Granite Point Mortgage Trust Inc.

Q2 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Chris Petta – *Investor Relations*

Jack Taylor – *President & Chief Executive Officer*

Steve Alpart – *Chief Investment Officer*

Marcin Urbaszek – *Chief Financial Officer*

Steve Plust – *Chief Operating Officer*

PRESENTATION

Operator

Good morning. My name is Anita and I will be your conference facilitator today. At this time, I would like to welcome everyone to Granite Point Mortgage Trust Second Quarter 2019 Financial Results Conference Call. All participants will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. Please note, this event is being recorded.

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

Chris Petta

Thank you and good morning everyone. Thank you for joining our call to discuss Granite Point's second quarter 2019 financial results. With me on the call this morning are Jack Taylor, our President and CEO; Marcin Urbaszek, our CFO; Steve Alpart, our CIO; and Steve Plust, our COO.

After my introductory comments, Jack will provide a summary of our business activities and a brief recap of market conditions, Steve Alpart will discuss our second quarter originations, our portfolio, and pipeline, and Marcin will highlight key items from our financials. The press release and financial tables associated with today's call 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 proved them to be inaccurate.

I will now turn the call over to Jack.

Jack Taylor

Thank you, Chris, and good morning everyone. We would like to welcome you all and thank you for joining our second quarter 2019 earnings call.

We are very pleased with the progress of our business in the first half of 2019 and are excited about maintaining our strong momentum for the rest of the year. Commercial real estate market fundamentals and the credit environment both remain solid. After a lower origination volume in the first quarter owing to market volatility and seasonality, we returned to our historical deployment

pace and had a very productive second quarter, funding over $415 million of loans. Our second quarter loan fundings, combined with manageable prepayments, resulted in portfolio growth of about 8% versus last quarter, to over $3.6 billion, and over $4.2 billion inclusive of our future funding commitments. The credit quality of our assets remains strong.

Real estate market transaction volume, though slightly lower than last year, remains at a healthy level, generating a strong flow of attractive lending opportunities for Granite Point. As evidence of this, while maintaining our high standards of credit underwriting and loan structuring, we have generated a robust forward investment pipeline of over $770 million of new senior floating rate loan commitments, some of which we have already closed in the current quarter. The credit quality of the new loans we are originating remains attractive, the weighted average LTV on our second quarter originations was 59%, and their resulting investment yields continue to meet our targets of low double digit ROIs. Assuming all the loans in our pipeline close and market conditions remain stable for the rest of the year, we anticipate to well exceed our originations from last year, despite active competition for assets and market volatility earlier in the year. We are currently on pace to originate about $1.5 billion of new loans through the first three quarters of 2019, up over 60% from the same period last year. This further illustrates the strong capabilities of our platform and our ability to deploy capital into high quality assets.

We continue to actively manage our balance sheet and multiple funding sources. To support our strong forward pipeline and our expectations for an active pace of originations later in the year, during the second quarter we issued an additional $50 million of common shares at premium to book value through our ATM program. During the quarter we also extended maturities of three of our financing facilities and, as we mentioned on a prior call, in April we closed on a new $150 million fully term-matched and non-mark-to-market asset-specific financing facility, further diversifying our funding mix. As our portfolio grows, we continue to focus on the stability, efficiency, and diversification of our financing sources.

As I mentioned earlier, commercial real estate market fundamentals and the over-all credit environment remain generally positive. Real estate transaction volume, while somewhat down, continues at a high level. Global demand for real estate remains vibrant, borrower demand for debt capital is strong and there are abundant financing opportunities from which to choose. This all continues to offer a solid operating environment for our business. While competition for loans remains active, more recently we have seen an easing of spread compression. We find the real estate finance markets attractive and lending standards generally rational.

The senior floating rate commercial real estate lending market continues to provide ample opportunities for us to grow our business and generate attractive risk-adjusted returns for our shareholders. We are confident about the prospects for Granite Point supported by our highly talented and respected team, long-standing industry relationships and strong balance sheet. We have had a busy and successful first half of 2019 and look forward to maintaining this performance for the rest of the year.

Now, I will turn the call over to Steve Alpart to discuss our investment activity and our portfolio in more detail.

Steve Alpart

Thank you Jack, and thank you all for joining, we appreciate your time this morning. I'll spend a few minutes reviewing our second quarter originations, our portfolio and our forward pipeline.

Following the overall slowdown in transaction and lending activities in the first quarter caused by year-end market volatility, we saw a strong rebound in the second quarter, which allowed us to return to our historical pace of originations. In the second quarter, we closed 10 new loans with total commitments of over $420 million. Our total fundings were $415 million, comprised of about $360 million of initial fundings for the new loans, over $54 million from our pre-existing loan commitments, and $1.5 million for one upsized loan. The loans we closed in the second quarter have strong credit characteristics and are secured by high quality, income-producing properties with highly experienced sponsors. These properties are well-diversified by geography and property type, with multifamily and office assets accounting for over 60% of the total, which is generally consistent with our overall portfolio mix. Our second quarter originations have a weighted average LTV of 59% and a weighted average yield of LIBOR plus 3.74%. The credit quality and yields on our new originations in the first half of the year have been relatively stable, as we remain highly selective within a large universe of lending opportunities.

During the second quarter, we realized about $152 million of prepayments and principal amortization, which were largely driven by the payoff of our second largest asset, a $108 million loan on an office property located in the Northeast.

Driven by strong net fundings, the outstanding principal balance of our portfolio grew to over $3.6 billion, and the fully committed balance to over $4.2 billion, at quarter end. Our overall portfolio is well diversified across markets and property types and continues to exhibit high credit quality, with a weighted average stabilized LTV of 63%, and a weighted average asset yield at origination of LIBOR plus 4.58%. Senior loans comprise over 98% of our investments and over 98% are floating rate. Additionally, consistent with our investment philosophy of emphasizing portfolio diversification and limiting exposure to binary risks, such as government related programs, our portfolio has minimal exposure to apartments that are subject to the new rent regulations in New York.

Moving on to our forward pipeline, which as a reminder, includes loans that have either already closed in the third quarter or are in the closing process, to date we have generated new loan commitments of over $770 million, with over $575 million of initial fundings. So far, we have funded about $150 million of new loans and we expect most of the remaining loans to close at some point during the third quarter, though some may slip into the fourth quarter, subject to customary closing conditions. Our pipeline is mainly comprised of loans on office and multifamily properties located across our target markets and the new investments continue to exhibit strong credit attributes and meet our general return targets. We estimate our current origination capacity in excess of our forward pipeline to be about $300 million before any potential prepayments. Depending on market conditions and the level of prepayments, we would expect to commit this capital to new loan opportunities over the next one to possibly two quarters.

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

Marcin Urbaszek

Thank you Steve and good morning everyone, thank you for joining our call.

Our business produced strong operating results in the second quarter. Our total Core Earnings grew over 7% quarter-over-quarter driven by 6% growth in net interest income which benefited from strong portfolio growth and a decline in financing costs. We also realized lower operating expenses as certain one-time items from prior quarter were eliminated. However, as we discussed on our last call, the EPS numbers reflect a temporary impact from the additional shares outstanding as a result of our capital raising activities. We would anticipate that this impact would become much less significant over time as we continue to deploy our capital.

Turning to specific results, our GAAP net income for the second quarter was $18.2 million, or $0.34 per share, and our Core Earnings were $19.4 million, or $0.36 per share. We declared a second quarter dividend of $0.42 per common share, which, at our current stock price, offers an attractive yield of 8.9%. Our book value at June 30th was $18.74 per common share, largely reflecting the dividends being paid on the new shares before our capital is fully deployed. Our Q2 earnings were also impacted by our originations closing late in the quarter, as over $320 million of loans funded in June, and a majority of those occurred in the last two weeks of the month.

Regarding financing and leverage, the outstanding balance on our credit facilities increased to over $1.3 billion from the first quarter, driven by the growth of our portfolio. At June 30, we had total borrowing capacity of over $2.3 billion inclusive of our options to upsize two of our facilities by a combined $300 million. As Jack mentioned earlier, during the second quarter we extended the maturities of three of our facilities and all of our agreements have extension options ranging from 1 to 3 years. After quarter end, we upsized one of our facilities from $250 million to $400 million and extended its maturity. We also amended our $75 million secured revolving facility. We extended its maturity to 2021, lowered its cost of funds by 50 basis points, and created an accordion feature allowing us to temporarily upsize it up to $150 million. This facility is a great short-term financing option for us with an attractive cost and structure, and provides us with a flexible liquidity management tool at times when we close a high volume of loans.

We ended the second quarter with a total debt-to-equity leverage ratio of 2.6 times, including the non-recourse, non-mark-to-market CLO debt. Excluding our CLOs, our leverage was only 1.5 times at June 30th. We would expect our leverage to increase in the second half of the year, as we continue to deploy our capital into new loans. We continue to emphasize diversification of our funding and increasing the utilization of non-mark-to-market financing, which at June 30 accounted for about 44% of our borrowings.

Thank you again for joining us today and now I will ask the operator to open the call to questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2). At this time, we will pause momentarily to assemble our roster.

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

Jade Rahmani

Thank you very much. Inclusive of the back-end weighted of the originations this quarter and the very robust pipeline, you sighted, you are anticipating earnings to meet or exceed the dividend in the third quarter or for the back half of the year? Can you give any indication?

Marcin Urbaszek

Hi, Jade. Good morning. It is Marcin, thank you for joining us. Thanks for the question. I would say we anticipate it will be closer to the dividend level towards the end of the year. I think the late closings in the quarter probably cost us $0.02 to $0.03 of earnings. So obviously, that will be reflected in Q3 numbers. We do anticipate that core will be higher in Q3, but the exact number is hard to predict, depending on when the new loans close, and what happens to LIBOR.

We will also have additional recognition of some of the shares that we sold in the second quarter, but we do anticipate it will be a little bit higher.

Jade Rahmani

You said you have minimal exposure to New York City rent control. Does that suggest that there is at least one loan that has some kind of exposure or are you saying there is no exposure?

Steve Alpart

Hey Jade, it is Steve, thank you for joining us. So, the market is still absorbing the overall impact of the regulations and the impact of these new regulations will be very specific to any particular asset. A lot of people think the general view is that it will negatively impact the market. We actually think that for a subset of the market with non-regulated units, it could actually be a positive for the market. As far as our New York City's exposure, we mentioned earlier, it is very limited to de minims in terms of both dollar exposure and the specific risks of those assets. Given the types of apartments we finance, as well as how we underwrote the business plans, we only have a few loans on New York City multi-family apartments, and with respect to these assets, there is a limited number of rent stabilized or rent controlled apartments. So that represents a very small part of the cash flow on those assets.

Further, I want to point out that underwriting does not assume that those rents will be transitioned to market in any material way. We do have one $30 million loan on a recent vintage property in Brooklyn, where the units are all rent stabilized. However, it is important to point that our underwriting assumes rent growth only at a level consistent with the annual rent stabilization permitted increases, and we did not assume that any of those units would become rented at market levels.

So, the way we think about this is actually a great example of our overall investment philosophy of avoiding credit exposure to government regulatory or legal changes that could have a significant negative impact on cash flow values and then I will conclude by saying that we do not believe that our portfolio has any significant credit risk associated with these new rent laws.

Jade Rahmani

Okay, and just to clarify, does that business plan in Brooklyn include putting in capital improvements in order to raise rents above what is now the 2% cap on growth from the prior 6%?

Steve Alpart

It did not. That property is a relatively new vintage property and there is no CapEx associated with that business plan in the near to medium-term.

Jade Rahmani

What do you expect for repayments? You mentioned your largest loan on an office property repaid. Does that suggest you expect repayments to moderate in the second half?

Steve Plust

Good morning, Jade, this is Steve Plust. Good to hear from you. As we said repeatedly in the past, we expect on a stabilized portfolio to run it about a 25% prepay rate per year. Right now, based upon the ongoing dialogues we have with many of our borrowers, we are expecting a level of repayments over the next two quarters of something like $150 million to $200 million per quarter.

Jade Rahmani

Then finally, could you give an update on the two risk four-rated loans?

Steve Alpart

Sure Jade, I will address that question. There is really no material update on these. We are continuing to monitor them. You probably saw that we maintain the risk rating of four on both of these loans for Q2. Both loans are current on payments. We currently do not expect to create any reserves for these loans. We have mentioned in the past that we have independent third-party appraisals done earlier in the year and we feel that we are well secured. I also want to point out that we do not have any other loans that are risk rated four or five. Obviously, the nature of this business is that some loans will perform, some loans will do better than planned, someone loans will lag plan, but we are closely monitoring all the assets and do not have any major concerns on credit performance.

Jade Rahmani

Thanks very much for taking the questions.

Steve DeLaney

If you have already addressed that, my apologies, but I am curious, obviously the Fed is in play. I think for now we are assuming that they are not just one and done and I am curious, with respect to floors, while there will be short-term pain, how far if you could estimate, on how far does the Fed need to go in terms of cuts before you are actually in the money on your floors and you actually are receiving a positive impact from the floors? Thank you.

Steve Alpart

Hey Steve, thanks for joining us. It is Steve Alpart. Let me just give you some general sense of where we are on floors, about 98% of our loans have LIBOR floors. Q2 originations have a weighted average floor of about 210, originations in the first half of 2019 have a weighted average floor of about 206. The forward pipelines have a weighted average floor of about 195, the portfolio weighted average is about 130. That is driven by a relatively significant part of our portfolio being loans that we originated between 2015 and 2017 when LIBOR was lower, and we have done a great job amending loans and preventing them from being refinanced early, which contributes to the lower average LIBOR floor, but also, it's helped us preserve attractiveness in the portfolio.

Steve DeLaney

That is helpful, if we think at looking at a year or so, and I think, with what the Fed has started is not likely to revert, probably for the next at least 12 months to 18 months probably. Would it be reasonable to think those 2015/2016 loans are going to be just from a seasoning standpoint and business plans? Are they the loans with the low floors that are going to be going away, to the greatest degree over the next 6 to 12 months, and then I assume the overall weighted average floor you would expect to move higher as those payoff?

Steve Alpart

I could not have said it better myself. That is exactly right. These loans, many of which, in that basket has been extended for say 12 months, the nature of these business plans is that we would expect that that cohort would be the most likely to be paying off the fastest and that the weighted average floor level should rise.

Steve DeLaney

So, probably not so much in 2019 but as we are modeling for 2020, it would seem like there is a positive and the Fed goes down three or four more, it seems like your floors could really help you in 2020. So, that was all I wanted to cover this morning, and thank you for the comments.

Operator

The next questions come from Rick Shane with JP Morgan. Please go ahead.

Rick Shane

My questions were on LIBOR floors. So, I appreciate all the details there. Just to sort of combine both Jade and Steve's topics and conversations related to the second quarter, we have seen LIBOR decline about 20 basis points since June 30, looking at the interest rate sensitivity, and looking at the deployment that you guys described on the back end of the second quarter, is it fair to say that about there is probably about a $0.01 pressure from the declining rates offset by the $0.02 to $0.03 that you guys have described in terms of timing?

Marcin Urbaszek

Hi Rick, it is Marcin. Yes, I think that is a fair statement.

Rick Shane

Great. Thanks so much, guys.

Marcin Urbaszek

Thank you.

Operator

The next question is a follow-up from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani

Thanks. Could you remind us what your target debt to equity ratio is in terms of leverage for the consolidated portfolio, and if you anticipate any need to access the common equity market in the remaining part of the year based on your current visibility, with respect to the pipeline?

Marcin Urbaszek

Sure, Jade. It is Marcin again. So, our target is around three times debt to equity on the total basis, with our pipeline available liquidity assuming no major prepays that we do not anticipate today, we should get to that level by the end of the year, again, depending on when loans close.

In terms of accessing the market, we have liquidity today, as Steve said, for about $300 million. As Steve once mentioned, if have another $300-$400 million on other prepays that we anticipate for the rest of the year, we should have a decent runway till the end of the year, depending on what we see in the market. In terms of loan opportunities, we have a variety of tools that we can use to potentially access the markets, one of which is our ATM program, which is a very efficient way for us to raise kind of in-time capital, which obviously we have done in the second quarter. So, we will monitor everything that I just discussed and make the appropriate decisions as long as accessing the market makes sense for our shareholders.

Jade Rahmani

Thank you very much.

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

CONCLUSION

Jack Taylor

Thank you, Anita and we would like to thank everyone for joining us today and for everyone supporting our business, we really appreciate it and we look forward to speaking with you all again soon. Thank you.

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