KKR Real Estate Finance Trust, Inc.

Second Quarter Financial Results

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CORPORATE PARTICIPANTS

Michael Shapiro – *Investor Relations*

Chris Lee – *Co-Chief Executive Officer*

Matt Salem – *Co-Chief Executive Officer*

Patrick Mattson – *Chief Operating Officer*

CONFERENCE CALL PARTICIPANTS

Jade Rahmani – *KBW*

Don Fandetti – *Wells Fargo*

Dan Occhionero – *Barclays*

PRESENTATION

Operator
Good morning and welcome to the KKR Real Estate Finance Trust, Inc. Second Quarter 2019 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 Michael Shapiro. Mr. Shapiro, please go ahead.

Michael Shapiro
Thank you. Welcome to the KKR Real Estate Finance Trust earnings call for the second quarter of 2019. I'm joined today by Chris Lee and Matt Salem, our co-CEOs; Patrick Mattson, our COO; and Mostafa Nagaty, our CFO. Before we begin, 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 it over to Chris, I will provide a quick recap of our results. For the second quarter 2019, our GAAP net income was $17.4 million, or $0.30 per share. Net core earnings were $20.5 million, or $0.36 per share. Book value per share as of June 30, 2019, was $19.54. As we had discussed on our Q1 earnings call, GAAP net income, net core earnings and book value were impacted by the timing of significant late quarter capital deployment.

In addition, our GAAP net income and book value was impacted by $2.2 million or $0.04 per share of unrealized loss in our CMBS portfolio. In July, we paid a dividend of $0.43 cents per share with respect to the second quarter. Based on July 31st closing price of $20.03, the dividend reflects an annualized yield of 8.6%. Our Board is scheduled to meet in mid-September to discuss the third quarter dividend and we'll make an announcement shortly thereafter.

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

Chris Lee
Thank you, Michael. Good morning, and thank you for joining us for our second quarter earnings call. This quarter marked a record origination quarter, where we closed six loans totaling $1.6 billion. Through July, we have originated approximately $2 billion of loans year-to-date, resulting in a funded portfolio of approximately $5.1 billion, a 23% increase since the end of 2018. Over the last 12 months ended July 31st, we have originated $3.5 billion, a 30% increase over our 2018 calendar year record origination volume. In addition, we have built a robust pipeline of another $267 million of loans, currently under exclusivity that we expect to close within the quarter subject to customary closing conditions. Matt will provide more detail on recent investment activity in his remarks.

The economic backdrop is favorable for our business. Real estate fundamentals in capital markets have remained strong, driven by a healthy economy, strong job market and robust equity and debt capital flows into real estate. Despite a competitive lending environment, we continue to focus on capital preservation

in creating a defensive investment portfolio. We continue to see the best risk-adjusted opportunities in lending on large transitional assets in the most liquid markets owned by the most experienced sponsors. This deliberate strategy has led to a 30% increase in our average loan size in the last 12 months ended June 30th to $182 million versus the same period ended June 30, 2018.

Consistent with our asset strategy, we continue to find ways to improve our liabilities and create a durable, attractively priced liability structure. In collaboration with our partners in KKR Capital Markets, we increased our corporate revolving credit facility by $110 million to $250 million and added incremental capacity to both our repo facilities and asset-specific financing facility. Additionally, as Patrick will discuss, we entered into a new $900 million non-mark-to-market term lending agreement with a third-party lender. As of quarter end, 73% of our outstanding borrowings were non-mark-to-market compared to 33% as of June 30, 2018.

In summary, we continue to believe that our risk-adjusted return on equity in this rate environment is attractive. We are encouraged by the quality and performance of our portfolio, the strength of our relationships and borrower base and the depth of our pipeline. We are confident in our ability to continue to deliver attractive risk-adjusted returns to our shareholders.

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

Matt Salem
Thank you, Chris, and good morning, everyone. I'll start by providing more detail on our recent investment activity. Our second quarter loan originations demonstrate our conservative investment strategy of lending on institutional quality real estate owned by the highest quality sponsors in the most liquid real estate markets. In the second quarter, we originated six floating rate senior loans totaling $1.6 billion. The weighted average LTV and coupon for these loans are 67% and LIBOR plus 2.7%, respectively. And on a levered basis, the loans have a weighted average underwritten IRR of 11.5% at spot LIBOR, which is consistent with our existing portfolio.

In order to highlight our differentiated conservative lending strategy, I'm going to provide some additional details on our origination this quarter. So please bear with me. First, in April, we made an approximately $183 million loan secured by a four-building, 711,000 square foot, predominantly office, mixed use portfolio in Philadelphia, Pennsylvania. The sponsor is a global investment bank with a market cap of approximately $80 billion. Two of the buildings recently went through renovations and have begun their lease-up. The sponsor's business plan includes capital improvements to complete the third asset's renovation, while also upgrading amenities across the portfolio with the goal of increasing occupancy from 62% to 90% at post-renovation rents.

In May, we made our largest loan to date, a $386 million whole loan on a recently constructed an 857 unit, two building, luxury multifamily asset located in Brooklyn, New York. The sponsor is a family owned investment and development firm founded in 1950s and had approximately $240 million of cash equity invested in the property at closing. Post-closing, the sponsor has commenced completion of the remaining 8% of development including interiors, common areas and amenity space.

Given the recent development, the property has 45% leased, but has shown strong momentum and we expect it to ultimately reach market levels of approximately mid-90%. At the end of May, we made a $260 million whole loan secured by a cross-collateralized three property, 1,100-unit multifamily portfolio across Atlanta, Birmingham, and Fort Worth. Each asset is being developed to a Class-A standard. The loan was made to a repeat sponsor and one of the largest multifamily operators in the United States. The sponsor acquired the land sites from 2013 and '14 commenced developments from 2016 and '17 and is on schedule to deliver the portfolio in phases over the next several months.

Fourth, in June, we closed $186 million loan to refinance a newly constructed 52% leased Class A multifamily in the high demand West Loop submarket of Chicago. Delivered in the fourth quarter of 2018, the property was built to a luxury finish with expansive views and amenities and has experienced a rapid lease-up. The repeat sponsor is a publicly traded global asset manager with approximately $140 billion of AUM. The last two loans were closed at the end of June. First, we originated a $339 million loan on 1,110 unit two property, Class A and Class B+ multifamily portfolio in Arlington, Virginia, to an experienced local sponsor, who owns nearly 5,000 multifamily units in Northern Virginia and the D.C. metro area.

The property is located directly across the street from the new Amazon headquarters. The sponsor plans to implement a capital improvement plan to reduce operating expenses due to synergies of owning two adjacent properties and marking rents to market levels.

Finally, we originated a $340 million loan on a newly constructed 800-unit, Class A, luxury multifamily building located in Chicago. The sponsor is a vertically integrated real estate firm that has developed and manages nearly 40,000 units across 150 properties. Post-closing, the sponsor has commenced completion of the remaining development budget, which includes finalizing unit interiors, common areas and amenity space and leasing up the property to market rents and occupancy.

Leasing momentum has also been strong with approximately 60 units per month at net-rents 27% above our underwritten rents. Through July, we closed an additional $170 million loan secured by a 1 million square foot Class A office property located in Chicago, Illinois. In addition, our forward pipeline remains strong with another $267 million of loans expected to close within the quarter. As always, these are subject to customary closing conditions.

During the quarter, we received approximately $200 million of repayments and had a $7.9 million pay down of our condo inventory loan. In addition, we syndicated a $65 million pari passu participation on our Queens office loan. While repayments were relatively light in the second quarter, we have received approximately $900 million of repayments through the first six months of the year. As we said in our call earlier this year, we expect to see higher level of repayments as our portfolio seasoned and our borrowers execute on their business plans. Repayments are difficult to predict and can be lumpy quarter-to-quarter, given our larger loan sizes. However, we expect a similar level of prepayments during the remainder of the year.

Turning to our portfolio. As of June 30th, the balance totaled approximately $5 billion, with another $533 million of future funding obligations. The portfolio is 99% invested in senior loans and is diversified both geographically and across property types. Notably, multifamily and office loans comprised 87% of the portfolio; 100% of our loans are performing.

In summary, we have a portfolio comprised of institutional real estate and sponsorship, implementing light transitional business plans. The brand and the franchise are delivering a strong pipeline of opportunities with approximately $2.3 billion of loans closed or pending closing year-to-date as of today.

Now I'll turn the call over to Patrick.

Patrick Mattson
Thank you, Matt. And good morning everyone. As previously mentioned, timing of deployment over the quarter was back-end weighted with a significant portion of closings occurring in mid to late June. The timing, therefore, had a negative impact on our net income for the quarter. By way of example, had the five loans which closed after May 1st all closed at the beginning of May, net core earnings per share would

have benefited by approximately $0.06 per share. Our portfolio which totaled $5 billion at the end of the quarter has a weighted average risk rating of 2.8% on a 5-point scale, consistent with the risk rating in the prior quarter. And we have no loans with a rating above a 3.

Given some of the recent legislative changes impacting certain New York multifamily assets, let me spend a minute on our exposure to that market. We have 6 multifamily loans with outstanding balance of $874 million secured by 1,800 units across seven properties. Our portfolio was carefully reviewed with respect to the new New York City Housing Stability and Tenant Protections Act.

And at this time, we believe the act has no material impact on the underwritten cash flows or the value of the assets backing our New York City multifamily portfolio. I would further note that none of the sponsor's business plans on any of these properties was related to changing the status of stabilized units to market rate units. The weighted average risk rating across our New York City multifamily loans is 2.6, with none rated 4 or 5.

As of quarter end, 99% of the portfolio was invested in LIBOR-based floating rate loans. More than 90% of the loan portfolio features a LIBOR floor of at least 50 basis points, providing rate protection in a declining rate environment. A third of the portfolio has a LIBOR floor of at least 2.25%. In our year-to-date 2019 originations, we have a weighted average LIBOR floor of 2.33%.

Finally, I would highlight that more than 95% of our financing facilities are not subject to a rate floor above zero, which should enable us to recapture incremental spread if we see further decline in LIBOR. Looking at the right-hand side of the balance sheet, we continue to optimize and diversify our financing. We entered into a new $900 million non-mark-to-market Term Lending Agreement with extension options out to seven years, matching the term of the longest underlying asset.

The financing has a coupon of LIBOR plus 1.9%, inclusive of ongoing admin fees and features an initial prorata pay-down structure, which preserves our leverage for a period of time. In addition, we increased the size of our corporate revolving credit facility by $110 million to $250 million and one of our repo facilities in our asset-specific financing by an aggregate of $250 million.

Finally, we continue to look at the A-note market as a source of matched term, non-mark-to-market, nonrecourse asset financing. During the quarter, we sold a $143 million senior mortgage on a loan we recently originated. All of these initiatives continue to optimize our balance sheet. And as of quarter end, 73% of our outstanding liabilities were non-mark-to-market.

With the continued diversification and improvement in our funding sources matched with a decrease in LIBOR, we have been focused on capital deployment and leverage efficiency. As a reminder, we generally target a 3 to 4 times leverage ratio on new senior loans depending on the source of financing. For loans on our non-mark-to-market financing lines, we are willing to flex leverage slightly higher. As of quarter end, our debt-to-equity ratio and total leverage ratio were 1.7 times and 3.4 times, respectively.

In summary, it was another strong quarter. We had record origination pace and our pipeline remains robust. Our portfolio is performing, and we continue to make significant progress creating differentiated financing. Thank you, again, for joining us today. And now we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press the star then two.

The first question today comes from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Thanks very much. Appreciate the color you gave on the loans originated in the quarter. Just on timing and earnings ramp or the cadence in the second half of the year. You mentioned that core EPS would have benefited by $0.06 based on timing of loans closed had they closed earlier in the quarter. But you also mentioned that in the second half of the year, I believe repayments in aggregate should match the $900 million you've received thus far through the second quarter. So how do you think about the trajectory of earnings in the second half of the year? Do you anticipate core earnings exceeding the dividend in each of the next two quarters?

Chris Lee
Hi Jade. Good morning, it's Chris. I'll take that. I think there are really a couple of things. Number one, we mentioned that we sized up our corporate revolver. So I think that, will allow us to manage our liquidity a little bit better and originate into more consistent repayments. I think, number two, we're evaluating some liquidity management tools on the asset side of the balance sheet that we think can help bridge any scenarios where we see a little bit more of a lumpier repayment in advance of loans that are already under exclusivity closing because effectively, that's what happened in this last quarter. We had a significant pipeline. We had already committed to these loans. We liked what we had on the balance sheet and they just ended up closing a little bit later. And we thought that it created a quarterly hole from an earnings perspective.

So we do feel good about the second half of this year from an earnings perspective. We're going to have a full second half of the year for all of these loans that we recently added to the portfolio. And if we make a couple of these tweaks around the revolver and liquidity management, we think that it will have a pretty meaningful impact on the earnings trajectory of the business on a go forward.

Jade Rahmani
Can you say whether for the combined third and fourth quarter you expect net core earnings to meet or exceed the dividend?

Chris Lee
We don't give guidance. But I think based on what we closed last quarter, I think we feel good about the second half of the year.

Jade Rahmani
Okay. In terms of having the balance sheet be fully invested, a couple of your peers have acquired CMBS securities, in particular CLOs. I think it's a wise strategy in terms of optimizing capital deployment, increasing NII and making sure that you mitigate the impact of repayments. Is this something you would consider? Considering the management team's experience with securities, I think it's something worth exploring.

Matt Salem
Hi, Jade. It's Matt. I think we're going to look at a number of different options, specifically as it relates to what Chris was discussing around just kind of liquidity management and trying to balance the timing of repayment versus origination. So that will definitely be one of the things that we're considering.

Jade Rahmani
Okay. And then just lastly, in terms of leverage, can you remind us what your leverage targets are, given the decline in leverage following the repayments that you've experienced?

Patrick Mattson
Hi Jade, Patrick. So we generally are targeting, as we said, 3 to 4 times on assets, depending on the type of financing. And so as we've ramped up the non-mark-to-market financing, you've seen our leverage increase up to 4x on an asset basis. But I think when you look at the company today, both in terms of the debt to equity and where we are in terms of a total leverage or a look-through leverage, I think we're kind of at a point where we expect to sort of maintain. This feels like the right level.

Jade Rahmani
Okay. Thanks very much.

Operator
Next question comes from Don Fandetti with Wells Fargo. Please go ahead.

Don Fandetti
Hi Chris. Can you talk a little bit about how you won the Brooklyn multifamily loan and what your competitive edge was? Were there other bidders? Also, can you talk a bit about the market overall in terms of banks continuing to be careful in commercial real estate lending. I'm talking about nonbanks being aggressive. Can you talk a little bit about how the market dynamic is right now?

Matt Salem
Hi Don, thanks for the question. It's Matt. I'll tackle that one. Let's just start with the market overall. I think the market is competitive. I think it's been a pretty consistent level of competitiveness over the last few quarters and that's demonstrated by, I think, relatively stable spreads or yields on the loans that we're quoting. I think the market is disciplined. The firms that we're competing against are all balance sheet lenders of substantial size with a lot of experience. So the market feels competitive, but disciplined. I would also add that our borrowers are not pushing leverage at this point in time. I think many of them continue to remember what happened to the last crisis and some actually have structural features within their vehicles that limit the amount of leverage they can put on a fund or an individual asset.

So the market still feels healthy, but it feels relatively efficient as well. Specifically, on the Brooklyn transaction, it was an interesting setup in that really, there were just two of us looking at that particular opportunity. There was the incumbent lender and ourselves. There was a broker involved, but again, only really two of us in the room trying to provide that loan. And that's not too unusual. There's only really a handful of lenders that can focus on these larger loans in the transitional lending space, which is one of the reasons why we like gravitating up in size or up in average loan size. The other reason is just quality of real estate, quality of sponsorship and market.

But in that particular case, it was just two of us and we were able to secure the loan just through our relationship not only with the broker, but developing a relationship with this borrower.

Don Fandetti
Thanks, Matt.

Matt Salem
Yes.

Operator
The next question comes from Dan Occhionero with Barclays. Please go ahead.

Dan Occhionero
Good morning. So I just wanted to ask about your growth plans in the second half of the year and the mix of financing that with debt as opposed to equity, given where the stock is trading and the prospects of potentially funding it with equity when it's trading below book?

Chris Lee
Hi, Dan. Good morning. It's Chris. As we've discussed before, we will be very prudent about how we think about adding capital to the balance sheet and increasing share count. As mentioned earlier in the call, we're very focused on earnings and particularly earnings per share in the near term. And over the long-term, we're focused on adding capital to the balance sheet in an accretive manner. We have several ways to add capital to the balance sheet. If we don't see the opportunity from a common perspective, but our view is that our common will trade better in the second half of the year, number one.

And number two, we also believe that our ATM and the combination of our revolver and some of these kind of new liquidity management processes we'll put in place are going to be pretty helpful in terms of managing the liquidity in the growth more on a just-in-time basis. So we're very focused on it, but we feel like right now we have enough capital to continue to execute on our pipeline and we'll be judicious about how we grow the company on a go forward.

CONCLUSION

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

Michael Shapiro
Thank you everybody for joining us today. I hope you have a good weekend. And if there's any follow-up questions, please feel free to reach out. Thank you.

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

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