STARWOOD PROPERTY TRUST, INC.
Form 10-Q
November 16, 2009

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**
**FORM 10-Q**

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

**For the quarterly period ended September 30, 2009**

**OR**

o **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** | **27-0247747** |
| *(State or Other Jurisdiction of Incorporation or Organization)* | *(I.R.S. Employer Identification No.)* |
| **591 West Putnam Avenue Greenwich, Connecticut** | **06830** |
| *(Address of principal executive offices)* | *(Zip Code)* |

**Registrant s telephone number, including area code:**
**(203) 422-7700**

Indicate by check mark whether the registrant (1) has filed all reports 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 earlier 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 þ No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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 definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer o | Non-accelerated filer þ<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The number of shares of the issuer s common stock, $0.01 par value, outstanding as of November 16, 2009, was 47,583,800.

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**PART I Financial Information**
**Item 1. Financial Statements**

**Starwood Property Trust, Inc. and Subsidiaries**
**Condensed Consolidated Balance Sheet**
**(Unaudited, amounts in thousands, except per share data)**

| | | As of September 30, 2009 |
|---|---|---|
| **Assets:** | | |
| Cash and cash equivalents | $ | 892,714 |
| Investments in mortgage backed securities held to maturity, net | | 202,635 |
| Contractual deposits | | 5,000 |
| Accrued interest receivable | | 1,025 |
| Deferred financing costs, net of accumulated amortization of $3 | | 340 |
| Other assets | | 1,072 |
| **Total assets** | **$** | **1,102,786** |
| **Liabilities and Stockholders Equity** | | |
| **Liabilities:** | | |
| Accounts payable and accrued expenses | $ | 697 |
| Related-party payable | | 2,210 |
| Dividends payable | | 5,349 |
| Secured financing agreements | | 171,507 |
| Deferred offering costs | | 27,195 |
| Other liabilities | | 281 |
| **Total liabilities** | | **207,239** |
| **Commitments and contingencies (Note 9)** | | |
| **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, $0.01 per share, 500,000,000 shares authorized, 47,583,800 issued and outstanding | | 476 |
| Additional paid-in capital | | 894,254 |
| Accumulated deficit | | (7,268) |
| Total Starwood Property Trust, Inc. Stockholders Equity | | 887,462 |
| Noncontrolling interests in consolidated entity | | 8,085 |
| **Total Equity** | | **895,547** |
| **Total liabilities and stockholders equity** | **$** | **1,102,786** |

See notes to condensed consolidated financial statements

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**Starwood Property Trust, Inc. and Subsidiaries**
**Condensed Consolidated Statement of Operations**
**(Unaudited, amounts in thousands, except per share data)**

| | For the Period from August 17, 2009 (Commencement of Operations) Through September 30, 2009 |
|---|---|
| **Net interest margin:** | |
| Interest income from mortgage backed securities | $ 865 |
| Interest expense | (253) |
| **Net interest margin** | **612** |
| **Expenses:** | |
| Management fees (including $811 of non-cash stock-based compensation) | 2,465 |
| General and administrative (including $11 of non-cash stock-based compensation) | 501 |
| **Total operating expenses** | **2,966** |
| Interest income from cash balances | 583 |
| **Net loss** | **$ (1,771)** |
| Net income attributable to noncontrolling interests | 148 |
| **Net loss attributable to Starwood Property Trust, Inc.** | **$ (1,919)** |
| **Net loss per common share:** | |
| Basic | $ (0.04) |
| Diluted | $ (0.04) |
| **Weighted average number of shares of common stock outstanding:** | |
| Basic | 47,575,000 |
| Diluted | 47,575,000 |

See notes to condensed consolidated financial statements

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**Starwood Property Trust, Inc. and Subsidiaries**
**Condensed Consolidated Statement of Stockholder s Equity**
**(Unaudited, amounts in thousands, except per share data)**

| | Common Stock Shares | Common Stock Par Value | Additional Paid-In Capital | Accumulated Deficit | Total Starwood Property Trust, Inc. Stockholders Equity | Non-controlling interests | Total Equity |
|---|---|---|---|---|---|---|---|
| **Balance at August 17, 2009 (Commencement of Operations)** | 100 | $ | $ 1 | $ | $ 1 | $ | $ 1 |
| Proceeds from public offering of common stock | 46,575,000 | 466 | 931,034 | | 931,500 | | 931,500 |
| Underwriting and offering costs | | | (57,592) | | (57,592) | | (57,592) |
| Proceeds from private placement | 1,000,000 | 10 | 19,990 | | 20,000 | | 20,000 |
| Cancelation of shares | (100) | | (1) | | (1) | | (1) |
| Stock-based compensation | | | 822 | | 822 | | 822 |
| Net loss | | | | (1,919) | (1,919) | 148 | (1,771) |
| Dividends declared, $0.11 per share | | | | (5,349) | (5,349) | | (5,349) |
| Contribution from noncontrolling interests | | | | | | 50,855 | 50,855 |
| Distribution to noncontrolling interests | | | | | | (42,918) | (42,918) |
| **Balance at September 30, 2009** | **47,575,000** | **$ 476** | **$ 894,254** | **$ (7,268)** | **$ 887,462** | **$ 8,085** | **$ 895,547** |

See notes to condensed consolidated financial statements

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**Starwood Property Trust, Inc. and Subsidiaries**
**Condensed Consolidated Statement of Cash Flows**
**(Unaudited, amounts in thousands, except per share data)**

| | For the Period from August 17, 2009 (Commencement of Operations) Through September 30, 2009 |
|---|---|
| **Cash Flows from Operating Activities:** | |
| Net loss | $ (1,771) |
| Adjustments to reconcile net loss to net cash provided from operating activities: | |
| Amortization of deferred financing costs | 3 |
| Amortization of net discount | (2) |
| Stock-based compensation | 822 |
| Changes in operating assets and liabilities: | |
| Related-party payable | 1,685 |
| Interest income receivable, less purchased interest | (772) |
| Other assets | (1,072) |
| Accounts payable and accrued expenses | 447 |
| Other liabilities | 281 |
| **Net cash used in operating activities** | **(379)** |
| **Cash Flows from Investing Activities:** | |
| Investment in commercial mortgage-backed securities held to maturity | (202,633) |
| Purchased interest on commercial mortgage-backed securities, net | (253) |
| Contractual deposits | (5,000) |
| **Net cash used in investing activities** | **(207,886)** |
| **Cash Flows from Financing Activities:** | |
| Borrowings of secured financing arrangements | 171,579 |
| Principal repayments on borrowings | (72) |
| Payment of deferred financing costs | (343) |
| Repurchase and retirement of shares | (1) |
| Proceeds from common stock offerings | 951,500 |
| Payments of underwriting and offering costs | (29,622) |
| Contribution from noncontrolling interest owners | 50,855 |
| Distribution to noncontrolling interest owners | (42,918) |
| Net cash provided by financing activities | 1,100,978 |
| **Net increase in cash and cash equivalents** | 892,713 |
| Cash and cash equivalents, beginning of period | 1 |
| Cash and cash equivalents, end of period | $ 892,714 |
| Supplemental disclosure of cash flow information: | |
| Cash paid for interest | $ 86 |
| Supplemental disclosure of non-cash financing activity: | |

| | | |
|---|---|---|
| Dividends declared | $ | 5,349 |
| Deferred offering costs | $ | 27,195 |

See notes to condensed consolidated financial statements

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

## 1. Business and Organization

Starwood Property Trust, Inc. and subsidiaries (the Company ) is a Maryland corporation that commenced operations on August 17, 2009, upon the completion of its initial public offering. The Company is focused primarily on originating, investing in, financing and managing commercial mortgage loans and other commercial real estate debt investments. The Company may also invest in residential mortgage-backed securities and residential mortgage loans. The Company is externally managed and advised by SPT Management, LLC (the Manager ).

The Company is organized and conducts its operations to qualify as a real estate investment trust ( REIT ) under the Internal Revenue Code of 1986, as amended (the Code ). As such, the Company will generally not be subject to U.S. federal corporate income tax on that portion of its net income that is distributed to stockholders if it distributes at least 90% of its taxable income to its stockholders by prescribed dates and complies with various other requirements.

The Company is organized as a holding company that conducts its business primarily through two wholly-owned subsidiaries, SPT Real Estate Sub I, LLC and SPT TALF Sub I, LLC. The Company has formed joint ventures (the Joint Ventures ) with Starwood Hospitality Fund II ( Hotel II ) and Starwood Opportunity Fund VIII ( SOF VIII ) collectively the Starwood Private Real Estate Funds, in accordance with the co-investment and allocation agreement with our Manager. These Joint Ventures are owned 75% by the Company and are consolidated into the Company s consolidated financial statements.

## 2. Summary of Significant Accounting Policies

***Recent Accounting Pronouncements***

***Accounting Standards Codification ( ASC )*** In June 2009, the Financial Accounting Standards Board ( FASB ) issued a pronouncement establishing the FASB Accounting Standards Codification ( Codification ) as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with GAAP. The standard explicitly recognizes rules and interpretive releases of the SEC under federal securities laws as authoritative GAAP for Securities and Exchange Commission ( SEC ) registrants. This standard is effective for financial statements issued for fiscal years and interim periods ending after September 15, 2009. The Company has adopted this standard in the third quarter of 2009.

***Disclosures about Fair Value of Financial Instruments*** In April 2009, the FASB issued a statement requiring an entity to provide qualitative and quantitative information on a quarterly basis about fair value estimates for any financial instruments not measured on the balance sheet at fair value. The Company adopted this pronouncement in the third quarter of 2009.

***Subsequent Events*** In May 2009, the FASB issued a statement which introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. The pronouncement is effective for interim periods ending after June 15, 2009. The Company adopted this pronouncement in the 2009 third quarter. The Company evaluates subsequent events as of the date of issuance of its financial statements and considers the impact of all events that have taken place to that date in its disclosures and financial statements when reporting on the Company s financial position and results of operations. The Company has evaluated subsequent events through November 16, 2009 and has determined that no other events need to be disclosed.

***Accounting for Transfers of Financial Assets*** In June 2009, the FASB issued a statement which eliminates the concept of a qualifying special-purpose entity ( QSPE ) and requires more information about transfers of financial assets, including securitization transactions as well as a company s continuing exposure to the risks related to transferred financial assets. This statement has not yet been codified but remains authoritative guidance until such time that it is integrated in the FASB ASC. This statement is effective for financial asset transfers made on or after January 1, 2010 and early adoption is prohibited. Management is currently evaluating the impact of adopting this statement on our consolidated financial statements.

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

***Amendments to Variable Interest Entity Accounting*** In June 2009, the FASB issued a statement which amends the consolidation guidance applicable to variable interest entities ( VIEs ). The amendments will significantly affect the overall consolidation analysis. It changes the way a primary beneficiary is determined in a VIE and how entities account for securitizations and special purpose entities as a result of the elimination of the QSPE concept. This statement has not yet been codified but remains authoritative guidance until such time that it is integrated in the FASB ASC. This statement will be effective on January 1, 2010 and early adoption is prohibited. Management is currently evaluating the impact on our consolidated financial statements of adopting this statement.

***Fair Value Measurements and Disclosures*** In August 2009, the FASB issued a statement which provides guidance on measuring the fair value of liabilities. It clarifies that the unadjusted quoted price for an identical liability, when traded as an asset in an active market is a Level 1 measurement for the liability and provides guidance on the valuation techniques to estimate fair value of a liability in the absence of a Level 1 measurement. This statement is effective for the first interim or annual reporting period after its issuance. The adoption of this statement did not have a material effect on our consolidated financial statements.

***Basis of Accounting and Principles of Consolidation***

The accompanying condensed consolidated financial statements and related footnotes are unaudited. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows have been made. Results for interim periods are not necessarily indicative of the results to be expected for the remainder of 2009.

The accompanying condensed consolidated financial statements include our accounts and those of our consolidated subsidiaries. All significant intercompany amounts have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( 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 and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The Company uses plain English when describing or referencing accounting standards in the notes to the financial statements. As a result, there may be no reference to particular accounting standards by name, standard number, or Codification reference number.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash in banks and short-term investments. Short-term investments are comprised of highly liquid instruments with original maturities of three months or less. The Company maintains its cash and cash equivalents in multiple financial institutions and at times these balances exceed federally insurable limits.

***Debt Securities***

GAAP requires that at the time of purchase, the Company designate debt securities as held-to-maturity, available-for-sale, or trading depending on ability and intent to hold such security to maturity. Held-to-maturity investments are stated at cost plus any premiums or discounts, which are amortized through the consolidated statements of income using the effective interest method. Securities that the Company does not hold for the purpose of selling in the near-term, but may dispose of prior to maturity, are designated as available-for-sale and are carried at estimated fair value with the net unrealized gains or losses recorded as a component of accumulated other comprehensive income (loss) in stockholders equity. As of September 30, 2009, all of the Company s debt securities were designated as held-to-maturity.

The Company evaluates securities for other-than-temporary impairment ( OTTI ) at least quarterly. Securities are considered to be other-than-temporarily impaired when it is probable that we will be unable to recover our investment. The evaluation of a security s estimated cash flows includes the following, as applicable: (i) review of the credit of the issuer or the borrower; (ii) review of the credit rating of the security, (iii) review of the key terms of the security, (iv) review of the performance of the loan or underlying loans, including debt service coverage and loan-to-value ratios; (v) analysis of the value of the collateral for the loan or underlying loans, (vi) analysis of the effect of local, industry, and broader economic factors, and (vii) analysis of historical and anticipated trends in defaults and loss severities for similar securities. Unrealized losses on securities that are other than temporary are charged against earnings as a loss on the consolidated statements of operations.

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

***Revenue Recognition***

Interest income is accrued based on the outstanding principal amount of the investment security or loan and the contractual terms. Discounts or premiums associated with the purchase of an investment security are amortized into interest income on an effective yield or interest method, based on expected cash flows through the expected maturity date of the security. Depending on the nature of the investment, changes to expected cash flows may result in a prospective change to yield or a retrospective change, which would include a catch up adjustment. Upon settlement of securities, the excess (or deficiency) of net proceeds over the net carrying value of such security or loan is recognized as a gain (or loss) in the period of settlement. Investment security transactions are recorded on the trade date.

***Deferred Financing Costs***

Costs incurred in connection with securitized financing are capitalized and amortized over the respective loan terms and are reflected on the accompanying statement of operations as a component of interest expense. As of September 30, 2009, the Company had approximately $340,000 of capitalized financing costs, net of amortization.

***Earnings per share***

The Company calculates basic earnings per share by dividing net income for the period by the weighted average of common shares outstanding for that period. Diluted earnings per share takes into effect the dilutive instruments, such as restricted stock and restricted stock units, except when doing so would be antidilutive. As of September 30, 2009, there were 1,051,300 dilutive securities outstanding.

***Share-based payments***

The Company recognizes the cost of share-based compensation and payment transactions in the consolidated financial statements using the same expense category as would be charged for payments in cash. The fair value of the restricted stock or restricted stock-units granted is recorded to expense on a straight-line basis over the vesting period for the entire award, with an offsetting increase in stockholders equity. For grants to employees and directors, the fair value is determined based upon the stock price on the grant date. For nonemployee grants, the fair value is based on the stock price when the shares vest, which requires the amount to be adjusted in each subsequent reporting period based on the fair value of the award at the end of the reporting period until such time as the award has vested.

***Income Taxes***

The Company has elected to be taxed as a REIT and intends to comply with the Code, as amended, with respect thereto. Accordingly, the Company will not be subject to federal income tax to the extent of its distributions to shareholders as long as certain asset, income and stock ownership test are met. Many of these requirements are technical and complex and if we fail to meet these requirements we may be subject to federal, state, and local income tax and penalties.

***Underwriting Commissions and Offering Costs***

Underwriting commissions and costs incurred in connection with our initial public offering totaled approximately $57.6 million and are reflected as a reduction of additional paid-in capital.

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

**3. Commercial Mortgage-Backed Securities ( CMBS )**

For the quarter ended September 30, 2009, the Company invested in CMBS through a joint venture with SOF VIII in which the Company owns a 75% controlling interest and is required to consolidate under GAAP. The table below represents 100% of the joint venture activity.

| | Gross Book Value | Premium (Discount) | Net Book Value |
|---|---|---|---|
| Balance as of August 11, 2009 (commencement of operations) | $ | $ | $ |
| Acquisitions | 202,699 | (66) | 202,633 |
| Discount/premium amortization | | 2 | 2 |
| Balance as of September 30, 2009 | $ 202,699 | $ (64) | $ 202,635 |

The overall statistics for our CMBS investments calculated on a weighted average basis assuming no early prepayments or defaults as of September 30, 2009 are as follows:

| | |
|---|---|
| Credit Ratings (A) | AAA |
| Coupon | 5.62% |
| Yield | 5.69% |
| Weighted Average Life | 2.20 years |

(A) Ratings per Fitch, Moody s or S&P.

The rating, vintage, property type, and location of the collateral securing our CMBS investments calculated on a weighted average basis as of September 30, 2009 are as follows:

| **Vintage** | **Percentage** |
|---|---|
| 2006 | 49.7% |
| 2007 | 50.3% |
| Total | 100.0% |

| **Property Type** | **Percentage** |
|---|---|
| Office | 37.2% |
| Retail | 31.0% |
| Multifamily | 14.4% |
| Hotel | 8.2% |
| Industrial | 3.5% |
| Other | 5.7% |
| Total | 100.0% |

| Location | Percentage |
| --- | --- |
| Northeast | 27.6% |
| South | 28.6% |
| Midwest | 11.6% |
| West | 23.9% |
| Other | 8.3% |
| Total | 100.0% |

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

## 4. Secured Financing Facilities

On August 28, 2009 and September 25, 2009, the Company entered into multiple Federal Reserve Bank of New York Term Asset-backed securities Loan Facilities ( TALF ) through its joint venture with SOF VIII. The TALF loans are non-recourse, bear a fixed interest rate and mature five years from the loan closing dates. The loans are collateralized by the Company s CMBS investments, which are held in a Master TALF Collateral Account and are under the control of the lender until the loan is satisfied. As of September 30, 2009, the amounts outstanding under the TALF facility were approximately $171.5 million.

| | Debt Book Value | Collateral Book Value |
|---|---|---|
| August 28, 2009, TALF loans, fixed rate 3.872%, mature August 2014 | $ 55,030 | $ 64,907 |
| September 25, 2009, TALF loans, fixed rate 3.796%, mature September 2014 | 116,477 | 137,728 |
| Total | $ 171,507 | $ 202,635 |

Principal repayments are due on the TALF financing when principal is collected on the underlying CMBS securities, which can be paid off earlier or later than expected based on certain market factors including asset sales or loan defaults. As of September 30, 2009, the Manager has no anticipation of early principal repayments loan defaults of the underlying CMBS. The following table represents our five-year principal repayments schedule for the TALF secured financing assuming no early prepayments or defaults of the underlying CMBS assets.

| | Debt Book Value |
|---|---|
| 2009 | $ |
| 2010 | |
| 2011 | 85,945 |
| 2012 | 85,562 |
| 2013 and thereafter | |
| Total | $ 171,507 |

## 5. Related-Party Transactions

***Management Agreement***

The Company entered into a management agreement with our Manager upon closing of our initial public offering, which provides for an initial term of three years with automatic one-year extensions thereafter unless terminated as described below. Under the management agreement, our Manager, subject to the oversight of our Board of Directors, is required to manage the day-to-day activities of the Company, for which the Manager receives a base management fee and is eligible for an incentive fee and stock awards. The Manager is also entitled to charge the Company for certain expenses incurred on behalf of the Company.

In accordance with the management agreement, the Company pays the Manager an annual base management fee calculated as 1.5% per annum of stockholders equity less adjustments for unrealized gains (losses) and other non-cash items affecting stockholders equity and less any common stock repurchased since inception. These fees are payable quarterly in arrears and adjustments shall be made at the end of each calendar year to reflect the actual management fees payable for the year. For the period ended September 30, 2009, approximately $1.7 million was incurred and payable to the Manager for base management fees.

**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**

Notes To Condensed Consolidated Financial Statements (Unaudited)

**September 30, 2009**

The Manager will be entitled to an incentive fee with respect to each calendar quarter based on annualized Core Earnings as defined below. The incentive fee is calculated as 20% of the excess of Core Earnings over 8% of the weighted average shares outstanding times the weighted average public offering issue price. Core Earnings is a non-GAAP measure defined as GAAP net income (loss) excluding non-cash equity compensation expense, the incentive fee, unrealized gains, losses, or other non-cash items. The incentive fee shall be payable one-half in common stock so long as the ownership of shares by the Manager does not exceed the 9.8% stock ownership limit set forth in the Company charter. As of September 30, 2009, no incentive fee was earned by the Manager.

The Company will be required to reimburse the Manager for operating expenses incurred by the Manager on behalf of the REIT, including legal, accounting, due diligence, executive compensation and other services. The expense reimbursement is not subject to any dollar limitations but will be subject to review by the Company s Board of Directors. For the period ended September 30, 2009, approximately $30,000 was incurred and payable to the Manager for executive compensation and other reimbursable expenses.

Prior to commencement of operations, the Manager advanced approximately $148,000 to the Company for the initial capitalization and cash for payment of SEC and other required filing fees in connection with the initial public offering. The Company repaid the cash advances in full after receipt of the proceeds from the initial public offering.

In connection with the initial public offering, the Company incurred an estimated $525,000 for services provided by parties related to affiliates of our Manager. As of September 30, 2009, these costs had been recorded as related-party payable and a reduction in additional paid-in capital.

After the initial three-year term, the Company can terminate the management agreement without cause with an affirmative two thirds vote by the independent directors and 180 days written notice to the Manager. Upon termination without cause, the Manager is due a termination fee equal to three times the sum of the average annual base management fee and incentive fee earned by the Manager over the preceding eight calendar quarters. No termination fee is payable if the Manager is terminated for cause, as defined in the management agreement, which can be done at anytime with 30 days written notice from the Company s board of directors.

**6. Stockholders Equity**

Our authorized capital stock consists of 100,000,000 shares of preferred stock, $0.01 par value and 500,000,000 shares of common stock, $0.01 par value.

On August 17, 2009, the Company completed its initial public offering, in which it sold 46,575,000 shares of common stock for $20 per share, and a concurrent private placement to an entity controlled by Starwood Capital Group of an additional 1,000,000 shares of common stock for $20 per share. The Company s total net proceeds from these offerings was approximately $921.1 million, excluding $27.2 million contingent underwriter fee (see Note 9).

The Company declared a dividend of $0.01 and $0.10 per share for the third and fourth quarters of 2009, respectively, on September 18, 2009. The dividends will be paid on January 29, 2010, to shareholders of record on October 31, 2009 and December 30, 2009, respectively.

***Equity Incentive Plans***

The Company has reserved 3,112,500 shares of common stock for issuance under the Equity Plan and Manager Equity Plan and an additional 100,000 shares of common stock for issuance under the Director Stock Plan. These plans provide for the issuance of restricted stock or restricted stock units. The holders of awards of restricted stock or restricted stock units will be entitled to receive dividends or distribution equivalents, which in either case will be payable at such time dividends are paid on outstanding shares.

**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

The Company granted each of its four directors 2,200 restricted shares in August 2009, with a total fair value of $176,000. The awards will vest ratably in three annual installments on each of the first second and third anniversaries of the grant, subject to the director s continued service. As of September 30, 2009, approximately $7,000 was included in general and administrative expense related to the grants.

In August 2009, the Company granted 1,037,500 restricted stock units with a fair value of approximately $20.8 million at the grant date to the Manager under the Manager Equity Plan. The award will vest ratably in quarterly installments over three years beginning on October 1, 2009. As of September 30, 2009, approximately $811,000 was included in Manager stock-based payment expense related to this grant.

The Company granted 5,000 restricted stock units with a fair value of $100,000 to employees under the Equity Plan in August 2009. The award will vest ratably in quarterly installments over three years beginning on October 1, 2009. As of September 30, 2009, approximately $4,000 was included in general and administrative expense related to this grant.

**7. Net Loss per Share**

Net loss per share for the period since commencement of operations through September 30, 2009, is computed as follows (amounts in thousands except share and per share):

| | | |
|---|---|---|
| **Basic:** | | |
| Net loss attributable to Starwood Property Trust, Inc. | $ | (1,919) |
| Weighted average number of common shares outstanding | | 47,575,000 |
| Basic net loss per common share | $ | (0.04) |
| **Diluted:** | | |
| Net loss attributable to Starwood Property Trust, Inc. | $ | (1,919) |
| Weighted average number of common shares outstanding | | 47,575,000 |
| Additional shares due to assumed conversion of dilutive instruments | | |
| Adjusted weighted average number of common shares outstanding | | 47,575,000 |
| Diluted net loss per common share | $ | (0.04) |

Potentially dilutive shares relating to 1,051,300 shares of restricted stock and restricted stock units are not included in the calculation of diluted net loss per share because the effect was antidilutive for the period ended September 30, 2009.

**8. Fair Value of Financial Instruments**

In cases where quoted market prices are not available, fair values are based upon the estimation of discount rates to estimated future cash flows using market yields or other valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair value. Accordingly, fair values are not necessarily indicative of the amount the Company could realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

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**STARWOOD PROPERTY TRUST, INC. and Subsidiaries**
Notes To Condensed Consolidated Financial Statements (Unaudited)
**September 30, 2009**

Due to the short maturities of cash and cash equivalents, accrued interest, and accounts payable, the carrying value was deemed to be an approximation of the fair value. The fair value of investment securities were based upon valuations obtained from dealers of those securities. The fair value of the secured financing facilities was based on a discounted cash flow analysis using the TALF rates on September 25, 2009.

| | Carrying Value | Fair Value |
|---|---|---|
| Financial Assets: | | |
| CMBS | $ 202,635 | $ 203,203 |
| Financial Liabilities: | | |
| Secured financing | $ 171,507 | $ 171,507 |

**9. Commitments and Contingencies**

In connection with the Company s initial public offering, the Company is required to pay $27.2 million of underwriters fee if the Company s Core Earnings exceeds an 8% performance hurdle rate over four consecutive quarters as defined in the underwriters agreement. Based on our original business plan, the Company expects to achieve this level of earnings. Therefore, the Company recorded a deferred liability and an offsetting reduction in additional paid-in capital for the full $27.2 million.

The Company has made a $5 million non-refundable deposit related to an agreement to acquire a portfolio of loans with $147.5 million principal value secured by seven properties located in the Southeast and leased a single tenant for approximately $110 million.

Management is not aware of any other contractual obligations, legal proceedings, or any other contingent obligations incurred in the normal course of business that would have a material adverse effect on the Company s financial statements.

**10. Subsequent Events**

The Company has evaluated subsequent events through November 16, 2009, the date these financial statements were issued, and determined that there have not been any events that have occurred that would require adjustments to or disclosures in the unaudited consolidated financial statements except for the following:

In October 2009, the Company acquired approximately $13 million face value of bonds secured by a mortgage on a New York City hotel for approximately $11 million.

In November 2009, the Company acquired a portfolio of loans with $147.5 million principal value secured by seven properties located in the Southeast and leased to a single tenant for approximately $110 million.

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## Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

*In this quarterly report on Form 10-Q, or this report , we refer to Starwood Property Trust, Inc. and our subsidiaries as we , us , the Company , or our unless we specifically state otherwise.*

The following should be read in conjunction with the consolidated financial statements and notes included herein. This Management s Discussion and Analysis of Financial Condition and Results of Operations contains certain Non-GAAP financial measures. See Non-GAAP Financial Measures and supporting schedules for reconciliation of our Non-GAAP financial measures to the comparable GAAP financial measures.

**Overview**

Starwood Property Trust, Inc. is a newly organized Maryland corporation focused primarily on originating, investing in, and financing commercial mortgage loans and other commercial real estate debt investments, commercial mortgage-backed securities ( CMBS ), and other commercial real estate-related debt investments. We may also invest in residential mortgage loans, residential mortgage-backed securities ( RMBS ) for which a U.S. Government agency or a federally chartered corporation guarantees payments of principal and interest on the securities, or Agency RMBS, and RMBS that are not guaranteed by any U.S. Government agency or federally chartered corporation, or Non-Agency RMBS. We collectively refer to commercial mortgage loans, other commercial real estate debt investments, CMBS, other commercial real estate-related debt investments, residential mortgage loans, and RMBS as our target assets.

Initially, we expect to focus on opportunities that exist in the U.S. commercial mortgage loan, commercial real estate debt, and CMBS markets. 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 believe that the diversification of our portfolio of assets, our expertise among the target asset classes, and the flexibility of our strategy will position us to generate attractive risk-adjusted returns for our stockholders in a variety of assets and market conditions.

We intend to construct a diversified investment portfolio by focusing on asset selection and the relative value of various sectors within the debt market. Initially, we expect to finance our investments with financing under the Federal Reserve s Term Asset-Backed Securities Loan Facility ( TALF ) or U.S. Treasury s Public-Private Investment Program ( PPIP ), to the extent available to us, as well as through securitizations and other sources of financing that may be available to u