Transcript of Ladder Capital Corp's Q2 2017 Earnings Call

August 2, 2017

Operator: Ladies and gentlemen, good afternoon, and welcome to Ladder Capital Corp's Earnings Call for the Second Quarter of 2017. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, today's call is being recorded.

At this time, I would like to turn the conference call over to Ladder's General Counsel, Ms. Kelly Porcella. 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 second quarter of 2017. 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 June 30, 2017. 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's Form 10-K for the year ended December 31, 2016, 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're 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.

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'm pleased to report that Ladder's core earnings, a non-GAAP measure for the second quarter were $51.2 million, or $0.42 per share. Our pre-tax return on equity was 14% and our after-tax ROE was 12.6% on an annualized basis.

Today, I will walk you through our three main business lines, real estate, securities and lending, and point out some of the highlights in a quarter, where all three of these product lines produced attractive returns.

During the quarter, we made new investments of $985.73 million, with $833.2 million from our lending area, $46.8 million from our real estate equity and $105.8 million in securities. With regard to our lending business, we originated $352.6 million in loans to be held on our balance sheet at an average mortgage interest rate of 6.58%. We also made $386.5 million in loans that we intend to securitize and we purchased 18 whole loans with an unpaid principal balance of $94.4 million from a bank.

All of the loans we purchased are secured by first mortgages on apartment buildings in Phoenix, Arizona. The purchase loans are all financed at the Federal Home Loan Bank, all are performing about three years old on average with a weighted average maturity of 40 months. We hope to refinance these loans over the nextfew years into our conduit program.

In the quarter, we also contributed $626 million in loans into a securitization, where 100% of the loans in the t rust were originated by Ladder. To meet risk retention requirements, Ladder retained a 2% vertical strip on all bond classes and sold a 3% horizontal B-piece, the securitization produced a taxable gain of $20.7 million. This securitization was an important step for Ladder and that it shows we can act independently and producing 100% of the collateral in a loan securitization and are able to meet risk retention requirements.

I want to take a step back to note a few important facts and hopefully clear up some questions that we get from time to time from investors regarding the loan securitization business and its relative risk. The $626 million in loans contributed to the trust was our largest contribution into any one pool since our inception in 2008. Since we started, we have securitized $13.2 billion in loan balances over a total of 44 securitizations, 43 of which were profitable producing total net profits to-date of $604 million, with an average profit margin over all 44 transactions of 4.6%.

These statistics fully support why we continue to stay in this business line as it is an important driver of returns at Ladder. It can be a little inconsistent in any quarter or two, but when looked at over longer time horizon, it is a very attractive business line. As we move forward into the third quarter, we originated a total of $117 million of loans in July, and as of today, have over $700 million in loans under application.

We hope to return to the securitization market again over the next few months. Our lending business was responsible for about 73% of our core earnings in the second quarter, with 26% of the total from the conduit and 47% from balance sheet loans.

The next product I'll mention is real estate. During the quarter, we invested $46.8 million in equity in nine separate transactions. We purchased 822,000 square feet of office in five buildings in Florida, all 100% leased for 14 years to Bank of America. We also purchased seven Dollar General stores with 15-year leases and a 70% interest in a mobile home park in California on 45 acres of land near Los Angeles.

At the end of the quarter, we had a total of $1.02 billion invested in commercial real estate assets on our balance sheet. Our real estate portfolio contributed 15% of our core earnings in the second quarter. The last product to discuss is our securities portfolio. During the second quarter, we added 105.8 million of securities, while we sold a total of 308 million over 87 transactions with an average profit margin of 1.72%.

Over the last three quarters, our portfolio of securities has received unscheduled pay downs of $458 million, while we actively sold an additional $900 million over the same-time period, making an average profit margin of 1.2% over 196 sales transactions.

All of the 196 transactions over the last three quarters were profitable.

Our securities product contributed 12% to our core earnings in the second quarter. Given the flatness of the yield curve and the preference as stated by the Fed to raise short-term interest rates, we would expect to rely less and less on our securities portfolio for earnings. But if volatility picks up, we will look for opportunities to add to our position. In the quarters ahead, we expect to rely more heavily on our high-quality holdings of real estate and our hefty portfolio of balance sheet loans for durable earnings that are sustainable for years to come.

On the corporate front, we've also been active. With the previously announced retirement of our former President, Mike Mazzei, we promoted Pamela McCormack, a co-founder of Ladder from Chief Operating Officer to President. Mike's responsibilities around pricing of parts of our loan originations will be picked up by myself, while we have moved responsibility for pricing of our bridge loans below $20 million over to Mike Scarola, our Chief Credit Officer.

Both Mike and Pamela have been integral members of lending operations under my management for most of the past 15 years. As previously announced, we have replaced our two board members from our private equity sponsors TowerBrook and GI Partners on the Board Of Directors with Mazz and Richard O'Toole.

We'd like to thank Howard Park and Jonathan Bilzin for all of their support over the last eight years in starting our company and for their guidance over the years since inception. After the changes in our board composition, our average daily volume has recently increased to about 650,000 shares a day, roughly double what it was a year ago. This higher float and added liquidity will make Ladder more of a suitable investment for long-term institutional money managers in the quarters ahead. All-in-all the second quarter was very solid with all parts of the business performing very well and we think this continues into the end of the year.

With that, I thank you for your time today and 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 ended June 30, 2017. Core earnings in the second quarter of 2017 were $51.2 million, this compares to $30.9 million in the same quarter a year ago. Core earnings in the first half of 2017 were $82.7 million compared to $69.1 million in the first six months of 2016.

Core EPS for the second quarter was $0.42 per share compared to $0.32 per share for the same quarter in 2016. Core EPS for the first six months of 2017 was $0.73 per share compared to $0.70 per share for the comparable period in 2016. On a GAAP basis, Ladder generated net income before taxes of $12 million for the three months ended June 30 and $30.2 million for the six months ended June 30, 2017. This compares favorably to a GAAP net loss before tax of $10.7 million reported in the first half of 2016.

Net results of derivative transactions, our interest rate hedge, gains and losses were the major cause of the swing from loss to profit in this year-over-year GAAP comparison. During this second quarter of 2017, core earnings were derived from Ladder's loans, CMBS and real estate portfolios, which generated recurring income in excess of Ladder's total corporate expenses in addition to the sale of $625.7 million of loans via securitization. The largest GAAP to core earnings adjustment in the quarter related to real estate depreciation.

As Brian noted, Ladder successfully executed its initial Ladder-Only multiple borrower securitization. The securitization closed on June 29.

In reviewing the $625.7 million transaction and its impact on Ladder's financial statements, it is important to note that other than risk retention and the related GAAP accounting implications, in many respects, this securitization was similar to the 43

Ladder securitizations that preceded it dating back to 2010.

For example, the 57 securitized first mortgage loans with a total UPB of $625.7 million were all originated by Ladder. While Ladder was the only contributor to this loan pool and the loans comprised Ladder's largest contribution to a single transaction, the characteristics of the loans were typical of Ladder's prior securitizations. Like previous transactions, Ladder contributed a mix of loans to third-party borrowers and loans secured by real estate owned by Ladder.

Similarly, Ladder purchased certain classes of the issued CMBS's investments just as it had done in many prior multi-seller securitizations to which it contributed loans. And from a core earnings accounting perspective, Ladder successfully transferred the risk associated with the contributed loans by selling the BPs to a third-party investor.

As a result of this risk transfer and consistent with Ladder's historic practice, the securitization is treated as a sale for core earnings and core EPS purposes resulting in the recognition of a Q2 core gain of $20.7 million, net of hedging and deal costs and reflecting a 3.3% profit margin.

Unlike prior securitizations, compliance with the Dodd-Frank risk retention rules was required and it was achieved by the creation of a 5% L-shaped risk retention interest. A 3% horizontal interest was sold to a qualified purchaser and a 2% vertical interest was retained by Ladder.

From a GAAP accounting perspective, ASC 860 is the key guiding in the determination of whether the securitization is treated as a sale or as a secured financing. ASC 860 states in summary that for a transfer of financial assets to be considered a sale, the company must surrender control over the transferred assets and the purchaser must have the right to pledge or sell the assets transferred. If the sale criteria are not met, the transfer is considered to be a secured borrowing, the assets remain on the company's balance sheet and the sale proceeds are recognized as a liability.

Since the 3% horizontal risk retention conveyed to the third-party investor is subject to restrictions on its sale under Dodd-Frank, the entire securitization did not qualify for sale treatment under ASC 860 and therefore was treated as a secured financing on Ladder's GAAP financial statements.

To further understand the GAAP accounting treatment applied to this transaction requires the bifurcation of the loan pool between securitized loans to third-party borrowers and securitized loans in which a Ladder entity was the mortgage loan borrower. Of the entire $625.7 million loan pool, $548.9 million in principal balance were to third-party borrowers. Those loans which had a carrying value of $547.7 million have been consolidated and are included in the $599.5 million balance shown next to the caption, mortgage loans transferred but not considered sold on the balance sheet. This line item also includes a previously sold B-note on the Two Riverfront loan that had a carrying value of $51.8 million at June 30.

The remaining $76.7 million of securitized loans were mortgage loans to Ladder affiliates secured by recently acquired net leased and office properties. Under GAAP, those loans were eliminated in consolidation on both sides of the balance sheet.

On the right side of the balance sheet, although the consolidated securitization trust issued CMBS resulting in proceeds net of issuance cost of $655.6 million, only $580 million of the issued CMBS is included as a GAAP debt obligation on Ladder's balance sheet and is included in the $632.1 million balance shown next to the caption liability but transfers not considered sales. Since Ladder acquired the remaining CMBS debt including a 1.97% vertical strip value to $12.9 million. In addition to $62.6 million of other securities, that debt is eliminated in consolidation and does not appear as a liability nor do the CMBS appear as assets on Ladder's balance sheet.

However, the net interest income from these securities investments will be included in the computation of core earnings and core EPS and the remaining portion of the liability for transfers not considered sales is $52.1 million represent the proceeds from the previously mentioned B-note sale.

Ladder's GAAP leverage ratio was increased by the consolidation of the CMBS to 3.15:1 at quarter end. Excluding the CMBS consolidated onto Ladder's balance sheet and including the securitized mortgage debt on Ladder's real estate investments, Ladder's leverage ratio at June 30, 2017 was 2.78:1, which we view as an appropriate measure of Ladder's financial leverage on a company-wide basis and it is the same approach applied in leverage covenants with Ladder's lenders.

On Ladder's second quarter income statement, the effect of the consolidation is minimal as the transaction closed on June 29. Going forward, Ladder's GAAP income statement will include the interest income derived from the securitized third-party loans and the interest expense from the consolidated CMBS debt. The impact of these amounts will be excluded from core earnings and core EPS calculations.

Likewise, the computation of core earnings and core EPS will reflect in net interest income on the $75.6 million of issued CMBS retained by Ladder as well as the interest expense related to the securitized loans secured by Ladder's real estate investments. Ladder will provide key statistical data on a GAAP basis as well as on basis consistent with industry practices that exclude the impact of consolidating the secured assets and liabilities going forward.

In terms of key balance sheet metrics, as of June 30, 2017, the following statistics are in line with Ladder's historical results. 96.3% of our debt investment assets were senior secured. Senior secured assets plus cash comprised 75.5% of our total asset base. Total unencumbered investments including cash were $1.1 billion and our encumbered assets to unsecured debt ratio is 1.44:1. The weighted average loan to value ratio of the commercial real estate loans on our balance sheet was approximately 64.7%. 81% of our securities were rated AAA or backed by agencies of the U.S. government as of quarter end. Just about 100% of our CMBS positions were rated investment grade and the weighted average duration of our securities portfolio was 38 months.

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Excluding the loans transferred but not sold to GAAP, Ladder ended the quarter with total assets of $5.6 billion and total equity of $1.5 billion.

Our core leverage decreased to 2.8 to 1 from 2.9 to 1 during the quarter. That was impacted by the addition of new balance sheet loan and real estate investments during the quarter as Ladder continued to deploy the $210 million of March net bond issuance proceeds remaining after the early payoff of almost $300 million of bonds scheduled to mature later this year.

So summing up, in the second quarter, Ladder generated $51.2 million of core earnings and core after-tax return on average equity of 12.6% for the second quarter and core earnings of $82.7 million and a core after-tax return on average equity of 10.8% for the first six months of the year. Ladder continued to cover – more than cover the $0.30 per share dividend in each of the first two quarters. Ladder successfully executed the first Ladder-only multi-borrower securitization of commercial mortgage loans and established Ladder's ability to independently address risk retention in a wide range of profitable formats.

Ladder acquired $178.1 million of real estate investments, including the Bank of America Merrill Lynch property with its 14-year lease bringing total real estate holdings to over $1 billion and 8 million square feet. We executed a smooth transition of our President to the Board of Directors, while promoting Pamela McCormack from Chief Operating Officer to President.

We experienced almost a 50% reduction in shareholdings of certain major long-term shareholders resulting in greater liquidity in our stock and a more than doubling of the average daily trading volumes since the beginning of the year. We experienced our first change in corporate credit rating as S&P upgraded our ratings to positive outlook. And finally, we continued to apply a disciplined approach to the use of leverage, to the allocation of capital in the face of the risk we encounter and to the selection of longer term investments in loans and real estate.

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

Q&A

Operator: Thank you. Ladies and gentlemen [Operator Instructions] Our first question comes from the line of Steve DeLaney from JMP Securities. Please go ahead.

Steve C. DeLaney
JMP Securities LLC

Thanks. Appreciate you taking the question guys. Held for sale loans at June 30, right at $200 million, and Brian, I think you said you had a $100-and-some million additional originations in July? Help us understand, you've demonstrated clearly what you set out to do at the beginning of the year with your first Ladder-only transaction.
Should we look at the loans held for investment as being primarily targeted for a second LCCM deal or is it possible that we will see you contribute loans to conduit transactions over the next several months as well?

Brian R. Harris
Chief Executive Officer & Director

Okay. Hi, Steve.

Steve C. DeLaney
JMP Securities LLC

Hi.

Brian R. Harris
Chief Executive Officer & Director

And I do want to let you know by the way we actually invited Mike Mazzei and Pamela to come in here today. I didn't know if they'd make it in traffic, but they did both arrive. So I don't want anyone asking me if Mazzei had a fight with me because he's sitting here with me now.

Steve C. DeLaney
JMP Securities LLC

Great. Hi Mike.

Michael Mazzei
Director, Ladder Capital Corp

Hey, how are you doing Steve?

Steve C. DeLaney
JMP Securities LLC

Great.

Brian R. Harris
Chief Executive Officer & Director

I think Mazz wanted to say goodbye to you guys. But in any event, I'll answer your question. Yes, you should consider those loans held for sale to quite likely wind up in a form of securitization. And yes, we did do our Ladder-only securitization, although possibly in a slightly different format because we did the L structure on a risk retention where I think we originally thought we might just hold the first loss piece, but we changed midstream on that which we said we might do.

I would anticipate both over the next year as far as sales goes. I have oftentimes said that our ability to operate independently should be viewed in addition to our desires and abilities to work with banks and other lenders in pool transactions. But I think the key to us doing the single transaction on our own was we wanted to be able to, because sometimes timing doesn't work or you can't find a partner or the B-piece calendar is busy, and I think what we really wanted to do was to demonstrate to the market and to ourselves that we do control our own destiny and if we want to do a transaction, we can and we'll do it alone, but that should not indicate that we have had any disagreements with our partners or any desire not to work with them in the future.

Steve C. DeLaney
JMP Securities LLC

That's very helpful to understand that you feel you do have that flexibility to go both directions. And I guess the first time, first time doing anything, ride on bicycle, doing your own deals, it's tough, but then you've learnt something from the process. Your spread was a little wider, I'm sure that you would have liked. Do you think that as your second deal comes or what you learned in that process and the new AAA bars that you met, are you optimistic that going forward, your transactions can be even more efficient and profitable?

Brian R. Harris
Chief Executive Officer & Director

Yeah. I think so and I certainly hope so. I'll be the first to admit that that was a less than stellar execution, although it certainly was profitable. I wish we had been here sitting talking about a $57 million quarter instead of a $51 million quarter. But – and I do think that we need, and me in particular, need to get ourselves in front of investors a little bit more, because sometimes there is some mixed messaging that goes on. And I will admit that I don't spend that much time marketing our AAA and AA bonds.

And from our perspective, I think there was some miscommunication in that. We actually included in the transaction, in the documents, that we might purchase bonds in the securitization. And frankly, naively thinking that skin in the game and eating your own cooking and all the buzzwords we've heard through the years, not only were we desirous to hold what was required under risk retention, but we were also wanting, not requiring but wanting to own more of the securitization, because we knew every loan in the pool. So if there was ever a pool that a multi-billion dollar owner of securities might want to buy, it would be the one that he home cooked himself.

That was interpreted by some investors in this space as creating some opaqueness in the market as to where bonds would clear. I don't know that it was necessarily directed at us. It was more of confusion I think and I also think that the calendar was relatively crowded in that week as it was towards the end of the quarter. So, we won't make any excuses. We will try to do better next time, but we had sold down over $1 billion of securities and we really did that, if you remember, we had telegraphed we sold those securities to raise cash to pay off the initial bond that we paid off and that we wind up doing a $500 million refi instead of a $300 million payoff.

So we had plenty of capital and we had just sold a lot of securities, so we were actually looking to acquire some of those bonds. However, we did acquire part of the IO and the AA class. We were asked not to participate in the AAA class, although I have been trying to buy those bonds ever since and have been unsuccessful.

Steve C. DeLaney
JMP Securities LLC

Great color. Thanks guys, appreciate it.

Operator: Thank you. Our next question comes from the line of Rick Shane from JPMorgan. Please go ahead.

Richard B. Shane
JPMorganSecuritiesLLC

Hey, guys. Thanks for taking my question. Hey, Marc. So next quarter, we're going to see an adjustment to core earnings where you reverse out the interest income and interest expense associated with the transferred but not considered sold and some of the CMBS. Can you walk us through that math, assuming that June 30th balances in terms of assets and liabilities, so we can just get that all straight right now?

Marc A. Fox
Chief Financial Officer

If we were to do that, it will be exactly what you just said. The amount of the interest income on loans that are consolidated onto our balance sheet, that were, as it says, transferred but not sold. That interest income would be carved out of our income statement. And you'll see in our supplemental, we actually will show you how you get from the reported balance sheet to a balance sheet that takes out these items, okay? And we'll do the same thing with the income statement for next quarter. This quarter it was a June 29 settlement, so there wasn't much of an impact, but we're going to do exactly what you said, we're going to take out the interest income from those loans, with regard to the CMBS, we're going to take that out as well.

However, what we'll also be doing as I said in the text was there are loans that from a GAAP accounting point of view are intercompany loans, because there are loans that the trust now owns, securitization trust now owns that are loans – mortgage loans against our own real estate, and the interest expense on those will be added back as we calculate core earnings, of course, and likewise the securities that Brian talked about that we bought, that we retain, the interest income – interest income on those will end up being added back in, as well as the interest expense on the financing that we end up placing on, not on the CMBS itself, but on the financing that we place them on.

So I think it ends up being a pretty straight forward, it will be much easier in a tabular format and I think that this is really industry standard treatment.

Operator: Thank you. Our next question comes from the line of Jade Rahmani from KBW. Please go ahead.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

Thanks. Brian, I was wondering if you could share your thoughts on the current lending environment, you just have an extremely helpful perspective. On the one hand, from my vantage point, the market seems flushed with liquidity and there's certainly been noticeable spread compression, but on the other hand, the coupons you quoted and the loans you originated in the quarter seem outsized. So I guess what's your view on the current competition? And do you feel like the same debt funds or PE sponsored vehicles are chasing the same deals and you're finding other more nuanced areas in which to compete?

Brian R. Harris
Chief Executive Officer & Director

Well, I think just I'll observe, rather than regarding opinion, I think if you take a look at some of the bank -led CMBS deals that are out there, they clearly are targeting a rating agency or actually an LTV below 60%, and that's a concerted effort and I think that – I think you'll see that move up. I think we're already beginning to see that move up, because when we saw the banks going down below 60% LTV, we also realized they were walking squarely into the universe, usually controlled by the insurance companies. And for the most part, the public markets and CMBS have been used for slightly higher leverage, maybe a little bit less institutional, and when it was more institutional, it was usually a single asset securitization.

So – but on the other hand, I think some of the people and lenders that were lending above 60% LTV, because of risk retention, I think that inadvertently, they wind up using some of the B-piece buyers as a credit committee, because they didn't want anything to be kicked out.

It's all very uniquely positioned at that point at Ladder, because we were able to – we don't check with anybody before we write loans, and we're more than happy to hold our own BPs.

So from our perspective, we don't have any desire necessarily to lend at 75% or 70% or over 65%. We just think that there is a one hell of a lot of real estate that requires that type of a lending profile and we feel that our credit skills are sufficient to lend safely through that. So we didn't make any concerted efforts to avoid or acquire below 60% LTV loans, and so our LTV is a little bit higher, and I think that, I think those banks are moving more towards us right now.

I think that they'll be lending at higher than 60% LTV is, because there's simply no profit margin when you're competing with insurance companies, and then building in cost for insurance companies, I'm sorry, B-piece buyers as well as rating agencies and printers. So I think it's a moment in time and I think it'll be changing, unfortunately coming more towards us on competition, but still with risk retention and the requirement that you have to be able to hold assets for long periods of time, you have to have a permanent equity capital structure or else very patient money, and as a result of that, competitive influence have really dropped and we're sensing that.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

And how about on the bridge loan side, can you talk about the types of loans you're originating, how you're able to generate the high coupons and if you're seeing a meaningful pick up in competition there?

Brian R. Harris
Chief Executive Officer & Director

Sure. I think that there is meaningful competition picking up, but most of it is in the above $50 million and $100 million loan range. You saw a couple of companies go public with a business plan towards writing large floating rate loans. And there is a couple – it is a very competitive field as far as I can tell, although I will point out that we rarely compete in it.

So it's mostly what I'm hearing as opposed to what I'm seeing. I think that we – again, we're a little more comfortable in smaller more diverse granular pools. So our typical borrower is somebody who owns a couple of buildings rather than half of the malls in the United States. So it's just a little bit more of a retail bent to the size of the loans we do. However, I could also tell you to that, we were very cautious around certain loans that we would make that we did not think we could finance in our first few years as a public company.

So, typically if there was a low cash flowing loan, we would charge a lot for it, because we couldn't finance it. But now, I think that we have some ability to finance some of those positions and because of all that competition in the over $50 million area, we're actually a little bit more comfortable being a little bit more aggressive. We haven't changed our underwriting statistics or our credit metrics, but we do believe that there are more lenders available to refinance the loans that we're creating in the transitional phase. So we're very happy with the competitors so far flying in the air above us. Not many people are in the $20 million range. There are some small loan lenders at $7 million, $8 million, I think, there was a CLO done today and those rates are higher than ours.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

And in terms of the type of properties, is there – was there any bent towards certain asset types in the loans you originated?

Brian R. Harris

Chief Executive Officer & Director

The only thing I think we've ever made any concerted effort to really focus on, I think, we avoid some geographic locations, because we're a little uncomfortable with them, but having said that, as soon as I name a city that we don't really like, we wind up doing a loan there, usually because the leverage is just lower and other people don't like lending there either.

But I would say we've made some concerted effort I think to be a little bit more in the multi-family space. And you saw where I mentioned that we purchased 18 home loans from a bank, they were all multi-families in Phoenix, Arizona.

So – and the reason for that is another source in seeking to further diversify our capital sources, and also to frankly join the packets and sell A-notes or do CLOs, things we hadn't done in the past. I think we noticed a lot of our pool didn't have a lot of multi-family in it, not because we disliked apartment buildings, it was just that they were frankly well bid and we had a view that because of the existence of Fannie Mae, Freddie Mac and HUD, it was over bid, and so we felt like it was an adversely selected group of assets that would wind up on our balance sheet.

So we did tend to avoid inadvertently the multi-family sector, although we just purchased a pool of loans that actually in our opinion are quite conservative, they're low LTV, they're three years old already and they only have four years to go. So in the CLO model, I think we'd like to show some component of multi-family loans, because I think it'll help the pool sell better.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

And what do you think the timing is on a potential CLO?

Brian R. Harris

Chief Executive Officer & Director

I would think we will certainly do one before the end of the year. I think we mentioned in the last quarter we looked at doing one, but because of the success we had in the corporate bond issuance that we did, we really didn't need the capital. So as we invest the capital that we picked up through the sale of securities, as well as the bond offering, if we exhaust that investable capital intelligently, and I think we're getting to that point, we'll be looking for the next scenario where we can raise capital.

Now that may very well be sale of securities, it could be pulling out that CLO that we consider doing in the last quarter. There are several scenarios and all of them are open to us.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Are you seeing any opportunity to originate longer duration loans or perhaps loans that are on assets closer to stabilization?

Brian R. Harris

Chief Executive Officer & Director

When you say longer duration, you mean more than 10 years.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Well, for the balance sheet, more than a typical three-year term with two one-year extensions?

Brian R. Harris
Chief Executive Officer & Director

Yeah. That's where we do feel that competition. When we see a borrower looking for a 3-1-1, we know damn well that is a securitizable instrument. I don't particularly like where we are in a credit cycle to be going out five years. So, there's plenty of opportunity to extend duration. I think there is not a lot of desire on our part to do that. We're pretty comfortable in the two to three-year transition period, because when you're dealing with $20 million assets, I don't know what could really take more than two or three years.

But when you're dealing with giant apartment buildings or malls or office buildings, sure, some of those things do take longer. But with the clientele that we deal with, for the most part, the transition that needs to take place should and will usually take place if managed properly inside of a two-year period. So, we like the idea of having fees for origination as well as exits, amortized over a shorter number of months. So, that's why we avoid the 311 if possible.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

On the real estate equity, can you give an update on the condo sales, how those projects are going in terms of cadence and also the assets held for sale on your website, just want to see if you can give an update on the triple net lease you're looking to sell?

Brian R. Harris
Chief Executive Officer & Director

I wouldn't say we're actively trying to sell any of them right now. The reason we put some of those on the website was really because we oftentimes get phone calls or for somebody who finds out that we own a Walgreens in some town. And so, we felt that it would be a little bit easier if we just lifted what we owned and give them an idea of what it looks like so that we don't have to take the calls one by one. But I don't want you to think there's any concerted effort, we don't have them listed with brokers. Those are cash flowing instruments that we've curated selectively over time and we're pretty comfortable with it.

As we said, we just passed the $1 billion mark in real estate. And so, I wouldn't say there is an effort underway to wholesale sell anything. However, we do now have some assets that we've owned for a reasonable period of time, some of which we wanted to extend leases on and they have extended. So the event that would be required for us to go ahead and sell the asset at stabilization has occurred.

We just haven't actually sold them yet, but I do think in the year to come, you will. I think we've always had a baseline level of return, ROE or cash, the earnings that we make and we've always supplemented that on occasion with our conduit securitizations. I think in the next year or so, you're going to see us also supplement those earnings with some occasional positive surprises in real estate sales.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

And how about on the condo site?

Brian R. Harris
Chief Executive Officer & Director

The condos are slowing down, but some of that is seasonal in the summer, some of it I think has been the result of rather reasonably timed price increases. So, the dollars per foot are very healthy. The sales pace has gone down, but we also own much, much less of them now. I think we have less than a year of inventory.

Now, the assets we own in Florida, those are fairly low price points. So, there's plenty of people who want to buy those. So those if we want to move them quickly, we can. When you're selling a condominium on Las Vegas Strip for hundreds of thousands of dollars, I think that's a little bit of a different customer and those customers come to Las Vegas periodically as opposed to, they're not walking by buying those units.

And we also have another condominium project down on the Lower East Side here which is going to be coming online I think by the end of the year, down on 2nd Avenue and I think that's only 40 units. So, it's not a big part of what we're doing. The sales velocity has slowed, but the margins are still good and we're really down just about out of inventory in Las Vegas and Florida.

Jade Rahmani
Keefe, Bruyette & Woods, Inc.

Great. Thanks so much for taking the questions.

Operator: [Operator Instructions] Our next question comes from the line of Jessica Levi-Ribner. Please go ahead.

Jessica S. Levi-Ribner
FBR Capital Markets & Co.

Hi, good afternoon. Thanks for taking my questions.

Brian R. Harris
Chief Executive Officer & Director

Sure.

Jessica S. Levi-Ribner
FBR Capital Markets & Co.

In terms of the risk retention slice, can you talk a little bit about why you elected for the vertical versus just the first lost piece?

Brian R. Harris
Chief Executive Officer & Director

I don't think that that was a slam dunk, that decision. I think we toyed back and forth with it. I think that from my own sanity standpoint, I wanted to make sure that there was a market that we weren't just marching out there with our $600 million pool of assets telling to ourselves they were great and that there was a market because I wanted to get some sense as to where that market was, where we could sell a first lost piece. We were quite successful in doing that. We're very happy to have worked with a partner we've worked with before.

On the other hand, so we didn't mind complying with it across the board. I think if we had not sold that B -piece, we would have just held the first – 5% first lost piece. And so I suspect we'll do that in the future. But by holding the vertical strip, we were able to generate taxable gains because we do have to pay people around here too when possible. And the other part of it, most of what we held in the vertical strip is mostly AA and AAA bonds. So, we're actually able to finance that position, whereas I don't think we could have done that if we had held the first lost piece. So, those are all components of what went into the decision.

Jessica S. Levi-Ribner
FBR Capital Markets & Co.

Okay. Thanks for that color. And then just last one for me is, can you give us an understanding of how you decide to allocate capital to real estate versus a lending channel, especially this quarter?

Brian R. Harris
Chief Executive Officer & Director

I would tell you that real estate is a very selective investment that we only make occasionally. When we come to work, if you ask everyone in the building what they do, we're lenders and we know we're lenders. But by reviewing hundreds and if not thousands of transactions, every once in a while, you see some things that are attractive that you see – as I know for decades, I used to sit there and say, I wish I owned this building. And because we're outside of the banking sector and because we're able to get a front row seat sometimes into the lending arena as to what a person is looking for, oftentimes we're able to meet the needs of a borrower on a very good transaction that we think has good value and will oftentimes say where are you getting the equity to purchase this asset.

And when the borrower tells us, well, I want to get the loan and then I'm going to go get the equity, we sometimes say, while you stay right here, maybe, we can solve the whole problem with one stop shopping and not have to go through two committees. So I would tell you that our real estate investments, we now own $1 billion and we've been curating them over an eight-year period of time. We've sold a few, but not many.

So on a pie chart of assets, it looks like we have a lot, but I would tell you 95% of what we do every month is debt. We're lenders. So, we do not have a real estate mindset that we're trying to make 10% or 12% returns or where we don't have a program, we don't buy one type of real estate. in fact, in this quarter, we purchased a large office complex with a garage, we purchased small Dollar Generals and we purchased a mobile home park in California.

And so while we don't claim to be expert in all of those, each one of those assets had something in particular that caught our interest. Both of the office as well as the retail components, both had long-term leases to very strong credits. So we were able to figure out the lending side of that and manufacture a rate of ret urn that was acceptable, because when you're on these companies, it's a bit of a hamster wheel, just riding loans and selling them every quarter.

When you can have assets on your books that generate returns for 10 years consistently and then still have years and years to go on the lease after the 10 years, that does take the pressure off of you on a quarter-to-quarter basis. And I think you've seen our percentage of income from loans and leases really increase as the years have gone by, and we were less and less dependent on again on sale business. Did I answer you?

Jessica S. Levi-Ribner
FBR Capital Markets & Co.

You did. Yes, sorry, taking notes. So fair enough, thanks so much for taking my questions,

Operator: Thank you. Ladies and gentlemen, there are no further questions in queue at this time. I would like to turn the floor back over to management for closing comments.

Brian R. Harris
Chief Executive Officer & Director

This is Brian. I'll just sign off and say thanks for everybody. We're sorry to see Mazz go, but at a certain age, we all get to that point and we look forward to the quarters ahead with Pamela in the President role. And I will be handling a lot of the pricing and I'm not going anywhere for a long time. So I look forward to the quarters ahead, and I'm actually pretty optimistic about the business. So we've done our best to try to increase the average daily volume and we think the future's quite bright. So, we'll see you next quarter.

Operator: Thank you. Ladies and gentlemen, this does conclude our teleconference for today. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.