



August 18, 2016

Dear Fellow Stockholders,

We had a solid second quarter, delivering a total return on book value of 3.7%⁽¹⁾ and comprehensive income of \$122 million. These results were achieved despite a volatile interest rate environment, with all signs pointing to rates being lower for longer due to global economic weakness. Our Rates⁽²⁾, Credit⁽³⁾ and Commercial⁽⁴⁾ strategies all contributed to this success.

Within our Rates strategy, we added to our Agency residential mortgage-backed securities (RMBS) holdings as spreads widened in the quarter and increased overall debt-to-equity to 4.0x at June 30, 2016 from 3.0x at March 31, 2016⁽⁵⁾. With respect to mortgage servicing rights (MSR), we added three new flow-sale arrangements, bringing our total flow-sale partners to thirteen. We expect near-term flow-sale acquisitions of around \$2 billion per month. MSR represents an excellent fit within our portfolio and complements Agency RMBS, providing a natural hedge. Agency RMBS and MSR have offsetting risk profiles and we believe that when combined, Agency and MSR generate better returns with less book value volatility than a strategy of hedging with interest rate swaps only.

U.S. economic growth albeit modest, low inflation, housing price improvement and low interest rates provide favorable tailwinds for our legacy non-Agency RMBS and overall Credit strategy. When we began purchasing non-Agency RMBS in 2009, we expected that we could benefit from upside driven by faster than expected prepayments, improving home price appreciation, better borrower performance, and potentially positive legal proceedings. We have benefitted from all of these over the past several years. Additionally, both credit performance and prepayments have been better than our initial expectations, contributing to the continued attractive yields on our legacy non-Agency holdings. As a result of this strong performance, we have again this quarter released credit reserves against this portfolio.

In commercial real estate, we continue to grow our portfolio as we added four assets in the second quarter, bringing the total carrying value to \$926 million at June 30. These assets had a weighted average stabilized loan-to-value (LTV) of 65.5% and a weighted average spread of LIBOR plus 486 basis points. Our investment approach allows us to be selective in crafting a diversified portfolio. We believe that the environment continues to be favorable for non-bank lenders, such as Two Harbors. Rents and occupancies are improving, new construction remains muted and our loans benefit from the healthy cushion provided by borrower equity. At June 30, we had deployed about \$430 million of equity capital to the Commercial strategy. As we have previously stated, due to the attractiveness of this opportunity, we intend to continue deploying capital past our initial \$500 million equity commitment.

From a financing perspective, we had \$9.7 billion of outstanding repurchase agreements at June 30, up from \$6.2 billion at March 31 due to the additional borrowings on Agency RMBS. The repurchase market continues to function efficiently, and importantly, we have observed improved advance rates and spreads on financing non-Agencies. In the quarter we introduced direct lending with one counterparty. This relationship affords us

further diversification of our financing profile and lowers our overall repo costs. Our Federal Home Loan Bank (FHLB) advances totaled \$4.0 billion at June 30, with a weighted average borrowing rate of 63 basis points. These advances were collateralized by \$3.4 billion of Agency RMBS, \$0.6 billion of prime jumbo loans and retained interests, over \$0.4 billion of senior commercial real estate loans. Additionally, we had two facilities in place for financing commercial real estate assets and expanded the usage of these in the second quarter.

Subsequent to quarter-end we announced the discontinuation of our mortgage loan conduit business. Over the past few months, we spent a significant amount of time analyzing the fundamentals of our entire business, reviewing the performance and growth potential of each area. The current environment in the prime jumbo mortgage market has made it difficult for us to grow our conduit business to a level where we can achieve economies of scale. We do not expect that these market conditions will change in the foreseeable future. Therefore, despite the best efforts of our team, we made the decision to discontinue the conduit business. While this was a difficult decision, it was made in the best interests of our stockholders. It will allow us to reduce the operating complexity and costs, as position us to redeploy capital to areas of the business that will generate stronger risk-adjusted returns for stockholders over the long-term. The wind-down process is expected to be substantially complete by the end of 2016.

We have an extraordinary opportunity ahead. The second quarter was strong across the board, and we are excited about the available opportunities in all of our strategies. We will continue to take a disciplined approach and allocate capital and resources to areas of our business to position us to drive strong, long-term returns for our stockholders. Thank you for your interest in and support of 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 June 30, 2016 is defined as the increase in book value from March 31, 2016 to June 30, 2016 of \$0.13, plus the dividend declared of \$0.23 per share, divided by March 31, 2016 book value of \$9.70 per share.
- (2) Assets in "Rates" include Agency RMBS, Agency Derivatives, MSR and Ginnie Mae buyout residential mortgage loans.
- (3) Assets in "Credit" include non-Agency RMBS, prime jumbo residential mortgage loans, net economic interest in securitization trusts and credit sensitive residential mortgage loans.
- (4) Commercial consists of senior and mezzanine commercial real estate debt and related instruments.
- (5) Defined as total borrowings to fund RMBS, residential mortgage loans held-for-sale, commercial real estate assets and Agency Derivatives, divided by total equity.

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 successfully securitize or sell mortgage loans; 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 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 refinancing 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.