# Transcript of Ladder Capital Corp's Q4 2016 Earnings Call

February 23, 2017

**Operator**: Welcome to the Ladder Capital Corp Fourth Quarter 2016 Earnings Call. [Operator Instructions]. I would now like to turn the conference over to your host, Kelly Porcella, General Counsel. 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 fourth 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 year ended December 31, 2016. The earnings release is available in the Investor Relations section of the Company's website and our annual report on Form 10-K 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's 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 provided – posted to our website, 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. I'd like to start today by highlighting a few items from the fourth quarter of 2016. After that I'll recap the full year that just ended and note some of the more important data points and trends as we look back and then relate some of those to how we see things developing in the year ahead in 2017.

In the fourth quarter, Ladder reported core earnings, a non-GAAP financial measure, of $44.6 million, or $0.37 per share. During the quarter, we participated in three loan securitizations contributing $663.8 million of loans producing a gain on sale of $18 million for a net profit margin of 2.71%.

At the end of 2016, our undepreciated book value was $14.76 per share while our GAAP book value was $13.57 per share. Our annualized after-tax core return on equity for the quarter was 10.8% and for all of 2016 it was 10.7%.

At year-end our debt to equity ratio fell to 2.6 to 1 largely as a result of $607 million in securities either being paid off before their maturity date or sold by us in the fourth quarter. This reduction in securities inventory has continued into the first quarter of 2017 with a further decrease of $324 million in the first six weeks of this year. So we have either sold or seen unscheduled pay-offs of $931 million from our securities inventory over the last 4.5 months.

As of last Friday, our debt to equity ratio had fallen to 2.5 to 1. We began to sell some of our securities in the fourth quarter in response to short-term interest rates rising and to enhance our liquidity as we approach April when our more expensive corporate bond becomes callable.

Loan origination in the fourth quarter was skewed more towards balance sheet loans with $438.4 million originated and $263.2 million in loans held for sale. This trend has continued into the first quarter of 2017 also with $129.5 million in balance sheet loans closed through last Friday and $45.6 million in loans held for sale.

I hesitate to draw too many conclusions from these production numbers over 4.5 months given that we had an election result in November that surprised many market participants accompanied by a robust rally in stocks along with rising interest rates into the end of 2016. Also let's not forget that numerous retention rules for issuers of securitizations went into effect in late December.

Risk retention rules and how market participants interpret them have put the conduit business into a state of flux and has already caused numerous originators of loans for securitization to exit this business line. At Ladder our overall permanent capital model positions us nicely to not only deal with the new changes, but to thrive under them. We have a solution to the new regulations. While the jury is still out on which risk retention model to use, we are favoring that so-called horizontal method where we would retain the bottom 5% of the securitization.

We are able to create pools of loans where all of the loans in the pool have been originated by us and we refer to this as the “Ladder-only” type of securitization. While this process allows us to operate independently of securitization partners, we would note that this type of transaction would be in addition to and not instead of selling loans into deals with other loan originators like we have in the past. We like having the flexibility to securitize our loans under both formats.

Two of the great barriers to entry to investing in high yielding horizontal B-pieces on pools of loans are, one, due diligence costs because investors are making relatively small investments in many different loans and need to evaluate each property associated with the various loans and, two, the need for permanent capital structures given the requirement to hold these investments for five years. If Ladder retains all or part of the horizontal B-pieces, this may change how we presently book gain on sales, because under accounting rules, we will not be given true sale treatment while we are holding the controlling class of bonds.

Interestingly enough, our quarterly gain on sale business has been difficult for analysts and investors to model from quarter to quarter, since constantly changing market forces impact this calculation in real time. By retaining the horizontal risk piece, we would then be creating high yielding investments that would have predictable and sustainable cash flows that last for up to ten years rather than booking gain on sale as we securitized loans each quarter, thus making Ladder much easier to model from quarter to quarter.

If we retain 100% of a 5% horizontal strip off of $2 billion worth of loans each year, we would hold about $100 million of investments in these risk retention tranches per year. And we would keep these positions for several years under the new regulations. This creates a long-term hold position but the annual yield associated with these types of investments is currently over 15% before risk adjusting for potential losses.

Ladder's uncompromising credit standards, along with our permanent equity capital base, along with the fact that all of our due diligence costs are covered by our borrowers when we originate the loan positions us well for the currently regulated investment environment.

The last detail I'll mention regarding the fourth quarter activity is in our real estate portfolio. We continue to see positive momentum at the property level. In Michigan, as expected we saw a large tenant extending an expiring lease for 130,000 square feet for five years and in Virginia, our JV partner was successful in leasing a recently vacated 135,000 square foot building to a very strong credit for a term of just over 11 years on an as is basis.

Looking back over 2016, we are reminded of what a difference a year makes. You might remember in our earnings call for the fourth quarter of 2015, we were reporting strong core earnings of over $50 million, but as 2016 began, the U.S. stock market was off to its worst start on record. Our stock price had temporarily fallen to about 65% of book value, credit spreads were widening and the freefall in energy prices was causing tremendous volatility in the high yield bond market, as several MLPs were cutting their dividends causing knock-on negative effects in the REIT space.

This volatility impacted the securitization market as money managers were raising cash to deal with margin calls, causing us to greatly scale back our plans to sell loans via securitization. Evidence of this interruption is clearly seen as we look back with our securitization business contributing just $3.7 million in the first half of 2016 only to rebound in the second half to $34.6 million in core earnings for total 2016 contribution of $38.4 million.

We have indicated to you in the past that the conduit business can seize up at times, stressing that it should be looked at year-over-year and not quarter-over-quarter. We tried to respond to these volatile episodes in an offensive manner. And we showed this again in the first half of 2016 when we repurchased $5 million of our stock, limited by average daily volume rules, and over $50 million of our corporate bonds that had fallen in value with the rest of the credit markets.

Ladder corporate bonds due in 2021 were bought at a price near 84 and have since rebounded to a price near par. While we generally rotate around our investment triangle favoring the purchase of existing mortgage backed securities with investment grade ratings rather than creating new ones that need to be sold, in this case, our triangle became a square for about a month while we purchased Ladder debt and equity instruments feeling that our shares and bonds were at exceptionally low prices.

At this time last year, I disclosed to all of you our three largest CUSIP holdings given the deep discount to book value that our stock was trading at. On that call, I mentioned that two of the three holdings were expected to pay off at par within one year, even though both had years to go until maturity. Today I can report that the two expected pay-offs both took place within the estimated 12-month time period, while the third holding was then and is still now expected to pay-off in November of 2018.

Before I turn you over to Marc, I just wanted to point out some interesting changes over a longer time period to the component contribution to earnings at Ladder. In 2013, our overall lending business contributed about 73% of our earnings, made up 59% from securitization, 10% from first mortgage balance sheet loans and 4% from mezzanine loans. Four years later in 2016, after going public in 2014 and becoming a REIT in 2015, securitization contributed 20%. Bridge loans made up 38% and mezzanine loans 9% for a total of 67% of our earnings.

In addition, securities contribution dropped from 17% in 2013 to 14% in 2016, while the component of earnings from real estate increased from 8% to 19% over the same period. As we move ahead in 2017 by complying with risk retention rules, our balance sheet lending and real estate owned should continue to increase their respective contribution percentages as we increase net interest margin and lease income while relying less on the gain on sale model.

Lastly, I'll remind you once again that Ladder is an internally managed REIT with inside ownership of 12% of outstanding shares. In December, we increased our quarterly cash dividend by 9% to $0.30 per share. And in a year where we barely had any income from our securitization program in the first six months, our core earnings covered the current $1.20 per share cash dividend rate by a healthy 123%. We will continue to try to increase our average daily volume making our shares a more suitable investment to larger portfolio managers as we did in December when some original investors sold 11.5 million shares in the secondary offering.

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

## Marc A. Fox

*Chief Financial Officer*

Thank you, Brian. I will now review Ladder Capital's financial results for the quarter and year ended December 31, 2016. Core earnings in the fourth quarter of 2016 were $44.6 million this compares to $50.1 million in the fourth quarter of 2015. Core earnings were $158.2 million for the full year compared to $191.5 million in 2015. In the fourth quarter of 2016, core EPS was $0.37 per share compared to $0.45 per share for the fourth quarter of prior year. For the year ended 12/31/2016 core EPS was $1.48 compared to $1.85 earned in 2015.

On an after-tax core basis, Ladder generated a 10.8% return on average equity during the fourth quarter and a 10.7% return over the full year. This is based on average equity excluding NCIs or consolidated JVs of approximately $1.5 billion. Major sources of core earnings in the fourth quarter included net interest income generated by Ladder's loan and securities portfolios and net rental income from our real estate portfolio, which together totaled $42.7 million in addition to gains on the sale of securitized loans net of hedging of $18 million.

GAAP net income before taxes for the fourth quarter was $72.4 million and $120 million for the calendar year 2016. These results compared to GAAP net income before taxes of $67.1 million for the fourth quarter of 2015 and $160.7 million for the full year ended December 31, 2015. The largest GAAP to core earnings adjustments in both 2016 and 2015 related to depreciation on our real estate portfolio.

Looking back on the year, loan origination and securitization volume increased significantly in the second half of 2016. Ladder originated $701.6 million of loans during the fourth quarter of 2016 bringing total loan originations during the second half to $1.55 billion compared to $551 million in loan originations during the first half.

Securitization volume was even more heavily weighted towards the second half as the $1.08 billion of loans securitized in the third and fourth quarters was more than four times of securitization volume in the first half of the year.

I will now review Ladder's income statement and balance sheet. Interest income was $60.7 million in the fourth quarter and $236.4 million for the year ended 12/31/2016, this compares to $62.9 million and $241.5 million for the three months and year ended 12/31/2015 respectively. Net interest income earned during the fourth quarter is comparable to net interest income earned during recent quarters.

Net rental income, which includes operating lease income and tenant recoveries, net of real estate operating expenses, was $14.2 million in the fourth quarter and $53.3 million for the full year, both amounts are comparable for the net rental income earned during the same periods in 2015. Ladder's portfolio of loans held for sale stood at $357.9 million at the end of the fourth quarter compared to $784.2 million at the end of the third quarter. This was a direct result of the increase in securitization volume in the fourth quarter to $663.8 million which exceeded Q4 conduit loan originations of $263.2 million.

As of 12/31/2016, Ladder's portfolio of loans held for investment stood at $2 billion, up almost 15% from the end of 2015. During the fourth quarter of 2016, Ladder's portfolio of CMBS investments decreased as Ladder sold a total of $230.9 million of securities and experienced amortization and prepayment of $376.3 million while purchasing $124.1 million of securities. In terms of real estate, our total real estate portfolio as of the end of the year stood at $822.3 million. During 2016, Ladder acquired 22 properties bringing our total square footage of real estate up to 7.2 million square feet.

In terms of key balance sheet metrics, as of 12/31/2016, 96.2% 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 78% of our total asset base. The average coupon on the loans held for sale that were originated in the fourth quarter of 2016 was approximately 4.81% and the average coupon on the loans held for investment originated in 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 64.8% slightly lower than the weighted average LTVs in prior quarters. With regard to securities, 83.2% of our securities positions were rated AAA or were backed by agencies of the U.S. government as of 12/31/2016 all of our CMBS positions were rated investment grade. The weighted average duration of our securities portfolio was 43 months or 3.6 years, slightly higher than the duration figures of recent quarters and reflecting the repayments of some of the larger shorter duration CMBS positions, Brian as referenced in today's call and on prior occasions.

Ladder ended the quarter with total assets of $5.6 billion and total equity of $1.5 billion. Ladder reduced its leverage to 2.6 to 1 from 3 to 1 during the quarter, reflecting the net pay downs of secured debt as we shifted capital from more levered investments in CMBS to less levered first mortgage balance sheet loans. With regard to financing, we continued to enhance our maturity profile, while maintaining a diverse set of funding sources. As of 12/31/2016, we had $3.9 billion of debt outstanding, and committed financing availability of over $1.7 billion for additional investments. We continue to execute advances with the Federal Home Loan Bank in the ordinary course of business.

Our FHLB borrowings comprised $1.66 billion of Ladder's total debt outstanding as of the end of the year. During the quarter, Ladder executed a new uncommitted securities repurchase facility and extended the final maturity date of one of our committed loan repurchase facilities. We continue to negotiate facility expansions and additional financing sources for our loan and securities portfolio.

Summing up, in 2016, Ladder generated a $158.2 million of core earnings and a return on average equity of 10.7%. We declared total dividends of $1.285 per share of Class A common stock and raised the cash component of the quarterly dividend by 9.1% to $0.30 per share during the fourth quarter.

We originated approximately $2.1 billion and securitized $1.3 billion of loans as Ladder finished the year strongly with almost three quarters of total originations and over 80% of total securitization occurring in the second half of the year. We continued to apply disciplined approaches to the use of leverage on our balance sheet and our lending activities, and to the credit review process applied to every investment decision and to the management of interest rate, counterparty and liquidity risk. And finally, we continue to maintain solid dividend coverage in each of the quarters of the year.

At this point, it's time to open the lines 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 Jade Rahmani with KBW. Please proceed with your question.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
Thanks very much for taking the questions. Just wondered, big picture question, how would you characterize your tone towards the coming year? Are you cautiously optimistic, or are you more cautious, or are you bullish about current investment opportunities and the environment?

Brian R. Harris
*Chief Executive Officer & Director*
Hi, Jade. This is Brian. I'm pretty optimistic generally I think. Yeah I think we were kind of getting towards the tail end of a credit cycle there. And now with the new administration, I think if they really

do cut corporate taxes and repatriate money I think that could add a couple years to what was a recovery that might have been slowing down a bit; so I think I feel pretty optimistic about it. And I think ultimately the risk retention rules that are in place today have really curtailed a lot of the competitive influences that we were dealing with, especially in the smaller loan players. And I think it really favors companies like ours with permanent capital. So, yeah, I'm pretty optimistic about it.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
The true sale treatment that you were referring to, is that in the case of both the Ladder sponsored securitizations and contributions to future deals with other sponsors in the horizontal strip case?

Brian R. Harris
*Chief Executive Officer & Director*
No, it's really I think one of each in the horizontal format, which I think we're favoring at this point if we do a Ladder transaction, when I say Ladder meaning we have all the loans in the deal. We will not get true sale treatment because we're holding a controlling class of bonds. And so as a result of that what we'll have is a very high yielding B-piece, for lack of a better term, and that will throw off cash flows over a ten year period of time, getting rid of the gain on sale associated with that securitization in that quarter. If you go the other way and securitize with what I would call a normal route, where you pool your loans with other people, if the banks hold the vertical strip, then I think the gain on sales comes back into play for the contributors of the loans. So that's why we kind of like having both options available.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
And just on the CMBS fund that due loans last quarter, are you getting any traction on that? Can you say how much the AUM is currently?

Brian R. Harris
*Chief Executive Officer & Director*
I think the AUM on that is about $12.5 million, but I would point out that we are deliberately keeping that on the – what I would call the down low, not because there is anything wrong with it, it’s just, as you heard on the call, we are generally sellers of securities right now. We've sold over $900 million or have been paid off on them. I think that the Ladder Select mutual fund will do very well during periods of high volatility, but during periods of low production and tighter spreads, I don't think that that would be a vehicle that we would try to invest a lot of capital into or raise a lot of capital in. So just because it's not a huge fund right now, I think that most of the inflows into that fund will take place during periods of high volatility.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
Turning to the condos, I was wondering if you could touch on the sales pace particularly at the Miami project. Both of them seems like remained at a pretty healthy pace quarter-over-quarter and the aggregate gains as a percentage of what you brought in was pretty high.

Marc Fox
*Chief Financial Officer*
Yeah, Jade, it's Marc Fox. That's correct. In Miami, we sold 16 units. We had a core gain there of about $650,000 on those units. In Vegas, we sold 15 units and we had a gain there of about $3.7 million.

Brian R. Harris
*Chief Executive Officer & Director*
So, Jade, we have been raising prices as is happening around the country when you hear the Case-Shiller numbers come out. The Miami property, as I think anyone who's in Miami in January during the CREFC conference, Miami is little overbuilt right now, but I think we have one of the lowest cost price points on the market. We don't have a beachfront condominium complex there. It's everything is about the same price and you can get into the unit for under $400,000. So there it isn't the high-end beachfront properties that I think are slowing down more.

In Las Vegas, we did see a slowdown in the first quarter, but I think that had more to do with just in general what went on in the economy as far as interest rates when they moved up after the election. So we don't have a lot of units left in Las Vegas, and Miami is doing very well.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
Thanks very much for taking the questions.

Brian R. Harris
*Chief Executive Officer & Director*
Sure.

**Operator**: Our next question comes from the line of Steve DeLaney with JMP Securities. Please go ahead.

Steven DeLaney
*JMP Securities*
Thanks. Good evening everyone. Brian, thanks for the heads up on the bond maturity that would look to be the 7 3/8 notes, about $300 million. I guess, looking at that, are you approaching it that you want

to run above average liquidity just in case the bond market / the high yield market is not open to you to refinance that if you will or just to float another issue to take out the maturing issue. And I'm just curious if that maturity is in any way affecting your appetite for making new loans on at this point. Thank you.

Brian R. Harris
*Chief Executive Officer & Director*
Sure the answer to the first part of your question, Steve, is yes. We were raising liquidity in the fourth quarter heading towards that call date of April 1st of the more expensive bond. And you know I think in December of last year, I probably thought we would float a $300 million to $350 million bond issue and pay that bond off. And then...

Steven DeLaney
*JMP Securities*
That kind of changed...

Brian R. Harris
*Chief Executive Officer & Director*
Yeah I think things changed. It felt like things got a little bit more favorable. So we may find ourselves in a position where we're able to do that that issuance in larger size and ultimately be faced with having a little too much liquidity for a quarter, but we'll call that a country club problem.

The second part of your question, is it causing us not to make loans. And no, that's not the case, I think what it's causing us to do is sell a lot of securities.

Steven DeLaney
*JMP Securities*
Got it.

Brian R. Harris
*Chief Executive Officer & Director*
So we have plenty of – left for lending and that's really where our focus is right now and we've always telegraphed that – we would go to the securities book as an ATM if we need cash to do anything.

Steven DeLaney
*JMP Securities*
Yeah, great. Okay. And when you think about a Ladder only securitization, should we assume that the size of that would need to be in the $800 million to $1 billion range to for you to get an execution?

Brian R. Harris
*Chief Executive Officer & Director*
That really depends on the size of the loans and the diversity scores that you get from the rating agencies. So you could certainly do a $600 million transaction as long as you didn't have a lot of big

loans in the pool. But I would think that really for the purposes of handling expenses over a bigger unit, we would probably shift $800 million to $1 billion.

Steven DeLaney
*JMP Securities*
Okay.

Brian R. Harris
*Chief Executive Officer & Director*
You also want to get something that you have a B-piece that's about 5%.

Steven DeLaney
*JMP Securities*
You know in this yes, in this financing versus sale treatment that I'm sure Marc is educating everybody about, I mean I want to just mention that this was, prior to the crisis, this was the way Redwood Trust ran their prime jumbo securitization business for about ten years or so. And it was very effective as a long-term investment program. I think one of the issues you may have to face is, gain on sale provides you with immediate cash revenue. I guess you're going to have to rethink some originator compensation programs, aren't you, if in fact you're converting an immediate income revenue stream into a 10-year income stream. How does that work out?

Brian R. Harris
*Chief Executive Officer & Director*
Yes, let me – he sounds like one of us. Yes that's exactly right, but I do think we're able to handle the originator portion of the compensation because you can really treat a loan origination as a commission. And you can estimate what you think the gain is at the time of the loan. I think probably the other thing that from an analyst standpoint you've got to keep in mind here is that our aggregation period will be longer. So instead of pulling the trigger with $300 million or $400 million into a pool, if we're going to go to market with $800 or a billion, we could be having less frequency.

Now that's why I think in the past it's always been hard for you guys to model how much we're making on gain on sale margin. And well I've talked to many investors who said that that volatility in the conduit that we don't really like because here we can't quite figure it out and this will get rid of that in the Ladder-only portion but what the analyst will have to do is figure out how to estimate a gain on sale when we're in a pool with other parties with a vertical tranche. So if it's a little more bifurcated but not undoable. Oddly enough I tend to like holding the B-piece portion as you described that had been done previously by Redwood.

And what it creates is long-lasting, very stable cash flows. And so try to imagine if you did a $1 billion securitization and you held a $50 million piece at 16%, you can readily figure out assuming no defaults what the next ten years look like there. So in the first year you have nothing at the end of five years if you do $10 billion you've got quite a bit of cash flow coming in each year.

Steven DeLaney
*JMP Securities*
And you can sleep at night knowing that your credits that you cooked in your own kitchen.

Brian R. Harris
*Chief Executive Officer & Director*
Yes it becomes a very credit-sensitive business. Under the old model where we had gain on sale the risk was removed from the building. Now it stays in, but that has never really been a big concern of ours.

Steven DeLaney
*JMP Securities*
Okay. Well thanks for the comments and congrats. It was a good solid quarter and a very volatile rate environment. So good job.

Brian R. Harris
*Chief Executive Officer & Director*
Thank you.

**Operator**: Our next question comes from the line of Jessica Levi-Ribner with FBR. Please go ahead.

Jessica S. Levi-Ribner
*FBR Capital Markets & Co.*
Okay guys, thanks so much for taking my question. We heard from two of the larger commercial mREITs that there's a lot of opportunity in the construction space. Is that's something you guys are seeing as well and if so, or if not, how do you think about that?

Brian R. Harris
*Chief Executive Officer & Director*
I think there is a lot of opportunity in the construction space because the banks are making that very, very difficult. So as a result there's a bit of a void there. I don't consider construction lending a core strength of our origination salesforce or our asset management group. Having said that, we don't – when I think construction lending, I mean ground up construction we don't usually pour foundations. We have in the past but it isn't something we like to do often. We don't particularly like long tail businesses because when you make a loan on a shopping center and you sell it 90 days later you know it's in the community sometimes for 40 years and you know who goes there. But when you're building oftentimes new construction the best way to own them is the second time around. And as a lender, the worst thing you ever want to be faced with is a construction loan on a half built building, where the

sponsor has run out of money. Because especially inside of a REIT, if you've got a $200 million or $300 million construction loan that's defaulted that's a lot of capital. That's no longer on a financing line and you have to go finish the building in a business that distributes 90% of its capital. So I don't like the fit inside of a REIT.

Jessica S. Levi-Ribner
*FBR Capital Markets & Co.*
Okay fair enough. And just kind of turning back toward tax policy, maybe some of the changes we could be expecting do you think that that's – from what we understand now and I know that's it's a big question – but how do you think about that impact on commercial real estate market as a whole?

Brian R. Harris
*Chief Executive Officer & Director*
I honestly don't know. Most of what I've heard I hesitate to comment on it because whatever I think is being discussed now I don't think is going to happen. If you do expense an entire cost of a building on the day of the purchase, I think you're going to see a lot of buildings purchased and the tax rate – the tax receivables will fall dramatically. So it's just intuitively a little uncomfortable to think that that's going to go through that way. But I think that the administration will certainly [indiscernible] balancing features and to try to interpret it in advance, I don't know, I don't see it. And obviously mortgage deductibility, interest deductibility, that's a lot of people. So I guess I'm hesitant to think that we really have the final version of what's coming out.

Jessica S. Levi-Ribner
*FBR Capital Markets & Co.*
Okay. Thank you so much.

Brian R. Harris
*Chief Executive Officer & Director*
Sure.

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

Charles Nabhan
*Wells Fargo Securities LLC*
Hey guys. Brian in the past you've talked about underwriting within the conduit business to a gain on sale margin of roughly 3% to 4% and you've talked about 15 bps change in spreads roughly impacting that gain on sale by 1% or so. I was wondering if there's been any changes to that benchmark under risk retention?

Brian R. Harris
*Chief Executive Officer & Director*
I think under risk retention again there's has two forms of it under the portion where we would hold our own B-piece and be the only contributor. I don't think it's changed. However, where it has changed, perhaps, is that you don't have the risk of a B-piece buyer kicking a loan out because you are the B-piece buyer. In the scenario where you're contributing with other loan contributors and a bank is holding a vertical strip, there's probably a cost associated with having that bank tie up their capital for that many years.

So I would say the expenses have gone up in all likelihood. But the 15 basis points on a 10-year, that's just math. But you might have to build in a little bit more expense cushion when securitizing with other people. And then again we still run the risk of who-ever that B-piece buyer is having a heavy-handed approach towards some of your loans.

Charles Nabhan
*Wells Fargo Securities LLC*
Okay.

Brian R. Harris
*Chief Executive Officer & Director*
I mean 15 basis points is about right.

Charles Nabhan
*Wells Fargo Securities LLC*
Got it. Just as a follow-up a quick high level question. Can you talk about what you're seeing in terms of underwriting trends and specifically if you're seeing any changes in behavior in terms of issuers kicking out loans in the type of loans that they've been kicking out over the past quarter or so?

Brian R. Harris
*Chief Executive Officer & Director*
We have not attempted to get involved in any securitizations in a little while with other parties because we kind of felt like the path was it was cloudy and we couldn't figure out because we had various discussions with the issuers about what it would cost for us to put in pools. So we decided to stress a little bit more onto the bridge loan portfolio the first mortgage held for balance sheet. And that's where I'll tell you something that is an interesting phenomenon that we do see going on, but it has nothing to do with underwriting, it has to do with borrower preferences.

We have seen an unusual amount of loans that want to be financed for two years instead of five or ten and they're stabilized, they're occupied, they're full. And I don't really have a good reason for you as to why they would want to go into a two-year loan other than they plan to sell the building. And they don't want to be locked out for an extended period of time. And when I tell you that phenomenon has been almost 50% of the loans we're writing.

So I think as you look out as the quarters tick by here assuming this continues, you're going to see probably higher coverage in our – bridge loan portfolio and it's becoming far less transitional. And I think this is one of the reasons that you're seeing the volume of the conduit securitization business is down so much. Because I think – and it may be because the borrowers are finally back from 2007 and they feel like they're finally back to where their buildings were at the time. And they want to not go into another downturn around it's just this unnatural fear in my opinion of interest rates raising. And they don't want to be in a situation where they've got an extended period of time on a fixed asset that will have to be financed later on at much higher rates.

There's something going on in the psyche of borrowers that's causing them to actually pay higher rates for shorter terms because they're valuing the prepayment option as much more valuable than it was since we started the company.

Charles Nabhan
*Wells Fargo Securities LLC*
And I guess just as a follow-up to that comment, what is and I know the trend – the pricing varies from deal to deal. But I guess generally speaking, what is the difference and could you talk about the difference of the spread between those transactions you were referring to as opposed to your more traditional loans that you've been underwriting over the past couple years?

Brian R. Harris
*Chief Executive Officer & Director*
Yes, I can give you a general commentary, but I don't want you to read too much into the numbers because I think that a marquee reference that our average coupon was five – 580 over LIBOR was it?

Marc Fox
*Chief Financial Officer*
It's actually 567 over the LIBOR.

Brian R. Harris
*Chief Executive Officer & Director*
Okay.

Marc Fox
*Chief Financial Officer*
On the newly originated stuff.

Brian R. Harris
*Chief Executive Officer & Director*
Okay, so that would be a 6.5% rate on newly originated loans. But I think it's a little bifurcated. I think it's a 5.5% for half the book and 7.5% for the other half of that book. A 5.5% rate on a two-year bridge

loan on a conduit eligible loan that could easily get a 4.5% rate if the borrower took lockout is a little surprising. But that stability seems to be viewed as paramount right now.

Charles Nabhan
*Wells Fargo Securities LLC*
Right. Okay, thank you for the color guys.

Brian R. Harris
*Chief Executive Officer & Director*
Sure.

**Operator**: [Operator Instructions] Your next question is a follow-up from Jade Rahmani. Please go ahead.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
Thanks very much. Just two quick questions, one obviously if you expect to do any securitization the first quarter, based on your current ability and also how you think about M&A in the specialty finance space if that's something you're focused on?

Brian R. Harris
*Chief Executive Officer & Director*
Sure I'm going to take it in pieces. The first part of your question, do I see a securitization in the first quarter? I will tell you we have a pool of short maturity loans a little bit over a $1 billion that we could securitize right now. And what we're wrestling with a little bit, we were going to originally do this into our first horizontal risk retention piece. And what we liked about it was since it's two years to three years in maturity, we wouldn't have to hold it for five years, we would get the book again over 24-month to 36-month period. So it would actually be a way to, not short circuited but certainly not the tail or the profitability because the coupons would be paying you very quickly.

I think we're going to chamber that bullet for a minute because it would cost us about $5 million in expenses to do that transaction. And when you expense that $5 million over a two-year period of time, effectively what happens is let's say the loans are 6%, which they are. So we get $60 million in interest from those assets over a year. And in the first year we would make $55 million.

So it's not a big cost associated with it and it would produce some added liquidity because our leverage has gone down significantly. Since we've been selling securities these portfolios are leveraged maybe 55%, 60%. So the securitization business would effectively finance us up to 70% or 75%.

So we were thinking about doing that. Again that was in a back up to Steve DeLaney's question of the earlier. You saw a shoring up our liquidity into year-end by selling securities. As we are approaching a call date on a 7 3/8 corporate bond, another place where we're looking to liquidity would be for that securitization to effectively upsize the leverage on the bridge loan portfolio. That would have created probably another $100 million worth of cash to us. However, as long as the bond market appears to be open and it looks like we're going to be able to do a transaction that easily finances that bond issue, then there's really no need for us to sell down and absorb that $5 million cost. Kind of a long answer there, but should make sense to you.

And the second part was M&A. I find M&A in the REIT space to be very difficult, mainly because everybody wants to sell their companies above book value and very few REITs trade above book value. And so as a result of that you pretty much have to overpay for things. Having said that, I do think there are a lot of small REITs out there. And the ones under $600 million, that probably would have material expense savings if they would consolidate. So I think it will happen one day but I don't see any catalyst for it just yet.

Jade Rahmani
*Keefe, Bruyette & Woods, Inc.*
Thanks, I appreciate it.

Brian R. Harris
*Chief Executive Officer & Director*
Sure.

**Operator**: Thank you. There are no further questions at this time. I'd like to turn the floor back to management for any final remarks.

Brian R. Harris
*Chief Executive Officer & Director*
I want to thank everybody for dialing in and listening to us. We will be back to you in 60 days, I think, with our first quarter results. Thanks.

**Operator**: Thank you. Ladies and gentlemen, this does conclude our teleconference for today. We thank you for your time and participation. You may disconnect your lines at this time. Have a wonderful rest of your day.