STARWOOD PROPERTY TRUST, INC.
Form 10-Q
May 04, 2018
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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, 2018

OR

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

Commission file number 001-34436

Starwood Property Trust, Inc.

(Exact name of registrant as specified in its charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	27-0247747 (I.R.S. Employer Identification No.)
591 West Putnam Avenue Greenwich, Connecticut (Address of Principal Executive Offices)	06830 (Zip Code)

Registrant's telephone number, including area code:

(203) 422-7700

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) 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth 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 Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the issuer’s common stock, $0.01 par value, outstanding as of April 30, 2018 was 261,986,337.

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Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements, including without limitation, statements concerning our operations, economic performance and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are developed by combining currently available information with our beliefs and assumptions and are generally identified by the words “believe,” “expect,” “anticipate” and other similar expressions. Forward-looking statements do not guarantee future performance, which may be materially different from that expressed in, or implied by, any such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their respective dates.

These forward-looking statements are based largely on our current beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us or within our control, and which could materially affect actual results, performance or achievements. Factors that may cause actual results to vary from our forward-looking statements include, but are not limited to:

· factors described in our Annual Report on Form 10-K for the year ended December 31, 2017 and this Quarterly Report on Form 10-Q, including those set forth under the captions “Risk Factors” and “Business”;

· defaults by borrowers in paying debt service on outstanding indebtedness;

· impairment in the value of real estate property securing our loans or in which we invest;

· availability of mortgage origination and acquisition opportunities acceptable to us;

· potential mismatches in the timing of asset repayments and the maturity of the associated financing agreements;

· national and local economic and business conditions;

· general and local commercial and residential real estate property conditions;

· changes in federal government policies;

· changes in federal, state and local governmental laws and regulations;

- increased competition from entities engaged in mortgage lending and securities investing activities;

- changes in interest rates; and

- the availability of, and costs associated with, sources of liquidity.

In light of these risks and uncertainties, there can be no assurances that the results referred to in the forward-looking statements contained in this Quarterly Report on Form 10-Q will in fact occur. Except to the extent required by applicable law or regulation, we undertake no obligation to, and expressly disclaim any such obligation to, update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, changes to future results over time or otherwise.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited, amounts in thousands, except share data)

	As of March 31, 2018	As of December 31, 2017
Assets:		
Cash and cash equivalents	$ 286,155	$ 369,448
Restricted cash	93,266	48,825
Loans held-for-investment, net	6,182,786	6,562,495
Loans held-for-sale, at fair value	723,733	745,743
Loans transferred as secured borrowings	74,463	74,403
Investment securities ($278,144 and $284,735 held at fair value)	514,463	718,203
Properties, net	2,988,864	2,647,481
Intangible assets ($24,945 and $30,759 held at fair value)	179,629	183,092
Investment in unconsolidated entities	160,112	185,503
Goodwill	140,437	140,437
Derivative assets	41,067	33,898
Accrued interest receivable	41,253	47,747
Other assets	467,320	138,140
Variable interest entity (“VIE”) assets, at fair value	49,233,307	51,045,874
Total Assets	$ 61,126,855	$ 62,941,289
Liabilities and Equity		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 157,563	$ 185,117
Related-party payable	31,781	42,369
Dividends payable	126,244	125,916
Derivative liabilities	57,600	36,200
Secured financing agreements, net	5,554,314	5,773,056
Unsecured senior notes, net	2,252,631	2,125,235
Secured borrowings on transferred loans, net	74,275	74,185
VIE liabilities, at fair value	48,167,760	50,000,010
Total Liabilities	56,422,168	58,362,088

Commitments and contingencies (Note 21)		
Equity:		
Starwood Property Trust, Inc. Stockholders' Equity:		
Preferred stock, $0.01 per share, 100,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $0.01 per share, 500,000,000 shares authorized, 267,135,302 issued and 261,955,162 outstanding as of March 31, 2018 and 265,983,309 issued and 261,376,424 outstanding as of December 31, 2017	2,671	2,660
Additional paid-in capital	4,728,183	4,715,246
Treasury stock (5,180,140 shares and 4,606,885 shares)	(104,194)	(92,104)
Accumulated other comprehensive income	75,310	69,924
Accumulated deficit	(243,438)	(217,312)
Total Starwood Property Trust, Inc. Stockholders' Equity	4,458,532	4,478,414
Non-controlling interests in consolidated subsidiaries	246,155	100,787
Total Equity	4,704,687	4,579,201
Total Liabilities and Equity	$ 61,126,855	$ 62,941,289

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited, amounts in thousands, except per share data)

	For the Three Months Ended March 31,	
	2018	2017
Revenues:		
Interest income from loans	$ 137,620	$ 111,883
Interest income from investment securities	15,269	15,224
Servicing fees	26,067	14,102
Rental income	81,110	57,042
Other revenues	521	469
Total revenues	260,587	198,720
Costs and expenses:		
Management fees	30,642	24,384
Interest expense	87,183	65,860
General and administrative	32,142	30,429
Acquisition and investment pursuit costs	377	671
Costs of rental operations	29,693	20,878
Depreciation and amortization	31,744	22,228
Loan loss allowance, net	1,538	(305)
Other expense	104	758
Total costs and expenses	213,423	164,903
Income before other income (loss), income taxes and non-controlling interests	47,164	33,817
Other income (loss):		
Change in net assets related to consolidated VIEs	52,653	69,170
Change in fair value of servicing rights	(5,814)	(8,433)
Change in fair value of investment securities, net	(149)	(1,171)
Change in fair value of mortgage loans held-for-sale, net	7,800	10,593
(Loss) earnings from unconsolidated entities	(1,462)	2,987
Gain (loss) on sale of investments and other assets, net	10,660	(56)
Loss on derivative financial instruments, net	(16,859)	(4,349)
Foreign currency gain, net	13,549	4,864
Loss on extinguishment of debt	—	(5,916)
Other income, net	108	365
Total other income	60,486	68,054
Income before income taxes	107,650	101,871
Income tax (provision) benefit	(2,856)	983
Net income	104,794	102,854
Net income attributable to non-controlling interests	(4,862)	(496)

Net income attributable to Starwood Property Trust, Inc.	$ 99,932	$ 102,358
Earnings per share data attributable to Starwood Property Trust, Inc.:		
Basic	$ 0.38	$ 0.39
Diluted	$ 0.38	$ 0.39
Dividends declared per common share	$ 0.48	$ 0.48

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31,	
	2018	2017
Net income	$ 104,794	$ 102,854
Other comprehensive income (net change by component):		
Cash flow hedges	5	76
Available-for-sale securities	1,163	1,846
Foreign currency translation	4,218	2,007
Other comprehensive income	5,386	3,929
Comprehensive income	110,180	106,783
Less: Comprehensive income attributable to non-controlling interests	(4,862)	(496)
Comprehensive income attributable to Starwood Property Trust, Inc.	$ 105,318	$ 106,287

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Equity

(Unaudited, amounts in thousands, except share data)

Common stock Shares	Par Value	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Amount	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Starwood Property Trust, Inc. Stockholders' Equity	Non-Controlling Interests
265,983,309	$ 2,660	$ 4,715,246	4,606,885	$ (92,104)	$ (217,312)	$ 69,924	$ 4,478,414	$ 100,787
7,651	—	159	—	—	—	—	159	—
—	—	—	573,255	(12,090)	—	—	(12,090)	—
598,701	6	4,762	—	—	—	—	4,768	—
545,641	5	10,978	—	—	—	—	10,983	—
—	—	—	—	—	99,932	—	99,932	4,862
—	—	—	—		(126,058)	—	(126,058)	—
—	—	—	—	—	—	5,386	5,386	—
—	—	—	—	—	—	—	—	569
—	—	—	—	—	—	—	—	366,691
—	—	(2,962)	—	—	—	—	(2,962)	(226,435
—	—	—	—	—	—	—	—	(319)

267,135,302	$ 2,671	$ 4,728,183	5,180,140	$ (104,194)	$ (243,438)	$ 75,310	$ 4,458,532	$ 246,155
263,893,806	$ 2,639	$ 4,691,180	4,606,885	$ (92,104)	$ (115,579)	$ 36,138	$ 4,522,274	$ 37,799
8,129	—	183	—	—	—	—	183	—
—	—	(12)	—	—	—	—	(12)	—
—	—	3,755	—	—	—	—	3,755	—
—	—	(18,105)	—	—			(18,105)	
514,379	5	3,154	—	—	—	—	3,159	—
418,016	4	9,543	—	—	—	—	9,547	—
—	—	—	—	—	102,358	—	102,358	496
—	—	—	—	—	(125,479)	—	(125,479)	—
—	—	—	—	—	—	3,929	3,929	—
—	—	—	—	—	—	—	—	5,177
—	—	—	—	—	—	—	—	(1,726)
264,834,330	$ 2,648	$ 4,689,698	4,606,885	$ (92,104)	$ (138,700)	$ 40,067	$ 4,501,609	$ 41,746

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31,	
	2018	2017
Cash Flows from Operating Activities:		
Net income	$ 104,794	$ 102,854
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of deferred financing costs, premiums and discounts on secured financing agreements and secured borrowings on transferred loans	5,167	4,686
Amortization of discounts and deferred financing costs on senior notes	3,869	6,093
Accretion of net discount on investment securities	(6,841)	(4,257)
Accretion of net deferred loan fees and discounts	(12,052)	(7,519)
Share-based compensation	4,768	3,159
Share-based component of incentive fees	10,983	9,547
Change in fair value of investment securities	149	1,171
Change in fair value of consolidated VIEs	(11,241)	(20,677)
Change in fair value of servicing rights	5,814	8,433
Change in fair value of loans held-for-sale	(7,800)	(10,593)
Change in fair value of derivatives	18,069	2,900
Foreign currency gain, net	(13,540)	(4,829)
(Gain) loss on sale of investments and other assets	(10,660)	56
Impairment charges	25	758
Loan loss allowance, net	1,538	(305)
Depreciation and amortization	31,412	21,297
Loss (earnings) from unconsolidated entities	1,462	(2,987)
Distributions of earnings from unconsolidated entities	2,675	2,643
Loss on extinguishment of debt	—	5,916
Origination and purchase of loans held-for-sale, net of principal collections	(245,027)	(445,690)
Proceeds from sale of loans held-for-sale	266,632	179,296
Changes in operating assets and liabilities:		
Related-party payable, net	(10,588)	(11,821)
Accrued and capitalized interest receivable, less purchased interest	(9,412)	(19,611)
Other assets	(6,188)	(1,855)
Accounts payable, accrued expenses and other liabilities	(31,612)	(14,686)
Net cash provided by (used in) operating activities	92,396	(196,021)
Cash Flows from Investing Activities:		
Origination and purchase of loans held-for-investment	(900,937)	(621,135)
Proceeds from principal collections on loans	870,400	226,039

Proceeds from loans sold	145,273	37,079
Proceeds from sales of investment securities	—	10,434
Proceeds from principal collections on investment securities	219,230	76,050
Proceeds from sale of properties	51,093	—
Purchases and additions to properties and other assets	(7,056)	(2,435)
Distribution of capital from unconsolidated entities	21,255	3,127
Payments for purchase or termination of derivatives	(15,604)	(32,700)
Proceeds from termination of derivatives	11,773	17,331
Return of investment basis in purchased derivative asset	—	62
Net cash provided by (used in) investing activities	395,427	(286,148)

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31,	
	2018	2017
Cash Flows from Financing Activities:		
Proceeds from borrowings	$ 1,515,241	$ 1,205,691
Principal repayments on and repurchases of borrowings	(1,629,449)	(957,529)
Payment of deferred financing costs	(10,506)	(5,967)
Proceeds from common stock issuances	159	183
Payment of equity offering costs	—	(647)
Payment of dividends	(125,730)	(124,506)
Contributions from non-controlling interests	310	—
Distributions to non-controlling interests	(229,397)	(1,726)
Purchase of treasury stock	(12,090)	—
Issuance of debt of consolidated VIEs	7,948	4,759
Repayment of debt of consolidated VIEs	(57,289)	(57,445)
Distributions of cash from consolidated VIEs	13,730	30,956
Net cash (used in) provided by financing activities	(527,073)	93,769
Net decrease in cash, cash equivalents and restricted cash	(39,250)	(388,400)
Cash, cash equivalents and restricted cash, beginning of period	418,273	650,755
Effect of exchange rate changes on cash	398	179
Cash, cash equivalents and restricted cash, end of period	$ 379,421	$ 262,534
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 75,696	$ 51,023
Income taxes paid	880	268
Supplemental disclosure of non-cash investing and financing activities:		
Dividends declared, but not yet paid	$ 126,058	$ 125,479
Consolidation of VIEs (VIE asset/liability additions)	1,089,881	1,127,952
Deconsolidation of VIEs (VIE asset/liability reductions)	875,240	1,528,137
Net assets acquired from consolidated VIEs	27,737	—
Contributions of Woodstar II Portfolio net assets from non-controlling interests	366,381	—
Loan principal collections temporarily held at master servicer	326,362	—

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

As of March 31, 2018

(Unaudited)

1. Business and Organization

Starwood Property Trust, Inc. ("STWD" and, together with its subsidiaries, "we" or the "Company") is a Maryland corporation that commenced operations in August 2009, upon the completion of our initial public offering. We are focused primarily on originating, acquiring, financing and managing commercial mortgage loans and other commercial real estate debt investments, commercial mortgage-backed securities ("CMBS"), and other commercial real estate investments in both the U.S. and Europe. We refer to the following as our target assets: commercial real estate mortgage loans, preferred equity interests, CMBS and other commercial real estate-related debt investments. Our target assets may also include residential mortgage-backed securities ("RMBS"), certain residential mortgage loans, distressed or non-performing commercial loans, commercial properties subject to net leases and equity interests in commercial real estate. As market conditions change over time, we may adjust our strategy to take advantage of changes in interest rates and credit spreads as well as economic and credit conditions.

We have three reportable business segments as of March 31, 2018:

· Real estate lending (the "Lending Segment")—engages primarily in originating, acquiring, financing and managing commercial first mortgages, subordinated mortgages, mezzanine loans, preferred equity, CMBS, RMBS, certain residential mortgage loans, and other real estate and real estate-related debt investments in both the U.S. and Europe.

· Real estate property (the "Property Segment")—engages primarily in acquiring and managing equity interests in stabilized commercial real estate properties, including multifamily properties, that are held for investment.

· Real estate investing and servicing (the "Investing and Servicing Segment")—includes (i) a servicing business in the U.S. that manages and works out problem assets, (ii) an investment business that selectively acquires and manages unrated, investment grade and non-investment grade rated CMBS, including subordinated interests of securitization and resecuritization transactions, (iii) a mortgage loan business which originates conduit loans for the primary purpose of selling these loans into securitization transactions, and (iv) an investment business that selectively acquires commercial real estate assets, including properties acquired from CMBS trusts. This segment excludes the consolidation of securitization variable interest entities ("VIEs").

We are organized and conduct our operations to qualify as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). As such, we will generally not be subject to U.S. federal corporate income tax on that portion of our net income that is distributed to stockholders if we distribute at least 90% of our taxable income to our stockholders by prescribed dates and comply with various other requirements.

We are organized as a holding company and conduct our business primarily through our various wholly-owned subsidiaries. We are externally managed and advised by SPT Management, LLC (our "Manager") pursuant to the terms of a management agreement. Our Manager is controlled by Barry Sternlicht, our Chairman and Chief Executive Officer. Our Manager is an affiliate of Starwood Capital Group, a privately-held private equity firm founded and controlled by Mr. Sternlicht.

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2. Summary of Significant Accounting Policies

Balance Sheet Presentation of the Investing and Servicing Segment's Variable Interest Entities

As noted above, the Investing and Servicing Segment operates an investment business that acquires unrated, investment grade and non-investment grade rated CMBS. These securities represent interests in securitization structures (commonly referred to as special purpose entities, or "SPEs"). These SPEs are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. Under accounting principles generally accepted in the United States of America ("GAAP"), SPEs typically qualify as VIEs. These are entities that, by design, either (1) lack sufficient equity to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) have equity investors that do not have the ability to make significant decisions relating to the entity's operations through voting rights, or do not have the obligation to absorb the expected losses, or do not have the right to receive the residual returns of the entity.

Because the Investing and Servicing Segment often serves as the special servicer of the trusts in which it invests, consolidation of these structures is required pursuant to GAAP as outlined in detail below. This results in a consolidated balance sheet which presents the gross assets and liabilities of the VIEs. The assets and other instruments held by these VIEs are restricted and can only be used to fulfill the obligations of the entity. Additionally, the obligations of the VIEs do not have any recourse to the general credit of any other consolidated entities, nor to us as the consolidator of these VIEs.

The VIE liabilities initially represent investment securities on our balance sheet (pre-consolidation). Upon consolidation of these VIEs, our associated investment securities are eliminated, as is the interest income related to those securities. Similarly, the fees we earn in our roles as special servicer of the bonds issued by the consolidated VIEs or as collateral administrator of the consolidated VIEs are also eliminated. Finally, an allocable portion of the identified servicing intangible associated with the eliminated fee streams is eliminated in consolidation.

Refer to the segment data in Note 22 for a presentation of the Investing and Servicing Segment without consolidation of these VIEs.

Basis of Accounting and Principles of Consolidation

The accompanying condensed consolidated financial statements include our accounts and those of our consolidated subsidiaries and VIEs. Intercompany amounts have been eliminated in consolidation. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position,

results of operations, and cash flows have been included.

These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “Form 10-K”), as filed with the Securities and Exchange Commission (“SEC”). The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the operating results for the full year.

Refer to our Form 10-K for a description of our recurring accounting policies. We have included disclosure in this Note 2 regarding principles of consolidation and other accounting policies that (i) are required to be disclosed quarterly, (ii) we view as critical, (iii) became significant since December 31, 2017 due to a corporate action or increase in the significance of the underlying business activity or (iv) changed upon adoption of an Accounting Standards Update (“ASU”) issued by the Financial Accounting Standards Board (“FASB”).

Variable Interest Entities

In addition to the Investing and Servicing Segment’s VIEs, certain other entities in which we hold interests are considered VIEs as the limited partners of these entities do not collectively possess (i) the right to remove the general partner without cause or (ii) the right to participate in significant decisions made by the partnership.

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We evaluate all of our interests in VIEs for consolidation. When our interests are determined to be variable interests, we assess whether we are deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. Accounting Standards Codification ("ASC") 810, Consolidation, 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. We consider our variable interests as well as any variable interests of our related parties in making this determination. Where both of these factors are present, we are deemed to be the primary beneficiary and we consolidate the VIE. Where either one of these factors is not present, we are not the primary beneficiary and do not consolidate the VIE.

To assess whether we have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, we consider all facts and circumstances, including our role in establishing the VIE and our ongoing rights and responsibilities. This assessment includes: (i) identifying the activities that most significantly impact the VIE's economic performance; and (ii) 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. The right to remove the decision maker in a VIE must be exercisable without cause for the decision maker to not be deemed the party that has the power to direct the activities of a VIE.

To assess whether we have 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, we consider all of our economic interests, including debt and equity investments, servicing fees, and other arrangements deemed to be variable interests in the VIE. This assessment requires that we apply 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 us.

Our purchased investment securities include CMBS which are unrated and non-investment grade rated securities issued by CMBS trusts. In certain cases, we may contract to provide special servicing activities for these CMBS trusts, or, as holder of the controlling class, we may have the right to name and remove the special servicer for these trusts. In our role as special servicer, we provide services on defaulted loans within the trusts, such as foreclosure or work-out procedures, as permitted by the underlying contractual agreements. In exchange for these services, we receive a fee. These rights give us the ability to direct activities that could significantly impact the trust's economic performance. However, in those instances where an unrelated third party has the right to unilaterally remove us as special servicer without cause, we do not have the power to direct activities that most significantly impact the trust's economic performance. We evaluated all of our positions in such investments for consolidation.

For securitization VIEs in which we are determined to be the primary beneficiary, all of the underlying assets, liabilities and equity of the structures are recorded on our books, and the initial investment, along with any associated

unrealized holding gains and losses, are eliminated in consolidation. Similarly, the interest income earned from these structures, as well as the fees paid by these trusts to us in our capacity as special servicer, are eliminated in consolidation. Further, an allocable portion of the identified servicing intangible asset associated with the servicing fee streams, and the corresponding allocable amortization or change in fair value of the servicing intangible asset, are also eliminated in consolidation.

We perform ongoing reassessments of: (i) whether any entities previously evaluated under the majority voting interest framework have become VIEs, based on certain events, and therefore subject to the VIE consolidation framework, and (ii) whether changes in the facts and circumstances regarding our involvement with a VIE causes our consolidation conclusion regarding the VIE to change.

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We elect the fair value option for initial and subsequent recognition of the assets and liabilities of our consolidated securitization VIEs. Interest income and interest expense associated with these VIEs are no longer relevant on a standalone basis because these amounts are already reflected in the fair value changes. We have elected to present these items in a single line on our condensed consolidated statements of operations. The residual difference shown on our condensed consolidated statements of operations in the line item "Change in net assets related to consolidated VIEs" represents our beneficial interest in the VIEs.

We separately present the assets and liabilities of our consolidated securitization VIEs as individual line items on our condensed consolidated balance sheets. The liabilities of our consolidated securitization VIEs consist solely of obligations to the bondholders of the related CMBS trusts, and are thus presented as a single line item entitled "VIE liabilities." The assets of our consolidated securitization VIEs consist principally of loans, but at times, also include foreclosed loans which have been temporarily converted into real estate owned ("REO"). These assets in the aggregate are likewise presented as a single line item entitled "VIE assets."

Loans comprise the vast majority of our securitization VIE assets and are carried at fair value due to the election of the fair value option. When an asset becomes REO, it is due to nonperformance of the loan. Because the loan is already at fair value, the carrying value of an REO asset is also initially at fair value. Furthermore, when we consolidate a CMBS trust, any existing REO would be consolidated at fair value. Once an asset becomes REO, its disposition time is relatively short. As a result, the carrying value of an REO generally approximates fair value under GAAP.

In addition to sharing a similar measurement method as the loans in a CMBS trust, the securitization VIE assets as a whole can only be used to settle the obligations of the consolidated VIE. The assets of our securitization VIEs are not individually accessible by the bondholders, which creates inherent limitations from a valuation perspective. Also creating limitations from a valuation perspective is our role as special servicer, which provides us very limited visibility, if any, into the performing loans of a CMBS trust.

REO assets generally represent a very small percentage of the overall asset pool of a CMBS trust. In a new issue CMBS trust there are no REO assets. We estimate that REO assets constitute approximately 3% of our consolidated securitization VIE assets, with the remaining 97% representing loans. However, it is important to note that the fair value of our securitization VIE assets is determined by reference to our securitization VIE liabilities as permitted under ASU 2014-13, Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity. In other words, our VIE liabilities are more reliably measurable than the VIE assets, resulting in our current measurement methodology which utilizes this value to determine the fair value of our securitization VIE assets as a whole. As a result, these percentages are not necessarily indicative of the relative fair values of each of these asset categories if the assets were to be valued individually.

Due to our accounting policy election under ASU 2014-13, separately presenting two different asset categories would result in an arbitrary assignment of value to each, with one asset category representing a residual amount, as opposed to its fair value. However, as a pool, the fair value of the assets in total is equal to the fair value of the liabilities.

For these reasons, the assets of our securitization VIEs are presented in the aggregate.

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Fair Value Option

The guidance in ASC 825, Financial Instruments, provides a fair value option election that allows entities to make an irrevocable election of fair value as the initial and subsequent measurement attribute for certain eligible financial assets and liabilities. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis and must be applied to an entire instrument and is irrevocable once elected. Assets and liabilities measured at fair value pursuant to this guidance are required to be reported separately in our consolidated balance sheets from those instruments using another accounting method.

We have elected the fair value option for eligible financial assets and liabilities of our consolidated securitization VIEs, loans held-for-sale originated or acquired for future securitization, purchased CMBS issued by VIEs we could consolidate in the future and certain investments in marketable equity securities which, effective January 1, 2018, are now required to be carried at fair value through earnings. The fair value elections for VIE and securitization related items were made in order to mitigate accounting mismatches between the carrying value of the instruments and the related assets and liabilities that we consolidate at fair value. The fair value elections for mortgage loans held-for-sale were made due to the short-term nature of these instruments.

Fair Value Measurements

We measure our mortgage backed securities, derivative assets and liabilities, domestic servicing rights intangible asset and any assets or liabilities where we have elected the fair value option at fair value. When actively quoted observable prices are not available, we either use implied pricing from similar assets and liabilities or valuation models based on net present values of estimated future cash flows, adjusted as appropriate for liquidity, credit, market and/or other risk factors.

As discussed above, we measure the assets and liabilities of consolidated securitization VIEs at fair value pursuant to our election of the fair value option. The securitization VIEs in which we invest are “static”; that is, no reinvestment is permitted, and there is no active management of the underlying assets. In determining the fair value of the assets and liabilities of the securitization VIE, we maximize the use of observable inputs over unobservable inputs. Refer to Note 19 for further discussion regarding our fair value measurements.

Loans Held-for-Investment and Provision for Loan Losses

Loans that are held for investment are carried at cost, net of unamortized acquisition premiums or discounts, loan fees, and origination costs as applicable, unless the loans are deemed impaired. We evaluate each loan classified as held-for-investment for impairment at least quarterly. In connection with this evaluation, we assess the performance of each loan and assign a risk rating based on several factors, including risk of loss, loan-to-collateral value ratio (“LTV”), collateral performance, structure, exit plan, and sponsorship. Loans are rated “1” through “5”, from less risk to greater risk, in connection with this review.

Impairment occurs when it is deemed probable that we 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, we record an allowance through the provision for loan losses 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 or the fair value of the collateral, if repayment is expected solely from the collateral. Actual losses, if any, could ultimately differ from these estimates.

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Cost Method Equity Investments

On January 1, 2018, ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities, became effective prospectively for public companies with a calendar fiscal year. This ASU requires entities to carry all investments in equity securities, including other ownership interests such as partnerships, unincorporated joint ventures, and limited liability companies, at fair value with changes in fair value recognized within net income. This ASU does not apply to equity method investments, investments in Federal Home Loan Bank ("FHLB") stock, investments that result in consolidation of the investee or investments in certain investment companies. For investments in equity securities without a readily determinable fair value, an entity is permitted to elect a practicability exception, under which the investment will be measured at cost, less impairment, plus or minus observable price changes from orderly transactions of an identical or similar investment of the same issuer.

Additionally, this ASU eliminated the requirement to assess whether an impairment of an equity investment is other than temporary. The impairment model for equity investments subject to this election is now a single-step model whereby an entity performs a qualitative assessment to identify impairment. If the qualitative assessment indicates that an impairment exists, the entity would estimate the fair value of the investment and recognize in net income an impairment loss equal to the difference between the fair value and the carrying amount of the equity investment.

Our equity investments within the scope of this ASU are limited to our cost method equity investments discussed in Note 7, with the exception of our FHLB stock which is outside the scope of this ASU, and to our marketable equity security discussed in Note 5 for which we had previously elected the fair value option. Our cost method equity investments within the scope of this ASU do not have readily determinable fair values. Therefore, we have elected the practicability exception whereby we measure these investments at cost, less impairment, plus or minus observable price changes from orderly transactions of identical or similar investments of the same issuer. Refer to Note 7 for further discussion.

Revenue Recognition

On January 1, 2018, new accounting rules regarding revenue recognition became effective for public companies with a calendar fiscal year. None of our significant revenue sources – interest income from loans and investment securities, loan servicing fees, and rental income – are within the scope of the new revenue recognition guidance. The revenue recognition guidance also included revisions to existing accounting rules regarding the determination of whether a company is acting as a principal or agent in an arrangement and accounting for sales of nonfinancial assets where the seller has continuing involvement. These additional revisions also did not materially impact the Company.

Earnings Per Share

We present both basic and diluted earnings per share ("EPS") amounts in our financial statements. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS reflects the maximum potential dilution that could occur from (i) our share-based compensation, consisting of unvested restricted stock ("RSAs") and restricted stock units ("RSUs"), (ii) shares contingently issuable to our Manager, (iii) the "in-the-money" conversion options associated with our outstanding convertible senior notes (see Notes 10 and 17), and (iv) non-controlling interests that are redeemable with our common stock (see Note 16). Potential dilutive shares are excluded from the calculation if they have an anti-dilutive effect in the period.

Nearly all of the Company's unvested RSUs and RSAs contain rights to receive non-forfeitable dividends and thus are participating securities. In addition, the non-controlling interests that are redeemable with our common stock are considered participating securities because they earn a preferred return indexed to the dividend rate on our common stock (see Note 16). Due to the existence of these participating securities, the two-class method of computing EPS is required, unless another method is determined to be more dilutive. Under the two-class method, undistributed earnings are reallocated between shares of common stock and participating securities. For the three months ended March 31, 2018 and 2017, the two-class method resulted in the most dilutive EPS calculation.

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Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The most significant and subjective estimate that we make is the projection of cash flows we expect to receive on our loans, investment securities and intangible assets, which has a significant impact on the amounts of interest income, credit losses (if any), and fair values that we record and/or disclose. In addition, the fair value of financial assets and liabilities that are estimated using a discounted cash flows method is significantly impacted by the rates at which we estimate market participants would discount the expected cash flows.

Recent Accounting Developments

On February 25, 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which establishes a right-of-use model for lessee accounting which results in the recognition of most leased assets and lease liabilities on the balance sheet of the lessee. Lessor accounting was not significantly changed by this ASU. This ASU is effective for annual periods, and interim periods therein, beginning after December 15, 2018 by applying a modified retrospective approach. Early application is permitted. We are in the process of assessing the impact this ASU will have on the Company.

On June 16, 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326) – Measurement of Credit Losses on Financial Instruments, which mandates use of an “expected loss” credit model for estimating future credit losses of certain financial instruments instead of the “incurred loss” credit model that current GAAP requires. The “expected loss” model requires the consideration of possible credit losses over the life of an instrument as opposed to only estimating credit losses upon the occurrence of a discrete loss event in accordance with the current “incurred loss” methodology. This ASU is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2019. Early application is permitted though no earlier than the first interim or annual period beginning after December 15, 2018. Though we have not completed our assessment of this ASU, we expect the ASU to result in our recognition of higher levels of allowances for loan losses. Our assessment of the estimated amount of such increases remains in process.

On January 26, 2017, the FASB issued ASU 2017-04, Goodwill and Other (Topic 350) – Simplifying the Test for Goodwill Impairment, which simplifies the method applied for measuring impairment in cases where goodwill is impaired. This ASU specifies that goodwill impairment will be measured as the excess of the reporting unit’s carrying value (inclusive of goodwill) over its fair value, eliminating the requirement that all assets and liabilities of the reporting unit be remeasured individually in connection with measurement of goodwill impairment. This ASU is effective for annual periods, and interim periods therein, beginning after December 15, 2019 and is applied prospectively. Early application is permitted. We do not expect the application of this ASU to materially impact the Company.

On August 28, 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities, which amends and simplifies existing guidance regarding the designation and measurement of designated hedging relationships. This ASU is effective for annual periods, and interim periods therein, beginning after December 15, 2018. Early application is permitted. We do not expect the application of this ASU to materially impact the Company.

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3. Acquisitions and Divestitures

Woodstar II Portfolio Acquisition

During the three months ended March 31, 2018, we acquired 18 of the 27 affordable housing communities comprising our "Woodstar II Portfolio." The Woodstar II Portfolio is comprised of 6,109 units concentrated primarily in Central and South Florida and is 99% occupied. The 18 affordable housing communities acquired during the three months ended March 31, 2018 comprise 4,057 units and were acquired for $404.7 million, including contingent consideration of $26.7 million (the "Q1 2018 Closing"). The properties acquired in the Q1 2018 Closing were recognized initially at their purchase price of $378.0 million plus capitalized acquisition costs of $3.6 million. Contingent consideration of $26.7 million will be recognized when the contingency is resolved. Government sponsored mortgage debt of $7.3 million with weighted average fixed annual interest rates of 2.88% and remaining weighted average terms of 17.7 years was assumed at closing. We financed the Q1 2018 Closing utilizing new 10-year mortgage debt totaling $300.9 million with weighted average fixed annual interest rates of 3.82% (as set forth in Note 9).

In December 2017, we acquired eight of the affordable housing communities (the "Q4 2017 Closing"), which include 1,740 units, for $156.2 million, including contingent consideration of $10.8 million. We financed the Q4 2017 Closing utilizing 10-year mortgage debt totaling $116.7 million with a fixed 3.81% interest rate.

We effectuated the Woodstar II Portfolio acquisitions via a contribution of the properties by third parties (the "Contributors") to SPT Dolphin Intermediate LLC ("SPT Dolphin"), a newly-formed, wholly-owned subsidiary of the Company. In exchange for the contribution, the Contributors received cash, Class A units of SPT Dolphin (the "Class A Units") and rights to receive additional Class A Units if certain contingent events occur. The Class A unitholders have the right, commencing six months from issuance, to redeem their Class A Units for consideration equal to the current share price of the Company's common stock on a one-for-one basis, with the consideration paid in either cash or the Company's common stock, at the determination of the Company.

The Q1 2018 Closing resulted in the Contributors receiving cash of $223.3 million, 6,979,089 Class A Units and rights to receive an additional 1,301,414 Class A Units if certain contingent events occur. In aggregate, the Q1 2018 Closing and Q4 2017 Closing have resulted in the Contributors receiving cash of $308.1 million, 9,758,863 Class A Units and rights to receive an additional 1,800,335 Class A Units if certain contingent events occur.

Since substantially all of the fair value of the properties acquired was concentrated in a group of similar identifiable assets, the Woodstar II Portfolio acquisitions were accounted for in accordance with the asset acquisition provisions of ASC 805, Business Combinations.

Master Lease Portfolio

During the three months ended March 31, 2018, we sold two retail properties within the Master Lease Portfolio for $37.2 million, recognizing a gain on sale of $3.9 million, within gain on sale of investments and other assets in our condensed consolidated statement of operations. Refer to Note 6 for further discussion of the Master Lease Portfolio.

Investing and Servicing Segment Property Portfolio

During the three months ended March 31, 2018, our Investing and Servicing Segment acquired the $27.7 million net assets of two commercial real estate properties from consolidated CMBS trusts for a total gross purchase price of $28.0 million. These properties, aggregated with the controlling interests in 23 remaining commercial real estate properties acquired from CMBS trusts during the years ended December 31, 2015, 2016 and 2017 for an aggregate acquisition price of $291.7 million, comprise the Investing and Servicing Segment Property Portfolio (the "REIS Equity Portfolio"). When the properties are acquired from CMBS trusts that are consolidated as VIEs on our balance sheet, the acquisitions are reflected as repayment of debt of consolidated VIEs in our condensed consolidated statements of cash flows.

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During the three months ended March 31, 2018, we sold three properties within the Investing and Servicing Segment for $15.1 million, recognizing a total gain on sale of $6.4 million, within gain on sale of investments and other assets in our condensed consolidated statement of operations. One of these properties was acquired by a third party which already held a $0.3 million non-controlling interest in the property. During the three months ended March 31, 2018, $1.3 million of the gain on sale was attributable to non-controlling interests. No Investing and Servicing Segment properties were sold during the three months ended March 31, 2017.

4. Loans

Our loans held-for-investment are accounted for at amortized cost and our loans held-for-sale are accounted for at the lower of cost or fair value, unless we have elected the fair value option. The following tables summarize our investments in mortgages and loans by subordination class as of March 31, 2018 and December 31, 2017 (dollars in thousands):

March 31, 2018	Carrying Value	Face Amount	Weighted Average Coupon		Weighted Average Life (“WAL”) (years)(1)
First mortgages (2)	$ 5,438,170	$ 5,459,593	6.4	%	2.2
Subordinated mortgages (3)	177,360	177,402	11.1	%	1.8
Mezzanine loans (2)	547,048	546,762	11.1	%	1.1
Other	26,076	29,660	8.6	%	3.6
Total loans held-for-investment	6,188,654	6,213,417			
Loans held-for-sale, fair value option, residential	662,971	642,752	6.2	%	6.6
Loans held-for-sale, fair value option, commercial	60,762	60,850	5.0	%	10.0
Loans transferred as secured borrowings	74,463	75,000	6.5	%	2.0
Total gross loans	6,986,850	6,992,019			
Loan loss allowance (loans held-for-investment)	(5,868)	—			
Total net loans	$ 6,980,982	$ 6,992,019			
December 31, 2017					
First mortgages (2)	$ 5,818,804	$ 5,843,623	6.2	%	2.0

Subordinated mortgages (3)	177,115	177,386	10.8	%	1.9
Mezzanine loans (2)	545,299	545,355	11.0	%	1.1
Other	25,607	29,320	8.5	%	3.9
Total loans held-for-investment	6,566,825	6,595,684			
Loans held-for-sale, fair value option, residential	613,287	594,105	6.2	%	5.4
Loans held-for-sale, fair value option, commercial	132,456	132,393	4.6	%	10.0
Loans transferred as secured borrowings	74,403	75,000	6.2	%	2.3
Total gross loans	7,386,971	7,397,182			
Loan loss allowance (loans held-for-investment)	(4,330)	—			
Total net loans	$ 7,382,641	$ 7,397,182			

(1) Represents the WAL of each respective group of loans as of the respective balance sheet date. The WAL of each individual loan is calculated using amounts and timing of future principal payments, as projected at origination or acquisition.

(2) First mortgages include first mortgage loans and any contiguous mezzanine loan components because as a whole, the expected credit quality of these loans is more similar to that of a first mortgage loan. The application of this methodology resulted in mezzanine loans with carrying values of $689.0 million and $851.1 million being classified as first mortgages as of March 31, 2018 and December 31, 2017, respectively.

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(3) Subordinated mortgages include B-Notes and junior participation in first mortgages where we do not own the senior A-Note or senior participation. If we own both the A-Note and B-Note, we categorize the loan as a first mortgage loan.

As of March 31, 2018, approximately $5.7 billion, or 92.8%, of our loans held-for-investment were variable rate and paid interest principally at LIBOR plus a weighted-average spread of 4.9%.

Our loans are typically collateralized by real estate. As a result, we regularly evaluate the extent and impact of any credit deterioration associated with the performance and/or value of the underlying collateral property, as well as the financial and operating capability of the borrower. Specifically, a property's operating results and any cash reserves are analyzed and used to assess (i) whether cash flow from operations is sufficient to cover the debt service requirements currently and into the future, (ii) the ability of the borrower to refinance the loan, and/or (iii) the property's liquidation value. We also evaluate the financial wherewithal of any loan guarantors as well as the borrower's competency in managing and operating the properties. In addition, we consider the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. Such impairment analyses are completed and reviewed by asset management and finance personnel who utilize various data sources, including (i) periodic financial data such as property operating statements, occupancy, tenant profile, rental rates, operating expenses, the borrower's exit plan, and capitalization and discount rates, (ii) site inspections, and (iii) current credit spreads and discussions with market participants.

Our evaluation process, as described above, produces an internal risk rating between 1 and 5, which is a weighted average of the numerical ratings in the following categories: (i) sponsor capability and financial condition, (ii) loan and collateral performance relative to underwriting, (iii) quality and stability of collateral cash flows, and (iv) loan structure. We utilize the overall risk ratings as a concise means to monitor any credit migration on a loan as well as on the whole portfolio. While the overall risk rating is generally not the sole factor we use in determining whether a loan is impaired, a loan with a higher overall risk rating would tend to have more adverse indicators of impairment, and therefore would be more likely to experience a credit loss.

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The rating categories generally include the characteristics described below, but these are utilized as guidelines and therefore not every loan will have all of the characteristics described in each category:

Rating	Characteristics
1	Sponsor capability and financial condition—Sponsor is highly rated or investment grade or, if private, the equivalent thereof with significant management experience. Loan collateral and performance relative to underwriting—The collateral has surpassed underwritten expectations. Quality and stability of collateral cash flows—Occupancy is stabilized, the property has had a history of consistently high occupancy, and the property has a diverse and high quality tenant mix. Loan structure—LTV does not exceed 65%. The loan has structural features that enhance the credit profile.
2	Sponsor capability and financial condition—Strong sponsorship with experienced management team and a responsibly leveraged portfolio. Loan collateral and performance relative to underwriting—Collateral performance equals or exceeds underwritten expectations and covenants and performance criteria are being met or exceeded. Quality and stability of collateral cash flows—Occupancy is stabilized with a diverse tenant mix. Loan structure—LTV does not exceed 70% and unique property risks are mitigated by structural features.
3	Sponsor capability and financial condition—Sponsor has historically met its credit obligations, routinely pays off loans at maturity, and has a capable management team. Loan collateral and performance relative to underwriting—Property performance is consistent with underwritten expectations. Quality and stability of collateral cash flows—Occupancy is stabilized, near stabilized, or is on track with underwriting. Loan structure—LTV does not exceed 80%.
4	Sponsor capability and financial condition—Sponsor credit history includes missed payments, past due payment, and maturity extensions. Management team is capable but thin. Loan collateral and performance relative to underwriting—Property performance lags behind underwritten expectations. Performance criteria and loan covenants have required occasional waivers. A sale of the property may be necessary in order for the borrower to pay off the loan at maturity. Quality and stability of collateral cash flows—Occupancy is not stabilized and the property has a large amount of rollover. Loan structure—LTV is 80% to 90%.
5	Sponsor capability and financial condition—Credit history includes defaults, deeds in lieu, foreclosures, and/or bankruptcies. Loan collateral and performance relative to underwriting—Property performance is significantly worse than underwritten expectations. The loan is not in compliance with loan covenants and performance criteria and may be in default. Sale proceeds would not be sufficient to pay off the loan at maturity. Quality and stability of collateral cash flows—The property has material vacancy and significant rollover of remaining tenants. Loan structure—LTV exceeds 90%.

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As of March 31, 2018, the risk ratings for loans subject to our rating system, which excludes loans for which the fair value option has been elected, by class of loan were as follows (dollars in thousands):

	Balance Sheet Classification							
	Loans Held-For-Investment					Loans Transferred		% of
Risk Rating Category	First Mortgages	Subordinated Mortgages	Mezzanine Loans	Other	Loans Held-For-Sale	As Secured Borrowings	Total	Total Loans
1	$ 1,789	$ —	$ —	$ 20,068	$ —	$ —	$ 21,857	0.3 %
2	2,221,941	32,049	209,751	—	—	74,463	2,538,204	36.3 %
3	2,980,626	133,334	337,297	6,008	—	—	3,457,265	49.5 %
4	183,452	—	—	—	—	—	183,452	2.6 %
5	50,362	11,977	—	—	—	—	62,339	0.9 %
N/A	—	—	—	—	723,733	—	723,733	10.4 %
	$ 5,438,170	$ 177,360	$ 547,048	$ 26,076	$ 723,733	$ 74,463	$ 6,986,850	100.0 %

As of December 31, 2017, the risk ratings for loans subject to our rating system, which excludes loans for which the fair value option has been elected, by class of loan were as follows (dollars in thousands):

	Balance Sheet Classification							
	Loans Held-For-Investment					Loans Transferred		% of
Risk Rating Category	First Mortgages	Subordinated Mortgages	Mezzanine Loans	Other	Loans Held-For-Sale	As Secured Borrowings	Total	Total Loans
1	$ 2,003	$ —	$ —	$ 20,267	$ —	$ —	$ 22,270	0.3 %
2	2,462,268	11,927	137,803	—	—	—	2,611,998	35.4 %
3	3,183,592	165,188	407,496	5,340	—	74,403	3,836,019	51.9 %
4	120,479	—	—	—	—	—	120,479	1.6 %
5	50,462	—	—	—	—	—	50,462	0.7 %
N/A	—	—	—	—	745,743	—	745,743	10.1 %
	$ 5,818,804	$ 177,115	$ 545,299	$ 25,607	$ 745,743	$ 74,403	$ 7,386,971	100.0 %

After completing our impairment evaluation process as of March 31, 2018, we concluded that none of our loans were impaired and therefore no individual loan impairment charges were required on any individual loans, as we expect to collect all outstanding principal and interest.

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In accordance with our policies, we record an allowance for loan losses equal to (i) 1.5% of the aggregate carrying amount of loans rated as a “4,” plus (ii) 5% of the aggregate carrying amount of loans rated as a “5, ” plus (iii) impaired loan reserves, if any. The following table presents the activity in our allowance for loan losses (amounts in thousands):

	For the Three Months Ended March 31,	
	2018	2017
Allowance for loan losses at January 1	$ 4,330	$ 9,788
Provision for loan losses	1,538	(305)
Charge-offs	—	—
Recoveries	—	—
Allowance for loan losses at March 31	$ 5,868	$ 9,483
Recorded investment in loans related to the allowance for loan loss	$ 245,791	$ 499,539

The activity in our loan portfolio was as follows (amounts in thousands):

	For the Three Months Ended March 31,	
	2018	2017
Balance at January 1	$ 7,382,641	$ 5,946,274
Acquisitions/originations/additional funding	1,178,560	1,067,021
Capitalized interest (1)	16,253	15,079
Basis of loans sold (2)	(411,625)	(216,431)
Loan maturities/principal repayments	(1,225,815)	(230,931)
Discount accretion/premium amortization	12,052	7,519
Changes in fair value	7,800	10,593
Unrealized foreign currency translation gain	22,552	6,053
Change in loan loss allowance, net	(1,538)	305
Transfer to/from other asset classifications	102	603
Balance at March 31	$ 6,980,982	$ 6,606,085

(1) Represents accrued interest income on loans whose terms do not require current payment of interest.

(2) See Note 11 for additional disclosure on these transactions.

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5. Investment Securities

Investment securities were comprised of the following as of March 31, 2018 and December 31, 2017 (amounts in thousands):

	Carrying Value as of	
	March 31, 2018	December 31, 2017
RMBS, available-for-sale	$ 240,853	$ 247,021
CMBS, fair value option (1)	1,045,217	1,024,143
Held-to-maturity ("HTM") securities	236,319	433,468
Equity security, fair value	13,322	13,523
Subtotal—Investment securities	1,535,711	1,718,155
VIE eliminations (1)	(1,021,248)	(999,952)
Total investment securities	$ 514,463	$ 718,203

(1) Certain fair value option CMBS are eliminated in consolidation against VIE liabilities pursuant to ASC 810.

Purchases, sales and principal collections for all investment securities were as follows (amounts in thousands):

	RMBS, available-for-sale	CMBS, fair value option	HTM Securities	Equity Security	Total
Three Months Ended March 31, 2018					
Purchases (1)	$ —	$ —	$ —	$ —	$ —
Sales (2)	—	—	—	—	—
Principal collections	10,150	777	208,303	—	219,230
Three Months Ended March 31, 2017					
Purchases (1)	$ —	$ —	$ —	$ —	$ —
Sales (2)	—	10,434	—	—	10,434
Principal collections	10,228	5,766	60,056	—	76,050

(1) During the three months ended March 31, 2018 and 2017, we purchased $30.2 million and $57.4 million of CMBS, respectively, for which we elected the fair value option. Due to our consolidation of securitization VIEs, $30.2 million and $57.4 million, respectively, of this amount is eliminated and reflected as repayment of debt of consolidated VIEs in our condensed consolidated statements of cash flows.

(2) During the three months ended March 31, 2018 and 2017, we sold $7.9 million and $15.2 million of CMBS,

respectively, for which we had previously elected the fair value option. Due to our consolidation of securitization VIEs, $7.9 million and $4.8 million, respectively, of this amount is eliminated and reflected as issuance of debt of consolidated VIEs in our condensed consolidated statements of cash flows.

RMBS, Available-for-Sale

The Company classified all of its RMBS as available-for-sale as of March 31, 2018 and December 31, 2017. These RMBS are reported at fair value in the balance sheet with changes in fair value recorded in accumulated other comprehensive income ("AOCI").

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The tables below summarize various attributes of our investments in available-for-sale RMBS as of March 31, 2018 and December 31, 2017 (amounts in thousands):

				Unrealized Gains or (Losses) Recognized in AOCI				
	Purchase Amortized Cost	Credit OTTI	Recorded Amortized Cost	Non-Credit OTTI	Gross Unrealized Gains	Gross Unrealized Losses	Net Fair Value Adjustment	Fair Value
March 31, 2018								
RMBS	$ 191,698	$ (9,897)	$ 181,801	$ —	$ 59,052	$ —	$ 59,052	$ 240,853
December 31, 2017								
RMBS	$ 199,029	$ (9,897)	$ 189,132	$ (94)	$ 58,011	$ (28)	$ 57,889	$ 247,021

	Weighted Average Coupon (1)	Weighted Average Rating	WAL (Years) (2)
March 31, 2018			
RMBS	3.0 %	CCC-	6.3
December 31, 2017			
RMBS	2.8 %	B	6.4

(1) Calculated using the March 31, 2018 and December 31, 2017 one-month LIBOR rate of 1.883% and 1.564%, respectively, for floating rate securities.

(2) Represents the WAL of each respective group of securities as of the respective balance sheet date. The WAL of each individual security is calculated using projected amounts and projected timing of future principal payments.

As of March 31, 2018, approximately $202.2 million, or 84.0%, of RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 1.22%. As of December 31, 2017, approximately $207.0 million, or 83.8%, of RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 1.22%. We purchased all of the RMBS at a discount, a portion of which will be accreted into income over the expected remaining life of the security. The majority of the income from this strategy is earned from the accretion of this accretable discount.

The following table contains a reconciliation of aggregate principal balance to amortized cost for our RMBS as of March 31, 2018 and December 31, 2017 (amounts in thousands):

	March 31, 2018	December 31, 2017
Principal balance	$ 355,083	$ 366,711
Accretable yield	(51,794)	(55,712)
Non-accretable difference	(121,488)	(121,867)
Total discount	(173,282)	(177,579)
Amortized cost	$ 181,801	$ 189,132

The principal balance of credit deteriorated RMBS was $334.8 million and $345.5 million as of March 31, 2018 and December 31, 2017, respectively. Accretable yield related to these securities totaled $45.6 million and $49.2 million as of March 31, 2018 and December 31, 2017, respectively.

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The following table discloses the changes to accretable yield and non-accretable difference for our RMBS during the three months ended March 31, 2018 (amounts in thousands):

Three Months Ended March 31, 2018	Accretable Yield	Non-Accretable Difference
Balance as of January 1, 2018	$ 55,712	$ 121,867
Accretion of discount	(2,819)	—
Principal write-downs, net	—	(1,478)
Purchases	—	—
Sales	—	—
OTTI	—	—
Transfer to/from non-accretable difference	(1,099)	1,099
Balance as of March 31, 2018	$ 51,794	$ 121,488

We have engaged a third party manager who specializes in RMBS to execute the trading of RMBS, the cost of which was $0.5 million for both the three months ended March 31, 2018 and 2017, which has been recorded as management fees in the accompanying condensed consolidated statements of operations.

The following table presents the gross unrealized losses and estimated fair value of any available-for-sale securities that were in an unrealized loss position as of March 31, 2018 and December 31, 2017, and for which OTTIs (full or partial) have not been recognized in earnings (amounts in thousands):

	Estimated Fair Value		Unrealized Losses	
	Securities with a loss less than 12 months	Securities with a loss greater than 12 months	Securities with a loss less than 12 months	Securities with a loss greater than 12 months
As of March 31, 2018				
RMBS	$ —	$ —	$ —	$ —
As of December 31, 2017				
RMBS	$ 10,321	$ 643	$ (99)	$ (23)

As of March 31, 2018, there were no securities with unrealized losses. As of December 31, 2017, there were three securities with unrealized losses reflected in the table above. After evaluating these securities and recording adjustments for credit-related OTTI, we concluded that the remaining unrealized losses reflected above were noncredit-related and would be recovered from the securities' estimated future cash flows. We considered a number of factors in reaching this conclusion, including that we did not intend to sell the securities, it was not considered more likely than not that we would be forced to sell the securities prior to recovering our amortized cost, and there were no material credit events that would have caused us to otherwise conclude that we would not recover our cost. Credit losses, which represent most of the OTTI we record on securities, are calculated by comparing (i) the estimated future

cash flows of each security discounted at the yield determined as of the initial acquisition date or, if since revised, as of the last date previously revised, to (ii) our amortized cost basis. Significant judgment is used in projecting cash flows for our non-agency RMBS. As a result, actual income and/or impairments could be materially different from what is currently projected and/or reported.

CMBS, Fair Value Option

As discussed in the "Fair Value Option" section of Note 2 herein, we elect the fair value option for the Investing and Servicing Segment's CMBS in an effort to eliminate accounting mismatches resulting from the current or potential consolidation of securitization VIEs. As of March 31, 2018, the fair value and unpaid principal balance of CMBS where we have elected the fair value option, before consolidation of securitization VIEs, were $1.0 billion and $4.1 billion, respectively. The $1.0 billion fair value balance represents our economic interests in these assets. However, as a result of our consolidation of securitization VIEs, the vast majority of this fair value (all except $24.0 million at March 31, 2018) is eliminated against VIE liabilities before arriving at our GAAP balance for fair value option CMBS.

As of March 31, 2018, none of our CMBS where we have elected the fair value option were variable rate.

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HTM Securities

The table below summarizes unrealized gains and losses of our investments in HTM securities as of March 31, 2018 and December 31, 2017 (amounts in thousands):

	Net Carrying Amount (Amortized Cost)	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
March 31, 2018				
CMBS	$ 215,847	$ 3,927	$ (6,657)	$ 213,117
Preferred interests	20,472	637	—	21,109
Total	$ 236,319	$ 4,564	$ (6,657)	$ 234,226
December 31, 2017				
CMBS	$ 413,110	$ 2,002	$ (7,779)	$ 407,333
Preferred interests	20,358	647	—	21,005
Total	$ 433,468	$ 2,649	$ (7,779)	$ 428,338

The table below summarizes the maturities of our HTM CMBS and our HTM preferred equity interests in limited liability companies that own commercial real estate as of March 31, 2018 (amounts in thousands):

	CMBS	Preferred Interests	Total
Less than one year	$ 119,073	$ —	$ 119,073
One to three years	66,211	—	66,211
Three to five years	30,563	20,472	51,035
Thereafter	—	—	—
Total	$ 215,847	$ 20,472	$ 236,319

Equity Security, Fair Value

During 2012, we acquired 9,140,000 ordinary shares from a related-party in Starwood European Real Estate Finance Limited (“SEREF”), a debt fund that is externally managed by an affiliate of our Manager and is listed on the London Stock Exchange. The fair value of the investment remeasured in USD was $13.3 million and $13.5 million as of March 31, 2018 and December 31, 2017, respectively. As of March 31, 2018, our shares represent an approximate 2% interest in SEREF.

6. Properties

Our properties are held within the following portfolios:

Ireland Portfolio

The Ireland Portfolio is comprised of 11 net leased fully occupied office properties and one multifamily property all located in Dublin, Ireland, which the Company acquired during the year ended December 31, 2015. The Ireland Portfolio, which collectively is comprised of approximately 600,000 square feet, includes total assets of $514.3 million and assumed debt of $283.0 million at acquisition. Following our acquisition, all assumed debt was immediately extinguished and replaced with new financing of $328.6 million from the Ireland Portfolio Mortgage.

Woodstar I Portfolio

The Woodstar I Portfolio is comprised of 32 affordable housing communities with 8,948 units concentrated primarily in the Tampa, Orlando and West Palm Beach metropolitan areas. During the year ended December 31, 2015, we acquired 18 of the 32 affordable housing communities of the Woodstar I Portfolio with the final 14 communities acquired during the year ended December 31, 2016 for an aggregate acquisition price of $421.5 million. We assumed federal, state and county sponsored financing and other debt in connection with this acquisition.

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Woodstar II Portfolio

The Woodstar II Portfolio is comprised of 27 affordable housing communities with 6,109 units concentrated primarily in Central and South Florida and is 99% occupied. Refer to Note 3 for further discussion of the Woodstar II Portfolio.

Medical Office Portfolio

The Medical Office Portfolio is comprised of 34 medical office buildings acquired for a purchase price of $758.7 million during the year ended December 31, 2016. These properties, which collectively comprise 1.9 million square feet, are geographically dispersed throughout the U.S. and primarily affiliated with major hospitals or located on or adjacent to major hospital campuses.

Master Lease Portfolio

In September 2017, we acquired 20 retail properties and three industrial properties (the "Master Lease Portfolio") for a purchase price of $553.3 million, inclusive of $3.7 million of related transaction costs. Concurrently with the acquisition, we leased the properties back to the seller under corporate guaranteed master net lease agreements with initial terms of 24.6 years and periodic rent escalations. These properties, which collectively comprise 5.3 million square feet, are geographically dispersed throughout the U.S., with more than 50% of the portfolio, by carrying value, located in Utah, Florida, Texas and Minnesota. We utilized $265.9 million in new financing in order to fund the acquisition.

Investing and Servicing Segment Property Portfolio

The REIS Equity Portfolio is comprised of 25 commercial real estate properties. Refer to Note 3 for further discussion of the REIS Equity Portfolio.

The table below summarizes our properties held as of March, 31, 2018 and December 31, 2017 (dollars in thousands):

	Depreciable Life	March 31, 2018	December 31, 2017
Property Segment			
Land and land improvements	0 – 15 years	$ 675,856	$ 585,915
Buildings and building improvements	5 – 45 years	2,092,139	1,838,266
Furniture & fixtures	3 – 7 years	40,888	31,028
Investing and Servicing Segment			
Land and land improvements	0 – 15 years	87,536	86,711
Buildings and building improvements	3 – 40 years	219,552	212,094
Furniture & fixtures	2 – 5 years	1,399	1,036
Properties, cost		3,117,370	2,755,050
Less: accumulated depreciation		(128,506)	&nb