KKR Real Estate Finance Trust, Inc.

Q2 2022 Earnings

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CORPORATE PARTICIPANTS

Jack Switala – *Investor Relations*

Matt Salem – *Chief Executive Officer*

Patrick Mattson – *President and Chief Operating Officer*

Kendra Decious – *Chief Financial Officer*

PRESENTATION

Operator
Good morning and welcome to the KKR Real Estate Finance Trust Inc. Second Quarter 2022 Financial Results Conference Call. All participants will be in a 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. Welcome to the KKR Real Estate Finance Trust earnings call for the second quarter of 2022. 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 would 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 2022, we reported GAAP net income of $19.4 million or $0.28 per diluted share. Distributable earnings this quarter were $33.1 million or $0.48 per share, covering our $0.43 per share Q2 dividend by over 1.1 times on a per share basis.

Book value per share as of June 30, 2022 was $19.36, a decline of less than 1% quarter-over-quarter, which includes the cumulative CECL impact of $0.49 per share. Increases in our CECL reserve's impact to book value this quarter were partially offset by the one million shares we repurchased, which generated $0.03 in book value accretion.

Finally, in early June, we paid a cash dividend of $0.43 per common share with respect to the second quarter. Based on yesterday's closing price, the dividend reflects an annualized yield of 9.2%.

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

Matt Salem
Thanks, Jack. Good morning, everyone. Thank you for joining us today. KREF is in a strong position to navigate this economic environment of higher inflation and quantitative tightening. Our portfolio is comprised of primarily first mortgage loans, secured by Class A real estate owned by institutional sponsors and located in growth markets.

The favorable lending market we discussed in our first quarter call continued into this quarter and we are seeing real estate equity values begin to decline from this higher cost of capital and lower market leverage.

Our strong second quarter loan originations of over $1 billion demonstrated our conservative investment selection, with 100% of our activity in multifamily or industrial property types and a low weighted average

loan to value of 63%. Multifamily and industrial loans now represent nearly 60% of the portfolio as of the second quarter.

While we believe this is an attractive market opportunity, as is our DNA, we are currently operating the company at higher levels of liquidity and lower leverage. Since January, we have been front-footed and intentional around increasing our equity capital, liquidity and non-mark-to-market financing facilities. Notably, we have raised over $187 million of common equity, $150 million of preferred equity at an attractive fixed-for-life coupon of 6.5% and increased our revolver by $275 million while extending its term to a new five years.

One of the challenges in this market is securing senior financing. Our ability to leverage the broader KKR relationships and Capital Markets team has enabled us to add approximately $1.5 billion of non-mark-to-market financing capacity, including $450 million this quarter. We have many avenues for financing and have historically accessed the CRE CLO market on an opportunistic basis. This diversified approach to financing our portfolio is a strong differentiator in the current market environment.

This quarter we had the opportunity to provide a $500 million loan on a crossed portfolio of high-quality, well-leased industrial properties with 97% occupancy located primarily in strong California markets with institutional sponsorship. The properties have embedded mark-to-market upside across existing leases as they expire. In a more stable market, the loan would have likely been securitized in a single asset, single borrower CMBS transaction. But that market is not fully functioning. Our focus on larger loans to institutional sponsors left us well-positioned to step in opportunistically. KREF, using its first-in-the-waterfall position, invested 50% for approximately $250 million. Our ability to split loans allows us to originate large loans to high-quality sponsors with favorable competitive dynamics and allows us to finance these loans more attractively, all while creating diversification benefits within our portfolio.

In the second quarter, we received $444 million in loan repayments. Given Q2's strong origination volumes and modest repayments, we grew the funded portfolio by $633 million. In the near term, we intend to continue to operate at a lower leverage with enhanced liquidity, so we anticipate matching new originations with repayments.

Finally, I'm also pleased to state that KREF's distributable earnings are now directly correlated to and poised to further benefit from short-term interest rate increases. A 150 basis point increase in short-term rates since June 30th would represent $0.30 a share increase in distributable earnings on today's portfolio on an annualized basis. As a reminder, base rates have already increased by approximately 50 basis points.

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

Patrick Mattson
Thank you, Matt. Good morning, everyone. I'll focus today on our efforts on the capital and liquidity front and provide a brief update around our watch list.

This quarter, with the help of our partners in KKR Capital Markets, we continued to successfully increase our non-mark-to-market financing capacity, which sits at 77% of our outstanding secured financing as of quarter end. Specifically, we entered into a new $350 million term lending agreement and a new $100 million asset-specific financing facility. Both of these facilities provide match-term asset-based financing on a non-mark-to-market basis and allow us to match our recent equity growth with new liabilities. Equally important, these facilities also give us access to attractively-priced financing at a time when spreads in the CRE CLO market have increased significantly with corresponding impacts being felt in the broader repo financing markets. In addition, our two existing CLOs with over 12 and 18 months of remaining

recycling period, respectively, provide us with a fixed cost of funds to continue to pursue high-quality assets as we receive repayments in each of these previously-issued managed transactions. This quarter $123 million of our repayments were in the CLOs.

In terms of equity capital, this was an active quarter. In early June, we completed our largest follow-on equity offering to date. Seven million shares were offered consisting of 2.75 million primary shares and 4.25 million secondary shares from our manager, KKR. We expect the offering allowed KKR to reach its anticipated long-term hold position of ten million shares, or approximately 14% of KREF shares outstanding today. We believe this is the highest ownership percentage held by a manager in the mortgage REIT sector and demonstrates continued, meaningful alignment between KKR and KREF.

In the middle of June, the broader equity markets declined in response to the May CPI print and the corresponding read-through to more significant rate hikes from the Fed. With commercial mortgage REITs impacted and KREF trading below book value, we began open market share repurchases to take advantage of the attractive price. Beginning of June this year and subsequent to quarter end, we repurchased approximately 1.4 million shares at a weighted average price per share of $17.32 for a total of $25.1 million. The share repurchases have been accretive to book value per share by over $0.04, of which approximately $0.03 was recognized in Q2.

I would also highlight that KREF was one of the first in the space to implement share repurchases at the onset of COVID. For example, back in the first quarter of 2020, we repurchased around $19 million in stock. In times where we feel there's been a dislocation and our shares are undervalued, we've been proactive in a meaningful way on the repurchase front and feel that we have been best-in-class on that front.

As Matt mentioned, we were operating at the low end of our target leverage with total leverage ratio of 3.5 times as of quarter end. We expect to keep leverage in the mid-3s in this market environment and we look for opportunities to deploy capital.

Our liquidity position remains very strong and record liquidity exceeding $790 million as of quarter end, which included over $118 million of cash and $610 million in undrawn corporate revolver capacity. In addition, unencumbered senior loan assets grew to $416 million at the end of Q2.

I also want to provide an update on our watch list. The current portfolio has a weighted average risk rating of 3.0 on a five-point scale relative to 2.9 in Q1, driven primarily by the payoff of a large one-rated loan, coupled with our new originations. Today, 96% of our loans are risk rated three or better. Quarter-over-quarter, our watch list exposure has decreased by a net $37 million on a principal basis.

Two Philadelphia office loans remain on the watch list. Both are performing with in-place occupancy and strong sponsors, but these loans remain on the watch list to reflect softer office leasing velocity within the Philadelphia MSA.

Regarding our New York condo inventory loan, three residential units remained at quarter end and subsequent to quarter end one additional unit sold. Recent sales for the units have been made well in excess of our basis, and as such, we have upgraded the outstanding loan to a three rating, removing it from the watch list.

In summary, KREF finished the quarter with a record $7.9 billion total funded portfolio, which has grown by approximately 40% on a year-over-year basis. We originated 11 senior loans in Q2 for over $1 billion and grew the funded portfolio by $633 million. We completed our largest follow-on equity offering to date for approximately $137 million in proceeds to both KREF and our manager KKR, added two non-mark-

to-market financing facilities and upsized our revolving credit facility to a total of $610 million. Lastly, we completed accretive share repurchases in June and July for approximately $25 million.

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

QUESTIONS AND ANSWERS

Operator
Thank you. 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're 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.

And the first question will come from Stephen Laws with Raymond James. Please go ahead.

Stephen Laws
Hi. Good morning. Strong origination quarter, and Matt, I think in your prepared remarks you talked about attractive lending opportunities. Looking at the 2Q originations, it looks like it may be coincidence, but looks like lower LTVs in June than maybe in April. Can you talk about how the market's changed over the last three months to six months, what you're looking for now, whether that's wider spreads, lower attachment points, other covenants? And talk about the competitive landscape and what that enables you to do in this market.

Matt Salem
Sure, Steve. It's Matt. Thank you for joining and thanks for the question. The point I think you're trying to highlight is the market continues to evolve in terms of the opportunity set and the lending environment. Really at the beginning of this year, we were thinking the market could potentially tighten in spread just given the increase in base rates and then obviously we got into geopolitical volatility as well as some of the inflation prints and the subsequent quantitative tightening and Fed hikes.

And so the market has evolved I would say from a leverage point call it at the beginning of the year and I always look to the multifamily segment of the market because it's highly transactional and it's about half of our portfolio so it's a lot of what we do. We were probably in the 70% loan-to-value context maybe high-60s at the beginning of the year. By March, we were certainly getting into the war in the Ukraine into the mid-60s and then that's probably in the very low-60s loan to cost today. So leverage has come down quite significantly in the lending market.

And at the same time you've seen spreads widen out call it 100-ish basis points I would say. Again it's not apples-to-apples because there's different leverage in the market available, but I'd say spreads are 75 to 100 basis points wider. And I think it can easily be characterized as a lenders' market today, so all the terms are better in the market.

So we like the market. It's certainly very attractive. You're probably seeing the most weakness in two segments of the market. One is in the larger loan segment just given the weakness in the capital markets and some of the CMBS execution; the second part of the market that's weak is in the transitional lending segment because of the weakness in the CRE CLO market and the follow-through on that into the repo providers.

So if you think about where we sit, the market's certainly playing to our favor from an opportunity perspective. We focus on large loans and we focus on transitional lending and a lot of our competitors that don't have as much diversified financing as we do are certainly finding it difficult to finance their new

originations because again either the repo market or the CRE CLO market is just not priced attractively. Whereas, I think, we've been able to as Patrick mentioned in his remarks really diversify that financing over the last few years and so we're still able to create some pretty interesting returns on that better lower-leverage, higher-quality credit.

So we're pretty excited about what we're seeing in the market and certainly reflected in our activity in the second quarter. That being said, we're not totally, I guess, immune from or we'll still have a cautious view on the overall market environment. And so that's why when you hear in our remarks things like running at lower leverage and higher liquidity, we're certainly not fully leaning into the opportunity set because we don't know exactly what the future holds as the Fed continues to tighten and raise rates.

So I think from a company positioning perspective we're going to continue to operate at this leverage level until we see a little bit more stability and then of course we can revert back to what historically has been our market leverage in call it the high-3s versus the mid-3s that they're running at today. So certainly like what we're seeing.

And one other difference that I would comment is: the pipeline is still big. It's not like the beginning of the onset of COVID where you had these markets shutdown and there really wasn't a lending opportunity in April or May or June of 2020. Our pipelines are very big right now. There's plenty of lending. There are acquisitions happening. There's a lot of refinance activity. With the capital markets weak, you're seeing a lot come out of that market into the balance sheet lender. So there's lots to do in today's market so I feel confident that we should be able to reinvest as we get repayments. And again to the extent we see a little bit more macro stability, we can certainly grow the portfolio through a more normalized leverage within the company.

Stephen Laws
Thanks, Matt. Helpful comments and your answer covered my follow-up question. I appreciate it.

Matt Salem
Thanks, Stephen.

Operator
And the next question will come from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thank you very much. Looking across the yield curve the 10-year in particular has declined notably of late. How important of a signal is that with respect to the outlook for commercial real estate? Is that a primary driver of the transitional lending market in terms of flow-through impact to loan pricing and securitizations? And so if the 10-year treasury holds in this range, would you expect improvement in spreads in the back half of the year or do you think that there are risk-off reasons driving the 10-year currently?

Matt Salem
Jade, it's Matt. Thanks for the question. I'll preface this statement with I'm not a rates trader, but I do think that real estate equity transaction volumes are certainly coming down. I think that's a function of the uncertainty in the market and the higher cost of capital and the impact on valuations.

And some of that is just trying to understand, what is the final resting place in this rate environment? And I think that the long end of the curve to your point is pretty meaningful in terms of how real estate is valued and how a lot of it is obviously financed. So I do think that having—if the market can understand where we're going to end up on a 10-year, that can cause more transaction activity to happen and a little bit of

a reboot on the equity side and more clarification on values.

That being said to your point I think this most recent rally is probably more around fears of recession and the impact from quantitative tightening so not necessarily a good thing. But it is a good thing if we can get some market stability in interest rates so that real estate transaction volume overall can increase and get a little healthier.

Jade Rahmani
Thank you very much. You mentioned you expect to match origination volumes to repayments. Is there a range or level of volumes and repayments to think about, something similar on the repayment side to the second quarter? Or any other color you could provide there?

Matt Salem
Yes, we look at our repayments every quarter when we go through our quarterly review. So the primary goal is a credit assessment and a risk rating, but one of the outputs of that exercise is repayments. I will caution you that it is always difficult to predict repayments on these loans. You don't know exactly when they're going to go. And given that we have larger loans, whether it repays on one month versus another can throw off some of the quarterly numbers.

If we look out over the course of the year, I think we're predicting repayments in the context of what we received this quarter on a quarterly basis. So I think we're looking at roughly that $400 million to $500 million a quarter of repayments. But again, that can kind of be chunky and a lot of it depends on how this market environment evolves and whether you see a little bit more stability. Clearly that will lead to more repayments as well.

Jade Rahmani
Thanks. I have a few more but I'll get back in the queue. Appreciate it.

Matt Salem
Thanks, Jade.

Operator
The next question will be from Don Fandetti with Wells Fargo. Please go ahead.

Don Fandetti
Hi. It looks like the pretty large provision in the quarter took the allowance up to maybe around 42 basis points. Can you talk about what you're thinking on the provision going forward will that allowance rise? And then secondly, can you provide any updated thoughts on the office market in terms of your appetite there?

Kendra Decious
Sure. Hi, Don, this is Kendra. I'll take your first question on CECL. So as you mentioned, we did take up our CECL reserve to $34 million at the end of the quarter, which is about 46 bps of principal balance. CECL is really inherently difficult to predict. We use a third-party model, historical loss rates that are refreshed each quarter. And again, it is a very quarter end driven process.

So as Matt referenced earlier, we conduct our own internal loan reviews, we get updated historical loss data from third-party database providers, and then it's heavily dependent on the macro assumptions at the time, so including evolving views on recession, unemployment, Fed policy.

I will say that we have consistently used a macro assumption that's on the conservative side, but I don't

really think that we can put a precise number or percentage in terms of where we think it's going to go. If the economic outlook continues to deteriorate, I think by virtue logically it will increase. And if it stabilizes, I think as we've seen in the past several quarters, it would probably stay or plateau at this level.

Don Fandetti
Okay. And the office market?

Matt Salem
Yes. Hi, Don, it's Matt. Thank you again for the question. On the office market, specifically, as we're positioned at KREF, our focus as you can see in our originations this quarter are really on where we're seeing the most growth and the most identifiable growth. And there's a market where like I mentioned it's a lenders' market and you can really focus on the easiest loans to underwrite and properties located in the best market so that's why we've been really focused on industrial and multi-family. I would put life science in that category as well in terms of the demand that we're seeing. So we're really focused on those major growth areas.

In terms of office, I don't think our views have changed from the last quarter. And I think there's generally a consensus. If you have a quality asset, if you have a Class A asset, certainly in our portfolio we're seeing momentum and leasing. And then I'd say there's a little bit broader range of positive activity when you get into the growth markets so certainly in some of the southeast markets you're seeing that carried through beyond just Class A and potentially into some of the Class B space as well. And then when you get into some of the markets that don't have that same growth projections or demographic trends, the Class B segment of the market becomes pretty challenged.

Operator
Thank you. Our next question will be from Eric Hagen with BTIG. Please go ahead.

Eric Hagen
Hi, thanks. Good morning. So, as we look at the LTVs in the portfolio, the credit coverage more generally, is there a debt service coverage ratio that one can think about for the overall portfolio either currently or on a fully-stabilized basis?

And then maybe for the origination of the refi loan on the industrial assets in California over the last quarter, can you talk some more about the use of proceeds in the refi? Like did the sponsor cash out any equity from the capital structure? And to that point maybe you can just talk about the attractiveness of loan growth at the expense of more leverage at the sponsor level. Thanks.

Patrick Mattson
Eric, good morning, it's Patrick. I'll take the first question. Thanks for asking that. So in terms of coverage and LTV, I think, as Matt had indicated, we're definitely seeing leverage come down in the market and specifically on the loans that were quoting. And you can even see a little bit of that, it's hard to read too much into the data set, I guess, when you're talking about a handful of loans each month. But certainly the leverage in June was lower than the leverage on the loans that we closed in April.

In terms of coverage, we're certainly underwriting to an exit-stabilized level. We think about probably debt yield first and foremost, but can translate that into a debt service coverage ratio. Obviously, a lot of the loans as we're initially making them are transitional and are not at a one times coverage and so those loans are structured with upfront reserves and ongoing reserves to mitigate that shortfall.

But when we think about exit, we're certainly thinking about debt yields in this environment that probably are a touch higher than where we are. We certainly want to underwrite to a cushion relative to where we

think the exit cap rates are. And with some uncertainty on the takeout, uncertainty on what that ultimate exit cap rate is, I would say we're erring toward the side of being a bit more conservative and so slightly higher debt yields.

Obviously, when we're thinking about debt yields that are in 6%, 7%-plus context, again not a crystal ball on rates, but given where we expect rates, we feel like coverage is certainly adequate at those takeout levels.

Eric Hagen
That was really helpful. My second question was around the origination of the refi loan on the industrial asset in California and the use of proceeds and the capital structure there. Thanks.

Matt Salem
Yes. It was basically a financing to take it off an acquisition facility, so almost like a recapitalization that was just occurring going from short-term financing obviously to our bridge loan there. And again I think the opportunity set was really driven by how expensive the capital markets are today and the single asset, single borrower CMBS market in particular. So, in terms of leverage, we're at around mid-60s leverage on that portfolio and value there it's not a big cash out to the sponsor in this particular case.

That being said, just given the run-up in values and the tremendous demand that we see for industrial space, we certainly have done loans in the past where you are providing cash back to the sponsors on these high-quality markets and in the industrial segment of the market.

Eric Hagen
That's helpful. I appreciate it, guys. Thanks.

Matt Salem
Yes, thank you.

Operator
And the next question is from Rick Shane with JPMorgan. Please go ahead.

Rick Shane
Hi, guys. One pretty specific question and then one more general question. When we look at the LTV distribution there's a tick up from 7% in the 75% LTV bucket to 10% and it looks like it was driven by a tick up in a Minneapolis loan from 69% to 77%. The balance didn't increase. The loan has maturity of less than half a year and its category 2. So, it looks like a good credit. I just want to make sure we understand what's going on here because in some ways that LTV description doesn't match with how you guys feel about the credit quality and I suspect that there's something there that we want to understand.

Patrick Mattson
Hi Rick, it's Patrick. I'll take the question. So, I think the point I would highlight here just the way that we look at the LTVs. So, when we close the loan we've got an initial balance and we have an as-is value. That's typically the LTV that we're going to show for the life of the loan. Obviously, these are transitional loans. We expect as capital is being put into these assets, as they're leasing up, that the value is improving. And so they should start to migrate toward a stabilized value.

We don't in fact then adjust our LTV lower to reflect what we think is probably an improved asset at that point. We keep with the static LTV that we initially had. The only exception to that is, if we do, do a subsequent new appraisal, for example, we're contributing the loan to a CLO, and we have a stale

appraisal then at that point, we'll update the LTV for the current balance, and the new as-is value. So I think what you're really seeing is just the reflection of a stale LTV number, and that's why you might have a disconnect between what we're thinking about as a real-world value and what the legacy LTV was.

Rick Shane
So, essentially what you're saying is that, that loan was reappraised during the second quarter presumably as you're approaching maturity, but I'm also assuming that that level two rating reflects conversations with the sponsor and visibility on a strong exit because otherwise it wouldn't be a two.

Patrick Mattson
It's a combination of expectation for exit for takeout, and then just performance of the loan. Clearly, sponsorship conversations play a part of that, but a lot of it's to do with how our own underwriting of the asset and view of value.

Rick Shane
Got it. Okay. And that actually dovetails into the more general question that I had alluded to, which is that again we can sit here and look at all of these numbers on a page, but what we've learned over the years is that each one of these loans is idiosyncratic and that LTV and geo in theory means something, but it doesn't in real-world based upon each sponsor's priorities and liquidity. When you are speaking with sponsors right now, how do you feel about their liquidity positions, their ability to hold on to properties during this period of transition and their commitments to do that?

Matt Salem
I can jump in on that one. It's Matt. I would say, we feel very good about our existing portfolio, especially as it relates to the sponsorship. Historically, that's probably been our highest bar and one of the distinguishing features, or factors, within our portfolio, and how we make credit decisions. The vast majority of our sponsors are institutional with a lot of financial wherewithal to carry these properties. And we're in segments of the market where there's a pretty strong outlook for real estate. We're in this world now where we're thinking about real estate values because the cost of capital has gone up and because there's uncertainty in the economic environment.

However, if you look on the ground and a lot of the portfolio that we have, you're seeing really big rental increases and very strong performance and these markets are structurally full. So, I think that our sponsors are very sophisticated and have, again, a lot of financial wherewithal to carry this through. But a large part, they're in the right sectors and I think they like the future in terms of the performance of the individual assets that they own.

Rick Shane
Great. Thank you, guys. I will say I really appreciate the way you guys disclosed the matched remaining term. It's very helpful particularly as we're in a period of greater uncertainty for everybody to understand the portfolio, so thanks.

Patrick Mattson
Thanks, Rick.

Operator
Your next question is from Steve Delaney with JMP Securities. Please go ahead.

Steve Delaney
Good morning, everyone, and thanks for taking the question. I wanted to go back to loan pricing briefly. Chris found the table on your 11 new loans in the 10-Q and we're seeing 2.7% to 3% type of pricing over

LIBOR. And Matt, I want to try to reconcile that to your comment that credit spreads have blown out 75 to 100 basis points. When we think about the first quarter, should we consider that the commitments on those loans and the final term sheets may have been done as early as fourth quarter or early first quarter before we got all the rate volatility?

And just to tie it in, so you only have to answer one, as we look into the second quarter, and the third quarter, should we expect your loan spreads even on these very high-quality assets to move higher? Thank you.

Matt Salem
Thanks for the question, Steve, I can jump in. And that was I think very astute to notice that. It's a couple things. One, it's timing. To your point, our loan closing processes take six to eight weeks and so a lot of the deals that we close in the second quarter closed in April and those would have been effectively first quarter term sheets. So, part of it was that. Now keep in mind, while those spreads look tight versus today's market they were also financed at tighter spreads. So, from an ROE perspective, they're still really accretive. It's not like we were making loans and then financing them in today's market environment. So, we are matched up.

Steve Delaney
Understood.

Matt Salem
I think generally speaking those are financed like the mid-100s so very accretive from that perspective. That's one part of it.

The second part of it, as we had gravitated to more stabilized loans, and so even if you think about us being able to lend on portfolios that could have accessed the CMBS market that tends to be more stabilized, outside of the CRE CLO space, but tends to be more stabilized assets. So we've shifted our posture. You may not see it in the LTV, but we certainly see it in terms of occupancy and cash flow. So, we've shifted a little bit more to I would say a more conservative within the transitional loan segment of the market. These are more stabilized than historically. So that's the other component of it.

And then finally, yes, I think that new loans that we originate will have today's market spreads which are substantially wider than what we saw in the first quarter as I mentioned earlier.

Steve Delaney
Great. I think from all the comments we've heard with respect to your capacity within your term facilities, your revolver and reinvestment in the CLOs, it sounds like you will be looking to take leverage up and grow the portfolio over the second half of this year even though it's pretty obvious now, at least currently, the CLO market is not receptive to help you accomplish that growth. Is it safe to say my assumption that you're going to be marching forward the next couple quarters with some loan portfolio growth regardless of what happens in the CLO market, the new issue market?

Matt Salem
Yes. I think that we do not feel beholden or tied to the CRE CLO market. We've always thought about that market on an opportunistic basis and it can be really attractive at times. And when that happens then we will go issue a CRE CLO and we like a lot of the features of it. We like the term financing of it; we like the fact that it has a reinvestment period. So, there are very favorable features within that.

However, it's never been our primary strategy to issue a CRE CLO. We were in business a number of years, a handful of years, before we even did one. So, we've always been more of the opinion that we

want to create more bespoke non-mark-to-market credit facilities for our portfolio. And part of that is just what we do for a living. We do bigger loans and they don't fit in the diversified CRE CLO model so we've had to go break that and find other ways.

But part of it's also to do that with that size comes a lot of quality real estate and quality sponsorship and there's a lot of financial intermediaries that want to participate in that origination on the senior basis. So, there's a number of factors that play into that.

In terms of how we're thinking about portfolio growth, I think right now, despite the fact that it's a very good market and we have access to senior financing at accretive levels, we're going to try to keep the portfolio about where it is until we see a little bit more stability in just the broader markets and let the Fed get through a little bit more of its tightening. And we're just trying to be prudent and manage the company at very high levels of liquidity—we're at record liquidity right now—and lower leverage. And then to the extent we see that macro start to clear up a little bit, we can obviously start to take advantage of some of the things we're seeing in the market. But in the near term here, we'll be predominantly recycling capital from repayments.

Steve Delaney
Got it. Well thank you. Very helpful comments. Thanks.

Matt Salem
Thanks, Steve.

Operator
Again, if you have a question, please press star then one. The next question is a follow-up question from Jade Rahmani from KBW. Please go ahead.

Jade Rahmani
Thanks. On the new deals you're currently looking at, what do you see as the incremental ROEs?

Matt Salem
Right now, I would say, if before we were solving for—or the market was offering 11% to 13% range, and is gross ROE, IRR, I would say in today's market, you're seeing things 200-ish basis points wide of that on an ROE basis, something in that context; teens, low-teens returns.

Jade Rahmani
Thanks very much. In terms of the outlook for transaction volumes, it seems likely there won't be many CRE CLOs issued. Do you expect that development to cause spread tightening on the funding cost side in the back half of the year?

Matt Salem
Sorry, Jade, just to make sure I understood your question, the lack of CRE CLOs will just cause more demand in the market and cause spreads to tighten?

Jade Rahmani
Yes, as well as securitization issue. A relative reduction in securitization issuance should potentially allow for the supply-demand dynamic between those bonds to improve thereby potentially leading to spread tightening.

Matt Salem
I see. I guess, yes, marginally, I would think that people want to put capital to work over time and if there's

not supply, the market will tighten accordingly. To some extent, I think about it the opposite way in that spreads are going to tighten when there's a healthy capital market. And I think what you're describing is the first thing that happens. Like, you have a dearth of activity and then there's pent-up demand and things tighten to a level where it makes sense for issuers to access the market. So I understand that part of it. But really, let's think about when spreads are really tightening, it's when the market's healthy and when it has its sea legs and when there's a lot of capital markets activity.

So, I think what you're describing starts it. But for us to really have a lot of spread tightening and consistent spread tightening, you're going to need a lot of transaction activity and a lot of CRE CLOs. And I think it'll start on the CMBS side; it'll start on the single asset, single borrower side is my guess. That's the most transparent part of the market, one of the most liquid parts of the market certainly on the floating rate side. My guess is it would start there. All these markets are still active and they're still functioning. It's just they're expensive. So I think when you start to see more and more activity come back, that's really when we'll start to see most of the spread tightening.

Jade Rahmani
Thank you.

Matt Salem
Thanks, Jade.

CONCLUSION

Operator
Ladies and gentlemen, 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
Great. Thanks everyone for joining the call this morning. Please reach out to me or the team here if you have any questions. Take care.

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

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