



Mortgage Loan Conduit & Securitization

November 4, 2015



TWO HARBORS
Investment Corp.

A Pine River Capital Managed Company

Safe Harbor



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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, 2014, 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 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.

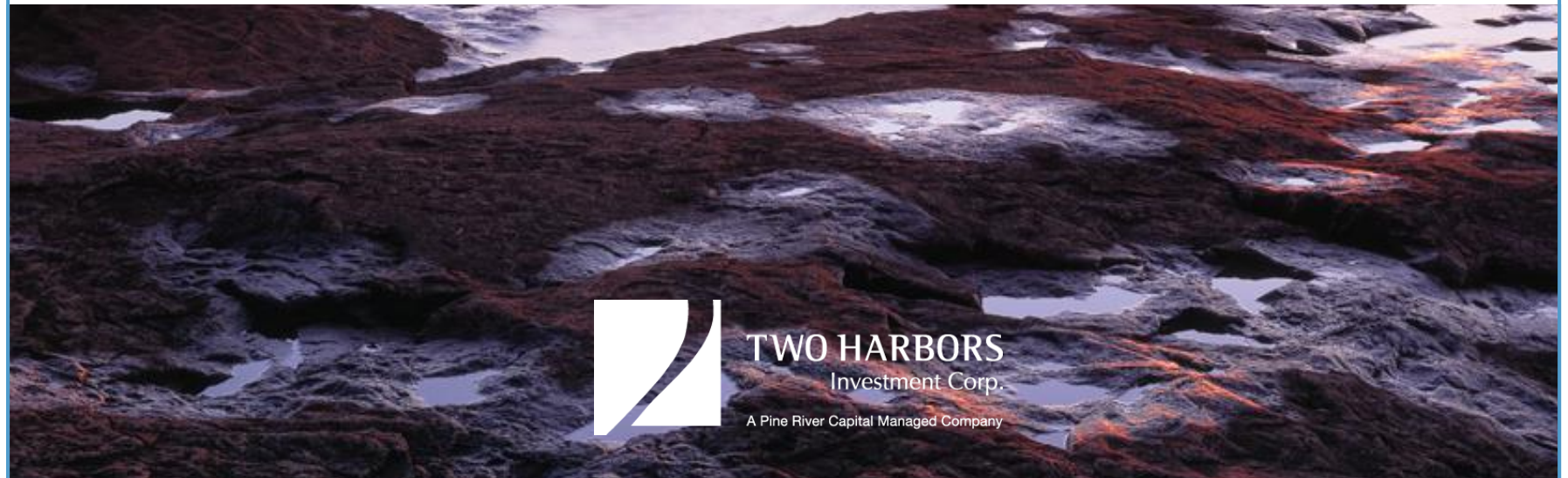
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Readers are advised that the financial information in this presentation is based on company data available at the time of this presentation and, in certain circumstances, may not have been audited by the company’s independent auditors.



Two Harbors Overview



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Mission-Based Strategy

OUR MISSION IS TO BE RECOGNIZED AS THE INDUSTRY-LEADING MORTGAGE REIT:

- Largest hybrid mortgage REIT investing in mortgage assets
- Market capitalization of approximately \$3.2 billion⁽¹⁾
- Provider of permanent capital to the U.S. mortgage market
- Thought leader in the U.S. housing market

BENEFIT OF OUR HYBRID MODEL:

- Flexibility to take advantage of opportunities the residential and commercial mortgage markets, including:
 - Residential mortgage-backed securities (RMBS)
 - Residential mortgage loans
 - Mortgage servicing rights (MSR)
 - Commercial real estate assets
 - Other financial assets

IMPERATIVES:

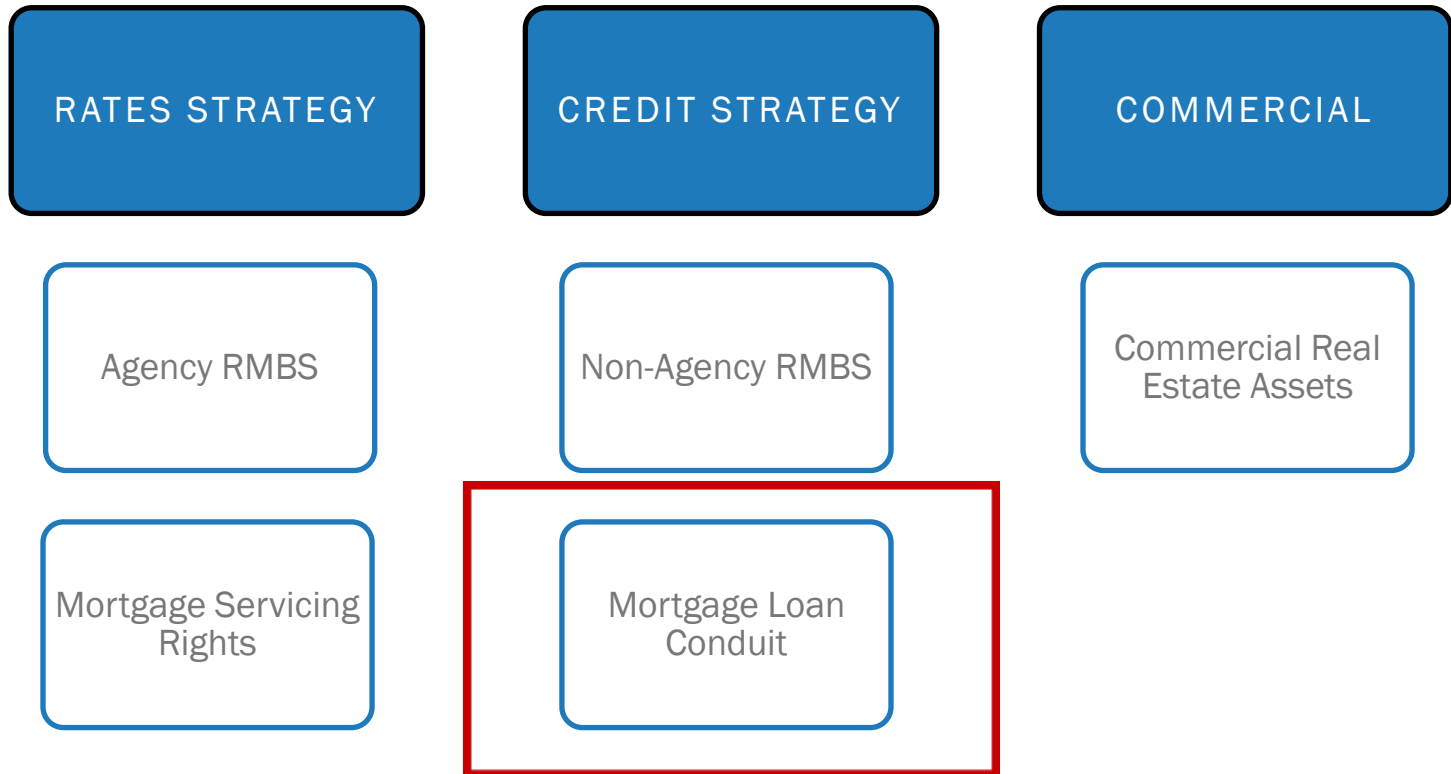
- Rigorous risk management system
- Strong administrative infrastructure
- Best practice disclosure and corporate governance
- Logically diversify portfolio for benefit of stockholders

(1) Source: Bloomberg as of September 30, 2015.



Opportunity Set

FLEXIBILITY TO TAKE ADVANTAGE OF OPPORTUNITIES ACROSS THE MARKET





Webinar Objectives



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Webinar Objectives

SECURITIZATION OVERVIEW

- Mortgage-Backed Securities (MBS)
- Creation of non-Agency Residential MBS
- Senior/Subordinated Bond Structure
- Credit Risk
- Other Risk Considerations
- The Role of Credit Enhancement
- The Ingredients of a Transaction Rating
- Benefits of Securitization

SECURITIZATION AT TWO HARBORS

- Overview of the Mortgage Loan Conduit
- Hypothetical Securitization
- Evolution of our Business



Securitization Overview



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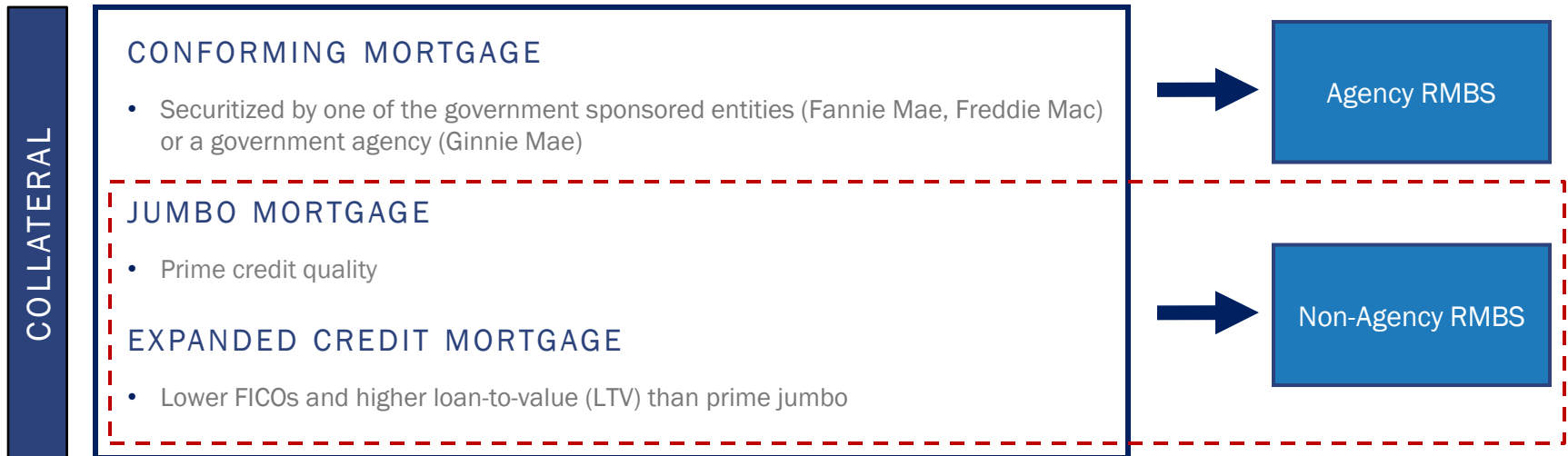
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Mortgage-Backed Securities

A MORTGAGE-BACKED SECURITY IS A BOND BACKED BY A POOL OF MORTGAGE LOANS

- The principal and interest payments from borrowers on the underlying mortgages are passed through to bond holders
- U.S. residential mortgage loans cover a wide spectrum of products, both with fixed or floating interest rates

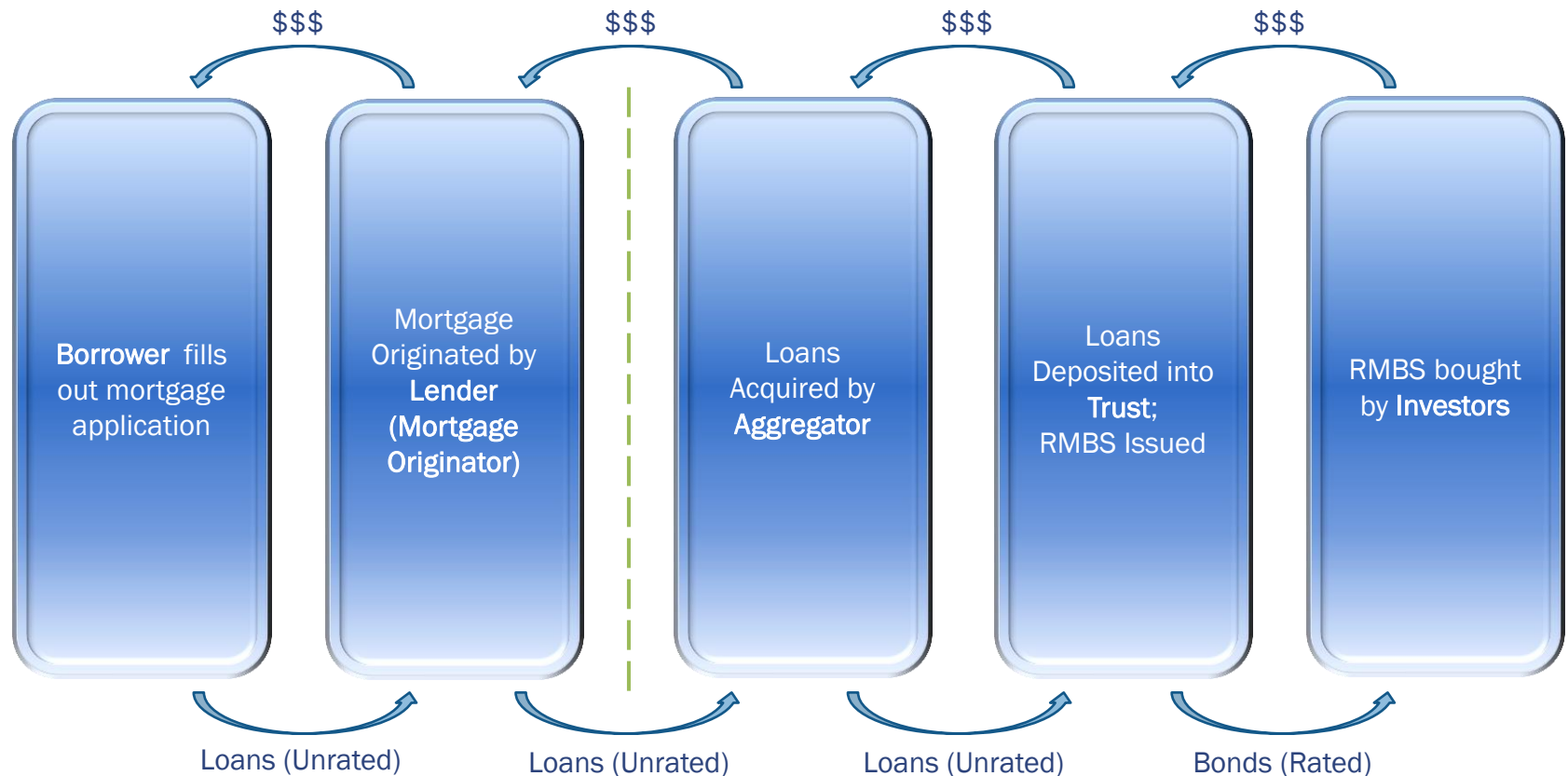




Creation of Non-Agency RMBS

PRIMARY MARKET
Mortgage lending

SECONDARY MARKET
Sale and securitization of mortgage loans



Senior/Subordinated Bond Structure



SUBORDINATED CLASSES PROVIDE CREDIT ENHANCEMENT TO SENIOR AAA CLASSES

- Each subordinated class provides credit support to all the classes senior to it
- Cash flows dispersed according to waterfall sequence (no extra money left at the end of the waterfall):
 - 1) Trust Expenses
 - 2) Interest to the Senior Bonds
 - 3) Principal to the Senior Bonds
 - 4) Interest to the Subordinated Bonds in order of priority
 - 5) Principal to the Subordinated Bonds in order of priority

SUBORDINATE
BONDS





Credit Risk

CREDIT RISK IS THE POTENTIAL FOR PRINCIPAL LOSSES DUE TO DEFAULTS ON THE UNDERLYING MORTGAGES

- Defaults result from the borrower missing several scheduled monthly payments
- Servicer may ultimately liquidate the loan to attempt to recover the principal and interest due
 - Liquidation may be carried out through legal proceedings (foreclosure) or negotiation (short sale)
- Frequency of default can be influenced by the following factors:
 - Changes in home prices
 - Credit score
 - Product type
 - Loan-to-value (LTV) ratio
 - Owner occupancy
 - Life events
- Severity of default is the net loss resulting from a default divided by the current principal balance
- Aggregate losses on RMBS are driven by default frequency and default severity



Other Risk Considerations and Drivers

PREPAYMENTS: Actual yield on investment can differ from anticipated yield due to higher/lower prepayment rates

- Housing turnover
- Rate/term refinance (falling interest rates)
- Cash-out refinance (increasing equity)
- Partial prepayments (curtailments)

LIQUIDITY: Ability or ease with which assets can be traded

- Change in rating of security
- Widening spreads
- Servicer under-performance or adverse development
- Collateral under-performance
- Interest rate changes
- Limited investor universe

BANKRUPTCY: Securitized assets could be clawed back if aggregator goes bankrupt

- Typically addressed by bankruptcy remote structure/special purpose entities (SPE)



The Role of Credit Enhancement

CREDIT ENHANCEMENT DETERMINED BY RATING AGENCIES BASED ON EXPECTED PORTFOLIO PERFORMANCE UNDER A WORST-CASE SCENARIO

- Objective of credit enhancement is to protect investor principal against credit losses
- A portfolio of mortgages cannot be AAA rated on a stand-alone basis
 - Credit needs to be enhanced by structure
- The type of credit enhancement is generally decided by the Issuer
 - A function of investor preferences
- Minimum size of the credit enhancement is determined by the rating agencies
 - Can be increased at the option of the issuer
 - Criteria among rating agencies may differ; general approach is based on a perceived worst case scenario
- Under this scenario, credit enhancement should be sufficient to allow for the timely payment of interest and ultimate payment of principal before a specified date



The Ingredients of a Transaction Rating

ELEMENTS EXAMINED BY RATING AGENCIES

- Legal Structure
- Collateral Review
 - Historical losses, projected prepayments, delinquencies and recoveries (i.e. historical experience with this type of collateral)
 - Geographic concentration
 - LTV, debt-to-income (DTI), FICO score
 - Estimates of frequency and severity of default
 - Review of loan level diligence reports provided by third party review firms
- Due Diligence on Originators, Servicer or Aggregator
 - Origination strategy, approval process, acquisition standards
 - If originator > 15% of pool, rating agency review typically required
- Cash-Flow and Structural Features
 - Strength of representations and warranties
 - Enforcement mechanisms



Benefits of Securitization

A HEALTHY SECURITIZATION MARKET PROVIDES CAPITAL TO BORROWERS AND LIQUIDITY TO THE HOUSING MARKET

CONSUMERS

- Lowers cost of credit
- Increases credit availability
- Expands the variety of credit available to meet consumer needs
- Encourages competition among lenders in the marketplace
- Contributes to economic vitality by ensuring consumer access to credit

INVESTORS

- Diversification of risk - pool of diverse mortgages versus unsecured corporate debt
- More predictable performance
- Greater liquidity compared to owning loans
- Flexibility and choice in desired level of risk and return
- Ratings stability
- High transparency and disclosure

ISSUERS

- Securitization is an alternative to unsecured borrowing
 - May provide cheaper financing than other sources and a more efficient, cost-effective and stable source of funding than unsecured market
- Allows issuers to obtain cash from the sale of assets (loans)



Securitization at Two Harbors



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Two Harbors' Conduit

EFFICIENT AND SCALABLE PROGRAM ALLOWS QUICK RESPONSE TO BROAD ARRAY OF OPPORTUNITIES

- Transaction management team oversees:
 - Due diligence
 - Contract management
 - Seller-servicer onboarding and implementation
 - Core technology infrastructure and oversight groups provide active surveillance and performance management of our sub-servicing and originator partners
- Intensive counterparty management process maximizes investment returns while minimizing risk
- Mortgage Compliance team provides legal and mortgage compliance guidance to mortgage servicing oversight and new loan product development teams
- Staffed by seasoned operators with an average experience of 16+ years



Illustrative Securitization Economics

GOAL IS TO CREATE ATTRACTIVE CREDIT ASSETS FOR THE TWO HARBORS PORTFOLIO

- Hypothetical \$1 billion loan portfolio of 30-year, 4.0% coupon residential mortgage loans
- Structured with 3.5% pass through and 25 basis points for MSR and IO
- Source loans at 102.46%
- Sell AAA, AA and A rated tranches; roughly \$40 million in assets remain

- Retain MSR, IO and subordinate bonds
- Apply 1x debt-to-equity to \$40 million of assets
 - Financing at approximately LIBOR +125
- Results in capital deployment of approximately \$20 million and levered ROE of 12-16%

Securitization Pricing ⁽¹⁾				
Class	Rating	Price	Market Value (\$m)	Yield
A's	AAA	101.14%	\$940.6	3.5%
B-1	AA	100.30%	26.1	3.7%
B-2	A	98.85%	17.3	3.9%
B-3	BBB	95.40%	12.4	4.3%
B-4	BB	63.45%	3.5	6.1%
B-5	B	45.00%	3.6	6.8%
MSR		1.09%	10.9	7.9%
IO		1.09%	10.2	6.7%
Total Stack		102.46%	\$1,024.6	3.5%
Market Value of Retained Bonds (\$m)			\$40.6	
Equity Invested (\$m)			\$20.3	
Unlevered ROE			6-8%	
Levered ROE			12-16%	

Note: The above scenario is intended to be illustrative. The numbers used in the scenarios are not projections of Two Harbors' results. The above scenarios are provided for illustration purposes only and may not represent all assumptions used. Actual results of a portfolio may differ materially.

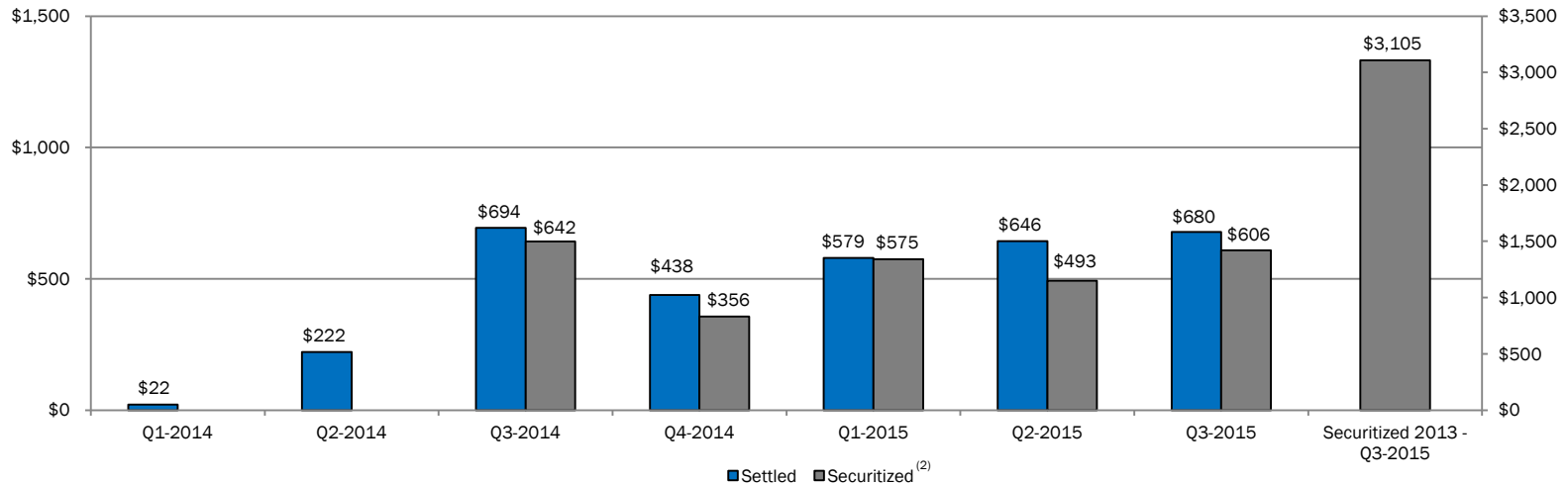
(1) Illustration excludes estimated deal costs of \$4.4 million. Due to accounting elections, deal costs are required to be immediately recognized in the income statement resulting in incremental ROE of 0.2% over the life of the securities.



Evolution of Conduit at Two Harbors

- Completed eleven Agate Bay Mortgage Trust securitizations since 2013⁽¹⁾
 - Retained subordinates and IOs
 - Achieved stated goal of completing 6-10 securitizations in 2015
- Robust pipeline (interest rate locks and prime jumbo residential mortgage loan holdings); approximately \$1.2 billion UPB at September 30, 2015
- Expanded Credit targets borrowers with lower FICOs and higher loan-to-value (LTV) ratios than prime jumbo program

SETTLED AND SECURITIZED LOANS



(1) As of October 31, 2015.

(2) Includes only securitizations sponsored under the Agate Bay Mortgage Trust issuer program.



Closing Remarks

CONTACT INFORMATION

Investor Relations

612-629-2500

investors@twoharborsinvestment.com



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