# KKR Real Estate Finance Trust Inc.

## Q2 2024 Earnings Call

## July 23, 2024, at 10:00 a.m. Eastern

**CORPORATE PARTICIPANTS**

**Jack Switala –** *Investor Relations*

**Matt Salem –** *Chief Executive Officer*

**Patrick Mattson –** *President and Chief Operating Officer*

**Kendra Decious –** *Chief Financial Officer and Treasurer*

**PRESENTATION**

**Operator**
Good morning and welcome to the KKR Real Estate Finance Trust Inc. Second Quarter 2024 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero.

After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two. Please note, this event is being recorded.

I would now like to turn the conference over to Jack Switala. Please go ahead.

**Jack Switala**
Great. Thanks, Operator, and welcome to the KKR Real Estate Finance Trust Earnings Call for the Second Quarter of 2024. As the Operator mentioned, this is Jack Switala. Today, I'm joined on the call by our CEO, Matt Salem, our President and COO, Patrick Mattson, and our CFO, Kendra Decious.

I'd like to remind everyone that we will refer to certain non-GAAP financial measures on the call, which are reconciled to GAAP figures in our earnings release and in the supplementary presentation, both of which are available on the Investor Relations portion of our website.

This call will also contain certain forward-looking statements, which do not guarantee future events or performance. Please refer to our most recently filed 10-Q for cautionary factors related to these statements.

Before I turn the call over to Matt, I'll provide a brief recap of our results. For the second quarter of 2024, we reported GAAP net income of $20.2 million or $0.29 per share. Distributable earnings this quarter were negative $108.7 million or negative $1.57 per share, including realized losses of $136 million or $1.97 per share. Distributable earnings prior to realized losses were $0.40 per share relative to our Q2 $0.25 per share dividend.

Book value per share as of June 30, 2024, was $15.24, representing an increase of $0.06 quarter-over-quarter. Our CECL allowance decreased to $1.65 per share from $3.54 per share last quarter, primarily driven by realized losses.

With that, I'd now like to turn the call over to Matt.

**Matt Salem**
Thank you, Jack. Good morning, everyone and thank you for joining us today. Before turning to KREF's second quarter results, I'd like to begin with a brief market update. In mid-July, US core CPI came in at the lowest level since 2021, signaling that inflation is subsiding. Fixed income and equity markets reacted positively. Within commercial real estate, values for most property types appear to have bottomed out at these lower levels. Transaction volume is slowly increasing and investor demand is present, albeit largely for more value-add and opportunistic equity with most core pools of capital dormant. While rental increases have largely subsided, lower new construction starts may lead to supply-demand imbalances over the next few years. On the lending side, new originations benefit from lower LTVs, more cash flow per unit of debt and a basis well-below replacement costs.

Given these factors, our expectation is that this vintage of real estate lending will be a very strong credit. We continue to think that the market opportunity, while attractive today, will accelerate as transaction

volumes normalize and bank activity remains muted. Banks historically represented 40% of the market and we expect their participation to come down materially. Our best guess is that the bulk of the opportunity will occur over the next 18 to 24 months. This dynamic will present KREF with an opportunity to step in as we look to turn to offense and resume lending over the next few quarters. Notably, US banks are demonstrating a shift of preference from direct mortgage origination to originating loan on loan facilities. So senior financing for our investments is readily available as we return to the market.

As a reminder, KREF sits within KKR's broader real estate business that manages over $70 billion of capital across both debt and equity globally. Within real estate credit, we have a number of different pockets of capital across our first mortgage origination and securities investing, as well as our K-Star Asset Management and special servicing platform. Our team of over 100 individuals is actively investing from our bank and insurance SMAs and private debt funds, which allows us to stay active in the market and service our strong client relationships.

Our own real estate credit pipeline is robust, totaling over $20 billion, which is up over 40% compared to last year's weekly average. We are converting the pipeline into investment activity. In the second quarter alone, we invested over $4.7 billion across our real estate credit complex.

Now, turning to our second quarter results. KREF's distributable earnings prior to realized losses of $0.40 comfortably covered our $0.25 per share dividend. As we stated earlier this year, we set our dividend at a level which we believe we can cover with distributable earnings prior to realized losses with our performing loan portfolio under a number of different scenarios. In the near term, we expect DE ex losses to continue to be significantly higher than our dividend.

This was an important quarter for us as we completed the transition of two watch-list loans to REO and while we realized losses, we were appropriately reserved. We have led with transparency and KREF has remained disciplined in adjusting CECL reserves. Importantly, we did not have any negative watch-list migration this quarter. Book value per share grew by $0.06 quarter-over-quarter to $15.24 at the end of the second quarter.

This quarter, we received $384 million in loan repayments, with full repayments across four loans, including hospitality, industrial and multifamily property types, one of which was previously a 4-rated loan. We funded $121 million in loan principal for a net reduction of $263 million. Repayments have now exceeded fundings in four of the last five quarters. Future funding obligations have declined to approximately 9% of the funded portfolio. Repayments have also allowed us to delever the balance sheet with current leverage of 3.9x, in line with our target leverage.

Within our current pipeline across the real estate credit business, we are focused on favored asset classes with strong fundamentals. Our current KREF portfolio is 60% multifamily and industrial, resilient property types with long-term tailwinds. To note, our multifamily portfolio has performed well with weighted average rent increases of 3.1% year-over-year.

In terms of other property types, while there is currently decreased tenant demand in the life science sector, we remain positive given the innovations in science and technology and our loan exposure is located in the deepest markets of Boston and San Francisco with around half of our loan portfolio in this sector comprised of new trophy real estate.

KREF has robust liquidity with $644 million of availability, up sequentially from the prior quarter. With the assistance of KKR Capital Markets, we have built a diversified financing structure, with sources totaling $8.4 billion and $2.8 billion of undrawn capacity; 79% of our secured financing is completely non-mark-to-market and the remaining balance is mark-to-credit only. KREF has termed out its debt structure as

well, with no corporate debt or final facility maturities until 2026.

Now, I want to take a step back and discuss how the company is positioned. We've come a long way through the stress induced by the work from home dynamic and the significant Fed hiking cycle. We've approached our issues in the portfolio proactively and transparently. Leveraging the full breadth of the KKR platform, we have taken various approaches to working out our watch list loans, including DPOs, modifications and foreclosures, always with the mindset of optimizing shareholder value over the long-term, despite any near-term noise it may cause.

We reduced the dividend in order to give us time to create value in our REO portfolio and we've maintained ample liquidity throughout. With repayments exceeding funding as anticipated, we've been able to reduce our leverage ratio to within our target range. While I can't say we're out of the woods yet, I do think we're at the edge of the woods and we're starting to see the proverbial light.

To that end, we've begun to discuss what a return to offense looks like in the second half of the year. We are evaluating all our options and thinking through relative value to maximize return for our shareholders. With over 75 years of collective experience across our leadership and asset management team and our access to the broader KKR Real Estate platform, KREF has the tools to continue to navigate the challenges of today's market.

With that, I'll turn the call over to Patrick.

**Patrick Mattson**
Thank you, Matt. Good morning, everyone. I'll begin with updates to our CECL allowance and watch list. CECL reserves decreased by $131 million to $115 million, driven primarily by realized losses in the quarter. There were no additions to the watch list and the risk ratings remain stable on the remaining loans in the portfolio. The weighted average risk-rating on the portfolio is now 3.1 compared to 3.2 last quarter and over 90% of our portfolio is risk rated 3 or better.

We continue to proactively manage the remaining watch list loans and have begun discussions with the sponsor on the 4-rated life science loan. We'll update everyone as those proceed.

For our Philadelphia assets that became REO in late 2023, this quarter, we succeeded in selling two of the four properties within the portfolio. As we have stated previously, we're comfortable holding the remaining office property and parking garage longer term but are in discussions to sell those two assets as well.

As projected last call, in June, we took title to a Class A office campus in Mountain View, California, and a Class A life science property in Seattle through deeds-in-lieu of foreclosure and wrote-off a mezzanine office loan in Boston that was deemed uncollectible, resulting in a combined realized loss of $136 million. This actual loss amount was less than the approximately $140 million CECL reserve we have previously recorded for these three loans.

With the transfer of the Mountain View and Seattle properties complete, we're beginning to work to position these assets for long-term success using the full breadth of the KKR platform. We will manage our remaining REO portfolio to maximize shareholder value and believe, upon future monetization of those assets, we can reinvest the capital to generate an additional $0.12 per share in distributable earnings per quarter. Details on our REO portfolio, which currently represents approximately $264 million of net equity in the aggregate, or $3.80 per share, are reflected on page 11 of our supplemental.

On the financing side, over 75% of the portfolio continues to be fully non-mark-to-market. Our two

outstanding CRE CLOs continue to perform well with no loan delinquencies, providing KREF with attractive leverage and accretive cost of capital.

Repayments are tracking above $1 billion for the full year. In addition to the $384 million received during the quarter, we have received an incremental $188 million of pay downs in July, bringing year-to-date repayments to over $900 million. With reduced future funding obligations, KREF was able to repay $242 million in financing during the quarter, reducing the debt-to-equity ratio and total leverage ratio to 1.9x and 3.9x, respectively, in the second quarter. Repayments are projected to outpace future funding obligations throughout the remainder of 2024.

In summary, KREF has a substantial liquidity position that increased this quarter to over $644 million. We had no negative credit migrations this quarter and our book value per share increased by $0.06 to $15.24. Given the progress we have made on the portfolio and the constructive lending backdrop we are seeing within real estate credit, we feel confident that KREF is well-positioned going into the back half of the year.

Thank you for joining us today. Now, we're happy to take your questions.

**QUESTION AND ANSWER**

**Operator**
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

The first question is from Stephen Laws with Raymond James.

**Stephen Laws**

Congratulations on a nice print and it looks like you got a lot done in the second quarter. I think, first, I'd like to start with the new investments and kind of outlook for leverage. Matt, I think you commented about shifting to offense having that discussion. Patrick, you followed up, talking about repays outpacing new originations. Should we look at leverage kind of troughing at year-end and then growing next year? How do we think about portfolio size in the coming quarters? As you think about moving to offense, do you see it being more the more competitive type assets that have a pretty strong bid just given their CLO type eligible collateral or are you looking at more opportunistic stuff, construction loans or maybe heavier lift stuff off that in the financing for that have higher returns?

**Matt Salem**
Thanks, Stephen, for the question. It’s Matt, I can take that. I think from a leverage perspective, we're going to maintain our target leverage range, which has been the same really over the last handful of years, which is that high 3x leverage. So, I don't think we're going to look to increase the kind of overall leverage of the portfolio, but as we start to get additional repayments in obviously, we'll have equity there, we can redeploy.

In terms of what we're looking at, we're going to stick to, I think, similar things that we've done in the past. So favorite property types, predominantly multifamily, industrial, student. We're seeing a lot of activity in the data center space right now, as well. There's an opportunity for us to increase our footprint as well over the last couple of years. We've stood up a team in London that focuses on Western Europe that's fully integrated with our real estate equity team in Europe. So certainly a geographic expansion is on the

table as well.

As it relates to construction, I do think there's an opportunity there. When you think about the bank retrenchment, it's really across the board, but it's most acute in construction lending, which tends to be a little bit less capital efficient for the banks. As they become more and more kind of capital focused, they've pulled back from that part of the market even more dramatically. So, it's an area that we'll continue to look at.

We're going to have to balance that a little bit. Obviously, that comes with a lot of future funding and you don't get dollars in the ground immediately, but I think some percent of our portfolio certainly could be allocated to that opportunity.

**Stephen Laws**
Patrick, a quick one. When you look at the CECL reserve, kind of what percentage of that do you allocate or roughly across the five watch list loans versus the other parts of the portfolio?

**Patrick Mattson**
Yes, Stephen, thanks for the question. We think about it, as you might expect, that the watch list loans tend to make up the majority of the CECL. That's been true over the last several quarters and continues to be true today.

**Stephen Laws**
Then lastly if I can sneak one more in. When you look at the five watch list loans four REO assets, which of those do you think may have resolutions in the second half of this year and which of them— I assume then the remainder would be longer-term resolution pass?

**Matt Salem**
Yes, if you look at the existing watch list loans, I think the one that comes to mind first is our 4-rated life science loan. So as Patrick mentioned, we're entering discussions with the sponsor on that. So, my guess is that we'll get some conclusion over the next quarter or two. It's always hard to time these. You never know exactly how long it's going to take.

Then, of course, on our Independence— on our Philadelphia office asset, again, we expect to likely sell those remaining— two of those properties by year-end and unclear on the timing for the remaining watch list loans at this point in time. Some of those certainly could continue to go into 2025.

But if you recall what we discussed on the last quarterly call, I really break it down by property type a little bit and the vast majority of the remaining loans are in the multifamily category. Again, while there could be noise there, there can certainly be loans transitioning to 4 or from 4 to 5. The real question is, is there a material loss content in that sector? From what we're seeing, there continues to be a lot of liquidity in multifamily. The performance is pretty solid and so we're not anticipating any real material losses in the multifamily property type at this point in time.

**Operator**
The next question is from Rick Shane with JPMorgan.

**Rick Shane**
I clearly need to queue in before Steve Laws because it's along the same vein, but look, as you shift to offense a little— I would describe shift as opposed to really move aggressively that way at this point, I'm guessing. I'm curious, when you look at your geographic exposure— concentration in California, concentration in Texas, lesser extent, Florida, I'm curious if, with the way we see some costs associated

with property ownership evolving in some of those regions, if you would expect to continue to keep the same distribution on the geographic side as well as on the property type side.

**Matt Salem**
Yes. Thank you for the question. I do think there's been a little bit of shift in terms of how we think about the geographic distribution of the portfolio and how we would invest going forward. I think the two things that I would highlight, one of which you mentioned, is just costs, especially around insurance. So, states like Florida, we have seen a pretty material increase in insurance cost there. So that's making us certainly evaluate that market a little bit more carefully.

The second thing we're watching is supply. There's a number of these sunbelt markets that have a lot of supply coming in. We've seen the highest levels of demand for multifamily that really we've ever seen. So, a lot of that is being met with strong demand, but there's certainly some cities that we’re a little bit more cautious on today.

But at the same time, I just want to reiterate that we are an institutional lender. We are a large loan lender. We do focus on the major markets. So, we're really a top 30 lender within that— or top 30 market lender. Within that, we'll have some preferences, but it will continue to be our focus is lending in the most populous areas where there's the most liquidity and transparency.

**Rick Shane**
You brought up something interesting, which had sort of resonated with me during your original comments. You talked about the fact that you continue to be constructive on multifamily and that you think the supply demand is sort of reaching a new equilibrium. That's my word, not yours. I apologize. But you also just alluded to the fact demand seems strong. Supply is still coming online. When do you expect the supply to sort of crest given the slowdown in new construction so we can really start to see those trends sort of shift very favorably.

**Matt Salem**
Yeah, I would say it's market-dependent. I think what some people are missing, it's not only market-dependent but it's very sub-market-dependent as well. I think it's hard to look at a market like Phoenix, where you do have a lot of new supply coming in but it can be very concentrated in certain sub-markets. But the high-level answer to your question is over the next six to nine months, most of that will get delivered into the market and there's a number of ways to look at new starts, but by most measures, we're at extremely low historical start levels.

So, it will take time to digest past that six- to nine-month period as supply continues to come in, but even our equity investors in the market— and we're seeing that across our client base. We see that in our own business on the real estate equity investing side. People are looking through the current levels of supply in most markets and thinking about what the supply demand looks like 24, 30 months out from now and recognizing that the market will tighten up, the market will absorb and it should be a very good intermediate investing opportunity.

**Operator**
The next question is from Don Fandetti with Wells Fargo.

**Don Fandetti**
If the Fed does begin cutting, can you sort of paint a picture of how you think this will play out in terms of series spreads, capital coming in, borrower willingness to hang on to properties that are marginal or on the edge? Do you expect an impact there?

**Matt Salem**
I can start and maybe Patrick jump in with anything I miss here. As much as it's been telegraphed through Fed statements, different inflation prints or economic prints, I do think there's a sentiment change when they actually start to cut. My belief is it will lead to higher transaction volumes. We're just going to get—people are going to get their sea legs a little bit more as sentiment improves. Cost of capital will clearly start coming down a little bit.

In my mind, the opportunity set really is going to be driven by how much transaction volume there is in the market. So, when I think about a Fed environment where we're cutting— and we're cutting just because inflation is under control and not more GDP issues or employment issues, I think that as those transaction volumes increase, it will not impact spreads dramatically. I think spreads will be largely unchanged. I could even imagine a world where those spreads widen because we have not felt the full absence of the banks yet.

If you think of transaction volumes being down 60% plus, banks being 40% of the lending market, as you start to get into a more normal transaction environment, you are going to feel the absence of the banks. No one knows what that exactly looks like, but you can certainly imagine a scenario where spreads widen because there's just not enough capital to meet the opportunity set.

Even if they don't widen, I'm a very firm believer that there's going to be a lot of relative value in real estate credit, just given the presence of the banks and how large they are in our space. So there should be a pretty good investing market over the next couple of years as we get back to a little bit of normal levels. So that's a little bit how we're thinking about the market opportunity here.

**Don Fandetti**
Then I guess, the provision was the lowest in the last few years. How are you feeling about the migration of 3s to 4? I guess, at this point, you're feeling comfortable that you're where you need to be and that that's a lower probability?

**Matt Salem**
As I said in the initial comments, we're not out of the woods yet. It's hard to kind of predict what happens over the next handful of quarters. A lot will be driven by what's the economic environment that we're living in, but it does feel like the bulk of the issues have been identified. They've been reserved for. They've now, in many cases, come through to REO or been liquidated. So, I don't want to say there's nothing ahead of us, but I think we've come through a vast majority of it. I think we'll still have here and there issues around—I'm sure there will be multifamily here and there that pops up in and out, but our expectation there again is that it's relatively contained from a loss perspective. So those are things that don't particularly concern us. Obviously, we'll be focused on it and we'll have to react to it. But from just a pure loss content, it does not feel like there's any big challenges there.

**Operator**
The next question is from Jade Rahmani with KBW.

**Jade Rahmani**
In the comment about DE ex losses will exceed the dividend, are you expecting upcoming losses as you proceed through the watch list loans?

**Matt Salem**
Well, we could have some, Jade. I mean, we're obviously still in negotiations on a number of these. So, yes, I don't think— we have to see what kind of happens with these individual negotiations and how we get to the end of those.

So, there is a watch list portfolio. Again, I think most of our focus is on the life science asset, but it certainly could result in increased reserves or realized losses on that component of the portfolio.

**Jade Rahmani**
On the REO side, can you talk to any parameters around the amount of capital you expect to contribute to those assets if those assets will be generating losses from an earnings standpoint in terms of just carrying the expenses and specifically on the Seattle life science, what the outlook is for attracting some tenants?

**Patrick Mattson**
I'll take that. So, nothing specific at this moment. We are going through a lot of the business plans, working through what that capital outlay might be over the next several quarters. So, I would anticipate that we'll have further guidance around that in the coming quarters, but nothing specific at the moment.

I think with regard to Seattle, similar to the Mountain View deal, we've got high-quality real estate in a market that is experiencing some leasing challenges at the moment. But we're starting with really good real estate and so we don't have a definitive view on sort of the timing of that lease-up, but we're active in those markets.

Our teams across our asset management are sort of in these markets and sort of coordinating with our broader real estate equity team. We'll obviously look to have further updates in the coming quarters, but nothing specific to report right now.

**Jade Rahmani**
In terms of loan modifications, has the rate slowed down— beyond just the rate of CECL reserves and of watch listed assets, has the rate of modification slowed, as well?

**Patrick Mattson**
Yes, certainly.

**Jade Rahmani**
Then just lastly, I was wondering if you could provide some color, Matt, on the $4-plus billion of KKR credit deals so far. Are these refis of existing deals from other lenders? Are they new acquisitions, opportunistic? How would you characterize the deal flow?

**Matt Salem**
Sure. Happy to, Jade. If you look at our pipeline right now, across our business, as I mentioned, it's $20 billion. Keep in mind, we're lending on behalf of bank, capital insurance, capital and debt fund capital. So, in terms of risk/reward profile, it really does stretch across everything.

If you look at the context of our pipeline, and this translates through to some of the investing activity also, it still is heavily weighted towards refinance, but we have seen the amount of acquisition requests increase steadily over the course of the last, call it, six months. Now, it's running, I think, just under 25% of our overall pipeline is acquisitions. Historically, that would have been around half. I think it bottomed out at like low double-digits last year. So, it just gives you some context of the direction of travel.

The other thing that we're seeing in our pipeline is a little bit more request for floating rate than for fixed. That's steadily been increasing again over the last six to nine months and now that's about half of our pipeline is a floating rate request versus a fixed request.

We're most active in our insurance capital. It's our biggest pool of capital. So, a lot of that activity is in the insurance business. But we've also done a number of more opportunistic deals that obviously KREF would participate in as well.

**Operator**
The next question is from Steve Delaney with Citizens JMP.

**Steve Delaney**
Matt and Patrick, congratulations on the progress you've made in the quarter and also on the positive market reaction, you got some people's attention this morning. I want to take you back— Matt, you made some comments about KKR from the equity side, looking at actually property dollars that you have under management. I think I heard you say that in terms of the potential buyers you're talking to about some of your REO properties that you would characterize it as more opportunistic money and that the core money, you're not really seeing the kind of flow coming in from core real estate equity investors. What has to change there? Is that what we really need to see— cap rates come in and property values improve materially as we move forward?

**Matt Salem**
Yes. Thanks for the question. I think what we've seen in the market broadly is a higher cost of capital, whether that's from the debt side. I would say when the banks are largely on the sidelines, they have the lowest cost of capital. I mean if that's being replaced by lenders like KREF or other alternative lenders, there's clearly a cost associated with that.

On the equity side, as we discussed in the opening remarks, almost all the capital available is value-add or opportunistic drawdown funds and you've seen a lot of the Odyssey funds or some of the Core+ non-traded REITs just really on the sidelines right now.

That being said, it's still in my mind, a little bit of a question of who the sellers are than who the buyers are. Yes, the buyers have a slightly higher cost of capital, but cap rates are not unreasonable in today's market. You have multifamily properties trading at very low 5s. We've seen 4 handles in some cases. So, in my mind versus the treasury complex, those are not unreasonable returns, but there certainly can be a fair amount of compression in the market and increased values, if we start to get some of this core capital back online.

I think that what changes that is sentiment and relative value. Real estate is living in a world with a lot of negative sentiment, and largely due to the rate environment. Clearly, office is creating losses in portfolios and issues in portfolios that are making people pull back from the market. That heals with time and relative value. You look at where some of these other markets are trading, you look at what's going on in the corporate credit world. I think real estate equity and real estate debt are going to start looking very attractive versus some of the alternatives, and money and capital is very efficient. It will find its way to opportunities, but it's going to take a little bit of time to get through some of the negative sentiment out there right now.

**Steve Delaney**
That's helpful. You also mentioned that banks have really pulled back. I assume you're referring to like transitional real estate lending broadly, but certainly on transitional as they were 40% of the market. Is it possible as we come out of this thing— let me ask you— well, first I'll say it's possible then I can ask you whether you think you can get there.

If that's the environment and we've got a broadly improving real estate equity market, the banks are not going to play for regulatory reasons or whatever. Is it possible that on your bridge loans going forward

that your levered ROE on your loan pricing, the terms of your bank financing, do you think your ROE will it be as good as it was before on your bridge portfolio or is it possible it could improve somewhat? That's my final question. Thank you very much.

**Matt Salem**
Thank you. I would say right now, again, in a lower volume environment, we're seeing returns slightly higher than what we've done historically in the portfolio by a magnitude. Hard to do the apples-to-apples comparison because the basis we're lending at is so low today.

When I think about the first part of the opportunity set, it's all about credit and you're lending— most real estate is trading or valued around replacement cost, in many cases, below replacement cost. Then if we're lending at 65% of that, we're talking about basis at 50% to 55% of replacement cost. This should be a very safe vintage of loans. So, my first is just safety.

In terms of yield and incremental return, what we're seeing in the market today is, call it, 100 to 200 basis points better than we were doing on an ROE basis, call it, in 2021. So, I do think it's a lot of relative value in the market. As the market stabilizes, I think there will be ample opportunity to replicate that kind of return in the market despite getting into a market that has rate cuts and a lower base rate environment.

**Operator**
The next question is from Tom Catherwood with BTIG.

**Tom Catherwood**
Matt, maybe taking the flip side to your response to Don's question from before, if we don't get rate cuts, what else could break the dam on transactions and bring sellers to the table? And do you need this pickup in transaction activity before KREF looks to go on offense?

**Matt Salem**
That's a good question. Working backwards, we don't need a pickup in transaction activity. There's enough going on right now that there's ample opportunities for us to lend at what we think are really attractive levels. As I mentioned, our pipeline is up 40% from last year. So, we're seeing that across everything we do.

If we got into a market that does not have rate cuts sustained inflation and a continued healthy economy, I think we're going to kind of limp along like we— the real estate brokers broadly are going to limp along like they are now. People are going to continue to try to delay sales, push out time lines to try to get to that moment in time where the cost of capital has decreased a little bit.

It does put more pressure, I would say, on like multifamily property types, for instance, where they were just low cap rates and even though you have good cash flow there and they're slowly increasing a higher rate environment, just causing more pressure there. So, you could create a little bit more noise in that component of the portfolio, but again, we've seen a lot of liquidity there. There's a lot of buyers looking to access that market. So, I don't think it would change my view materially on, call it, loss content, but you could certainly see more transition to watch those loans in that environment.

**Tom Catherwood**
Then maybe last for me. On the Philadelphia office sale and origination, what is the sponsor's new plan for the assets and what is the expected timing of funding the remaining $53 million or so that's committed under the new loan?

**Patrick Mattson**

Good morning, Tom. It is Patrick. Welcome to the call. I appreciate the question. So on Philadelphia, the $30 million that's reflected is our initial funding. As you said, we've got future funding here. The sponsor is going to take this asset. It's going to be a mixed-use development. So presently it's 100% office and in the future it will be sort of a mix of a couple of different property types. So, office will not be a majority of the use going forward.

In terms of timing, because it's a redevelopment, we expect that funding to happen over the course of about 24 months is what we're projecting. Then just one thing that I would note, because it wasn't maybe clear from our initial funding and the proceeds that we received back on this asset, this loan is struck at 70% loan to cost.

**Tom Catherwood**
Got it. Really, really helpful. That's it for me. Thanks everyone.

**Operator**
Again, if you have a question, please press star then one.

The next question is a follow-up from Jade Rahmani with KBW.

**Jade Rahmani**
Just two quick ones. One, if the banks are pulling back, do you think that's just a short-term opportunity over 12 months to 18 months or do you see that as permanent? Because that would clearly have implications for takeout financing of transitional loans. Then number two, just any thoughts on M&A, if you see that as the best opportunity for KREF to be able to grow its scale and size?

**Matt Salem**
Yeah, I guess a little bit deeper dive on the banking dynamic. If we're talking about a $4.5 trillion market size and banks are 40% of that, we don't think they're going to zero. They're a fraction of that 40% today, but we do think they're going to come back online more than they are right now. As you well know better than I do, I think there's 4,000 banks in the United States, to take a broad brush and say they're all out, I think is too extreme. But I think you could see that 40% come down to 30% and you could see $0.5 trillion of commercial mortgages come out of the banking system into alternative lenders like KREF. I think that's very plausible.

At the same time, keep in mind, in the opening comments we made, they're shifting what they do. They are moving from more of a direct origination model, again, not 100%, but on the margin, from a direct origination model to lending to folks like us on loan-on-loan facilities. It's more capital efficient to do that and they're becoming much more capital focused. It's safer. Their loss content in those books over the last few years has been de minimis versus we all know the CECL reserves that they're taking and losses that they're taking on the balance sheet. And it's more efficient to manage and survey on an ongoing basis. So, there's a lot of really good reasons why they're going to shift that profile.

So, I don't think it's going to create distress in the market. I do think the cost of capital will increase a little bit more, like we mentioned. These alternative fund complexes, whether that's KREF or debt funds, have to get a lot bigger to be able to take on that additional capacity that's coming out of the banks.

On the M&A side, I think it's the same answer we always give. I think there will be consolidation through this period of time and it's certainly something that we'll look at. There's a number of benefits to being larger from a liquidity perspective, access different capital sources. So, it's certainly something that we'll continue to evaluate as the market evolves.

**Jade Rahmani**
Thank you very much.

**CONCLUSION**

**Operator**
This concludes our question and answer session. I would like to turn the conference back over to Jack Switala for any closing remarks.

**Jack Switala**
Thanks, Operator, and thanks, everyone, for joining today. Please reach out to me or the team here if you have any questions. Take care.

**Operator**
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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