Granite Point Mortgage Trust Inc.
Q2 2024 Earnings Call Transcript
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Presenters
Jack Taylor, CEO, President and Director
Steve Alpart, VP, CIO and Co-Head of Originations
Marcin Urbaszek, VP, CFO and Treasurer
Chris Petta, Investor Relations

Q&A Participants
Steve DeLaney—Citizens JMP
Doug Harter—UBS
Stephen Laws—Raymond James
Jade Rahmani—KBW

Operator
Good morning. My name is Daryl, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Granite Point Mortgage Trust second quarter 2024 financial results conference call. All participants will be in a 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, Investor Relations for Granite Point.

Chris Petta
Thank you, and good morning, everyone.

Thank you for joining our call to discuss Granite Point's second quarter 2024 Financial Results. With me on the call this morning are Jack Taylor, our President and Chief Executive Officer; Martin 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 of 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 of our risks that could affect results. We do not undertake any obligation to update any forward-looking statements.

We will also refer to certain non-GAAP measures on this call. This information is not intended to be considered in isolation or a substitute for 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 second-quarter 2024 earnings call.

The first half of 2024 has been characterized by macroeconomic uncertainty, including volatility and uncertainty about the path of interest rates, which in turn has continued to impact transaction activity in the commercial real estate market. More recently, however, consensus has been building about the potential for the Fed to begin reducing short-term rates in the coming months, which was bolstered by the Fed meeting last week and solidified even further by the weak employment report and the market reaction. This shift in rate expectations over the last few months has led to improving confidence in the real estate market and a market pickup in transaction activity still remains well below historical levels. Securitization funding markets for stabilized properties have seen increased activity this year, while liquidity for transitional assets is slowly returning. As transaction flows continue to improve, we're seeing some more market transparency around property valuations. We believe that the move away from the sharply negative sentiment in the market that occurred in March and April, following the substantial rise in interest rates at the end of the first quarter, will continue to improve the overall level of real estate transaction activity, while property valuations continue their bottoming process.

These trends are beginning to play out in our portfolio with recent resolutions of assets and more on the horizon in the coming months and quarters, as well as a step up in anticipated loan repayments. Our proactive approach to asset management has resulted in meaningful progress in that we resolved four nonaccrual loans over the last couple of months with an aggregate principal balance of over $135 million, each involving a different strategy in order to drive the best possible outcome for the company.

We are actively pursuing resolutions of the remaining nonaccrual loans, which are in various stages of their respective processes. We have visibility on approximately $200 million to $300 million of more loan resolutions, which we believe should resolve by the end of 2024. The exact timing and ultimate outcomes remain difficult to predict given the nature of such transactions and market uncertainty. However, we are encouraged by the progress we continue to make on these assets given their pressure on our run-rate profitability. Our approach to nonaccrual resolutions emphasizes a balance between timing, potential earnings and book value impacts, liquidity needs and other factors while we work to maximize economic outcomes and best position the company for long-term success.

Improved visibility regarding the future path of interest rates is likely to be the main factor affecting the activity and the performance of the commercial real estate floating rate loan market in the near to medium term. A higher level of real estate investor confidence around the cost of capital, and price discovery on property values, should continue to drive deployment of capital into this market, including the large amount of dry powder that is still on the sidelines, improving overall liquidity. As we progress towards additional nonaccrual loan resolutions over the next quarters, we have increased our CECL reserves to reflect the ongoing pressure on property values. We have been proactive in identifying potential credit issues and building loan loss reserves ahead of the potential charge-offs as market trends continue to evolve with more price discovery, and as visibility improves based on the resolution progress of individual assets.

We are encouraged by the meaningfully slower pace of credit migration within the portfolio in the second quarter, resulting in stable risk ratings quarter-over-quarter. We believe we are getting closer to the end of this period of extreme market stresses and further potential credit issues within the sector and in our portfolio. Nonetheless, while the market tone has been improving of late and transaction activity picking up, given how volatile and unpredictable this cycle has been, the risk remains for select additional credit migration and incremental credit loss provisions. However, given our recent experience and our outlook on nonaccrual loan resolutions, the level of our total CECL reserves should decline in the coming quarters.

As we see market stabilizing and capital fully returning to the floating rate transitional space, we remain highly focused on our asset and liquidity management activities while moving through this credit cycle. Repositioning our portfolio over time will position us to return to our core lending business and regrow the portfolio while improving run rate profitability. At the same time, we have maintained our flexible capital allocation strategy focused on relative value and generating attractive total shareholder returns over the long term. As such, in June, our Board of Directors decided to reduce our quarterly common dividend to $0.05 per share to protect investors' capital considering the challenging credit environment and the near-term pressure on our earnings. Because the company's public market valuation presents a compelling relative value, during the second quarter, we repurchased about one-half million of our common shares at a deep discount, which benefited our book value by about $0.05 per share. We currently have about 3.6 million common shares remaining under the current share repurchase authorization, and we intend to remain opportunistic with respect to any potential future buyback activity, taking into consideration market valuation, liquidity, leverage and portfolio performance, among other factors.

We believe that accretive share repurchases during times of deeply discounted market valuation are a prudent way to generate attractive total economic returns over time. We firmly believe that during challenging periods, emphasizing balance sheet stability and protecting our investors' capital is the prudent and effective strategy to drive long-term shareholder returns, while continuing to reposition the business for future growth opportunities. As we look out into the next few quarters, expected interest rate reductions are likely to contribute to the ultimate recovery of the commercial real estate market. We will continue to proactively asset manage our portfolio and emphasize our liquidity while driving further loan repayments and nonaccrual resolutions, which will significantly contribute to improving our run rate profitability and position 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.

Since our last call, we've seen some increased transaction activity and improved liquidity and are beginning to see capital slowly returning to transitional assets. Improved market sentiment has contributed to better visibility on certain loan repayments and progress on nonaccrual resolutions. During the second quarter, we realized about $56 million of net repayments and paydowns, while resolving two nonaccrual loans totaling about $47 million in UPB. Since quarter end, we've realized an additional $143 million of repayments, including a $54 million office loan from a fixed rate CMBS refinancing, and have resolved two additional nonaccrual loans with an aggregate UPB of about $88 million.

We've used a number of different strategies to resolve assets while balancing multiple objectives to achieve the best economic outcomes. The $12 million loan secured by the multifamily property located in Milwaukee was repaid during the second quarter at a small loss and around our carrying value. We worked collaboratively with the borrower over several quarters to effectuate a successful sale of the property without having to provide seller financing to the buyer. Also, during the second quarter, we acquired title to an office property located in suburban Boston which had previously secured a $36 million senior loan. The asset was transferred to REO at the loan's carrying value and the property is generating positive cash flow. We believe there is embedded value in the property with attractive optionality for alternative uses for the parts of the building and development opportunity related to excess land.

Since quarter-end, we have resolved two additional loans totaling $88 million. The first was the $37 million nonaccrual loan secured by a mixed-use office and retail property located in downtown Los Angeles. This transaction also involved our coordination with the borrower to sell the collateral property for cash without providing acquisition financing. The loan was unlevered and resulted in a positive liquidity event for the company. Also in July, we restructured the $51 million senior loan collateralized by a mixed-use multifamily office and event space building located in Pittsburgh. The property is well located with many attractive attributes. However, the performance of the office and multifamily components have been impacted by weakness in the technology sector, which has a large presence in the local market. The modification included a bifurcation of the loan into a new $32 million mortgage loan and a $19 million mezzanine loan with the sponsor committing additional capital to further support and improve the collateral property.

We're very pleased with the progress we've been making to resolve our credit impacted loans. As Jack stated earlier, we have visibility on additional resolutions in the near term, with seven of the eight remaining risk-rated "5" loans in various stages of their individual sale processes, though the exact timing is hard to predict. The mixed-use office and retail property securing our $94 million loan in New York is likely to be under our sales contract soon, with an anticipated closing during the fourth quarter. The mixed-use retail and office property collateralizing the $82 million loan in Baton Rouge is in a sales process and, though the ultimate timing remains hard to predict, we hope to reach a potential resolution in the coming months. Similarly, coordinated sales processes are ongoing for the $26 million loan secured by the office property in Boston, the $29 million loan securing the Minneapolis Hotel, and the $34 million loan securing the multifamily property in Chicago, which we anticipate all could conclude by the end of the year.

During the second quarter, we experienced relatively limited credit migration within the loan portfolio with one $20 million loan collateralized by an office property in Denver, moved from a risk rating of 4 to a rating of 5. The property has been negatively impacted by local market office leasing dynamics and the sponsor is in the initial stages of marketing the property for sale. In addition, we also downgraded two other loans, one office and one hotel, with an aggregate UPB of about $82 million to a risk rating of 4, as the collateral properties have been impacted by varying degrees by leasing challenges and limited market liquidity. The portfolio -- the loan portfolio risk ratings remain stable quarter-over-quarter.

We're encouraged by the progress we've made so far addressing the nonaccrual loans and are pleased to see that most of our high-quality institutional sponsors continue to support their properties and are progressing on their business plans in what we expect to be a slowly improving market.

We ended the second quarter with total loan portfolio commitments of $2.7 billion and an outstanding principal balance of about $2.6 billion with about $118 million of future fundings, which account for only about 4% of total commitments. Our loan portfolio remains well diversified across regions and property types and includes 68 loan investments with an average size of about $38 million at a weighted average stabilized LTV at origination of 63.7%. Our realized loan portfolio yield for the second quarter was about 7%, net of the impact of the nonaccrual loans, which we estimate to be approximately 229 basis points for the three months ended June 30. During the quarter, we funded about $17 million of existing loan commitments and upsizes and realized about $104 million of UPB loan repayments, paydowns, amortization and resolutions. So far in the third quarter, we have funded about $3 million of existing loan commitments and realized about $143 million of loan repayments, paydowns and loan resolutions. Given current market conditions, we expect the volume of loan repayments and resolutions in the second half of 2024 to be higher than what we realized during the first six months of the year. We expect our loan portfolio balance to trend lower by the end of the year as we maintain our conservative stance and continue emphasizing carrying higher levels of liquidity and working diligently to resolve our nonaccrual loans.

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 second-quarter GAAP net loss of $66.7 million or $1.31 per basic share, which includes a provision for credit losses of $60.8 million or $1.19 per basic share, mainly related to certain risk-rated 5 loans. Distributable loss for the quarter was $9.1 million or $0.18 per basic share reflecting loan write-offs of $6.6 million or $0.13 per basic share and a decline in net interest income, mainly driven by nonaccrual loans. Our book value at June 30, was $9.84 per common share, a decline of about $1.30 per share from Q1, which was primarily due to loan loss provision mentioned earlier, partially offset by the accretive share buybacks we opportunistically executed during the quarter, which we estimate benefited book value by about $0.05 per common share.

The two small write-offs this quarter were related to the resolution of our multifamily loan in Milwaukee and a modification of our loans secured by a design building in New York, which created a small mezzanine note we deemed uncollectible. For more details on this modification, please refer to our Form 10-Q. Given our outlook on the potential near-term nonaccrual resolutions Jack discussed earlier, we anticipate incurring over $100 million of write-offs over the next couple of quarters, which should reduce our overall CECL reserve balance.

Our operating results continue to be pressured by the nonaccrual loans which accounted for over 20% of our portfolio as of quarter end. Some of these loans are on cost recovery and any incoming interest is applied to reduce loan principle rather than being recognized in earnings.
We anticipate the run rate profitability of the company to improve in the coming quarters as we continue to make progress on resolving nonearning assets, though the exact timing and magnitude remain difficult to predict.

Our CECL reserve at quarter end was about $267 million or $5.27 per share, representing 9.7% of our portfolio commitments as compared to $213 million or 7.5% of total commitments last quarter. The change in our CECL reserve was mainly related to the additional allowance on loans that were risk-rated 5, reflecting additional pressure on property values and increased pricing transparency in the market as transaction volumes and the pace of our resolutions begins to pick up. Our Q2 general reserve increased by about $14 million due to some macro assumptions, expectations for ongoing challenges in the CRE market, and certain loan specific assumptions. Over 70% of our total CECL reserve, or $195 million, is allocated to individually assessed loans, which implies an average estimated loss severity of about 36% on those assets. As of quarter end, we had about $665 million of loans on nonaccrual status, which we estimate impacted our Q2 results by about $15 million or approximately $0.30 per share.

Turning to liquidity and capitalization. We ended the quarter with about $86 million of unrestricted cash and total leverage increased modestly to 2.5x in Q2 compared to 2.3x in Q1 mainly due to a lower equity balance as a result of the higher CECL reserves. During the quarter, we extended the maturity of our Morgan Stanley facility and adjusted its maximum borrowing capacity to better reflect our near- to medium-term financing needs. We also elected to terminate our Goldman Sachs funding facility, which matured in July, as it had no outstanding borrowings, and we anticipate a limited use in the near term. We continue to enjoy strong support from our lenders, highlighting our long-standing relationships in the market, and we expect to expand our financing capacity once we return to originating new loans more actively.

As of a few days ago, we carried about $92 million in cash, which we expect to increase in the coming weeks driven by some loan repayment activity and the planned financing of the two REO assets that are currently unleveraged. We remain focused on maintaining a high level of liquidity in the near to medium term. We will continue to prioritize financial flexibility and the ability to proactively manage our assets as we simultaneously transition the portfolio to position the company for future growth opportunities.

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 star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two 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 your questions. Our first question has come from the line of Steve DeLaney with Citizens JMP. Please proceed with your questions.

Steve DeLaney
Hello, everyone, and thank you for taking the question. I guess, your obviously in a defensive mode and that we certainly understand that and appreciate that. The loan portfolio is in runoff, whether it's repayments, which I think you probably welcome right now, or moving loans into REO and then trying to dispose of that.

But $2.6 billion, I believe, Marcin, at the end of June. As you guys look out in the second half of the year, any sense and I realize I'm asking you for a rough estimate, where might the loan portfolio bottom out? Because I'm trying to sense and I'm thinking that maybe distributable EPS, we'd love to see that turn around and be breakeven or positive. But it feels like that's going to be hard to do with a shrinking loan portfolio. Just would welcome any of your comments on that particular topic. Thank you.

Marcin Urbaszek
Good morning, Steve, thank you for the question.

Look, I think it's difficult to predict exactly where things are going to be. I think, as you mentioned, we are sort of maintaining our conservative stance as we sort of resolve these assets and manage REO. As Steve Alpart mentioned in his prepared remarks that we anticipate portfolio to sort of trend down by the end of the year. I think some of the resolutions will have a positive impact on run rate profitability. I think in the near term, I think distributable EPS sort of run-rate ex losses will probably trail the dividend a little bit.

But as these resolutions happen, in whatever shape or form they may happen, whether it's REO that's cash flow positive or we provide seller financing to a new ownership group or paydown expensive debt, that should improve run-rate profitability in the coming quarters. And hopefully, that's again sort of hard to predict as to where that's going to shake out and when, but we feel pretty good about the overall trajectory.

Steve DeLaney
Okay. And do I have the math right here? It seems that you've got about maybe it was a comment that Jack made, but I wrote down $100 million of realized losses over the next period, whether that was the next year or whatever, 51 million shares, $2.00 hit to distributable EPS from your current expected losses in your loans that you're carrying at 5 rated or whatever. Is that range of something in the neighborhood of a $2.00 share impact to DE over loss realizations? Does that jive with where you see your portfolio and your reserves?

Marcin Urbaszek
Yes. I think that's right. I think I said anticipate over $100 million in the coming quarters. We have the two resolutions in Q3 already. We are fully reserved on the B note on that Pittsburgh asset, which we anticipate may get written off as well. So, between that and the LA office retail, that's around $40 million already.

And I think as you heard, Jack and Steve mentioned the additional visibility will likely add to that. So, depending on timing and when these deals can close, it could be north of $100 million by the end of the year. But exactly whether it's Q3 or Q4, it's sort of hard to predict, but I think you're roughly in the neighborhood.

Steve DeLaney
You guys are working through it and doing best you can. In the meantime, I appreciate the effort towards helping shareholders add a little bit with the stock buyback. I think that's a nice balance to your asset resolution efforts internally. So, thanks for your comments.

Operator
Our next questions come from the line of Doug Harter with UBS. Please proceed with your questions.

Doug Harter
Thanks. I believe in the prepared remarks you said you're seeing greater transparency around property pricing. Can you just talk about your comfort in being able to resolve your loans at or near the marks kind of given that improving transparency on price?

Marcin Urbaszek
Sure. Good morning, Doug. Thank you for joining us. Thanks for your question.

Look, I think we feel pretty good as we sort of go through the process and there's more visibility and more transparency. You obviously try to be proactive with respect to some of these reserves as some of these assets go through the process. I think generally, no one in this market is going to be 100% correct on these marks. But we feel pretty good about where we are sort of in the near term for some of the assets that we have in the pipeline to hopefully resolve by the end of the year.

Doug Harter
Great. And then, Jack, I know you said that there still could be kind of one-off new problem assets. Can you just help us get comfort in the fact that kind of the current risk ratings, do you kind of have your arms around the problems and as we look to kind of see the pace of new problem asset formation flow?

Jack Taylor
Yes. Thank you, Doug, and thanks for joining us.

We are comfortable with the current risk ratings. And in fact, I would say we've been on our forward foot in terms of moving things from a 4 to a 5. And we're looking at the overall environment that makes us still be circumspect about what's to come.

We think things are improving. We think that the market and our own portfolio is towards the end of this stress period and we're emerging into greater liquidity in the market as well as greater price transparency because the transaction volume is picking up. That's not to say that we won't have some additional loans that move into the 4 category or down to a 5 category.

But I will say with respect to the 4s, those are some that we expect that we'll see a full payoff for some of them. And we may see some migrate to 5 as we did with the Denver office loan. And we are not sure about the direction for some of them, but it looks like they're progressing in a way that we're comfortable maintaining as a 4 at this time. I don't know if that's responsive to you. I hope it is.

Doug Harter
It is. Thank you, Jack.

Operator
Thank you. As a reminder, if you would like to ask a question, please press star one on your telephone keypad. Our next question comes from the line of Stephen Laws with Raymond James. Please proceed with your questions.

Stephen Laws
I wanted to follow up on a couple of Steve DeLaney's questions. First, as you think about the nonaccrual loans, I think you mentioned $15 million and $0.30 drag. I was curious, how much financing do you currently have on those loans? And what would the rate be on that cost of debt?

Marcin Urbaszek
Good morning, Stephen, thanks for joining us. Thank you for your question.

So, it really depends on which asset it is. They are mainly financed through a variety of different sources. We obviously have the NPL line that you can see in our filings that we have been utilizing that sort of 650 over SOFR. Obviously, that's expensive, but it's a good liquidity tool for us. Some of the other assets are on different facilities. So, they are generally financed to varying degrees, while the REO is currently unlevered. But as I said earlier, we will and we intend to finance them as well just to increase liquidity and give us some more flexibility going forward.

Stephen Laws
And so, when we think about use of liquidity or proceeds as these resolutions occur, is it fair to say that's probably where you get the biggest bang for your buck is paying down the financing on those nonaccrual facilities, and that's what's going to drive any near-term improvements in profitability?

Marcin Urbaszek
I think it's either that or if the collateral property on a loan gets sold, so then we would sort of pay off the financing. Or if we provide financing to the new ownership group, which we've done in the past, it will most likely be from sort of interest income on the new asset and that we may choose to finance it more efficiently. So, it's going to be a variety of different tools, depending on which direction some of these assets go.

Stephen Laws
Great. It's like you can see my notes because that's my next question is how are you thinking about providing financing on the loans? I think, if I heard correctly, that the two resolutions that took place in Q2, you did not provide financing to the buyers of those assets.

So, curious kind of how do you guys make that decision? Are there certain assets that you're more likely to stay attached to other assets maybe that you don't want to lend against going forward? Kind of how do you guys make that decision? And how much more difficult is it to do a resolution when you're not willing to provide financing to the buyer?

Steve Alpart
Hey Steve, good morning, it's Steve Alpart. Thanks for joining. I'll take that one.

It really depends on the specific asset. As you heard on the call this morning, some of these have resolved without staple financing and some of them will need to resolve with staple financing. It will always be asset-by-asset decision.

But for the office assets, it would be very typical that we would consider or need to provide staple financing. Now that won't always be the case. We talked about the LA mixed-use office and retail asset. And that was an all-cash buyer, no staple financing, but there will be other cases where we may need to provide staple financing. So, it will always be case by case, but in general, I would say it will be more likely on some of the office assets.

Operator
Our next question comes from the line of Jade Rahmani with KBW. Please proceed with your questions.

Jade Rahmani
Thank you. The nonaccruals in the 10-Q show up as $453 million, while the collateral dependent loans are $545 million. Do you happen to know what the difference is?

Marcin Urbaszek
I think that maybe carrying value on the nonaccruals ex the reserves, I think that's the difference. The balance of the nonaccruals is about $665 million, as I mentioned in my prepared remarks.

Jade Rahmani
Okay, thanks a lot. That makes sense. I guess just the realized losses that you identified is the preponderance of those already reflected in book value? Could you give a sense as to where you expect book value to trough?

Marcin Urbaszek

Yes, that's a good question. The numbers that we've cited are reserved for already. So, the realized losses, we feel pretty good about those reserves. Again, there may be some adjustments, some minor adjustments as these loans sort of get to the finish line. I think it's hard to sort of predict where book value might be sort of generally in this type of market.

If you recall, Jack mentioned there may be some additional credit migration. I think we generally feel pretty good about where we are. I don't think this cycle is over. But I think we're encouraged by slower pace of credit migration. And as we said in the prepared remarks, we feel like the balance of the CECL reserve should trend down from here. But again, there may be some one-offs here and there going forward, it's hard to predict.

Operator
Thank you. There are no further questions at this time. I'd now like to hand the call back over to Jack Taylor for any closing comments.

Jack Taylor
Well, thank you, everybody, for participating in our call. We want to thank you for your continued support. And I would be quick to say to the team thank you for all the hard work that they're doing through this challenging period where we're making very good progress and have some more wood to chop, and we're confident that we'll get there. Thank you, everybody.

Operator
Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.