction settled on August 22, 2006.

On April 6, 2006, the Company entered into an underwriting agreement pursuant to which it sold 39,215,000 shares of its common stock for net proceeds following underwriting expenses of approximately \$437.7 million. On April 6, 2006, the Company entered into a second underwriting agreement pursuant to which it sold 4,600,000 shares of its 6% Series B Cumulative Convertible Preferred Stock for net proceeds following underwriting expenses of approximately \$111.5 million. Both of these transactions settled on April 12, 2006.

During the year ended December 31, 2006, 500,000 shares of the Company's common stock were issued pursuant to the Company's ATM Equity Offering(sm) Sales Agreement with Merrill Lynch, totaling \$6.7 million in net proceeds. During the year ended December 31, 2006, no shares of the Company's common stock were issued pursuant to the Company's ATM Equity Sales Agreement with UBS Securities.

During the year ended December 31, 2006, 1.1 million shares of the Company's common stock were issued through the Equity Shelf Program, totaling net proceeds of \$14.2 million. During the year ended December 31, 2006, 22,160 options were exercised under the Incentive Plan for an aggregate exercise price of \$183,000.

### (B) Preferred Stock

At December 31, 2008 and 2007, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), with a par value \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock must be paid a dividend at a rate of 7.875% per year 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 (whether or not declared) exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). The Series A Preferred Stock is senior to the Company's common stock and is on parity with the Series B Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series A Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series A Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series A Preferred Stock, together with 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 apart for payment. In addition, certain material and adverse changes to the terms of the Series A Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock. Through December 31, 2008, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

At December 31, 2008, the Company had issued and outstanding 3,963,525 shares of Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock"), with a par value \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B Preferred Stock must be paid a dividend at a rate of 6% per year on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends.

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

At December 31, 2007, the Company had issued and outstanding 4,600,000 shares of Series B Preferred Stock.

The Series B Preferred Stock is not redeemable. The Series B Preferred Stock is convertible into shares of common stock at a conversion rate that adjusts from time to time upon the occurrence of certain events, including if the Company distributes to its common shareholders in any calendar quarter cash dividends in excess of \$0.11 per share. Initially, the conversion rate was 1.7730 shares of common shares per \$25 liquidation preference. At December 31, 2008, the conversion ratio was 2.0650 shares of common stock per \$25 liquidation preference. Commencing April 5, 2011, the Company has the right in certain circumstances to convert each Series B Preferred Stock into a number of common shares based upon the then prevailing conversion rate. The Series B Preferred Stock is also convertible into common shares at the option of the Series B preferred shareholder at anytime at the then prevailing conversion rate. The Series B Preferred Stock is senior to the Company's common stock and is on parity with the Series A Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series B Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series B Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B Preferred Stock, together with 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 apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock. Through December 31, 2008, the Company had declared and paid all required quarterly dividends on the Series B Preferred Stock. During the year ended December 31, 2008, 636,475 shares of Series B Preferred Stock were converted into 1,268,081 shares of common stock. During the year ended December 31, 2007, no shares of Series B Preferred Stock were converted.

### (C) Distributions to Shareholders

During the year ended December 31, 2008, the Company declared dividends to common shareholders totaling \$1.1 billion or \$2.08 per share, of which \$270.7 million were paid to shareholders on January 29, 2009. During the year ended December 31, 2008, the Company declared dividends to Series A Preferred shareholders totaling approximately \$14.6 million or \$1.97 per share, and Series B shareholders totaling approximately \$6.6 million or \$1.50 per share, which were paid to shareholders on December 31, 2008.

During the year ended December 31, 2007, the Company declared dividends to common shareholders totaling \$339.8 million or \$1.04 per share, of which \$136.6 million were paid on January 28, 2008. During the year ended December 31, 2007, the Company declared and paid dividends to Series A preferred shareholders totaling \$14.6 million or \$1.97 per share and Series B Preferred shareholders totaling \$6.9 million or \$1.50 per share.

During the year ended December 31, 2006, the Company declared dividends to common shareholders totaling \$102.6 million or \$.57 per share, of which \$39.0 million were paid on January 26, 2007. During the year ended December 31, 2006, the Company declared and paid dividends to Series A preferred shareholders totaling \$14.6 million or \$1.97 per share and Series B Preferred shareholders totaling \$5.0 million or \$1.08 per share.

### 10. NET INCOME PER COMMON SHARE

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

The following table presents a reconciliation of the net income and shares used in calculating basic and diluted earnings per share for the years ended December 31, 2008, 2007, and 2006.

	For the years ended (amounts in thousands)	
	December 31, 2008	December 31, 2007
Net income	\$346,180	\$414,384
Less: Preferred stock dividends	21,177	21,493
Net income available to common shareholders, prior to adjustment for Series B dividends, if necessary	325,003	392,891
Add: Preferred Series B dividends, if Series B shares are dilutive	-	6,900
Net income, as adjusted	\$325,003	\$399,791
Weighted average shares of common stock outstanding-basic	507,025	297,488
Add: Effect of dilutive stock options and Series B Cumulative Convertible Preferred Stock	-	8,775
Weighted average shares of common stock outstanding-diluted	507,025	306,263

Options to purchase 5.2 million shares of common stock, were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the year ended December 31, 2008. The Series B Cumulative Convertible Preferred Stock was anti-dilutive for the years ended December 31, 2008 and 2006.

F-17

### 11. LONG-TERM STOCK INCENTIVE PLAN

The Company has adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Incentive Plan"). The Incentive Plan authorizes the Compensation Committee of the board of directors to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Incentive Plan authorizes the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to ceiling of 8,932,921 shares. Stock options are issued at the current market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. The grant date fair value is calculated using the Black-Scholes option valuation model.

For the year ended



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

	December 31, 2008		December 31, 2007
	Number of Shares	Weighted Average Exercise Price	Number of Shares
Options outstanding at the beginning of year	3,437,267	\$15.23	2,984,995
Granted	2,043,700	16.02	687,250
Exercised	(293,243)	9.59	(55,738)
Forfeited	(2,550)	15.84	(174,240)
Expired	(5,010)	20.67	(5,000)
Options outstanding at the end of period	5,180,164	\$15.87	3,437,267
Options exercisable at the end of the period	2,119,964	\$16.36	1,286,004

The weighted average remaining contractual term was approximately 7.6 years for stock options outstanding and approximately 5.6 years for stock options exercisable as of December 31, 2008. As of December 31, 2008, there was approximately \$9.3 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 3.3 years.

The weighted average remaining contractual term was approximately 7.0 years for stock options outstanding and approximately 5.3 years for stock options exercisable as of December 31, 2007. As of December 31, 2007, there was approximately \$2.9 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.7 years.

F-18

During the year ended December 31, 2007, the Company granted 7,000 shares of restricted common stock to certain of its employees. As of December 31, 2008, 3,360 of these restricted shares were unvested and subject to forfeiture.

12. INCOME TAXES

As a REIT, the Company is not subject to federal income tax on earnings distributed to its shareholders. Most states recognize REIT status as well. The Company has decided to distribute the majority of its income and retain a portion of the permanent difference between book and taxable income arising from Section 162(m) of the Code pertaining to employee remuneration.

During the year ended December 31, 2008, FIDAC recorded \$4.0 million of income tax expense for income attributable to FIDAC, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2008, Merganser recorded \$94,000 of income tax expense for income attributable to Merganser. During the year ended December 31, 2008, the Company recorded \$21.9 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 53% for the year ended December 31, 2008.

During the year ended December 31, 2007, the Company did not record income tax expense for income attributable to FIDAC, its taxable REIT subsidiary, and the portion of earnings retained based on Code Section 162(m)

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

limitations. During the year ended December 31, 2007, the Company recorded \$9.0 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 51% for the year ended December 31, 2007.

During the year ended December 31, 2006, the Company recorded \$3.1 million of income tax expense for income attributable to FIDAC, its taxable REIT subsidiary, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2006, the Company recorded \$4.5 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations. The effective tax rate was 45% for the year ended December 31, 2006.

The Company's effective tax rate was 53%, 51%, and 45% for the years ended December 31, 2008, 2007, and 2006, respectively. These rates differed from the federal statutory rate as a result of state and local taxes and permanent difference pertaining to employee remuneration as discussed above.

The statutory combined federal, state, and city corporate tax rate is 45%. This amount is applied to the amount of estimated REIT taxable income retained (if any, and only up to 10% of ordinary income as all capital gain income is distributed) and to taxable income earned at the taxable subsidiaries. Thus, as a REIT, the Company's effective tax rate is significantly less as it is allowed to deduct dividend distributions.

### 13. LEASE COMMITMENTS AND CONTINGENCIES

The Company has a non-cancelable lease for office space, which commenced in May 2002 and expires in December 2009. The Company's aggregate future minimum lease payments total \$532,000.

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements and therefore no accrual is required as of December 31, 2008.

Merganser's prior owner may receive additional consideration as an earn-out during 2010, 2011 and 2012 if Merganser meets specific performance goals under the merger agreement. The Company cannot currently calculate how much consideration will be paid under the earn-out provisions because the payment amount will vary depending upon whether and the extent to which Merganser achieves specific performance goals. Any amounts paid under this provision will be recorded as additional goodwill.

F-19

### 14. INTEREST RATE RISK

The primary market risk to the Company 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 the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with the interest-bearing 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 the Investment Securities and the Company's ability to realize gains from the sale of these assets. A decline in the value of the Investment Securities pledged as collateral for borrowings under repurchase agreements could result in the

## Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels. Liquidation of collateral at losses could have an adverse accounting impact, as discussed in Note 1.

The Company seeks to manage the extent to which net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. The Company may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the portfolio of Investment Securities by entering into interest rate agreements such as interest rate caps and interest rate swaps. As of December 31, 2008, the Company entered into interest rate swaps to pay a fixed rate and receive a floating rate of interest, with a total notional amount of \$17.6 billion.

Changes in interest rates may also have an effect on the rate of mortgage principal prepayments and, as a result, prepayments on Mortgage-Backed Securities. The Company will seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets purchased at a premium with assets purchased at a discount. To date, the aggregate premium exceeds the aggregate discount on the Mortgage-Backed Securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce net income compared to what net income would be absent such prepayments.

### 15. RELATED PARTY TRANSACTIONS

At December 31, 2008, the Company had lent \$562.1 million to Chimera in an overnight reverse repurchase agreement. This amount is included at the principal amount which approximates fair value in the Company's Statement of Financial Condition. The interest rate at December 31, 2008 was an at the market rate of 1.43%. The average rate for the year was 2.96%. The collateral for this loan is mortgage-backed securities with a fair value of \$680.8 million.

On October 29, 2008, the Company purchased approximately 11.7 million shares of Chimera common stock at a price of \$2.25 per share for aggregate proceeds of approximately \$26.3 million. Chimera is managed by FIDAC, and the Company owns approximately 8.6% of Chimera's common stock.

### 16. MERGANSER CAPITAL MANAGEMENT, INC.

The Company acquired Merganser pursuant to a merger which was consummated before the opening of business on October 31, 2008. The merger was accounted for using the purchase method of accounting in accordance with SFAS No. 141, and the purchase price was allocated to the acquired assets and liabilities based on their fair values, with the excess allocated to goodwill. The purchase price was paid in cash and Company's stock. Accordingly, the consolidated balance sheet as of December 31, 2008 includes the effects of the merger and the Company's application of the purchase method of accounting. Additionally, the consolidated statements of operations and of cash flows for the year ended December 31, 2008 include the results of the Merganser for the period from October 31, 2008 to December 31, 2008.

A summary of the fair values of the net assets acquired is as follows:

	(dollars in thousands)
Receivable for advisory fees and services	\$2,849
Other assets	654
Customer relationships	6,600
Trade name	330
Goodwill	4,488
Favorable leasehold interest	1,310
Payables	(1,169)

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Total purchase price	\$15,062
----------------------	----------

17. SUBSEQUENT EVENTS

Pursuant to NASD Rule 1014, the application of RCap was granted membership in FINRA on January 26, 2009. RCap is expected to commence operations as a broker dealer during the first quarter of 2009.

F-20

18. SUMMARIZED QUARTERLY (UNAUDITED)

The following is a presentation of the quarterly results of operations for the year ended December 31, 2008.

	March 31, 2008	June 30, 2008	Septem 2
	(dollars in thousands, except		
Interest income	\$791,128	\$773,359	
Interest expense	537,606	442,251	
Net interest income	253,522	331,108	
Other income:			
Investment advisory and service fees	6,598	6,406	
Gain (loss) on sale of Investment Securities	9,417	2,830	
Income (loss) from trading securities	1,854	2,180	
Dividend income from available-for-sale equity securities	941	580	
Loss on other-than-temporarily impaired securities	-	-	
Unrealized loss on interest rate swaps	-	-	
Total other income	18,810	11,996	
Expenses:			
Distribution fees	633	370	
General and administrative expenses	23,995	27,215	
Total expenses	24,628	27,585	
Income (loss) before income taxes and minority interest	247,704	315,519	
Income taxes	4,610	7,527	
Income (loss) before minority interest	243,094	307,992	
Minority interest	58	-	

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Net Income	243,036	307,992	
Dividends on preferred stock	5,373	5,334	
Net income (loss) available (related) to common shareholders	\$237,663	\$302,658	
Weighted average number of basic common shares outstanding	443,812,432	503,758,079	53
Weighted average number of diluted common shares outstanding	452,967,457	512,678,975	54
Net income available to common shareholders per average common share:			
Basic	\$0.54	\$0.60	
Diluted	\$0.53	\$0.59	

F-21

The following is a presentation of the quarterly results of operations for the year ended December 31, 2007.

	March 31, 2007	June 30, 2007	Septem 2
	(dollars in thousands, except		
Interest income	\$449,564	\$556,262	
Interest expense	380,164	468,748	
Net interest income	69,400	87,514	
Other income:			
Investment advisory and service fees	5,562	5,366	
Gain on sale of Investment Securities	6,145	7,293	
Gain on termination of interest rate swaps	67	-	
Income from trading securities	3,429	243	
Dividend income from available-for-sale equity securities	-	-	
Loss on other-than-temporarily impaired securities	(491)	(698)	
Total other income	14,712	12,204	
Expenses:			
Distribution fees	904	861	
General and administrative expenses	12,886	12,272	

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

Total expenses	13,790	13,133	
Income before income taxes and minority interest	70,322	86,585	
Income taxes	2,604	839	
Income before minority interest	67,718	85,746	
Minority interest	286	13	
Net income	67,432	85,733	
Dividends on preferred stock	5,373	5,373	
Net income available to common shareholders	\$62,059	\$80,360	
Weighted average number of basic common shares outstanding	217,490,205	264,990,422	31
Weighted average number of diluted common shares outstanding	225,928,127	273,578,836	32
Net income available to common shareholders per average common share:			
Basic	\$0.29	\$0.30	
Diluted	\$0.28	\$0.30	

F-22

SIGNATURES

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

ANNALY CAPITAL MANAGEMENT, INC.

Date: February 25, 2009

By: /s/ Michael A. J. Farrell

Michael A. J. Farrell  
Chairman, Chief Executive Officer, and  
President

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 date indicated.

Signature

Title

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-K

/s/ KEVIN P. BRADY ----- Kevin P. Brady	Director	Febru
/s/ KATHRYN F. FAGAN ----- Kathryn F. Fagan	Chief Financial Officer and Treasurer (principal financial and accounting officer)	Febru
/s/ MICHAEL A.J. FARRELL ----- Michael A. J. Farrell	Chairman of the Board, Chief Executive Officer, President and Director (principal executive officer)	Febru
/s/ JONATHAN D. GREEN ----- Jonathan D. Green	Director	Febru
/s/ MICHAEL E. HAYLON ----- Michael E. Haylon	Director	Febru
/s/ JOHN A. LAMBIASE ----- John A. Lambiase	Director	Febru
/s/ E. WAYNE NORDBERG ----- E. Wayne Nordberg	Director	Febru
/s/ DONNELL A. SEGALAS ----- Donnell A. Segalas	Director	Febru
/s/ WELLINGTON DENAHAN-NORRIS ----- Wellington Denahan-Norris	Vice Chairman of the Board, Chief Investment Officer, Chief Operating Officer and Director	Febru