KKR Real Estate Financial Trust

3rd Quarter Financial Results

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CORPORATE PARTICIPANTS

Chris Lee - *co-Chief Executive Officer*

Matt Salem - *co-Chief Executive Officer*

Patrick Mattson - *Chief Operations Officer*

William Miller - *Chief Financial Officer*

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Jade Rahmani – *Keefe, Bruyette, & Woods, Inc., Research Division*

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PRESENTATION

Operator
Good day everyone and welcome to the KKR Real Estate Finance Trust, Inc Third Quarter 2017 Financial Results conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your telephone keypad. To withdraw your question, please press "*" then "2." Please note today's event is being recorded.

I would now like to turn the conference over to Sasha Hamilton. Please go ahead.

Sasha Hamilton
Thank you. Welcome to the KKR Real Estate Finance Trust earnings call for the third quarter, 2017. I'm joined today by Chris Lee and Matt Salem, our co-CEOs, Patrick Mattson, our COO and Will Miller, our CFO.

Before we begin, I would like to remind everyone that our remarks and responses to your questions today may contain forward-looking statements that are based on current expectations of management and involve inherent risks and uncertainties that could cause actual results to differ materially from those indicated, including those identified in the risk factor section of our prospectus dated May 4, 2017 filed with the SEC on May 8, 2017. Such factors may be updated from time to time in our filings with the SEC, which are available on our website at kkrreit.com.

We assume no obligation to update any forward-looking statements except as required by law. In today's remarks, we will refer to certain non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most comparable measures calculated and presented in accordance with GAAP are available in our earnings release and in the supplementary information, both of which are available on the investor relations portion of our website.

With that, I would now like to turn the call over to Chris Lee.

Chris Lee
Thank you, Sasha. Good morning and thank you for joining us for our third-quarter earnings call. We continued to demonstrate the strength of our franchise this quarter. We originated $629 million of loans and we have a robust pipeline with another $484 million of loans closed or under exclusivity since the end of the quarter.

We expect the loans under exclusivity to close by year end, but they are subject to customary closing conditions and there is no guarantee that these loans will close on time or at all. We've continued to execute on our investment strategy of originating floating rate senior transitional loans with a focus on institutional quality real estate in major markets owned by high-quality sponsors.

Despite increased competition, we believe that the market environment for this opportunity set has remained favorable. In general, capital flows to real estate remain steady and real estate fundamentals have remained healthy across most asset classes and markets. We believe the economic backdrop is supportive of stable real estate prices and demand. These factors have resulted in increased competition for light transitional lending opportunities, which in turn has led to continued spread compression.

Despite a competitive environment, we have been able to find good opportunities to invest capital consistent with the same risk return parameters we have had over the last several quarters. Importantly, we have relied heavily on our extensive relationships with borrowers, sponsors and intermediaries to differentiate ourselves in the marketplace and these relationships have played a key role in the six loans that we have already closed during the second half of 2017.

We have also sought out opportunities where we can differentiate ourselves through noneconomic variables, like speed, certainty and the ability to deal with complexity. As the year has progressed, our brand awareness and market presence has improved, which has led to increased market penetration. These competitive advantages have translated into differentiated deal flow and improved ability to secure transactions.

Turning to our portfolio, as of September 30, the currently-funded portfolio totaled $1.8 billion, with another $287 million of future funding obligations. A hundred percent of our loans are performing and our securities portfolio is performing as expected. The portfolio is 90% invested in senior loans and is diversified both geographically and across property types. The three largest exposures by property type are 38% office, 23% multifamily and 15% retail.

Overall, we are pleased with our origination activity, our market positioning, our portfolio and our pipeline. We believe the economic climate remains favorable for our business model and we look forward to continuing to create value for our shareholders. With that, I'll turn the call over to Matt.

Matt Salem
Thank you, Chris, and good morning everyone. Let me walk you through our recent capital deployment. In the third quarter, we originated five floating-rate senior loans totaling $629 million. These loans are collateralized by two Class A multifamily properties, one located in Honolulu and one located in CBD Denver, an office property in Atlanta, an industrial property in Queens, New York, and a luxury condo inventory loan in Manhattan.

The weighted average LTV and coupon for these loans are 69% and LIBOR +4.1% respectively. On a levered basis, the five loans have a weighted average underwritten IRR of 11.7% at spot LIBOR, which is consistent with our existing portfolio. Two of these loans were to repeat borrowers, and we have direct relationships with all five property owners.

As Chris mentioned, our relationships increased our competitiveness in the market and we are highly focused on growing our existing relationships and creating new ones. Our strong origination pace has continued into the fourth quarter. We have already closed a $150 million senior loan secured by a Class A multifamily property in New Jersey. This loan has an LTV of 57% and a coupon of LIBOR +4.25% with an underwritten IRR of 12.9%.

We are also in the process of closing three more loans totaling approximately $334 million. All three loans are secured by office properties and are located in dense infill locations. We saw some repayment activity this quarter, totaling $47 million. This included a $14 million paydown of our condo loan that we discussed on the last call. As a reminder, the loan is collateralized by the remaining inventory of a newly-constructed luxury New York condo and we'll periodically pay down and de-lever as units are sold.

The additional repayments include a preferred equity redemption and a mezzanine loan repayment. Our portfolio is still relatively young, with only nine months weighted average seasoning. So while we will see periodic repayments in the near term, we expect to see more consistent repayments beginning in 2019.

In summary, we've made good progress growing our portfolio since the start of the year, with approximately $1.6 billion of loans closed or pending closing as of today. We are in line with our target pace of originations and are pleased with the quality and performance of our portfolio. Now, I'll turn the call over to Patrick.

Patrick Mattson
Thank you, Matt, and good morning everyone. For the third quarter 2017, our GAAP net income was $17.3 million or $0.32 per share. Net core earnings, which is core earnings less incentive fees, were $16.5 million or $0.31 per share. Book value per share was $19.78. Our portfolio, which totaled $1.8 billion at the end of the quarter has a weighted average risk rating of 3.0 on a five-point scale and has 100% credit performance. As of September 30, 92% of the portfolio was invested in LIBOR-based, floating-rate loans, which positions us well to benefit from increases in short-term interest rates.

Looking at the right-hand side of the balance sheet, we continue to enhance our liquidity. Post-quarter-end, we successfully upsized our Goldman Sachs credit facility from $250 million to $400 million and extended the term maturity date to October 2020. As we grow the portfolio, we will continue to focus on scaling and diversifying our financing channels to further optimize our overall financing strategy.

Looking at total leverage, we closed the quarter at 0.7X and we continue to releverage the portfolio as we fund new originations. We generally target a 3X leverage ratio on new senior loans. So as we ramp the portfolio, we expect the total leverage ratio to increase but remain at a prudent level.

One other note on the balance sheet. Post-IPO, the board authorized the share repurchase of $100 million of common stock over a 12-month period, commencing in June, 2017. Fifty million of the total is available to repurchase stock when the market price trades below book value per share, and the remaining $50 million is subject to board approval.

In the third quarter, we repurchased approximately 26,000 shares at an average price of $19.80 per share, leaving $49.5 million in place for future stock repurchases below book value.

Finally, I want to discuss our dividend. For the third quarter, we declared a dividend of $19.9 million or $0.37 per share, which was paid on October 12. Based on yesterday's closing price, this represents a 7.3% annualized dividend yield.

It should be noted that our dividend policy takes into account our taxable earnings on an annual basis and there may be some differences between taxable income and net core earnings in the short term. This quarter, our $0.37 dividend is approximately $0.06 above our net core earnings due to increased taxable income.

Two main components are contributing to this. The first is a one-time event related to the redemption of our preferred equity investment. This resulted in approximately a $0.03 per share difference as the accrued interest, which had been accounted for on a GAAP basis, was recognized for tax during the quarter. The second component is related to the accretion of OID on our CMBS B-piece investments, representing approximately $0.02 per share. This is disclosed on page three of our earnings release.

In short, these two items do not flow through to net core earnings, but are included in our taxable income. We would expect that over time our taxable income per quarter to more closely correlate to our net core earnings. Our board is scheduled to meet in mid-December to discuss the Q4 dividend, and we will make an announcement shortly thereafter.

In summary, we had another strong quarter. Our origination pace was robust, our portfolio is performing and we continue to enhance our liquidity profile. We remain confident in our ability to execute in the market and ramp our portfolio. Thank you again for joining us today, and now we are happy to take your questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" 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 "*" then "2." And at this time, we will pause for a moment to assemble our roster.

And the next questioner today will be Jade Rhamani with KBW. Please go ahead.

Ryan Tomasello
Good morning, this is actually Ryan Tomasello. I'm on for Jade. Thanks for taking the questions. I was just hoping to start off with some commentary on the competitive environment. You mentioned the greatest pressure points being on price, so perhaps you could quantify the amount of spread impression you've seen perhaps on a year-to-date basis or year-over-year, and secondly are you seeing any other lenders compromise on fees, leverage or structure?

Matt Salem
Hi, Ryan, it's Matt. Thanks for joining the call today. I'll take that one. You know, as you mentioned I think most of the competition we've seen has manifested itself in price. In previous calls, we had noted that we saw market tightening of roughly 50 to 75 basis points over the course of the year.

I would note that was largely at the first half of the year. We haven't seen that same type of tightening, certainly, over the last quarter. We have not seen competition play out through structure or increased leverage, so I think we'd still characterize the market as disciplined. Part of that is also driven by the type of sponsors that we're lending to, and they are not asking for higher proceeds, but overall I would say that the market has stabilized somewhat on the pricing side and continues to remain disciplined in terms of structure and leverage.

Ryan Tomasello
As a follow-up, what do you think is driving the increased competition in the first half that drove the spread compression and maybe how has the competition trended into 4Q so far?

Matt Salem

I think it was really a factor of two things. Number one, I would say was the overall health of the macro market and the rally in other sectors postelection, and number two, the relative values specifically within the real estate credit sector has led to increased capital deployment in that sector. So I think it was largely a function of that.

I think the pipeline has picked up enough over the course of the last quarter or so that it helps offset some of that initial spread tightening for the first half of the year.

Ryan Tomasello
And then can you remind us of target corporate leverage and over what time frame you expect to get there after deploying the IPO proceeds and potentially could you provide a range of what you're targeting for a stabilized ROE or dividend once you deploy IPO proceeds?

Patrick Mattson
Hey, Ryan, it's Patrick. I'll start here. So in terms of the leverage, on each individual senior loan, we're targeting about a three times leverage ratio. As you see, total leverage right now is at 0.7x, and as you noted, that's a result of the IPO proceeds that we had in the second quarter and we continue to kind of releverage the portfolio toward that optimal leverage.

I think we're still on target where we're aiming for deployment, full deployment of the IPO proceeds toward the end of the first quarter, and so at that time I would expect to see us at a more optimal leverage. Remember that some of the financing that we do is in the form of structural leverage where we're selling an A note. And so when we think about our total debt to equity ratio, we still think we're going to be in the high 1 to 2X ratio.

Ryan Tomasello
Great, thanks for that color. And then on the repayments of the quarter aside from the condo loan, were those prepayments rather than scheduled maturities, and do you see any risk of a potential uptick in prepayments given the strong liquidity in the market today?

Chris Lee
Hey, Ryan, it's Chris. With respect to the condo loan, those were condos that were under contract, so we expected to receive those payments, and the way that loan works is as condos are sold, we will deleverage on basically a dollar for dollar basis. You should expect to see that as condos are sold.

I think on repayments more generally, the weighted average seasoning of our portfolio is around nine months right now, so we will expect to see some repayments throughout 2018, but we're not on a normal repayment schedule yet just given the young nature of the portfolio. We expect to see a more normalized repayment pace starting in something like 2019.

Ryan Tomasello
And outside of the condo loan repayments, I believe that you mentioned it was a preferred equity investment and a mezzanine loan. Were those expected? And given the liquidity in the market, do you expect…is there any risk of the prepayments coming in higher than you anticipate?

Chris Lee
So on the loan that was repaid, that was a 2015 vintage loan, so it was well within its kind of maturation phase. It was actually a development loan, so the underlying collateral had already leased up. It was mature, so it was taken out with a stabilized loan in the market, so it was

expected. Could it have come a quarter later? Maybe, but in terms of the maturation of that underlying collateral, it was within kind of a normal repayment window.

To answer your other question, yes the capital markets are quite healthy, but most of our lending is to sponsors that are executing a business plan, and most of those business plans, especially in a portfolio that has a weighted average tenure of nine months, most of those sponsors are still within that business plan. All of our loans have some form of call protection, so the health and the capital markets probably would not impact our portfolio in the near term from a portfolio prepayment perspective.

Ryan Tomasello
Great, thanks. And then just lastly, can you comment on the B-piece buying in the quarter within the KKR JV and the outlook for further capital deployment there?

Matt Salem
Right. So as you recall KREF is investing side-by-side with a larger existing fund that targets the risk retention CMBS B-pieces, and so KREF has a $40 million commitment that we expect to invest really over the next year and a half or so. And so the activity that you see this quarter just reflects that partial commitment alongside the larger fund for its investing activity.

I'd say just overall outside of KREF, KKR in that particular fund has been very active in that sector. We are one of the largest buyers of the risk retention CMBS B-pieces in the market, and so it's a part of the market that we still find very attractive.

Ryan Tomasello
Great, thanks for taking the questions.

Matt Salem
Sure.

Chris Lee
Thanks, Ryan.

Operator
And as a reminder, it is "*" then "1" if you would like to ask a question. And our next questioner today will be Melissa Wedel with JP Morgan. Please go ahead.

Melissa Wedel
Hey, guys, thanks for taking our questions. This is Melissa for Rick Shane. I was hoping to touch on the industrial property that you guys originated during the quarter. I'm wondering why the rate on that was a bit lower than the remainder of the originations. Is that a function of the property type or one of the value or something else?

Chris Lee
Yeah, this is Chris. The rate there was, like you said, a little bit lower, but I think it is a function of the underlying fundamentals in the market. If you think about the industrial market here in the broader five boroughs, it has very little vacancy. There's very…almost basically a negative supply in the market, so there is actually a lot of demand for industrial property on the fundamental side, so that type of loan tends to price inside of where an office lease-up play might price, etc.

So we think it was very attractive relative to the risk profile, the underlying asset and also relative to the underlying fundamentals of the business plan that our sponsor is executing there. We like that loan a lot. We'd like to make more in the industrial sector if we could.

Melissa Wedel
Okay, got it. And then on the upsized credit facility, I'm wondering is there a usage fee that you pay on the amount that's not used on that line?

Patrick Mattson
Hey, Melissa, it's Patrick. No, there is no unused fee on that facility, and for that matter on our term repo facilities in general.

Melissa Wedel
Okay, great. Thanks for taking my question.

Patrick Mattson
Sure.

Operator
And once again, if you would like to ask a question, please press "*" then "1" on your touchtone phone. And there looks to be no more questions, so this will conclude the question and answer session. I would like to turn the conference back over to Sasha Hamilton for any closing remarks.

CONCLUSION

Sasha Hamilton
Thank you, Will, and thank you everyone for joining the call. If you have any follow-up questions, please feel free to call me directly. Thank you.

Operator
And the conference has now concluded. Thank you all for attending today’s presentation. You may now disconnect your lines.