KKR Real Estate Finance Trust, Inc.

Third Quarter 2018 Financial Results

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CORPORATE PARTICIPANTS

Chris Lee – *Co-Chief Executive Officer*

Matt Salem – *Co-Chief Executive Officer*

Patrick Mattson – *Chief Operating Officer*

Mostafa Nagaty – *Chief Financial Officer*

Sasha Hamilton – *Investor Relations*

CONFERENCE CALL PARTICIPANTS

Ryan Tomasello – *Keefe, Bruyette, & Woods, Inc.*

Don Fandetti – *Wells Fargo*

Steven DeLaney – *JMP*

Rick Shane – *JPMorgan*

Arren Cyganovich – *Raymond James*

PRESENTATION

Operator
Good morning and welcome to the KKR Real Estate Finance Trust Incorporated Third Quarter 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 (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 now would like to turn the conference over to Sasha Hamilton. Please go ahead.

Sasha Hamilton
Thank you. Welcome to the KKR Real Estate Finance Trust earnings call for the third quarter of 2018. 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.

A quick recap of our results before I turn things over to Chris. For the third quarter of 2018, our GAAP net income was $20.8 million or $0.37 per share. Net core earnings were $21.4 million or $0.38 per share, up 18% from the prior quarter excluding the gain on our sale of CMBS B-piece investments in the second quarter. Book value as of September 30, 2018 was $1.15 billion or $19.76 per share. In October we paid a dividend of $0.43 per share with respect to the third quarter. Based on yesterday's closing stock price of $19.89, the dividend reflects an annualized yield of 8.6%. Our Board is scheduled to meet in mid-December to discuss the fourth quarter dividend, and we will make an announcement shortly thereafter.

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

Chris Lee
Thank you, Sasha. Good morning and thank you for joining us for our third quarter earnings call. This was another very active quarter for the Company. We originated $681 million of loans and closed an additional $122 million of senior loans post quarter end. This brings us to total year-to-date originations of $1.9 billion compared to $1.5 billion for the entire year of 2017. We have secured a robust pipeline of another $621 million of loans currently under exclusivity that we expect to close in the coming months subject to customary closing conditions. As of today, the total portfolio stands at $3.5 billion, a 62% increase since the beginning of the year and a 168% increase since the second quarter of 2017 when we completed our IPO. Matt will provide more details on our investment activity shortly. This quarter, we also increased our total financing capacity to $2.9 billion compared to $1.8 billion at year end, and we made progress on improving the cost and structure of our liabilities. We put in place a new $200 million non-mark-to-market facility, and subsequent to quarter end, we increased the size of our term financing facility by $400 million to $1 billion. Patrick will provide the details in his remarks. Including this increase, nearly 40% of our financing capacity is now non-mark-to-market. Finally, this quarter we successfully completed our first follow-on offering post IPO for 5 million primary shares and net proceeds of $98 million, increasing our book value by 9% since the second quarter to $1.1 billion. This capital allowed us to continue to fund our robust pipeline. Assuming no near-term repayments, with the

aforementioned pipeline we expect to be substantially deployed by the end of the quarter.

The market environment continues to offer us attractive investment opportunities but remains very competitive. However, our relationships with borrowers and intermediaries, our growing brand awareness, and our access to information to quickly assess credit continue to differentiate us in the marketplace. In addition, we have been able to reduce our cost of liabilities to offset some of the spread compression. Our attractive cost of capital has allowed us to compete effectively on price in the market and continues to deliver an attractive risk-adjusted return on equity to our shareholders. Overall, we are pleased with our origination activity, our market positioning, our portfolio, and pipeline. Despite some recent equity market volatility, we believe the economic climate remains favorable for our business model, and we look forward to continuing to create value for our shareholders.

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

Matt Salem
Thanks Chris and good morning everyone. I'll start by discussing our investment activity. In the third quarter, we originated four floating-rate senior loans totaling $681 million. This includes the refinance of an existing loan in our portfolio, creating a new $75 million senior loan secured by an 84% occupied Class B+ industrial property located in Atlanta, Georgia with an additional 18 months of call protection. The other three loans are collateralized by a Class A- and B+ multifamily portfolio located in Atlanta and Tampa and a Class A multifamily property located in Seattle and two Class A office buildings, also located in Seattle. The weighted average LTV and coupon for these four loans are 73% and LIBOR plus 3.2% respectively. And, on a levered basis, the loans have a weighted average underwritten IRR of 11.6% at spot LIBOR, which is consistent with our existing portfolio. These loans fit our program of light transitional lending to institutional sponsors in major markets. The average occupancy of these properties is 91%, which creates in-place cash flow and the possibility for near-term stabilization.

Year-to-date, we originated $1.9 billion of senior loans with a weighted average LTV and coupon of 70% and LIBOR plus 3% respectively. This volume is 49% higher than the same period of 2017 and 31% higher than full-year 2017 originations. Our average loan size is also increasing, with an average of $139 million year to date, up 17% from the same period last year. Also of note, our origination activity is driven by existing relationships, as three of the four loans this quarter and 50% of the loans originated year-to-date are to repeat borrowers. Borrower experience is important in transitional lending. We pride ourselves on being responsive and providing high-quality service. Our ability to convert existing borrowers to repeat borrowers speaks volumes about our team, process, and reputation. Our strong origination pace has continued into the fourth quarter. We have already closed two senior loans totally $122 million. The loans are secured by Class A multifamily properties located in Queens and Philadelphia. Both loans are to repeat borrowers, and have a weighted average LTV and coupon of 72% and LIBOR plus 2.7% respectively.

Our forward pipeline is robust as well, with four loans totaling approximately $621 million under exclusivity to close over the next few months. Half of these loans are to repeat borrowers. As always, these are subject to customary closing conditions. In terms of repayments, we had $281 million of loan repayments in the quarter, resulting in $2.1 million of prepayment income. These repayments included two loans on retail properties, reducing our exposure to that property type to 4%. In addition, we had a $9 million paydown of our condo inventory loan this quarter associated with the sale of units and an additional $8 million paydown subsequent to quarter end. As our portfolio seasons, we are starting to see a pickup in repayment volume and we expect to

enter a run rate payoff schedule in the first half of 2019.

Turning to our portfolio, as of September 30th the portfolio was $3.4 billion, with another $386 million of future funding obligations. 100% of our loans are performing, and our securities portfolio is performing as expected. The portfolio is 98% invested in senior loans and is diversified both geographically and across property types. Office and multifamily loans comprise 87% of the portfolio. As we discussed on the last few calls, we continue to concentrate on the multifamily and office property types due to their shorter term, light transitional business plans. As of quarter end, the average occupancy of the office properties in our portfolio was 77%. We are focused on creating a defensively positioned portfolio, and we will continue to target the highest quality opportunities, trading incremental yield for credit quality.

In summary, we were ahead of our target pace of originations, with approximately $2.6 billion of loans closed or pending closing as of today, and we are pleased with the quality and performance of our portfolio.

Now, I'll turn the call over to Patrick.

Patrick Mattson
Thank you, Matt, and good morning everyone. Our portfolio, which totaled $3.4 billion at the end of the quarter, has a weighted average risk rating of 2.9 on a five-point scale, consistent with the prior quarter. We have no loans with a rating above a 3, as our one 4-rated loan paid off in the quarter. Additionally, as of quarter end, 98% of the portfolio was invested in LIBOR-based floating-rate loans, which positions us well to benefit from further increases in short-term interest rates.

Looking at the right-hand side of the balance sheet, we continue to optimize our financing. As discussed on the last few calls, we have been working closely with KKR Capital Markets to explore funding options and improve the cost and structure of our liabilities. This quarter, we closed on a new $200 million asset-specific financing facility which is matched-term, non-mark-to-market, and partial recourse for the Company, and funds at a rate of LIBOR plus the mid-100s. Additionally, post quarter end, we increased the size of our existing term loan financing facility from $600 million to $1 billion of total capacity. As a reminder, this facility provides us matched-term financing on a non-mark-to-market and nonrecourse basis. As of September 30th, the weighted average rate on the term loan facility was LIBOR plus 1.4%. The attractive cost of these facilities allows us to compete for the highest-quality lending opportunities and secure better credits for KREF while still delivering an attractive return to the Company. In addition, the liability structure is more durable from a mark-to-market perspective and improves our ability to manage risk and liquidity on the balance sheet. In addition to these new facilities, we also upsized our Wells Fargo repurchase facility from $750 million to $1 billion this quarter, bringing our total committed financing capacity to $3.3 billion as of today.

Turning to the debt-to-equity ratio, we closed the quarter at 1.3 x, and 1.9 x from a total leverage perspective. We continue to releverage the portfolio as we fund new originations, and as a reminder, we generally target a 3x to 4x leverage ratio on new senior loans. One other note on the balance sheet. This quarter, we issued 5 million shares of common stock through an underwritten offering in August raising approximately $98 million of net proceeds.

Wrapping things up, another strong quarter and a solid start to the fourth quarter. Our origination pace remains robust, our portfolio is performing, and we continue to make significant progress creating differentiated financing. Thank you again for joining us.

And now we are 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 (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). At this time we will pause momentarily to assemble our roster. The first question comes from Jade Rahmani with KBW. Please go ahead.

Ryan Tomasello
Good morning. This is actually Ryan on for Jade. Um, just in terms of the $621 million pipeline you mentioned. Can you give us some detail on the types of loans you, that was represented? You mentioned I think four loans, so maybe the average spread on those deals and the types of properties and markets?

Matt Salem
Hey Ryan, it's Matt. You know, we're still in the process of closing those, so I don't think we want to go into specifics on the spreads yet, but I would say that it's largely in line with what we've delivered over the last few quarters in terms of both business plan, focusing on light transitional properties as well as coupons that we're originating at. We haven't seen a lot of changes in the, you know, in the spread complex over the last quarter or two.

Ryan Tomasello
And then as a follow-up to spreads, do you think that spreads have generally troughed from the strong compression that we've seen year-to-date, or do you think that there is additional room for spreads to continue to compress, assuming the Fed continues on its expected path of rate hikes?

Matt Salem
You know, I think, as I mentioned before, it does feel like there's been some stability in the spreads over the last few quarters, but as we've seen, you do see compression as we've seen increases in LIBOR, and so our expectation is that would continue as rates go up.

Ryan Tomasello
And given the large average loan size, you mentioned I think like $140 million year-to-date, which was up around 17%, can you talk about how you think about concentration risk in the portfolio and maybe more generally your approach to asset management across the portfolio?

Chris Lee
Hey, this is Chris. From a concentration perspective, we take a, we look at these deals on a, really on an individual basis. For instance, the large loan that we made in this past quarter, it's actually a loan that if you broke it up into the loan in Atlanta or the loan in Tampa, you would actually look at those at not being that large from a concentration perspective. We actually think we're getting better risk reward by the fact that those loans are actually crossed, so we actually think about that as derisking because those loans are crossed, not that it's actually made our exposure larger. I guess from a geographic perspective, we always monitor how much exposure we have to any particular geography. Right now we don't think we have any outsized concentration, including property type, you know, we focus on as well, and we, as Matt mentioned in the remarks, we like the multifamily and lighter transitional office sites. We do make, we do

take some concentration areas where we think that we like the fundamentals and we like the risk profile. From an asset management perspective, we meet quarterly. We go through all of the risk ratings, we go through all of the business plans, our team focuses on all these loans on a really a monthly basis, so we're very up to speed on the progress of these business plans and right now we're very happy with the quality of the portfolio and the underlying performance of the collateral that we have lent on.

Ryan Tomasello
And just lastly, I'm not sure if you are able to comment, but we've seen the presale reports in the markets for a CLO from you guys. I just was wondering if you were able to give us any color on that and maybe just your overall rationale behind the attractiveness of doing a CLO?

Patrick Mattson
Hey, good morning Ryan, it's Patrick. You know, as we've mentioned on some previous calls, we're actively looking to diversify our financing sources and increase kind of our non-mark-to-market capacity. But, we can't comment on any potential transactions, but we'll certainly update you on any material developments when we're in a position to do so.

Ryan Tomasello
Okay. Thanks for taking the questions.

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

Don Fandetti
Good morning. So, on the $341 million multifamily in the Southeast this quarter, can you talk a little bit about how you won that deal, were there other bidders, and then, I think I could be wrong, but it sounds like maybe that was a little bit more of a leaning towards a stabilized property and we hear about banks highlighting that nonbanks are taking share, is this the type of loan that would have potentially met the criteria of the bank, and can you talk a little bit about that theme in general or what you think of that, if its good or bad, because on one hand, maybe the nonbanks are taking credits that the banks don't want?

Matt Salem
Hey Don, it's Matt here. I'll take that one. Just in terms of the sourcing, and I think you heard in our comments we're driving a lot of our volume through existing relationships and this is one example of that. So, it's a repeat borrower for us. In terms of sourcing, and they came directly to us so there was no, we weren't in competition on this loan with either banks or other debt funds or mortgage REITs, so it's just a direct negotiation on this particular deal. I think it highlights where we like to focus in terms of the light transitional nature of the business plan, but it's still going through some value-add and so that keeps the banks away and I think the sponsors didn't want, or probably couldn't access some of the bank capital given that they're still some value-add going on at the asset. They've largely renovated the asset, so they're 80% to 90% through a renovation plan; however, I don't think they've realized the full renovations. They're still delivering some of the amenities, so they're still, our sponsors still expect increases in rent over the next year or so as all those packages come online. And then secondly, part of our collateral, a small component of the collateral was recently delivered, was recently constructed, and is in the process of lease-ups, so it's around 50% leased today, it has a certificate of occupancy and it's in the process of being leased. And so the business plan for our sponsor is just to stabilize the property from an occupancy perspective as that leases up. The property's been about 90% leased today and so it's probably got a few more points of leasing to go, especially on the newer constructed

component of it, and then obviously continue to drive rents higher as the renovations and the amenity packages are put in place. So, this is a perfect example of our ability to lend on an asset that's still going through some value-add, but is close to stabilization to a repeat sponsor that we've had a great relationship on a noncompetitive basis.

Don Fandetti
Okay. And then I guess maybe a follow-up, rates continue to go up on the short and on the long end a little bit. Have you seen any change in behavior in terms of borrowers? It seems like the deal flow across the commercial mortgage REIT space continues to be fairly healthy, and do you expect, are you worried about the velocity of transactions slowing down? What are you seeing today from higher rates?

Matt Salem
I mean, up to this point we haven't really seen any impact, and I think most of our borrowers are traditionally floating rate borrowers that are implementing some type of value-add strategy, so, and if you look at our origination volumes over the last few quarters and look at the pipeline for the fourth quarter, you know, these have been the most active origination quarters we've had, so we aren't seeing any impact of that, and I don't think we're particularly worried about it.

Don Fandetti
Thanks.

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

Steve DeLaney
Good morning and congratulation on the earnings beat this quarter. I would like to ask you a little bit about repayments, $281 million in the third quarter, can you give us a feel for how the fourth quarter might look relative to the third quarter, and then looking out to next year, if we were to assume something like a 30%, 35% annual runoff rate over next year, would that seem realistic to you? Thank you.

Chris Lee
Hey, Steve, it's Chris. Thanks for the compliment. With respect to your question, we, remember, our loans are quite sizeable, so we do have some lumpiness in the repayments,

Steve DeLaney
Yes.

Chris Lee
So, it's hard to project out, but we do think that by next year, at least in the first half of next year we'll get on a more normalized repayment schedule. So, I think your 35% of the book feels probably about right once you get into that normalized basis. Remember, most of our loans are 2017, 2018 vintage loans and the book is still a little bit less seasoned than some of our competitors in the market, but that assumption feels like a pretty good run rate once we get on a more normalized path.

Steve DeLaney
Okay, that's helpful. Thank you, Chris. And then just looking at the portfolio today, $3.8 billion. Patrick went through some of the new financing facilities that you have. How much additional net lending capacity do you see that you have at this time, or if you'd rather get at it this way, in terms

of this core loan portfolio, how large could that grow to with your current capital base? Thanks.

Chris Lee
Steve, it's Chris again. So, we think that after this pipeline closes that we discussed at the beginning of the call, we think we'll be substantially deployed with the existing capital base. So, in the short term, we want to get these loans on the books in the next quarter and then have that, you know, have the portfolio in the earnings profile of the company seasoned, but we think that given the size of our team and given the size of the opportunity set that we have the ability to originate similar types of loan volumes over, that we have experienced over the last couple of quarters. So, we'd expect at some point we will need to continue to grow our equity base and our debt base to continue to support the originations, volumes, and the demand for our product that we're seeing from our clients and borrowers.

Steve DeLaney
And Chris, that pipeline that you referred to, is that the $620 million that Ryan mentioned?

Chris Lee
Yes, that's what we mentioned.

Steve DeLaney
Okay. Thank you very much for the color.

Operator
Again, if you have a question please press star (*) then one (1). The next question comes from Rick Shane with JP Morgan. Please go ahead.

Rick Shane
Hey guys, thanks for taking my questions. I just want to follow-up a little bit on what Steve was discussing in terms of repayments. During the quarter, you guys had $281 million; you said $2.1 million in fees associated with that. That equates to about 75 basis points on repayments. As we move into 2019, should we assume somewhere in the 50 to 75 basis-point range for repayment fees?

Patrick Mattson
Rick, good morning. It's Patrick. The prepayment fees are difficult to model. They're, obviously, we get prepayment fees if the borrowers repay during the spread maintenance period. As these loans season and as they hit their business plans, they hit an open period and obviously we don't collect prepayments. So, we don't, as we forecast, we don't sort of model any sort of prepayment income. That said, it's not uncommon for us to receive it. We've received it in past quarters. I would expect that we would receive it in the future. It's just difficult to model.

Rick Shane
Sure, yeah, it's certainly a recurring part of the business. So, is one way to think of this that, and you alluded to the fact that as you go into sort of a more normal repayment cycle as opposed to a early repayment cycle that will drift down, is it also fair to assume that early repayments may slow a bit as spread tightening starts to abate, the incentive to repay early starts to go away?

Patrick Mattson
Yes, I think that's a fair statement.

Rick Shane

Okay. Last question, and this is just geography, I want to make sure that we understand exactly where the $2.1 million went through the P&L. There's $476,000 of other income. I'm assuming the bulk of that income went through the interest income line. Can you just help us map it out?

Mostafa Nagaty
Good morning, Rick. This is Mostafa Nagaty. I hope you're doing well. The $2.1 million of prepayment penalty income is actually reflected as interest income in the $52 million of interest income in the quarter.

Rick Shane
Okay. 100% of it goes through the interest income line?

Mostafa Nagaty
That's correct.

Rick Shane
Great. Thank you guys for taking my questions.

Mostafa Nagaty
Thank you.

Operator
The next question comes from Arren Cyganovich with Citi. Please go ahead. Mr. Cyganovich, your line is open. Perhaps it's muted on your side?

Arren Cyganovich
Sorry about that. The geography exposure, maybe can you just talk about where you're seeing maybe extra supply? I know you have more of a lean towards multifamily and office, maybe just talk kind of broadly about the supply for those asset classes and if there's any particular areas where you feel better or worse about financing?

Chris Lee
Arren, it's Chris Lee. I think on supply it's very specific to the markets, but maybe broadly, we clearly focus on a lot in the multifamily space. We are very cognizant of certain markets in some of the Sunbelt markets where there is supply. That being said, we are very focused on our basis. Atlanta, for instance, has a supply on the multifamily side, but our particular deal that we just made a loan on that Matt went through is in a more infilled part of Atlanta, it's right off of 285, it's in the Loop from our perspective, and it's much more supply-constrained. So we look at a lot of these markets on a more micro basis. But, in the multifamily space we focus on it a lot. On the office side, we are focused on not just supply of new buildings but also rehabilitations and adaptive reuse of old buildings, because a lot of our buildings end up being renovated to a new spec and we're focused on how many other similar business plans are going on in the market and then factoring in that supply relative to the net absorption that we're seeing and then coming to our own view on whether that supply/demand makes sense for us to lend on.

And I think the last part is in addition to supply, we focus on the basis that our borrower owns the property at, because you might have supply in a market, but if your borrower has a basis where they are effectively meeting or even undercutting rents, and this could be office, it could be multifamily, it could be other property types, that dynamic is also important. And I think the last part is we mitigate a lot of this through loan structure and making sure that we have milestones within our loans that allow us to track these business plans, and if we aren't seeing the

improvement in the property that we've underwritten, then we have the ability to turn off future funding or enter cash sweeps, etcetera to make sure that our loan is deleveraging if the business plan is not going as planned. So long answer, but it's a nuanced question, it's not just we look on a map and see how many buildings are going up. It's much more of a micro focus.

Arren Cyganovich
That's very helpful. Thank you.

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

CONCLUSION

Sasha Hamilton
Thanks everyone for joining us today. If you have any further questions, please call me after this call. Thank you.

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

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