

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

Ares Commercial Real Estate Corp
Form 10-Q
November 01, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from _____ to _____

Commission File No. 001-35517

ARES COMMERCIAL REAL ESTATE CORPORATION

(Exact name of Registrant as specified in its charter)

Maryland 45-3148087

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

245 Park Avenue, 42nd Floor, New York, NY 10167

(Address of principal executive offices) (Zip Code)

(212) 750-7300

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes ý 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See 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 o Accelerated filer x

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a 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 7(a)(2)(B) of the Securities Act. ☒

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

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

Class	Outstanding at October 31, 2017
Common stock, \$0.01 par value	28,589,968

ARES COMMERCIAL REAL ESTATE CORPORATION

INDEX

Part I. Financial Information

Item 1. Consolidated Financial Statements

Consolidated Balance Sheets as of September 30, 2017 (unaudited) and December 31, 2016 2

Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016 (unaudited) 3

Consolidated Statement of Equity for the nine months ended September 30, 2017 (unaudited) 4

Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016 (unaudited) 5

Notes to Consolidated Financial Statements (unaudited) 6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 29

Item 3. Quantitative and Qualitative Disclosures About Market Risk 40

Item 4. Controls and Procedures 42

Part II. Other Information

Item 1. Legal Proceedings 42

Item 1A. Risk Factors 42

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 42

Item 3. Defaults Upon Senior Securities 42

Item 4. Mine Safety Disclosures 42

Item 5. Other Information 42

Item 6. Exhibits 43

PART I — FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	As of September 30, 2017 (unaudited)	December 31, 2016
ASSETS		
Cash and cash equivalents (\$8 related to consolidated VIEs as of December 31, 2016)	\$28,245	\$47,270
Restricted cash	379	375
Loans held for investment (\$341,158 and \$21,514 related to consolidated VIEs, respectively)	1,543,261	1,313,937
Other assets (\$873 and \$203 of interest receivable related to consolidated VIEs, respectively)	15,583	12,121
Total assets	\$1,587,468	\$1,373,703
LIABILITIES AND EQUITY		
LIABILITIES		
Secured funding agreements	\$730,228	\$780,713
Secured term loan	151,761	149,878
Collateralized loan obligation securitization debt (consolidated VIE)	270,961	—
Due to affiliate	2,567	2,699
Dividends payable	7,717	7,406
Other liabilities (\$374 of interest payable related to consolidated VIEs as of September 30, 2017)	3,734	3,334
Total liabilities	1,166,968	944,030
Commitments and contingencies (Note 5)		
EQUITY		
Common stock, par value \$0.01 per share, 450,000,000 shares authorized at September 30, 2017 and December 31, 2016, and 28,582,690 and 28,482,756 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	283	283
Additional paid-in capital	420,428	420,056
Accumulated deficit	(211)	(1,310)
Total stockholders' equity	420,500	419,029
Non-controlling interests in consolidated VIEs	—	10,644
Total equity	420,500	429,673
Total liabilities and equity	\$1,587,468	\$1,373,703

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net interest margin:				
Interest income from loans held for investment	\$28,551	\$ 20,776	\$72,321	\$ 58,455
Interest expense	(13,825)	(9,018)	(36,845)	(25,958)
Net interest margin	14,726	11,758	35,476	32,497
Expenses:				
Management and incentive fees to affiliate	1,554	1,690	5,020	4,380
Professional fees	350	678	1,169	1,703
General and administrative expenses	724	690	2,006	2,099
General and administrative expenses reimbursed to affiliate	986	860	2,883	2,417
Total expenses	3,614	3,918	11,078	10,599
Income from continuing operations before income taxes	11,112	7,840	24,398	21,898
Income tax expense, including excise tax	54	161	149	168
Net income from continuing operations	11,058	7,679	24,249	21,730
Net income from operations of discontinued operations, net of income taxes	—	1,866	—	4,221
Gain on sale of discontinued operations	—	10,196	—	10,196
Net income attributable to ACRE	11,058	19,741	24,249	36,147
Less: Net income attributable to non-controlling interests	—	(1,299)	(25)	(3,876)
Net income attributable to common stockholders	\$11,058	\$ 18,442	\$24,224	\$ 32,271
Basic earnings per common share:				
Continuing operations	\$0.39	\$ 0.22	\$0.85	\$ 0.63
Discontinued operations	—	0.42	—	0.51
Net income	\$0.39	\$ 0.65	\$0.85	\$ 1.13
Diluted earnings per common share:				
Continuing operations	\$0.39	\$ 0.22	\$0.85	\$ 0.63
Discontinued operations	—	0.42	—	0.51
Net income	\$0.39	\$ 0.65	\$0.85	\$ 1.13
Weighted average number of common shares outstanding:				
Basic weighted average shares of common stock outstanding	28,481,292	28,428,766	28,475,362	28,462,143
Diluted weighted average shares of common stock outstanding	28,582,690	28,513,137	28,537,723	28,536,921
Dividends declared per share of common stock	\$0.27	\$ 0.26	\$0.81	\$ 0.78

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

(in thousands, except share and per share data)

(unaudited)

	Common Stock		Additional	Accumulated	Total	Non-Controlling	Total
	Shares	Amount	Paid-in Capital	Deficit	Stockholders' Equity	Interests	Equity
Balance at December 31, 2016	28,482,756	\$ 283	\$ 420,056	\$ (1,310)	\$ 419,029	\$ 10,644	\$ 429,673
Stock based compensation	99,934	—	372	—	372	—	372
Net income	—	—	—	24,224	24,224	25	24,249
Dividends declared	—	—	—	(23,125)	(23,125)	—	(23,125)
Contributions from non-controlling interests	—	—	—	—	—	12	12
Distributions to non-controlling interests	—	—	—	—	—	(10,681)	(10,681)
Balance at September 30, 2017	28,582,690	\$ 283	\$ 420,428	\$ (211)	\$ 420,500	\$ —	\$ 420,500

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the nine months ended September 30,	
	2017	2016
	(unaudited)	(unaudited)
Operating activities:		
Net income	\$24,249	\$ 36,147
Adjustments to reconcile net income to net cash provided by (used in) operating activities (inclusive of amounts related to discontinued operations):		
Amortization of deferred financing costs	5,596	4,782
Change in mortgage banking activities	—	(10,386)
Change in fair value of mortgage servicing rights	—	6,457
Accretion of deferred loan origination fees and costs	(4,893)	(3,717)
Provision for loss sharing	—	(146)
Cash paid to settle loss sharing obligations	—	(681)
Originations of mortgage loans held for sale	—	(639,413)
Sale of mortgage loans held for sale to third parties	—	571,714
Stock-based compensation	372	202
Gain on sale of discontinued operations	—	(10,196)
Depreciation expense	—	167
Deferred tax expense	—	2,049
Changes in operating assets and liabilities:		
Restricted cash	(4)	1,411
Other assets	(1,988)	39,706
Due to affiliate	(132)	284
Other liabilities	692	1,805
Net cash provided by (used in) operating activities	23,892	185
Investing activities:		
Issuance of and fundings on loans held for investment	(504,554)	(782,364)
Principal repayment of loans held for investment	273,985	444,272
Receipt of origination fees	6,138	6,009
Proceeds from sale of discontinued operations, net of cash sold	—	89,981
Purchases of other assets	—	(354)
Net cash provided by (used in) investing activities	(224,431)	(242,456)
Financing activities:		
Proceeds from secured funding agreements	533,880	1,288,698
Repayments of secured funding agreements	(584,365)	(932,371)
Payment of secured funding costs	(7,445)	(4,221)
Proceeds from issuance of debt of consolidated VIEs	272,927	—
Repayments of debt of consolidated VIEs	—	(197,445)
Proceeds from warehouse lines of credit	—	863,382
Repayments of warehouse lines of credit	—	(795,684)
Proceeds from secured term loan	—	80,000
Repurchase of common stock	—	(1,436)
Dividends paid	(22,814)	(21,994)
Contributions from non-controlling interests	12	11

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

Distributions to non-controlling interests	(10,681)	(3,896)
Net cash provided by (used in) financing activities	181,514	275,044
Change in cash and cash equivalents	(19,025)	32,773
Cash and cash equivalents of continuing operations, beginning of period	47,270	5,066
Cash and cash equivalents of discontinued operations, beginning of period	—	3,929
Cash and cash equivalents, end of period	\$28,245	\$ 41,768
Cash and cash equivalents of continuing operations, end of period	\$28,245	\$ 41,768
Cash and cash equivalents of discontinued operations, end of period	\$—	\$—

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2017

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

1. ORGANIZATION

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

The Company is primarily focused on directly originating and managing a diversified portfolio of CRE debt-related investments for the Company’s own account. The Company’s target investments include senior mortgage loans, subordinated debt, preferred equity, mezzanine loans and other CRE investments, including commercial mortgage backed securities. These investments are generally held for investment and are secured, directly or indirectly, by office, multifamily, retail, industrial, lodging, senior-living, self-storage and other commercial real estate properties, or by ownership interests therein.

On June 28, 2016, the Company entered into a Purchase and Sale Agreement (as amended, the “Agreement”) with Barings Real Estate Advisers LLC (formerly known as Cornerstone Real Estate Advisers LLC), a Delaware limited liability company (the “Buyer”), to sell ACRE Capital Holdings LLC (“TRS Holdings”), the holding company that owned the Company’s mortgage banking subsidiary, ACRE Capital LLC (“ACRE Capital”). Under the terms and subject to the conditions set forth in the Agreement, on September 30, 2016, the Buyer purchased from the Company all of the outstanding common units of TRS Holdings (the “ACRE Capital Sale”). ACRE Capital primarily originated, sold and serviced multifamily and senior-living related loans under programs offered by government-sponsored enterprises and by government agencies. Under the terms of the Agreement, the Buyer paid approximately \$93 million in cash as consideration for the ACRE Capital Sale.

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

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and the related management's discussion and analysis of financial condition and results of operations included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 filed with the SEC.

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

Basis of Presentation

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

operations and financial condition as of and for the periods presented. All intercompany balances and transactions have been eliminated.

Interim financial statements are prepared in accordance with GAAP and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The current period's results of operations will not necessarily be indicative of results that ultimately may be achieved for the year ending December 31, 2017.

Discontinued Operations

As discussed in Note 1 included in these consolidated financial statements, the Company completed the ACRE Capital Sale on September 30, 2016. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 205-20, Presentation of Financial Statements - Discontinued Operations, defines the criteria required for a disposal transaction to qualify for reporting as a discontinued operation. The Company determined that the ACRE Capital Sale met the criteria for discontinued operations. As a result, the operating results of ACRE Capital, which formerly comprised the Mortgage Banking segment, are presented separately in the Company's consolidated financial statements as discontinued operations for the three and nine months ended September 30, 2016. The operating results of discontinued operations are included in the line item "Net income from operations of discontinued operations, net of income taxes" in the consolidated statements of operations for the three and nine months ended September 30, 2016. Summarized financial information for the discontinued Mortgage Banking segment is shown in Note 13 included in these consolidated financial statements.

Variable Interest Entities

The Company evaluates all of its interests in VIEs for consolidation. When the Company's interests are determined to be variable interests, the Company assesses whether it is deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. FASB ASC Topic 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. The Company considers its variable interests, as well as any variable interests of its related parties in making this determination. Where both of these factors are present, the Company is deemed to be the primary beneficiary and it consolidates the VIE. Where either one of these factors is not present, the Company is not the primary beneficiary and it does not consolidate the VIE.

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

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

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

The Company performs an ongoing reassessment of: (1) whether any entities previously evaluated under the majority voting interest framework have become VIEs, based on certain events, and therefore are subject to the VIE consolidation framework, and (2) whether changes in the facts and circumstances regarding its involvement with a VIE cause the Company's consolidation conclusion regarding the VIE to change. See Note 12 included in these consolidated financial statements for further discussion of the Company's VIEs.

Loans Held for Investment

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

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

In addition, the Company evaluates the entire portfolio to determine whether the portfolio has any impairment that requires a valuation allowance on the remainder of the loan portfolio. As of September 30, 2017 and December 31, 2016, the Company did not recognize any impairment charges with respect to its loans held for investment.

Loans are generally placed on non-accrual status when principal or interest payments are past due 30 days or more or when there is reasonable doubt that principal or interest will be collected in full. Accrued and unpaid interest is generally reversed against interest income in the period the loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment regarding the borrower's ability to make pending principal and interest payments. Non-accrual loans are restored to accrual status when past due principal and interest are paid and, in management's judgment, are likely to remain current. The Company may make exceptions to placing a loan on non-accrual status if the loan has sufficient collateral value and is in the process of collection.

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

Debt Issuance Costs

Debt issuance costs under the Company's indebtedness are capitalized and amortized over the terms of the respective debt instrument. Debt issuance costs related to debt securitizations are capitalized and amortized over the term of the underlying loans using the effective interest method. When an underlying loan is prepaid in a debt securitization and the outstanding principal balance of the securitization debt is reduced, the related unamortized debt issuance costs are

charged to expense based on a pro rata share of the debt issuance costs being allocated to the specific loans that were prepaid. Amortization of debt issuance costs is included within interest expense in the Company's consolidated statements of operations while the unamortized balance on (i) Secured Funding Agreements (each individually defined in Note 4 included in these consolidated financial statements) is included within other assets and both (ii) the Secured Term Loan (defined in Note 4 included in these consolidated financial statements) and (iii) debt securitizations are included as a reduction to the carrying amount of the liability, in the Company's consolidated balance sheets.

The original issue discount ("OID") on amounts drawn under the Company's Secured Term Loan represents a discount to the face amount of the drawn debt obligations. The OID is amortized over the term of the Secured Term Loan using the effective interest method and is included within interest expense in the Company's consolidated statements of operations while the unamortized balance is a reduction to the carrying amount of the Secured Term Loan in the Company's consolidated balance sheets.

Revenue Recognition

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

A reconciliation of the Company's interest income from loans held for investment, excluding non-controlling interests, to the Company's interest income from loans held for investment as included within its consolidated statements of operations for the three and nine months ended September 30, 2017 and 2016 is as follows (\$ in thousands):

	For the three months ended September 30, 2017		For the nine months ended September 30, 2016	
Interest income from loans held for investment, excluding non-controlling interests	\$28,551	\$19,473	\$72,286	\$54,573
Interest income from non-controlling interest investment held by third parties	—	1,303	35	3,882
Interest income from loans held for investment	\$28,551	\$20,776	\$72,321	\$58,455

Net Interest Margin and Interest Expense

Net interest margin in the Company's consolidated statements of operations serves to measure the performance of the Company's loans held for investment as compared to its use of debt leverage. The Company includes interest income from its loans held for investment and interest expense related to its Secured Funding Agreements, securitizations debt and the Secured Term Loan (individually defined in Note 4 included in these consolidated financial statements) in net interest margin. For the three and nine months ended September 30, 2017 and 2016, interest expense is comprised of the following (\$ in thousands):

	For the three months ended September 30, 2017		For the nine months ended September 30, 2016	
Secured funding agreements and securitizations debt	\$10,312	\$6,914	\$26,635	\$20,339
Secured term loan	3,513	2,104	10,210	5,619
Interest expense	\$13,825	\$9,018	\$36,845	\$25,958

Comprehensive Income

For the three and nine months ended September 30, 2017 and 2016, comprehensive income equaled net income; therefore, a separate consolidated statement of comprehensive income is not included in the accompanying consolidated financial statements.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this ASU supersedes the revenue recognition requirements in Revenue Recognition (Topic 605). Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU No. 2014-09 are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal Versus Agent Considerations, which clarifies the guidance in ASU No. 2014-09 and has the same effective date as the original standard. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, an update on identifying performance obligations and

accounting for licenses of intellectual property. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which includes amendments for enhanced clarification of the guidance. In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Revenue from Contracts with Customers (Topic 606), the amendments in this update are of a similar nature to the items typically addressed in the technical corrections and improvements project. Additionally, in February

2017, the FASB issued ASU No. 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets, an update on clarifying that a financial asset is within the scope of Subtopic 610-20 if it is deemed an “in-substance non-financial asset.” The application of this guidance is not expected to have a material impact on the Company’s consolidated financial statements, primarily because the majority of the Company’s revenue is accounted for under FASB ASC Topic 310, Receivables, which is scoped out of this standard.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The standard will replace the incurred loss impairment methodology pursuant to GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU No. 2016-13 is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period, with early adoption permitted after December 15, 2018, including interim periods within that reporting period. The Company is currently evaluating the impact of adopting this ASU on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which intends to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. ASU No. 2016-15 provides guidance on eight specific cash flow issues and clarifies that in the absence of specific guidance, an entity should classify each separately identifiable cash source and use on the basis of the nature of the underlying cash flows. For cash flows with aspects of more than one class that cannot be separated, the classification should be based on the activity that is likely to be the predominant source or use of cash flow. ASU No. 2016-15 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, with early adoption permitted. The Company is currently evaluating the impact of adopting this ASU on its consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (A Consensus of the FASB Emerging Issues Task Force). The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU No. 2016-18 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, with early adoption permitted. The adoption of this ASU will impact the presentation of the statement of cash flows, as well as require additional footnote disclosure to reconcile the balance sheet to the revised cash flow statement presentation.

3. LOANS HELD FOR INVESTMENT

As of September 30, 2017, the Company’s portfolio totaled 36 loans held for investment, excluding 55 loans that were repaid or sold since inception. The aggregate originated commitment under these loans at closing was approximately \$1.7 billion and outstanding principal was \$1.6 billion as of September 30, 2017. During the nine months ended September 30, 2017, the Company funded approximately \$504.6 million of outstanding principal and received repayments of \$263.4 million of outstanding principal, excluding non-controlling interests held by third parties, as described in more detail in the tables below. Such investments are referred to herein as the Company’s “investment portfolio.” As of September 30, 2017, 89.3% of the Company’s loans have London Interbank Offered Rate (“LIBOR”) floors, with a weighted average floor of 0.61%, calculated based on loans with LIBOR floors. References to LIBOR or “L” are to 30-day LIBOR (unless otherwise specifically stated).

The Company’s investments in loans held for investment are accounted for at amortized cost. The following tables summarize the Company’s loans held for investment as of September 30, 2017 and December 31, 2016 (\$ in

thousands):

10

As of September 30, 2017

	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Minimum Loan Borrowing Spread (2)	Weighted Average Unleveraged Effective Yield (3)	Weighted Average Remaining Life (Years)
Senior mortgage loans	\$1,483,786	\$1,492,488	4.8 %	6.0 %	1.7
Subordinated debt and preferred equity investments	59,475	60,276	10.3 %	11.4 %	3.2
Total loans held for investment portfolio	\$1,543,261	\$1,552,764	5.0 %	6.2 %	1.8

As of December 31, 2016

	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Minimum Loan Borrowing Spread (2)	Weighted Average Unleveraged Effective Yield (3)	Weighted Average Remaining Life (Years)
Senior mortgage loans	\$1,181,569	\$1,188,425	4.7 %	5.7 %	1.8
Subordinated debt and preferred equity investments	121,828	123,230	10.7 %	11.5 %	4.1
Total loans held for investment portfolio (excluding non-controlling interests held by third parties) (4)	\$1,303,397	\$1,311,655	5.2 %	6.3 %	2.0

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

Minimum Loan Borrowing Spread is equal to (a) for floating rate loans, the margin above the applicable index rate (e.g., LIBOR) plus floors, if any, on such applicable index rates, and (b) for fixed rate loans, the applicable interest rate.

Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults. The Total Weighted Average Unleveraged Effective Yield is calculated based on the average of Unleveraged Effective Yield of all loans held by the Company as of September 30, 2017 and December 31, 2016 as weighted by the Outstanding Principal balance of each loan.

(4) The table above as of December 31, 2016 excludes non-controlling interests held by third parties. A reconciliation of the Carrying Amount of loans held for investment portfolio, excluding non-controlling interests held by third parties, to the Carrying Amount of loans held for investment, as included in the Company's consolidated balance sheets, is presented below.

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

As of December 31,
2016

	Carrying Amount	Outstanding Principal
Total loans held for investment portfolio (excluding non-controlling interests held by third parties)	\$ 1,303,397	\$ 1,311,655
Non-controlling interest investment held by third parties	10,540	10,540
Loans held for investment	\$ 1,313,937	\$ 1,322,195

As of September 30, 2017, there were no non-controlling interests held by third parties.

A more detailed listing of the Company's investment portfolio based on information available as of September 30, 2017 is as follows (\$ in millions, except percentages):

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

Loan Type	Location	Outstanding Principal (1)	Carrying Amount (1)	Interest Rate	Unleveraged Effective Yield (2)	Maturity Date (3)	Payment Terms (4)	
Senior Mortgage Loans:								
Various	(5) Diversified	\$159.2	\$158.5	L+4.35%	6.2%	Oct 2018(5)	I/O	
Office	TX	96.0	95.0	L+3.60%	5.3%	July 2020	I/O	
Multifamily	FL	89.7	89.4	L+4.75%	6.5%	Sep 2019	I/O	
Various	(6) Diversified	82.3	81.9	L+4.75%	6.6%	Oct 2018(6)	I/O	
Retail	IL	75.9	75.9	L+4.00%	5.7%	Nov 2017(7)	I/O	
Mixed-use	NY	65.6	65.3	L+4.16%	5.8%	Apr 2019	I/O	
Office	TX	63.9	63.5	L+4.30%	6.4%	Dec 2018	I/O	
Office	CA	57.7	57.3	L+4.40%	6.2%	Aug 2019	I/O	
Office	IL	55.9	55.4	L+3.99%	5.7%	Aug 2019	I/O	
Multifamily	FL	53.8	53.3	L+3.65%	5.3%	Mar 2021	I/O	
Office	CO	53.4	52.8	L+4.15%	5.8%	June 2021	I/O	
Office	NJ	48.4	47.9	L+4.65%	6.5%	July 2020	I/O	
Multifamily	FL	45.4	45.2	L+4.75%	6.5%	Sep 2019	I/O	
Student Housing	CA	41.8	41.4	L+3.95%	5.7%	July 2020	I/O	
Student Housing	NC	38.4	38.0	L+4.75%	7.0%	Feb 2019	I/O	
Hotel	NY	37.3	37.2	L+4.75%	6.4%	June 2018	I/O	
Hotel	MI	35.2	35.2	L+4.15%	5.4%	July 2018 (8)	I/O	
Multifamily	MN	34.1	33.9	L+4.75%	6.5%	Oct 2019	I/O	
Industrial	OH	32.3	32.3	L+4.20%	5.7%	May 2018	P/I	(9)
Office	OR	31.5	31.4	L+3.75%	5.4%	Oct 2018	I/O	
Multifamily	NY	31.4	31.2	L+4.55%	6.3%	Feb 2019	I/O	
Multifamily	NY	29.4	29.3	L+3.75%	5.4%	Oct 2018 (10)	I/O	(9)
Multifamily	TX	27.5	27.3	L+3.20%	4.9%	Oct 2020	I/O	
Multifamily	TX	26.3	26.2	L+3.80%	5.2%	Jan 2019	I/O	
Multifamily	CA	25.1	24.9	L+3.85%	5.6%	July 2020	I/O	
Student Housing	AL	24.1	23.9	L+4.45%	6.2%	Feb 2020	I/O	
Multifamily	FL	21.9	21.8	L+4.25%	6.2%	Feb 2019	I/O	
Multifamily	CA	21.6	21.5	L+3.90%	5.5%	Mar 2021	I/O	
Office	CO	19.6	19.6	L+3.95%	5.6%	Dec 2017	I/O	
Office	PA	19.6	19.5	L+4.70%	6.4%	Mar 2020	I/O	
Office	FL	18.4	18.2	L+4.30%	6.1%	Apr 2020	I/O	
Multifamily	NY	16.3	16.3	L+3.85%	5.4%	Nov 2017	I/O	
Multifamily	CA	13.5	13.3	L+3.80%	5.5%	July 2020	I/O	

Subordinated Debt
and Preferred Equity

Investments:

Multifamily	NY	33.3	33.2	L+8.07%	9.6%	Jan 2019	I/O	
Office	NJ	17.0	16.3	12.00%	12.8%	Jan 2026	I/O	(9)
Office	TX	10.0	10.0	14.00%	15.2%	Dec 2018	I/O	
Total/Weighted Average		\$1,552.8	\$1,543.3		6.2%			

- (1) The difference between the Carrying Amount and the Outstanding Principal amount of the loans held for investment consists of unamortized purchase discount, deferred loan fees and loan origination costs. Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults. Unleveraged Effective Yield for each loan is
- (2) calculated based on LIBOR as of September 30, 2017 or the LIBOR floor, as applicable. The Weighted Average Unleveraged Effective Yield is calculated based on the average of Unleveraged Effective Yield of all loans held by the Company as of September 30, 2017 as weighted by the Outstanding Principal balance of each loan. Certain loans are subject to contractual extension options that vary between one and two 12-month extensions and may be subject to performance based or other conditions as stipulated in the loan agreement. Actual maturities may
- (3) differ from contractual maturities stated herein as certain borrowers may have the right to prepay with or without paying a prepayment penalty. The Company may also extend contractual maturities and amend other terms of the loans in connection with loan modifications.
- (4) I/O = interest only, P/I = principal and interest. The senior mortgage loan is collateralized by a portfolio of self-storage, retail and office properties. The total principal balance of the senior mortgage loan is \$159.2 million as of September 30, 2017, of which \$122.2 million
- (5) is allocable to the self-storage properties and \$37.0 million is allocable to the retail and office properties. The borrower was obligated to repay an amount equal to \$42.5 million with respect to the retail and office properties (which includes

\$37.0 million of allocated loan amount and \$5.5 million of release premium) in September 2017, which is prior to the initial maturity date of the loan in October 2018. See below in Note 3 included in these consolidated financial statements for further discussion of this loan.

The senior mortgage loan is collateralized by a portfolio of self-storage properties and one retail property.

The total principal balance of the senior mortgage loan is \$82.3 million as of September 30, 2017, of which \$70.2 million is allocable to the self-storage properties and \$12.1 million is allocable to the retail property.

(6) The borrower was obligated to repay an amount equal to \$13.9 million with respect to the retail property (which includes \$12.1 million of allocated loan amount and \$1.8 million of release premium) in September 2017, which is prior to the initial maturity date of the loan in October 2018. See below in Note 3 included in these consolidated financial statements for further discussion of this loan.

(7) In July 2017, the Company and the borrower entered into an amendment to the loan agreement, which extended the maturity date on the senior Illinois loan from August 2017 to November 2017.

(8) In April 2017, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior Michigan loan to July 2018.

In May 2017, amortization began on the senior Ohio loan, which had an outstanding principal balance of \$32.3 million as of September 30, 2017. In October 2017, amortization will begin on the senior New York loan, which had an outstanding principal balance of \$29.4 million as of September 30, 2017. In February 2021, amortization will begin on the subordinated New Jersey loan, which had an outstanding principal balance of \$17.0 million as of September 30, 2017. The remainder of the loans in the Company's portfolio are non-amortizing through their primary terms.

(10) In August 2017, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior New York loan to October 2018.

The Company has made, and may continue to make, modifications to loans, including loans that are in default. Loan terms that may be modified include interest rates, required prepayments, asset release prices, maturity dates, covenants, principal amounts and other loan terms. The terms and conditions of each modification vary based on individual circumstances and will be determined on a case by case basis.

For the nine months ended September 30, 2017, the activity in the Company's loan portfolio was as follows (\$ in thousands):

Balance at December 31, 2016	\$1,313,937
Initial funding	491,561
Origination fees and discounts, net of costs	(6,138)
Additional funding	12,993
Amortizing payments	(251)
Loan payoffs	(273,734)
Origination fee accretion	4,893
Balance at September 30, 2017	\$1,543,261

As of September 30, 2017, the following two senior mortgage loans, which were made to affiliated borrowers controlled indirectly by the same individual, are each in an event of default.

As of September 30, 2017, the \$159.2 million senior mortgage loan collateralized by a portfolio of self-storage, retail and office properties is in payment default due to the failure of the borrower to repay an amount equal to \$42.5 million with respect to the retail and office properties (which includes \$37.0 million of allocated loan amount and \$5.5 million of release premium). This payment amount was due in September 2017, which is prior to the initial maturity date of the loan in October 2018. The Company evaluated this loan for impairment and concluded that no impairment charge should be recognized as of September 30, 2017 and that this loan should not be placed on non-accrual status as of

September 30, 2017. This conclusion was based on the following: (1) the current estimated fair market value of the underlying collateral and applicable reserves, (2) the estimated cash flow from operations of the underlying collateral and (3) the recourse payment guarantee of up to \$40.2 million from an individual that is the indirect owner of the underlying collateral and an affiliate of the borrower. The estimated fair market value of the underlying collateral was determined using the income capitalization approach and comparable market sales approach. As of September 30, 2017, the loan is current on its interest payments.

As of September 30, 2017, the \$82.3 million senior mortgage loan collateralized by a portfolio of self-storage properties and one retail property is in payment default due to the failure of the borrower to repay an amount equal to \$13.9

million with respect to the retail property (which includes \$12.1 million of allocated loan amount and \$1.8 million of release premium). This payment amount was due in September 2017, which is prior to the initial maturity date of the loan in October 2018. The Company evaluated this loan for impairment and concluded that no impairment charge should be recognized as of September 30, 2017 and that this loan should not be placed on non-accrual status as of September 30, 2017. This conclusion was based on the following: (1) the current estimated fair market value of the underlying collateral and applicable reserves, (2) the estimated cash flow from operations of the underlying collateral and (3) the recourse payment guarantee of up to \$12.1 million from an individual that is the indirect owner of the underlying collateral and an affiliate of the borrower. The estimated fair market value of the underlying collateral was determined using the income capitalization approach and comparable market sales approach. As of September 30, 2017, the loan is current on its interest payments.

Except as described above, as of September 30, 2017, all loans were paying in accordance with their contractual terms. No impairment charges have been recognized during the three and nine months ended September 30, 2017 and 2016.

4. DEBT

Financing Agreements

The Company borrows funds, as applicable in a given period, under the Wells Fargo Facility, the Citibank Facility, the BAML Facility, the CNB Facility, the MetLife Facility, the UBS Facility and the U.S. Bank Facility (individually defined below and collectively, the “Secured Funding Agreements”) and the Secured Term Loan (as defined below). The Company refers to the Secured Funding Agreements and the Secured Term Loan as the “Financing Agreements.” The outstanding balance of the Financing Agreements in the table below are presented gross of debt issuance costs. As of September 30, 2017 and December 31, 2016, the outstanding balances and total commitments under the Financing Agreements consisted of the following (\$ in thousands):

	September 30, 2017		December 31, 2016		
	Outstanding	Total	Outstanding	Total	
	Balance	Commitment	Balance	Commitment	
Wells Fargo Facility	\$221,631	\$ 500,000	(1) \$218,064	\$ 325,000	
Citibank Facility	175,738	250,000	(2) 302,240	250,000	(2)
BAML Facility	56,320	125,000	77,679	125,000	
CNB Facility	—	50,000	—	50,000	
MetLife Facility	118,037	180,000	53,130	180,000	
UBS Facility	—	140,000	71,360	140,000	
U.S. Bank Facility	158,502	185,989	(3) 58,240	125,000	
Secured Term Loan	155,000	155,000	155,000	155,000	
Total	\$885,228	\$ 1,585,989	\$935,713	\$ 1,350,000	

- (1) In May 2017, the Company amended the Wells Fargo Facility (as defined below) to increase the facility’s commitment amount from \$325.0 million to \$500.0 million.
- (2) The Citibank Facility (as defined below) has an accordion feature that provides for an increase in the \$250.0 million commitment amount with respect to approved assets, as determined by Citibank, N.A. in its sole discretion.
- (3) In June 2017, the Company amended the U.S. Bank Facility (as defined below) to increase the facility’s commitment amount from \$125.0 million to \$186.0 million.

Some of the Company's Financing Agreements are collateralized by (i) assignments of specific loans, preferred equity or a pool of loans held for investment or loans held for sale owned by the Company, (ii) interests in the subordinated portion of the Company's securitization debt, or (iii) interests in wholly owned entity subsidiaries that hold the Company's loans held for investment. The Company is the borrower or guarantor under each of the Financing Agreements. Generally, the Company partially offsets interest rate risk by matching the interest index of loans held for investment with the Secured Funding Agreements used to fund them. The Company's Financing Agreements contain various affirmative and negative covenants, including negative pledges, and provisions regarding events of default that are normal and customary for similar financing arrangements.

Wells Fargo Facility

The Company is party to a master repurchase funding facility with Wells Fargo Bank, National Association (“Wells Fargo”) (the “Wells Fargo Facility”), which allows the Company to borrow up to \$500.0 million. Under the Wells Fargo Facility, the Company is permitted to sell, and later repurchase, certain qualifying senior commercial mortgage loans, A-Notes, pari passu participations in commercial mortgage loans and mezzanine loans under certain circumstances, subject to available collateral approved by Wells Fargo in its sole discretion. In May 2017, the Company amended the Wells Fargo Facility to increase the facility’s commitment amount from \$325.0 million to \$500.0 million and extend the initial maturity date to December 14, 2018. The initial maturity date of the Wells Fargo Facility is subject to two 12-month extensions, each of which may be exercised at the Company’s option, subject to the satisfaction of certain conditions, including payment of an extension fee, which, if both were exercised, would extend the maturity date of the Wells Fargo Facility to December 14, 2020. Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) one-month LIBOR plus (ii) a pricing margin range of 1.75% to 2.35%. The Company incurs a non-utilization fee of 25 basis points per annum on the average daily available balance of the Wells Fargo Facility to the extent less than 75% of the Wells Fargo Facility is utilized. For the three and nine months ended September 30, 2017, the Company incurred a non-utilization fee of \$148 thousand and \$240 thousand, respectively. For the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$132 thousand and \$278 thousand, respectively. The non-utilization fee is included within interest expense in the Company’s consolidated statements of operations.

Citibank Facility

The Company is party to a \$250.0 million master repurchase facility with Citibank, N.A. (“Citibank”) (the “Citibank Facility”). Under the Citibank Facility, the Company is permitted to sell and later repurchase certain qualifying senior commercial mortgage loans and A-Notes approved by Citibank in its sole discretion. The Citibank Facility has an accordion feature that provides for an increase in the \$250.0 million commitment amount with respect to approved assets, as determined by Citibank in its sole discretion. The initial maturity date of the Citibank Facility is December 10, 2018, subject to three 12-month extensions, each of which may be exercised at the Company’s option assuming no existing defaults under the Citibank Facility and applicable extension fees being paid, which, if all three were exercised, would extend the maturity date of the Citibank Facility to December 8, 2021. Advances under the Citibank Facility accrue interest at a per annum rate equal to one-month LIBOR plus a pricing margin range of 2.25% to 2.50%, subject to certain exceptions. Advances applicable to assets funded under the Citibank Facility prior to December 8, 2016 accrue interest at a per annum rate equal to one-month LIBOR plus a pricing margin range of 2.00% to 2.50%. The Company incurs a non-utilization fee of 25 basis points per annum on the average daily available balance of the Citibank Facility. For the three and nine months ended September 30, 2017, the Company incurred a non-utilization fee of \$36 thousand and \$118 thousand, respectively. For the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$3 thousand and \$95 thousand, respectively. The non-utilization fee is included within interest expense in the Company’s consolidated statements of operations.

BAML Facility

The Company is party to a \$125.0 million Bridge Loan Warehousing Credit and Security Agreement with Bank of America, N.A. (“Bank of America”) (the “BAML Facility”). Under the BAML Facility, the Company may obtain advances secured by eligible commercial mortgage loans collateralized by multifamily properties. Bank of America may approve the loans on which advances are made under the BAML Facility in its sole discretion. In May 2017, the Company amended the BAML Facility to extend the period during which the Company may request individual loans under the facility to May 24, 2018. Individual advances under the BAML Facility generally have a two-year maturity, subject to one 12-month extension at the Company’s option upon the satisfaction of certain conditions and applicable extension fees being paid. In addition, in May 2017, the final maturity date of individual loans under the BAML

Facility was extended to May 25, 2021. Advances under the BAML Facility accrue interest at a per annum rate equal to one-month LIBOR plus a spread ranging from 2.25% to 2.75% depending upon the type of asset securing such advance. The Company incurs a non-utilization fee of 12.5 basis points per annum on the average daily available balance of the BAML Facility to the extent less than 50% of the BAML Facility is utilized. For the three and nine months ended September 30, 2017, the Company incurred a non-utilization fee of \$11 thousand and \$42 thousand, respectively. For the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$20 thousand and \$52 thousand, respectively. The non-utilization fee is included within interest expense in the Company's consolidated statements of operations. See Note 14 included in these consolidated financial statements for a subsequent event related to the BAML Facility.

CNB Facility

The Company is party to a \$50.0 million secured revolving funding facility with City National Bank (the “CNB Facility”). The Company is permitted to borrow funds under the CNB Facility to finance investments and for other working capital and general corporate needs. In March 2017, the Company amended the CNB Facility to extend the initial maturity date to March 11, 2018. The Company has two 12-month extensions, each of which may be exercised at the Company’s option, subject to the satisfaction of certain conditions, including payment of an extension fee, which, if both were exercised, would extend the maturity date of the CNB Facility to March 10, 2020. Advances under the CNB Facility accrue interest at a per annum rate equal to the sum of, at the Company’s option, either (a) LIBOR for a one, two, three, six or, if available to all lenders, 12-month interest period plus 3.00% or (b) a base rate (which is the highest of a prime rate, the federal funds rate plus 0.50%, or one-month LIBOR plus 1.00%) plus 1.25%; provided that in no event shall the interest rate be less than 3.00%. Unless at least 75% of the CNB Facility is used on average, unused commitments under the CNB Facility accrue unused line fees at the rate of 0.375% per annum. For the three and nine months ended September 30, 2017, the Company incurred a non-utilization fee of \$46 thousand and \$140 thousand, respectively. For the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$28 thousand and \$74 thousand, respectively. The non-utilization fee is included within interest expense in the Company’s consolidated statements of operations.

MetLife Facility

The Company and certain of its subsidiaries are party to a \$180.0 million revolving master repurchase facility with Metropolitan Life Insurance Company (“MetLife”) (the “MetLife Facility”), pursuant to which the Company may sell, and later repurchase, commercial mortgage loans meeting defined eligibility criteria which are approved by MetLife in its sole discretion. In August 2017, the Company amended the MetLife Facility to extend the initial maturity date to August 12, 2020. The initial maturity date of the MetLife Facility is subject to two 12-month extensions, each of which may be exercised at the Company’s option, subject to the satisfaction of certain conditions, including payment of an extension fee, which, if both were exercised, would extend the maturity date of the MetLife Facility to August 12, 2022. In addition, in August 2017, the Company decreased the interest rate on advances under the MetLife Facility to a per annum rate equal to one-month LIBOR plus a spread of 2.30%. Beginning in January 2018, the Company will incur a non-utilization fee of 25 basis points per annum on the average daily available balance of the MetLife Facility to the extent less than 65% of the MetLife Facility is utilized.

UBS Facility

The Company and certain of its subsidiaries are party to a \$140.0 million revolving master repurchase facility with UBS Real Estate Securities Inc. (“UBS”) (the “UBS Facility”), pursuant to which the Company may sell, and later repurchase, commercial mortgage loans and, under certain circumstances, other assets meeting defined eligibility criteria that are approved by UBS in its sole discretion. The maturity date of the UBS Facility is October 21, 2018, subject to annual extensions in UBS’ sole discretion. The interest rate on advances under the UBS Facility is one-month LIBOR plus (a) 1.88% per annum, for assets that are subject to an advance for one year or less, (b) 2.08% per annum, for assets that are subject to an advance in excess of one year but less than two years and (c) 2.28% per annum, for assets that are subject to an advance for greater than two years.

U.S. Bank Facility

The Company and certain of its subsidiaries are party to a \$186.0 million master repurchase and securities contract with U.S. Bank National Association (“U.S. Bank”) (the “U.S. Bank Facility”). Pursuant to the U.S. Bank Facility, the Company is permitted to sell, and later repurchase, eligible commercial mortgage loans collateralized by retail, office, mixed-use, multifamily, industrial, hospitality, student housing, manufactured housing or self-storage properties. U.S.

Bank may approve the mortgage loans that are subject to the U.S. Bank Facility in its sole discretion. In June 2017, the Company amended the U.S. Bank Facility to increase the facility's commitment amount from \$125.0 million to \$186.0 million and extend the initial maturity date to July 31, 2020. The initial maturity date of the U.S. Bank Facility is subject to two 12-month extensions, each of which may be exercised at the Company's option, subject to the satisfaction of certain conditions, including payment of an extension fee, which if both were exercised, would extend the maturity date of the U.S. Bank Facility to July 31, 2022. Advances under the U.S. Bank Facility generally accrue interest at a per annum rate equal to one-month LIBOR plus a spread of 2.25%, unless otherwise agreed between U.S. Bank and the Company, depending upon the mortgage loan sold to U.S. Bank in the applicable transaction. The Company incurs a non-utilization fee of 25 basis points per annum on the average daily available balance of the U.S. Bank Facility to the extent less than 50% of the U.S. Bank Facility is utilized. For the three months ended September 30, 2017, the Company did not incur a non-utilization fee. For the nine months ended September 30, 2017, the Company incurred a non-utilization fee of \$83 thousand. For both the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$8 thousand. The non-utilization fee is included within interest expense in the Company's consolidated statements of operations.

Secured Term Loan

The Company and certain of its subsidiaries are party to a \$155.0 million Credit and Guaranty Agreement with Highbridge Principal Strategies, LLC, as administrative agent, and DBD Credit Funding LLC, as collateral agent (the “Secured Term Loan”). The Company made an initial draw of \$75.0 million on December 9, 2015, the closing date. The Company drew the remaining \$80.0 million of the Secured Term Loan on September 9, 2016. The Secured Term Loan bears interest at a per annum rate of LIBOR plus 6.0% with a LIBOR floor of 1.0% on drawn amounts. The Secured Term Loan has a maturity date of December 9, 2018. The Company was subject to a monthly non-utilization fee equal to 1.0% per annum on the unused commitment amount during the nine-month commitment period following the closing date for which the \$80.0 million of the Secured Term Loan was not utilized. For the three and nine months ended September 30, 2017, the Company did not incur a non-utilization fee. For the three and nine months ended September 30, 2016, the Company incurred a non-utilization fee of \$156 thousand and \$560 thousand, respectively. The non-utilization fee is included within interest expense in the Company’s consolidated statements of operations. The total original issue discount on the Secured Term Loan draws was \$2.3 million, which represents a discount to the debt cost to be amortized into interest expense using the effective interest method over the term of the Secured Term Loan. The estimated per annum effective interest rate of the Secured Term Loan, which is equal to LIBOR (subject to a floor of 1.0%) plus the stated rate of 6.0% plus the accretion of the original issue discount and associated costs, was 8.7% and 8.6% for the three and nine months ended September 30, 2017, respectively. For both the three and nine months ended September 30, 2016, the estimated per annum effective interest rate was 8.5%.

5. COMMITMENTS AND CONTINGENCIES

As of September 30, 2017 and December 31, 2016, the Company had the following commitments to fund various senior mortgage loans, subordinated debt investments, as well as preferred equity investments accounted for as loans held for investment (\$ in thousands):

	As of	
	September 30, 2017	December 31, 2016
Total commitments	\$1,651,467	\$1,380,805
Less: funded commitments	(1,552,764)	(1,311,655)
Total unfunded commitments	\$98,703	\$69,150

The Company from time to time may be party to litigation relating to claims arising in the normal course of business. As of September 30, 2017, the Company is not aware of any legal claims that could materially impact its business, financial condition or results of operations.

6. EQUITY

Stock Buyback Program

In May 2015, the Company announced that the Company’s board of directors authorized the Company to repurchase up to \$20.0 million of the Company’s outstanding common stock over a period of one year (the “Stock Buyback Program”). In February 2016, the Company’s board of directors increased the size of the existing \$20.0 million Stock Buyback Program to \$30.0 million and extended the Stock Buyback Program through March 31, 2017, which was not extended.

Common Stock

There were no shares issued in public or private offerings for the three and nine months ended September 30, 2017. See “Equity Incentive Plan” below for shares issued under the plan.

Equity Incentive Plan

On April 23, 2012, the Company adopted an equity incentive plan (the “2012 Equity Incentive Plan”). Pursuant to the 2012 Equity Incentive Plan, the Company may grant awards consisting of restricted shares of the Company’s common stock, restricted stock units and/or other equity-based awards to the Company’s outside directors, employees, officers, ACREM and other eligible awardees under the plan, subject to an aggregate limitation of 690,000 shares of common stock (7.5% of the issued and outstanding shares of the Company’s common stock immediately after giving effect to the issuance of the shares sold in the IPO). Any restricted shares of the Company’s common stock and restricted stock units will be accounted for under

FASB ASC Topic 718, Compensation—Stock Compensation, resulting in share-based compensation expense equal to the grant date fair value of the underlying restricted shares of common stock or restricted stock units.

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

The following table details the restricted stock grants awarded as of September 30, 2017:

Grant Date	Vesting Start Date	Shares Granted
May 1, 2012	July 1, 2012	35,135
June 18, 2012	July 1, 2012	7,027
July 9, 2012	October 1, 2012	25,000
June 26, 2013	July 1, 2013	22,526
November 25, 2013	November 25, 2016	30,381
January 31, 2014	August 31, 2015	48,273
February 26, 2014	February 26, 2014	12,030
February 27, 2014	August 27, 2014	22,354
June 24, 2014	June 24, 2014	17,658
June 24, 2015	July 1, 2015	25,555
April 25, 2016	July 1, 2016	10,000
June 27, 2016	July 1, 2016	24,680
April 25, 2017	April 25, 2018	81,710
June 7, 2017	July 1, 2017	18,224
Total		380,553

The following tables summarize the (i) non-vested shares of restricted stock and (ii) the vesting schedule of shares of restricted stock for the Company's directors and officers as of September 30, 2017:

Schedule of Non-Vested Share and Share Equivalents

	Restricted Stock Grants—Directors	Restricted Stock Grants—Officer	Total
Balance at December 31, 2016	21,514	—	21,514
Granted	18,224	81,710	99,934
Vested	(20,232)	—	(20,232)
Forfeited	—	—	—
Balance at September 30, 2017	19,506	81,710	101,216

Future Anticipated Vesting Schedule

	Restricted Stock Grants—Directors	Restricted Stock Grants—Officer	Total
2017	5,390	—	5,390
2018	12,448	27,237	39,685
2019	1,668	27,237	28,905
2020	—	27,236	27,236

2021 —	—	—
Total 19,506	81,710	101,216

18

Non-Controlling Interests

The non-controlling interests held by third parties in the Company's consolidated balance sheets represented the equity interests in a limited liability company, ACRC KA Investor LLC ("ACRC KA") that were not owned by the Company. A portion of ACRC KA's consolidated equity and net income were allocated to these non-controlling interests held by third parties based on their pro-rata ownership of ACRC KA. As of December 31, 2016, ACRC KA's total equity was \$21.7 million, of which \$11.1 million was owned by the Company and \$10.6 million was allocated to non-controlling interests held by third parties. As of September 30, 2017, the equity interests in ACRC KA held by the Company and third parties had been repaid in full and as such, there was no equity outstanding that was allocated to non-controlling interests held by third parties. See Note 12 included in these consolidated financial statements for more information on ACRC KA.

7. EARNINGS PER SHARE

The following information sets forth the computations of basic and diluted earnings per common share from continuing operations and discontinued operations for the three and nine months ended September 30, 2017 and 2016 (\$ in thousands, except share and per share data):

	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
Net income from continuing operations, less non-controlling interests	\$11,058	\$ 6,380	\$24,224	\$ 17,854
Net income from discontinued operations, including gain on sale of discontinued operations	\$—	\$ 12,062	\$—	\$ 14,417
Divided by:				
Basic weighted average shares of common stock outstanding:	28,481,298	28,428,766	28,475,368	28,462,143
Non-vested restricted stock	101,392	84,371	62,354	74,778
Diluted weighted average shares of common stock outstanding:	28,582,690	28,513,137	28,537,722	28,536,921
Basic earnings per common share:				
Continuing operations	\$0.39	\$ 0.22	\$0.85	\$ 0.63
Discontinued operations	—	0.42	—	0.51
Net income	\$0.39	\$ 0.65	\$0.85	\$ 1.13
Diluted earnings per common share:				
Continuing operations	\$0.39	\$ 0.22	\$0.85	\$ 0.63
Discontinued operations	—	0.42	—	0.51
Net income	\$0.39	\$ 0.65	\$0.85	\$ 1.13

8. INCOME TAX

The Company wholly owns ACRC Lender W TRS LLC and ACRC Lender U TRS LLC, which are taxable REIT subsidiaries ("TRS") formed in order to issue and hold certain loans intended for sale. The Company also wholly owns ACRC 2017-FL3 TRS LLC, which is a TRS formed in order to hold a portion of the CLO Securitization (as defined below) to the extent it generates excess inclusion income.

The income tax provision for the Company and the TRSs consisted of the following for the three and nine months ended September 30, 2017 and 2016 (\$ in thousands):

	For the three months ended September 30, 2017		For the nine months ended September 30, 2016	
Current	\$4	\$4	\$14	\$11
Deferred	—	—	—	—
Excise tax	50	157	135	157
Total income tax expense, including excise tax	\$54	\$161	\$149	\$168

For the three and nine months ended September 30, 2017, the Company recorded an expense of \$50 thousand and \$135 thousand, respectively, for U.S. federal excise tax. For both the three and nine months ended September 30, 2016, the Company recorded an expense of \$157 thousand for U.S. federal excise tax. Excise tax represents a 4% tax on a portion of the required amount of the Company's ordinary income and net capital gains not distributed during the year. If it is determined that the Company's estimated current year taxable income plus any undistributed shortfall from its prior calendar year will be in excess of estimated dividend distributions (including capital gain dividend) for the current year, the Company will accrue excise tax on estimated excess taxable income as such taxable income is earned. The quarterly expense is calculated in accordance with applicable tax regulations.

The TRSs recognize interest and penalties related to unrecognized tax benefits within income tax expense in the consolidated statements of operations. Accrued interest and penalties, if any, are included within other liabilities in the consolidated balance sheets.

As of September 30, 2017, tax years 2014 through 2016 remain subject to examination by taxing authorities. The Company does not have any unrecognized tax benefits and the Company does not expect that to change in the next 12 months.

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

- Level 1-Quoted prices in active markets for identical assets or liabilities.

- Level 2-Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest

rates, prepayment speeds, credit risk and others.

Level 3-Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

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

that are current as of the measurement date, which may fall within periods of market dislocation, during which price transparency may be reduced.

As of September 30, 2017 and December 31, 2016, the Company did not have any assets or liabilities required to be recorded at fair value on a recurring or nonrecurring basis.

As of September 30, 2017 and December 31, 2016, the carrying values and fair values of the Company's financial assets and liabilities recorded at cost are as follows (\$ in thousands):

	Level in Fair Value Hierarchy	As of September 30, 2017		December 31, 2016	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:					
Loans held for investment	3	\$1,543,261	\$1,552,764	\$1,313,937	\$1,322,195
Financial liabilities:					
Secured funding agreements	2	\$730,228	\$730,228	\$780,713	\$780,713
Secured term loan	2	151,761	155,000	149,878	155,000
Collateralized loan obligation securitization debt (consolidated VIE)	3	270,961	272,927	—	—

The carrying values of cash and cash equivalents, restricted cash, interest receivable, due to affiliate liability and accrued expenses, which are all categorized as Level 2 within the fair value hierarchy, approximate their fair values due to their short-term nature.

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

10. RELATED PARTY TRANSACTIONS

Management Agreement

The Company is party to a Management Agreement under which ACREM, subject to the supervision and oversight of the Company's board of directors, is responsible for, among other duties, (a) performing all of the Company's day-to-day functions, (b) determining the Company's investment strategy and guidelines in conjunction with the Company's board of directors, (c) sourcing, analyzing and executing investments, asset sales and financing, and (d) performing portfolio management duties. In addition, ACREM has an Investment Committee that oversees compliance with the Company's investment strategy and guidelines, investment portfolio holdings and financing strategy.

In exchange for its services, ACREM is entitled to receive a base management fee, an incentive fee, expense reimbursements, grants of equity-based awards pursuant to the Company's 2012 Equity Incentive Plan and a termination fee, if applicable.

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

Company's independent directors. As a result, the Company's stockholders' equity, for purposes of calculating the management fee, could be greater or less than the amount of stockholders' equity shown in the Company's consolidated financial statements.

The incentive fee is an amount, not less than zero, equal to the difference between: (a) the product of (i) 20% and (ii) the difference between (A) the Company's Core Earnings (as defined below) for the previous 12-month period, and (B) the product of (1) the weighted average of the issue price per share of the Company's common stock of all of the Company's public offerings of common stock multiplied by the weighted average number of all shares of common stock outstanding including any restricted shares of the Company's common stock, restricted stock units or any shares of the Company's common stock not yet issued, but underlying other awards granted under the Company's 2012 Equity Incentive Plan (see Note 6 included in these consolidated financial statements) in the previous 12-month period, and (2) 8%; and (b) the sum of any incentive fees earned by ACREM with respect to the first three fiscal quarters of such previous 12-month period; provided, however, that no incentive fee is payable with respect to any fiscal quarter unless cumulative Core Earnings for the 12 most recently completed fiscal quarters is greater than zero. "Core Earnings" is a non-GAAP measure and is defined as GAAP net income (loss) computed in accordance with GAAP, excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (to the extent that any of the Company's target investments are structured as debt and the Company forecloses on any properties underlying such debt), any unrealized gains, losses or other non-cash items recorded in net income (loss) for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income (loss), and one-time events pursuant to changes in GAAP and certain non-cash charges after discussions between ACREM and the Company's independent directors and after approval by a majority of the Company's independent directors. For the three months ended September 30, 2017, no incentive fees were incurred. For the nine months ended September 30, 2017, \$381 thousand of incentive fees were incurred. For both the three and nine months ended September 30, 2016, \$321 thousand of incentive fees were incurred.

The Company reimburses ACREM at cost for operating expenses that ACREM incurs on the Company's behalf, including expenses relating to legal, financial, accounting, servicing, due diligence and other services.

The Company will not reimburse ACREM for the salaries and other compensation of its personnel, except for the allocable share of the salaries and other compensation of the Company's (a) Chief Financial Officer, based on the percentage of his time spent on the Company's affairs and (b) other corporate finance, tax, accounting, internal audit, legal, risk management, operations, compliance and other non-investment professional personnel of ACREM or its affiliates who spend all or a portion of their time managing the Company's affairs based on the percentage of their time spent on the Company's affairs. The Company is also required to pay its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of ACREM and its affiliates that are required for the Company's operations. The term of the Management Agreement ends on May 1, 2018, with automatic one-year renewal terms thereafter. Except under limited circumstances, upon a termination of the Management Agreement, the Company will pay ACREM a termination fee equal to three times the average annual base management fee and incentive fee received by ACREM during the 24-month period immediately preceding the most recently completed fiscal quarter prior to the date of termination, each as described above.

Certain of the Company's subsidiaries, along with the Company's lenders under certain of the Company's Secured Funding Agreements, as well as under the CLO transaction have entered into various servicing agreements with ACREM's subsidiary servicer, Ares Commercial Real Estate Servicer LLC ("ACRES"). The Company's Manager will specially service, as needed, certain of the Company's investments. Effective May 1, 2012, ACRES agreed that no servicing fees pursuant to these servicing agreements would be charged to the Company or its subsidiaries by ACRES or the Manager for so long as the Management Agreement remains in effect, but that ACRES will continue to receive reimbursement for overhead related to servicing and operational activities pursuant to the terms of the Management Agreement.

The following table summarizes the related party costs incurred by the Company related to continuing operations for the three and nine months ended September 30, 2017 and 2016 and amounts payable to the Company's Manager as of September 30, 2017 and December 31, 2016 (\$ in thousands):

22

	Incurred For the three months ended September 30,		For the nine months ended September 30,		Payable As of September 30, December 2017 31, 2016	
	2017	2016	2017	2016	2017	2016
Affiliate Payments						
Management fees	\$1,554	\$1,369	\$4,639	\$4,059	\$1,554	\$1,549
Incentive fees	—	321	381	321	—	27
General and administrative expenses	986	860	2,883	2,417	986	1,024
Direct costs	89	(1)227	(2)177	(1)730	(2)27	99
Total	\$2,629	\$2,777	\$8,080	\$7,527	\$2,567	\$2,699

(1) For the three and nine months ended September 30, 2017, direct costs incurred are included within general and administrative expenses in the Company's consolidated statements of operations.

For the three and nine months ended September 30, 2016, direct costs incurred are included within (i) general and (2) administrative expenses of \$107 thousand and \$368 thousand, respectively, and (ii) interest expense of \$120 thousand and \$362 thousand, respectively, in the Company's consolidated statements of operations.

Credit Support Fee Agreement

In July 2014, the Company and certain of its subsidiaries entered into a Credit Support Fee Agreement with Ares Management under which the Company agreed to pay Ares Management a credit support fee in an amount equal to 1.50% per annum times the average amount of the loans outstanding under the \$75 million revolving funding facility (the "July 2014 CNB Facility") with City National Bank and to reimburse Ares Management for its out-of-pocket costs and expenses in connection with the transaction. During the three and nine months ended September 30, 2016, the Company incurred a credit support fee of \$120 thousand and \$362 thousand, respectively, under the July 2014 CNB Facility which is included within interest expense in the Company's consolidated statements of operations. On September 30, 2016, the July 2014 CNB Facility was repaid in full and its terms were not extended. In conjunction with the repayment in full of the July 2014 CNB Facility, the Credit Support Fee Agreement was terminated.

11. DIVIDENDS AND DISTRIBUTIONS

The following table summarizes the Company's dividends declared during the nine months ended September 30, 2017 and 2016 (\$ in thousands, except per share data):

Date Declared	Record Date	Payment Date	Per Share Amount	Total Amount
August 3, 2017	September 29, 2017	October 16, 2017	\$ 0.27	\$7,717
May 2, 2017	June 30, 2017	July 17, 2017	0.27	7,718
March 7, 2017	March 31, 2017	April 17, 2017	0.27	7,690
Total cash dividends declared for the nine months ended September 30, 2017			\$ 0.81	\$23,125
August 4, 2016			\$ 0.26	\$7,406

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

	September 30, 2016	October 17, 2016		
May 5, 2016	June 30, 2016	July 15, 2016	0.26	7,413
March 1, 2016	March 31, 2016	April 15, 2016	0.26	7,429
Total cash dividends declared for the nine months ended September 30, 2016			\$ 0.78	\$ 22,248

12. VARIABLE INTEREST ENTITIES

Consolidated VIEs

As discussed in Note 2, the Company evaluates all of its investments and other interests in entities for consolidation, including its investments in: (a) the CLO securitization and (b) a preferred equity investment in an LLC entity (discussed below), all of which are generally considered to be variable interests in a VIE.

CLO Securitization

On March 2, 2017, ACRE Commercial Mortgage 2017-FL3 Ltd. (the “Issuer”) and ACRE Commercial Mortgage 2017-FL3 LLC (the “Co-Issuer”), both wholly owned indirect subsidiaries of the Company, entered into an Indenture (the “Indenture”) with Wells Fargo Bank, National Association, as advancing agent and note administrator, and Wilmington Trust, National Association as trustee, which governs the issuance of approximately \$308.8 million principal balance secured floating rate notes (the “Notes”) and \$32.4 million of preferred equity in the Issuer (the “CLO Securitization”).

The Notes are collateralized by interests in a pool of twelve mortgage assets having a total principal balance of approximately \$341.2 million (the “Mortgage Assets”) that were originated by a subsidiary of the Company. During the reinvestment period ending on March 15, 2019, the Company may direct the Issuer to acquire additional mortgage assets meeting applicable reinvestment criteria using the principal repayments from the Mortgage Assets, subject to the satisfaction of certain conditions, including receipt of a Rating Agency Confirmation and investor approval of the new mortgage assets.

The contribution of the Mortgage Assets to the Issuer is governed by a Mortgage Asset Purchase Agreement between ACRC Lender LLC (the “Seller”), a wholly owned subsidiary of the Company, and the Issuer, and acknowledged by the Company solely for purposes of confirming its status as a REIT, in which the Seller made certain customary representations, warranties and covenants.

In connection with the securitization, the Issuer and Co-Issuer offered and issued the following classes of Notes: Class A, Class A-S, Class B, Class C and Class D Notes (collectively, the “Offered Notes”) to a third party. A wholly owned subsidiary of the Company retained approximately \$35.8 million of the Notes and all of the \$32.4 million of preferred equity in the Issuer, which totaled \$68.2 million. The Company, as the holder of the subordinated Notes and all of the preferred equity in the Issuer, has the obligation to absorb losses of the CLO, since the Company has a first loss position in the capital structure of the CLO.

After March 15, 2021, the Issuer may redeem the Offered Notes subject to paying a make whole prepayment fee of 1.0% of the then outstanding balance of the Offered Notes. In addition, once the Class A Notes, Class A-S Notes, Class B Notes and Class C Notes have been repaid in full, the Issuer has the right to redeem the Class D Notes, subject to paying a make whole prepayment fee of 1.0% on the Class D Notes.

As the directing holder of the CLO Securitization, the Company has the ability to direct activities that could significantly impact the CLO Securitization’s economic performance. ACRES is designated as special servicer of the CLO Securitization and has the power to direct activities during the loan workout process on defaulted and delinquent loans, which is the activity that most significantly impacts the CLO Securitization’s economic performance. ACRES did not waive the special servicing fee, and the Company pays its overhead costs. If an unrelated third party had the right to unilaterally remove the special servicer, then the Company would not have the power to direct activities that most significantly impact the CLO Securitization’s economic performance. In addition, there were no substantive kick-out rights of any unrelated third party to remove the special servicer without cause. The Company’s subsidiaries,

as directing holders, have the ability to remove the special servicer without cause. Based on these factors, the Company is determined to be the primary beneficiary of the CLO Securitization; thus, the CLO Securitization is consolidated into the Company's consolidated financial statements.

The CLO Securitization is consolidated in accordance with FASB ASC Topic 810 and is structured as a pass through entity that receives principal and interest on the underlying collateral and distributes those payments to the note holders, as applicable. The assets and other instruments held by the CLO Securitization are restricted and can only be used to fulfill the obligations of the CLO Securitization. Additionally, the obligations of the CLO Securitization do not have any recourse to the general credit of any other consolidated entities, nor to the Company as the primary beneficiary.

The inclusion of the assets and liabilities of the CLO Securitization of which the Company is deemed the primary beneficiary has no economic effect on the Company. The Company's exposure to the obligations of the CLO Securitization is generally limited to its investment in the entity. The Company is not obligated to provide, nor has it provided, any financial

support for the consolidated structure. As such, the risk associated with the Company's involvement in the CLO Securitization is limited to the carrying value of its investment in the entity. As of September 30, 2017, the Company's maximum risk of loss was \$68.2 million, which represents the carrying value of its investment in the CLO Securitization. For the three and nine months ended September 30, 2017, the Company incurred interest expense related to the CLO Securitization of \$2.1 million and \$4.7 million, respectively, which is included within interest expense in the Company's consolidated statements of operations.

Investment in VIE

On December 19, 2014, the Company and third party institutional investors formed a limited liability company, ACRC KA, which acquired \$170.0 million of preferred equity in a REIT whose assets were comprised of a portfolio of 22 multifamily, student housing, medical office and self-storage properties managed by its sponsor. The Company's investment in ACRC KA was considered to be an investment in a VIE. As of December 31, 2016, the Company owned a controlling financial interest of 51.0% of the equity shares in the VIE and the third party institutional investors owned the remaining 49.0% minority financial interest. The preferred equity shares were entitled to a preferred monthly return over the term of the investment at a fixed rate of 10.95% per annum. In January 2017, the Company's investment in ACRC KA was repaid in full. Accordingly, as of September 30, 2017, the Company's investment was no longer outstanding.

ACREM was the non-member manager of the VIE. Based on the terms of the ACRC KA LLC agreement, ACREM had the ability to direct activities that could significantly impact the VIE's economic performance. There were no substantive kick-out rights held by the third party institutional investors to remove ACREM as the non-member manager without cause. As ACREM served as the manager of the Company, the Company had the right to receive benefits from the VIE that could potentially be significant. As such, the Company was deemed to be the primary beneficiary of the VIE and the party that was most closely associated with the VIE. Thus, the VIE was consolidated into the Company's consolidated financial statements and the preferred equity interests owned by the third party institutional investors were reflected as a non-controlling interest held by third parties in the Company's consolidated balance sheets.

As of December 31, 2016, the carrying value of the preferred equity investment, which is net of unamortized fees and origination costs, was \$21.3 million, and was included within loans held for investment in the Company's consolidated balance sheets. The risk associated solely with respect to the Company's investment in this VIE was limited to the outstanding principal of its investment in the entity. As of December 31, 2016, the Company's maximum risk of loss solely with respect to this investment was \$11.0 million.

Unconsolidated VIEs

The Company also holds variable interests in VIEs structured as preferred equity investments, where the Company does not have a controlling financial interest. For these structures, the Company is not deemed to be the primary beneficiary of the VIE, and the Company does not consolidate these VIEs. These preferred equity investments are accounted for as loans held for investment and are carried at cost, net of unamortized loan fees and origination costs, unless the loans are deemed impaired, and are included within loans held for investment in the Company's consolidated balance sheets.

The Company is not obligated to provide, nor has it provided, any financial support for any of the Company's unconsolidated VIEs. As such, the risks associated with the Company's involvement in these unconsolidated VIEs are limited to the outstanding principal of the Company's investment in the entity.

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

As of September 30, 2017, there are no unconsolidated VIEs outstanding. The following table presents the carrying value and the maximum exposure to loss of unconsolidated VIEs as of December 31, 2016 (\$ in thousands):

Carrying value	\$37,373
Maximum exposure to loss	\$37,679

13. DISCONTINUED OPERATIONS

ACRE Capital primarily originated, sold and serviced multifamily and senior-living related loans under programs offered by government-sponsored enterprises, such as the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and by government agencies, such as the Government National Mortgage Association (“Ginnie Mae”) and the Federal Housing Administration, a division of the U.S. Department of Housing

25

and Urban Development (together with Ginnie Mae, “HUD”). ACRE Capital was approved as a Fannie Mae Delegated Underwriting and Servicing lender, a Freddie Mac Program Plus® Seller/Servicer, a Multifamily Accelerated Processing and Section 232 LEAN lender for HUD, and a Ginnie Mae issuer. While ACRE Capital earned little interest income from these activities because it generally only held loans for short periods, ACRE Capital received origination fees when it closed loans and sale premiums when it sold loans. ACRE Capital also retained the rights to service the loans, which were known as mortgage servicing rights (“MSRs”), and received fees for such servicing during the life of the loans, which generally lasted 10 years or more.

On September 30, 2016, the Company closed the ACRE Capital Sale for a purchase price of \$93 million in accordance with the Agreement dated June 28, 2016.

Discontinued Operations - Financial Summary

The following information reconciles the net income from operations of discontinued operations, net of income taxes, that are presented separately in the consolidated statements of operations (\$ in thousands):

	For the three months ended September 30, 2016	For the nine months ended September 30, 2016
Mortgage banking revenue:		
Servicing fees, net	\$ 4,115	\$ 11,081
Gains from mortgage banking activities	10,862	24,034
Provision for loss sharing	(143)	) 146
Change in fair value of mortgage servicing rights	(2,562)	) (6,457)
Mortgage banking revenue	12,272	28,804
Expenses:		
Management fees to affiliate	154	446
Professional fees	347	718
Compensation and benefits	7,864	18,108
Transaction costs	282	797
General and administrative expenses	1,011	3,049
General and administrative expenses reimbursed to affiliate	185	622
Total expenses	9,843	23,740
Income from operations before income taxes	2,429	5,064
Income tax expense	563	843
Net income from operations of discontinued operations, net of income taxes	\$ 1,866	\$ 4,221

Revenue Recognition

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

from operations of discontinued operations, net of income taxes, in the Company's consolidated statements of operations.

Gains from mortgage banking activities included the initial fair value of MSRs, loan origination fees, gain on the sale of loans originated, interest income and fees earned on loans held for sale, changes to the fair value of derivative financial instruments attributable to the loan commitments and forward sale commitments and reduced by the expense related to the initial fair value of the servicing fee payable and the interest expense related to the Warehouse Lines of Credit (as defined below). The initial fair value of MSRs, loan origination fees, gain on the sale of loans originated, certain direct loan origination costs for loans held for sale and the expenses related to the initial fair value of the servicing fee payable were recognized when

ACRE Capital committed to make a loan to a borrower. When ACRE Capital settled a sale agreement and transferred the mortgage loan to the buyer, ACRE Capital recognized a MSR asset equal to the present value of the expected net cash flows associated with the servicing of loans sold. Gains from mortgage banking activities are included within net income from operations of discontinued operations, net of income taxes, in the Company's consolidated statements of operations.

Derivatives

Non-designated Hedges

Derivatives not designated as hedges were derivatives that did not meet the criteria for hedge accounting under GAAP or for which ACRE Capital had not elected to designate as hedges.

Loan commitments and forward sale commitments

ACRE Capital entered into loan commitments with borrowers on loan originations whereby the interest rate on the prospective loan was determined prior to funding. In general, ACRE Capital simultaneously entered into forward sale commitments with investors in order to hedge against the interest rate exposure on loan commitments. The forward sale commitment with the investor locked in an interest rate and price for the sale of the loan. The terms of the loan commitment with the borrower and the forward sale commitment with the investor were matched with the objective of hedging interest rate risk. Loan commitments and forward sale commitments were considered undesignated derivative instruments. Accordingly, such commitments, along with any related fees received from potential borrowers, were recorded at fair value, with changes in fair value recorded in earnings. For the three and nine months ended September 30, 2016, ACRE Capital entered into 30 and 49 loan commitments, respectively, and 30 and 49 forward sale commitments, respectively.

Income Tax

The Company established a TRS, TRS Holdings, in connection with the acquisition of ACRE Capital. TRS Holdings' income tax provision consisted of the following for the three and nine months ended September 30, 2016 (\$ in thousands):

	For the three months ended September 30, 2016	For the nine months ended September 30, 2016
Current	\$ (804)	\$ (1,206)
Deferred	1,367	2,049
Total income tax expense	\$ 563	\$ 843

Deferred income taxes reflected the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. TRS Holdings was not subject to tax in any foreign tax jurisdiction.

TRS Holdings recognized interest and penalties related to unrecognized tax benefits within net income from operations of discontinued operations, net of income taxes, in the Company's consolidated statements of operations.

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

The following table is a reconciliation of TRS Holdings' statutory U.S. federal income tax rate to TRS Holdings' effective tax rate for the three and nine months ended September 30, 2016:

	For the three months ended September 30, 2016		For the nine months ended September 30, 2016	
Federal statutory rate	35.0	%	35.0	%
State income taxes	4.4	%	4.4	%
Federal benefit of state tax deduction	(1.5)	)%	(1.5)	)%
Effective tax rate	37.9	%	37.9	%

As of September 30, 2017, tax years 2014 through 2016 remained subject to examination by taxing authorities. TRS Holdings did not have any unrecognized tax benefits.

Intercompany Notes

In connection with the acquisition of ACRE Capital, the Company partially capitalized TRS Holdings with a \$44.0 million note. In October 2014, the Company entered into an \$8.0 million revolving promissory note with TRS Holdings (collectively, the two intercompany notes described above are referred to as the “Intercompany Notes”). In connection with the ACRE Capital Sale, the Intercompany Notes were repaid in full with the proceeds from the sale on September 30, 2016. At the time of the closing of the ACRE Capital Sale, the outstanding principal balance of the Intercompany Notes was \$51.9 million. The income statement effects of the Intercompany Notes were eliminated in consolidation for financial reporting purposes, but the interest income and expense from the Intercompany Notes affected the taxable income of the Company and TRS Holdings.

Related Party Transactions

The following table summarizes the related party costs incurred by the Company related to discontinued operations for the three and nine months ended September 30, 2016 (\$ in thousands):

	For the three months ended September 30, 2016	For the nine months ended September 30, 2016
Affiliate Payments		
Management fees (1)	\$ 154	\$ 446
General and administrative expenses (1)	185	622
Direct costs (1)	35	68
Total	\$ 374	\$ 1,136

Management fees incurred are included in management fees to affiliate, general and administrative expenses incurred are included in general and administrative expenses reimbursed to affiliate and direct costs incurred are included in general and administrative expenses for the three and nine months ended September 30, 2016 in the reconciliation of net income from operations of discontinued operations, net of income taxes.

14. SUBSEQUENT EVENTS

The Company’s management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. There have been no subsequent events that occurred during such period that would require disclosure in this Form 10-Q or would be required to be recognized in the consolidated financial statements as of and for the nine months ended September 30, 2017, except as disclosed below.

On October 2, 2017, the Company entered into an amendment to its existing \$125.0 million BAML Facility. The purpose of the amendment was to, among other things, decrease the interest rate on advances under the BAML Facility to a per annum rate equal to one-month LIBOR plus a spread of 2.00%.

On October 25, 2017, the Company originated a \$19.2 million senior mortgage loan on a multifamily property located in Florida. At closing, the outstanding principal balance was approximately \$18.3 million. The loan has a per annum interest rate of LIBOR plus 4.00% (plus fees) and an initial term of three years.

On November 1, 2017, the Company declared a cash dividend of \$0.27 per common share for the fourth quarter of 2017. The fourth quarter 2017 dividend is payable on January 16, 2018 to common stockholders of record as of December 29, 2017.

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

Some of the statements contained in this quarterly report constitute forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and we intend such statements to be covered by the safe harbor provisions contained therein. The information contained in this section should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this quarterly report on Form 10-Q. This description contains forward-looking statements that involve risks and uncertainties. Actual results could differ significantly from the results discussed in the forward-looking statements due to the factors set forth in "Risk Factors" and elsewhere in this quarterly report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. In addition, some of the statements in this quarterly report (including in the following discussion) constitute forward-looking statements, which relate to future events or the future performance or financial condition of Ares Commercial Real Estate Corporation ("ACRE" and, together with its consolidated subsidiaries, the "Company," "we," "us" and "our"). The forward-looking statements contained in this report involve a number of risks and uncertainties, including statements concerning:

- our business and investment strategy;
- our projected operating results;
- the return or impact of current and future investments;
- the timing of cash flows, if any, from our investments;
- estimates relating to our ability to make distributions to our stockholders in the future;
- defaults by borrowers in paying amounts due on outstanding indebtedness and our ability to collect all amounts due according to the contractual terms of our investments;
- our ability to obtain and maintain financing arrangements, including securitizations;
- market conditions and our ability to access alternative debt markets and additional debt and equity capital;
- the amount of commercial mortgage loans requiring refinancing;
- our expected investment capacity and available capital;
- financing and advance rates for our target investments;
- our expected leverage;
- changes in interest rates and the market value of our investments;
- effects of hedging instruments on our target investments;
- rates of default or decreased recovery rates on our target investments;
- rates of prepayments on our mortgage loans and the effect on our business of such prepayments;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;

• availability of investment opportunities in mortgage-related and real estate-related investments and securities;

• the ability of Ares Commercial Real Estate Management LLC (“ACREM” or our “Manager”) to locate suitable investments for us, monitor, service and administer our investments and execute our investment strategy;

• allocation of investment opportunities to us by our Manager;

• our ability to successfully identify, complete and integrate any acquisitions;

our ability to maintain our qualification as a real estate investment trust (“REIT”) for U.S. federal income tax purposes;

our ability to maintain our exemption from registration under the Investment Company Act of 1940 (the “1940 Act”);

our understanding of our competition;

general volatility of the securities markets in which we may invest;

adverse changes in the real estate, real estate capital and credit markets and the impact of a protracted decline in the liquidity of credit markets on our business;

changes in governmental regulations, tax law and rates, and similar matters (including interpretation thereof);

actions and initiatives of the U.S. Government and changes to U.S. Government policies;

the state of the U.S. economy generally or in specific geographic regions;

uncertainty surrounding the financial stability of the United States, European Union and China;

global economic trends and economic recoveries;

market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy; and

our ability to redeploy the net proceeds from the sale of ACRE Capital Holdings LLC, the holding company that owned our mortgage banking subsidiary, ACRE Capital LLC (“ACRE Capital”).

We use words such as “anticipates,” “believes,” “expects,” “intends,” “will,” “should,” “may” and similar expressions to identify forward-looking statements. Our actual results could differ materially from those expressed in the forward-looking statements for any reason, including the factors set forth under “Risk Factors” and elsewhere in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and elsewhere in this quarterly report on Form 10-Q.

We have based the forward-looking statements included in this quarterly report on information available to us on the date of this quarterly report, and we assume no obligation to update any such forward-looking statements.

Overview

We are a specialty finance company primarily engaged in originating and investing in commercial real estate (“CRE”) loans and related investments. We are externally managed by ACREM, a subsidiary of Ares Management, L.P. (NYSE: ARES) (“Ares Management”), a publicly traded, leading global alternative asset manager, pursuant to the terms of the management agreement dated April 25, 2012, as amended, between us and our Manager (the “Management Agreement”). From the commencement of our operations in late 2011, we have been primarily focused on directly originating and managing a diversified portfolio of CRE debt-related investments for our own account.

We were formed and commenced operations in late 2011. We are a Maryland corporation and completed our initial public offering in May 2012. We have elected and qualified to be taxed as a REIT for U.S. federal income tax purposes under the Internal Revenue Code of 1986, as amended, commencing with our taxable year ended December 31, 2012. We generally will not be subject to U.S. federal income taxes on our REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, to the extent that we annually distribute all of our REIT taxable income to stockholders and comply with various other requirements as a REIT. We

also operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

We are an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, and we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies.” In addition, Section 107 of the JOBS Act also provides that an “emerging growth company” can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended (the “Securities Act”), for complying with new or revised accounting standards. However,

we chose to “opt out” of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

We could remain an “emerging growth company” for up to five years, or until the earliest of (i) the last day of the first fiscal year in which our annual gross revenues exceed \$1.0 billion, (ii) the date that we become a “large accelerated filer” as defined in Rule 12b-2 under the Exchange Act which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (iii) the date on which we have issued more than \$1.0 billion in non-convertible debt during the preceding three-year period. Unless any of the above criteria are met earlier, starting December 31, 2017, we will no longer be treated as an “emerging growth company.”

Developments During the Third Quarter of 2017:

▲ACRE originated an \$18.1 million senior mortgage loan on a multifamily property located in California.

▲ACRE originated a \$39.7 million senior mortgage loan on a student housing property located in North Carolina.

▲ACRE originated a \$27.5 million senior mortgage loan on a multifamily property located in Texas.

ACRE amended the MetLife Facility (as defined below) to extend the initial maturity date to August 12, 2020 and decrease the interest rate on advances under the MetLife Facility to a per annum rate equal to one-month LIBOR plus a spread of 2.30%. The initial maturity date of the MetLife Facility is subject to two 12-month extensions, each of which may be exercised at our option, subject to the satisfaction of certain conditions, including payment of an extension fee, which, if both were exercised, would extend the maturity date of the MetLife Facility to August 12, 2022.

Factors Impacting Our Operating Results

The results of our operations are affected by a number of factors and primarily depend on, among other things, the level of our net interest income, the market value of our assets and the supply of, and demand for, commercial mortgage loans, CRE debt and other financial assets in the marketplace. Our net interest income, which reflects the amortization of origination fees and direct costs, is recognized based on the contractual rate and the outstanding principal balance of the loans we originate. Interest rates will vary according to the type of investment, conditions in the financial markets, credit worthiness of our borrowers, competition and other factors, none of which can be predicted with any certainty. Our operating results may also be impacted by credit losses in excess of initial anticipations or unanticipated credit events experienced by borrowers.

Investment Portfolio

As of September 30, 2017, our portfolio totaled 36 loans held for investment, excluding 55 loans that were repaid or sold since inception. Such investments are referred to herein as our investment portfolio. As of September 30, 2017, the aggregate originated commitment under these loans at closing was approximately \$1.7 billion and outstanding principal was \$1.6 billion. During the nine months ended September 30, 2017, we funded approximately \$504.6 million of outstanding principal and received repayments of \$263.4 million of outstanding principal, excluding non-controlling interests held by third parties. As of September 30, 2017, 89.3% of our loans have London Interbank Offered Rate (“LIBOR”) floors, with a weighted average floor of 0.61%, calculated based on loans with LIBOR floors. References to LIBOR or “L” are to 30-day LIBOR (unless otherwise specifically stated).

Other than as set forth in Note 3 to our consolidated financial statements included in this quarterly report on Form 10-Q, as of September 30, 2017, all loans were paying in accordance with their contractual terms. During the nine

months ended September 30, 2017, there were no impairments with respect to our loans held for investment.

Our loans held for investment are accounted for at amortized cost. The following table summarizes our loans held for investment as of September 30, 2017 (\$ in thousands):

31

As of September 30, 2017

	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Minimum Loan Borrowing Spread (2)	Weighted Average Unleveraged Effective Yield (3)	Weighted Average Remaining Life (Years)
Senior mortgage loans	\$1,483,786	\$1,492,488	4.8 %	6.0 %	1.7
Subordinated debt and preferred equity investments	59,475	60,276	10.3 %	11.4 %	3.2
Total loans held for investment portfolio	\$1,543,261	\$1,552,764	5.0 %	6.2 %	1.8

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

Minimum Loan Borrowing Spread is equal to (a) for floating rate loans, the margin above the applicable index rate (e.g., LIBOR) plus floors, if any, on such applicable index rates, and (b) for fixed rate loans, the applicable interest rate.

Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults. The Total Weighted Average Unleveraged Effective Yield is calculated based on the average of Unleveraged Effective Yield of all loans held by us as of September 30, 2017 as weighted by the Outstanding Principal balance of each loan.

Non-Controlling Interests

The non-controlling interests held by third parties in our consolidated financial statements represent the equity interests in ACRC KA Investor LLC (“ACRC KA”) that are not owned by us. In January 2017, our investment in ACRC KA was repaid in full. Accordingly, as of September 30, 2017, our investment was no longer outstanding.

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

	For the three months ended September 30, 2017	For the nine months ended September 30, 2017
Interest income from loans held for investment, excluding non-controlling interests	\$ 28,551	\$ 72,286
Interest income from non-controlling interest investment held by third parties	—	35
Interest income from loans held for investment	\$ 28,551	\$ 72,321

See Notes 6 and 12 to our consolidated financial statements included in this quarterly report on Form 10-Q for more information about ACRC KA.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles, which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and other factors management believes to be reasonable. Actual results may differ from those estimates and assumptions. There have been no significant changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. See Note 2 to our consolidated financial statements included in this quarterly report on Form 10-Q, which describes recently issued accounting pronouncements not yet required to be adopted by us.

RESULTS OF OPERATIONS

The following table sets forth a summary of our consolidated results of operations for the three and nine months ended September 30, 2017 and 2016 (\$ thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
Net interest margin	\$14,726	\$11,758	\$35,476	\$32,497
Total expenses	3,614	3,918	11,078	10,599
Income from continuing operations before income taxes	11,112	7,840	24,398	21,898
Income tax expense, including excise tax	54	161	149	168
Net income from continuing operations	11,058	7,679	24,249	21,730
Net income from operations of discontinued operations, net of income taxes	—	1,866	—	4,221
Gain on sale of discontinued operations	—	10,196	—	10,196
Net income attributable to ACRE	11,058	19,741	24,249	36,147
Less: Net income attributable to non-controlling interests	—	(1,299)	(25)	(3,876)
Net income attributable to common stockholders	\$11,058	\$18,442	\$24,224	\$32,271

The following tables set forth select details of our consolidated results of operations from continuing operations for the three and nine months ended September 30, 2017 and 2016 (\$ thousands):

Net Interest Margin

	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
Interest income from loans held for investment	\$28,551	\$20,776	\$72,321	\$58,455
Interest expense	(13,825)	(9,018)	(36,845)	(25,958)
Net interest margin	\$14,726	\$11,758	\$35,476	\$32,497

For the three months ended September 30, 2017 and 2016, net interest margin was approximately \$14.7 million and \$11.8 million, respectively. For the three months ended September 30, 2017 and 2016, interest income from loans held for investment of \$28.6 million and \$20.8 million, respectively, was generated by weighted average earning assets of \$1.6 billion and \$1.2 billion, respectively, offset by \$13.8 million and \$9.0 million, respectively, of interest expense, unused fees and amortization of deferred loan costs. The weighted average borrowings under the Wells Fargo Facility, the Citibank Facility, the BAML Facility, the CNB Facility, the MetLife Facility, the UBS Facility and the U.S. Bank Facility (individually defined above or below and collectively, the “Secured Funding Agreements”) and securitization debt and the Secured Term Loan (defined above) were \$1.2 billion for the three months ended September 30, 2017 and \$850.9 million for the three months ended September 30, 2016 (which included one facility which was subsequently paid in full). The increase in interest income from loans held for investment and interest expense for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 primarily relates to an increase in our weighted average earning assets and weighted average borrowings for the three months ended September 30, 2017.

For the nine months ended September 30, 2017 and 2016, net interest margin was approximately \$35.5 million and \$32.5 million, respectively. For the nine months ended September 30, 2017 and 2016, interest income from loans held for investment of \$72.3 million and \$58.5 million, respectively, was generated by weighted average earning assets of

\$1.5 billion and \$1.2 billion, respectively, offset by \$36.8 million and \$26.0 million, respectively, of interest expense, unused fees and amortization of deferred loan costs. The weighted average borrowings under the Secured Funding Agreements and securitization debt and the Secured Term Loan were \$1.1 billion for the nine months ended September 30, 2017 and \$843.5 million for the nine months ended September 30, 2016 (which included two facilities which were subsequently paid in full). The increase in interest income from loans held for investment and interest expense for the nine months ended September 30,

2017 compared to the nine months ended September 30, 2016 primarily relates to an increase in our weighted average earning assets and weighted average borrowings for the nine months ended September 30, 2017.

Operating Expenses

The operating expenses below do not include expenses of ACRE Capital. See Note 13 to our consolidated financial statements included in this quarterly report on Form 10-Q for more information about the operating expenses of ACRE Capital.

	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
Management and incentive fees to affiliate	\$1,554	\$1,690	\$5,020	\$4,380
Professional fees	350	678	1,169	1,703
General and administrative expenses	724	690	2,006	2,099
General and administrative expenses reimbursed to affiliate	986	860	2,883	2,417
Total expenses	\$3,614	\$3,918	\$11,078	\$10,599

For the three months ended September 30, 2017 and 2016, we incurred operating expenses of \$3.6 million and \$3.9 million, respectively. As discussed below, the decrease in operating expenses for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 primarily relates to a decrease in our use of third party professionals due to changes in transaction activity year over year.

For the nine months ended September 30, 2017 and 2016, we incurred operating expenses of \$11.1 million and \$10.6 million, respectively. As discussed below, the increase in operating expenses for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 primarily relates to an increase in management fees and general and administrative expenses due to our Manager that were allocated to continuing operations for the nine months ended September 30, 2017 and partially offset by a decrease in our use of third party professionals due to changes in transaction activity year over year.

Related Party Expenses

For the three months ended September 30, 2017, related party expenses included \$1.6 million in management fees due to our Manager and \$1.0 million for our share of allocable general and administrative expenses for which we were required to reimburse our Manager pursuant to the Management Agreement. For the three months ended September 30, 2016, related party expenses included \$1.4 million in management fees due to our Manager and \$0.9 million for our share of allocable general and administrative expenses for which we were required to reimburse our Manager pursuant to the Management Agreement. The increase in management fees due to our Manager for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 primarily relates to an increase in management fees that were allocated to continuing operations subsequent to the closing of the sale of ACRE Capital on September 30, 2016. The increase in general and administrative expenses due to our Manager for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 primarily relates to an increase in general and administrative expenses that were allocated to continuing operations as employees of our Manager allocated a significant percentage of their time during the three months ended September 30, 2016 to discontinued operations for due diligence work associated with the closing of the sale of ACRE Capital. For the three months ended September 30, 2017, there were no incentive fees due to our Manager. For the three months ended September 30, 2016, there were \$0.3 million of incentive fees due to our Manager.

For the nine months ended September 30, 2017, related party expenses included \$4.6 million in management fees due to our Manager and \$2.9 million for our share of allocable general and administrative expenses for which we were required to reimburse our Manager pursuant to the Management Agreement. For the nine months ended September 30, 2016, related party expenses included \$4.1 million in management fees due to our Manager and \$2.4 million for our share of allocable general and administrative expenses for which we were required to reimburse our Manager pursuant to the Management Agreement. The increase in management fees due to our Manager for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 primarily relates to an increase in management fees that were allocated to continuing operations subsequent to the closing of the sale of ACRE Capital on September 30, 2016. The increase in general and administrative expenses due to our Manager for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 primarily relates to an increase in general and administrative expenses that were allocated to continuing operations as employees of our Manager allocated a significant percentage of their time during the nine months ended September 30, 2016 to

discontinued operations for due diligence work associated with the closing of the sale of ACRE Capital. For the nine months ended September 30, 2017 and 2016, related party expenses also included \$0.4 million and \$0.3 million, respectively, of incentive fees due to our Manager.

Other Expenses

For the three months ended September 30, 2017 and 2016, professional fees were \$0.4 million and \$0.7 million, respectively. The decrease in professional fees for the three months ended September 30, 2017 compared to the three months ended September 30, 2016 primarily relates to a decrease in our use of third party professionals due to changes in transaction activity year over year. For both the three months ended September 30, 2017 and 2016, general and administrative expenses were \$0.7 million.

For the nine months ended September 30, 2017 and 2016, professional fees were \$1.2 million and \$1.7 million, respectively. The decrease in professional fees for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 primarily relates to a decrease in our use of third party professionals due to changes in transaction activity year over year. For the nine months ended September 30, 2017 and 2016, general and administrative expenses were \$2.0 million and \$2.1 million, respectively, which was relatively consistent for both periods.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders and other general business needs. We use significant cash to purchase our target investments, make principal and interest payments on our borrowings, make distributions to our stockholders and fund our operations. Our primary sources of cash generally consist of unused borrowing capacity under our Secured Funding Agreements, the net proceeds of future offerings, payments of principal and interest we receive on our portfolio of assets and cash generated from our operating activities. However, principal repayments from mortgage loans in securitizations where we retain the subordinate securities are applied sequentially, first used to pay down the senior notes, and accordingly, we will not receive any proceeds from repayment of loans in the securitizations until all senior notes are repaid in full. Subject to maintaining our qualification as a REIT and our exemption from the 1940 Act, we expect that our primary sources of financing will be, to the extent available to us, through (a) credit, secured funding and other lending facilities, (b) securitizations, (c) other sources of private financing, including warehouse and repurchase facilities, and (d) public or private offerings of our equity or debt securities. See “Recent Developments” included in this quarterly report on Form 10-Q for information on our available capital as of October 31, 2017. We may seek to sell certain of our investments in order to manage liquidity needs, interest rate risk, meet other operating objectives and adapt to market conditions.

Cash Flows

The following table sets forth changes in cash and cash equivalents for the nine months ended September 30, 2017 and 2016, which are inclusive of amounts related to discontinued operations (\$ in thousands):

	For the nine months ended September 30,	
	2017	2016
Net income	\$24,249	\$36,147
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	(357)	(35,962)
Net cash provided by (used in) operating activities	23,892	185

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

Net cash provided by (used in) investing activities	(224,431)	(242,456)
Net cash provided by (used in) financing activities	181,514	275,044
Change in cash and cash equivalents	\$(19,025)	\$32,773

During the nine months ended September 30, 2017 and 2016, cash and cash equivalents decreased by \$19.0 million and increased by \$32.8 million, respectively.

Operating Activities

For the nine months ended September 30, 2017 and 2016, net cash provided by operating activities totaled \$23.9 million and \$0.2 million, respectively. For the nine months ended September 30, 2017, adjustments to net income related to

operating activities primarily included accretion of deferred loan origination fees and costs of \$4.9 million, amortization of deferred financing costs of \$5.6 million and change in other assets of \$2.0 million. For the nine months ended September 30, 2016, adjustments to net income related to operating activities primarily included originations of mortgage loans held for sale of \$639.4 million, sale of mortgage loans held for sale to third parties of \$571.7 million, change in the fair value of MSRs (as defined above) of \$6.5 million, gain on sale of discontinued operations of \$10.2 million, and change in other assets of \$39.7 million.

Investing Activities

For the nine months ended September 30, 2017 and 2016, net cash used in investing activities totaled \$224.4 million and \$242.5 million, respectively. This change in net cash used in investing activities was primarily as a result of the cash used for the origination of new loans held for investment exceeding the cash received from principal repayment of loans held for investment for the nine months ended September 30, 2017 and 2016.

Financing Activities

For the nine months ended September 30, 2017, net cash provided by financing activities totaled \$181.5 million and primarily related to proceeds from our Secured Funding Agreements of \$533.9 million and proceeds from the issuance of debt of consolidated variable interest entities ("VIEs") of \$272.9 million, partially offset by repayments of our Secured Funding Agreements of \$584.4 million. For the nine months ended September 30, 2016, net cash provided by financing activities totaled \$275.0 million and primarily related to proceeds from our Secured Funding Agreements of \$1.3 billion, proceeds from our secured term loan of \$80.0 million and proceeds from our Warehouse Lines of Credit (defined below) of \$863.4 million, partially offset by repayments of our Secured Funding Agreements of \$932.4 million, repayments of debt of consolidated VIEs of \$197.4 million and repayments of our Warehouse Lines of Credit of \$795.7 million.

We, through our previously owned subsidiary, ACRE Capital, borrowed funds under the ASAP Line of Credit and the BAML Line of Credit (individually defined below and together, the "Warehouse Lines of Credit"). ACRE Capital was party to an \$80.0 million multifamily as soon as pooled sale agreement (the "ASAP Line of Credit") with the Federal National Mortgage Association ("Fannie Mae") to finance installments received from Fannie Mae. ACRE Capital was party to a \$135.0 million line of credit agreement with Bank of America, N.A. (as amended and restated, the "BAML Line of Credit"), which was used to finance mortgage loans originated by ACRE Capital.

Summary of Financing Agreements

The sources of financing under our Secured Funding Agreements and the Secured Term Loan (collectively, the "Financing Agreements") are described in the following table (\$ in thousands):

	As of September 30, 2017					December 31, 2016			
	Total Commitment	Outstanding Balance	Interest Rate	Maturity Date		Total Commitment	Outstanding Balance	Interest Rate	Maturity Date
Secured Funding Agreements:									
Wells Fargo Facility	\$500,000	(1)\$221,631	LIBOR+1.75 to 2.35%	December 14, 2018	(1)	\$325,000	\$218,064	LIBOR+1.75 to 2.35%	December 14, 2017 (1)
Citibank Facility	250,000	(2)175,738	LIBOR+2.25 to 2.50%	December 10, 2018	(2)	250,000	(2)302,240	LIBOR+2.25 to 2.50%	December 10, 2018 (2)

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

BAML Facility	125,000	56,320	LIBOR+2.25 to 2.75%	May 24, 2018	(3) 125,000	77,679	LIBOR+2.25 to 2.75%	May 25, 2017	(3)
CNB Facility	50,000	—	LIBOR+3.00%	March 11, 2018	(4) 50,000	—	LIBOR+3.00%	March 11, 2017	(4)
MetLife Facility	180,000	118,037	LIBOR+2.30%	(5) August 12, 2020	(5) 180,000	53,130	LIBOR+2.35%	August 12, 2017	(5)
UBS Facility	140,000	—	LIBOR+1.88 to 2.28%	(6) October 21, 2018	140,000	71,360	LIBOR+1.88 to 2.28%	(6) October 21, 2018	
U.S. Bank Facility	185,989	(7) 158,502	LIBOR+1.85 to 2.25%	July 31, 2020	(7) 125,000	58,240	LIBOR+2.25%	July 31, 2019	(7)
Subtotal	\$1,430,989	\$730,228			\$1,195,000	\$780,713			
Secured Term Loan	\$155,000	\$155,000	LIBOR+6.00%	(8) December 9, 2018	\$155,000	\$155,000	LIBOR+6.00%	(8) December 9, 2018	
Total	\$1,585,989	\$885,228			\$1,350,000	\$935,713			

The maturity date of the master repurchase funding facility with Wells Fargo Bank, National Association (the “Wells Fargo Facility”) is subject to two 12-month extensions at our option provided that certain conditions are met (1) and applicable extension fees are paid. In May 2017, we amended the Wells Fargo Facility to increase the facility’s commitment amount from \$325.0 million to \$500.0 million and extend the initial maturity date to December 14, 2018.

The maturity date of the master repurchase facility with Citibank, N.A. (the “Citibank Facility”) is subject to three 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid. (2) The Citibank Facility has an accordion feature that provides for an increase in the \$250.0 million commitment amount with respect to approved assets, as determined by Citibank, N.A. in its sole discretion.

Individual advances on loans under the Bridge Loan Warehousing Credit and Security Agreement with Bank of America, N.A. (the “BAML Facility”) generally have a two-year maturity, subject to a 12-month extension at our (3) option provided that certain conditions are met and applicable extension fees are paid. In May 2017, we amended the BAML Facility to extend the period during which we may request individual loans under the facility to May 24, 2018. See Note 14 to our consolidated financial statements for a subsequent event related to the BAML Facility.

The maturity date of the secured revolving funding facility with City National Bank (the “CNB Facility”) is subject (4) to two 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid. In March 2017, we amended the CNB Facility to extend the initial maturity date to March 11, 2018.

The maturity date of the revolving master repurchase facility with Metropolitan Life Insurance Company (the “MetLife Facility”) is subject to two 12-month extensions at our option provided that certain conditions are met and (5) applicable extension fees are paid. In August 2017, we amended the MetLife Facility to extend the initial maturity date to August 12, 2020 and decrease the interest rate on advances under the facility to a per annum rate equal to one-month LIBOR plus a spread of 2.30%.

The interest rate on advances under the revolving master repurchase facility with UBS Real Estate Securities Inc. (6) (the “UBS Facility”) is one-month LIBOR plus (i) 1.88% per annum, for assets that are subject to an advance for one year or less, (ii) 2.08% per annum, for assets that are subject to an advance in excess of one year but less than two years, and (iii) 2.28% per annum, for assets that are subject to an advance for more than two years.

The maturity date of the master repurchase and securities contract with U.S. Bank National Association (the “U.S. Bank Facility”) is subject to two 12-month extensions at our option provided that certain conditions are met and (7) applicable extension fees are paid. In June 2017, we amended the U.S. Bank Facility to increase the facility’s commitment amount from \$125.0 million to \$186.0 million and extend the initial maturity date to July 31, 2020. (8) The Secured Term Loan has a LIBOR floor of 1.0% per annum on drawn amounts.

Our Financing Agreements contain various affirmative and negative covenants, including negative pledges, and provisions related to events of default that are normal and customary for similar financing agreements. As of September 30, 2017, we were in compliance with all financial covenants of each respective Financing Agreement. See Note 4 to our consolidated financial statements included in this quarterly report on Form 10-Q for more information on our Financing Agreements.

Securitizations

We may seek to enhance the returns on our senior mortgage loan investments through securitizations, if available. To the extent available, we intend to securitize the senior portion of some of our loans, while retaining the subordinate securities in our investment portfolio. The securitization of this senior portion will be accounted for as either a “sale” and the loans will be removed from our balance sheet or as a “financing” and will be classified as “loans held for investment” in our consolidated balance sheets, depending upon the structure of the securitization. As of September 30, 2017, the carrying amount and outstanding principal of our CLO Securitization was \$271.0 million and \$272.9

million, respectively. See Note 12 to our consolidated financial statements included in this quarterly report on Form 10-Q for additional terms and details of our CLO Securitization.

Capital Markets

We may periodically raise additional capital through public offerings of debt and equity securities to fund new investments. On June 6, 2016, we filed a registration statement on Form S-3 with the Securities and Exchange Commission (“SEC”), which became effective on August 29, 2016, in order to permit us to offer, from time to time, in one or more offerings or series of offerings up to \$1.25 billion of our common stock, preferred stock, debt securities, subscription rights to purchase shares of our common stock, warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units.

Other Sources of Financing

In addition to the sources of liquidity described above, in the future, we may also use other sources of financing to fund the origination or acquisition of our target investments or to refinance expiring Financing Agreements and securitizations, including other credit facilities, warehouse facilities, repurchase facilities, non-convertible or convertible debt, securitized financings and other public and private forms of borrowing. These financings may be issued by us or our subsidiaries, be collateralized or non-collateralized, accrue interest at either fixed or floating rates and may involve one or more lenders.

Leverage Policies

We intend to use prudent amounts of leverage to increase potential returns to our stockholders. To that end, subject to maintaining our qualification as a REIT and our exemption from registration under the 1940 Act, we intend to continue to use borrowings to fund the origination or acquisition of our target investments. Given current market conditions and our focus on first or senior mortgages, we currently expect that such leverage would not exceed, on a debt-to-equity basis, a 4-to-1 ratio. Our charter and bylaws do not restrict the amount of leverage that we may use. The amount of leverage we will deploy for particular investments in our target investments will depend upon our Manager's assessment of a variety of factors, which may include, among others, the anticipated liquidity and price volatility of the assets in our investment portfolio, the potential for losses and extension risk in our portfolio, the gap between the duration of our assets and liabilities, including hedges, the availability and cost of financing the assets, our opinion of the creditworthiness of our financing counterparties, the health of the U.S. economy generally or in specific geographic regions and commercial mortgage markets, our outlook for the level and volatility of interest rates, the slope of the yield curve, the credit quality of our assets, the collateral underlying our assets, and our outlook for asset spreads relative to the LIBOR curve.

Dividends

We elected to be taxed as a REIT for U.S. federal income tax purposes and, as such, anticipate distributing at least 90% of our REIT taxable income determined without regard to the deduction for dividends paid and excluding net capital gains. To the extent that we distribute less than 100% of our REIT taxable income in any tax year (taking into account any distributions made in a subsequent tax year under Sections 857(b)(9) or 858 of the Code), we will pay tax at regular corporate rates on that undistributed portion. Furthermore, if a REIT distributes less than the sum of 85% of its ordinary income for the calendar year, 95% of its capital gain net income for the calendar year plus any undistributed shortfall from its prior calendar year (the "Required Distribution") to its stockholders during any calendar year (including any distributions declared by the last day of the calendar year but paid in the subsequent year), then it is required to pay non-deductible excise tax equal to 4% of any shortfall between the Required Distribution and the amount that was actually distributed. Any of these taxes would decrease cash available for distribution to our stockholders. The 90% distribution requirement does not require the distribution of net capital gains. However, if a REIT elects to retain any of its net capital gain for any tax year, it must notify its stockholders and pay tax at regular corporate rates on the retained net capital gain. The stockholders must include their proportionate share of the retained net capital gain in their taxable income for the tax year, and they are deemed to have paid the REIT's tax on their proportionate share of the retained capital gain. Furthermore, such retained capital gain may be subject to the nondeductible 4% excise tax. If we determine that our estimated current year taxable income (including net capital gain) will be in excess of estimated dividend distributions (including capital gains dividends) for the current year from such income, we accrue excise tax on a portion of the estimated excess taxable income as such taxable income is earned.

Before we make any distributions, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our Financing Agreements and other debt payable. If our cash available for distribution is less than our REIT taxable income, we could be required to sell assets or borrow funds to

make cash distributions or we may make a portion of the Required Distribution in the form of a taxable stock distribution or distribution of debt securities.

OFF-BALANCE SHEET ARRANGEMENTS

We have commitments to fund various senior mortgage loans, as well as subordinated debt and preferred equity investments in our portfolio.

Other than as set forth in this quarterly report on Form 10-Q, we do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, special purpose entities or VIEs, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities or entered into any commitment or intend to provide additional funding to any such entities.

RECENT DEVELOPMENTS

On October 2, 2017, we entered into an amendment to our existing \$125 million BAML Facility. The purpose of the amendment was to, among other things, decrease the interest rate on advances under the BAML Facility to a per annum rate equal to one-month LIBOR plus a spread of 2.00%.

On October 25, 2017, we originated a \$19.2 million senior mortgage loan on a multifamily property located in Florida. At closing, the outstanding principal balance was approximately \$18.3 million. The loan has a per annum interest rate of LIBOR plus 4.00% (plus fees) and an initial term of three years.

As of October 31, 2017, we had approximately \$190 million in capital, either in cash or in undrawn capacity expected to be available under our Secured Funding Agreements. After holding in reserve \$10 million in liquidity requirements, we expect to have approximately \$180 million in capital available to fund new loans, fund outstanding commitments on existing loans and for other working capital and general corporate purposes. Assuming that we use all such amounts as capital to make new senior loans and we are able to leverage such amounts under our Secured Funding Agreements at a debt to equity ratio of 2.5:1, we would have the capacity to fund approximately \$630 million of additional senior loans.

As of October 31, 2017, the total unfunded commitments for our existing loans held for investment were approximately \$97 million. In addition, borrowings under our Secured Funding Agreements were approximately \$713 million, borrowings under our Secured Term Loan was approximately \$155 million and debt issued in the form of a CLO was approximately \$273 million.

On November 1, 2017, we declared a cash dividend of \$0.27 per common share for the fourth quarter of 2017. The fourth quarter 2017 dividend is payable on January 16, 2018 to common stockholders of record as of December 29, 2017.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As part of our risk management strategy, our Manager closely monitors our portfolio and actively manages the credit, interest rate, market, prepayment, real estate inflation and financing risks associated with holding a portfolio of our target investments. We manage our portfolio through an interactive process with our Manager and Ares Management. Our Manager has an Investment Committee that oversees compliance with our investment strategy and guidelines, investment portfolio holdings and financing strategy. We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of our capital stock. While we do not seek to avoid risk completely, we believe the risks can be quantified from historical experience and seek to actively manage those risks, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Credit Risk

We are subject to varying degrees of credit risk in connection with holding our target investments. We have exposure to credit risk on our CRE loans and other target investments in our business. Our Manager seeks to manage credit risk by performing our due diligence process prior to origination or acquisition and through the use of non-recourse financing, when and where available and appropriate. Credit risk is also addressed through our Manager's ongoing review of our investment portfolio. In addition, with respect to any particular target investment, our Manager's investment team evaluates, among other things, relative valuation, comparable analysis, supply and demand trends, shape of yield curves, delinquency and default rates, recovery of various sectors and vintage of collateral.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and our related financing obligations, including our borrowings under the Financing Agreements. We primarily originate or acquire floating rate mortgage assets and finance those assets with index-matched floating rate liabilities. As a result, we significantly reduce our exposure to changes in portfolio value and cash flow variability related to changes in interest rates. However, we regularly measure our exposure to interest rate risk and assess interest rate risk and manage our interest rate exposure on an ongoing basis by comparing our interest rate sensitive assets to our interest rate sensitive liabilities. Based on that review, we determine whether or not we should enter into hedging transactions and derivative financial instruments, such as forward sale commitments and interest rate floors in order to mitigate our exposure to changes in interest rates.

While hedging activities may mitigate our exposure to adverse fluctuations in interest rates, certain hedging transactions that we may enter into in the future, such as interest rate swap agreements, may also limit our ability to participate in the benefits of lower interest rates with respect to our investments. In addition, there can be no assurance that we will be able to effectively hedge our interest rate risk.

In addition to the risks related to fluctuations in asset values and cash flows associated with movements in interest rates, there is also the risk of non-performance on floating rate assets. In the case of a significant increase in interest rates, the additional debt service payments due from our borrowers may strain the operating cash flows of the real estate assets underlying our mortgages and, potentially, contribute to non-performance or, in severe cases, default.

Interest Rate Effect on Net Interest Margin

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing. The cost of our borrowings generally is based on prevailing market interest rates. During a period of rising

interest rates, our borrowing costs generally increase while the yields earned on our leveraged fixed-rate mortgage assets remain static, which could result in a decline in our net interest spread and net interest margin.

For the three and nine months ended September 30, 2017, the following fluctuations in the average 30-day LIBOR would have resulted in the following increases in net interest margin on our loans held for investment (\$ in millions):

40

Change in Average 30-Day LIBOR	For the three months ended September 30, 2017	For the nine months ended September 30, 2017
Up 300 basis points	\$ 2.9	\$ 7.9
Up 200 basis points	\$ 1.9	\$ 5.3
Up 100 basis points	\$ 0.9	\$ 2.7
Down to 0 basis points	\$ 0.5	\$ 0.8

The severity of any such impact depends on our asset/liability composition at the time as well as the magnitude and duration of the interest rate increase and any applicable floors and caps. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target investments. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Interest Rate Cap and Floor Risk

We primarily originate or acquire floating rate mortgage assets. These are assets in which the mortgages may be subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the asset's interest yield changes during any given period. However, our borrowing costs pursuant to our Financing Agreements sometimes are not subject to similar restrictions or have different floors and caps. As a result, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest rate yields on our floating rate mortgage assets could be limited if we do not implement effective caps. In addition, floating rate mortgage assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on such assets than we would need to pay the interest cost on our related borrowings. In addition, in a period of decreasing interest rates, the interest rate yields on our floating rate mortgage assets could decrease, while the interest rate costs on certain of our borrowings could be fixed at a higher floor. These factors could lower our net interest income or cause a net loss during periods of decreasing interest rates, which would harm our financial condition, cash flows and results of operations.

Market Risk

The estimated fair values of our investments fluctuate primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of the fixed-rate securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of the fixed-rate securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted.

Prepayment and Securitizations Repayment Risk

Our net income and earnings may be affected by prepayment rates on our existing CRE loans. When we originate our CRE loans, we anticipate that we will generate an expected yield. When borrowers prepay their CRE loans faster than we expect, we may be unable to replace these CRE loans with new CRE loans that will generate yields which are as high as the prepaid CRE loans. Additionally, principal repayment proceeds from mortgage loans in the CLO Securitization are applied sequentially, first going to pay down the senior CLO Securitization notes. We will not receive any proceeds from repayment of loans in the CLO Securitization until all senior notes are repaid in full.

Financing Risk

We borrow funds under our Financing Agreements to finance our target assets. Over time, as market conditions change, in addition to these financings, we may use other forms of leverage. Weakness or volatility in the financial markets, the commercial real estate and mortgage markets and the economy generally could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing.

Real Estate Risk

Commercial mortgage assets are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions; changes or continued weakness in specific industry segments; local markets with

a significant exposure to the energy sector; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay the underlying loan or loans, as the case may be, which could also cause us to suffer losses. We seek to manage these risks through our underwriting and asset management processes.

Inflation Risk

Virtually all of our assets and liabilities are sensitive to interest rates. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. In each case, in general, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Item 4. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act). Based upon such evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures were effective, as of September 30, 2017, to provide assurance that information that is required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. During the three months ended September 30, 2017, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business, we may be subject to various legal proceedings from time to time. Furthermore, third parties may try to seek to impose liability on us in connection with our loans. As of September 30, 2017, we were not subject to any material pending legal proceedings.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016. You should carefully consider the risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016, which could materially affect our business, financial condition and/or operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

42

Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Exhibit Description
<u>2.1</u> *	Purchase and Sale Agreement, among Ares Commercial Real Estate Corporation and Cornerstone Real Estate Advisers LLC. (1) Waiver and Amendment to Purchase and Sale Agreement, dated as of September 29, 2016, among Ares Commercial Real Estate Corporation and Barings Real Estate Advisers LLC (formerly known as Cornerstone Real Estate Advisers LLC). (2)
<u>3.1</u> *	Articles of Amendment and Restatement of Ares Commercial Real Estate Corporation. (3)
<u>3.2</u> *	Amended and Restated Bylaws of Ares Commercial Real Estate Corporation. (4)
<u>10.1</u> *	First Amendment to Master Repurchase Agreement, dated as of August 4, 2017, by and between ACRC Lender ML LLC, as seller, and Metropolitan Life Insurance

Company, as buyer.
(5)

10.2*

Reaffirmation of
Guarantor, dated as
of August 4, 2017,
by Ares
Commercial Real
Estate Corporation
in favor of
Metropolitan Life
Insurance
Company. (6)

First Supplemental
Indenture, dated as
of August 16, 2017,
to the Indenture,
dated as of March
2, 2017, among
ACRE Commercial
Mortgage
2017-FL3 Ltd, as
issuer, ACRE
Commercial
Mortgage
2017-FL3 LLC, as
co-issuer,
Wilmington Trust,
National

10.3

Association, as
trustee, Wells
Fargo Bank,
National
Association, as note
administrator,
paying agent,
calculation agent,
transfer agent,
authentication
agent and
custodian, and
Wells Fargo Bank,
National
Association, as
advancing agent.

10.4*

Amendment No. 2
to Amended and
Restated Bridge
Loan Warehousing
Credit and Security
Agreement, dated
as of October 2,

	2017, by and among ACRC Lender B LLC, Bank of America, N.A., as Administrative Agent and Lender and the other Lenders. (7) Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.1</u>	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<u>32.1</u>	XBRL Instance Document
101.INS	XBRL Taxonomy Extension Schema Document
101.SCH	XBRL Taxonomy Extension Calculation Linkbase Document
101.CAL	XBRL Taxonomy Extension Label Linkbase
101.LAB	

Edgar Filing: Ares Commercial Real Estate Corp - Form 10-Q

101.PRE	Document
	XBRL Taxonomy
	Extension
	Presentation
101.DEF	Linkbase
	Document
	XBRL Taxonomy
	Extension
	Definition Linkbase
	Document

* Previously filed

- (1) Incorporated by reference to Exhibit 2.1 to the Company's Form 8-K (File No. 001-35517), filed on June 29, 2016.
- (2) Incorporated by reference to Exhibit 2.2 to the Company's Form 10-Q (File No. 001-35517), filed on August 3, 2017.
- (3) Incorporated by reference to Exhibit 3.1 to the Company's Form 10-K (File No. 001-35517), filed on March 1, 2016.
- (4) Incorporated by reference to Exhibit 3.2 to the Company's Form S-8 (File No. 333-181077), filed on May 1, 2012.
- (5) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (File No. 001-35517), filed on August 9, 2017.
- (6) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K (File No. 001-35517), filed on August 9, 2017.
- (7) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (File No. 001-35517), filed on October 3, 2017.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARES COMMERCIAL REAL ESTATE CORPORATION

Date: November 1, 2017 By/s/ James A. Henderson

James A. Henderson

Chief Executive Officer (Principal Executive Officer)

Date: November 1, 2017 By/s/ Tae-Sik Yoon

Tae-Sik Yoon

Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)