KKR Real Estate Finance Trust Inc.

Q4 2021 Earnings Conference Call

Wednesday, February 9, 2022, 11:00 A.M. Eastern

CORPORATE PARTICIPANTS

Jack Switala – *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 2021 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 (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*), then one (1) on your telephone keypad. To withdraw your question, please press star (*), then two (2). 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. Thank you, operator. Welcome to the KKR Real Estate Finance Trust earnings call for the fourth quarter of 2021. We hope that all of you and your families are safe and healthy.

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, 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 certain 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 2021, we had GAAP net income of $35.2 million or $0.59 per share. Distributable earnings this quarter were negative $2.9 million or negative $0.05 per share due to $0.55 per share in realized losses on loan write-offs this quarter.

Book value per share as of December 31, 2021, increased to $19.37, which includes the cumulative CECL impact of $0.39 per share as compared to $19.09 per share as of September 30th. This increase in book value was largely driven by CECL reversal benefit, along with an accretive equity offering in October of 2021. This is the seventh consecutive quarter in which we have grown book value per share. Finally, in mid-January, we paid a cash dividend of $0.43 per common share with respect to the fourth quarter.

Based on yesterday's closing price, the dividend reflects an annualized yield of 8.1%. With that, I'd now like to turn the call over to Matt.

Matt Salem
Great. Thank you, Jack. Good morning, everyone, and thank you for joining the call today. KREF delivered record originations this quarter, closing on 18 loans for $1.8 billion to cap off a record year of $4.8 billion.

In 2021, we grew our portfolio by approximately 35% from $5 billion to start the year to $6.8 billion as of year-end. I'll highlight four major drivers contributing to our increased activity. First, the size of our real estate credit team is now 53 professionals, an increase from 24 pre-COVID, and our senior investment team has grown. We now have eight senior originators with deep borrower and broker relationships.

In 2021, we originated 37 loans, 24 of which were to repeat borrowers. Second, we've grown our suite of CRE lending products across KKR and can offer a host of solutions to our clients, fixed rate, floating rate, and core to value add. This broader product suite helped drive over $14 billion in total KKR Real Estate credit originations in 2021, which has led to broader and deeper relationships. KREF is well-positioned to capitalize on this increased connectivity with the first priority in the allocation waterfall for senior floating rate commercial real estate loans.

Third, we've leveraged the KKR platform to further diversify our capital base, including upsizing existing facilities, such as our CLO and term loan B at attractive terms, raising bespoke fully non-mark-to-market financing, and strategically increase our permanent equity base through issuing fixed for life preferred shares and raising accretive common equity. Fourth and finally, we've benefited greatly from being embedded within the broader KKR organization. We have unique access to economic views from our global macro team, which are particularly valuable to us in a changing interest rate environment and real-time market and property-level data from our real estate private equity team, and from an alignment perspective, KKR has been our largest shareholder since inception and owns 23% of our shares today.

These factors helped drive originations higher than $1 billion in both the third quarter and fourth quarter, and we expect a similar pace of originations going forward. Still, with record growth, our credit DNA remains very much the same. 46% of our portfolio is in multifamily, 28% in office, of which 91% is Class A. We made 18 loans in the fourth quarter, totaling $1.8 billion, 13 were in the multifamily segment, representing 64% of the fourth quarter originations. Two were in office and life science each representing 18% and 14% respectively, and we originated one hospitality loan for $66 million, representing 4% of fourth-quarter originations. These loans were underwritten at an attractive low double-digit weighted average IRR, which is in line with our target returns pre-COVID. In the fourth quarter, we received $680 million in repayments across six loan repayments and three partial paydowns.

We messaged to the market that the back half of last year would have higher repayments, and while always difficult to predict, we now expect a more normal repayment rate of around $2 billion per year with a modest weighting toward the first half of 2022. Since the beginning of COVID, our earnings have benefited from LIBOR floors. However, these floors are transitioning through repayments and portfolio growth.

Our new originations have floors set close to zero. In the coming few quarters, we expect income to become positively correlated to increases in short-term interest rates. Additionally, in the midst of the rate environment, we are constructive on the senior secured CRE loan market backdrop. We have already seen robust activity in January and have nearly $900 million of loans either closed or under exclusivity subsequent to quarter-end.

Multifamily loans comprise much of our pipeline, but we expect to be active in some of the growth segments such as life science and industrial, which now represent 9% and 4% of our portfolio respectively. I want to close by saying that what has been a record quarter and year, our portfolio is stronger than it has been since the start of COVID. The portfolio is 100% performing, 100% floating rate with a weighted average LTV of 68%. At the beginning of the pandemic, we placed seven loans on our watchlist, and today, only three risk floor-rated loans remain, and each of those has positive momentum.

Lastly, on the personnel front, I want to take a moment to thank our CFO, Mostafa Nagaty, who will be leaving us in early March to pursue other opportunities. Mostafa has been an integral part

of our team and has made significant contributions since joining in 2018, and we wish him well in his future endeavors. With that, I'll turn the call over to Patrick.

Patrick Mattson
Thank you, Matt, and good morning, everyone. I'll first touch on our capital base, which has grown over the course of the last 12 months to support our $6.8 billion funded portfolio as of year-end. On the liability side, we executed on a $350 million repricing and add-on to our term loan B in the fourth quarter, reducing our cost of capital relative to our inaugural issuance by 175 basis points. And just last week, we priced a $1 billion CRE CLO supported by 100% multifamily properties with an investment-grade advance rate of 84.75%.

This is our third CLO and our second issuance within the last six months. This transaction will result in approximately $850 million of new matched term, non-mark-to-market and nonrecourse liabilities, increasing our percentage of non-mark-to-market liabilities back above 75%. The CLO price to a weighted average running cost of capital of term SOFR plus 171 basis points before amortized fees and expenses. Related, going forward, we expect all our new loan originations and associated financings will be SOFR based.

While existing loans, financing facilities, and future borrowing on existing financings may remain in LIBOR until June 2023, we are actively managing the LIBOR to SOFR transition with the goal of mitigating basis risk. Turning to other areas of our capital structure. In January, we raised approximately $155 million of gross proceeds through a follow-on issuance of our Series A preferred shares at a fixed for life cost of 6.5%. This permanent capital helped support a funded portfolio of $6.8 billion as of year-end, which grew by over $950 million in Q4 on a net basis.

This raise, along with the issuance of approximately $120 million in common equity in October 2021, which is accretive to book value by $0.22 per share, helped grow our permanent equity capital base to approximately $1.5 billion today. I also want to touch on the positive momentum we are experiencing with respect to our watchlist. The current portfolio has a risk rating of 2.9 on a five-point scale, a slight improvement from 3.0 last quarter, and notably, 94% of our loans are now risk-rated 3 or better, which is an improvement from 91% last quarter and from 84% as of year-end 2020.

At the beginning of the pandemic, we placed seven loans on the watchlist, and today, only three remain. Most recently, in January, our Brooklyn-based hospitality loan, which was originated in January 2019 was repaid in full through a property refinance with a money center bank. In December, we took title to the Portland retail property, which we had discussed on our Q3 call.

We have capitalized the property through a joint venture with our partners at Urban Renaissance Group or URG and are beginning the planning phase for the revitalization process of Lloyd Center. URG is a full-service institutional real estate company with a local Portland presence and specializes in reimagining, developing, and managing Class A commercial real estate. On the equity side of our business, we have a long-standing relationship with URG where we own a $2.5 billion, 2.6 million square foot portfolio of Class A office across the Puget Sound region. From an accounting perspective, we were more than adequately reserved for this loan on a GAAP basis with a CECL reserve of $40.3 million as of Q3 on a $109.6 million outstanding principal balance.

As a result, in Q4, we recognized an $8.2 million GAAP gain from the CECL reversal with respect to this loan. We also realized a $32.1 or $0.54 per share loss on this loan through distributable earnings, contributing to negative $0.05 per share in Q4 DE. We are seeing positive underlying trends with our remaining watchlist loans. For example, on our New York luxury condo loan,

which had an initial loan balance of $240 million, has now paid down to $40 million through unit sales.

Only six units remain to be sold, three of which are under contract. Lastly, KREF finished the quarter with a strong liquidity position of approximately $530 million. This total included over $270 million of cash and $200 million in undrawn corporate revolver capacity available to us. We also had $235 million of unencumbered and unpledged loans as of quarter-end that can be levered to provide additional liquidity.

In summary, a record originations quarter capped off a record year with $1.8 billion in originations last quarter and a solid start to the year with $900 million closed or under exclusivity since year-end. We grew the funded portfolio by over $950 million in Q4 to a record $6.8 billion, which compares to $5 billion at the start of 2021, all while maintaining our high credit quality standards. We expanded our permanent equity base to approximately $1.5 billion, raising $120 million in accretive common equity in October 2021 and approximately $155 million in gross proceeds of preferred stock last month, and finally, book value increased by $0.28 per share in Q4 and was the seventh consecutive quarter of book value per share growth.

Thank you for joining us today, and 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 (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2). At this time, we will pause momentarily to assemble our roster. The first question will come from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thank you very much. Can you talk to where you see levered ROEs in the business, if they're consistent now versus prior period? And also, what, if any rough commentary you could give toward sequential earnings trajectory. One of your peers did talk about NII outlook based on timing of originations and repayments, noting that this quarter for KREF's distributable EPS ex items was around $0.50, still in excess of the dividend, but yields are coming in. So, just if you could talk to levered ROEs and maybe something around earnings trajectory.

Matt Salem
Sure, Jade. Thanks a lot for the question, and thanks for joining the call today. It's Matt.

Let's take that first part. I think returns are generally in line with what we saw pre-COVID on an ROE basis. So, let's think about that as an 11% to 13% range. So, pretty healthy, and keep in mind that the constituent of that return is largely at the asset level and spread at this point in time with most of -- every new loan we're making has a SOFR floor of somewhere around zero, and so, you will benefit -- those ROEs will benefit from future increases in rates. So, that's where we see kind of the spot market, and I think that's been consistent over the course of the last few quarters.

The market is relatively stable on both the asset and the liability side right now, and then as that translates into earnings, we're not going to give projections at this point in time, but I think we've messaged to the market a couple of things. One, that as our LIBOR floors roll off and we reset

the portfolio at a zero LIBOR so forth floor that that earnings is going to come back down in line with what it was on a pre-COVID basis, and I think we still see that and expect that to happen.

So, that's maybe the negative side of the equation. I think on the positive side of the equation, as we messaged in the prepared remarks, the portfolios will become positively convex to short-term increase in interest rates over the course of the next quarter or two, so you can get growth from that side of things.

Jade Rahmani
Thank you. Just on the credit side, how would you describe the quality and characteristics of post-COVID or post-March 2020 originations versus the preceding period? Is it consistent? Are there any changes? I know you've increased exposure to industrial, life sciences, multifamily remains a core focus. Beyond that, anything more specifically you could provide on just how credit might be comparing?

Matt Salem
From a pre-COVID basis, Jade?

Jade Rahmani
Yeah. The loans you are doing now. Clearly, the production level has materially increased. The platform has grown, the type of deals you're looking at probably a lot broader than before. So, how would you characterize credit characteristics?

Matt Salem
Okay. Yeah. I would say let me approach it in a couple of different ways. Let me approach on the equity side and on the credit side. I think largely speaking, the market is very favorable now, I would say, more favorable than certainly the quarter or 2 preceding COVID from a fundamental lending perspective. First of all, on the equity side, the fundamental backdrop there is very strong, and clearly, you're seeing rent increases and the favorite property types. You're seeing a lot of demand for real estate from capital allocators.

I think that there's a lot of tailwinds in terms of people seeking yield on real assets as inflation hedges, and that's driving transaction volumes, and that increase in transaction volume is filling all of our pipelines, and so, if you look at our activity in the fourth quarter, if you look at some of our peers' activity in the fourth quarter, it's really a function of all that demand, all that activity going on, on the equity side of the business as we help fund that transaction volume, and then I think you shift to the other side of the equation, you think about credit.

On the credit side, I think partially because we have these big volumes coming through, it's a very balanced trade right now, and LTVs are reasonable, covenants, cash flow sweeps, etc., are consistent with previous quarters. We're not feeling the weight of capital, we're not feeling the weight of the search for yield on the market currently. So, there's lots of transactions to look at, and the market, I'd say, is very balanced in how it's approaching lending today.

Jade Rahmani
Thanks for taking the questions.

Matt Salem
Thank you.

Operator

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

Tim Hayes
Hey, good afternoon, guys. Congrats on a nice quarter. First question here, just about, I guess, one more about asset sensitivity. I know you made a lot of comments around it, Matt, but do you have an estimate of how much of the portfolio needs to turn over before you're in a position to benefit from, call it, like a 50-basis-point rate hike? I'm just curious if any internal modeling you can share with us? Or even if it's just kind of like at what point and I think you mentioned over the next couple of quarters, but just any way to triangulate that a little bit more based on the pipeline and the repayment activity you see when you think you'll be in a position to benefit from a modest hike in short-term rates?

Matt Salem
Tim, thank you for joining the call, and thanks for the question. I think that we have a better feel for the timing than we do for the sensitivity right now, and that's just because, of course, we can run the math, but it’s a multi-variable equation and you're really trying to guess repayments, originations, and it's kind of a delicate modeling exercise that ultimately probably creates a little bit more uncertainty around really what the impact could be. That being said, I do think we have a lot of confidence that in the next quarter or two that we will be positively convex to those interest rates. Just look at the portfolio growth, look at the repayment since COVID, like the portfolio is repositioning very quickly and has already gone -- obviously come a long way. We need a little bit further to go to positive convexity -- you can see in some of the charts that we put in the earnings supplement that that's come down a lot, that sensitivity. So, we expect it to turn in the first or second quarter. I wish I could give you more, but it's a little bit of a guessing game.

Tim Hayes
Yeah. That's helpful. I just wasn't -- when you said, I guess, next quarter or two, I wasn't sure if you meant kind of like end of 1Q, early 2Q or end of 2Q, early 3Q, but it sounds like it's the former there, which is good. So, thanks for clarifying there.

Then a question I probably asked before, and I asked some of your peers. I mean, you guys have done a lot at the broader KKR platform, and you recently bought a resi transitional lending platform. You've gotten deeper in single-family rental over the summer on the equity side. So, I'm just curious as KKR, the parent company makes more moves and gets deeper in some of these asset classes that haven't been a traditional focus for KREF and your lending portfolio, what type of benefits that could bring you, and if there's opportunities for you to kind of expand your scope there?

Matt Salem
Yeah. I think that's a great question, Tim, and something we think about every day. I think what it mostly translates back into -- well, first and foremost, is market connectivity, and the easiest way to think about it is the equity side of our business has grown substantially and has multiple vehicles. It's investing for now across opportunistic and core-plus and is transacting, as you mentioned, in lots of different property types now. So, we are a much more relevant counterparty for banks, for brokers in the market for operating partners, and that translates, I think into better looks and that just add connectivity with the overall market.

So, that would be one. Just relationships are much deeper and broader across the overall real estate business.

Number two would be as we start to invest in equity in some of these segments we perhaps weren't in historically, that gives us obviously the market data and the diligence and gives us more confidence to transact on the debt side as well, and so, I think a couple of examples of that would be like SFR, right, where we have a sizable history there, and we've translated some of that into our lending book, not a huge position for us, but we certainly are active in that space, but even more simple things like industrial, where we're lending on the industrial space, we own millions of square feet there. We've been active in that market for some time now, but just the size of our portfolio gives us so much market data that it really allows us to lean into opportunities because we have that additional information or insight that perhaps some of the competitors don't have.

Lastly, I'll just say, geographically, we have a global platform, a global real estate equity platform as well, and we are actively building a team in Europe, so I'd expect us to be active, and again, same business model. It's a collaborative business model. It's an integrated business model across debt and equity. So, I expect us to be active in Europe over the course of the year.

Tim Hayes
Can you just remind me kind of where you're at with that -- that initiative in terms of building up the team in Europe? And are you acquiring kind of existing infrastructure/teams that are already based there? Or like how is that -- or is it being built out organically?

Matt Salem
No. So, we basically hired someone to lead that effort for us. His name is Ali Imraan. He came over from LaSalle. He's here working with us today in London, and we're in the process of building out his team, and so, when we get the team in place, then we'll start lending.

Tim Hayes
Got it, got it. okay. Well, thanks for taking my questions this morning.

Matt Salem
Thank you, Tim.

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

Stephen Laws
Hi. Good morning. I wanted to touch on just geographic. It looks like the exposure to Florida roughly doubled sequentially.

Can you talk about your origination pipeline there, is it existing borrowers taking you to Florida? Or is it you guys winning new relationships there? Kind of talk about the strength in that market, please?

Matt Salem
Sure, Stephen. Thank you for the question. I think that, obviously, Florida is a market that's easily identifiable as a growth market with lots of positive fundamental tailwinds, and I think this is a good example of how synergistic some of the other pockets of capital we have for KREF.

So, by way of example, we've really increased our lending on the insurance segment of our business outside of KREF, specifically through our affiliate Global Atlantic, and that's given us a lot more borrower relationships of folks that borrow a lot on the core or core-plus side and a lot in multifamily space that we didn't historically have some of those touchpoints because we didn't

have the right cost of capital, and usually, these sponsors are borrowing across while they're predominantly core, core plus borrowers, they do have some needs for a KREF type of loan. So, that's really driven a lot of our activity, some of the increased activity that we have is increased client base.

So, I think you see some of that in what we did in Florida this year, some of those newer clients were very active in the multifamily segment of the market within Florida, and we were able to transact with them on the KREF front as they were acquiring properties, and you just think about the growth and the demographic growth in Florida, we clearly set itself up very well for a multifamily equity and lending investment. So, really, it was driven by new client base, the multifamily originations that we had, and then obviously a market that's supportive of that theme.

Stephen Laws
Great. Thanks. And then to touch on unfunded commitments. That's kind of increased over the past year, probably by design, but can you talk a little bit about what's driving that? Is it a shift in mix? Are you doing some things with more deferred financing involved, kind of what's driving the increase there?

Matt Salem
Yeah, I can start out, and then, Patrick, feel free to jump in with anything that I miss. It is by design, I think when we think about some of the business plans that we're lending on, some of the market opportunity that we're seeing, it comprises a larger piece of future funding, the most obvious being construction lending. So, if you look at what we've done on a post-COVID basis, we have done a little bit more construction lending, most of which has been in the industrial segment of the market.

So, clearly, when we think about future funding, there's a number of things we think about cash drag, liquidity constraints, and then how quickly the capital gets allocated into the loan, and I think from an industrial perspective, the construction period is typically very short and so you get capital into the ground relatively quickly, but that's really what's driving that number. I think we're in the band of where we'll be going forward.

Of course, it will bounce around from quarter-to-quarter, but it's in the range of what we would expect over the next few quarters.

Stephen Laws
Great. Appreciate the comments.

Matt Salem
Thank you.

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

Don Fandetti
Yes. Matt, I was wondering if you could talk about on your CLOs. Are you seeing the same buyers or investors today that you saw pre-COVID? And how much depth do you think there is to that market to handle sort of, let's say, credit widening hiccups and things of that nature?

Patrick Mattson

Hey, Don, good morning. It's Patrick. I'll take that one. I think as we think about the CLO market today, obviously, last year was a huge year in issuance.

This segment has really grown significantly over the last couple of years. As part of that, we've seen a widening of that investor base throughout this time. I think if you sort of fast forward to today and we see the deals that are getting done, I think we largely see that same investor base buying. I think the big difference that we're witnessing in the first part of this year is the demand and the size allocation that some of those large buyers were previously taking has been reduced, and I think the question will be, is that a short-term phenomenon? Or will that persist over the longer term? Obviously, to get to the type of gross CLO volumes that we had last year, those buyers have to be bigger in the space or you have to grow the investor base, but I think we're seeing a little bit of a pullback in the market just given some of that demand, not that people are exiting the market, but that people aren't buying as much.

Don Fandetti
Okay. Thanks Patrick.

Matt Salem
The one thing I would add to that also is that we really take advantage of that market opportunistically, and we've got so many other options within KREF. I think you've really seen us be a leader through Patrick and through our capital markets team developing these bespoke non-mark-to-market facilities. Of course, we're the leader in terms of that – that component of our liabilities. So, for us, it's not necessarily a material thing, whether that market is attractive or not because I think we have a lot of other outlets to go to, but clearly, we watch it as an indication for return on equity for the competitive set.

Don Fandetti
Thank you.

Operator
The next question will be from Rick Shane with J.P. Morgan. Please go ahead.

Rick Shane
Hey, guys, thanks for taking my question this morning. Look, it's interesting, almost two years to the day before all of COVID and everything that's happened, we would have been talking a lot about CECL reserves, and the good news is that we're kind of going back now to where we were hopefully two years ago, and you're going to drive some good growth. We're going to have some good loan growth. We're going to have normalization of reserves. With all of the information that you have gathered over the past two years and sort of thinking about CECL reserves from an actuarial perspective, how many basis points roughly when you add $100 million of loans, for example, should we expect in terms of incremental reserve because it's going to be an important part of the story over the next few years?

Mostafa Nagaty
Hi, Rick, this is Mostafa. I'll take this one. So, with respect to the CECL reserve, obviously, the model that we use, as well as our peers, broadly speaking, is highly dependent on the macroeconomic environment, and one of the key factors there is kind of the CRE price index projections over the next few quarters. So, also the property type has an impact on what the CECL reserve would be. So, it's kind of hard to pinpoint a CECL reserve in terms of basis points

to -- for new originations. That said, I mean, if you have seen historically, and looking at the quarter-over-quarter change in our CECL reserve, I think we ended Q3 with about 110 basis points or so of CECL reserve on outstanding principal balance of our loans.

We ended Q4 with about 37 basis points. The significant reduction was result from -- a result of the $40 million of reversal on CECL for the Lloyd loan that we wrote off in Q4. So, you can see most of our reserve historically had been attributed to watchlist loans. So, we expect -- so I guess, to answer your question. Besides the macro environment, which is one of the key factors that impacts our CECL reserve, any significant changes other than that will be attributed to any changes in our watchlist loans. We expect the -- in a stable macroeconomic environment, we expect the CECL reserve on performing loans, rated 3 or better, would be in the range of -- I don't want to put numbers, but maybe, call it, 20 basis points to 50 basis points depending on the macroeconomic environment. I hope that answers your question.

Rick Shane
It does, and obviously, we understand the difference between the specific reserve and the general reserve, and I'm thinking about this more from a general reserve perspective. I am curious -- so the 20 basis points to 50 basis points is a pretty wide range and probably, I think our expectation is somewhere in the middle of that. If you were to go back to your day 1 general reserve, what was it and what changes you're thinking to the extent -- and fine, I understand portfolio mix and all sorts of different -- their nuances, these loans are idiosyncratic, but this is an actuarial measure, and if we think generically what has changed in your thought process on a general reserve from day 1 to February 2022?

Mostafa Nagaty
Yeah. If you look at -- if you think about the general reserve that we had in '20 pre-COVID in the first quarter or the initial 01/01/2020, our CECL reserve was 109 basis points. So, it was not a significant pre-COVID. Post-COVID obviously us and all of our peers have increased the CECL reserve significantly as a result of the impact of COVID on the macro environment.

So, again, it's very highly sensitive to the macroeconomic environment, and it's hard to pinpoint a range or a number, but it is just hard. It's just hard. I can tell you that day 1 pre-COVID, our CECL reserve was lower than Q1 2020.

Right now, we're reaching a phase where our CECL reserve is more stable, given the macroeconomic backdrop. So, as long as this continues, we expect it to be at that ranges that I alluded to earlier.

Rick Shane
Okay. Thank you very much.

Operator
Once again, if you have a question, please press star (*), then one (1). The next question is from Steve Delaney with JMP Securities. Please go ahead.

Steve Delaney
Thank you. Good morning, everyone. So, I wanted to ask a question about leverage. In the fourth quarter, we saw it move up to 3.7 really on the strength of about $800 million in net fundings in the quarter and now Patrick's presented us with FL3, and so, you now have CLO financing of, what, $2 billion, and that looks to be about 40% of total funding. FL3 looks like initial, and you've got two years reinvestment, I think, but at five times leverage, right, with an 84% advance rate.

So, my question is this, with the commercial mortgage REIT industry, we sort of were accustomed to thinking about leverage, you know, three, three and a half times, but looks like to me, for this year, when we update the models and roll it forward, it looks like that KREF may average something north of four turns of leverage just because of the benefit of the higher advance rates on the nonrecourse CLOs. Could you comment on that? And whether you would -- if we come out with a model or something shows four, four and a quarter times debt-to-equity, are we thinking about that wrong?

Patrick Mattson
Sure, Steve. Good morning. It's Patrick. So, I'll take that. Good morning. So, a couple of comments there. One, if you recall when we do the CLO, it's not new debt that we're adding. Obviously, we're taking loans from other places. So, we're pulling those off of repo facilities, we're taking those off of other warehouse facilities when we put that on. So, we've got that net. Obviously, as you're pointing out, the leverage, the advance rate that we're getting, just given the profile of our assets is pretty high. It's close to 85%.

The offset to that is that if you look at -- and we do highlight this number, our unencumbered assets. By taking a little bit more leverage there in the CLO, we can dial back the leverage that we're taking on other assets in the portfolio. So, we've got some other assets that effectively are unencumbered as a result of -- the other factor to consider just as you think about going from fourth quarter to first quarter, we did raise preferred stock in the first quarter. So, that's obviously equity that's going to offset that, but that 3.7 really represents kind of the fairway for us as we're thinking about target leverage being in that mid- to high 3s. Just to be clear, that's inclusive of all of our financing, including the CLOs. So, when we show that total leverage number, we're including the CLOs. We're not excluding it.

Steve Delaney
No, understood. Yeah, I knew that was inclusive. What I'm hearing you say is while you get the benefit of higher leverage on the multifamily loans and the CLOs, on an overall aggregate basis, you're not going to -- you're going to use the additional net cash from the CLO refinancing to just pay down other debt, of course, but just to have more unencumbered assets. So, that's helpful because I think if we didn't adjust for that, we would end up with something higher than your kind of your run rate of 3.7.

So, I appreciate that. Thank you.

Patrick Mattson
You're welcome.

Steve Delaney

That's all for me and I just would say Mostafa, all the best in the future. We've enjoyed working with you. Thanks.

Mostafa Nagaty
Thanks a lot. Appreciate it.

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.

CONCLUSION

Jack Switala
Great. Thanks, everyone, for joining today's call. Feel free to reach out to me or the team here with any follow-up questions. Take care.

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

COMPANY DISCLAIMER - THE COMPANY HAS NOT VERIFIED THE ACCURACY OR COMPLETENESS OF THIS TRANSCRIPT.