Granite Point Mortgage Trust

Q1 2020 Earnings Conference Call

Tuesday, May 12, 2020, 10:00 A.M. Eastern

CORPORATE PARTICIPANTS

John Taylor – *President & Chief Executive Officer*

Stephen Alpart – *Chief Investment Officer*

Marcin Urbaszek – *Chief Financial Officer*

Steven Plust – *Chief Operating Officer*

Chris Petta – *Investor Relations*

PRESENTATION

Operator
Good morning. My name is Andrea, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Granite Point Mortgage Trust First Quarter 2020 Financial Results Conference call. All participants will be in listen-only mode. After the speaker's remarks, there will be a question-and-answer period. Please note today's event is being recorded.

I would now like to turn the conference over to Chris Petta with Investor Relations for Granite Point. Please go ahead.

Chris Petta
Thank you, and good morning, everyone. Thank you for joining our call to discuss Granite Point's First Quarter 2020 Financial Results. With me on the call this morning are Jack Taylor, President and CEO; Marcin Urbaszek, our CFO; Steve Alpart, our CIO; and Steve Plust, our COO.

After my introductory comments, Jack will review our current business activities and a brief recap of market conditions. Steve Alpart will discuss our first quarter originations and our portfolio, and Marcin will highlight key items from our financial results.

The press release and financial tables associated with today's call as well as our Form 10-Q were filed yesterday with the SEC. If you do not have a copy, you may find them on our website or on the SEC's website at sec.gov. In our earnings release and slides, which are now posted in the Investor Relations section of our website, we have provided a reconciliation of GAAP to non-GAAP financial measures. We urge you to review this information in conjunction with today's call. I would also like to mention that this call is being webcast and may be accessed on our website in the same location.

Before I turn the call over to Jack, I would like to remind you that remarks made by management during this conference call and the supporting slides may include forward-looking statements. Forward-looking statements reflect our views regarding future events and are typically associated with the use of words such as anticipate, expect, estimate and believe or other such words. We caution investors not to rely unduly on forward-looking statements. They imply risks and uncertainties, and actual results may differ materially from expectations. We urge you to carefully consider the risks described in our filings with the SEC, which may be obtained on the SEC's website at sec.gov. We do not undertake any obligation to update or correct any forward-looking statements, if later events prove them inaccurate.

I will now turn the call over to Jack.

John Taylor
Thank you, Chris, and good morning, everyone. We would like to welcome you all and thank you for joining our first quarter 2020 earnings call. Before we begin, we sincerely hope that everyone and their families remain healthy and safe during these challenging times. We also want to send our deep appreciation to all those who are at the front lines battling this pandemic.

As this health crisis first began unfolding, we moved to ensure the safety and well-being of our personnel and to maintaining our business activities. We were very well prepared from a business continuity perspective and want to thank everyone across the organization for their preparedness and efforts to make sure the company was ready for an event such as this one. Since mid-March, we have been working remotely very effectively, and our team is well connected and unified. Despite working remotely, we remain deeply engaged with all of our business counterparties and have been operating efficiently and without interruption as we navigate these uncertain times and markets.

Since our last communication, given the dramatically changed landscape due to the negative impacts of the COVID-19 pandemic on the outlook for the overall economy as well as commercial real estate markets, we've been very busy and pivoted our efforts. We will update you during the course of this call on a number of things, including the following: first, we rapidly shifted our focus to maximizing and preserving our liquidity, including ceasing new loan originations and announcing the suspension of our dividend. Second, we have concentrated our team's efforts on intensive asset management. Third, we have proactively enhanced the near-term stability of our balance sheet through agreements with lenders, and finally, we have been preparing a more deliberate process and working closely with Evercore, as our financial adviser to evaluate various longer-term financing alternatives to further improve our liquidity and better position the company for the current environment and for the future. As always, we continue to focus on preserving the value of our investments as well as furthering the franchise value we have built and ultimately expanding it for the benefit of our stockholders.

Our first quarter results were largely unaffected by the pandemic other than our increased allowance for credit losses related to the adoption and application of the new CECL accounting standard, which Marcin will discuss in more detail later. As a reminder, this credit reserve is a noncash adjustment to our financial statements, and its increase is predominantly driven by the COVID-19 pandemic's impact on the macroeconomic outlook, and it is not related to any specific loan losses or impairments in our portfolio. Steve Alpart will discuss our portfolio and investment activities a bit later, but in summary, we originated about $200 million of new loan commitments and funded about $80 million of loan balances, net of $108 million of repayments during the first quarter. At March 31st, the overall credit quality of our portfolio was strong with no loan impairments or non-accruals. Our April interest payment collections were very strong, with 123 out of 124 of our investments current on their debt service.

Our business model is to be a direct originator of senior floating rate first mortgage loans on high-quality commercial real estate located in attractive markets in the United States and backed by strong and experienced sponsors. We employ a disciplined credit underwriting process focused on protecting against the downside. We have remained disciplined and stuck to our knitting. Our portfolio is comprised of 99% first mortgage loans secured by a diverse pool of existing properties located primarily in the top 25 and generally up to the top 50 markets in the U.S., with 124 discrete investments. We believe that the attractive diversification profile of our portfolio across geographies, property types and sponsors reduce concentrated event risk and helps during times of economic, and market distress such as the current one. Our overall philosophy of fundamental value investing in high-quality real estate through a derisked position of a first mortgage loan is designed to protect against the downside. Our portfolio's initial LTV at origination of about 66% means that sponsors have significant equity in their properties, providing strong motivation to protect their assets and powerful support for our loans and in the aggregate for our company. Our senior team has an average of over 25 years of experience successfully navigating various economic and real estate cycles as balance sheet lenders and managers of proprietary and third-party capital.

As we have stated many times before, commercial real estate lending is fundamentally based on relationships on both sides of the balance sheet. Having been in this business for so long, we have developed strong and long-standing relationships with many of our borrowers as well as with our financing counterparties, who have been supportive and constructive through this unprecedented environment. While we're satisfied as previously reported, our limited requirements to post cash collateral with respect to certain investments, drawing on those bank relationships and our extensive market experience, we proactively engaged in productive dialogue with all of our lenders. Our financing facilities have no significant near-term maturities, are generally term matched and predominantly have no capital markets mark-to-market provisions. Our constructive lender discussions have resulted in executed and agreed in principle agreements with certain of our lenders on over $1.4 billion of outstanding borrowings on our repurchase facilities, which provides us with greater balance sheet stability and flexibility for a period of time, in exchange for deleveraging. In the process, we have reduced borrowings on 100% of our hotel loans and almost all retail loans financed with our repurchase facilities with an agreement in principle for the remainder. Having obtained greater stability in our liabilities, and as I said earlier, we are working closely with our advisers on exploring various longer-term financing alternatives to further bolster the company's liquidity and to position it to weather these uncertain times and flourish beyond.

As with our lender discussions, we have also been in active and productive dialogue with many of our borrowers regarding loan modifications on properties impacted by the COVID-19 pandemic, that have been fettered, on jointly ensuring that they can sustain their properties through the current disruptions. Asset management is a key component of our overall risk mitigation strategy, and has been, and will continue to be a significant focus for us, as we navigate this uncertain market environment. While we have tremendous confidence in our fundamental investment approach, disciplined credit and underwriting and overall quality of our portfolio, we do not expect to be unaffected by the impact of the COVID-19 pandemic. Currently, more than ever, it is critical to have the skills and experience to actively manage our assets. Our team has the skills and experience and as we previously reported, in 2018, Charles Citro joined us to head our asset management function. Charles is a team member of our senior team and brings with him over 20 years of asset management and commercial real estate credit experience, including previously heading an asset management and credit department at a major financial institution for many years.

Heading into this period of volatility caused by COVID-19, the overall real estate market fundamentals and the economy were on solid footing. Industry lending standards were generally rational with responsible levels of leverage, liquid and balanced capital markets, active real estate transaction volumes and no significant oversupply of properties, which was largely not the case before the great financial crisis of 2007 to 2008. As a result, we believe that as we get past this crisis, the real estate transaction activity should return. As there is a significant supply and demand for both equity and debt capital and U.S., commercial real estate will continue to be viewed as an attractive asset class generating attractive risk-adjusted returns.

In summary, I am very pleased with and proud of the strong performance of our entire team in response to this market environment caused by the COVID-19 pandemic. Our seasoned team has successfully navigated multiple cycles and market disruptions, each presenting its own unique challenges, this one being no different. We have the experience and expertise to handle whatever challenges are before us, managing both our assets and our liabilities in a thoughtful way, while focusing on protecting our investors' capital. On behalf of the entire team, I would also like to thank our Board of Directors for their continued partnership and support as we are working together in navigating these unprecedented events. Together, we will be able to position our company for future growth and success.

Now I will turn the call over to Steve Alpart to discuss our portfolio and recent activities in more detail.

Stephen Alpart
Thank you, Jack, and thank you all for joining our call this morning. Our thoughts are with everyone affected by this global pandemic.

During the first quarter, as the overall economy in commercial real estate markets began to experience the impact of the COVID-19 pandemic, we shifted our focus from new loan originations, asset management and working with our borrowers. Overall, investment philosophy emphasizes a holistic approach to investing and managing our assets. Granite Point, the team that originates and underwrites the loan is also responsible for asset managing it through repayment. This approach creates a strong sense of alignment and ownership, enhances dialogue with our borrowers, resulting in an active feedback loop, also leads to a significant repeat business and augments the building of strong long-term relationships. We have a great group of high-quality institutional borrowers ranging from well-known global private equity firms, vertically integrated owner operators with regional and property-specific expertise. Majority of our borrower ownership structures include a private equity firm or other institutional capital partner. Growing on our relationships, we have been actively engaged with our borrowers, testing and analyzing the status of their properties, while working hand-in-hand with both our borrowers as well as our lenders. Discussions with our borrowers have mainly centered on their plans to protect their assets over the next few months and quarters, how Granite Point can be supportive in that process. Each of these discussions is highly customized to the specifics of the situation. Some of the general themes involving flexibility around reallocating reserves, short-term deferrals of our LIBOR floor, typically paired with additional sponsor equity, all with the objective to help navigate through the business disruptions. We believe our borrowers have a strong desire to protect their assets given the level of borrower equity in these properties, resulting from our conservative underwriting and the relatively moderate leverage levels of our loans.

Our portfolio's outstanding principal balance at March 31st was approximately $4.4 billion, $5.1 billion including our future funding commitments, consisting of 124 discrete investments. These investments are broadly diversified across geographic markets, property types and sponsors. Back to markets, underlying properties are primarily located in the top 25 and up to the top 50 MSAs. We believe should help reduce concentrated event risk such as the fallout from the COVID-19 pandemic. While we expect our portfolio's performance is likely to be affected by the impact of the pandemic, currently in the short term, it continues to exhibit strong credit characteristics. In particular, our portfolio has a weighted average stabilized LTV at origination of less than 64%. 99% of our portfolio is comprised of senior first mortgage loans. We had no loan impairments or non-accruals at the end of the first quarter. 123 out of 124 of our investments paid their interest in April.

Turning to our portfolio activity for the first quarter, we closed 4 new loans with total commitments of about $200 million. Funded over $187 million of loan balances, consisted of $125 million of initial fundings of new loans and about $62 million of fundings of our preexisting loan commitments. Lower first quarter originations compared to recent quarters reflects our capital being largely fully committed as well as our rapid shift to preserve liquidity as the markets began to experience more volatility. As Jack mentioned earlier, we were able to use some of our liquidity to obtain greater balance sheet stability for a period of time. The loans we closed during the first quarter have a weighted average stabilized LTV of 55% and a weighted average yield of LIBOR plus 3.81%. In addition, we realized about $108 million of prepayments and principal amortization. Considering the current environment and lack of any meaningful transaction activity in the commercial real estate market, we expect the pace of loan repayments to remain significantly lower in the near term than what we've discussed in the past. We do not anticipate realizing any loan repayments during the second quarter, and it is difficult to predict what may happen for the rest of the year. General market expectations are that as the economy reopens, some transaction activity should return in the second half of the year, and if it does, we may realize some loan repayments in the third and fourth quarters. Exact timing and volume are hard to forecast. We expect that the funding of our commitments on existing loans should also slow down, particularly those related to capital expenditures and leasing costs. I mentioned earlier, we funded about $62 million of such commitments in the first quarter.

Looking forward, it is challenging to predict when and to what degree transaction activity will return to the commercial real estate markets, and we would not be surprised to see some activity reemerge over the next few quarters. As of today, we have no new loan commitments, and we are largely focused on asset managing our existing portfolio, along with our liabilities and continuing our constructive dialogue with our borrowers and lenders. We have seen some limited activity in certain areas of our market, and all market participants are focused on price discovery and how to evaluate and price risk in this new environment. Once markets stabilize and activity returns, we believe we will see wider loan spreads, along with higher cost of funds and lower leverage, probably resulting in somewhat higher returns to lenders. Granite Point has a well-established presence in the commercial real estate debt market as a reliable lending counterparty to a strong roster of repeat borrowers. Given the capabilities of our direct origination platform, evidenced by the strong track record of new loan originations since the inception of our business, we are highly confident that we will be able to take advantage of attractive future market opportunities to the benefit of our stockholders.

Now I'll turn the call over to Marcin for a more detailed review of our financial results.

Marcin Urbaszek
Thank you, Steve, and good morning, everyone. Thank you for joining us this morning.

For the first quarter of 2020, we reported GAAP loss of $37.2 million or $0.68 per share, which included a $53.3 million or $0.97 per share provision for loan losses related to the application of the new CECL accounting standard. Our core earnings for the first quarter were $17.5 million or $0.32 per share. Book value as of March 31st was $17.43 per share and included $1.31 per share aggregate impact of the adoption and application of the CECL standard. Additional details regarding CECL's impact on our financial statements can be found on pages 5 and 6 of our earnings presentation.

Focusing on some of the drivers of our first quarter earnings away from CECL. Our net interest income increased by about $800,000 versus last quarter, largely due to lower LIBOR, resulting in lower interest expense. We also recognized other income of about $0.5 million related to certain onetime loan fees. Despite the fact that our overall realized yield on our portfolio declined by about 30 basis points versus Q4, our net interest margin expanded a bit as our cost of funds declined along with short-term rates and we benefited from LIBOR floors in our loans. At quarter end, about 88% of our LIBOR floors were in the money, and as of last week, that ratio increased to over 95%. The combined increase in net interest income and other income of about $0.02 per share was more than offset by higher operating expenses, largely related to higher professional and advisory fees, which drove the decline in our core earnings by about $0.02 quarter-over-quarter.

Turning to our balance sheet, our portfolio principal balance increased slightly to about $4.4 billion and was 99% comprised of senior first mortgage loans. We had about $99 million of cash at quarter end and about $83 million as of Friday. As Jack mentioned earlier, over the course of the last several weeks, we used some of our liquidity to deliver certain of our assets and achieved greater stability and flexibility of our balance sheet for a period of time through agreements with our lenders. We ended the quarter with total leverage, including the nonrecourse, non-mark-to-market CLO debt of about 3.5x debt-to-equity, and our recourse leverage was at 2.5x, both of which also reflect the impact of CECL on our GAAP equity.

In terms of credit performance, while our portfolio continues to exhibit strong credit characteristics with no impairments, non-accruals or maturity defaults, in the first quarter, we downgraded risk ratings on over $670 million of total committed loan balances, largely related to the impact of the COVID-19 pandemic. Among those downgrades, we moved 2 additional loans with a combined committed balance of over $55 million to a risk category rating of 4. We are actively monitoring the credit performance of our assets and may further adjust our risk ratings in the future if we believe that additional new facts warrant such adjustments.

Finally, I would like to conclude my remarks with an overview of our CECL methodology and some detail around our current reserve for credit losses. As a reminder, CECL became effective for GPMT and other similar public companies on January 1, 2020, and requires lenders to record an estimated lifetime reserve for credit losses against all investments in our portfolio. As disclosed in our Form 10-Q, given the lack of loan losses or specific loss reserves since the inception of our business, in connection with our implementation and application of the CECL standard, we elected to use a probability of default and loss-given-default analytical model combined with a subset of historical loan loss data licensed from Trepp LLC. In addition to the $18.5 million, or $0.34 per share, day-one impact from adoption of CECL on January 1 recorded as a reduction of equity, we also recorded a provision for loan losses of $53.3 million, or $0.97 per share, in our income statement, related to the application of CECL in Q1. Our cumulative impact to book value of our total CECL reserve is $71.8 million, or $1.31 per share, and represents approximately 140 basis points of our total loan commitments as of March 31st. Our provision for loan losses recorded in Q1 is largely related to the change in macroeconomic conditions and projected impact of the COVID-19 pandemic on the outlook for the economy and commercial real estate market in general, and is not specific to any loan losses or impairments in our portfolio. For further discussion of the CECL topic please refer to our 10-Q.

Thank you again for joining us today, and now I will ask the operator to open the call to 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 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 the roster, and our first question comes from Steve Delaney of JMP Securities. Please go ahead.

Steven Delaney
Good morning everyone. I am glad to hear that you are all well. I would like to start with the CECL reserve. Marcin, you mentioned that there have been no impairments as well as no non-

accruals, so, that tells me the entire $71.8 million that you have, we should consider that to be a general reserve without any specific reserves. Am I interpreting your comments correctly?

Marcin Urbaszek
Good morning Steve, thank you for joining us. Yes, that's how we thought about it. It's a general reserve for us, yes.

Steven Delaney
Okay. Great, and just looking at Page 6 in the deck, certainly, as you break down the reserve impact, loans, securities, but you have other liabilities with the $5.7 million mark. Can you clarify that for me, please?

Marcin Urbaszek
Sure. That's related to the unfunded commitments. We're required to book a reserve for both funded and unfunded. So, this is the unfunded piece.

Steven Delaney
Makes perfect sense. I knew that, but I wasn't sure for some reason, not focusing on liabilities, and that's exactly where you would have to put it. Okay. Great, and there was talk of deleveraging certain hotel loans, that you were financing on certain lines. Just generally, can you comment on post that deleveraging? Can you offer some type of a range of what your advance rate on those hotel loans are, and the financing of those hotel loans might look like after you have deleveraged? Not specifically, some kind of a general range.

John Taylor
You're asking what our advance rate on the hotels would be after the deleveraging?

Steven Delaney
Yes. The borrowing advance rate on the hotels, yes, sir.

John Taylor
Right. We prefer not to get into specifics on that, but we'll say that we voluntarily paid them down. Which is in line with what our discussions with the lenders, we agreed at reasonable levels and that they felt comfortable with.

Steven Delaney
Okay. I can understand that, thank you. I understand building liquidity, deleveraging is very important. At some point, I know you have to consider your taxable income for the full year, and we are classifying your dividend currently as being suspended related to the first quarter. Can you share any thoughts about when you feel the Board might readdress the issue of a cash dividend?

Marcin Urbaszek
Hi Steve, it's Marcin again.

Steven Delaney
Hi Marcin.

Marcin Urbaszek
Look, I think you're correct. As we said in our press release, we suspended a Q1 dividend to preserve liquidity given what's going on in the world. We are in constant dialogue with our

Board. We will be discussing the second quarter dividend and going forward later in June. So obviously, there is a lot of different factors that go into that, but we'll discuss that with the Board, and then we'll come back to the market with our next steps around that.

Steven Delaney
Well, obviously, we'd like to see a dividend, the analysts, the investment community, I think, would love to see one, but not at the risk of hampering liquidity. Liquidity and operating flexibility would seem to be the paramount need at this time. So, thank you. Thank you each for your comments. That's it from me, thank you.

Marcin Urbaszek
Thank you.

Operator
Our next question comes from Jade Rahmani of KBW. Please go ahead.

Jade Rahmani
With the stock trading at 27% of book value, have you given any consideration to the prospect of selling loans? even at discounts to par and using proceeds to then pay off any repo funding those loans and the net equity to buy back shares? At 27% of Par, do you believe the assets are generally good? At 27% of book value, that might be a highly accretive to book value on a go-forward basis.

John Taylor
Hi Jade, this is Jack. Good to speak with you and thank you for your question. So first, I'll say, contrary to some press reports that have been out there, we've not in fact, been actively engaged in selling portfolios of loans, just want to set the record straight on that. We are closely working with Evercore as our financial adviser to explore various financing alternatives, and as we said, that's to improve our liquidity position, and those alternatives can take a variety of forms, and we will not exclude loan sales, but we're not actively selling loans at the moment, as I just said. I will add, as part of an asset management decision, it would not be unusual to strategically sell some assets, depending on a variety of different circumstances relating to a particular asset, but we are aware that selling the loan at par or close to par when you're trading at a very low book value would be helpful. So that's part of our overall analysis, as we look at our financing alternatives.

Jade Rahmani
Thanks very much, I think it's worth noting that in the past cycle coming out of the financial crisis, there were a couple of mortgage REITs that were able to do such actions and ended up putting a floor under their stock and helping provide a path to recovery. I wanted to ask about the April collections, you mentioned 123 out of 124 loans are current, what percentage of the April debt service was funded out of reserves?

Stephen Alpart
Hi Jade, it's Steve. Thank you for joining us today. It really varies by asset. Some of these loans are paying debt service out of cash flow and some of the loans are paying debt service from built-in reserves, so it's really a mix. You can assume that on a lot of the hotel loans that are closed, it is being paid out of reserves, and on a lot of the multifamily, office and industrial properties it is coming out of cash flow, but it really varies a lot deal to deal.

Jade Rahmani
Okay, and if you adjusted for the original structure of the loan, how much of negative migration was there toward loans that had been funding debt service out of cash flow to loans funding out of reserves? And generally speaking, what percentage of the loan balance is the reserve when you make an origination?

Stephen Alpart
Again, it really varies deal by deal, wish I could give you a more specific answer, so for loans that when we originate them are cash flowing loans, there may not even be a need for a reserve at all. For a typical bridge loan, you might expect to see a debt service reserve built into the loan while the property is in the ramp mode, and then just depending on where that loan is in its business plan and life cycle will dictate whether or not there's existing reserves, and most of these loans are built with replenishment obligations. We're having very constructive conversations with our borrowers. These loans are generally fairly low levered. There's a lot of equity built into the loans and the borrowers have a lot of equity to protect, so what we're seeing is that to the extent that there was a reserve and there is a need for reserve, we're seeing that borrowers are stepping up typically to replenish that.

Jade Rahmani
Thank you, and in terms of the unfunded commitments, which total about $760 million, how much would you anticipate being funded in 2020 from 2Q through year-end?

Stephen Alpart
Thanks, Jade. Steve again. So, the timing of the funding is very variable, and it depends on market conditions. In a bull market when loans are getting refinanced before they mature, it's likely that not all future fundings will be drawn. In the current environment, a lot of these loans are likely to extend, and we would expect that the pace of future fundings would likely slow and be funded over a longer period of time, and then the specific future fundings are always going to be highly dependent on the specifics of each property. Then another point just to make for liquidity purposes, we assume that all future fundings will be drawn. This is the assumption that we make, and we're typically responsible for about 25% of that amount, and we tend to finance the rest, and we are meeting all of our future funding obligations. As far as your specific question as to how many will be drawn by the end of the year, it's really a function of the pace of business plans.

Jade Rahmani
Thank you for taking the questions. Hope you're all doing well. I will try to get back in the queue.

Steve Alpart
Thanks Jade.

Operator
Our next question comes from Doug Harter of Crédit Suisse. Please go ahead.

Douglas Harter
Thanks. In your prepared remarks you talked about exploring various financing alternatives, I am just wondering if you could sort of talk through big picture what some of those alternatives might be?

John Taylor
Sure. Hi, this is Jack, thank you, and good to speak with you. Can you hear me okay?

Douglas Harter
I can.

John Taylor
Okay, thank you. Yes, we're in extensive discussions about financing alternatives, and it's early to speculate as to which pipes there might be. I would say that our approach is we have very specific ideas about how we might like to proceed, but our approach is to engage with the market in a priced and structured discovery process and optimize the best benefits through that process. So, it's early now to go into any detail, but we're working closely with Evercore to look at those.

Douglas Harter
Understood, and then I was just wondering on the deleveraging, you talked about with your lenders, I guess, is all of that deleveraging kind of captured in your current liquidity? And then if you could just talk about what you might have received back from the lenders? Is there a standstill as far as future margin goals? Just any kind of the give and take that you had there with your lenders?

John Taylor
Sure. Understandable question. First, as we said in our prepared remarks, we reduced the borrowings on our hotel loans that are financed on the repurchase facilities, and we've similarly done so with our retail property loans. There's a couple that are agreed in principle that we expect to document and finish in the next day or so. The dollar amounts are not for the remainder of the agreed principle, the dollar amounts are not included in the cash position, but I will say we expect those to be modest, and not dramatic movements in our cash position in the single-digit millions. We have limitations, in March with respect to the $1.4 billion that we mentioned, and on the other lines, that we've engaged with our lenders on, those are asset-specific paydowns and it wasn't though that we would be paying out the full line across the board. What we received in exchange was the limitations on March for a period of time, those run from 90 to 120 days. Our view is that has given ourselves time to deliberatively explore longer-term financing alternatives to improve liquidity, and we've been very satisfied with the response of the banks and their support.

Douglas Harter
Great. Thank you, Jack.

John Taylor
Thank you.

Operator
Our next question comes from Rick Shane of JP Morgan.

Richard Shane
Hey, guys, thanks for taking my questions, and I hope everybody's well. Look, you guys are in an interesting position in a lot of ways, and you've provided a lot of detail on your conversations with the banks and your financing, I'm curious about your conversations with the sponsors and owners of properties. We had a call this morning for one of your peers, I think you probably listened in, and they talked about what is effectively a strategic default and deed in lieu, I am

curious given the diversity of owners of your types of property, what conversations you're having? How do you feel they're going to behave in terms of strategic default or financial resources to buffer properties in the short term?

Stephen Alpart
Hey Rick, it's Steve Alpart, hope you're well this morning. Thanks for joining. So, I would say, we have a very active portfolio management process. When the pandemic hit, we're in active dialogue with our borrowers. Those conversations I would describe as being very constructive. We're not seeing what you were just describing from the prior call, so I would describe those conversations as productive. We're in conversation with a number of our borrowers. You could assume it's a lot of the hotel and retail borrowers. We're talking to folks that which you've heard us describe the type of borrowers that we have, high-quality institutional borrowers. Relatively moderately leveraged loans, lots of equity to protect, and again, I would describe those conversations as very constructive.

Rick Shane
Got it. Great. Thank you very much. Take care, guys.

Steve Alpart
Thanks, Rick

Operator
Our next question comes from Stephen Laws of Raymond James.

Stephen Laws
Appreciate what you've covered so far and a couple of follow-up questions. I guess, first, Jack, thinking about the management structure, can you give us any idea of how we should think about expenses? What's the run rate expense under internal structure? And how much of the incremental advisory fee is contributing right now to the operating expenses that we see? And then kind of coupled with that, with regards to Evercore, are they advising on the internalization as well? Are they looking at other strategic options that look at other things with the manager? Can you provide any color there would be great?

John Taylor
I'll pass it on to Marcin in a minute to talk about the advisory fees. First, as we discussed in our press release from March 2nd, any details relating to the internalization process will be announced at a later date when they become available and when a final agreement and definitive documentation are expected to be delivered. So, I can't make any more commentary or comments about that internalization process at this time. I would pass it on to Marcin to answer your questions about the expenses.

Marcin Urbaszek
Hi Steven, good morning, thanks for joining us. Again, as Jack mentioned, we can't really talk about the expenses related to the internalization. Evercore is working with us on exploring various financing alternatives to provide more stability to our balance sheet, that involves a lot of different options, as you can imagine. I will take this opportunity to address expenses since you asked about it, just in general for our earnings in Q2. In Q1 and Q2, as I said, in Q1, we had some higher expenses. In Q2, I would also assume we will have a couple of million more of operating expenses related to all the different advisory fees that we're incurring, but beyond that I would like to not comment beyond that.

Stephen Laws
Okay, and to clarify, is that a couple of million more than Q1 or just a couple of million more than the run rate you saw through last year, which is more of a normalized level?

Marcin Urbaszek
I would assume it's incremental to the first quarter level.

Stephen Laws
Great, and to move up the income statement, appreciate the disclosure on the LIBOR floors. Certainly, that's going to be a benefit, and we'll make some adjustments to offset with lower repay and origination fees, but can you talk to financing spreads should see a benefit from lower LIBOR as you renegotiate these financing facilities? Are you giving up some of that benefit and paying a higher spread to LIBOR that we need to consider as we forecast the net interest income number?

Marcin Urbaszek
I would say, so far, we haven't seen much in change of financing costs. I think that's not to say that may not change as we continue our discussions with our financing providers, and our earnings, obviously, we have pretty much most if not all of our LIBOR floors right now in the money. So, we should benefit from that, but obviously, there's a lot of moving pieces around of net interest income, what will happen for the rest of the year and what potential other financing alternatives, we have options to use, so.

Stephen Laws
Great, and a final question, Marcin, around the leverage covenants in the financing facilities, I was reading a little bit in your 10-Q, and I appreciate the disclosure there. Can you talk about the impact CECL is having there? If there's another big write-down just because the economy deteriorates and it's, again, noncash, is it tied to GAAP equity and you potentially have issues there? Or do you have labors from these counterparties to adjust your equity to add back your noncash CECL reserve?

Marcin Urbaszek
It is based on GAAP equity, and as you can imagine, things like this will obviously be part of our discussions with our lenders going forward.

Stephen Laws
Appreciate the comments you guys, and it's good to hear from everyone. I hope you all are doing well.

Jack Taylor
Thank you. We hope you're doing well.

Marcin Urbaszek
Thank you.

Operator
Our next question comes from Arren Cyganovich of Citi.

Arren Cyganovich
On the internal risk ratings, I was just looking at the migration there, I guess, clear to me is that there's about $1.1 billion of hotel and retail loans, but the risk rated 3 and 4 are only about $738 million, which I guess would imply $320 million is being rated 2, which is kind of like your average risk. Why wouldn't those be put into a lower risk category or I guess, maybe higher risk, I should say in this environment?

Steven Plust
Hi Arren, it's Steve Plust. I hope you're well. As you noted, we constructed our ranking system, establishing a score of 2 as average risk for our portfolio, and the system is highly quantitative. It takes into consideration a range of variables, including sponsorship, property quality, market, property cash flow, both in place and prospective and loan-to-value, and all of those factors are taken into consideration when we risk rate loans.

Quarter-over-quarter, we moved slightly over $670 million loans down 1 risk rating level, which does represent almost 15% of our portfolio, so we think what we've done is appropriate and it's given all the characteristics of all the loans in the portfolio.

Arren Cyganovich
Okay, and then in terms of the specific reserving in the future, you do have a few loans that are rated 4. Is that expected whenever one of these loans would move into a non-accrual? Or is it only if you then look at the collateral value underneath, and you see the probability of a loss? How are you thinking about in terms of specific reserves for any of your loans?

Marcin Urbaszek
Yes. Arren, it's Marcin. Thanks for joining us. I think you're thinking about it the right way. If conditions were to deteriorate from here as we get more information potentially about what's going on with these properties, that's when kind of we would move to the more specific reserves for particular assets.

Arren Cyganovich
Okay, and then have you received any loan modification request yet or exercised any for any of your borrowers?

Stephen Alpart
Hi, it's Steve. Yes, we have and we have a robust asset management process, we've been very proactive with our borrowers. We are in discussions with a number of them, as I think I mentioned earlier, it's very focused right now on our hotel loans. We don't have a lot of retail loans, but there's a few retail loans we're talking about also, and it's been pretty quiet, I would say, with office and warehouse, and multifamily being some place in between, but there's not a lot of conversations right now on multifamily, so it's mainly been on the hotels for us.

Arren Cyganovich
Okay. Thank you.

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

Jade Rahmani
Thank you very much. Just circling back to Steve's question about covenants, how much room is there on the tangible net worth covenant, the 80% advance rate against that?

Marcin Urbaszek
We have a couple of different covenants. The tangible net worth covenants, obviously, it's 75% of our capital, roughly, that's a little bit separate from the leverage covenant. The leverage covenant is at 80%, and I think we were at 78.5% by the end of the quarter. There's still obviously some room there, but obviously, this is something we're monitoring closely, and as we are managing our liabilities and discussing things with our lenders, this is something we are paying attention to.

Jade Rahmani
And can you give a range of what the magnitude of anticipated deleveraging is over the next two quarters?

John Taylor
Hey, Jade, this is Jack. Sorry about that. I have my phone on mute. I actually prefer not to give a range on that, and I'll explain why. The type and structure of the longer-term financing alternatives will largely impact what other and the extent of any other further deleverage that we'll be pursuing. So, it's really premature to go there now, and I'll just say it's an iterative process on the capital raise discussions, the financing alternative discussions for liquidity and the discussions with our banks.

Jade Rahmani
Okay, and I guess a big-picture question. You've all been in the industry for a very long period of time and have had business models in different aspects, whether it be CMBS coming out of the RTC days or mezzanine lending. Has the pressure from repo given caused any rethinking of the business model, do you ultimately think that the best relative value is first mortgages levered on repurchase facilities? Or would you consider post crisis assuming the company survives, and things come back, would you consider more of mezzanine lending model with off-balance sheet financing, but a lot of asset management control of the asset, but no margin call risk?

John Taylor
Thanks for the question. This is Jack again. I'll try to answer that. It's very early days, but I'll do my best to say, first, yes, I think the assumption should be that we're going to survive, and so we have been giving thought to our future, and we believe that senior first mortgage loans will continue to be a superior investment opportunity to profitably deploy capital and significant amounts of capital. We do, as you point out, broad experience across a whole variety of market structures and forms, and it's difficult to predict just now what the market will look like after our whole country gets through this crisis. We like to keep an eye out for ways to exploit the more structural changes that result, and one thing that we do believe is that there will be an even greater demand for first mortgage loans. We're pursuing other types of, I'll call it, investment structure that there would be a rethinking by the whole community of lenders, whether they're commercial mortgage REITs or debt funds, about the use of the financing world that's available to them.

Jade Rahmani
Thanks very much.

John Taylor
Thanks.

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

CONCLUSION

John Taylor
Thank you very much and we would thank everybody for being on the call with us. These are very, very challenging times. We are delighted to hear our analyst community friends and family well and on the call with us, and we look forward to speaking with you again soon, and to give you further updated reports on how we're doing, and we wish everybody good health and safety through this period of time. Thank you.

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