Transcript of Ladder Capital Corp's Presentation at the JMP Financial Services & Real Estate Conference

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Ben Zucker – Analyst, JMP Securities:

All right, good afternoon everyone and welcome to the JMP Financial Services and Real Estate Conference. My name is Ben Zucker, and I'm the associate that assists Steve DeLaney with coverage of the commercial mortgage REITs. And this afternoon I have the privilege of introducing the team from Ladder Capital. Ladder is a well-established direct commercial real estate lender and investor. The company's asset base consists of mortgage loans, shorter-duration CMBS investments, and an owned real estate portfolio comprised mostly of triple-net leased assets. Ladder is one of the most active non-bank conduit loan sellers in the CMBS market as well who are ranked number 10 by total volume in 2015. The company is internally managed and insiders own nearly 12% of the total company, demonstrating a strong alignment with its shareholders. JMP rates their shares "market outperform", and we assign a $14.50 price target based on a sum-of-the-parts analysis. The market cap is $1.5 billion and the current dividend yield is 8.4%.

With me today is President, Mike Mazzei to my left, Head of Merchant Banking and Capital Markets, Tom Harney; and Executive Director of Capital Markets, David Merkur. They will provide an overview of the company and then we'll conclude with some open form of Q&A, where I would encourage the audience to participate.

And with that, I'll turn it over to Mike.

Michael Mazzei – President, Ladder Capital:

Thank you for attending. I am going to try to blast through just a couple of pages here about our business model, and how we distinguish versus other commercial mortgage REITs that you may know. And this first page kind of basically does that. First of all, we're internally managed, and management owns a significant amount of stock, I believe management and Board members individually own like 13% of the company. So there is a financial alignment of interest there. It's not an AUM model.

In terms of assets that we have in comparing us to other commercial REITs, our assets are first mortgage assets, originated by a team that is on the balance sheet in the company, not part of another entity controlled by us. Everything is on balance sheet. Our originators are originating first mortgages that sometimes we securitize if they are on stable assets, or we are doing them for balance sheet. All the loans that we have on the balance sheet are zero attachment point, meaning first dollar out, which is a very important distinction between some of the commercial REITs out there, the mortgage REITs out there, that are doing very large deals retaining a B-note and selling an A note to create much higher leverage. And the issue with that is that they may retain a B-note for $100 million, they may sell an A-note for $300 million, but if it's on the high end project in New York City that doesn't work out well, the ability to defend and protect your $100 million by keeping the $300 million current becomes very difficult. At Ladder, the average loan size is roughly $15 million to $20 million, and all the loans are financed on balance sheet, not through CDOs, on balance sheet with all our lines where we have multiple lines if you look in the book, all the major banks, three of the major banks give us long-term warehouse lines. We are a member of the FHLB of Indianapolis for 4.5 years. There is a sunset provision on that unless it gets renewed, and we are unsecured borrowers. So we have an unsecured debt outstanding. We're rated double-B and we have unsecured facilities with the banks that is public.

So, different construct in terms of borrowing. We produced 10.7% after tax return on equity for the last 12 months ended June. So performance, high ROE, first mortgages, internally managed and financially aligned. This is just kind of you've seen this stuff before. These are just the wall of maturities basically we're at the wall, we're here, and that is happening right now. And I'm going to kind of discuss the business lines and how we work. We basically, we're not doing one thing making loans for our balance sheet or just investing in securities. We basically look at it in this triangle as allocation of capital and we very much pay attention to the capital markets at what they are telling us.

So every day we come in, we look at corner A, and we're originating loans, loans for our balance sheet that we're holding, that are transitional loans, that will turn into stabilized properties and be sold or will provide company financing on them once they have reached stabilization. So transition lending is LIBOR + 6-handle type spreads, one point in, one point out, debt yields are probably lower single digit debt yields, and the terms are probably one year with one year extension, or two year with one year extension, but very short, no five-year type paper that some of the other firms are doing.

In addition to originating balance sheet loans and right now at the balance sheet we have a over $1.5 billion of balance sheet loans and the breakout is in the book in terms of the configuration of our balance sheet. We also lend on conduit. Conduit is gain-on-sale business. So those property types in most properties are much more stable and they are looking for longer term financing typically 10 years and that is a market where we're turning over capital constantly in that market.

Last year in 2015 we did 10 securitizations. This year much less given what happened in the beginning of the year. We still made money in the securitization business despite the horrific first quarter that everyone had and that market has kind of like bounced back now. So the pendulum swung one way in the first quarter and the market has adjusted. The spreads have come in considerably. So that market is much more stable and performing well and we just completed a securitization very recently.

So that businesses is on. When the businesses aren't on, when we can’t do gain-on-sale, which is basically making loans that are the equivalents of raw material that we're going to put into a securitization, get rated and sold into the final product; when that market is not behaving well, we, rather they make loans and hold those loans for 60 to 90 days, we buy securities. So there are securities, and we reported this in the first quarter, that we bought and 30 days later sold them up 16 points, 20 points. So we just look at the capital markets and we deploy capital and Brian and I will have a discussion and he will say, hey can you make a loan at 6% because I could buy a single-A at 6%. And so we throttle back on making loans which is what we did in the first quarter of the year and we buy more securities and we make more bridge loans.

So it interplays very well and it is kind of synergistic, the way we allocate capital between gain-on- sale and CMBS.

When you look at corner A, it is pretty well leveraged. The conduit there just turns over using the same amount of capital $100 million to $200 million of capital you know now because we are turning that balance sheet over, and the balance sheet loans are very low levered, maybe one times leverage on the balance sheet loans.

The securities that we buy, those go very well with the FHLB. Some of the transitional loans also fit on the FHLB. We'll do that occasionally and the securities are very high rated securities and mostly AAA I think the vast majority them 98% of them are investment grade, those more highly levered, 85% advance rates.

So when you look at our balance sheet it is important to distinguish that the highly liquid part of our balance sheet is where the leverage is. Those things could be sold very quickly. The duration is very short. I think there is a three handle on the duration and then the other side of the business is where we're holding assets in the balance sheet and we're selling loans with securitization where there is lower leverage. The leverage on our balance sheet is generally matched to the liquidity of the assets; more liquid assets are more highly levered.

Occasionally, we go to corner C and through the eyes of our staff who are working to originate loans we occasionally see a deal and this has happened four or five or six times where we say to the borrower, hey this is really interesting, where are you getting your equity? And they say the great words, “friends and family”, which means I don't have it yet. And so if we like the asset that much we may lean into the leverage and leaning into the leverage sometimes going from 65% to 80%, we may get a kicker.

Or we have a situation where the borrower came in on the condos that we own in Las Vegas and he said, “well I really want 98% financing and I've got these tied up” and we said the difference between 98 and 100 is zero and you know there is no skin in the game, why don't we just buy them and we'll put you into the promote structure which is what we did. So we went – instead of doing a loan in 98% leverage we just bought the assets and we've been selling ever since.

Also in category C where most of our real estate is, we've got about 7 million square feet of real estate on the balance sheet, most of it is in triple-net. So leases at our 15-plus years on credits that we like, on real estate that we look at, we will occasionally go into the triple-net market – we buy a triple-net, we put a loan on it ourselves, we'll sell the loan into a securitization, the securitization trust will become our lender, and we'll have a levered equity position at some low double-digit cash-on-cash return. And we'll also make money on the gain-on-sale of the loan and we make sure our cash on cash on the equity is well balanced with the loan advance with how much leverage we're putting on it, and the credit and the real estate is throwing off low double-digit returns, also throwing off a lot of depreciation. There is about a buck of depreciation in our stock price today.

When we're in that market, again we pay attention to the capital markets. It is a situation where cap rates haven't moved, interest rates are lower, and in this case spreads have come in which is happening right now and that's a perfect way to lever up assets where the cap rate is not moving. So we're able to go in, and there's a wider margin of arbitrage that we can make by financing the assets at today's rate, today's spread, and the cap rates in that market have not yet adjusted or come down.

Now if you have a situation where rates go up a little bit and we have a deal under LOI, and while we have an under LOI we are now looking at the assets rates go up 25 basis points or spreads widen and it doesn't work, we're gone. And we say thank you very much, but we can't do the transaction. So we're very much in tune with the capital markets and this is what we do every day, we allocate capital. And some of our competitors are only in corner A with bridge loans, some of them are in corner A with the small conduit businesses, but none of them has the synergistic allocation of capital in real estate debt and debt-like products with triple-net that we have.

So that's kind of the overview of the business. Tom, do you have anything you want to add? Tom is, what we often do is I'd like Tom to give a quick overview of how he looks at our company versus other REITs and then I think we'd like to take it up for questions while we have the rest of the time.

Thomas Harney – Head of Merchant Banking & Capital Markets, Ladder Capital:

Thanks Mike. Yeah I think on that triangle page that the main takeaway is we are a firm believer of that the bundle of those related products is safer and produces more durable earnings in a wider spectrum of market conditions than ever being a mono-line player. And that's the same business model that this group has done for 20-plus years. There's nothing new. It has worked. It produces good cash flows. The company now is mostly a rent and NIM driven earnings company.

In addition, we have we have gain-on-sale from conduit securitization, and I think you can summarize it into between those products in the REIT side of our business, which is pretty much everything other than conduit and condominiums – the REIT produces about a 9% to 10% ROE day in day out, inclusive of having the cost of having the conduit staff personnel around; so good steady core, and then when conduit is really working well it's a turbo-charger that brings our

ROE into higher level, 11, 12, 13, etcetera. The 9 to 10 is actually pretty good compared to most competitors and comparables.

As Mike said, our attachment point is truly first mortgage. We are generally the attachment weight dollar zero. We don't have a lot of hidden organic leverage by virtue of structural subordination. The debt that you see on our balance sheet, corporate debt is our debt. There is not a lot of organic leverage in there.

And that's it, it's a pretty simple model. I think a lot of people focus on Ladder on conduit. The reality is that is actually it's a supplement these days as opposed to the core of it. I think probably the best thing to do is just go to Q&A. From a REIT investor perspective we think there's a couple basic blocking and tackling things that we investors like to do when it comes to REITs specifically and we believe we cover this pretty well.

First and foremost, if you really want to be aligned you have the management team aligned with you. So internally managed, not oriented towards growing AUM and doing more equity issuance for other reasons. Second is, sustainable dividend. We have amongst the lowest payout ratios in this space. On an LTM basis last 12 months our dividend payout is at 71% which compares favorably to 100 and 110 in others. And then you want the price to have some reasonable relationship to NAV to estimated net asset value. We don't provide an estimated net asset value, but our undepreciated book value is $14.30 a share, and I use underappreciated because unlike most mortgage REITs we have a seven million square-foot equity portfolio, which does depreciate. We have $110 million of accumulated depreciation, and we have some long-tail, 15 year-plus net lease assets, we have some office joint ventures, and we have condominiums that have been selling at an average of about 1.5 times book value.

So I'm not going to turn on the screen to this page, but in your books in the Supplemental, the back part where there's a lot more detail on the assets, page S-3 is something called “Ladder Snapshot”. And what we've tried to do there was give you all of the building blocks necessary to be able to build your own estimate of net asset value by segment. So you can look at conduit, let's say that's what one times book. There is balance sheet loans, something related to book. There is securities. Those are marked. Those are carried at fair market value, so book. Then there is net lease, here is the in-place NOI. You could apply a range of cap rates to it.

Here is other real estate joint ventures with Ladder's proportionate share of ownership. You could apply a cap rate to that. And then here is condominiums. You can add that all up and then take off the liabilities which is shown on the right side of the page and come up with your own estimates. You could also look at the research analysts. But it is interesting, we think that we show well on those three main basic tenants of REIT investment. And as Mike said, we're corporate family rated BB.

So let's hand it over to Q&A.

Q&A:

<Q>: Can you please discuss competitive advantages/marketplace dynamics for Ladder right now?

<A> – Michael Mazzei: Absolutely. What plays to our strength right now is the fact that we could be one stop option for mezz and for first mortgage. So, many of the loans that are maturing right now having been originated in 2007, you would imagine that they are probably more on the highly levered side. So we're expecting some of that would play to more balance sheet lending and also the fact that we can do a first mortgage on it, securitize the first and hold the mezz. We do not buy mezz from the street. There are many commercial mortgage REITs that are involved with transactions with investment banks where the investment bank is componentizing the loan and the commercial REIT is taking down the mezz component. We don't do that. We only take mezz when we have done the first. So I do think with the way the maturities are, coupled with risk retention, coupled with our ability to do balance sheet or fixed-rate with mezz will play it over with advantage to us. And it is like, I think it was like $10 billion a month maturing so I think that is enough for everyone, but I think it will play to our advantage, yes.

<Q>: Can you provide an update on your views of risk retention?

<A> – Michael Mazzei: Uncertain, the way we are defining the market right now, those who have balance sheet and capital that can solve the risk retention themselves or just a.k.a. "retain the risk", those are kind of price setters and then there are going to be those who don't have the ability to retain risk. And we think that those platforms believe that it's just a matter of price in terms of what the market will charge them. The B-piece bugs now who have the ability to go up to 5% and meet all the other terms of risk retention, they are not disclosing what their pricing will be and you could imagine, I mean there are what, there are just a few at the table that are going to be price setters, why would they do that? So there's uncertainty in that. So if we don't like that price, Ladder can use its own shelf and retain its own risk.

The other side of the equation, you have some banks who have test-piloted taking what they call vertical slice. This will apply to ABS and other MBS stuff, like resi. They've taken the vertical slice in commercial, they've gotten approval from agencies involved to treat that as a loan, and they will be at the table when third parties are contributing loans to their transaction. So you have the B-piece buyer, regular-way, that will be opining our loans, and now you have a vertical slice holder who is going to opine on loans.

So we think that it is not the pricing but it is the actual execution that is going to make some platforms that don't have risk retention solution uncertain and so we think that there'll be some net-net some fall-away in the market after the first couple of months of the year, next year and they realize they are kind of screwed. So the fact that we have a solution, we expect to do a securitization on our own shelf and retain the risk in 2017, and the way that will change our business is it will go from a gain-on-sale on a securitization to a net interest margin return over time for that piece of holding.

<Q>: Mike, did I hear you right that the regulator has decided to treat that retained interest as a loan participation rather than securitization exposure?

<A> – Michael Mazzei: I am pretty confident that I think there is going to be another transaction that's done with the banks where they've done one just a couple months ago which was very well received by investors and I think they are confident enough that the answer is yes.

<Q>: And that is the less onerous of the two capital charges?

<A> Michael Mazzei: Yes, it is actually not – it's not a bad trade. Some of the banks won't do it because they just feel like they don't have to. It is not a big enough business for management to give that level of support to and some banks where real estate is very important they'll do that business. I think the foreign banks will not retain risk because they've, just as you can see in the papers every day, the foreign banks are at the table trying to get capital.

<Q>: Maybe taking a step back then, as far as the prospects for the rest of this year are concerned before risk retention takes place, given the fact that spreads have stabilized and people have re-engaged the pipelines, how do you see this market playing out for the rest of the year? Could there be an oversupply as people rush to clear inventories ahead of risk retention? Could demand be impacted by a potential rate hike in December? I'm just curious how you see the timeline.

<A> – Michael Mazzei: Yes, and yes. So I think there will be – spreads will be stable and I think investors who are reading about insurance companies right now who are realizing that, hey, usually when rates are down spreads are wider. Now we had rates down, spreads tighter, gold is up, stock market is up. I think, investors are underinvested in CMBS because they have a lot of payoffs and we had a dearth of issuance in the first half of the year. So I think spreads will hold in but they may drift wider to the end of the year for the reason you said. I think everyone is going to try to get things off their balance sheet and tidy up, and then you have fed thing could be "risk-off" and you know anything could happen.

<Q>: Maybe just as a last point, could you expand on your FHLB membership a little bit, about how much longer you have under your sunset provision, what your current borrowing rate is and how you use this as a competitive advantage over your peers?

<A> – Michael Mazzei: Do you want to cover that, Tom?

<A> – Thomas Harney: I'm happy to take that one. You know we were one of two or three REITs that our grandfathered through I believe it's 2021, and we are a member in good standing now. It is a very good facility for us because we have a lot of flexibility in being able to borrow short-term long-term and having daily liquidity, it's a borrowing-base type of arrangement. The FHLB is a smart lender. They are not taking a lot of risk on types of collateral. They finance our easiest to finance collateral, our securities fit very well. We are generally investment-grade and oriented towards AAA. They do down to AA. So that fits very well with us. Their advance rates there are basically the same as the private market. Their cost is attractive. They do finance for us conduit loans and again good flexibility, similar terms in terms of advance rates to the private market on the margin better pricing. And we do a little bit of our transitional loans but not that much.

So in general, they finance our easiest to finance and/or most liquid assets. So we don't see it as an issue of hard to replace the financing. There is probably some cost differential, although particularly in securities is actually very close which is the bulk of where we borrow from them. But overall, we have an excellent relationship with FHLB bank that we deal with. It's four and a half years remaining which is a very long time in a political environment and banking environment.

<A> – Michael Mazzei: I'm 55, it's a long time.

<A> – Thomas Harney: I think that's probably the best way we can describe.

Ben Zucker: So it's perfectly timed actually, so I guess we'll leave it there, and thanks for your time.

Michael Mazzei, President: Okay, thank you for your time.

Thomas Harney: Thank you.