

Ares Commercial Real Estate Corp
Form 10-Q
May 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period to

Commission File No. 001-35517

ARES COMMERCIAL REAL ESTATE CORPORATION

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(Exact name of Registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

45-3148087
(I.R.S. Employer
Identification Number)

One North Wacker Drive, 48th Floor, Chicago, IL 60606

(Address of principal executive office) (Zip Code)

(312) 252-7500

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

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Class
Common stock, \$0.01 par value

Outstanding at May 6, 2015
28,584,095

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ARES COMMERCIAL REAL ESTATE CORPORATION

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

	March 31, 2015 (unaudited)	As of	December 31, 2014
ASSETS			
Cash and cash equivalents (\$27 and \$47 related to consolidated VIEs, respectively)	\$ 9,005	\$	16,551
Restricted cash	30,280		66,121
Loans held for investment (\$679,113 and \$848,224 related to consolidated VIEs, respectively)	1,304,821		1,462,584
Loans held for sale, at fair value	146,324		203,006
Mortgage servicing rights, at fair value	58,525		58,889
Other assets (\$3,579 and \$3,438 of interest receivable related to consolidated VIEs, respectively; \$18,352 of other receivables related to consolidated VIEs as of December 31, 2014)	40,826		60,502
Total assets	\$ 1,589,781	\$	1,867,653
LIABILITIES AND EQUITY			
LIABILITIES			
Secured funding agreements	\$ 504,345	\$	552,799
Warehouse lines of credit	139,689		193,165
Convertible notes	68,541		68,395
Commercial mortgage-backed securitization debt (consolidated VIE)	83,288		219,043
Collateralized loan obligation securitization debt (consolidated VIE)	256,995		308,703
Allowance for loss sharing	11,745		12,349
Due to affiliate	2,763		2,735
Dividends payable	7,146		7,147
Other liabilities (\$349 and \$498 of interest payable related to consolidated VIEs, respectively)	28,114		22,431
Total liabilities	1,102,626		1,386,767
Commitments and contingencies (Note 7)			
EQUITY			
Common stock, par value \$0.01 per share, 450,000,000 shares authorized at March 31, 2015 and December 31, 2014, 28,584,095 and 28,586,915 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	284		284
Additional paid-in capital	420,543		420,344
Accumulated deficit	(17,758)		(17,674)
Total stockholders' equity	403,069		402,954
Non-controlling interests in consolidated VIEs	84,086		77,932
Total equity	487,155		480,886

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Total liabilities and equity	\$	1,589,781	\$	1,867,653
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See accompanying notes to consolidated financial statements.

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ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	For the three months ended March 31,	
	2015	2014
	(unaudited)	(unaudited)
Net interest margin:		
Interest income from loans held for investment	\$ 23,170	\$ 15,152
Interest expense	(10,178)	(6,625)
Net interest margin	12,992	8,527
Mortgage banking revenue:		
Servicing fees, net	3,916	5,219
Gains from mortgage banking activities	4,144	1,298
Provision for loss sharing	566	(119)
Change in fair value of mortgage servicing rights	(3,181)	(1,847)
Mortgage banking revenue	5,445	4,551
Gain on sale of loans	-	680
Total revenue	18,437	13,758
Expenses:		
Management fees to affiliate	1,476	1,492
Professional fees	775	925
Compensation and benefits	4,637	4,021
Acquisition and investment pursuit costs	-	20
General and administrative expenses	1,831	2,219
General and administrative expenses reimbursed to affiliate	1,065	1,000
Total expenses	9,784	9,677
Income from operations before income taxes	8,653	4,081
Income tax benefit	(642)	(674)
Net income attributable to ACRE	9,295	4,755
Less: Net income attributable to non-controlling interests	(2,233)	-
Net income attributable to common stockholders	\$ 7,062	\$ 4,755
Net income per common share:		
Basic and diluted earnings per common share	\$ 0.25	\$ 0.17
Weighted average number of common shares outstanding:		
Basic weighted average shares of common stock outstanding	28,484,293	28,442,560
Diluted weighted average shares of common stock outstanding	28,584,784	28,550,982
Dividends declared per share of common stock	\$ 0.25	\$ 0.25

See accompanying notes to consolidated financial statements.

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ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

(in thousands, except share and per share data)

(unaudited)

	Common Stock		Additional	Accumulated	Total	Non-	Total
	Shares	Amount	Paid-in	Deficit	Stockholders	Controlling	Equity
			Capital		Equity	Interests	
Balance at December 31, 2014	28,586,915	\$ 284	\$ 420,344	\$ (17,674)	\$ 402,954	\$ 77,932	\$ 480,886
Stock-based compensation	(2,820)	-	199	-	199	-	199
Net income	-	-	-	7,062	7,062	2,233	9,295
Dividends declared	-	-	-	(7,146)	(7,146)	-	(7,146)
Contributions from non-controlling interests	-	-	-	-	-	5,685	5,685
Distributions to non-controlling interests	-	-	-	-	-	(1,764)	(1,764)
Balance at March 31, 2015	28,584,095	\$ 284	\$ 420,543	\$ (17,758)	\$ 403,069	\$ 84,086	\$ 487,155

See accompanying notes to consolidated financial statements.

Table of Contents**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	For the three months ended March 31,	
	2015	2014
	(unaudited)	(unaudited)
Operating activities:		
Net income	\$ 9,295	\$ 4,755
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred financing costs	2,776	1,069
Change in mortgage banking activities	(1,194)	46
Change in fair value of mortgage servicing rights	3,181	1,847
Accretion of deferred loan origination fees and costs	(1,525)	(592)
Provision for loss sharing	(566)	119
Originations of mortgage loans held for sale	(162,175)	(52,794)
Sale of mortgage loans held for sale to third parties	216,394	56,115
Stock-based compensation	199	264
Amortization of convertible notes issuance costs	236	214
Accretion of convertible notes	146	132
Depreciation expense	54	29
Deferred tax expense (benefit)	(15)	(632)
Changes in operating assets and liabilities:		
Restricted cash	38,680	(797)
Other assets	18,217	(2,688)
Due to affiliate	28	(246)
Other liabilities	1,823	845
Net cash provided by operating activities	125,554	7,686
Investing activities:		
Issuance of and fundings on loans held for investment	(58,669)	(147,561)
Principal repayment of loans held for investment	218,094	-
Proceeds from sale of a mortgage loan held for sale	-	80,197
Receipt of origination fees	398	897
Purchases of property and equipment	(56)	(52)
Net cash provided by (used in) investing activities	159,767	(66,519)
Financing activities:		
Proceeds from secured funding agreements	20,870	145,679
Repayments of secured funding agreements	(69,324)	(68,556)
Secured funding costs	(248)	(748)
Repayments of debt of consolidated VIEs	(187,463)	-
Payment of offering costs	-	(113)
Proceeds from warehouse lines of credit	175,689	42,880
Repayments of warehouse lines of credit	(229,165)	(42,880)
Dividends paid	(7,147)	(7,127)
Contributions from non-controlling interests	5,685	-
Distributions to non-controlling interests	(1,764)	-
Net cash provided by (used in) financing activities	(292,867)	69,135
Change in cash and cash equivalents	(7,546)	10,302
Cash and cash equivalents, beginning of period	16,551	20,100
Cash and cash equivalents, end of period	\$ 9,005	\$ 30,402

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See accompanying notes to consolidated financial statements.

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ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of March 31, 2015

(in thousands, except share and per share data, percentages and as otherwise indicated)

(unaudited)

1. ORGANIZATION

Ares Commercial Real Estate Corporation (together with its consolidated subsidiaries, the Company or ACRE) is a specialty finance company that operates both as a principal lender and a mortgage banker (with respect to loans collateralized by multifamily and senior-living properties). Through Ares Commercial Real Estate Management LLC (ACREM or the Company's Manager), a Securities and Exchange Commission (SEC) registered investment adviser and a subsidiary of Ares Management L.P. (NYSE: ARES) (Ares Management), a publicly traded, leading global alternative asset manager, it has investment professionals strategically located across the United States and Europe who directly source new loan opportunities for the Company with owners, operators and sponsors of commercial real estate (CRE) properties. The Company was formed and commenced operations in late 2011. The Company is a Maryland corporation and completed its initial public offering (the IPO) in May 2012. The Company is externally managed by its Manager, pursuant to the terms of a management agreement (the Management Agreement).

In the Company's principal lending business, it is primarily focused on directly originating, managing and servicing a diversified portfolio of CRE debt-related investments for the Company's own account. The Company's target investments in its principal lending business include senior loans, bridge loans, subordinated debt, preferred equity and other CRE-related investments. These investments, which are referred to as the Company's principal lending target investments, are generally held for investment and are secured, directly or indirectly, by office, multifamily, retail, industrial, lodging, senior-living and other commercial real estate properties, or by ownership interests therein.

The Company is also engaged in the mortgage banking business through its wholly owned subsidiary, ACRE Capital LLC (ACRE Capital), which the Company believes is complementary to its principal lending business. In this business segment, the Company primarily originates, sells and services multifamily and senior-living related loans under programs offered by government and government-sponsored enterprises (GSEs), such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Government National Mortgage Association (Ginnie Mae) and the Federal Housing Administration, a division of the U.S. Department of Housing and Urban Development (together with Ginnie Mae, HUD). ACRE Capital is approved as a Fannie Mae Delegated Underwriting and Servicing (DUS) lender, a Freddie Mac Program Plus® Seller/Servicer, a Multifamily Accelerated Processing and Section 232 LEAN lender for HUD, and a Ginnie Mae issuer. While the Company earns little interest income from these activities as it generally only holds loans for short periods, the Company receives origination fees when it closes loans and sale premiums when it sells loans. The Company also retains the rights to service the loans, which are known as mortgage servicing rights (MSRs) and receives fees for such servicing during the life of the loans, which generally last ten years or more.

The Company has elected and qualified to be taxed as a real estate investment trust (REIT) for U.S. federal income tax purposes under the Internal Revenue Code of 1986, as amended, commencing with its taxable year ended December 31, 2012. The Company generally will not be subject to U.S. federal income taxes on its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, to the extent that it annually distributes all of its REIT taxable income to stockholders and complies with various other

requirements as a REIT.

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and the related management's discussion and analysis of financial condition and results of operations included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014 filed with the SEC.

Refer to the Company's Form 10-K for a description of the Company's recurring accounting policies. The Company has included disclosure below regarding basis of presentation and other accounting policies that (i) are required to be disclosed quarterly or (ii) the Company views as critical as of the date of this report.

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Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with United States generally accepted accounting principles (GAAP) and include the accounts of the Company, the consolidated variable interest entities (VIEs) that the Company controls and of which the Company is the primary beneficiary, and the Company s wholly owned subsidiaries. The consolidated financial statements reflect all adjustments and reclassifications that, in the opinion of management, are necessary for the fair presentation of the Company s results of operations and financial condition as of and for the periods presented. All intercompany balances and transactions have been eliminated.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The current period s results of operations will not necessarily be indicative of results that ultimately may be achieved for the year ending December 31, 2015.

Variable Interest Entities

The Company evaluates all of its interests in VIEs for consolidation. When the Company s interests are determined to be variable interests, the Company assesses whether it is deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810, *Consolidation* (ASC 810), defines the primary beneficiary as the party that has both (i) the power to direct the activities of the VIE that most significantly impact its economic performance, and (ii) the obligation to absorb losses and the right to receive benefits from the VIE which could be potentially significant. The Company considers its variable interests, as well as any variable interests of its related parties in making this determination. Where both of these factors are present, the Company is deemed to be the primary beneficiary and it consolidates the VIE. Where either one of these factors is not present, the Company is not the primary beneficiary and it does not consolidate the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE s economic performance, the Company considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE s economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Company considers all of its economic interests, including debt and equity investments, servicing fees, and other arrangements deemed to be variable interests in the VIE. This assessment requires that the Company applies judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE s capital structure; and the reasons why the interests are held by the Company.

For VIEs of which the Company is determined to be the primary beneficiary, all of the underlying assets, liabilities, equity, revenue and expenses of the structures are consolidated into the Company s consolidated financial statements.

The Company performs an ongoing reassessment of: (1) whether any entities previously evaluated under the majority voting interest framework have become VIEs, based on certain events, and therefore are subject to the VIE consolidation framework, and (2) whether changes in the facts and circumstances regarding its involvement with a VIE causes the Company's consolidation conclusion regarding the VIE to change. See Note 15 included in these consolidated financial statements for further discussion of the Company's VIEs.

Segment Reporting

The Company has two reportable business segments: principal lending and mortgage banking. See Note 16 included in these consolidated financial statements for further discussion of the Company's reportable business segments.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. Other interest expense related to the unsecured 7.00% Convertible Senior Notes that mature in 2015 (the 2015 Convertible Notes)

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has been reclassified into interest expense, other interest expense related to the Warehouse Lines of Credit (as defined in Note 5 included in these consolidated financial statements) has been reclassified into gains from mortgage banking activities and other interest expense related to escrow accounts has been reclassified into servicing fees, net in the consolidated statements of operations. As of December 31, 2014, the Company no longer presents other interest expense in its consolidated statements of operations.

Loans Held for Investment

The Company originates CRE debt and related instruments generally to be held for investment. Loans that are held for investment are carried at cost, net of unamortized loan fees and origination costs, unless the loans are deemed impaired. Impairment occurs when it is deemed probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan. If a loan is considered to be impaired, the Company will record an allowance to reduce the carrying value of the loan to the present value of expected future cash flows discounted at the loan's contractual effective rate.

Each loan classified as held for investment is evaluated for impairment on a periodic basis. Loans are collateralized by real estate. The extent of any credit deterioration associated with the performance and/or value of the underlying collateral property and the financial and operating capability of the borrower could impact the expected amounts received. The Company monitors performance of its investment portfolio under the following methodology: (1) borrower review, which analyzes the borrower's ability to execute on its original business plan, reviews its financial condition, assesses pending litigation and considers its general level of responsiveness and cooperation; (2) economic review, which considers underlying collateral, (i.e. leasing performance, unit sales and cash flow of the collateral and its ability to cover debt service, as well as the residual loan balance at maturity); (3) property review, which considers current environmental risks, changes in insurance costs or coverage, current site visibility, capital expenditures and market perception; and (4) market review, which analyzes the collateral from a supply and demand perspective of similar property types, as well as from a capital markets perspective. Such impairment analyses are completed and reviewed by asset management and finance personnel who utilize various data sources, including periodic financial data such as property occupancy, tenant profile, rental rates, operating expenses, and the borrower's exit plan, among other factors.

In addition, the Company evaluates the entire portfolio to determine whether the portfolio has any impairment that requires a valuation allowance on the remainder of the loan portfolio. As of March 31, 2015 and December 31, 2014, the Company did not recognize any impairments with respect to its loans held for investment.

Preferred equity investments, which are subordinate to any loans but senior to common equity, are accounted for as loans held for investment and are carried at cost, net of unamortized loan fees and origination costs, unless the loans are deemed impaired, and are included within loans held for investment in the Company's consolidated balance sheets. The Company accretes or amortizes any discounts or premiums over the life of the related loan receivable utilizing the effective interest method.

Loans Held for Sale

Through its subsidiaries, including ACRE Capital, ACRC Lender W TRS LLC (ACRC W TRS) and ACRC Lender U TRS LLC (ACRC U TRS), the Company originates mortgage loans held for sale, which are recorded at fair value and accounted for under FASB ASC Topic 860, *Transfers and Servicing*. The holding period for loans originated by ACRE Capital is approximately 30 days. The carrying value of the mortgage

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loans sold is reduced by the value allocated to the associated retained MSR based on relative fair value at the time of the sale. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the adjusted value of the related mortgage loans sold.

Mortgage Servicing Rights

When a mortgage loan is sold, ACRE Capital retains the right to service the loan and recognizes the MSR at fair value. The initial fair value represents expected net cash flows from servicing, as well as interest earnings on escrows and interim cash balances, borrower prepayment penalties, delinquency rates, late charges along with ancillary fees that are discounted at a rate that reflects the credit and liquidity risk of the MSR over the estimated life of the underlying loan. After initial recognition, changes in the MSR fair value are included within change in fair value of mortgage servicing rights in the Company's consolidated statements of operations for the period in which the change occurs.

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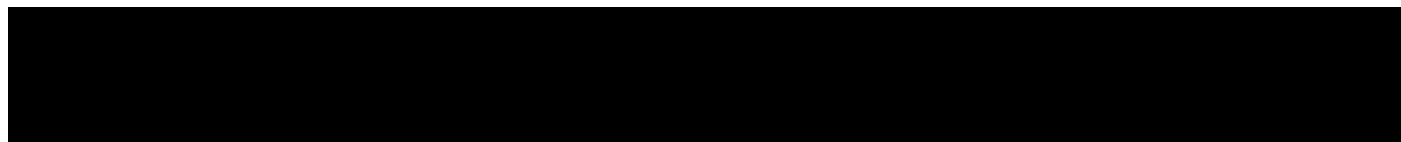
Allowance for Loss Sharing

When a loan is sold under the Fannie Mae DUS program, ACRE Capital undertakes an obligation to partially guarantee the performance of the loan. The date ACRE Capital commits to make a loan to a borrower, a liability for the fair value of the obligation undertaken in issuing the guaranty is recognized. Subsequent to the initial commitment date, the Company monitors the performance of each loan for events or circumstances which may signal a liability to be recognized if there is a probable and estimable loss. The initial fair value of the guarantee is estimated by examining historical loss share experienced in the ACRE Capital Fannie Mae DUS portfolio since inception. The initial fair value of the guarantee is included within the provision for loss sharing in the Company's consolidated statements of operations. These historical loss shares serve as a basis to derive a loss share rate which is then applied to the current ACRE Capital DUS portfolio (net of specifically identified impaired loans that are subject to a separate loss share reserve analysis).

Revenue Recognition

Interest income from loans held for investment is accrued based on the outstanding principal amount and the contractual terms of each loan. For loans held for investment, origination fees, contractual exit fees and direct loan origination costs are also recognized in interest income from loans held for investment over the initial loan term as a yield adjustment using the effective interest method.

A reconciliation of the Company's interest income from loans held for investment, excluding non-controlling interests, to the Company's interest income from loans held for investment as included within its consolidated statements of operations is as follows (\$ in thousands):



Servicing fees are earned for servicing mortgage loans, including all activities related to servicing the loans, and are recognized as services are provided over the life of the related mortgage loan. Also included in servicing fees are the net fees earned on borrower prepayment penalties and interest earned on borrowers' escrow payments and interim cash balances, along with other ancillary fees and reduced by write-offs of MSR for loans that are prepaid, changes in the fair value of the servicing fee payable (defined below) and interest expense related to escrow accounts. ACRE Capital provides additional payments to certain personnel by providing them with a percentage of the servicing fee revenue that is earned by ACRE Capital, which is initially recorded as a liability when ACRE Capital commits to make a loan to a borrower (the servicing fee payable).

Gains from mortgage banking activities includes the initial fair value of MSRs, loan origination fees, gain on the sale of loans originated, interest income and fees earned on loans held for sale, changes to the fair value of derivative financial instruments attributable to the loan commitments and forward sale commitments and reduced by the expense related to the initial fair value of the servicing fee payable and the interest expense related to the Warehouse Lines of Credit (as defined in Note 5 included in these consolidated financial statements). The initial fair value of MSRs, loan origination fees, gain on the sale of loans originated, certain direct loan origination costs for loans held for sale and the expenses related to the initial fair value of the servicing fee payable are recognized when ACRE Capital commits to make a loan to a borrower. When the Company settles a sale agreement and transfers the mortgage loan to the buyer, the Company recognizes a MSR asset equal to the

present value of the expected net cash flows associated with the servicing of loans sold.

Comprehensive Income

For the three months ended March 31, 2015 and 2014, comprehensive income equaled net income; therefore, a separate consolidated statement of comprehensive income is not included in the accompanying consolidated financial statements.

Net Interest Margin and Interest Expense

Net interest margin within the consolidated statements of operations is a measure that is specific to the Company's principal lending business and serves to measure the performance of the principal lending segment's loans held for investment as compared to its use of debt leverage. The Company includes interest income from its loans held for investment and interest

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expense related to its secured funding agreements, securitizations debt and the 2015 Convertible Notes in net interest margin. As of March 31, 2015 and 2014, interest expense is comprised of the following (\$ in thousands):

	For the three months ended March 31,			
	2015		2014	
Secured funding agreements and securitizations debt	\$	8,589	\$	5,072
Convertible notes		1,589		1,553
Interest expense	\$	10,178	\$	6,625

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this ASU supersedes the revenue recognition requirements in Topic 605, Revenue Recognition. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU No. 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the impact of adopting this ASU on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation: Amendments to the Consolidation Analysis (Topic 810). The guidance in this ASU includes amendments to Topic 810, Consolidation. The new guidance modifies the consolidation analysis for limited and general partnerships and similar type entities, as well as variable interests in a variable interest entity, particularly those that have fee arrangements and related party relationships. Additionally, it provides a scope exception to the consolidation guidance for certain entities. The amendments in ASU No. 2015-02 are effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Early adoption is permitted. The Company is currently evaluating the impact of adopting this ASU on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The new guidance modifies the requirements for reporting debt issuance costs. Under the amendments in ASU No. 2015-03, debt issuance costs related to a recognized debt liability will no longer be recorded as a separate asset, but will be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by ASU No. 2015-03. ASU No. 2015-03 shall be applied retrospectively for periods beginning on or after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact of adopting this ASU on its consolidated financial statements.

3. LOANS HELD FOR INVESTMENT

As of March 31, 2015, the Company had originated or co-originated 41 CRE middle market loans, excluding 17 loans that were repaid since inception. The aggregate originated commitment under these loans at closing was approximately \$1.4 billion and outstanding principal was \$1.2 billion, excluding non-controlling interests held by third parties, as of March 31, 2015. During the three months ended March 31, 2015, the Company funded approximately \$59.2 million of outstanding principal and received repayments of \$218.1 million of outstanding principal as described in more detail in the tables below. Such investments are referred to herein as the Company's investment portfolio. As of March 31,

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2015, 67.6% of the Company's loans have LIBOR floors, with a weighted average floor of 0.24%, calculated based on loans with LIBOR floors. References to LIBOR or L are to 30-day LIBOR (unless otherwise specifically stated).

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The Company's investments in mortgages and loans held for investment are accounted for at amortized cost. The following tables summarize the Company's loans held for investment as of March 31, 2015 and December 31, 2014 (\$ in thousands):

As of March 31, 2015					
	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Interest Rate	Weighted Average Unleveraged Effective Yield (2)	Weighted Average Remaining Life (Years)
Senior mortgage loans	\$ 1,032,296	\$ 1,039,078	4.4%	4.9%	2.0
Subordinated debt and preferred equity investments	189,238	191,604	10.6%	11.0%	6.6
Total investment portfolio (excluding non-controlling interests held by third parties)	\$ 1,221,534	\$ 1,230,682	5.4%	5.9%	2.7
As of December 31, 2014					
	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Interest Rate	Weighted Average Unleveraged Effective Yield (2)	Weighted Average Remaining Life (Years)
Senior mortgage loans	\$ 1,156,476	\$ 1,164,055	4.5%	5.0%	2.1
Subordinated debt and preferred equity investments	228,499	231,226	10.3%	10.7%	6.1
Total investment portfolio (excluding non-controlling interests held by third parties)	\$ 1,384,975	\$ 1,395,281	5.5%	6.0%	2.8

(1) The difference between the Carrying Amount and the Outstanding Principal face amount of the loans held for investment consists of unamortized purchase discount, deferred loan fees and loan origination costs.

(2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults. The Total Weighted Average Unleveraged Effective Yield is calculated based on the average of Unleveraged Effective Yield of all loans held by the Company as of March 31, 2015 and December 31, 2014 as weighted by the Outstanding Principal balance of each loan.

A reconciliation of the Company's investment portfolio excluding non-controlling interests compared to the Company's loans held for investment as included within its consolidated balance sheets is as follows (\$ in thousands):

As of March 31, 2015			
	Carrying Amount	Outstanding Principal	
Total investment portfolio (excluding non-controlling interests held by third parties)	\$ 1,221,534	\$ 1,230,682	
Non-controlling interest investment held by third parties	83,287	83,287	
Loans held for investment	\$ 1,304,821	\$ 1,313,969	

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	As of December 31, 2014	
	Carrying Amount	Outstanding Principal
Total investment portfolio (excluding non-controlling interests held by third parties)	\$ 1,384,975	\$ 1,395,281
Non-controlling interest investment held by third parties	77,609	77,609
Loans held for investment	\$ 1,462,584	\$ 1,472,890

A more detailed listing of the Company's investment portfolio, based on information available as of March 31, 2015 is as follows (\$ in millions, except percentages):

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Loan Type	Location	Outstanding Principal (1)	Carrying Amount (1)	Interest Rate	Unleveraged Effective Yield (2)	Maturity Date (3)	Payment Terms (4)
Transitional Senior Mortgage Loans:							
Office	CA	\$ 75.0	\$ 74.6	L+3.75%	4.2%	Aug 2017	I/O
Retail	IL	70.0	69.5	L+4.25%	4.9%	Aug 2017	I/O
Office	TX	69.5	68.8	L+5.00%	6.1%	Jan 2017	I/O
Mixed-use	IL	47.5	46.9	L+3.60%	4.2%	Oct 2018	I/O
Multifamily	TX	44.7	44.6	L+3.75%	4.5%	July 2016	I/O
Healthcare	NY	41.6	41.2	L+5.00%	5.8%	Dec 2016	I/O
Industrial	MO/KS	37.8	37.6	L+4.30%	5.1%	Jan 2017	P/I
Multifamily	FL	35.6	35.4	L+3.75%	4.7%	Mar 2017	I/O
Multifamily	TX	35.0	34.9	L+3.75%	4.5%	July 2016	I/O
Office	FL	32.8	32.6	L+3.65%	4.0%	Oct 2017	I/O
Office	OH	30.2	30.2	L+5.35%-L+5.00% (5)	6.0%	Nov 2015	I/O
Retail	IL	29.0	28.7	L+3.25%	3.9%	Sep 2018	I/O
Office	CA	27.8	27.6	L+4.50%	5.2%	Apr 2017	I/O
Multifamily	TX	27.5	27.4	L+3.65%	4.4%	Jan 2017	I/O
Office	OR	27.4	27.1	L+3.75%	4.4%	Oct 2018	I/O
Multifamily	NY	27.3	27.0	L+3.75%	4.4%	Oct 2017	I/O
Mixed-use	NY	26.4	26.3	L+4.25%	4.8%	Aug 2017	I/O
Office	KS	25.5	25.4	L+5.00%	5.8%	Mar 2016	I/O
Multifamily	TX	24.9	24.7	L+3.65%	4.4%	Jan 2017	I/O
Multifamily	GA	22.1	22.0	L+3.85%	4.8%	May 2017	I/O
Multifamily	AZ	21.9	21.9	L+4.25%	5.9%	Sep 2015	I/O
Industrial	CA	20.0	19.8	L+5.25%	6.1%	May 2017	I/O
Industrial	VA	19.0	18.9	L+5.25%	6.4%	Dec 2015	I/O
Office	CO	16.8	16.6	L+3.95%	4.6%	Dec 2017	I/O
Office	CA	15.9	15.8	L+3.75%	4.5%	July 2016	I/O
Multifamily	NC	15.1	14.9	L+4.00%	4.8%	Apr 2017	I/O
Office	CA	14.8	14.7	L+4.50%	5.3%	July 2016	I/O
Multifamily	NY	14.4	14.3	L+3.85%	4.4%	Nov 2017	I/O
Multifamily	FL	13.7	13.6	L+3.80%	4.6%	Feb 2017	I/O
Mixed-use	NY	12.8	12.7	L+3.95%	4.7%	Sep 2017	I/O
Multifamily	FL	11.6	11.5	L+3.75%	4.6%	Apr 2017	I/O
Multifamily	FL	10.9	10.8	L+3.80%	4.6%	Feb 2017	I/O
Stretch Senior Mortgage Loans:							
Office	FL	47.3	47.3	L+5.25%	5.4%	Apr 2016	I/O
Industrial	OH	32.7	32.4	L+4.20%	4.7%	May 2018	I/O
Office	CA	14.5	14.5	L+4.75%	5.7%	Feb 2016	I/O
Subordinated Debt and Preferred Equity Investments:							
Multifamily	GA and FL	37.4	36.8	L+11.85% (6)	12.3%	June 2021	I/O
Multifamily	NY	33.3	33.2	L+8.07%	8.5%	Jan 2019	I/O
Office	GA	14.3	14.3	9.5%	9.5%	Aug 2017	I/O
Mixed-use	NY	15.1	15.0	11.50% (7)	11.9%	Nov 2016	I/O
Multifamily	TX	4.9	4.8	L+11.00% (8)	11.6%	Oct 2016	I/O
Various	Diversified (9)	86.7	85.2	10.95%	11.4%	Dec 2024	I/O
Total/Average		\$ 1,230.7	\$ 1,221.5		5.9%		

- (1) The difference between the Carrying Amount and the Outstanding Principal amount of the loans held for investment consists of unamortized purchase discount, deferred loan fees and loan origination costs.
- (2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults. Unleveraged Effective Yield for each loan is calculated based on LIBOR as of March 31, 2015 or the LIBOR floor, as applicable. The Weighted Average Unleveraged Effective Yield is calculated based on the average of Unleveraged Effective Yield of all loans held by the Company as of March 31, 2015 as weighted by the Outstanding Principal balance of each loan.
- (3) Certain loans are subject to contractual extension options that vary between one and two 12-month extensions and may be subject to performance based or other conditions as stipulated in the loan agreement. Actual maturities may differ from contractual maturities

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stated herein as certain borrowers may have the right to prepay with or without paying a prepayment penalty. The Company may also extend contractual maturities in connection with loan modifications.

- (4) I/O = interest only, P/I = principal and interest. In January 2015, amortization began on the transitional senior Missouri/Kansas loan, which had an outstanding principal balance of \$37.8 million as of March 31, 2015. In May 2017, amortization will begin on the stretch senior Ohio loan, which had an outstanding principal balance of \$32.7

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million as of March 31, 2015. The remainder of the loans in the Company's principal lending portfolio are non-amortizing through their primary terms.

- (5) The initial interest rate for this loan of L+5.35% steps down based on performance hurdles to L+5.00%.
- (6) The preferred return is L+11.85% with 2.00% as payment-in-kind (PIK), to the extent cash flow is not available. There is no capped dollar amount on accrued PIK.
- (7) The interest rate is 11.50% with a 9.00% current pay and up to a capped dollar amount as PIK based on the borrower's election.
- (8) The preferred return is L+11.00% with a L+9.00% current pay and up to a capped dollar amount as PIK.
- (9) The preferred equity investment is in an entity whose assets are comprised of multifamily, student housing, medical office and self-storage properties.

For the three months ended March 31, 2015, the activity in the Company's loan portfolio was as follows (\$ in thousands):

Balance at December 31, 2014	\$ 1,462,584
Initial funding	41,600
Receipt of origination fees, net of costs	(367)
Additional funding	17,573
Amortizing payments	(153)
Loan payoffs	(217,941)
Origination fee accretion	1,525
Balance at March 31, 2015	\$ 1,304,821

No impairment charges have been recognized during the three months ended March 31, 2015 and 2014.

4. MORTGAGE SERVICING RIGHTS

MSRs represent servicing rights retained by ACRE Capital for loans it originates and sells. The servicing fees are collected from the monthly payments made by the borrowers. ACRE Capital generally receives other remuneration including rights to various loan fees such as late charges, collateral re-conveyance charges, loan prepayment penalties, and other ancillary fees. In addition, ACRE Capital is also generally entitled to retain the interest earned on funds held pending remittance related to its collection of loan principal and escrow balances. As of March 31, 2015 and December 31, 2014, the carrying value of MSRs was approximately \$58.5 million and \$58.9 million, respectively. As of March 31, 2015 and December 31, 2014, ACRE Capital had a servicing portfolio consisting of 970 and 976 loans, respectively, with an unpaid principal balance of \$4.2 billion and \$4.1 billion, respectively, which excludes ACRE's loans held for investment portfolio (see Note 13).

Activity related to MSRs as of and for the three months ended March 31, 2015 and 2014 was as follows (\$ in thousands):

Balance at December 31, 2014	\$	58,889
Additions, following sale of loan		3,144
Changes in fair value		(3,181)
Prepayments and write-offs		(327)
Balance at March 31, 2015	\$	58,525
Balance at December 31, 2013	\$	59,640

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Additions, following sale of loan		2,500
Changes in fair value		(1,847)
Prepayments and write-offs		(161)
Balance at March 31, 2014	\$	60,132

As discussed in Note 2 included in these consolidated financial statements, the Company determines the fair values of the MSR's based on discounted cash flow models that calculate the present value of estimated future net servicing income. The

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fair values of ACRE Capital's MSR's are subject to changes in discount rates. For example, a 100 basis point increase or decrease in the weighted average discount rate would decrease or increase, respectively, the fair value of ACRE Capital's MSR's outstanding as of March 31, 2015 and December 31, 2014 by approximately \$1.8 million.

5. DEBT**Financing Facilities**

The Company borrows funds under the ASAP Line of Credit and the BAML Line of Credit (the Warehouse Lines of Credit), and the Wells Fargo Facility, the Citibank Facility, the Capital One Facility, the CNB Facilities, the MetLife Facility and the UBS Facilities (individually defined below and collectively, the Secured Funding Agreements). The Company refers to the Warehouse Lines of Credit and the Secured Funding Agreements as the Financing Facilities. As of March 31, 2015 and December 31, 2014, the outstanding balances and total commitments under the Financing Facilities consisted of the following (\$ in thousands):

	March 31, 2015		December 31, 2014	
	Outstanding Balance	Total Commitment	Outstanding Balance	Total Commitment
Wells Fargo Facility	\$ 121,325	\$ 225,000	\$ 120,766	\$ 225,000
Citibank Facility	93,432	250,000	93,432	250,000
Capital One Facility	-	100,000	-	100,000
March 2014 CNB Facility	-	50,000	42,000	50,000
July 2014 CNB Facility	62,500	75,000	75,000	75,000
MetLife Facility	150,160	180,000	144,673	180,000
April 2014 UBS Facility	19,685	140,000	19,685	140,000
December 2014 UBS Facility	57,243	57,243	57,243	57,243
ASAP Line of Credit	7,274	80,000 (1)	58,469	80,000 (1)
BAML Line of Credit	132,415	135,000 (2)	134,696	180,000 (2)
Total	\$ 644,034	\$ 1,292,243	\$ 745,964	\$ 1,337,243

(1) The commitment amount is subject to change at any time at Fannie Mae's discretion.

(2) During the three months ended December 31, 2014, the BAML Line of Credit's commitment size temporarily increased from \$80.0 million to \$180.0 million for the period November 25, 2014 through January 26, 2015. During the three months ended March 31, 2015, the BAML Line of Credit's commitment size increased from \$80.0 million to \$135.0 million. See Note 18 included in these consolidated financial statements for information on a subsequent event relating to the BAML Line of Credit.

Some of the Company's Financing Facilities are collateralized by i) assignments of specific loans or a pool of loans held for investment or loans held for sale owned by the Company, ii) interests in the subordinated portion of the Company's securitized debt, or iii) interests in wholly owned entity subsidiaries that hold the Company's loans held for investment. The Financing Facilities (excluding the Warehouse Lines of Credit) are guaranteed by the Company. Generally, the Company partially offsets interest rate risk by matching the interest index of loans held for investment with the Financing Facilities used to fund them. The Company's Financing Facilities contain various affirmative and negative covenants. As of March 31, 2015, the Company is in compliance in all material respects with the terms of each respective Financing Facility.

Wells Fargo Facility

The Company is party to a master repurchase funding facility arranged by Wells Fargo Bank, National Association (as amended and restated, the Wells Fargo Facility), which allows the Company to borrow up to \$225.0 million. In December 2014, the Company amended and restated the Wells Fargo Facility to, among other things, extend the maturity date from December 14, 2014 to December 14, 2015 and waive the non-utilization fee from December 14, 2014 through April 14, 2015. Provided that certain conditions are met and applicable extension fees are paid, the maturity date is subject to two 12-month extensions at the Company's option. Under the Wells Fargo Facility, we are permitted to sell, and later repurchase, certain qualifying senior

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commercial mortgage loans, A-Notes, pari passu participations in commercial mortgage loans and mezzanine loans under certain circumstances, subject to available collateral. Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR plus (ii) a pricing margin range of 2.00%-2.50%. Subject to the waiver set forth above, the Company incurs a non-utilization fee of 25 basis points on the daily available balance of the Wells Fargo Facility to the extent less than 75% of the Wells Fargo Facility is utilized. For the three months ended March 31, 2015, the Company did not incur a non-utilization fee. For the three months ended March 31, 2014, the Company incurred a non-utilization fee of \$9 thousand.

Citibank Facility

The Company is party to a \$250.0 million master repurchase facility (the Citibank Facility) with Citibank, N.A. Under the Citibank Facility, the Company has sold, and must later repurchase, qualifying senior commercial mortgage loans and A-Notes approved by Citibank, N.A. in its sole discretion. Advances under the Citibank Facility accrue interest at a per annum rate equal to 30 day LIBOR plus a pricing margin of 2.00% to 2.50%, subject to certain exceptions. Under the Citibank Facility, the maturity date is December 8, 2016, subject to three 12-month extensions at the Company's option assuming no existing defaults under the Citibank Facility and the payment of an extension fee. The Company incurs a non-utilization fee of 25 basis points on the daily available balance of the Citibank Facility. For the three months ended March 31, 2015, the Company incurred a non-utilization fee of \$97 thousand.

Capital One Facility

The Company is party to a secured revolving funding facility with Capital One, National Association (as amended, the Capital One Facility), which allows the Company to borrow up to \$100.0 million. The Company is permitted to borrow funds under the Capital One Facility to finance qualifying senior commercial mortgage loans, subject to available collateral. Under the Capital One Facility, the Company borrows funds on a revolving basis in the form of individual notes evidenced by individual loans. Each individual loan is secured by an underlying loan originated by the Company. Amounts outstanding under each individual loan accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR, plus (ii) a pricing margin of 2.00% to 3.50%. The Company may request individual loans under the Capital One Facility through and including May 18, 2015, subject to successive 12-month extension options at the lender's discretion. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. The Company does not incur a non-utilization fee under the terms of the Capital One Facility.

City National Bank Facilities

March 2014 CNB Facility

The Company is party to a \$50.0 million secured revolving funding facility with City National Bank (the March 2014 CNB Facility). The Company is permitted to borrow funds under the March 2014 CNB Facility to finance new investments and for other working capital and general corporate needs. Advances under the March 2014 CNB Facility accrue interest at a per annum rate equal to the sum of, at the Company's option, either (a) LIBOR for a one, two, three, six or, if available to all lenders, 12-month interest period plus 3.00% or (b) a base rate (which is the highest of a prime rate, the federal funds rate plus 0.50%, or one month LIBOR plus 1.00%) plus 1.25%; provided that in no event shall the interest rate be less than 3.00%. Unless at least 75% of the March 2014 CNB Facility is used on average, unused commitments under the

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March 2014 CNB Facility accrue unused line fees at the rate of 0.375% per annum. For the three months ended March 31, 2015 and 2014, the Company incurred a non-utilization fee of \$37 thousand and \$8 thousand, respectively. The initial maturity date is March 11, 2016, subject to one 12-month extension at the Company's option provided that certain conditions are met.

July 2014 CNB Facility

The Company and certain of its subsidiaries are party to a \$75.0 million revolving funding facility (the July 2014 CNB Facility) and together with the March 2014 CNB Facility, the CNB Facilities) with City National Bank. The Company is permitted to borrow funds under the July 2014 CNB Facility to finance new investments and for other working capital and general corporate needs. Advances under the July 2014 CNB Facility accrue interest at a per annum rate equal, at the Company's option, to either (a) LIBOR for a one, two, three, six or, if available to all lenders, 12-month interest period plus 1.50% or (b) a base rate (which is the highest of a prime rate, the federal funds rate plus 0.50%, or one month LIBOR plus 1.00%) plus 0.25%; provided that in no event shall the interest rate be less than 1.50%. Unless at least 75% of the July 2014 CNB Facility is used on average, unused commitments under the July 2014 CNB Facility accrue unused line fees at the rate of 0.125% per annum. For the three months ended March 31, 2015, the Company did not incur a non-utilization fee. The initial maturity date is July 31, 2015, subject to one 12-month extension at the Company's option, provided that certain conditions are met and

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applicable extension fees are paid. See Note 13 included in these consolidated financial statements for more information on a credit support fee agreement.

MetLife Facility

The Company and certain of its subsidiaries are party to a \$180.0 million revolving master repurchase facility (the *MetLife Facility*) with Metropolitan Life Insurance Company (*MetLife*), pursuant to which the Company may sell, and later repurchase, commercial mortgage loans meeting defined eligibility criteria which are approved by MetLife in its sole discretion (*Eligible Assets*). Advances under the *MetLife Facility* accrue interest at a per annum rate of 30 day LIBOR plus 2.35%. The Company will pay MetLife, if applicable, an annual make-whole fee equal to the amount by which the aggregate price differential paid over the term of the *MetLife Facility* is less than the defined minimum price differential, unless certain conditions are met. The initial maturity date of the *MetLife Facility* is August 12, 2017, subject to two annual extensions at the Company's option, provided that certain conditions are met, including payment of an extension fee.

UBS Facilities

April 2014 UBS Facility

The Company is party to a \$140.0 million revolving master repurchase facility (the *April 2014 UBS Facility*) with UBS Real Estate Securities Inc. (*UBS*), pursuant to which the Company may sell, and later repurchase, commercial mortgage loans and, under certain circumstances, commercial real estate mezzanine loans and other assets meeting defined eligibility criteria that are approved by UBS in its sole discretion. The price differential (or interest rate) on the *April 2014 UBS Facility* is one-month LIBOR plus 1.88%, excluding amortization of commitment and exit fees. Upon termination of the *April 2014 UBS Facility*, the Company will pay UBS, if applicable, the amount by which the aggregate price differential paid over the term of the *April 2014 UBS Facility* is less than the defined minimum price differential and an exit fee, in each case, unless certain conditions are met. The initial maturity date of the *April 2014 UBS Facility* is April 7, 2017, subject to annual extensions in UBS sole discretion.

December 2014 UBS Facility

The Company is party to a global master repurchase agreement (the *December 2014 UBS Facility*) with UBS AG (*UBS AG*), pursuant to which the Company will sell, and later repurchase, certain retained subordinate notes in the Company's commercial mortgage-backed securities (*CMBS*) securitization (the *Purchased Securities*) for an aggregate purchase price equal to \$57.2 million. The scheduled repurchase date of the *Purchased Securities* under the *December 2014 UBS Facility* is January 6, 2016 (the *Repurchase Date*). The transaction fee (or interest rate), which is payable monthly on the *December 2014 UBS Facility*, is equal to one-month LIBOR plus 2.74% per annum on the outstanding amount. If the outstanding amount of the *Purchased Securities* subject to the *December 2014 UBS Facility* is reduced or repaid prior to the *Repurchase Date*, UBS AG shall be entitled to a termination fee.

Warehouse Lines of Credit

ASAP Line of Credit

ACRE Capital is party to a multifamily as soon as pooled (ASAP) sale agreement with Fannie Mae (the ASAP Line of Credit) to finance installments received from Fannie Mae. To the extent the ASAP Line of Credit remains active through utilization, there is no expiration date. The commitment amount is subject to change at any time at Fannie Mae's discretion. Fannie Mae advances payment to ACRE Capital in two separate installments according to the terms as set forth in the ASAP sale agreement. The first installment is considered an advance to ACRE Capital from Fannie Mae and not a sale until the second advance and settlement is made.

BAML Line of Credit

In November 2014, ACRE Capital amended the line of credit with Bank of America, N.A. (as amended and restated, the BAML Line of Credit) to, among other things, temporarily increase the size of the commitment from \$80.0 million to \$180.0 million for the period November 25, 2014 through January 26, 2015. In February 2015, ACRE Capital amended the BAML Line of Credit to, among other things, increase the size of the commitment from \$80.0 million to \$135.0 million and extend the maturity date to June 30, 2016. The stated interest rate on the BAML Line of Credit is LIBOR Daily Floating Rate plus 1.60%. ACRE Capital incurs a non-utilization fee of 12.5 basis points on the daily available balance of the BAML Line of Credit to the extent less than 40% of the BAML Line of Credit is utilized. For the three months ended March 31, 2015 and

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2014, the Company incurred a non-utilization fee of \$15 thousand and \$23 thousand, respectively. See Note 18 included in these consolidated financial statements for information on a subsequent event relating to the BAML Line of Credit.

2015 Convertible Notes

On December 19, 2012, the Company issued \$69.0 million aggregate principal amount of the 2015 Convertible Notes. Of this aggregate principal amount, \$60.5 million aggregate principal amount of the 2015 Convertible Notes was sold to the initial purchasers (including \$9.0 million pursuant to the initial purchasers' exercise in full of their over-allotment option) and \$8.5 million aggregate principal amount of the 2015 Convertible Notes was sold directly to certain directors, officers and affiliates of the Company in a private placement.

The 2015 Convertible Notes bear interest at a rate of 7.00% per year, payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2013. The estimated effective interest rate of the 2015 Convertible Notes, which is equal to the stated rate of 7.00% plus the accretion of the original issue discount and associated costs, was 9.4% for the three months ended March 31, 2015 and 2014. For the three months ended March 31, 2015 and 2014, the interest expense incurred on this indebtedness was \$1.6 million. The 2015 Convertible Notes will mature on December 15, 2015, unless previously converted or repurchased in accordance with their terms.

6. ALLOWANCE FOR LOSS SHARING

Loans originated and sold by ACRE Capital to Fannie Mae under the Fannie Mae DUS program are subject to the terms and conditions of a Master Loss Sharing Agreement by ACRE Capital, which was amended and restated during 2012. Under the Master Loss Sharing Agreement, ACRE Capital is responsible for absorbing certain losses incurred by Fannie Mae with respect to loans originated under the DUS program, as described below in more detail. The compensation for this risk of loss is a component of servicing fees on the loan.

The losses incurred with respect to individual loans are allocated between ACRE Capital and Fannie Mae based on the loss level designation (Loss Level) for the particular loan. Loans are designated as Loss Level I, Loss Level II or Loss Level III. All loans are designated Loss Level I unless Fannie Mae and ACRE Capital agree upon a different Loss Level for a particular loan at the time of the loan commitment, or if Fannie Mae determines that the loan was not underwritten, processed or serviced according to Fannie Mae guidelines.

Losses on Loss Level I loans are shared 33.33% by ACRE Capital and 66.67% by Fannie Mae. The maximum amount of ACRE Capital's risk-sharing obligation with respect to any Loss Level I loan is 33.33% of the original principal amount of the loan. Losses incurred in connection with Loss Level II and Loss Level III loans are allocated disproportionately to ACRE Capital until ACRE Capital has absorbed the maximum level of its risk-sharing obligation with respect to the particular loan. The maximum loss allocable to ACRE Capital for Loss Level II loans is 30% of the original principal amount of the loan, and for Loss Level III loans is 40% of the original principal amount of the loan.

According to the Master Loss Sharing Agreement, Fannie Mae may unilaterally increase the amount of the risk-sharing obligation of ACRE Capital with respect to individual loans without regard to a particular Loss Level if (i) the loan does not meet specific underwriting criteria, (ii) the loan is defaulted within twelve (12) months after it is purchased by Fannie Mae, or (iii) Fannie Mae determines that there was fraud,

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material misrepresentation or gross negligence by ACRE Capital in its underwriting, closing, delivery or servicing of the loan. Under certain limited circumstances, Fannie Mae may require ACRE Capital to absorb 100% of the losses incurred on a loan by requiring ACRE Capital to repurchase the loan.

The amount of loss incurred on a particular loan is determined at the time the loss is incurred, for example, at the time a property is foreclosed by Fannie Mae (whether acquired by Fannie Mae or a third party) or at the time a loan is modified in connection with a default. Losses may be determined by reference to the price paid by a third party at a foreclosure sale or by reference to an appraisal obtained by Fannie Mae in connection with the default on the loan.

In connection with the Company's acquisition of ACRE Capital, Alliant, Inc., a Florida corporation, and The Alliant Company, LLC, a Florida limited liability company (the Sellers), are jointly and severally obligated to fund directly (if permitted) or to reimburse ACRE Capital for amounts due and owing after the closing date to Fannie Mae pursuant to ACRE Capital's allowance for loss sharing with respect to settlement of certain DUS program mortgage loans originated and serviced by ACRE Capital, subject to certain limitations. In addition, the Sellers are jointly and severally obligated to indemnify ACRE Capital for, among other things, certain losses arising from Sellers' failure to fulfill the funding or reimbursement obligations described above. As of March 31, 2015 and December 31, 2014, the preliminary estimate of the portion of such contributions towards such losses relating to the allowance for loss sharing of ACRE Capital is \$346 thousand and \$494 thousand,

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respectively, and is included within other assets in the consolidated balance sheets. Additionally, with respect to the settlement of certain non-designated DUS program mortgage loans originated and serviced by ACRE Capital, the Sellers are jointly and severally obligated to fund directly (if permitted) or to reimburse ACRE Capital in each of the three 12 month periods following the closing date for eighty percent (80%) of amounts due and owing after the closing date to Fannie Mae pursuant to ACRE Capital's allowance for loss sharing in excess of \$2.0 million during such 12 month period; provided that in no event shall Sellers obligations exceed in the aggregate \$3.0 million for the entire three year period.

ACRE Capital uses several tools to manage its risk-sharing obligation, including maintenance of disciplined underwriting and approval processes and procedures, and periodic review and evaluation of underwriting criteria based on underlying multifamily housing market data and limitation of exposure to particular geographic markets and submarkets and to individual borrowers. In situations where payment under the guaranty is probable and estimable on a specific loan, the Company records an additional liability through a charge to the provision for loss sharing in the consolidated statements of operations. The amount of the provision reflects the Company's assessment of the likelihood of payment by the borrower, the estimated disposition value of the underlying collateral and the level of risk-sharing. Historically, among other factors, the loss recognition occurs at or before the loan becoming 60 days delinquent.

A summary of the Company's allowance for loss sharing as of and for the three months ended March 31, 2015 and 2014 is as follows (\$ in thousands):

Balance at December 31, 2014	\$	12,349
Current period provision for loss sharing		(566)
Settlements/Writeoffs		(38)
Balance at March 31, 2015	\$	11,745
Balance at December 31, 2013	\$	16,480
Current period provision for loss sharing		119
Settlements/Writeoffs		-
Balance at March 31, 2014	\$	16,599

As of March 31, 2015 and December 31, 2014, the maximum quantifiable allowance for loss sharing associated with the Company's guarantees under the Fannie Mae DUS agreement was \$1.2 billion and \$1.1 billion, respectively, from a total recourse at risk pool of \$3.3 billion and \$3.2 billion, respectively. Additionally, as of March 31, 2015 and December 31, 2014, the non-at risk pool was \$1.9 million and \$2.0 million, respectively. The at risk pool is subject to Fannie Mae's Master Loss Sharing Agreement and the non-at risk pool is not subject to such agreement. The maximum quantifiable allowance for loss sharing is not representative of the actual loss the Company would incur. The Company would be liable for this amount only if all of the loans it services for Fannie Mae, for which the Company retains some risk of loss, were to default and all of the collateral underlying these loans was determined to be without value at the time of settlement.

7. COMMITMENTS AND CONTINGENCIES

As of March 31, 2015 and December 31, 2014, the Company had the following commitments to fund various stretch senior mortgage loans, transitional senior mortgage loans, subordinated and mezzanine debt investments, as well as preferred equity investments accounted for as loans held for investment (\$ in thousands):

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		As of	
	March 31, 2015		December 31, 2014
Total commitments	\$ 1,381,878	\$	1,565,117
Less: funded commitments	(1,230,682)		(1,395,281)
Total unfunded commitments	\$ 151,196	\$	169,836

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Commitments to extend credit by ACRE Capital are generally agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. As of March 31, 2015 and December 31, 2014, ACRE Capital had the following commitments to sell and fund loans (\$ in thousands):

		March 31, 2015	As of		December 31, 2014
Commitments to sell loans	\$	235,371	\$		249,803
Commitments to fund loans	\$	90,897	\$		51,109

Occasionally for both ACRE and ACRE Capital, the commitments may expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements.

The Company from time to time may be party to litigation relating to claims arising in the normal course of business. As of March 31, 2015, the Company is not aware of any legal claims that could materially impact its business, financial condition or results of operations.

8. DERIVATIVES

Non-designated Hedges

Derivatives not designated as hedges are derivatives that do not meet the criteria for hedge accounting under GAAP or for which the Company has not elected to designate as hedges. Changes in the fair value of derivatives related to the loan commitments and forward sale commitments are recorded directly in gains from mortgage banking activities in the consolidated statements of operations.

Loan commitments and forward sale commitments

Through its subsidiary, ACRE Capital, the Company enters into loan commitments with borrowers on loan originations whereby the interest rate on the prospective loan is determined prior to funding. In general, ACRE Capital simultaneously enters into forward sale commitments with investors in order to hedge against the interest rate exposure on loan commitments. The forward sale commitment with the investor locks in an interest rate and price for the sale of the loan. The terms of the loan commitment with the borrower and the forward sale commitment with the investor are matched with the objective of hedging interest rate risk. Loan commitments and forward sale commitments are considered undesignated derivative instruments. Accordingly, such commitments, along with any related fees received from potential borrowers, are recorded at fair value, with changes in fair value recorded in earnings. For the three months ended March 31, 2015, the Company entered into 16 loan commitments and 16 forward sale commitments. For the three months ended March 31, 2014, the Company entered into two loan commitments and two forward sale commitments.

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As of March 31, 2015, the Company had seven loan commitments with a total notional amount of \$90.9 million and 14 forward sale commitments with a total notional amount of \$235.4 million, with maturities ranging from 30 days to 22 months that were not designated as hedges in qualifying hedging relationships. As of December 31, 2014, the Company had one loan commitment with a total notional amount of \$51.1 million and ten forward sale commitments with a total notional amount of \$249.8 million, with maturities ranging from nine days to 23 months that were not designated as hedges in qualifying hedging relationships.

MSR purchase commitment

In March 2015, ACRE Capital entered into a MSR purchase agreement (the "Purchase Agreement") with a third party to purchase the servicing rights for a HUD loan. Under the Purchase Agreement, the purchase price for the servicing rights was \$500 thousand and ACRE Capital is expected to assume the rights to service the loan in September 2015. The derivative asset associated with the right to service the loan is included within other assets in the consolidated balance sheets as of March 31, 2015.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification within the Company's consolidated balance sheets as of March 31, 2015 and December 31, 2014 (\$ in thousands):

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	March 31, 2015		As of	December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	
Derivatives not designated as hedging instruments					
Loan commitments	Other assets	\$ 6,365	Other assets	\$ 3,082	
Forward sale commitments	Other assets	-	Other assets	116	
MSR purchase commitment	Other assets	513	Other assets	-	
Forward sale commitments	Other liabilities	(2,159)	Other liabilities	(1,528)	
Total derivatives not designated as hedging instruments		\$ 4,719		\$ 1,670	

9. EQUITY

Common Stock

There were no shares issued in public or private offerings for the three months ended March 31, 2015 and for the year ended December 31, 2014.

Equity Incentive Plan

On April 23, 2012, the Company adopted an equity incentive plan (the 2012 Equity Incentive Plan). Pursuant to the 2012 Equity Incentive Plan, the Company may grant awards consisting of restricted shares of the Company's common stock, restricted stock units and/or other equity-based awards to the Company's outside directors, employees, officers, ACREM and other eligible awardees under the plan, subject to an aggregate limitation of 690,000 shares of common stock (7.5% of the issued and outstanding shares of the Company's common stock immediately after giving effect to the issuance of the shares sold in the IPO). Any restricted shares of the Company's common stock and restricted stock units will be accounted for under FASB ASC Topic 718, *Compensation - Stock Compensation* (ASC 718), resulting in share-based compensation expense equal to the grant date fair value of the underlying restricted shares of common stock or restricted stock units.

Restricted stock grants generally vest ratably over a one to four year period from the vesting start date. The grantee receives additional compensation for each outstanding restricted stock grant, classified as dividends paid, equal to the per-share dividends received by common stockholders.

During the year ended December 31, 2014, an ACRE Capital employee was granted restricted stock that vests in proportion to certain financial performance targets being met over a specified period of time. The fair value of the performance based restricted stock granted is recorded to expense on an accelerated basis using the accelerated attribution method over the performance period for the award, with an offsetting increase in stockholders' equity.

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The following table details the restricted stock grants awarded as of March 31, 2015:

Grant Date	Vesting Start Date	Shares Granted
May 1, 2012	July 1, 2012	35,135
June 18, 2012	July 1, 2012	7,027
July 9, 2012	October 1, 2012	25,000
June 26, 2013	July 1, 2013	22,526
November 25, 2013	November 25, 2016	30,381
January 31, 2014	March 15, 2016	48,273
February 26, 2014	February 26, 2014	12,030
February 27, 2014	August 27, 2014	22,354
June 24, 2014	June 24, 2014	17,658
Total		220,384

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The following tables summarize the non-vested shares of restricted stock and the vesting schedule of shares of restricted stock for the Company's directors and officers and employees of ACRE Capital as of March 31, 2015:

Schedule of Non-Vested Share and Share Equivalents

	Restricted Stock Grants Directors	Restricted Stock Grants Officer	Restricted Stock Grants Employees	Total
Balance as of December 31, 2014	21,324	10,936	78,654	110,914
Granted	-	-	-	-
Vested	(6,918)	(1,562)	-	(8,480)
Forfeited	(2,820)	-	-	(2,820)
Balance as of March 31, 2015	11,586	9,374	78,654	99,614

Future Anticipated Vesting Schedule

	Restricted Stock Grants Directors	Restricted Stock Grants Officer	Restricted Stock Grants Employees (1)	Total
2015	7,416	4,688	-	12,104
2016	3,336	4,686	30,381	38,403
2017	834	-	-	834
2018	-	-	-	-
2019	-	-	-	-
Total	11,586	9,374	30,381	51,341

(1) Future anticipated vesting related to employees of ACRE Capital that were granted restricted stock that vests in proportion to certain financial performance targets being met over a specified period of time are not included due to uncertainty in actual vesting date.

Non-Controlling Interests

The non-controlling interests held by third parties in the Company's consolidated balance sheets represent the equity interests in a limited liability company, ACRC KA Investor LLC (ACRC KA) that are not owned by the Company. A portion of ACRC KA's consolidated equity and statement of operations are allocated to these non-controlling interests held by third parties based on their pro-rata ownership of ACRC KA. As of March 31, 2015, ACRC KA's total equity was \$171.6 million, of which \$87.5 million was owned by the Company and \$84.1 million was allocated to non-controlling interests held by third parties. As of December 31, 2014, ACRC KA's total equity was \$170.7 million, of which \$92.8 million was owned by the Company and \$77.9 million was allocated to non-controlling interests held by third parties. See Note 15 included in these consolidated financial statements for more information on ACRC KA.

10. EARNINGS PER SHARE

The following information sets forth the computations of basic and diluted earnings per common share for the three months ended March 31, 2015 and 2014 (\$ in thousands, except share and per share data):

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	For the three months ended March 31,	
	2015	2014
Net income attributable to common stockholders:	\$ 7,062	\$ 4,755
Divided by:		
Basic weighted average shares of common stock outstanding:	28,484,293	28,442,560
Non-vested restricted stock	100,491	108,422
Diluted weighted average shares of common stock outstanding:	28,584,784	28,550,982
Basic earnings per common share:	\$ 0.25	\$ 0.17
Diluted earnings per common share:	\$ 0.25	\$ 0.17

The Company has considered the impact of the 2015 Convertible Notes and the restricted shares on diluted earnings per common share. The number of shares of common stock that the 2015 Convertible Notes are convertible into were not included in the computation of diluted net income per common share because the inclusion of those shares would have been anti-dilutive for the three months ended March 31, 2015 and 2014.

11. INCOME TAX

The Company established a taxable REIT subsidiary (TRS), TRS Holdings, in connection with the acquisition of ACRE Capital. In addition, in December 2013 and March 2014, the Company formed ACRC W TRS and ACRC U TRS, respectively, in order to issue and hold certain loans intended for sale. The TRS income tax provision consisted of the following for the three months ended March 31, 2015 and 2014 (\$ in thousands):

	For the three months ended March 31,	
	2015	2014
Current	\$ (627)	\$ (42)
Deferred	(15)	(632)
Total income tax benefit	\$ (642)	\$ (674)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are presented net by tax jurisdiction and are included within other assets and other liabilities in the consolidated balance sheets, respectively. As of March 31, 2015 and December 31, 2014, the TRS U.S. tax jurisdiction was in a net deferred tax liability position. The TRS are not currently subject to tax in any foreign tax jurisdictions.

As of December 31, 2014, TRS Holdings had a net operating loss carryforward of \$4.0 million, which may be carried back to 2013 and forward 20 years. The following table presents the U.S. tax jurisdiction and the tax effects of temporary differences on the TRS respective net deferred tax assets and liabilities (\$ in thousands):

	March 31, 2015	As of	December 31, 2014
Deferred tax assets			
Mortgage servicing rights	\$ 3,793	\$	2,844
Net operating loss carryforward	1,465		1,465

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Other temporary differences		1,215		1,055
Sub-total-deferred tax assets		6,473		5,364
Deferred tax liabilities				
Basis difference in assets from acquisition of ACRE Capital		(2,654)		(2,654)
Components of gains from mortgage banking activities		(5,110)		(4,046)
Amortization of intangible assets		(200)		(170)
Sub-total-deferred tax liabilities		(7,964)		(6,870)
Net deferred tax liability	\$	(1,491)	\$	(1,506)

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Based on the TRS assessment, it is more likely than not that the deferred tax assets will be realized through future taxable income. The TRS recognize interest and penalties related to unrecognized tax benefits within income tax expense in the consolidated statements of operations. Accrued interest and penalties, if any, are included within other liabilities in the consolidated balance sheets.

The following table is a reconciliation of the TRS effective tax rate to the TRS statutory U.S. federal income tax rate for the three months ended March 31, 2015 and 2014:

	For the three months ended March 31,	
	2015	2014
Federal statutory rate	35.0%	35.0%
State income taxes	2.4%	5.7%
Federal benefit of state tax deduction	(0.8)%	(2.0)%
Effective tax rate	36.6%	38.7%

As of March 31, 2015, tax years 2011 through 2014 remain subject to examination by taxing authorities. The Company does not have any unrecognized tax benefits and the Company does not expect that to change in the next twelve months.

Intercompany Note

In connection with the acquisition of ACRE Capital, the Company partially capitalized TRS Holdings with a \$44.0 million note. In October 2014, the Company entered into a \$8.0 million revolving promissory note with TRS Holdings (collectively, the two intercompany notes described above are referred to as, the Intercompany Notes). As of March 31, 2015 and December 31, 2014, the outstanding principal balance of the Intercompany Notes was \$51.9 million and \$50.9 million, respectively. The income statement effects of the Intercompany Notes are eliminated in consolidation for financial reporting purposes, but the interest income and expense from the Intercompany Notes will affect the taxable income of the Company and TRS Holdings.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company follows FASB ASC Topic 820-10, *Fair Value Measurement* (ASC 820-10), which expands the application of fair value accounting. ASC 820-10 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosure requirements for fair value measurements. ASC 820-10 determines fair value to be the price that would be received for a financial instrument in a current sale, which assumes an orderly transaction between market participants on the measurement date. The financial instruments recorded at fair value on a recurring basis in the Company's consolidated financial statements are derivative instruments, MSRs and loans held for sale. ASC 820-10 specifies a hierarchy of valuation techniques based on the inputs used in measuring fair value.

In accordance with ASC 820-10, the inputs used to measure fair value are summarized in the three broad levels listed below:

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- Level I-Quoted prices in active markets for identical assets or liabilities.
- Level II-Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.
- Level III-Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the financial statements, for which it is practical to estimate the value. In cases where quoted market prices are not available, fair values are based upon the application of discount rates to estimated future cash flows using market yields, or other valuation methodologies. Any changes to the valuation methodology will be reviewed by the Company's management to ensure the changes are appropriate. The methods used may produce a fair value calculation that is not indicative of net realizable value or reflective of future fair values. Furthermore, while the Company anticipates that the valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of

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certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may fall within periods of market dislocation, during which price transparency may be reduced.

Financial Instruments Reported at Fair Value

The Company has certain assets and liabilities that are required to be recorded at fair value on a recurring basis in accordance with GAAP. Financial instruments reported at fair value in the Company's consolidated financial statements include MSRs, MSR purchase commitment, loan commitments, forward sale commitments and loans held for sale.

The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments were categorized as of March 31, 2015 and December 31, 2014 (\$ in thousands):

	Fair Value as of March 31, 2015				Total
	Level I	Level II	Level III		
Loans held for sale	\$ -	\$ 146,324	\$ -	\$ -	\$ 146,324
Mortgage servicing rights	-	-	58,525	-	58,525
Derivative assets:					
Loan commitments	-	-	6,365	-	6,365
Forward sale commitments	-	-	-	-	-
MSR purchase commitment	-	-	513	-	513
Derivative liabilities:					
Forward sale commitments	-	-	(2,159)	-	(2,159)
	Fair Value as of December 31, 2014				Total
	Level I	Level II	Level III		
Loans held for sale	\$ -	\$ 203,006	\$ -	\$ -	\$ 203,006
Mortgage servicing rights	-	-	58,889	-	58,889
Derivative assets:					
Loan commitments	-	-	3,082	-	3,082
Forward sale commitments	-	-	116	-	116
Derivative liabilities:					
Forward sale commitments	-	-	(1,528)	-	(1,528)

There were no transfers between the levels as of March 31, 2015 and December 31, 2014. Transfers between levels are recognized based on the fair value of the financial instrument at the beginning of the period.

Loan commitments and forward sale commitments are valued based on a discounted cash flow model that incorporates changes in interest rates during the period. The MSRs and the MSR purchase commitment are valued based on discounted cash flow models that calculate the present value of estimated future net servicing income. The model considers contractually specified servicing fees, prepayment assumptions, delinquency rates, late charges, other ancillary revenue, costs to service and other economic factors. The loans held for sale are valued based on discounted cash flow models that incorporate quoted observable prices from market participants. The valuation of derivative instruments are determined using widely accepted valuation techniques, including market yield analyses and discounted cash flow analysis on the expected cash

flows of each derivative.

The following table summarizes the significant unobservable inputs the Company used to value financial instruments categorized within Level III as of March 31, 2015 (\$ in thousands):

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Asset Category	Fair Value	Primary Valuation Technique	Input	Unobservable Input Range	Weighted Average
Mortgage servicing rights	\$ 58,525	Discounted cash flow	Discount rate	8 - 14%	11.4%
Loan commitments and forward sale commitments	4,206	Discounted cash flow	Discount rate	8 - 12%	9.8%
MSR purchase commitment	513	Discounted cash flow	Discount rate	8 - 8%	8.0%

The following table summarizes the significant unobservable inputs the Company used to value financial instruments categorized within Level III as of December 31, 2014 (\$ in thousands):

Asset Category	Fair Value	Primary Valuation Technique	Input	Unobservable Input Range	Weighted Average
Mortgage servicing rights	\$ 58,889	Discounted cash flow	Discount rate	8 - 14%	11.4%
Loan commitments and forward sale commitments	1,670	Discounted cash flow	Discount rate	8 - 8%	8.0%

The table above is not intended to be all-inclusive, but instead is intended to capture the significant unobservable inputs relevant to the Company's determination of fair values. Changes in market yields, discount rates or EBITDA multiples, each in isolation, may have changed the fair value of the financial instruments. Generally, an increase in market yields or discount rates or decrease in EBITDA multiples may have resulted in a decrease in the fair value of the financial instruments.

The Company's management is responsible for the Company's fair value valuation policies, processes and procedures related to Level III financial instruments. The Company's management reports to the Company's Chief Financial Officer, who has final authority over the valuation of the Company's Level III financial instruments.

The following table summarizes the change in derivative assets and liabilities classified as Level III related to mortgage banking activities as of and for the three months ended March 31, 2015 and 2014 (\$ in thousands):

Beginning balance, as of December 31, 2014	\$	1,670
Settlements		(4,337)
Realized gains (losses) recorded in net income (1)		2,667
Unrealized gains (losses) recorded in net income (1)		4,719
Ending balance, as of March 31, 2015	\$	4,719
 Beginning balance, as of December 31, 2013	 \$	 3,527
Settlements		(3,724)
Realized gains (losses) recorded in net income (1)		197
Unrealized gains (losses) recorded in net income (1)		1,096

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Ending balance, as of March 31, 2014 \$ 1,096

(1) Realized and unrealized gains (losses) from derivatives are included within gains from mortgage banking activities in the consolidated statements of operations.

See Note 4 included in these consolidated financial statements for the changes in MSRs that are classified as Level III.

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As of March 31, 2015 and December 31, 2014, the carrying values and fair values of the Company's financial assets and liabilities recorded at cost are as follows (\$ in thousands):

	Level in Fair Value Hierarchy	As of			
		March 31, 2015		December 31, 2014	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:					
Loans held for investment	3	\$ 1,304,821	\$ 1,313,969	\$ 1,462,584	\$ 1,472,890
Financial liabilities:					
Secured funding agreements	2	\$ 504,345	\$ 504,345	\$ 552,799	\$ 552,799
Warehouse lines of credit	2	139,689	139,689	193,165	193,165
Convertible notes	2	68,541	69,000	68,395	69,000
Commercial mortgage-backed securitization debt (consolidated VIE)	3	83,288	83,288	219,043	219,043
Collateralized loan obligation securitization debt (consolidated VIE)	3	256,995	256,995	308,703	308,703

The carrying values of cash and cash equivalents, restricted cash, interest receivable, due to affiliate and accrued expenses approximate their fair values due to their short-term nature.

Loans held for investment are recorded at cost, net of unamortized loan fees and origination costs and net of an allowance for loan losses. The Company may record fair value adjustments on a nonrecurring basis when it has determined that it is necessary to record a specific reserve against a loan and the Company measures such specific reserve using the fair value of the loan's collateral. To determine the fair value of the collateral, the Company may employ different approaches depending on the type of collateral. The Financing Facilities, convertible notes, CMBS debt and collateralized loan obligation (CLO) debt are recorded at outstanding principal, which is the Company's best estimate of the fair value.

13. RELATED PARTY TRANSACTIONS

Management Agreement

The Company is subject to a Management Agreement under which ACREM, subject to the supervision and oversight of the Company's board of directors, is responsible for, among other duties, (a) performing all of the Company's day-to-day functions, (b) determining the Company's investment strategy and guidelines in conjunction with the Company's board of directors, (c) sourcing, analyzing and executing investments, asset sales and financing, and (d) performing portfolio management duties. In addition, ACREM has an Investment Committee that oversees compliance with the Company's investment strategy and guidelines, investment portfolio holdings and financing strategy. In exchange for its services, ACREM is entitled to receive a base management fee, an incentive fee, expense reimbursements, grants of equity-based awards pursuant to the Company's 2012 Equity Incentive Plan and a termination fee, if applicable.

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The base management fee is equal to 1.5% of the Company's stockholders' equity per annum, which is calculated and payable quarterly in arrears in cash. For purposes of calculating the base management fee, stockholders' equity means: (a) the sum of (i) the net proceeds from all issuances of the Company's equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus (ii) the Company's retained earnings at the end of the most recently completed fiscal quarter determined in accordance with GAAP (without taking into account any non-cash equity compensation expense incurred in current or prior periods); less (b) (x) any amount that the Company has paid to repurchase the Company's common stock since inception, (y) any unrealized gains and losses and other non-cash items that have impacted stockholders' equity as reported in the Company's consolidated financial statements prepared in accordance with GAAP, and (z) one-time events pursuant to changes in GAAP, and certain non-cash items not otherwise described above, in each case after discussions between ACREM and the Company's independent directors and approval by a majority of the Company's independent directors. As a result, the Company's stockholders' equity, for purposes of calculating the management fee, could be greater or less than the amount of stockholders' equity shown in the Company's consolidated financial statements.

The incentive fee is an amount, not less than zero, equal to the difference between: (a) the product of (i) 20% and (ii) the difference between (A) the Company's Core Earnings (as defined below) for the previous 12-month period, and (B) the

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product of (1) the weighted average of the issue price per share of the Company's common stock of all of the Company's public offerings of common stock multiplied by the weighted average number of all shares of common stock outstanding, including any restricted shares of the Company's common stock, restricted stock units or any shares of the Company's common stock not yet issued, but underlying other awards granted under the Company's 2012 Equity Incentive Plan (See Note 9 included in these consolidated financial statements) in the previous 12-month period, and (2) 8%; and (b) the sum of any incentive fees earned by ACREM with respect to the first three fiscal quarters of such previous 12-month period; *provided, however*, that no incentive fee is payable with respect to any fiscal quarter unless cumulative Core Earnings for the 12 most recently completed fiscal quarters is greater than zero. Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) computed in accordance with GAAP, excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (to the extent that any of the Company's target investments are structured as debt and the Company forecloses on any properties underlying such debt), any unrealized gains, losses or other non-cash items recorded in net income (loss) for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income (loss), and one-time events pursuant to changes in GAAP and certain non-cash charges after discussions between ACREM and the Company's independent directors and after approval by a majority of the Company's independent directors. No incentive fees were incurred for the three months ended March 31, 2015 and 2014.

The Company reimburses ACREM at cost for operating expenses that ACREM incurs on the Company's behalf, including expenses relating to legal, financial, accounting, servicing, due diligence and other services. The Company will not reimburse ACREM for the salaries and other compensation of its personnel, except for the allocable share of the salaries and other compensation of the Company's (a) Chief Financial Officer, based on the percentage of his time spent on the Company's affairs and (b) other corporate finance, tax, accounting, internal audit, legal, risk management, operations, compliance and other non-investment professional personnel of ACREM or its affiliates who spend all or a portion of their time managing the Company's affairs based on the percentage of their time spent on the Company's affairs. The Company is also required to pay its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of ACREM and its affiliates that are required for the Company's operations. The term of the Management Agreement ends on May 1, 2016, with automatic one-year renewal terms thereafter. Except under limited circumstances, upon a termination of the Management Agreement, the Company will pay ACREM a termination fee equal to three times the average annual base management fee and incentive fee received by ACREM during the 24-month period immediately preceding the most recently completed fiscal quarter prior to the date of termination, each as described above.

Certain of the Company's subsidiaries, along with the Company's lenders under certain of the Company's Secured Funding Facilities, as well as under the CMBS and CLO have entered into various servicing agreements with ACREM's subsidiary servicer, Ares Commercial Real Estate Servicer LLC (ACRES), a Standard & Poor's-rated commercial special servicer that is included on Standard & Poor's Select Servicer List. Effective January 1, 2015, ACREM transferred primary servicing of the Company's loans held for investment to ACRE Capital. The Company's Manager will specially service, as needed, certain of the Company's investments. Effective May 1, 2012, ACRES agreed that no servicing fees pursuant to these servicing agreements would be charged to the Company or its subsidiaries by ACRES or the Manager for so long as the Management Agreement remains in effect, but that ACRES will continue to receive reimbursement for overhead related to servicing and operational activities pursuant to the terms of the Management Agreement.

There was an amendment to the Management Agreement whereby ACREM agreed not to seek reimbursement of restricted costs in excess of \$1.0 million per quarter for the quarterly periods between September 30, 2013 through December 31, 2014.

Summarized below are the related party costs incurred by the Company, including ACRE Capital, for the three months ended March 31, 2015 and 2014 and amounts payable to the Company's Manager as of March 31, 2015 and December 31, 2014 (\$ in thousands):

Incurred	Payable
For the three months ended March 31,	As of

2015

2014

March 31, 2015

December 31, 2014

Affiliate Payments