Transcript of Ladder Capital Corp's Q3 2016 Earnings Call

November 3, 2016

Operator: Welcome to the Ladder Capital Corp Third Quarter 2016 Earnings Call. [Operator Instructions]. I would now like to turn the conference over to your host, Kelly Porcella, General Counsel for Ladder Capital Corp. Thank you. You may begin.

Kelly Porcella

General Counsel

Thank you and good afternoon, everyone. I'd like to welcome you to Ladder Capital Corp's earnings call for the third quarter of 2016. With me this afternoon are Brian Harris, the Company's Chief Executive Officer; and Marc Fox, the Company's Chief Financial Officer.

This afternoon, we released our financial results for the quarter ended September 30, 2016. The earnings release is available in the investor relations section of the Company's website and our quarterly report on Form 10-Q will be filed with the SEC later this week.

Before the call begins, I'd like to remind everyone that certain statements made in the course of this call are not based on historical information and may constitute forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of trends and uncertainties that could cause actual results to differ materially from those described in these forward-looking statements. I refer you to Ladder Capital Corp Form 10-K for the year ended December 31, 2015, for a more detailed discussion of the risk factors that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today. Accordingly, you are cautioned not to place undue reliance on these forward-looking statements. The Company undertakes no duty to update any forward-looking statements that may be made during the course of this call.

Additionally, certain non-GAAP financial measures will be discussed on this conference call. The Company's presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Reconciliations of these non-GAAP financial measures to the most comparable measures prepared in accordance with GAAP are contained in our earnings release and/or are otherwise posted to our website at www.laddercapital.com.

With that, I'll turn the call over to our Chief Executive Officer, Brian Harris.

Brian R. Harris

Chief Executive Officer & Director

Thank you, Kelly. In the third quarter, Ladder had $44.5 million of Core Earnings, a non-GAAP measure, or $0.40 per share. Our after-tax core return on average equity in the third quarter was a healthy 11.7% and was driven by the welcome return of more robust gains in our securitization business.

All of our related business segments performed well in the quarter, resulting in a more balanced contribution to profitability from each of our revenue streams. Our conduit business accounted for 27% of Core Earnings, up meaningfully from the previous two quarters. We originated $526 million of loans targeted for securitization, while we've securitized $415 million of loans, resulting in a gain on sale of $17.1 million in the quarter. We also originated $320 million of balance sheet loans at a weighted-average spread over one-month LIBOR of 5.67% and an average LTV of 64%. Our balance sheet loans contributed 43% of our total Core Earnings. Our securities portfolio contributed 15% of Core Earnings, while our real estate portfolio also added 15%.

One item worth noting took place in one of our JV partnerships that was formed two years ago, when we purchased four office buildings in an office park, comprised of about 677,000 square feet of space, leased to various state agencies. After purchasing and developing adjacent land into additional parking for the tenants, our partnership was able to secure lease extensions through June 2026 for 85% of the total space. While this positive development isn't evident in the figures on this earnings report, we believe the value of our investment has increased substantially and our shareholders will benefit from additional cash flows over the next ten years from a very strong, highly rated tenant.

Market conditions in the third quarter were mostly stable, with one exception being the so-called Brexit week. And while credit spreads continue to be at historically elevated levels, they have largely stabilized at these higher levels since March of 2016.

While credit spreads have remained on the wide side, actual mortgage rates continue to hover near historically low levels and lending markets have been reasonably active as a result. We do see lower year-over-year volumes in CMBS originations, however.

As we look ahead to the election in just a few days, with risk retention taking effect in December and a Federal Reserve Bank that seems to want to raise interest rates, we believe that our market will be mostly stable, but we expect occasional bouts of volatility, as has become the norm.

We also believe Ladder is well positioned to take advantage of risk-retention rules, with our deep credit culture, diverse funding sources and our permanent capital base. We have seen some competitors already pull back from securitized lending and we expect this trend to continue as the impact of risk-retention rules becomes more apparent to various lenders.

Given the flexibility of Ladder's balance sheet, we're not taking a wait-and-see approach and we're actively quoting and closing high-quality mortgage loans in the normal course of our business on a day-to-day basis. We expect to be an active loan contributor to securitizations in 2017 and beyond. While we expect to securitize our loans with a variety of partners, we're in a position to securitize loans on our own if conditions make that direction more attractive. We're confident in our ability to manage credit risk through down cycles and welcome the opportunity to distinguish ourselves in a regulatory environment that requires loan contributors to have skin in the game.

While we expect the risk-retention rules to be modified over time, we stand ready to adapt as needed to an evolving regulatory environment. While some of the regulations being implemented do seem somewhat inconvenient, we have a history of being able to uncover investment opportunities that invariably arise from changes like this. These opportunities will be best exploited by market participants who are not only nimble and well capitalized, but by those who understand asset values and who can adapt quickly as things change.

As a final note, before handing things over to Marc, I'm pleased to announce that on October 18, Ladder Capital Asset Management launched its first mutual-fund product, the Ladder Select Bond Fund, with a ticker of LSBIX for the institutional class and LSBKX for the advisor class. The Fund's investment strategy is focused on investment grade CMBS and related products, building on Ladder's core investment competencies. You are invited to read the Fund's prospectus and related materials at ladderfunds.com. We at Ladder are looking forward to building our track record in the mutual fund space as a foundation for a growing asset management platform.

With that, I'll now turn you over to Marc Fox, our CFO.

Marc A. Fox

Chief Financial Officer

Thank you, Brian. I will now review Ladder Capital's financial results for the quarter and nine months ended September 30, 2016. Core Earnings in the third quarter of 2016 were $44.5 million, compared to $41.2 million in the same quarter of 2015. For the first nine months, Core Earnings were $113.6 million, compared to $141.3 million in the same period of the prior year. In the third quarter of 2016, core EPS was $0.40, equal to the core EPS earned in the third quarter of 2015. For the nine months ended September 30, 2016, core EPS was $1.10, compared to $1.40 earned in the first nine months of 2015.

On an after-tax core basis, Ladder generated an 11.7% return on average equity during the third quarter and a 10.7% return over the first nine months of 2016. This is based on an average equity excluding noncontrolling interest of consolidated joint ventures of approximately $1.5 billion. GAAP net income before taxes for the third quarter of 2016 was $58.3 million and was $47.6 million year-to-date through September 30, 2016. These results compared to a net loss before taxes of $1.4 million for the third quarter of 2015 and $93.6 million of net income for the first nine months of 2015.

Net interest income generated by Ladder's loans and securities portfolios, net rental income from our real estate portfolio, and gains on the sale of loans were the major sources of Core Earnings during the quarter. Compared to the third quarter of 2015, Ladder reported more income from the sale of securitized loans net of hedging and from sales of securities.

Core Earnings for the first nine months of 2016 reflect lower income from sales of securitized loans net of hedging and lower gains on sales of securities, as compared to the first nine months of the prior year. The lower year-over-year income was partially offset by reduced operating expenses in the first nine months of 2016 versus the same period in the prior year. The largest GAAP to Core Earnings adjustment in the first nine months of year related to the timing of the recognition of hedge results to coincide with the realization of gains and losses on the disposition of hedged assets.

In this quarter only, you will also note a one-time adjustment has been made in the reconciliation of pretax income to Core Earnings. Under GAAP, Ladder recorded an additional $3.2 million income tax expense for a proposed tax settlement for pre-acquisition liabilities on certain corporate entities acquired in the IPO reorganization transaction. Ladder also recorded other income of $3.2 million, relating to the expected recovery of these amounts pursuant to an indemnification. While these items are presented on a gross basis, there will be no impact on either net income or Core Earnings. Accordingly, since pretax income excludes the tax expense but includes the recovery of $3.2 million pursuant to the indemnification, the recovery amount has been excluded from Core Earnings.

Loan origination volume increased significantly from the first half of the year. Ladder originated $845.5 million of loans during the third quarter, compared to $431.9 million and $119.1 million in the second and first quarters of the year, respectively.

Ladder also reported income from one securitization transaction that occurred during the quarter, in which Ladder contributed $414.9 million of principal balance of loans held for sale, generating a total of $18.7 million of securitization gains; $17.1 million of that profit, attributable to $353.3 million of whole loans sold, were included in our third quarter Core Earnings.

The remainder $1.6 million of securitization profit was attributable to noncontrolling interest in three mortgage loans, totaling $61.6 million. It is anticipated that Ladder will sell the controlling interest in each of these individual loans via future securitization transactions.

For each of the loans, upon the sale of the controlling interest, the entire gain or loss realized from the sales of all interest in the loans will be recognized in accordance with GAAP and for the purpose of computing Core Earnings.

I'll now review Ladder's income statement and balance sheet. Interest income was $60.3 million in the third quarter and $175.7 million for the nine months ended September 30, 2016. This compares to $63 million and $178.6 million for the three and nine months ended September 30, 2015, respectively. Net interest income earned during the third quarter was comparable to net interest income earned during the prior quarter.

As mentioned, Ladder's loan origination activity increased during the third quarter of 2016. As a result, Ladder's portfolio of loans held for sale stood at $784.2 million at the end of the quarter, up from $583.5 million at the end of the second quarter of 2016, as origination volumes exceeded the principal value of the loans that were sold into the securitization transaction during the third quarter. As of September 30, 2016, Ladder's portfolio of loans held for investment stood at $1.6 billion.

During the quarter, our portfolio of CMBS investments decreased, as Ladder sold a total of $178.8 million of securities and experienced amortization and prepayment of $172.2 million, while purchasing $322.8 million of securities.

In terms of real estate, our total real estate portfolio as of September 30, 2016, stood at $825.6 million. During the first nine months of 2016, Ladder acquired 18 properties, bringing our total square footage of real estate up to 6.9 million square feet. Net rental income of $12.7 million in the third quarter and $39.1 million for the first nine months of the year are comparable to the net rental income earned during the same periods in 2015.

In terms of balance-sheet metrics, as of September 30, 2016, 96.7% of our debt investment assets were senior secured, including first mortgage loans and commercial mortgage-backed securities secured by first mortgage loans. This is consistent with the senior-secured focus of the Company. Our senior-secured assets plus cash comprised 80.5% of our total asset base. Total unencumbered assets, including cash, were $735.8 million, reflecting a 1.11 to 1 ratio to unsecured debt outstanding which totaled $663.9 million at September 30, 2016.

The average coupon on loans held for sale that originated in the third quarter of 2016 was approximately 4.65%. The average coupon on the loans held for investment originated during the quarter reflected a weighted-average spread of approximately 5.67% over one-month LIBOR. The weighted-average loan to value ratio of the commercial real estate loans on our balance sheet was approximately 66.8%, consistent with the weighted-average LTVs in prior quarters.

With regard to securities, 84.5% of our securities positions were rated AAA or were backed by agencies of the U.S. Government as of September 30, 2016. 97.7% of our CMBS positions were rated investment grade.

The weighted average duration of our securities portfolio was 38 months, in line with the weighted-average duration at the end of the prior quarter. Ladder ended the quarter with total assets of $6.2

billion and total equity of $1.5 billion. Ladder remained levered at 3.0 to 1, based on a computation that excludes the impact of the nonrecourse CMBS debt financing that was consolidated onto Ladder's balance sheet in conjunction with the sale of the previously mentioned noncontrolling loan interests.

With regard to financing, we continued to enhance our maturity profile, while maintaining a diverse set of funding sources. As of September 30, 2016, we had $4.5 billion of debt outstanding, excluding the nonrecourse CMBS debt just referenced and committed financing availability of over $1.5 billion for additional investments.

Our FHLB borrowings comprised $1.8 billion of Ladder's total debt outstanding at September 30. We continued to execute advances with the Federal Home Loan Bank in the ordinary course of business. In the meantime, we also continued to negotiate facility extensions and seek additional financing sources for both our loans and our securities portfolios. During the third quarter, we also expanded a loan repurchase facility to $100 million of capacity and established a new securities repurchase facilities relationship.

So summing up, to date in 2016, Ladder has generated $113.6 million of Core Earnings and core after-tax return on average equity of 10.7%. We've originated approximately $1.4 billion and securitized $664 million of loans and continued to maintain solid dividend coverage in each of the quarters of the year.

At this point, it's time to open the line for questions and answers.

Q&A

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions]. Our first question comes from the line of Steven DeLaney with JMP Securities. Please proceed with your question.

Steven DeLaney
JMP Securities
Brian, when I first look at the release, one of the numbers that jumped out was the $784 million of loans held for sale which struck us as being larger than normal. So good news is, you're finding loans that you want to originate. Did raise a question in our mind, as far as your strategy for ultimately disposing of those loans.

So when I heard your comments about conduit activity, I thought you were focusing more on 2017, rather than fourth quarter. Is it possible that you will continue to hold a larger-than-normal held-for-sale inventory in waiting to get past the implementation of risk retention before you pull the trigger on disposing of those loans? Just curious about your strategy on the inventory you currently have.

Brian R. Harris
Chief Executive Officer & Director
Sure. It's probably less strategy than you think there.

Steven DeLaney
JMP Securities
Okay.

Brian R. Harris
Chief Executive Officer & Director
I apologize, but--.

Steven DeLaney
JMP Securities
No, I appreciate the honesty.

Brian R. Harris
Chief Executive Officer & Director
As you get into the fourth quarter, we're seeing some -- I would call it a lack of competition in some ways, in that a lot of people are adding premium pricing, anticipating some additional costs and looking to dispose of their normal conduit securitizations as a result of risk retention. And we have not really done that. We're pushing forward, trying to take the higher quality assets where we can and we're not adding any premium pricing to it as a result of it, because we just don't think that there's that much friction as a result of the oncoming regulations, at least from our standpoint.

And also in the fourth quarter, you've got a fairly crowded field. That's actually been received well so far. And there is only a certain amount of space you have -- shelf space, effectively, with partners. And so we're participating in several transactions, probably more than usual, in the quarter. But were not able to conclude all that we would have liked to have in the fourth quarter.

But on the other hand, I wouldn't dismiss your first comment, in that -- as we've said many times, we're very comfortable holding loans. And we never really try to regurgitate every loan that we could possibly sell in a quarter. We really try to take a little bit more artful approach to it, to be a cool beneficiary, where we try to make the sauce with the right amounts of different things, with the right LTVs and the right product mix. And if that means hanging onto a few loans into the first quarter, that's fine with us. So, yes inventory, but we do anticipate securitizing those.

Steven DeLaney
JMP Securities
And we're all aware that you had filed for your own securitization shelf and you now have that capability. Are there any advantages strategically or financially to doing your own deals? Phrases that pop into my mind are branding, value, flexibility, profitability. Could you just comment on -- if you were to decide to take this $700 million and some others and float a $900-million Ladder-only deal,

what would the impact of that be on your business relative to what you're doing now by partnering with Wells and others?

Brian R. Harris
Chief Executive Officer & Director
Well, first of all, if you're partnering with other parties, you have some natural benefits that come from the partnership. One is, they have a distribution sales force. They also have -- they handle a lot of the roadshow. They'll handle a lot of the analytics for you and they'll take a lot of the calls through their syndicate desk. But keep in mind that much of the personnel here at Ladder actually ran those kinds of desks for the better part of 25 years.

So we know how to do it. It's easier for us as a smaller company not to have all those fixed costs internally in the building and we would actually -- you know, one of the reasons when we first opened we became a broker dealer -- and that also sent some waves, people wondering why we became a broker dealer -- we didn't become a broker dealer because we thought we were going to securitize our own loans. We wanted to be able to market our own assets. And in order to sell bonds, you have to be registered.

So that was really the only reason we did that. As risk retention came into play, there are some bank formats where there's nothing but banks in the transaction; and I think that there's a strategy there regarding them.

And we were a little concerned that the day might come when we wouldn't have enough ability to partner up with other people who are now partnering together, where we might have to go alone.

And while it's not our preferred route, it certainly is acceptable to us. We don't have a distribution sales force, but we do have very high credit standards and I think most of the bond buyers know that. We would no doubt still use the -- or we would rent the sales forces of various Wall Street firms to the extent they wanted to do it. We think we can certainly shoulder that cost.

But in addition to that, we're not going to be in a position I think where we're forced to say, we want to sell $600 million of loans in the quarter but we're only able to find shelf space for $200 million. We want to be able to control our own destiny.

The benefit would be no additional costs to us. On the other hand, you'll hear the questions about, well, what about the secondary support of these bonds? What will happen if we buy them? And I think people who also know us very well also know we're very large bond buyers and we probably have a bigger inventory of securities than most Wall Street firms. So I don't think that will be a big deal.

Operator: Our next question comes from the line of Rick Shane with JP Morgan. Please proceed with your question.

Richard B. Shane

JPMorgan Securities LLC

Just curious -- obviously with -- you guys are building inventory, basically full steam ahead, comfortable with what's going to happen with risk retention. I'm curious if you're seeing that affect pricing. And obviously -- I know you can't think too much about what execution is going to look like in the new world, but all things being equal, do you think that you're creating loans today that would have generated higher gains historically?

Brian R. Harris

Chief Executive Officer & Director

I would say pricing -- again, historically -- I have a lot of history, so that can go back pretty far, but -- I think relative certainly to the first and second quarters, the entire business is easier right now. I think there has been a pullback in the competitive forces out there, largely as a result of having to hold some of these inventories for long periods of time. Some people's balance sheets are not able to accommodate that.

So it's causing some natural freeze-up, I think, in the origination. On the other hand, from our perspective -- yes, we're writing loans now and the spreads that we're writing them at, they would have historically made more money than they're making now. However, we do feel like profit margins are acceptable right now, also.

Operator: Our next question is from Jessica Levi-Ribner of FBR & Company. Please go ahead.

Jessica S. Levi-Ribner

FBR Capital Markets & Co.

One big one from me, just looking back at your Core Earnings for the last few quarters -- and you mentioned it during the call -- you're easily out-earning your dividend. How do we think about that going forward, especially considering the opportunities that you're facing which seems to be pretty robust, in a market that's gotten, like you just said Brian, a lot easier?

Brian R. Harris

Chief Executive Officer & Director

Well, clearly we're out-earning it at this point and that's by design, if you remember the way that we set up the Company and how we handle our dividend policy. Obviously with a quarter like this, if you multiplied it by four with $110-million payout, there's obviously a lot of room between the payout versus what we could pay out. So we're revisiting our dividend policy, as we always do around the fourth quarter. So yes, we're looking at it and we'll be making some determinations, I think, as we go into the fourth quarter as to how we're going to handle it. But we clearly have some room.

Jessica S. Levi-Ribner

FBR Capital Markets & Co.

And just one around your liquidity -- and if I missed it, I apologize -- can you walk us through your lending -- kind of your capacity? And maybe -- I know you evaluate each of your strategies based on the returns that they offer and what the market looks like and that's obviously worked well for you, especially this year. But how can we think about your capital allocation in the fourth quarter and maybe into 2017, if you have that view?

Brian R. Harris

Chief Executive Officer & Director

Sure. The best products for us today are bridge loans and conduit loans. So we have taken a step back on the purchase of CMBS and that kind of makes sense. When we're selling conduit loans and we feel that they're at attractive levels, meaning we like the price we're selling them at, we're not usually aggressive buyers at those levels. And when we don't like selling conduit loans because the spreads are wide, that is when we're acquiring them rather than selling securities.

So that all fits hand in glove. And so I think that today we, at about a $6.1-billion or $6.2-billion balance sheet, we're pretty full. But do keep in mind that we do have $2 billion and change worth of securities and we always view that as a -- where we can get cash whenever we want.

So to the extent that we feel the need to reach in and create some liquidity, we'll sell the AAA securities that are quite short in our portfolio and they are rather highly leveraged at about 85% because they're AAA and they're three-year in duration.

So, to the extent that we do liquidate some of those positions to create capital to take advantage of the conduit business and the bridge-loan business, we'll naturally de-lever the organization, also. And I would anticipate that happening. That's quite likely.

Operator: [Operator Instructions] Our next question comes from Jade Rahmani from KBW.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Just wanted to get your thoughts on M&A in the specialty finance sector. Do you think there are benefits to combining with another platform to increase scale, diversify your revenue base or add additional capabilities? And also, does the asset management initiative suggest a decision to remain independent?

Brian R. Harris

Chief Executive Officer & Director

I would say there are always natural economies of scale. We're a little undersized relative to some of our competitors, but we're pretty nimble and well capitalized, also. We certainly plan on being independent and are very comfortable in that capacity. I would view us more as somebody who looks at companies, as opposed to how we get looked at. But that doesn't mean it has to stay that way. But I think in general, we come to work every day planning to run the company independently.

And the asset management vehicle that we set up was really just a natural extension of our competency in the building. We don't have to hire anyone to do that. We have it already in house. And it's an easy situation for us to allocate, because obviously we run a very large portfolio of our own in that category. So we have an allocation policy -- and often sometimes when the spreads get very wide, our phone rings and people want to know how to buy CMBS. And it's surprising that there really aren't many ways to do it.

So we thought we would create a pure-play vehicle, where if people want to be invested in CMBS and have liquidity and be able to get their money out at certain times, it would be a convenient thing to do. Because I think most people know we know how to handle that business. But I would expect the balances to go up quite a bit during periods when spreads are widening dramatically.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Just on the real property side, can you discuss what you're seeing out there that's attractive? You seem to continue to find interesting opportunities on the net lease side. And also if you could discuss the pace of condo sales, which seems to have moderated slightly.

Brian R. Harris

Chief Executive Officer & Director

Sure. The pace of condo sales -- we have a development project here on the Lower East Side of Manhattan which will be coming on line shortly. But the condominiums that we have in Las Vegas and Miami, we probably have about four or five quarters left of the inventory there. I don't attribute the moderate pace to anything other than the prices are higher. I think if we weren't pushing price and if you look in the Case-Shiller reports, you can see housing prices are increasing in many places. So we're deliberately slowing it down and waiting for better prices, although certainly not looking to hang onto them into the next up-turn.

So I suspect we'll be out of condos in four or five quarters, but we have replacements coming through. That's one of the reasons I highlighted the four office buildings that we purchased, where we extended leases through ten years. So we do occasionally see opportunities where buildings need capex or some development hand and perhaps the landlord doesn't have the money to do what the tenant needs.

The net lease space has gotten more interesting, actually, the main reason being that the 1031 market is still alive and well. But I think some of the retailers -- there's a natural concern around some retailers because of technology. But in addition to that, even very healthy retailers, like Walgreens, are now talking about closing a lot of stores.

So as a result of that uncertainty, cap rates have backed up a bit. And while interest rates -- while spreads are wide, rates are rather low. And when we look at a rate relative to a cap rate, if we can put on ten years of cash flows at very attractive returns into the REIT, then that's when we'll pull the trigger.

We haven't been overly aggressive, but we certainly have been able to find various situations there. I think we purchased four assets during the quarter. Three of them were rather small retail properties and one was an office building, headquarters.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.
And can you also comment on the condo situation that I believe is characterized as a nonperforming loan in New York City? But I think you may have originated that with intention of owning that. Can you just comment on that?

Brian R. Harris
Chief Executive Officer & Director
Sure. We have one loan that we made to a borrower who owned a property and needed to refinance it. And as he was about to refinance it, the single tenant in the building went bankrupt. And as a result of that, the cash flow went to zero. When we try to get you to read the breadcrumb trail, we tell people that we originated the loan the day after the company went into bankruptcy, so there should be some relevance to that.

We certainly stepped into it at a real estate level that we were comfortable with, knowing that the cash flow might very well go down. It's in a very densely populated area and a very wealthy area of New York City and we feel very comfortable should we ever own the property, although we don't intend to. But if that's what happens, that's fine. We're currently running the loan -- it's not a terribly large loan, but we're running at a default interest rate of close to 16%.

Operator: [Operator Instructions] Our next question comes from Charles Nabhan from Wells Fargo. Please proceed with your question.

Charles Nabhan
Wells Fargo Securities LLC
I was hoping you could elaborate on the asset management strategy, in terms of any economic impact you expect from the business and your expectations for growth within the business, as well.

Brian R. Harris
Chief Executive Officer & Director
Sure. Obviously, there are a lot of asset managers out there that we sell assets to on a regular basis. And of course, they own them for periods of time of time, be it short or long, and they earn management fees as well as performance fees. And as a result of that, sometimes we look at that and say, should we not possibly be just vertically integrating the company.

We believe asset management revenues will garner a better multiple than our conduit business, for instance. A lot of people think that that's very episodic and can occasionally go to zero, for that matter, but asset management is something we've toyed around with for a long time. Before going public, we ran several managed accounts for other parties and it's a skill set that we've got.

The reason we really haven't been doing too much of it is, we've actually been working on, how do we allocate assets. Because we invest in all of these categories. So if you buy a AAA ten-year bond, you can sell $5 million to one party and $5 million to another party pretty easily; you can split it up. So allocation gets very easy. But if you make a $10 million loan, it's very hard to give half to one fund and half to another to avoid any conflicts of interest.

So we're very cautious around our conflict-of-interest policy. We want to make sure that everybody is comfortable with it. We started with the CMBS business because, for one, it is more attractive than a cash vehicle. It's an open end mutual fund, I believe.

And we picked that because it has, easily, the ability to scale dramatically. Management fees won't be very high, so I don't expect a lot of impact, but this is how asset managers start. And I would anticipate us continuing to -- when we can find investment opportunities that don't conflict or that we're able to handle the conflicts in a fair and allocated policy, then I would expect us to do more of that.

Charles Nabhan

Wells Fargo Securities LLC

Okay. And just as a follow-up, looking into 2017, beyond the implementation of Dodd-Frank risk retention -- I know there's a lot of moving parts and questions around how the industry will go about complying with the new regulations, but I was wondering if you could talk about your expectations for industry volume in 2017 and sort of how you think about the different scenarios for compliance for the industry and how that could potentially play into volumes.

And I guess in addition to that, in the past year there's obviously been some smaller conduit lenders that have closed up shop. And I was wondering if you think that trend will continue or if you think that the players in the space right now are sort of the same set that we'll see going forward.

Brian R. Harris

Chief Executive Officer & Director

Sure. That's a mouthful. If I don't get to all of it, please remind me of parts that I missed. If we take a look at this year, 2016 at this point, I think we're at $58 billion in securitized assets, where at this point last year, we were at $92 billion. So that's actually a 37% drop year over year, despite the fact that interest rates were quite low.

So that is a little bit of a conundrum for us. I don't fully understand why there has been no volume. I think it has to do -- really, there are two places you find loans. One is the acquisition channel which is actually very attractive right now and active. And the other is the refinance channel.

The refinance channel -- I guess interest rates -- people have paid their prepayment penalties if they had the cash flows when liquidity returned to the market after 2008, so there's just not a lot of refinance left, unless they couldn't refinance it. But perhaps of more interest, there's about $7 billion or $8 billion maturing every month next year in the CMBS world. So we think it's going to be a very good opportunity. We're anticipating some of those assets to be good enough not to default but not good enough to refinance in full.

And with our ability to position bridge loans as well as conduit loans as well as mezzanine loans on top of these all in one shop, we think this provides us with a great opportunity. So we think next year, volume will be higher, but honestly I'm not an expert in that. I don't really know. It does look like there's plenty of activity coming our way with that maturity wall. And the competitive set is definitely decreasing.

Not only is it decreasing outright when they close their doors, some of the smaller players -- the banks, I think, are going to have a decision made here pretty soon as to whether -- how capital treatment works. Are they going to continue to allocate capital to these businesses that might not be the best use of their capital from a risk-weighted perspective?

And then you also have the European banks, where I think some other decisions are going to have to be made as to whether or not they're going to capitalize their entities here in the U.S., the way the government is asking them to.

So I think that the lending apparatus has pulled back quite a bit and we're looking to fill those gaps. The conduit business is -- anything down the middle is still pretty competitive. Anything just off the center of the fairway is actually not very competitive. And the bridge loan business is very attractive today. There are just not that many people in it.

Operator: Thank you. There are no further questions at this time. I'd like to turn the floor back to Management for closing comments.

Brian R. Harris

Chief Executive Officer & Director

Thank you all for getting on the call with us today. I did want to mention that this will probably be the last time we talk to you for a while before we come up with year-end audited financials. I did want to leave you with a taste in your mouth that we're very optimistic about what we see over the next few months.

We have a fairly robust pipeline of assets with a reasonable supply and demand mix going on. As we said, that $92 billion from last year down to $58 billion this year really does create some demand because there's a lot of investment dollars available. So we look forward to it. We'll be talking in the spring and we'll catch up with you then. Thanks.