Granite Point Mortgage Trust Inc.

Q3 2021 Earnings Conference Call

Tuesday, November 09, 2021, 10:00 A.M. Eastern

CORPORATE PARTICIPANTS

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*

PRESENTATION

Operator
Good morning. My name is Grant, and I will be your conference facilitator. At this time, I would like to welcome everyone to Granite Point Mortgage Trust's Third Quarter 2021 Financial Results Conference Call. All participants will be in listen-only mode. After the speakers' remarks, there will be a question-and-answer period.

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 third quarter 2021 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 review our current business activities and provide a brief recap of market conditions. Steve Alpart will discuss 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 and are available in the Investor Relations section of our website.

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 obligations to update any forward-looking statements.

We also refer to certain non-GAAP measures on this call. This information is not intended to be considered in isolation or as 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 all to our third quarter 2021 earnings call.

We have made tremendous progress since the beginning of the year to further position Granite Point to successfully execute on our strategy of investing in a diversified portfolio of floating rate first mortgage loans. Since restarting originations in the second quarter, we are on pace to deploy over $800 million of capital into new loans for the year. I am also pleased to report that we continue to further improve our funding profile with the recently announced pricing of our second commercial real estate CLO of the year and our fourth overall. Granite Point's status as an established and respected repeat issuer afforded us the opportunity to issue the $621 million transaction with attractive financing on a term matched, non-recourse and non-mark-to-market basis, including a two-year reinvestment period, providing us with more balance sheet and origination flexibility. Upon the closing of this securitization, we estimate our percentage of credit non-mark-to-market funding to be over 75% of our total borrowings. Since 2018, we have sponsored four CLOs totaling $3.1 billion, and we continue to view this market as an attractive way to finance a meaningful portion of our business. It matches very well with our senior loan investment strategy, focused on high credit quality and well-diversified assets with light to moderate transitional business plans.

During the third quarter, we advanced our business on a number of fronts. We had an active quarter with respect to originations, closing eight new loans totaling over $310 million in commitments and we currently have an additional $270 million of loans in our pipeline that have either closed or are in the process of closing. We have been prioritizing loans collateralized by high-quality properties with favorable fundamentals, such as multi-family, well-leased and well-located office, self-storage and warehouse industrial. The market for lending on transitional properties is very active, which allows us to be highly selective and pick the most appropriate investments for our portfolio.

Our overall portfolio risk rating improved during the quarter from 2.8 in the second quarter to 2.6, as the overall credit of our portfolio continues to progress positively. The better overall portfolio average risk rating reflects the progress of business plans for the collateral properties, the ongoing economic and market recovery from the pandemic and the resulting generally improved performance of the property securing our loans. These factors resulted in risk rating upgrades of multiple loan investments within our portfolio.

We also successfully resolved two of our watchlist loans. As we previously disclosed in our press release in October, during the third quarter, we resolved a $68 million Minneapolis Hotel loan through a coordinated sale of the property. The resolution of the hotel loan resulted in a previously reserved for write-off and temporarily affected our distributable earnings. As part of the sale, Granite Point provided acquisition financing at a reset basis with the new hotel owner making a meaningful contribution of fresh equity in the property. We also resolved the $22 million loan on the New York mixed-use retail and office property. The borrower brought the loan current with all back-interest repaid and funded additional interest reserves. At September 30, we had two remaining loans that were risk rated 5, as we continued to work with our borrowers and evaluate a variety of potential strategies.

During the quarter, we also took advantage of our stock's discounted valuation and deployed some of our excess liquidity into open market repurchases, totaling 1 million shares, which meaningfully contributed to our quarter-over-quarter book value growth to $17.33 per share, and helped offset some of the dilution related to the settlement of all warrants we issued as part of our term loan financing facility last year. In two transactions, one in late September and the other in early October, we settled all the outstanding warrants to purchase approximately 4.5 million shares for a net cash amount of about $32 million, which resulted in a relatively limited combined book value impact of about 3.5%. Using our excess cash to settle the warrants rather than issue shares at a discount, helped limit the impact of book value, while at the same time, it removed a potential overhang in our stock's market valuation.

We have been very pleased with the performance of our platform over the course of this year, delivering solid operating results and earnings supported by income generated by our well-balanced and high credit quality portfolio.

With our continued emphasis on further improving our capital structure, lowering our overall cost of funds and focus on delivering attractive risk-adjusted returns to our stockholders, we are excited about the future growth opportunities for the company as we close out 2021 and head into the new year and beyond.

I would now like to turn the call over to Steve Alpart to discuss our originations, forward pipeline and portfolio in more detail.

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

In the third quarter, we continued to deploy capital into high quality loans that meet our credit and return criteria. We closed eight new loans with total commitments of over $310 million and initial fundings of over $285 million. We also funded an additional $35 million on existing loan commitments for total portfolio fundings of over $320 million. Four of the new loans, representing over 50% of our Q3 originations are secured by multifamily properties and three loans totaling about a third of our new loan volume are collateralized by well-leased office buildings. One new hotel loan is related to the sale of the Minneapolis Hotel to a new ownership group, where Granite Point provided a $45 million first mortgage loan at a reset basis supported by fresh equity capital invested into the transaction. The newly originated loans carry attractive return and credit profiles with a weighted average yield of LIBOR plus 391 and a weighted average stabilized LTV of under 66%, generally consistent with our overall portfolio LTV.

During the third quarter, we realized $290 million of repayments, which were diversified across various property types, including office, multifamily and one warehouse loan. Through the first nine months of the year, we realized over $800 million of repayments and principal amortization, which has been largely consistent with our initial full year estimate of between $500 million and $1 billion. We currently anticipate approximately $150 million of loan repayments in the fourth quarter, though the exact timing and volume are highly dependent on the typical loan closing process, which if realized, would bring full year repayments to almost $1 billion or about 25% of our portfolio balance at the beginning of the year. We believe that healthy loan payoff activity is indicative of continued improvement in real estate fundamentals and the overall credit quality of our investments.

Over the course of the third quarter, the outstanding principal balance of our portfolio increased moderately to about $3.7 billion across 100 loans, with an additional $430 million in future funding commitments, which account for only about 11% of our total commitments and is consistent with the generally lighter transitional nature of our loans. Our assets continue to generate attractive returns and exhibit healthy overall credit characteristics with a weighted average unlevered realized yield of about 5.2% and a weighted average stabilized LTV of 63%.

We currently have a forward pipeline of attractive investments with over $270 million of total commitments and over $240 million of initial fundings. So far in the fourth quarter, we have closed four loans and funded approximately $135 million of principal, plus another $14 million on prior commitments. The loans in our current pipeline are secured by multifamily office, self-storage and industrial properties with strong fundamentals and have attractive risk-adjusted return profiles. Market for transitional floating rate loans is very active with ample lending opportunities, which allows us to be highly disciplined in selecting the most attractive investments for our portfolio. Assuming market conditions remain stable and depending on the pace of loan repayments, we intend to grow our portfolio over the next several quarters as we further rationalize our funding profile and redeploy our excess capital.

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

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

Yesterday afternoon, we reported our third quarter GAAP net income of $18.6 million, or $0.34 per basic share as compared to $14.2 million, or $0.26 per basic share in Q2. Our Q3 GAAP earnings include a benefit from provision for credit losses of $5.8 million, or $0.11 per basic share related to certain reserve releases. Distributable earnings for the third quarter were $5.1 million, or $0.09 per basic share versus $15.7 million, or $0.29 per share in Q2. As we disclosed in our business update a few weeks ago, we incurred a $9.7 million, or $0.18 per basic share write-off related to a resolution of our loan collateralized by hotel property located in Minneapolis. This write-off was the main driver of our distributable earnings variance as compared to the prior period. Our write-off adjusted distributable earnings of $0.27 per basic share, supported by the attractive returns generated by our portfolio and the ongoing benefits from LIBOR floors continue to cover our $0.25 per share common dividend. The weighted average floor rate was 130 basis points in Q3, which declined from 155 basis points in the prior period, as our portfolio mix has continued to shift to newly originated assets with lower index floors while legacy loans with higher floors have been paying off.

Our Q3 book value increased to $17.33 per share from $17.27 per share in Q2. The increase was driven by our share repurchases, which contributed around $0.07 per share and the release of CECL reserves of about $0.11 per share. These benefits were partially offset by the net cash settlement of warrants to purchase about 1.1 million shares, which impacted our third quarter book value by about $0.14 per share. As we disclosed in our October press release, the remaining warrants to purchase about 3.5 million shares were net settled for cash in early Q4 and impacted our book value by an additional $0.46 per share. The September 30 book value also includes an allowance for credit losses of $0.88 per share.

Our third quarter allowance declined by about $15.5 million to $47.4 million, which was largely driven by the $9.7 million write-off on the hotel loan resolution. We also released some reserves due to modestly better economic forecasts, loan repayments, the continued improvement in the overall performance of our portfolio as well as certain reserves related to future funding commitments on the non-performing office loan. These reserve releases were partially offset by the establishment of an allowance for our newly originated loans. Our total CECL reserve represents about 116 basis points of our total portfolio commitments as of September 30. About $22 million of the $47 million total allowance is allocated to our two-remaining collateral-dependent loans that continue to be risk-weighted 5 at quarter end.

Turning to our liquidity and leverage, we ended the quarter with about $154 million in cash, and as of November 5th, we had approximately $134 million in cash and about $89 million of unencumbered whole loans, which we can finance with our facility subject to lender approval. Our total debt-to-equity ratio at September 30 was 3.0 times, up slightly from 2.8 times in the prior quarter, and our target remains in the range of 3.0 times to 3.5 times.

Thank you again for joining us today, and I will now 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 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. Again, if you have a question, star (*) then one (1).

First question today comes from Doug Harter with Credit Suisse. Please go ahead.

Josh Bolton
Good morning, everyone. This is Josh Bolton on for Doug. Thanks for taking the question. As you're thinking about your current excess liquidity position, how are you thinking about your ability to repay or pay down or replace some of the senior secured debt? And what could the timing look like on reducing some of the cost of funds associated? Thanks.

Marcin Urbaszek
Hey, good morning, this is Marcin. Thank you for your question.

As we said before, refinancing our 8% term loan remains our strategic priority, it is something we're spending quite a bit of time, and it is market dependent. We're evaluating a lot of different potential alternatives to refinance it, so timing, again, is TBD. I would say from an earnings perspective, it's probably a 2022 event, then 2021 event, given where we are in the year, but it is something we're focused on, but again, it's highly dependent of market conditions and which type of product we eventually decide to go with.

Josh Bolton
Great. Thanks, Marcin, and then just thinking about leverage, the target leverage that you mentioned versus currently where you guys are today, which is at the lower end of that. Just curious, should we expect leverage to slowly increase to maybe the middle of that range? Or any thoughts around leverage over the next several quarters would be helpful. Thank you.

Marcin Urbaszek
Sure. Happy to address that. Good question. I think given the structure of our liabilities with a meaningful allocation to non-recourse term match non-mark to market financing. I think we'll be comfortable bringing leverage up towards the higher end of that range over the next, I would say, two to four quarters. So, I would expect us over the course of 2022 to increase leverage. So we have some room to grow the portfolio and earnings, but again, it's going to take us some time.

Josh Bolton
Great. Appreciate the comments, Marcin.

Marcin Urbaszek
Thank you.

Operator
Again, if you would like to ask a question today, it is star (*) then one (1) -- star (*) then one (1) to ask a question.

The next question comes from Chris Muller with JMP Securities. Please go ahead.

Chris Muller
Hey, guys. Thanks for taking the question. I'm on for Steve today. Just one quick one from me. It's nice to see the resolution of some of the non-accruals and 5-rated loans. Do you guys have an estimate of what the drag on EPS is from the remaining non-accruals and I guess what that would look like flowing into earnings once you resolve this? Thanks.

Marcin Urbaszek
Hey, Chris, good morning, It's Marcin. Happy to take this.

Look, I would say it's a few cents a share. There's a lot that goes into it in terms of financing and capital. We are evaluating a lot of different options for the two remaining loans, which may require some capital if we decide to foreclose on one of them or both of them. So, we need some liquidity for that. I would say, it's several cents a quarter, but again, as to the timing and when that may materialize, it's still TBD. I'll turn it over to Steve Alpart to give some more clarity on that.

Steve Alpart
Sure. I can give a quick update on the watch list assets. So, I guess starting with the Pasadena retail deal. We have no major update on that one. We mentioned in the past that this is a well-secured, well-located, open-air infill retail center. It's in a great area of Pasadena. It was low levered. When we made the loan, it was performing very well prior to the pandemic, property was disproportionately impacted by the COVID lockdown protocols, some of the operating restrictions in LA County. We made a determination that it was not likely to be repaid at the July maturity date, and as a result, we moved it to 5 in Q2. We've maintained that 5 ranking for Q3. We're continuing to be in active conversations with the borrower looking at a variety of potential options, which could include negotiated deal in lieu foreclosure, sale of the property or sale of a loan. Just to reiterate, property has multiple demand drivers and we're confident of the intrinsic value of the property. We'll keep you updated as these conversations progress.

Turning to the D.C. office loan, secured by a very well-located office building in the District of Columbia. Prior to the pandemic, the submarket was about a 5% vacancy. We have a great sponsor here, lots of equity, a business plan as a lease-up play. As people probably know, the D.C. market has been impacted by the pandemic. A lot of the big space users like law firms, government users are lagging the return to the office.

So, leasing has been very slow. We moved this one to a 5 in Q2, also maintaining the risk ranking for this one in Q3. Conversations remain productive with the borrower and similar to Pasadena retail, we're looking at a variety of potential options, foreclosure deed in lieu, sale of the property or sale of the loan. So those are the two non-accrual loans, and then the third watch list asset is a newer vintage student housing property in Louisville, Kentucky. The asset has remained as a 4, because it's been behind on business plan due to property-related issues, which the borrower has been addressing. As a result of that, the borrower has requested, and we are going to grant an extension to November 2022. Meanwhile, the property's occupancy has been in the high 80s. We're monitoring the asset, and we're going to continue our conversations with the borrower. So that's the update on those three.

Overall, in the portfolio, we're seeing very positive credit migration. We feel good about the overall credit quality, and as Jack said earlier, we think we'll deliver good results over time.

Chris Muller
Very helpful. Thanks for taking the question.

Operator
Ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Jack Taylor for any closing remarks.

CONCLUSION

Jack Taylor
Well, thank you for joining us on our call today. We very much appreciate your support and your attention, and we look forward to reporting back to you next quarter as we continue our progress for Granite Point and positioning for future growth. Thank you, again.

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