KKR Real Estate Finance Trust, Inc.

Q4 Financial Results Conference Call

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CORPORATE PARTICIPANTS

Anna Thomas - *Head of Investor Relations*

Matt Salem - *Chief Executive Officer*

Patrick Mattson - *President and Chief Operating Officer*

Mostafa Nagaty - *Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to the KKR Real Estate Finance Trust Inc. fourth quarter and full year 2020 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 Anna Thomas, Head of Investor Relations. Please go ahead.

Anna Thomas
Thank you, operator. Welcome to the KKR Real Estate Finance Trust earnings call for the fourth quarter of 2020. We hope that all of you and your families are continuing to stay safe and healthy. Today, I am joined on the call by our CEO, Matt Salem; our President and COO, Patrick Mattson; and our CFO, Mostafa Nagaty. 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 forward-looking statements, which do not guarantee future events or performance. Please refer to our most recently filed 10-K for cautionary factors related to these statements. Before I turn the call over to Matt, I will provide a brief recap of our results.

For the fourth quarter 2020, we had GAAP net income of $28.8 million, or $0.52 per share, which included a $3.4 million benefit from a lower CECL provision. Distributable earnings this quarter were $26.5 million, or $0.48 per share, driven by the continued strong performance of our portfolio. This quarter, we began using distributable earnings as a supplementary non-GAAP earnings metric to replace core earnings. Consequently, our prior quarter's results have been relabeled to reflect the change in presentation but no change in the calculation or reported figures. Book value per share as of December 31, 2020, increased to $18.76, which included the impact of $1.09 per share from CECL as compared to $18.73 as of September 30th. Finally, I would note that, in mid-January, we paid a cash dividend of $0.43 per share with respect to the fourth quarter. Based on the closing stock price on February 12th, the dividend reflects an annualized yield of 9.2%.

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

Matt Salem
Thank you, Anna. Good morning and thank you for joining us today. We hope you're all healthy and safe. In a year where we experienced a global pandemic and the resulting health and economic damage, KREF delivered its strongest performance to date with record distributable earnings of $1.95 a share.

We held our dividend constant, despite a significant decrease in interest rates, and our earnings covered our dividends by 1.13x. The volatility throughout the year put a spotlight on the industry, allowing us to showcase our defensive investing strategy and increase our investor base. Our financing, which is 83% fully non-mark to market, demonstrated its resilience. This best-in-class liability structure, which was years in the making, demonstrates the tremendous effort across the KKR platform to differentiate KREF. And as transaction activity resumed in the market, we were among the first lenders to take advantage of the new environment and originated $565 million in the fourth quarter. As we look into the year ahead, KREF will continue to benefit from our conservative lending and liability strategy.

Turning to our portfolio, as of December 31st, the balance was approximately $5 billion, with only $472 million, or 9% of our total commitments, of future funding obligations. Our almost exclusive senior loan portfolio focuses on institutional real estate and sponsorship and is secured predominantly by Class A lighter transitional, multifamily, and office properties located in the most liquid real estate markets. Our average loan size is $118 million, and our investment portfolio is 98% senior loans, with no direct holdings of securities.

Performance on the portfolio remains strong, with interest collected on approximately 98% of the portfolio as of the fourth quarter. Through our robust quarterly asset review process, we evaluate every loan in the portfolio to assign an updated risk rating. Our portfolio had a weighted average risk rating of 3.1 on a 5 point scale, consistent with the weighted average risk rating at September 30th. 84% of the portfolio was risk rated 3 or better, and we feel very confident about the performance on those properties.

As we did in the second and third quarters, we continue to provide a detailed breakout of our watch list loans in our supplemental presentation. While our watch list remains the same, we are seeing improving trends in a number of properties, which we expect to lead to positive credit momentum in those assets. Approximately 2% of our portfolio is rated a 5 and is primarily comprised of our Portland retail loan. This property remains challenged, and we are in ongoing discussions with the sponsor. We continue to believe there are adequate CECL reserves.

As mentioned during our last earnings call, we returned to offense and originated a total of seven loans for $565 million during the fourth quarter. Despite the yield compression in the broader market, there continues to be good relative value in this sector, with opportunities to create returns similar to pre-COVID on loans with more structure. I would characterize our lending as more of the same. We continue to focus on high-quality real estate and light transitional business plans. In the fourth quarter, 55% of our originations by commitment were secured by multifamily properties. We've also started to see new opportunities stemming from the COVID impact on real estate. The demand for industrial space has accelerated, and we are seeing increased opportunities to lend on industrial construction projects. For example, in December, we originated a $95.8 million loan for the construction of an industrial park located in Denver.

In terms of repayments, we received $535 billion during the fourth quarter, including the repayment of one of our largest exposure to the New York City market. Our forward pipeline remains active with two loans closed since year-end and several loans under exclusivity, totaling $497 million in aggregate, all of which are expected to close in the next couple of months. While the pipeline continues to grow, KREF is effectively fully deployed. Origination opportunities will likely exceed available capital. And in the near-term, we will need to manage the timing of originations to repayments.

Before turning the call over to Patrick, I wanted to update everyone on the growth of KKR's real estate platform. Going back to our IPO, we've highlighted the benefits to KREF of being part of a larger asset management platform with a culture of collaboration. It contributes value across everything we do from sourcing and underwriting to liability management. This has only accelerated as the business has scaled. Today, KKR's real estate business manages over $25 billion, with strategies ranging from credit to opportunistic equity, core plus equity, and net lease. Recently, KKR acquired Global Atlantic, a leading provider of life and annuity products. This addition broadens the lending products we can offer our clients, creating more opportunities to connect with borrowers and intermediaries, and KREF is well positioned to capitalize on this increased connectivity. We remain excited about the competitive position of our franchise and the market opportunities ahead in 2021.

Now, let me turn the call over to Patrick.

Patrick Mattson
Thank you, Matt. Good morning, everyone. We hope that you continue to stay safe. As of quarter-end, a market-leading 83% of our in-place asset financing was completely non-mark-to-market, and the 17% remaining balance was only subject to credit marks. While we will continue to prioritize non-mark-to-market financing, we expect to maintain a balanced and diversified approach to our secured financing and expect our credit facilities to continue to be an active and efficient form of financing within our capital structure.

However, it was our intense focus on non-mark-to-market financing prior to the pandemic that allowed us to lower the risk of our liabilities while at the same time maintain target leverage levels despite the volatility last year. As of quarter-end, our debt-to-equity ratio and total leverage ratio were 1.9x and 3.6x respectively. The leverage ratio reflects a slight decrease from the third quarter, given some recent repayments. As a reminder, we have generally targeted 3x to 4x leverage ratio on new senior loans, depending on the source of financing. While we've been willing to finance loans at low 80s advance rates on our non-mark-to-market financing, we would expect our total leverage ratio to remain in this range in the coming quarters and expect our debt-to-equity ratio to be in the low 2x area.

As Matt noted, with the company near full deployment, repayments will be a key driver of our near-term origination pace. And while it's always difficult to predict repayments with certainty, our current expectation is for the existing portfolio to have some additional duration this year with repayments weighted more towards the latter half of 2021. In the near-term, KREF will continue to benefit from the in-place LIBOR floors and elevated effective net interest margins. As a reminder, while the portfolio is almost entirely floating rate, 85% of the loan portfolio has a LIBOR floor of at least 1%, while only 2% of our liabilities, excluding the Term Loan B, have a floor above zero. As we experience a rotation in our portfolio through loan repayments and new originations, we expect LIBOR floors on new loans to set close to spot rates, and we expect our effective NIMs to compress over time.

Finally, KREF's liquidity position remained strong at over $480 million. This total includes over $110 million of cash and full access to our $335 million corporate revolver. In addition to reported liquidity, at quarter-end, we had approximately $275 million of unencumbered senior loans on the balance sheet that are able to provide additional liquidity when pledged to our existing financing facilities.

With that, I'll turn the call over to Mostafa to touch on some of the 2020 highlights.

Mostafa Nagaty
Thank you, Patrick, and good morning, everyone. Before I turn to the key financial highlights, let me call out the change in our non-GAAP earnings measure. Historically, we reported core earnings as our key non-GAAP earnings metric to assist the performance of our business. Starting with the fourth quarter and based on updated guidance from the SEC, we renamed the metric to Distributable Earnings to better reflect the purpose of this metric, which serves as an indicator of our ability to cover and determine our dividend. To be clear, this change and the naming convention does not change the way we historically calculated and reported this metric, which adjusts GAAP net income to exclude certain non-cash items.

Reflecting on 2020, in a very challenging and unprecedented year, we have achieved record distributable earnings of $1.95 per share, comfortably covering our dividend of $1.72 per share for the year. We conservatively managed a strong liquidity position through the initial COVID volatility and ended the year with over $480 million of liquidity. We closed a $300 million Term Loan B, a $500 million warehouse facility, increased the borrowing capacity on our revolver to $335 million, which remains undrawn at year-end, and maintained a best-in-class liability structure, with over 80% of our secured financing on non-mark to market facilities. We accretively repurchased 2 million shares of our stock, totaling $25 million at an average price of $12.27 per share. We also returned to the offense following a market shutdown, with originations over $565 million across seven loans in the fourth quarter. We look forward to continuing to deliver attractive risk-adjusted returns and strong results for our shareholders. Thank you again for joining us this morning. And with that, we're happy to take your questions.

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 speaker phone, 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 comes from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thank you very much for taking the questions. In terms of your comments surrounding capital management and the companies being in a position of full deployment, with the stock trading at about 99% of GAAP book value and below book value ex the CECL reserve, what options might you consider? I assume that the unencumbered assets you want to keep as a liquidity insurance. And I'm wondering if perhaps you could pursue a CLO, as some of your peers are reported to be looking at. I'm wondering if you might consider issuing some form of unsecured debt, whether it'd be a convert, perhaps a preferred. What are you currently considering?

Matt Salem
Hi, Jade. It's Matt. Thank you for joining us. I appreciate the question. I'd say, right now, we're primarily focused on managing the originations through repayments. Obviously, I think, as we look at the stock price, and you mentioned where we are versus book value with and without CECL, we'll continue to track that and think about raising capital if we can do so accretively. Certainly, the pipeline is very big right now. It feels like there's been some pent-up demand over the course of the last six-to-nine months. And so, we're seeing good opportunities there.

I think from the debt side, we're going to take advantage of some of the things you mentioned. The markets are very strong right now on the liability side of the equation certainly. The CLO market has been very active and is pricing at very attractive levels. But I think from a total debt perspective, we're in a good place. So, we don't expect to add debt. But, obviously, we can change forms of debt or refinance existing facilities to take advantage of some of the current environment. So, right now, I think we're, again, most focused on repayments and potential equity to the extent we can do so accretively.

Jade Rahmani
Thank you very much. Looking at the watch list assets, I would agree with your commentary that, overall, there seems to be the potential for improvement in the quarters ahead. The New

York condo market has seen a meaningful uptick in sales over the last two months. Everyone knows that Florida is seeing very strong occupancy rates in hotels. So, I assume the Fort Lauderdale Hotel would do well. Even the Brooklyn Hotel, I believe, is a recently constructed asset. So, it could be in good position. Industrial is doing well. So, Queens Industrial, I assume, would also do well. San Diego multifamily, I also believe is a recently developed property and is probably in a state of lease-up. So, that may be just a timing factor, and there's lots of liquidity.

So, that leaves the Portland retail loan, which is total principal of $110 million. $100 a square foot basis seems low. And I know in the past, you've indicated you're comfortable with the location, but it does seem to be potentially a redevelopment. So, I'm wondering if you feel that there is a risk of impairment on that or how you think we should evaluate that risk?

Matt Salem
Yes. Well, I think—it's Matt again. I think, first of all, as you walk or tick through the watch list loans, I think we have a similar view to much of what you said. We've seen continued improvement in the hotel sector, in the—certainly the condo sector. There's been a number of sales at that property post COVID, including one in the fourth quarter. So, we continue to see progress there. And as I alluded to on the call, I think some of these, you could see positive credit migration over time. We've had some modifications recently in one of our hotel loans and accommodated a paydown on the loan came with that—a principal paydown on the loan. So, things are definitely proceeding in a positive manner on the watch list.

So, let’s turn to Lloyd Center. I think, first of all, it's only 2% of the overall portfolio so let’s just put it in perspective. Currently, we are granting short-term extensions while we continue discussions with the borrower. It's a complicated asset. It's a complicated business plan. As you mentioned, it's in a good location. There are real demand drivers around it for both multifamily, office, and mixed use. The question is, how do you get there and what format. It's going to take time. So, I think we're at the stage now in discussions where it's probably most appropriate to keep those direct with the sponsor at this point in time. But we will try to give more details when we have a little bit more clarity on the path forward. But, again, I think when you look at that, it all comes back to what we reserved for to some extent, and we still feel comfortable with the existing CECL reserve on that particular loan.

Jade Rahmani
Thank you. I'll get back in the queue.

Operator
The next question is from Stephen Laws with Raymond James. Please go ahead.

Stephen Laws
Hi. Good morning. Can you talk—you have been more active on the origination front. Can you spend some time talking what's changed, what hasn't changed as you underwrite these new loans versus 12 months ago?

Matt Salem
Sure. I said on the call—it's Matt again, and thank you for the call, Stephen. I think—where we're focused is a similar place, predominantly multifamily, lighter transitional properties, including office. The biggest change in the underwriting is really in the timing for how long it's going to take the borrowers to implement their business plans. We're clearly in a—still in a difficult economic environment for many retail—for many real estate properties. And so, there's going to be a timing element to how quickly you can ramp cash flows back up. And then, there's obviously, the concession as we think about multifamily and rental rates and what the impact of

COVID could be and what the future holds as you burn off concessions and potentially see a rise in rental rates in some of these larger markets.

So, I think that the biggest difference and the underwriting is really around some of the concessions or the rental rates and, again, the timing. But there's lots of opportunity. As I mentioned, there's pent-up demand. The pipeline has never been bigger. And then, I would segue to there are new opportunities that come from COVID. So, we are seeing increased interest and demand on the industrial sector, as you would imagine, in the life science sector. So, some of the haves—some of the winners in the real estate properties certainly are in need of financing and to create new space that can really take advantage of that demand for some of the things coming out of COVID.

Stephen Laws
Great. Thanks for the color, Matt. Mostafa—could you touch on G&A? It looks like we're back to the level we saw pre-COVID and how do we think about that moving forward?

Mostafa Nagaty
Hello. Yes. So, I think we had excluded—excluding the stock comp, Q4, we had lower G&A load compared to Q3, and that's mainly driven by higher non-recurring items that took place in Q2 or Q3 in connection with the COVID disruption. So, going forward, looking into 2021, we expect our G&A load to be fairly consistent with what you have seen in 2020 with a little bit of an expected spike in the first quarter consistent with the—some of the Q1 work with the proxy and related costs.

Stephen Laws
Great. Thanks for the color on that. Appreciate you taking my questions today.

Operator
The next question is from Steve DeLaney with JMP Securities. Please go ahead.

Steve DeLaney
Thanks for taking my question this morning. And hello, everyone. Matt, your—I wanted to ask about your co-origination strategy. You did that on a number—six of loans or so in the fourth quarter. You've certainly got the demonstrated ability to make a $150 million loan on your own. Talk about why you would split them 50/50 and how that fits into adding to the diversification and reduced exposure to any one project, any one borrower. Just how you view co-origination versus putting a loan on your books 100% funded by KREF. Thanks.

Matt Salem
Yes, Steve. Thanks for the question. Good to hear from you. Let's first start out with allocation. And for the things that KREF does from—primarily does, so think about senior lending on transitional properties, KREF has a priority and a first shot at all the opportunities that fit that segment of the market. And so, then it just becomes a question of—for KREF, okay, how much capital do we have, and how do we optimize some of the other things, like you said, diversity of the portfolio, financing availability, returns as we look at each individual opportunity.

I think you're right to say that, if $150 million loan comes in, and we have available capital, that most likely will go to—100% to KREF. I think that there are some timing differences in what we did in the fourth quarter around some repayments when we issued a Term Loan B, et cetera, where some of those early closes, it was unclear the amount of capital that was available at that particular moment in time. And so, those were effectively allocated across other pools of capital. So, KREF will continue to take that priority. And then, I think about as a real positive—because from a risk management perspective and from a financing optimization and ultimately ROE, KREF can effectively use other pools of capital to originate larger loans. So, if we could do a $400, $500 million loan, it's very helpful to have other pools of capital available so that we can show up as a one-stop solution to our clients. So, I think that's the net positive. But hopefully that gives you a little bit more color on how we think about it.

Steve DeLaney
Yes. No, that's helpful, especially the part about, if you have the capacity and need to put $150 million to work that you're not in any situation where you're required to split it with anyone else. So, that's what I really wanted to hear, that it's going to be really at your discretion how you choose to split it up.

And then, one quick thing for Patrick. So, obviously, financing, probably that's the story of 2020, those that had good financing versus those that did not. And 83% is exceptional for fully non-mark-to-market. Let me just ask this. This is hypothetical. But in the extreme—so—okay, no market—no credit, no—like capital markets marks no actual credit marks on those. But the hypothetical of a loan going non-accrual, maybe just take Portland—and I don't even know. Portland may not even be financed on a line. But at some point, you may have to foreclose on a property. At what point in that whole process when you've got a loan financed with a bank would the bank come to you and say, okay, we don't finance REO? And I'm just curious how far that no call actually goes in a workout.

Patrick Mattson
Thanks, Steve. That's a good question. So, when I think about—it obviously depends on the financing facility that you're talking about. And even on the non-mark-to-market facilities, there are differences in how a loan that's in default might be treated. I would say what's typical on the credit facilities, the repo facilities, is that defaulted loans are not meant to be financed on those facilities. And so, you're generally required, after some period of time to purchase the asset off of the facility. Obviously, if it's on something like a CLO or another facility, there's no requirement to purchase that back. But if you get enough of those types of defaults, it might start to impact your ability to cash flow back to the equity, i.e., some of your triggers may trip and you may end up flipping to something that's more of a sequential pay where all of the lenders are going to get sort of paid back. And, obviously, it depends ultimately on the asset, right, that's being financed on there. Obviously, not all assets are equal. And for a multifamily, that's going to be treated different than, let's say, another property type.

Steve DeLaney
Yes. Thank you, both, for your comments. Appreciate it.

Operator
The next question is from Charlie Arestia with JP Morgan. Please go ahead.

Charlie Arestia
Hi. Good morning, guys. Thanks for taking the questions today. I wanted to ask about the corporate loan. I thought that was interesting, given the focus near-exclusively on senior loans in recent years. Just wondering if you could give a little more color on the decision process on that loan, the underlying business plan. I mean, LIBOR plus 12 definitely caught my eye there. And I'm wondering, is the underlying real estate portfolio there entirely multifamily?

Matt Salem
Yes. Thanks for the questions. It’s Matt, I can jump in there. It's a little different than what we've done in the past and a unique situation. But, first of all, it's an existing sponsor for us, someone

we've went to multiple times. And so, we've got a great relationship there and know how excellent they are at operating assets. And we called it a corporate loan. I think that's a good description. If you want to translate that into like a more real estate speak, it's really more of a mezzanine-type position.

But we were able to do that across the entire portfolio of the company, so obviously creating a pretty strong collateral package for the loan and diversifying across the entire asset base. And the underlying collateral is all multifamily properties, majority of which are in some level of stabilization—built assets that are in some level of stabilization. So, overall, it's a strong—we think a great credit and certainly one we were highly focused on coming out of COVID trying to take advantage of some of the pricing in the market or some of the unique situations in the market. And this was with a sponsor, again, that we knew very well and liked a lot. And we're happy to be able to get something done with them.

Charlie Arestia
Okay. Got it. And I'm getting the sense that this was relatively opportunistic and a unique situation. Do you think, going forward, that you guys will diversify the loans that you make in 2021? Or is this kind of like a one-off situation?

Matt Salem
I think it's more one-off. It was kind of a unique capital markets activity for the company there that created the opportunity. In a market like this, and obviously, going back to pre-COVID, as well, we like the senior lending market for a number of reasons. First of all, our clients like it, because we're showing up with an entire solution to them, and they don't need to worry about a senior sub relationships or closing issues. So, it gives them certainty of execution. Number two, it allows us to capture all of the economics and then figure out what the best—how to optimize the financing and create the best ROE. And then, obviously, there is the security package that goes along with that, that we like being in a senior loan.

So, I think that's going to continue going forward for those reasons.

Charlie Arestia
Understood. Thanks very much for the color.

Operator
The next question is from Tim Hayes with BTIG. Please go ahead.

Tim Hayes
Hi. Good morning, guys. Hope you're doing well. My first question here, just on the comments around net interest margin. Can you give us a little color on the all-in coupons on the pipeline today versus the existing portfolio? And then, part B of my question there is, you mentioned—and we all know just how accommodative the capital markets are right now. And I'm curious that—if there are options for you to lower your cost of funds through execution on the capital market side, or if you're seeing any pressure on banks to take down your repo costs, given the execution there. So, I know that's a couple of questions there, but I appreciate the comments.

Patrick Mattson
Hi, Tim. Good morning. I'll take that one, and welcome to the call. Good to have you with us here today. So, I guess, first, just thinking about the existing, I guess, cost of capital. Clearly, the market’s improved from a financing standpoint. So, we're seeing that—across the liabilities, we're seeing a tightening on the credit facilities, and we can see demonstrations of this in the CLO market. When I think about our net interest margins, if you look at our coupons on our

existing portfolio, they're around 480 at the end of last year. That's down 20 basis points from the beginning of the year. And so, that just demonstrates a little bit of the benefit that we had from the LIBOR floors. The LIBOR dropped from about 175 basis points to around 11 basis points today, but we only saw around a 20 basis point drop in our asset spread. So, pretty remarkable. And we effectively took what was floating rate loans and essentially made them almost fixed rate loans at that point. Our liabilities, obviously, dropped. And so, if you look at our effective NIM today, it's something north of 2.5%.

Now, pre-COVID, some of those loans were being quoted in a low 100s-type of area. And I would say today that that market is probably closer to mid-100s to high 100s. And so, if you think about the walk a little bit, we've got around a 480 coupon in the portfolio. Look at our senior loans that we originated in the fourth quarter. That was somewhere in the mid 4s. And I would say with the pipeline today, that's somewhere probably on a blended basis in and around the high 3s to low 4% area, just to give some context there.

And so, as I look at our liabilities, we're pretty efficient at the moment, just given our existing structure in place. Our existing CLO was priced at a pretty attractive level two years ago. We continue to get benefit there. And our other facilities equally are attractively priced, predominantly in the 100s over spreads and then LIBOR again today at 11 basis points. So, we're getting a lot of pull-through with that net interest income.

Tim Hayes
Okay. That's a great walk through. I appreciate it. So, I guess, maybe to kind of recap all that, I'm calculating about a core ROE of just over 10% this quarter. I'm curious how you feel about KREF's ability to achieve a double-digit ROE, given this type of environment. And we're going to keep rates static in this example, we'llstay in the vacuum. So, just curious how you feel about the ROE you're able to achieve.

Patrick Mattson
I think, at the moment, we feel good. I mean, if you look at the fourth quarter and we look at what our underwritten IRRs are there, we've got a number—now, this is, again, sort of blended with some of those non-senior loans that we talked about. But you're talking about an IRR that's in the 14% context. So, we're getting pretty good return on that profile of deals. Obviously, as we continue to see some asset compression in the market, we'll see further pressure on that level. But at the moment, it's been a pretty good environment to make new loans. So, obviously, we're happy to have gotten back on to the offense. And, obviously, as we said, the pipeline looks really good for us. And so, at the moment, we feel like we're in a good spot.

Tim Hayes
Okay. I appreciate those comments there. And then, just one more from me, back to the Portland retail loan. If you could just remind me—I know, obviously, it was placed on non-accrual status this quarter versus last quarter. But was there any major impact in the actual earnings collection that you were accruing for that loan quarter-over-quarter?

Patrick Mattson
I would say—it's Patrick again. I would say, when we think about third quarter to fourth quarter earnings, that was certainly one of the impacts that flowed through in this quarter. Another impact being repayments that we received earlier in the fourth quarter. We, obviously, had a good origination quarter, but a lot of those originations were back-ended. And then, obviously, as we've been talking about some of that rotation down in spread or in coupon from, call it, the upper 4s to the sort of mid-4s. So, those are really the driving forces over this quarter.

Obviously, we're really pleased with where we ended up, but those were the areas where we saw some impact quarter-over-quarter.

Tim Hayes
Okay. Thanks again for taking my questions.

Operator
The next question is from Matthew Howlett with Wolfe Research. Please go ahead.

Matthew Howlett
Hi, guys. Thanks for taking my question. Just on a modeling question—a modeling question from me. I know you don't provide forecast on distributed earnings. But you’ve got great coverage on the dividend. You’ve had that for a couple of quarters. I hear you with the NIM coming in. But it sounds like you were a little bit under-deployed in fourth quarter. And then, with your comments on the IRRs, can we assume that that cushion to the dividend is going to be maintained? And at what point would you think about distributing 100% of your distributed earnings?

Matt Salem
Hi. It's Matt. I can jump in there. I think that the two major factors that we think about to go forward right now are repayments, as we mentioned, and then obviously what the yield on the new loans are. The existing portfolio is, you can see in this quarter, previous quarters, and for the year concerning substantial amount, given the LIBOR floors Patrick described. So, I think that's kind of first order of business is trying to understand what that repayment can look like before we get into more normalized, historically pre-COVID type of earnings level.

And as we mentioned on the call, difficult to predict repayments. But from what we can see now—and we go through this portfolio every quarter and update our assumptions, not only from a credit perspective, but also just from a *when do we think these will be paid* perspective, also. We think that repayments are going to be more back-half of the year. So, that creates some sustainability to earnings if that plays out, given other things staying the same.

So, that gives us a little bit of confidence on a go-forward here. And then, as Patrick mentioned, we're still able to create, I think, good returns on the new loans that we're making, albeit not at the same earnings level we've seen over the last couple of quarters here, given the power of those LIBOR floors. In terms of your last question, we'll continue to look at our earnings and look at the dividend. We're living in effectively a 0% interest rate world right now in the short end of the curve. And so, we'll make that determination. The Board will make that determination as we move forward here. But, right now, we're comfortable with where we're at.

Matthew Howlett
And then, just on the visibility with prepayments, are you just seeing really strong lease-up rates and access to other parts of the market? Is that how you forecast what you think is going to get repaid?

Matt Salem
I mean, we're looking at—it's a number of factors, because the capital markets are a part of that. But I think what COVID has done to some of—think about a transitional business plan, it's elongated that business plan. And it's going to take a little bit more time, even on what we lend on simple—think about a simple lease-up of a multifamily property. Well, that's going to take a little bit longer to lease that up. You're going to give away more concessions in a market like this

to accomplish that lease-up. And, therefore, the sponsors may—they may wait another quarter or two to lease it up a little bit more or to burn off some of those concessions. So, it's just pushed things out. Things are progressing well. But it's just going to take a little bit more time. And, quite frankly, we'll be the beneficiary of that, again, given the LIBOR floors versus the liabilities and the NIM that we've got in the portfolio today. So, I think that's really what we're seeing on the ground.

Matthew Howlett
Great. And just one last one. In terms of the loan participation sale, you're taking on more structural leverage. Any—what's the appetite? You haven't done many of them. What's the appetite to do that?

Matt Salem
I mean—Patrick, feel free to jump in after I go. I think it—for us, we take—we make a loan, and then we figure out what the—how to optimize the ROE through the financing. So, it's really not driving the decisions at all in terms of do we do an A note sale. Do we finance it on a CLO, one of our bespoke financing facilities that we've spent so much time putting in place? Each of those options has different requirements, and we look at each loan and see where it fits best on the different financing options that we have.

And so, I think it's hard to sit right today and say, hey, we're going to pick—we're going to do more A note sales or we're going to—put it more in the CLO. It's hard to say. It really depends on what the pipeline looks like, what the originations look like, and ultimately, where that puzzle piece fits in. If that make sense?

Matthew Howlett
Yeah, it does. Appreciate it. Thank you.

Operator
The next question is a follow-up from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thank you very much. Besides the loans on watch list, are there any others that jump out in terms of areas that investors should be focused on in terms of risks?

Matt Salem
No, I don't think so. Through the last quarterly—again, through our last quarterly review process of each loan, I think we're—and we made this comment in the prepared remarks. We feel pretty good about the non-watch list loans and the stability there from a credit or ratings perspective. And we already covered where we are on the watch list loans. So, we could potentially have some positive migrations on a few of those.

Jade Rahmani
Thanks. You mentioned that you're seeing increased opportunities on the industrial side, and that seems to be one of the most heated, if not the most heated, sectors. So, are you building in protections—additional protections since you're underwriting? I know that, historically, light warehouse definitely is one of the easiest assets to develop. So, there's a risk that that market could be oversupplied. I assume that that's something that you factored into your underwriting.

Matt Salem
Yes, of course. I mean, I think it's—I don't think our underwriting has changed materially from pre-COVID to today outside of just adjusting for that increased demand. But, of course, with

industrial, as you suggest, it's not the hardest thing to build. It's relatively straightforward. And so, you've really got to think about replacement cost as you're entering these projects. But, clearly, as you get more infill—and some of the deals we've done have been relatively infill. Those costs are still pretty high. And we're active on the equity side of our business in the industrial sector. We've clearly lent on some within KREF. And it's really—the demand we're seeing there is quite strong, and the lease-up rates are very good. So, I think it's a sector we'll continue to focus on, we like, and hopefully we could do more.

Jade Rahmani
On the Portland loan, is one of the options potentially a joint venture in which KREF takes an equity stake in a redevelopment of the building or otherwise brings in one of KKR's vehicles to assume some kind of interest?

Matt Salem
Yes. I don't think we've—we haven't ruled out any options at this point in time. And it's going to be a redevelopment of some sort. And the question is, who's going to be a part of that? So, that's a possibility for us. I don't think we would partner up with other capital within KKR from a conflicts perspective. But I think there's a lot of interest from developers—large national plan developers in the market that—for that particular site, that particular location. So, we'll see how it plays forward. But at this point in time, we’ll try to keep all our options available.

Jade Rahmani
Okay. And just last question, something I've asked some of your peers, and a couple of them have been kind enough to provide the answer. Do you have the percentage of loans in the portfolio that, to-date, have been modified since the onset of the pandemic? And I know the sector has a habit of giving this interest collections perspective. But if you modify a loan, then you can be able to maintain a high percent of interest collections. So, do you know, also, the percentage interest collections relative to, say, a snapshot of the pre-pandemic portfolio, just how that 98% compares to what it would have been previously?

Patrick Mattson
Hi, Jade. It's Patrick. Let me take that one. So, I think—in terms of modifications, I think the watch list page is a good place to look at. In reality, there's only been a handful of loans that I would think about as material modifications. Modifications are a part of business plans, right, as things are progressing, whether you're in a pandemic or not. But I think, as we've talked about in the past, where I was focused on is what's happened certainly on the interest rate side. There have been no cuts in interest rates on any of our loans. There has been, as we've talked about, on the hotel side, two loans where we did partial deferments of interest or partial forbearances. Matt mentioned on one of those, we've, subsequent to year-end, have done another modification to that loan. But this modification brought the deferred interest current, set up a carry reserve, and it had a partial paydown on the loan. So, we would consider that a pretty major modification. But clearly—I don't think that's the area that you're sort of focused on.

And so, when I think about that 98% number, what it really is, is the two loans that are on non-accrual. We've talked about both of those, the mezzanine—small mezzanine loan and then the Portland Retail asset. So, even when you look at our percentages in the fourth quarter and in the first quarter number that we quoted, there isn't a change in the performance. It's a change in the denominator. But it's still those two same loans that are on non-accrual. Everything else is paying current, and no other loan has been reduced from an interest rate standpoint. So, I think that's really what we think about when we think about modifications. And, obviously, we think that's a pretty strong track record.

Jade Rahmani
Yes. Thank you very much, and I appreciate the clarity there. Definitely sounds like the portfolio is performing well and certainly on a relative basis, also. Lastly, with the comment around scarce capital and the company's—the management team's historical experience of that in the CMBS space, wondering if you could comment as to, one, whether the sale of the CMBS portfolio—that equity interest, I think it's $34 million or so, could be a source of funds, although that's modest. But also whether you would consider forming a CMBS conduit. Clearly, the company has a lot of multifamily, and I think that collateral is probably in high demand in the CMBS market. The GSEs are highly competitive, but that could also be contributed to CMBS securitizations. Would you consider or are you considering formation of a CMBS conduit to be able to provide longer-duration loans on stabilized assets and that would also supplement the company's earnings stream?

Matt Salem
Hi, Jade. From a capital perspective, we obviously have an interest in a fund that we manage and invest in CMBS. It's a small position, so I don't think about that. Which you mentioned, as like really a source of capital for us if we were to sell that. I think we'll continue to invest in that fund. And, obviously, there is different liquidity investing in a fund and directly in security. So, as it relates to the conduit origination business, it's not something we're contemplating currently. So, there's been a lot of changes in that market. We're a very large investor in that space. I still think that the best way to play that is on the investing side as opposed to origination and contribution of loans to deals.

Jade Rahmani
Thanks very much for taking the questions.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Anna Thomas for any closing remarks.

Anna Thomas
Hi, everyone. Thank you for joining our call today. Feel free to reach out to me or the team with any follow-ups. Thanks.

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

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