Transcript of Ladder Capital Corp's Q1 2018 Earnings Call

May 2, 2018

Operator: Ladies and gentlemen, greetings and welcome to the Ladder Capital Corporation First Quarter 2018 Earnings Call. 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, this conference is being recorded.

It is now my pleasure to introduce your host, Michelle Wallach. Thank you. You may begin.

Michelle Wallach

Chief Compliance Officer & Senior Regulatory Counsel, Ladder Capital Corp

Thank you, and good afternoon, everyone. I'd like to welcome you to the Ladder Capital Corp's earnings call for the first quarter of 2018. 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 March 31, 2018. 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 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 2017 Form 10-K 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 we request to 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 in 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 the 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, Ladder Capital Corp

Thanks, Michelle. On our last call I mentioned that I would walk you through the year ahead and how we plan to profit from our more efficient capital structure and how we expect it to deliver strong returns for the benefit of our shareholders, especially in a rising interest rate environment. Today I'm pleased to report our first quarter core earnings, a non-GAAP measure of $63.8 million, or $0.55 cents per share, our best quarter since going public in 2014.

The foundation of this very strong earnings report is rooted in our emphasis on investments in balance sheet loans which have grown from $2 billion at the start of 2017 to $3.6 billion today with a weighted average coupon of 7.3% at the end of April.

Since most of these loans are floating rate, Ladder's positive net asset exposure to LIBOR has also expanded. As we have built up this position and as the Federal Reserve Bank has gradually but consistently raised short term interest rates, Ladder has benefited to an increasing degree each quarter.

If the Fed continues on their current trajectory of raising the Fed funds rate three more times this year and three to four times in 2019, we expect Ladder's annual earnings power should be enhanced by about $0.15 per share for every 100 basis point increase in LIBOR so long as the existing positive exposure to LIBOR is maintained.

While first quarter earnings certainly reflect the benefit of rising short term interest rates on our hefty balance sheet loan inventory, this was also a quarter where the true earnings power of our multi-cylinder approach to investing in commercial real estate was on full display. We've generally guided investors and analysts to look at our net interest margin and our income from leased properties that we own as we aim to cover our quarterly dividend from these recurring income streams.

We've always said that we try to earn a 9% to 10% ROE from these basic and highly predictable cash flows. We also say that our capital light business of making loans targeted for securitization, our conduit business would allow us to supplement that 9% to 10% yield above the stated objective. In the first quarter, we contributed $436.5 of loans to two conduit securitizations earning a $11.9 for a profit margin of 2.72%, since going public in early 2014 we have contributed $9.3 billion of loans into 35 transactions all of which were profitable.

We earned an average profit margin of 3.2% with cumulative profits of $299 million. On our last earnings call, I also mentioned that we had a second product, our $1 billion real estate investment portfolio that we were going to begin to sell portions of, and that those sales were also likely to further supplement the baseline earnings goal of 9% to 10% ROE. In the first quarter we sold $93.4 million of real estate investments in two separate transactions producing total core gains of $17.2 million during the quarter.

With the addition of $17.2 million in gains from the sale of real estate and $11.9 million from our conduit to our expanding base of recurring income, we were able to produce $63.8 million in core earnings, $0.55 per share in core EPS resulting in an annualized after tax ROE of 16.3% in the quarter. Our GAAP book value increased to $13.37 per share and our un-depreciated book value also increased in the quarter to $14.82 per share.

In reviewing these earnings results, I don't want to overlook our strong first quarter loan origination activity. We originated a total of $967.5 million in mortgage loans in the quarter comprised of $532.9 million of conduit loans in addition to $434.6 million of balance sheet loans.

In the first quarter, we also acquired an industrial property with a partner near Atlanta for $24.5 million. We own about

70% of the equity in this deal and it is financed with non-recourse mortgage debt from a third-party lender. This investment will be held in our taxable REIT subsidiary as we expect to sell this asset within the next two years.

Looking forward to the second quarter, we expect to participate in further conduit securitizations and we are also slated to purchase some residential properties on the California coast in a JV for approximately $88 million, which we also expect to finance with third-party debt. We hope our results over the last two quarters in which we –we reported combined core earnings of $124.2 million over six months is a clear indication that our business strategy is successfully unfolding as planned.

With a cash dividend payment in the quarter of $0.315 per share, our $0.55 in core earnings per share continues to position Ladder as having among the highest dividend coverage ratios in our peer group.

Before I turn you over to Marc, I wanted to briefly address recent developments with Related Fund Management. As previously announced, on January 15, 2018, we received an unsolicited non-binding proposal from Related to acquire the company. Following careful consideration and with the assistance of financial and legal advisors and after numerous discussions with Related, the Ladder board determined that the proposal significantly undervalued the company and the parties were unlikely to reach an agreement on value that would be in the best interest of the company and its shareholders.

The Ladder board takes its fiduciary responsibilities to shareholders very seriously. The board fully aligned as both board members and significant shareholders continues to be focused on enhancing long-term shareholder value and will always give due consideration to any credible proposal. While we wanted to address this matter and provide this recap, the purpose of today's call is to review our strong financial results in the first quarter. And we ask you to keep your questions focused on that topic as we do not intend to comment further with respect to Related.

With that, I'll now hand you off to Marc.

Marc A. Fox

Chief Financial Officer, Ladder Capital Corp

Thank you, Brian. I will now review Ladder Capital's financial results for the quarter ended March 31, 2018. As you noted, in the first quarter Ladder generated core earnings of $63.8 million and core EPS of $0.55 per share, resulting in an after-tax return on average equity of 16.3%. Each of these performance measures exceeds Q1 2017 results when Ladder earned core earnings of $31.6 million and core EPS of $0.31 per share while generating a 9% return on average equity during a period when Ladder did not participate in any securitization transactions or sell any non-condominium real estate assets.

During the first quarter of 2018, core earnings were primarily derived from net interest income generated by Ladder's balance sheet loan portfolio, net rental income from our real estate portfolio, and gains on the sale of securitized loans and real estate. Overall in terms of net revenues, net interest income and net rental income totaling $52.8 million was supplemented by $29.1 million of gains from loan securitization and non-condo real estate sales during the quarter.

On a GAAP basis, Ladder generated net income before taxes of $71.7 million for the three months ended March 31, 2018 compared to net income before taxes of $18.3 million reported in Q1 last year. The largest GAAP to core earnings adjustment in the quarter 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.

During the quarter, Ladder's portfolio balance sheet loss increased over $3.53 billion up from $3.28 billion at the beginning of the year. This growing portfolio has three major components. The largest component is the $2.72 billion of floating rate loans which had an average mortgage loan interest rate of LIBOR plus 5.57%.

In addition the balance sheet loan portfolio includes $646 million of fixed rate loans, with a weighted average loan interest rate of 5.24% and a weighted average remaining term to maturity of two years. The final major component of the balance sheet loan portfolio is $158.1 million of mezzanine loans that had a weighted average mortgage loan interest rate of 10.85% at quarter end.

Altogether this portfolio had a weighted average mortgage loan interest rate of 7.1% at March 31, 2018. The interest rates on the $2.72 billion of floating rate loans were adjusted upward by 0.25 of a point in early April, which will increase the annual interest income earning rate on those loans by approximately $6.6 million. This portfolio was financed by a combination of CLO debt, FHLB advances and committed loan repurchase facilities.

Ladder's conduit loan balance stood at $273.6 million at the end of the quarter during which Ladder originated $532.9 million of new conduit loans, while contributing $436.5 million principal balance of loans to two securitization transactions. Much of the capital used to fund the expanding balance sheet loan – loan portfolio has been freed up as our securities portfolio has been reduced over the last 18 months.

As a result of the steady and methodical reallocation of capital into balance sheet loans and real estate investments, and away from investments in CMBS during recent quarters approximately 73.4% of net revenues over the past four quarters have been derived from recurring sources of earnings.

Finally, during the quarter we also completed the sales of two properties, an office building and a manufactured housing community. From our portfolio real estate equity investments generating $17.2 million of core gains. We also acquired one property, an industrial building by $24.5 million during the first quarter. A closer look at these three transactions reveals an investment approach that has worked and that we continue to apply.

In the case of the office building sale Ladder acquired that building as part of a joint venture investment in a portfolio of office buildings in 2013. At the time this particular building was occupied by a bank under the terms of a below-market lease. Our underwriting analysis at acquisition and our purchase price reflected a view that this 135,000 square foot space would be vacated in June 2016 when the lease expired. The tenant did vacate the building. And six months later a AA rated tenant commenced its occupancy of the building under an 11-year lease priced at a higher per square foot rental rate. As a result of the successful re- leasing at an appreciably higher rent than was being paid by the prior tenant and the realization of the level of cash flow we projected at the time of the acquisition the joint venture in which Ladder had a 77.5% controlling interest was well positioned to sell the property in Q1.

Ladder's share of the sale proceeds resulted in a core gain of $6.2 million and an annualized return on equity of approximately 28%. It is important to note that consistent with Ladder's plan to hold this property for a multi-year period and re-lease it at market rates, this building was held by Ladder as a REIT asset because the incremental value that resulted in the $6.2 million core gain was all created while it was a REIT asset, there will be little if any tax payable on this gain.

Moving on to the manufactured housing community sale. In March 2017, Ladder acquired a 70% interest in a 421- pad community in El Monte, California. In underwriting this investment, Ladder envisioned a much broader investment period being required before a gain could be realized. In that case, the key value enhancing event, the acquisition of a ground lease affecting a portion of the property was achieved in conjunction with the acquisition of a mobile home park. The market value of the property increased upon the reconstitution of the full fee simple interest in the property effectively leaving the JV with a substantial unrealized gain that we decided to capture as soon as possible. Ladder opted to hold this investment in a taxable REIT subsidiary.

In February less than a year after this acquisition, this property was sold with Ladder share of the proceeds resulting in a total core gain of $11 million reflecting a 74% annualized ROE. This gain will be taxed at the recently reduced corporate tax rate. In Q1, Ladder acquired a 600,000-square foot warehouse distribution building that was constructed in 2007 on a 40-acre parcel near Atlanta.

Similar to the manufactured housing community investment exited in the first quarter, Ladder foresees a near- term value enhancement event, and is therefore electing to hold this property in a taxable REIT subsidiary as well.

The building, which is currently vacant was acquired for $40 per square foot by a joint venture, in which Ladder owns a 70.6% controlling interest. It was previously occupied by a well-known beverage firm that invested over $160 per square foot to improve the building, to meet food industry standards. It is anticipated that the re-leasing of the building to one or more food or beverage industry tenants will substantially enhance the property's value within the next two years. We'll keep you posted as events develop.

We wanted to take the extra time to discuss these real estate investments, because they provide some concrete insight regarding the strategies applied and our ability to foresee and execute value enhancing events over time, and on a repeated basis. We have referenced this in-house skill set on previous calls with you, so this is meant to close that loop and provide some perspective regarding future possibilities.

Turning to key balance sheet and investment activity metrics, as of March 31, 2018, 96.8% of our debt investment assets were senior secured, including first mortgage loans and commercial mortgage backed securities secured by first mortgage loans, which is consistent with the senior secured focus of the company. Senior secured assets plus cash comprise 77.9% of our total asset base. Total assets stood at $6.23 billion, 3.4% higher than at the end of 2017. Quarter end total equity was $1.5 billion resulting in an adjusted debt-to-equity ratio of 2.62:1. Total unencumbered investments including cash were $1.7 billion at quarter end and unsecured debt outstanding stood at $1.2 billion reflecting an unencumbered assets to unsecured debt ratio of 1.43 times. In terms of originations, Ladder produced a total of $967.5 million of loans in the first quarter.

The average mortgage loan interest rate on balance sheet loans originated during the first quarter was LIBOR plus 5.83%. The average interest rate on conduit loans originated during the quarter was 5.01%. And the weighted average loan-to-value ratio, the commercial real estate loans on our balance sheet at March 31, 2018 was 66.2%. During the quarter, Ladder reduced the amount of interest we expect to receive related to our sole defaulted loan by $2.7 million. This was the first quarter that Ladder's TRS or taxable REIT subsidiary earnings primarily securitization gains and real estate sales gains were impacted by the recently enacted federal tax reform legislation.

The reduction of the federal corporate tax rate from 35% to 21% resulted in a $1.7 million increase in after-tax core earnings or about $0.015 per share impact on core EPS. Our shareholders also benefited from the 20% reduction applied to REIT dividends. On the financing side, as of March 31, we have $3.9 billion of core debt outstanding, and committed financing availability of over $2.3 billion for additional investments. Over the past four quarters, we have continued to enhance the diversity of our funding base through the issuance of $900 million of five-year and eight-year unsecured corporate bonds. Two issuances of nonrecourse CLO debt with a total balance of $683.1 million at 3.31% and the net addition of $94.3 million of nonrecourse, 10 year mortgage debt to finance real estate investments.

When combined with $1.5 billion of permanent equity and a $103.5 million of other liabilities, $4.13 billion or 66.2% of Ladder's capital base is comprised of equity, unsecured debt, and nonrecourse, non-mark-to-market debt. In addition at

03/31, we had the full $241.4 million capacity of our syndicated unsecured revolving credit facility available to us.

So far this year, we've exercised our options to extend the maturities of two of our existing bank financing facilities. At 03/31, $550.5 million was outstanding under these facilities. Adding to the net interest income tailwind referenced previously over the course of the past four to six months, we have seen notable spread reductions in our cost of balance sheet loan funding from banks from approximately LIBOR plus 250 basis points to the LIBOR plus 200 basis point range.

At quarter end, we had $1.3 billion of FHLB borrowings with a 2.44 year weighted average maturity and an average cost of 1.86%. Finally, we paid a $0.315 per share cash dividend in the first quarter. On a rolling four- quarter basis, Ladder has paid $1.23 per share of dividends while core – earning core EPS of $1.79 per share, resulting in a 69% dividend payout ratio.

So summing up, in the 2018 first quarter, Ladder generated $63.8 million of core earnings, $0.55 per share of core EPS, resulting in a core after tax return on average equity of 16.3%. We've originated a total of $967.5 million and securitized $436.5 million of loans resulting in $11.9 million of net securitization gains reflecting a 2.72% profit margin.

We sold two properties in transactions that generated $17.2 million of core gains and added $0.13 per share to core EPS, and we paid a $0.315 per share cash dividend in a quarter and with core EPS was $0.55 per share. And we continue to apply a discipline approach to the use of leverage, the allocation of capital in the face of the risk we encounter, and so 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.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now be conducting our question-and-answer session. [Operator Instructions] Our first question comes from the line of Steve DeLaney from JMP Securities. Please go ahead.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

Good afternoon, everyone. Thank for taking the questions. Marc, you were describing the office building story. Could you tell us what market that was in? It does not sound like it is the larger complex in St. Paul, Minnesota that you've highlighted in your slide deck. So if you could identify that one so we can find it in the K that would be helpful?

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

Yeah, that's the part of the Richmond, Virginia portfolio.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

Yes. Okay. And that was like Highwoods Properties or something over there and that that Innsbruck complex I think.

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

The Innsbruck complex. That's correct.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

Yeah. Okay. Thank you for that. And, an unusual one in the income statement provision for loan loss, $3 million and it brings the total reserve it appears to $7 million. You mentioned a single defaulted loan. Is this a specific reserve on that particular loan and can you give us a little detail on that?

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

Sure. The $3 million has two components to it. There's a $2.7 million specific reserve that's on – a loan, this is actually a first mortgage loan and a mezzanine loan on the same property originated simultaneously and that $2.7 million reduction relates to that. That leaves us at this point with a basis that is in excess of the amount we've lent, which was $26.9 million in total. The other $300,000 is, we're building up our general reserve. We had been building one for a couple of years and got to a point before we started expanding our balance sheet loans to where we felt we were overdoing it and then we stopped adding to that reserve. And then we went and expanded the balance sheet loan portfolio, decided to start putting that reserve back on every quarter at a rate of $300,000 a quarter. So, you'll see that going forward.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

All right.

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

The building – the property that is the subject to the property that's in default is just give you an update on that, got new tenants in it, it's 100% occupied, it's a 10-year leased and we don't have any expectation and we haven't incurred any kind of principal loss.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

Great. Appreciate these comments and so the – we should assume that the balance sheet provision or the allowance for loan loss, all of that but for the $2.7 million specific would be considered general. Is that correct?

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

That's correct. That's correct.

Steve C. DeLaney Q

Analyst, JMP Securities LLC

Okay.

Marc A. Fox A

Chief Financial Officer, Ladder Capital Corp

That's the only specific reserve we have.

Steve C. DeLaney
Analyst, JMP Securities LLC

Q

Okay. Thank you very much for the comments.

Operator: Thank you. Our next question comes from the line of Stephen Laws from Raymond James. Please go ahead.

Stephen Laws
Analyst, Raymond James & Associates, Inc.

Q

Hi, good afternoon. Brian, could you comment a little, you talked about the real estate sales and continuing to look at those. Any identified properties or expected pace this year that we should think about with regards to future sales?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Sure. This is Brian. We have a decision to make, I think, on the St. Paul property that was just referenced, 100% of the tenancy has now renewed their leases. And so, as a result of that, it'll pretty much be the same story for the next 10 years we think. So, I think we have to make a decision as to whether or not, we'd like to sell that property now that it's been fully extended or should we refinance it in a mortgage and hang on to it in the REIT. And I am not sure what we're going to do there, but we are very comfortable with the basis where we own it.

And I think we're going to continue to sell some condominiums, as you know we almost run out of condominiums in Las Vegas. We've got some left in Florida still, but we have a third condominium project, which is on the lower east side of Manhattan, and it's less than 50 units, I think it's about 40 units. And we would expect those assuming the construction finishes up and the CLO comes online, we may see sales there and closings in the third – maybe at the end of the third or fourth quarter.

Stephen Laws
Analyst, Raymond James & Associates, Inc.

Q

Great. Appreciate the update on that. And switching to securitization markets, strong volume in Q1, solid gain on sale margins, can you maybe just talk just a general update on what the securitization markets are like today, it can be a little choppy, a little lumpy, as we've seen historically. But, maybe an update on what you're seeing in the securitization markets?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Sure. Volumes are a little bit light I would say, and when I talk about the securitization market, I'm not really talking about the single asset securitization. For instance, I think a property that we own some bonds on – there is a book out to refinance that at $1.6 billion. So that's not what I'm talking about. The general conduit business, I think the volumes are down a little bit, we've seen in the banks, so as they've reported their earnings have indicated that loan demand had slowed a bit, and I think that we may be seeing a little bit of a
– wouldn't call it a slowdown, I think, I would call it a bit of a pause mainly because how rates had moved up, and some of that frequently will be accompanied by a wait-and-see moment on the behalf on borrower's part.

So, I'm not overly concerned. I think, the amount of competition in this space is down a little bit. I think, the result of that is because the other conduit business that's emerging is the CLO market, which is, I'll call it conduit for floaters, but – and that is occupying quite a bit of time in lot of the lending operations in New York.

So the securitization business is a little bit down I think with rates rising and spreads actually are out a little bit. I think that should be reasonably healthy. But as I said, I do think that there is this wait-and-see sensation going on, on the part of buyers as well as sellers of things because the 5-year and the 10-year rate have been very close to each in this flat curve. So I think it's a pause, I don't think it's a slowdown naturally, but we'll see. But we are active really in the floating rate and the fixed rate businesses.

Stephen Laws
Analyst, Raymond James & Associates, Inc.

Q

Great. And one final question I kind of want to touch on the stock price and valuation. You're pretty clear the board determined the recent offer was not reflective of the value of the company. And I know in the prepared remarks, you guys discussed the significant dividend coverage you have, can you talk a little about thoughts regarding stock repurchase or buyback. How you think about capital allocation between doing something like that and repurchasing shares versus pushing capital into the core business, possibly looking at something like allocating a portion of the gains on that you're generating from real estate sales towards repurchasing stock, it just seems like given the statements around that proposal that the company certainly feels like the stock is significantly undervalued at these levels.

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Yeah I think I would agree with that statement and that sentiment. I think in the fourth quarter we had repurchased some shares, although not too many. But we are pretty sensitive to what our cost of capital is. I think our earnings – when we think about capital and where we allocate it if – I think, last quarter we had a very good ROE, in the first quarter, we had a $16.3 million. So obviously we're finding places to allocate capital pretty comfortably well in excess of our dividend.

However, I'm of the opinion that we are sort of lumping in the REIT space with REITs that are maybe one new phenomenon in this turnaround the cycle is the ETFs. So I think that if REITs don't do well I think we occasionally struggle also. But that doesn't mean we can't find other ways to reward our shareholders. So we've long said that we run a 9 to 10 ROE type business and occasionally supplement it. It's previously been with securitization profit, we made over $30 million in the fourth quarter, about $11 million – over $11 million this quarter. But now we have the other product coming online which is the real estate portfolio which I do think we will be harvesting some gains.

It is literally selling a piece of real estate, so it's a binary event. And it doesn't work the same way as a conduit does. But, well, I wouldn't say that we'll deliver those returns every quarter, I do think that you will see them more frequently than you have in the past. We have plenty of capital. So I don't see any need to issue shares by any stretch of the imagination, but I do think that our stock does appear cheap to us. We have a $41 million plus stock repurchase allowance at this point that we haven't used.

And I would expect there is a very good chance that we will take a look at that depending on what happens when our earnings come out and what happens with the rest of the REIT stocks. But also we constantly – we would prefer to revisit our dividend policy on our fairly regular basis that's rather predictable. We certainly don't want to be in a position where we're having difficulty on any level needing it and clearly we're not at this point, I think we have one of the highest coverage ratios in the peer set.

So, I think that is the question about when not if. And while I wouldn't normally want to recommend raising the dividend in a mid-year cycle, certainly consecutive quarters, I think if the Fed continues on the path that they're on and they continue raising short-term interest rates, there is going to be a very reasonable argument for moving a little bit sooner.

Stephen Laws Q
Analyst, Raymond James & Associates, Inc.

Great, Brian. Thank you very much for the comments on those topic, appreciated.

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

Okay. Thanks.

Operator: Thank you. Our next question comes from the line of Tim Hayes from FBR. Please go ahead.

Tim Hayes Q
Analyst, B. Riley FBR, Inc.

Hey guys thanks for taking my questions. Looking out a year from now just kind of assuming the same macro conditions persist and there we see a couple more rate hikes, how do you see capital allocation mix looking like at that point. Should we expect it to be a net seller of real estate as you continue to harvest gains and just kind of opportunistically sell some securities and just redeploy all that into the lending business or any color around that would be helpful.

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

Yeah, and please understand the next few comments are going to be with not a lot of conviction, because we have to deal with what the market conditions are in front of us. Frankly, it's been a little bit quiet lately, we had a little bit of an interruption there during that big spike that took place. And but realistically I think the markets have been a little bit quiet. And I tell you it feels to me like things are a little too quiet and I've just got a sense about me that there is going to be a little bit more turbulence in the future here.

So our securities portfolio is down quite a bit, I think it's down to about $1 billion now. We have not been adding aggressively to that, but we stand ready to, should there be any kind of turbulence or spread widening for unforeseen purposes. The last bout of spread widening took place when oil prices fell at a very precipitous drop, down to around $20 a barrel.

Interest rate seemed to be rising. That's making some people nervous. You've seen some of the high-yield bonds that have been issued recently. They've taken a dive pretty quickly after being priced. So these are all things that factor in to what we're allocating capital. I think, as rates rise, we've got a very healthy book of floaters that will benefit from that. We would like to keep adding, but at some point, I do think you have to assume there might be some demand disruption there as rates rise.

At this point, I think one of the slowdowns that I mentioned earlier in the conduit business is really the fact that there's two types of loans you do in the securitization business, you securitize loans where somebody purchases a property and acquisition or else you do a refinance. The refinance channel is a voluntary channel unless you have a maturity date. And I think, the refinance channel has been reduced quite a bit because of the recent move in interest rates.

So if I look out over a year, I think we're going to get a chance to buy some securities if there is any volatility. I think, the conduit business is going to be reasonably healthy, mainly because I think, rates rising and volume falling creates a supply and demand imbalance. And the bridge loan business, there's a lot of players in it, but I think everybody is shooting at a little bit of a different target and I think the target we go after is really a middle market lending business and it's frankly, not as – as competitive as some of the larger loan businesses. So we'd expect to stay in them, but we'll emphasize them differently in different ways.

The real estate product is an interesting one though because we have purchased, as Marc mentioned we bought a $24 million warehouse in Atlanta. Yesterday, I think or today, we settled down an $88 million purchase of some housing out in Santa Barbara. So, we're finding plenty of opportunities in the equity side, so while we happen to have $1 billion portfolio of equity, I do see us adding to that. And sometimes people will sell real estate because they think rates are rising. And so there's just always opportunities in real estate, and we just happen to be seeing more of them recently.

Tim Hayes
Analyst, B. Riley FBR, Inc. Q

Got it. Thanks for all your comments there. On the real estate portfolio, I guess, it sounds more like you're going to be adding there even as you harvest some gains, but would you mind just kind of identifying or sizing just how many of your properties are stabilizing in a position to be sold right now?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp A

Well, I would bifurcate our portfolio into what I'll call the net lease business. And I think that's about $600 million of our portfolio that's leased 100% for I think on average about 13 or 14 years. Those are all financed with 10-year nonrecourse financing and those loans are assumable. While they're throwing off double-digit returns, there's no active effort on our part presently to sell those, but occasionally somebody who does want to buy one and calls us. But, I think we'll continue building there but with a flat yield curve, that's a difficult prospect.

The rest of the portfolio is what I'll call value-add. We get together with the JV. It's maybe not occupied, it could be vacant, the Atlanta warehouse that we purchased is vacant. We think that's a great opportunity and we don't think – we put that in our TRS because we think we're going to lease it and sell it that quickly that we wouldn't even put it in the REIT. But, there are – the value-add where we have a JV partner, an operating partner on the ground, we usually try to get involved with seminal events that take place quickly, that require capital, for instance the El Monte Mobile Home Park, we needed to acquire a ground lease to make that value proposition take hold and we did very quickly. We actually got hold of it before we closed. So that was a quick turn.

I would call our real estate portfolio a conveyor belt. There's going to be some coming on, there's going to be some coming off. But we don't have any opinion about holding on to things forever or never selling things, nor do we have an opinion about selling things immediately either. It generates a lot of good REIT income that our loan and lease business really generates a lot of recurring income and that's been an effort that we've been undertaking. 2017, we spent a lot of the year getting our balance sheet in optimum format where we could properly leverage assets safely and we're in that position today. So 2018 will be a year where we spend most of our time on investments, reaping profits and trying to move the stock price up with shareholder value.

Tim Hayes
Analyst, B. Riley FBR, Inc. Q

Okay. Thanks for all the comments, Brian.

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Yeah.

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

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

In terms of the overall CRE market, how many rate hikes do you think that the market can absorb before we start seeing diminishing credit performance?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

I think realistically, if the rates are going up because the economy is doing well then I think that number is higher. And I would say at 4%, easily, because that still wouldn't be a very high interest rate. But if the rates are going up because the government is borrowing too much money and there's too much demand – and there's too much demand from them and there's a crowding out phenomenon and that takes place then I think it gets into trouble quickly.

But I am also of the opinion the Fed, I think, is signaling that they're going to raise rates three more times this year and possibly four times next year. I do not believe that. I am of the opinion they may go once more in June. I suspect they probably will and I wouldn't be at all surprised if that's the end of it for the year.

So I don't think anything is going to cause a problem here in real estate as far as loan origination or purchases of equity or making bridge loans. I think we've got to a reasonably healthy economy that's doing okay, I think any potential downturn in the economy was forestalled by the tax cuts as well as the repatriation.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Just on the REIT side, we are seeing a continued trend of rent growth slowing, NOI growth slowing. So the worry that could be emerging in the market is that additional Fed rate hikes could start to spur cap rates widening. Are you starting to see any upward pressure on cap rates?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Yeah, I would say so. There's been some, I wouldn't call it any kind of dramatic pressure, but I also believe interest rates were artificially low for a very long time and a lot of things were built especially in the residential side of the business, multi-family. But you also had technology causing a lot of retail square footage to become obsolete. And some office converted and the hotel business seems to be doing well. So yeah, I do feel some push up especially in the retail side. And I do think you'll see some upward pressure on the apartment side also but I think the industrial side of the market is very tight.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And in terms of lending spreads with all the debt funds seeming to take market share from CMBS, do you feel that at this point debt fund – the spread compression has kind of reached its bottom because most of the debt funds are shooting for dividend yields after fees similar to the mortgage REITS in the 8% to 9% range. And so, with further tightening, we would start to have returns – levered returns below that. So, do you feel like most of the spread compression we've seen over the last six months has kind of run its course?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp
A

No, I don't think so. I think a couple of phenomenon taking place at the same time which maybe giving a little bit of a head fake into the equation. Spreads have actually been widening for the last I would say 90 days or so, and certainly rates went up for a period of time, but then they went back down. So, when you look at some spread compression that took place earlier on in January, and part of February, you really didn't have absolute borrowing rates much different than they were in the fourth quarter. So, I mean, we write loans today, it looks like we're in the 5% to 5.25% for the conduit.

And our bridge loan portfolio really runs the gamut between LIBOR plus 375 basis points all the way up to LIBOR plus 800 basis points. I think that we have a little bit more bandwidth than many. But what I am seeing which is a little surprising, if not a little bit early in the cycle I think is that many of the funds – there's been frankly too much capital raised in the bridge loan market and that's largely as a result of the reemergence of the CLO business.

And we're seeing some of the large loan originators really putting a lot of pressure on the banks to lower their borrowing rates and their repo. And the CLO business afforded REIT that employed this CLO model to actually borrow money at rates that were lower than repo rates in the banks, so the banks are responding with lower rates there. So I think it'll keep going for a while, I think you can lower rates and spreads a bit more as long as the banks continue to lower their repo rates, but we opted to go with the corporate bond model where we borrowed a lot of long-term money at higher than repo rates, and we're hoping over the long-term that will be the right decision. So it's not impacting us, but we do see, when I look at dividends at 8%, 9% and 10% and loans are being made at LIBOR plus 300 to 350 that becomes a bit of a hard sell to pull that off without a lot of leverage. So we're avoiding that.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Thanks for taking the questions.

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp
A

Sure.

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

Richard B. Shane
Analyst, JPMorgan Securities LLC
Q

Hey, guys. Thanks for taking my questions, this afternoon. Very quickly, I would – we're looking at the gain on sales say that is sort of towards the lower end of what we've seen from your guys historically. Brian, given the flexibility of the business model what point do you just put those loans on balance sheet as opposed and weight them out?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp
A

There is a lot of products that we take a look at every day as to where we want to allocate capital. And you're right, the conduit market is a little bit difficult on the distribution side right now. You're seeing a lot of banks getting together and what you're seeing is smaller deals and the rating agencies are even moving some of their models around a little bit. So the conduit business is a little tricky right now.

Spreads in the conduit business, profit margins tend to hit their low in the year. It's a seasonal thing I think, usually in the second quarter and that's – yeah we're experiencing that. And – but that's a not a surprise. I don't think anything fundamental is going on there. I think it's just the second quarter. Once the New Year came in, all the allocations to fixed income were there, stock market had done well last year. So everybody was buying things.
And typically, the lenders will overdo it on the inventory side and overwhelm the buyers and that's kind of what's going on I think. But that doesn't last, I think this is temporary. I think it's a technical issue. I don't think it's a credit issue by any means. But when we look at allocable investments where we would put our capital, we look at our stock with a 9% dividend, and that weighs in on where we'll lend money and put them on the balance sheet.

The conduit loan market is, as I said, around 5% to 5.25%, so that's sort of a toss-up there. And I do believe if rates continue to go even higher we have to be very respectful of our bondholders also and we want to keep our debt-to-equity ratios healthy and if we need to acquire some of those bonds that are outstanding in a high rate environment they would be sold at a discount.

So we would – we would also go in that direction. But right now we still think the best business for our capital is the real estate business as well as the bridge loan business. And so far there has been a couple of pressing points on it but nothing to change the direction.

Richard B. Shane Q
Analyst, JPMorgan Securities LLC

Okay. It's very helpful. Thank you very much.

Operator: Thank you. Our next question comes from the line of Ben Zucker from BTIG. Please go ahead.

Benjamin Zucker Q
Analyst, BTIG

Good evening, everyone and thanks for taking my question. Just real quickly, if I heard you correctly you said that subsequent to quarter end, you're making $88 million investment in some residential properties in California.
Could you just expand on that a little, is that like a portfolio of single-family rental homes for rental income or how should we think about that investment?

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

It's coastal properties, it's I think a little over – it's over 40 buildings. It's student housing and it's in Southern California. We are not buying it ourselves for $88 million, we borrowed money from a third-party. So our equity investment in the transaction is only $14 million, and we own I think about 75% of the equity in the deal.

Benjamin Zucker Q
Analyst, BTIG

Okay. That's helpful. And then just lastly how much capacity do you guys have to fund new investments right now? I know throughout 2017 there was a lot of selling down the higher leverage CMBS to kind of free-up capital, but I'm curious more about aside from just reallocating the capital, how much room do you have right now to kind of grow the overall portfolio at this time? I only ask because of the impressive balance sheet growth that we've seen throughout 2017. I'm just wondering how much longer that can continue.

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

Well, we certainly have to be mindful of debt-to-equity ratios, and just margin of safety, but we do believe we can continue to grow and we have a lot of liquidity right now, I think we could easily add $500 million worth of assets, probably up to $1 billion. Obviously these all get impacted if you start buying stock back or if – again, you have to look at it, but keep in mind we have a lot of assets, and we still have $1 billion worth of securities, and they're all very short in duration, not all of them, but almost all of them.

And so what you sometimes experience in a falling rate environment and as you hear analysts talking about banks and they're saying well their high coupon loans are paying off, and as the years go by and lower rates the bank earnings will fall. We actually have the opposite going on right now. Our low coupon loans are paying off. So we have hundreds of millions of dollars of loans and securities that are match funded. So, I don't want you to think that we're upside down. We put them on match funding, fixed against fixed, but they'll be paying off and those rates are 3%, and we'll be reallocating those funds into lower leveraged perhaps, but also higher rate 7.5%, 8% type assets.

So we've got plenty of room, and I think if we wanted to – if we wanted to redline the debt-to-equity ratio, which we will not do, don't make be mistaken we could add $1 billion.

Benjamin Zucker Q
Analyst, BTIG

All right, well, that's really helpful and congratulations on a great first quarter, guys. Thanks.

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

Thanks.

Operator: Thank you. Our next question comes from the line of George Bahamondes from Deutsche Bank. Please go ahead.

George Bahamondes Q
Analyst, Deutsche Bank Securities, Inc.

Hi, guys, good afternoon. Just a quick question on credit, which geographies or asset classes are you watching most closely or avoiding – and also if you can maybe touch on some of the things you closely monitor to ensure you have a clear view of – on early signs of credit downturn?

Brian R. Harris A
Chief Executive Officer & Director, Ladder Capital Corp

Well, we have a large portfolio of transitional assets, so we see business plans unfolding all over the country on a monthly basis. So, we do keep an eye on that. The hotel sector is a little bit more impacted by the strength of the dollar. When we had a very weak dollar, you saw, in my opinion – luxury hotels in New York we're having a problem. But, I think the weak dollar really brought back the tourists and I can hear them outside. So, I think that that was an accident possibly heading in the wrong direction, but it didn't happen, at least not yet. Airbnb had done a number on a lot of the major metropolitan cities.

Retail is its own animal, you have to look at that versus supply and demand. So I don't know that I can tell you that I look at something that makes retail do worse. I think you look at consumers and consumers are getting pretty tapped out I think. And so, there was initial spend there. And so that will affect retail. But the office market is a densification business, but a lot of office product is turning into apartments. So, certain areas, what I worry about more is macro trends, like for instance the recent loss of the state and local tax deduction in places like New York and New Jersey. I think that is a big problem and we are very hesitant to undertake loans that require a lot of cash flow increases because we do think that there is going to be pressure on asset values and housing prices for that matter. I think it is already taking place. We do believe a lot of those pains that are absorbed in the Northeast will benefit Texas and Florida because if there are no state tax policies.

So you have to look at every example as to what's going on around it. And we're always, always concerned about that replacement cost. So when we see things dollars per foot that make sense that you can't build them for less, that's a much safer environment than when you're just lending very high dollars per foot on something that somebody can build another one across the street. But we're not seeing that. We're not seeing credit problems yet, we are seeing hotels plateau. I wouldn't say that there's a credit problem yet. And I do think as prices of gasoline continue to rise probably something that hasn't been talked about a lot yet but will be soon I think the hotel businesses will flatten out a little bit the drive to markets.

George Bahamondes
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks for the color, Brian.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Ken Bruce from Bank of America Merrill Lynch. Please go ahead.

Ken Bruce
Analyst, Bank of America Merrill Lynch

Q

Thanks. Good evening, gentlemen. Just coming at the end, most of the detailed questions have been asked and answered. I guess the one that I'd like to revisit relates to shareholder value and enhancing that. You've discussed the valuation on the stock, it's a substantial discount to your underappreciated book value, it's a discount to what most of us would consider the – kind of the peer group and our work would suggest that this company can be valued considerably above that both on an absolute basis and on a relative basis. I'm interested in hearing what you think needs to happen for that – for the market to begin to rerate the stock. Do you think it's consistency of earnings, do you think its dividend growth buybacks, I personally don't feel like that's the solution, but what do you think needs to happen for the rerating to occur?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

It's a theoretical question and I appreciate it because – I'll tell you, I grew up and went through school and always thought that the efficient market theory you were told, right. If you – if information was available, markets would get to their efficient level, but we live in a sector that is very interesting and when I look at our – some of our largest shareholders, they're ETFs and I never met anybody from one of those ETF companies and they are our largest shareholders and when I open up my screens in the morning and I look at what I consider to be our peers and if Ladder is up 1% and the peers are up 1%, I can pretty much tell you what the inflows were in the ETFs for REIT and income stocks because that's just to me is allocated capital just moving into the sector because funds have been received, and you see the opposite also and as the funds are being redeemed, you'll see certain – all the peers follow the same amount on a percentage basis that day and that's usually ETF buying and that's something I really haven't seen too much of before.

We spend a lot of time meeting people and investors that run with first and last names and we tell our story to them and we give them the value proposition about internally managed company with a lot of internal ownership. We've never raised secondary capital. We've got a ironclad balance sheet, and we go through all the checkmarks that we do to run a safe company. But deep down inside, I do believe, half of this market is driven by three factors, market cap, dividend and average daily volume. And I don't think that those algorithms that make those purchases, no if you own subordinate debt or senior secured, they don't know if you're internally or externally managed. And I think that they pay attention to rising interest – price to book value, and I think they pay attention to dividend increases on a regular basis.

But I think we've – we've been walking around here at Ladder, questioning, how do we make something happen? And finally, you just have to sit down and realize, we're REIT, and REITs are perceived to be an out of favor asset class, when rates are perceived to be rising. There are plenty of REITs that do very well, while interest rates rise. And that is a fact that I think everybody on this call knows. But I don't think, a lot of those algorithms take that into account. And you will see sometimes where, the bond market is available at 6%, but a REIT might raise money at a dividend rate much higher than that. So why would they do that? That's typically an externally managed REIT, that's in the assets under management model. But I don't think that the – that the algorithms are picking that up.

So I think as I said last year, we went to great pains to set up our balance sheet and our asset liability set to make sure that we could really optimize our earnings power. We've got the right product mix. I think the analysts and our investors do understand that, and I think we're in the self-help model now, because I don't think we can wait any more to reward our shareholders. I don't think we can wait for the efficient market theory, because if the Fed says they're going to raise rates four times, REITs are going to go down. Now I understand why residential mortgage REITs go down. I don't understand why mortgage servicer would go down, nor do I understand why a REIT with a lot of exposure to LIBOR assets goes down, but down they go.

And I think that that's rather than fight city hall and get frustrated by it. I think we have to pick and choose our opportunities with those buying patterns instead of waiting for them to correct themselves. So I think that we will spend a good part of 2018 being a lot more active in the self-help shareholder reward column.

Q

Well that sounds I guess both good and bad. I'm a little concerned about the indiscriminate selling if that's what you're alluding to is the yield stocks go out of favor with rates. Some of that would argue for frankly not having Ladder as a public company. And I know you don't want to address Related and won't ask about that, but what is it that you think you need to see to consider essentially kind of going in a different strategic direction?

Brian R. Harris
Chief Executive Officer & Director, Ladder Capital Corp

A

Well, I think that we have to open up investor classes that we haven't really met yet, and we take a lot of email from the retail side of the world who certainly didn't want us to go private under any circumstances because they felt that it's very hard to find an investment that they feel safe with at a 9% dividend yield. Now I'd like to tell them that 9% dividend yield shouldn't be 9% I'd like to get them down a lot. But you have to walk before we run. But, look at the end of the day we know what the company's worth. We know how it work, how it operates and we know what our prospects are. I think if we can walk into a portfolio manager's office and explain to him the value proposition and probably get a buy ticket as we walk out there, but we cannot convince an algorithm that you should separate Ladder and buy it rather – from the residential mortgage REITs. I don't know how to do it mainly because I don't know how to talk to them because I've never met them. They are large shareholders and they've never called here and they've never shown up at a meeting.

So I think that rather than – this is a new phenomenon. I think the 'ETF-ization' of the stock market in many ways. But I do think there's certainly a place for us with our high dividend rate and easily covering it. I mean we could make it much higher if we wanted to. But I think that there's plenty of investment opportunities that are not available to the general public and so I don't think the retail side of the business really does need to be spoken to a bit more, and with all the data available to people at home on their computers I think we can really talk to them that way and we may have to start doing that.

We'll certainly continue and want to be owned institutionally and I think we will be. But I can feel for institutions who say reinvestments in REITs have been difficult lately. Now, they get a little popular when the FANG stocks drop 10% or 15%, but – and the tide will turn, but I don't think we need to wait for that because we run a company that does very well in a down market and does pretty, pretty damn well also in a fairly safe market. So we're an all-weather REIT. We think we know how to avoid the problems, we keep the leverage in check and we always focus on credit and I think we keep doing that I just don't know how long a 16% ROE over a couple of quarters – again with certain – I don't say we're going to make $60 plus million a quarter every quarter but I don't think you've seen the last one today. And so I think we continue to spring those along, will either have to dividend out some of our earnings to those shareholders that have been believing in us and buying into our model of multi- cylinder approach. And we actually talked about possibly just setting up the conduit and the real estate portfolios as when we make money, we'll distribute it. Those feel like special dividends and those have never been very helpful to most companies, but I do think that we'll take a more aggressive posture towards shareholder rewards.

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

Brian R. Harris

Chief Executive Officer & Director, Ladder Capital Corp

I just want to thank everybody for getting on the call with us today. We had a lot to talk about, so probably ran a little later. but we look forward to catching up with you next time. Thank you.

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.