



May 24, 2016

Dear Fellow Stockholders,

In the first quarter, investment opportunities for our target assets became more attractive. We opportunistically purchased Agency residential mortgage-backed securities (RMBS), while continuing to add commercial real estate assets and mortgage servicing rights (MSR). While still maintaining low overall interest rate exposure, we increased our debt-to-equity to 3.0x at March 31, 2016, from 2.5x at December 31, 2015. Subsequent to quarter-end, we continued to raise our debt-to-equity, bringing it into the mid-3's in April.

We reported book value of \$9.70 per common share as of March 30, 2016, representing a (1.8%)<sup>(1)</sup> total return on book value for the quarter after accounting for the first quarter dividend of \$0.23. We also repurchased 8.0 million shares in the quarter, representing 2.3% of our common stock outstanding at December 31, 2015. This was accretive to book value by over \$0.05 per share. We continue to evaluate share repurchases with consideration to a number of factors, not the least of which is our prevailing share price relative to book value and available investment alternatives.

Opportunities in the commercial real estate market remain quite attractive, and we increased our capital allocation to 11% at March 31, 2016 from 8% at December 31, 2015. In the next few years, there will be a wave of maturities and transaction volumes are currently high. Additionally, regulatory requirements are constraining traditional lenders, leading more borrowers to seek balance sheet lenders, like Two Harbors, to provide financing. In the first quarter, we added three assets, bringing the total carrying value of the portfolio to \$744 million. The assets in our portfolio are secured by a diverse group of properties located throughout the U.S., and the majority are floating rate, which provides potential upside to higher rates. Post quarter-end, we closed on another two loans for \$125 million, bringing our total holdings to about \$870 million. We initially targeted an equity capital allocation of \$500 million to commercial real estate. We expect to complete that commitment sometime in the third quarter of 2016 and it is our anticipation that we will continue to deploy capital beyond that initial allocation.

This was an exciting quarter for MSR, as we increased our portfolio to \$55 billion in unpaid principal balance (UPB) via both flow sale arrangements and a bulk purchase. Our focus continues to be on adding flow MSR sellers, and we added four in the quarter. We have seen an increase in monthly flow volume and anticipate that near-term volumes will be around \$1.5 billion to \$2.0 billion per month. The growth in our MSR investments improves the economics of our Rates<sup>(2)</sup> strategy, as MSR is a natural hedge to our Agency RMBS investments, providing positive yield and negative duration.

With respect to the mortgage loan conduit, our Agate Bay brand continues to gain traction, and we are seeing both repeat and new investors. In the first quarter, we sponsored two prime jumbo securitizations totaling approximately \$628 million UPB. We have said in the past, we may retain some higher pieces of the capital structure of our securitizations when it is compelling. Late in the first quarter and into April, we saw improvement in AAA spreads and we sold some of these to meet market demand. Capital allocated to the conduit was lower this quarter, primarily due to both these sales and materially lower lock volumes. The

combination of regulatory constraints and competitive pricing have led to a challenging market environment for aggregating loans for securitization. Our pipeline of prime jumbo loans and interest rate lock commitments was \$558 million UPB at March 31, 2016.

In the quarter, we secured a second \$250 million facility for financing senior commercial real estate loans, further expanding our financing capability. Our debt-to-equity on commercial real estate assets was 1.3x at March 31, 2016, up from about 0.7x at December 31, 2015. We expect our debt-to-equity ratio to trend higher as we fully utilize these facilities. Our FHLB advances totaled \$4.0 billion at March 31, 2016, and in the quarter we added senior commercial real estate collateral. Our repurchase agreements totaled \$6.2 billion at March 31, 2016, up from \$5.0 billion at December 31, 2015, due to the purchase of Agency RMBS. Importantly, the repo market continues to function efficiently and in a normal manner for us. We have 20 active counterparties and continue to ladder our repo maturities to protect against a disruption in our financing. Subsequent to quarter-end we also introduced direct lending with one counterparty. We believe the addition of direct lending relationships can further diversify our funding sources as well as lower our overall repo costs. With a wide variety of available tools, we believe that we have the ability to navigate various regulatory and market impacts on financing.

From a macroeconomic perspective, interest rates in the first quarter moved lower as the Federal Reserve's commentary indicated caution with regard to future rate hikes. Currently, the market suggests that there is a 14% chance of a June rate hike, and a 45% probability of a September rate hike<sup>(3)</sup>. Whatever the future holds, lower for longer seems increasingly likely.

We are optimistic about the current investment landscape, particularly for commercial real estate and MSR. One of the benefits of our recent conservative risk positioning and low leverage is that we are able to take advantage of better investment opportunities when they arise. Our hybrid model allows us the ability to dynamically allocate capital, which we believe drives returns for our stockholders.

Thank you for the confidence demonstrated by your investment in Two Harbors. As always, we welcome any questions you may have.

Sincerely,



Thomas Siering  
President and Chief Executive Officer

(1) Return on book value for the quarter ended March 31, 2016 is defined as the decrease in book value from December 31, 2015 to March 31, 2016 of \$0.41, plus the dividend declared of \$0.23 per share, divided by December 31, 2015 book value of \$10.11 per share.

(2) Assets in the "Rates" strategy include Agency RMBS, Agency Derivatives, MSR and Ginnie Mae buyout residential mortgage loans.

(3) Source: Bloomberg, as of May 2, 2016.

#### Forward-Looking Statements

This presentation includes "forward-looking statements" within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Actual results may differ from expectations, estimates and projections and, consequently, readers should not rely on these forward-looking statements as predictions of future events. Words such as "expect," "target," "assume," "estimate," "project," "budget," "forecast," "anticipate," "intend," "plan," "may," "will," "could," "should," "believe," "predicts," "potential," "continue," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements involve significant risks and uncertainties that could cause actual results to differ materially from expected results, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2015, and any subsequent Quarterly Reports on Form 10-Q, under the caption "Risk Factors." Factors that could cause actual results to differ include, but are not limited to: the state of credit markets and general economic conditions; changes in interest rates and the market value of our assets; changes in prepayment rates of mortgages underlying our target assets; the rates of default or decreased recovery on the mortgages underlying our target assets; the occurrence, extent and timing of credit losses within our portfolio; the concentration of credit risks we are exposed to; declines in home prices; our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio; the availability and cost of our target assets; the availability and cost of financing; changes in the competitive landscape within our industry; our ability to successfully implement new strategies and to diversify our business into new asset classes; our ability to manage various operational risks and costs associated with our business; interruptions in or impairments to our communications and information technology systems; our ability to acquire mortgage loans and successfully securitize the mortgage loans we acquire; our ability to acquire mortgage servicing rights (MSR) and successfully operate our seller-servicer subsidiary and oversee our subservicers; the impact of any deficiencies in the servicing or foreclosure practices of third parties and related delays in the foreclosure process; the state of the commercial real estate markets and our ability to acquire or originate commercial real estate loans or related assets; our exposure to legal and regulatory claims; legislative and regulatory actions affecting our business; the impact of new or modified government mortgage refinance or principal reduction programs; our ability to maintain our REIT qualification; and limitations imposed on our business due to our REIT status and our exempt status under the Investment Company Act of 1940.

Readers are cautioned not to place undue reliance upon any forward-looking statements, which speak only as of the date made. Two Harbors does not undertake or accept any obligation to release publicly any updates or revisions to any forward-looking statement to reflect any change in its expectations or any change in events, conditions or circumstances on which any such statement is based. Additional information concerning these and other risk factors is contained in Two Harbors' most recent filings with the Securities and Exchange Commission (SEC). All subsequent written and oral forward-looking statements concerning Two Harbors or matters attributable to Two Harbors or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements above.