Granite Point Mortgage Trust, Inc.
First Quarter 2024 Financial Results Conference Call
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<u>**Presenters**</u>
Jack Taylor, President and Chief Executive Officer
Steve Alpart, Chief Investment Officer and Co-Head of Originations
Peter Morral, Chief Development Officer and Co-Head of Originations
Steve Plust, Chief Operating Officer
Marcin Urbaszek, Chief Financial Officer
Chris Petta, Investor Relations

<u>**Q&A Participants**</u>
Stephen Laws – Raymond James
Doug Harter – UBS
Steve DeLaney – Citizens JMP
Jade Rahmani – KBW

Operator
Good morning. My name is Paul, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Granite Point Mortgage Trust First Quarter 2024 Financial Results Conference Call.

All participants will be in listen-only mode. After the speakers' remarks, there will be a question-and-answer period. Please note today's call is being recorded.

I would now like to turn the call over to Chris Petta with Investor Relations for Granite Point.

Chris Petta
Thank you, and good morning, everyone. Thank you for joining our call to discuss Granite Point's First Quarter 2024 Financial Results. With me on the call this morning are Jack Taylor, our President and Chief Executive Officer; Marcin Urbaszek, our Chief Financial Officer; Steve Alpart, our Chief Investment Officer and Co-Head of Originations; Peter Morral, our Chief Development Officer and Co-Head of Originations; and Steve Plust, our Chief Operating Officer.

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

The press release, financial tables and earnings supplemental associated with today's call were filed yesterday with the SEC and are available in the Investor Relations section of our website, along with our Form 10-Q. I would like to remind you that remarks made by management during this call and the supporting slides may include forward-looking statements, which are uncertain and outside of the company's control. Forward-looking statements reflect our views regarding future events and are subject to uncertainties that could cause actual results to differ, materially, from expectations. Please see our filings with the SEC for a discussion of some risks that could affect our results. We do not undertake any obligation to update any forward-looking statements.

We will also refer to non-GAAP measures on this call. This information is not intended to be considered in isolation or as a substitute to the financial information presented in accordance with GAAP. A reconciliation of these non-GAAP financial measures to the most comparable GAAP measures can be found in our earnings release and slides, which are available on our website.

I will now turn the call over to Jack.

Jack Taylor
Thank you, Chris, and good morning, everyone. We would like to welcome you and thank you for joining us for Granite Point's First Quarter 2024 Earnings Call.

The first few months of 2024 have resulted in diverging trends with the ongoing strength of the overall economy and a healthy rebound in the equity and fixed income markets, while the commercial real estate sector continues to be pressured by high interest rates, suppressed transaction volumes, some fundamental shifts such as the work-from-home trends, and higher costs such as materials and labor impacting properties that require some level of capital expenditure.

The year began with a more upbeat sentiment in the commercial real estate market, fueled by expectations of six to seven interest rate cuts by the Fed over the course of 2024 and an anticipated rebound in real estate transaction activity which, along with pent-up capital demand, contributed to a tightening of credit spreads and a strong pickup in CMBS issuance. However, since then, higher-than-expected inflation readings and stronger employment reports have lowered the consensus estimates for interest rate cuts to a hope for one to two cuts by year-end, resulting in higher interest rates across the curve and with uncertainty and sentiment in the commercial real estate markets, notably worsening in the past several weeks. We believe that the path of interest rates will continue to be the main factor affecting the activity in and the performance of the commercial real estate floating rate loan market in the near to medium term. We expect the prolonged elevated rates will further impact the real estate market in the near-term by continuing to suppress transaction activity and property values and by putting more pressure on certain borrowers who may be reluctant to support their properties, especially those with additional capital needs in more challenged markets and may, instead, choose to sell the properties, rather than continue to wait for a lower cost of capital. While we are seeing this in the market and in our portfolio, we want to note that most of our borrowers are continuing to support their properties. However, driven by some of these dynamics and the change in sentiment within the commercial real estate market, we lowered the risk ratings on several of our loans and increased our CECL reserves to reflect the market uncertainty and ongoing pressure on property values. Our GAAP results include additional credit loss provisions, mainly related to the risk-rated five loans, which increased our overall first quarter CECL reserve to 7.5% of total commitments from about 4.7%, last quarter. Our five rated loans are in various stages of their respective resolutions with some expected to occur in the nearer term, while the timelines of others may extend longer.

Although we see lending activity is currently subdued, we anticipate that improving market liquidity and opportunistic capital, actively, looking for investments should help drive our non-performing loan resolutions over the course of this year, though timing remains difficult to predict. We have visibility on resolutions for most of our risk-rated five loans, which may occur over the next several quarters. We believe we could resolve some $150 million to $200 million of these loans in the near term. Most of the credit impact on our portfolio is driven, to varying degrees, by the office exposure, including on some where the overall value of the property may currently be mainly concentrated in retail or multifamily with an underperforming office component. While office leasing remains slow, we have seen some improvement in office leasing activity in select markets. Multifamily fundamentals remain generally favorable. However, we have seen some pressure on property values in this sector, resulting from higher interest rates and higher cap rates. While there is meaningful liquidity in the apartment market, even properties with strong cash flow are not immune from the effects of higher rates, and we are likely to realize modest losses on select multifamily loan resolutions, where sponsors have decided to transact in the near term. That said, we do not anticipate these select multifamily credit events to be very material in the context of our portfolio.

We remain highly focused on our asset management activities and moving through this credit cycle, while maximizing economic outcomes for the business and our shareholders. We believe that the process of repositioning our portfolio, even though it results in additional credit reserves and associated losses, will position us to return to our core business of lending, so we can grow the portfolio and improve our run rate profitability, over time, and support our total shareholder returns. Our strategy for this year reflects our ongoing conservative approach to the market with an emphasis on maintaining higher liquidity and, proactively, managing our portfolio to protect our balance sheet. We benefit from our team's decades of experience successfully managing through various real estate cycles and market volatility. Over the course of the last couple of years, we have materially reduced our leverage through paying off corporate debt and deleveraging our loan portfolio, modified and resolved many loans and realized healthy prepayment levels. We firmly believe that during challenging periods, emphasizing balance sheet stability is the prudent and effective strategy to navigate market uncertainty and to reposition the business for future growth opportunities, even though such steps pressure the company's returns on profitability in the near-term.

Recent market consensus points to the bottoming of the property value declines, while the future path of macro trends remains uncertain and fundamentals across property types continue to be uneven and the timing of interest rate cuts will drive the path of recovery for commercial real estate. We agree that once there is more visibility on the cost of capital in the market, the sentiment and activity should improve significantly, particularly later in the year, all of which will be aided by the large amounts of capital currently available on the sidelines.

We will continue working with our borrowers to facilitate repayments and resolutions of our risk-rated five loans. Given their material effect on our current returns, we believe that these actions, over time, will help improve our run rate profitability, while positioning us to take advantage of attractive investment opportunities in the future.

I would now like to turn the call over to Steve Alpart to discuss our portfolio activities in more detail.

Steve Alpart
Thank you, Jack, and thank you, all, for joining our call, this morning.

We ended the first quarter with total portfolio commitments of $2.8 billion and an outstanding principal balance of about $2.7 billion, with about $134 million of future fundings, which account for only about 5% of total commitments. Our portfolio remains well diversified across regions and property types and includes 71 loan investments with an average size of about $38 million and a weighted average stabilized LTV at origination of 63.5%. Our realized portfolio yield for the first quarter was about 7.7%, net of the impact of the non-accrual loans, which we estimate to be about 175 basis points for the first three months of the year. During the first quarter we funded about $17 million of existing loan commitments and upsizes, and realized about $35 million of loan repayments and paydowns. So far in the second quarter, we have funded about $3 million of existing loan commitments and realized about $13 million in loan paydowns.

Given the macro uncertainty, high interest rates and a meaningful shift in market sentiment, particularly over the last few weeks, we anticipate our volume of loan repayments to be lower than the $725 million we realized, during 2023. We expect our portfolio balance to trend lower in the coming quarters as we maintain our conservative stance and continue to prioritize maintaining higher levels of liquidity and working diligently to resolve our risk-rated five loans.

The change in market sentiment, expectations for higher cost of capital and lower property value that Jack just discussed, has contributed to the risk rating downgrades of certain of our loans and higher provisions for credit losses during the quarter. During Q1, we downgraded five loans to a risk rating of five, which we will briefly highlight. The first is a $94 million mixed-use office and retail loan in New York City, where the sponsor had been pursuing a recapitalization plan, potential JV with a new partner or a sale of the property. The recapitalization did not materialize, and over the course of the quarter, the sponsor made the decision to instead sell the building. The sale process is in its early stages, and we are in active discussions with the borrower about next steps. The next one is a $26 million office loan in the Boston CBD, where the property has been impacted by challenging office leasing dynamics and low liquidity in the office sector. The sponsor has been exploring a potential residential conversion opportunity for the property. They may also choose to list it for sale in the near term, and we are working with them on potential resolution options. The remaining three include a $51 million mixed-use, multifamily event space office loan in Pittsburgh, a $34 million multifamily loan in Chicago and a $12 million multifamily loan in Milwaukee. The borrowers on these three loans have been conducting sales processes for their properties to repay our loans. The recent interest rate and capital markets environment has resulted in an expectation that the ultimate sale proceeds on all three will likely come in below our loan amounts which, in turn, resulted in our impairment assessments, as of March 31st.

In addition, during the first quarter, we also downgraded three other office loans with an aggregate UPB of about $90 million to a risk rating of four, as the collateral properties have been impacted to varying degrees by office leasing challenges and reduced liquidity for office properties, generally. The risk rating downgrades, which were partially offset by several upgrades to loans where the business plan has been achieved, resulted in our portfolio weighted-average risk rating modestly increasing to 3.0, as of March 31, compared to 2.8 in the prior period.

With respect to our other risk-rated five loans, most of them are in various stages of their respective resolution processes, which remain ongoing. The mixed-use retail and office property collateralizing our $84 million loan in Baton Rouge, LA, is in a sales process and though the ultimate timing and outcome remain hard to predict in this market, we hope to reach a potential resolution in the coming months or quarters. Similarly, the office property with a retail component that secures our $81 million loan in Chicago is also in the process of being sold, which could happen in the intermediate term. The sale process for the Minneapolis hotel securing our $28 million loan remains ongoing and may take some time, given the local market dynamics. We are in discussions with the sponsor on the $37 million L.A. mixed-use office and retail loan, as they are evaluating various leasing opportunities for the property. We are actively managing our one REO office asset in Phoenix, while also marketing it for a potential sale, later this year. The office property securing our $36 million, four risk-rated loan in Massachusetts is likely to be transferred to REO in the coming months through a negotiated deed in lieu. The asset has positive cash flow, and we intend to maximize the value of the asset, over time.

Despite the low real estate transaction volumes overall, there is some increased liquidity in the market as buyers believe we're getting close to the bottom in valuations, have capital to deploy and are beginning to invest in the long-term recovery. Our strategies for these loans are likely to include property sales, sometimes with staple financing from Granite Point, loan sales, discounted payoffs, loan restructurings and select transfers to REO, where we see potential for medium-term value upside, all with the goal of maximizing economic outcomes for the company. Timing is hard to predict in this type of market but given the current macro backdrop and ongoing discussions with our borrowers, we believe we could resolve many of these assets by the end of 2024 with some potentially taking longer to resolve, given more challenging local market dynamics. Our goal is to balance the timing of resolutions, realized losses and improving the company's run rate profitability by repaying higher cost financing and/or returning some of these assets to accrual status on a de-levered basis with new equity sponsors supporting the properties.

Despite the headwinds impacting the loans we've just discussed, we remain pleased that most of our high-quality institutional sponsors continue to support their properties and are progressing on their business plans. While we have a lot of work to do, we look forward to resolving our five rated loans, an REO asset, and returning to our core business, as soon as possible.

I will now turn the call over to Marcin for a more detailed review of our financial results and capitalization.

Marcin Urbaszek
Thank you, Steve. Good morning, everyone, and thank you for joining us, today.

Yesterday afternoon, we reported a first quarter GAAP net loss of $77.7 million, or $1.53 per basic share, which includes a provision for credit losses of $75.6 million, or $1.49 per basic share, mainly related to certain risk-rated five loans. Distributable earnings for the quarter were $1.3 million, or $0.03 per basic share, and were mainly impacted by non-accrual loans, which pressured interest income by approximately $12 million, or $0.24 per basic share. Our book value at March 31, was $11.14 per common share, a decline of about $1.77 per share from Q4, which was primarily due to the loan loss provision mentioned earlier.

Our CECL reserve at quarter end was about $213 million, or $4.17 per share, representing 7.5% of our portfolio commitments, as compared to $137 million, or 4.7% of total commitments last quarter. The change in our CECL reserve was mainly related to the additional provisions on loans that were newly risk-rated five, this quarter. Our general reserve increased by about $12 million in Q1 due to macro assumptions, expectations for ongoing challenges in the commercial real estate market and pressure on property values. Over 70% of our total CECL reserve, or $155 million, is allocated to select individually-assessed loans, which implies an average estimated loss severity of about 29% of those assets. As of quarter end, we had about $690 million of loans on nonaccrual status, most of which are in various stages of resolutions. The additional five loans that were placed on non-accrual as of March 31, accounted for about $4 million of interest income realized during the first quarter. Given the impact our non-performing loans have on the company's run rate profitability, we anticipate our earnings to be below our dividend in the near term. As we make progress on resolving these assets, we believe the company's profitability should improve, over time, though the exact timing remains difficult to predict in this uncertain market.

Turning to liquidity and capitalization, we ended the quarter with over $155 million of unrestricted cash, and our total leverage modestly increased to 2.3x in Q1, compared to 2.1x in

Q4, mainly due to a lower equity balance impacted by the higher CECL reserves. Our funding mix remains well balanced, and we enjoy continued support from our lenders, highlighting our long-standing relationships in the market. As of a few days ago, we had about $130 million in cash.

I would like to thank you again for joining us today and we will now open the call for questions.

Operator
Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press "*", "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press "*", "2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

One moment please while we poll for questions.

Thank you. Our first question is from Stephen Laws with Raymond James. Please proceed with your question.

Stephen Laws
Hey, good morning. Steve, I wanted to circle back to something you mentioned specifically around Pittsburgh, Chicago and Milwaukee, the three new loans, two multi, one mixed-use multi-unit. It went from three to five during the quarter. Can you give us a little more detail on that? Was it a situation where they were going to defend and buy caps and then rates moved and they changed their strategy on protecting assets? Kind of what caused those double downgrades during the quarter?

Steve Alpart
Sure. Steve, good morning, thanks for joining our call this morning. Yeah, look, these two loans had some similarities to them. They were good sponsors, both very far along on business plan, the properties were at or near stabilization. Each of them are involved in active bidding and sales processes. The Milwaukee one is pretty far along. They're both kind of in the middle of the process, if you will. It was really a function of bids began to come in, it looked like they were coming in below the loan amount. So they came in a little bit below expectations. I think I would say that the Chicago asset, the investment sales market there has been a little soft. The Milwaukee deal is primarily multifamily, has some ground floor retail. It's partially leased, not fully leased.

So, those are the reasons why we moved it to a five, mainly because we thought the bids are coming in below the loan amount. We wouldn't generalize too much from these loans. In general, we're feeling pretty comfortable with the fundamentals we're seeing in our multifamily loans, but it was mainly just a function of where we think the bids are coming in.

Stephen Laws
Appreciate that. Marcin, I wanted to follow up on the comments on CECL, and I believe Steve may have also mentioned, you don't expect significant losses on the multi where you do take them, but roughly 30% reserve level as far as specific reserves on those 5-rated loans. Could you maybe bifurcate that? How do you allocate that to the specific reserve as a percentage of the office loans versus the remaining specific reserves against the non-office component?

Marcin Urbaszek
Sure. Good morning, Stephen, thanks for joining us. Yeah, I would say it really varies by loan, but I think generally, office impairments are higher than multifamily. It's hard to get to sort of specifics on particular assets, but I would say the majority of the reserve on the specific reserve is related to office issues and, meaningfully, less on the multifamily.

Stephen Laws
Great. Appreciate your comments this morning. Thank you.

Operator
Thank you. Our next question is from Doug Harter with UBS. Please proceed with your question.

Doug Harter
Thanks. Just given the starting point of earnings this quarter, plus the incremental drag from non-accruals, can you talk about your commitment to paying the dividend or how you would think about, instead, using that cash to buy back stock, which would be clearly more accretive?

Marcin Urbaszek
Sure, good morning, Doug. Thanks for joining us. Look, I think the dividend, we and the board look at the dividend sort of over a longer time horizon in terms of run rate profitability. Obviously, we reduced the dividend for the first quarter and today, there's going to be some pressure on earnings as we sort of resolve these assets. Timing is sort of hard to predict, but I think some of these resolutions can have a pretty material impact to our runway profitability. So, from our point of view, it's sort of a matter of sort of time rather than if that happens. So again, timing is difficult to predict.

But as we said in the prepared remarks, we think that many of these assets may be resolved by the end of the year. And we look at all of that every single quarter with our Board, and as we assess the dividend. So, it's going to be an ongoing process.

Jack Taylor
Doug, this is Jack. Good morning. I would add just about the stock buybacks, so as we normally will say, we don't give guidance on stock buybacks. We have been pretty opportunistic over the course of 2023, for example purchasing I think it was about 2 million common shares. And we do think that our stock price presents a great value opportunity for the investors, given the

fundamentals of the business and the potential repurchases in current valuation would be quite accretive. But I do want to note that our #1 priority for now is on maintaining liquidity, as we work through the non-accrual loans.

Doug Harter
I guess just on that, what would be your comfort of being able to transact on some of those non-accrual loans in the short term at or close to the current marks and being able to use that liquidity to buyback stock?

Jack Taylor
Well, that's a complex question because it's an ever dynamic market. We think that, as we said, $150 million to $200 million is nearer term visibility, call it the next two quarters on things. We have visibility, eight out of the 10 fives are in a process of resolution and sales process, in particular. But the $150 million to $200 million seems riper or nearer in the stage. And so, we would have to assess, at the time of those resolutions, what our position is with respect to liquidity and earnings potential and the like, at that time. So I couldn't say, right now.

Doug Harter
Okay, thank you.

Operator
Thank you. Our next question is with Steve Delaney with Citizens JMP. Please proceed with your question.

Steve Delaney
Good morning. Can you hear me, everyone?

Jack Taylor
Yes.

Steve Delaney
Wonderful. Good to be on with you this morning. So, we've observed over the last few days, reports, I guess, TRTX last week and then CMTG, yesterday. Both companies had been able to sell loans as opposed to taking the property into REO. Richard Mack, yesterday actually offered some comments on that and sounded pretty optimistic about the amount of opportunistic, he sounded positive about the opportunistic money that he was seeing of people that are looking to get in and maybe in sort of a loan-to-own strategy.

Just your thoughts on, are you looking at opportunities and discussions with possible loan purchasers? And how you feel about taking a loss but a pretty clean loss rather than having to go through the REO process. Appreciate your comments.

Jack Taylor
Well, I'll make a quick comment, Steve, which is, we've done it in the past, we're able to do it in the future. Steve, you've looked at me like you wanted to answer, so, go ahead, please.

Steve Alpart
Steve, it's Steve Alpart, good morning. We have a number of resolution strategies that you've heard us talk about, quarter-over-quarter. For a lot of the loans that we just talked about, trying to resolve by the end of the year, many of them, I would say most of them we are working with a good borrower on a cooperative basis to sell the property. In general, we think you get a better price by selling the property versus selling the loan, although they're both very good strategies; we've done both. In fact, last quarter, we did a loan sale.

In a few cases, we've been marketing the property, and we're simultaneously running a deed in lieu and/or a foreclosure process, sometimes both. So, we know when the buyer is ready, we can deliver the fee. If we don't like the bid price or we think we need to take ownership of the property for a variety of reasons, as we did on the Phoenix office deal, in probably a smaller number of cases, we'll take title, own the REO, do what we think we need to do to kind of maximize value in the short term or medium term.

We're not going to look to own those assets in the long term, and then we can sell the REO. So it really is very situational and we've done all the different flavors of it. Alot of them, right now are working with the borrower to sell the property. We think that gets you, in general, the best bid.

Steve Delaney
Got it. And when you're working with those borrowers to find a new buyer or a new capital infusion, is it usually with the understanding that your existing loan will remain in place to benefit the new buyer and the new equity?

Steve Alpart
It can be the existing loan, but I would say more often, we're going to provide, and we don't do it in every case, but if we need to, certainly on an office sale today, it's probably likely that we're going to need to provide staple financing, at least in the short to medium term. It's more likely, if we are providing financing case-by-case, that we would be providing a new loan at a reset basis as opposed to a buyer just assuming a loan. There are ways to do that but, more often than not, it's going to be what we refer to as staple financing, providing a new loan to a new buyer at a reset basis.

Steve Delaney
Thank you for the comments, this morning.

Steve Alpart
Thank you.

Operator
Thank you. Our next question is from Jade Rahmani with KBW. Please proceed with your question.

Jade Rahmani
Thank you very much. This quarter has been kind of a tale of two cities between the banks and the commercial mortgage REITs with the banks offering some relief in terms of commercial real estate credit performance. Essentially, I believe they're modifying and extending loans and there's less pressure on their liabilities as rates, while volatile, have been more stable than a year ago.

On the other hand, the commercial mortgage REITs have taken significant losses and so it raises the question as to whether most of the pressure is on the asset side or if it's on the liability side. I was wondering if you could comment on that.

Jack Taylor
Well, I'll start off by saying, I think it's on both. In general, the banks have lent at a lower advance rate than the non-bank lenders. So, you would expect that there would be some difference between the non-bank lenders at a higher advance rate, even though a low advance rate with what we like to call from stealing from the bond world, positive convexity on credit, which has worked out in many cases, but not at all in the current environment. Meaning that the loans are meant to improve the assets with the capital from the loan and the borrowers meant to improve credit over time, with a double punch of the pandemic and now very elevated interest rates has proven more difficult than some of the cases. So, I do think on the asset side, that's true.

On the liability side, we have, in our own case and in many others of our peers, very stable, broadly diverse financing facilities and other structures that have provided us with our leverage. However, the banks have deposits, and it's a lower cost of capital to work with. So, I think this is why we're observing that.

Jade Rahmani
And so do you think that if GPMT was part of a bigger balance sheet or some type of investment management firm that had access to multiple lines of capital that are retrieved on the liquidity side, you mentioned that's your top priority, would it help cushion the credit outcomes. You're saying that there's better results when properties are sold than when loans are sold. So wondering if you could put a finer point on that.

Jack Taylor
Well, so with respect to the better results, when sometimes the best route is to sell a loan. Other times, if you particularly have a cooperative borrower who's working with you, you can get a better result by taking over the property and selling it and probably in a simultaneous sell, in the deed in lieu structure. So I don't think of that as so much of as a liquidity aspect,

compared to what you were talking about with banks having deposit bases. So it's a case-by-case basis on the loan sale versus equity sale. But oftentimes, not always, but oftentimes, somebody who's buying the note wants to do so at a discount to what they think the property is worth. And so, that's what I believe Steve was referencing, when he made that comment.

Jade Rahmani
Thanks very much.

Jack Taylor
Thank you.

Operator
Thank you. There are no further questions. I would like to turn the floor back over to Jack Taylor for any closing comments.

Jack Taylor
Thank you. We appreciate all of our investor’s support and the team's effort in navigating this extraordinarily challenging market, and we look forward to speaking with you next time. Thank you very much.

Operator
This concludes today's conference. You may disconnect your lines at this time.