

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2021
OR
☐ **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
(State or other jurisdiction of
incorporation or organization)

45-3148087
(I.R.S. Employer
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)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$0.01 par value per share	ACRE	New York Stock Exchange

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

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 November 2, 2021
Common stock, \$0.01 par value	47,001,821

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FORWARD-LOOKING STATEMENTS

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, 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, 2020. 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 severity and duration of the novel coronavirus (“COVID-19”) pandemic;
- the impact of the COVID-19 pandemic, on our business and the United States and global economies;
- the impact of the COVID-19 pandemic on the real estate industry and our borrowers, the performance of the properties securing our loans that may cause deterioration in the performance of our investments and, potentially, principal losses to us;
- whether, or how much, we or our borrowers have benefited or may benefit from government stimulus programs in response to the COVID-19 pandemic;
- the length of the economic slowdown resulting from the COVID-19 pandemic as well as the rate and extent of economic recovery;
- management’s current estimate of expected credit losses and current expected credit loss reserve;
- the collectability and 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, maintain, repay or refinance 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;
- the demand for commercial real estate loans;
- our expected investment capacity and available capital;
- financing and advance rates for our target investments;
- our expected leverage;
- changes in interest rates, credit spreads and the market value of our investments;

- the impact of the replacement of the London Interbank Offered Rate (“LIBOR”) on our operating results;
- 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 United States 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);
- authoritative or policy changes from standard-setting bodies such as the Financial Accounting Standards Board, the Securities and Exchange Commission, the Internal Revenue Service, the stock exchange where we list our common stock, and other authorities that we are subject to, as well as their counterparts in any foreign jurisdictions where we might do business;
- actions and initiatives of the United States Government or governments outside of the United States, and changes to United States Government policies;
- the state of the United States, European Union and Asian economies generally or in specific geographic regions;
- global economic trends and economic conditions; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

We use words such as “anticipates,” “believes,” “expects,” “intends,” “will,” “should,” “may” and similar expressions to identify forward-looking statements, although not all forward-looking statements include these words. Our actual results and condition could differ materially from those implied or expressed in the forward-looking statements for any reason, including the factors set forth in “Risk Factors” and the other information included in our annual report on Form 10-K 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. Although we

undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we have filed or in the future may file with the Securities and Exchange Commission (“SEC”), including annual reports on Form 10-K, registration statements on Form S-3, quarterly reports on Form 10-Q and current reports on Form 8-K.

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, 2021	December 31, 2020
	(unaudited)	
ASSETS		
Cash and cash equivalents	\$ 15,787	\$ 74,776
Loans held for investment (\$1,135,660 and \$550,590 related to consolidated VIEs, respectively)	2,363,499	1,815,219
Current expected credit loss reserve	(22,691)	(23,604)
Loans held for investment, net of current expected credit loss reserve	2,340,808	1,791,615
Real estate owned, net	36,695	37,283
Other assets (\$2,524 and \$1,079 of interest receivable related to consolidated VIEs, respectively; \$47,618 and \$6,410 of other receivables related to consolidated VIEs, respectively)	73,395	25,823
Total assets	<u>\$ 2,466,685</u>	<u>\$ 1,929,497</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Secured funding agreements	\$ 656,014	\$ 755,552
Notes payable	47,381	61,837
Secured term loan	60,000	110,000
Collateralized loan obligation securitization debt (consolidated VIEs)	940,133	443,871
Secured borrowings	59,962	59,790
Due to affiliate	3,947	3,150
Dividends payable	16,523	11,124
Other liabilities (\$549 and \$391 of interest payable related to consolidated VIEs, respectively)	9,982	11,158
Total liabilities	<u>1,793,942</u>	<u>1,456,482</u>
Commitments and contingencies (Note 9)		
STOCKHOLDERS' EQUITY		
Common stock, par value \$0.01 per share, 450,000,000 shares authorized at September 30, 2021 and December 31, 2020 and 47,001,821 and 33,442,332 shares issued and outstanding at September 30, 2021 and December 31, 2020, respectively	464	329
Additional paid-in capital	701,370	497,803
Accumulated other comprehensive income	19	—
Accumulated earnings (deficit)	(29,110)	(25,117)
Total stockholders' equity	<u>672,743</u>	<u>473,015</u>
Total liabilities and stockholders' equity	<u>\$ 2,466,685</u>	<u>\$ 1,929,497</u>

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,	
	2021	2020	2021	2020
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenue:				
Interest income	\$ 34,023	\$ 30,626	\$ 95,587	\$ 91,908
Interest expense	(12,669)	(11,875)	(35,900)	(40,450)
Net interest margin	21,354	18,751	59,687	51,458
Revenue from real estate owned	5,850	3,623	12,271	10,032
Total revenue	27,204	22,374	71,958	61,490
Expenses:				
Management and incentive fees to affiliate	3,175	1,847	8,693	5,771
Professional fees	480	639	1,880	2,202
General and administrative expenses	1,119	969	3,470	2,797
General and administrative expenses reimbursed to affiliate	773	802	2,313	2,890
Expenses from real estate owned	5,339	4,046	12,458	13,976
Total expenses	10,886	8,303	28,814	27,636
Provision for current expected credit losses	6,367	(1,048)	(756)	22,063
Realized losses on loans sold	—	4,008	—	4,008
Change in unrealized losses on loans held for sale	—	(3,998)	—	—
Income before income taxes	9,951	15,109	43,900	7,783
Income tax expense, including excise tax	—	181	593	350
Net income attributable to common stockholders	\$ 9,951	\$ 14,928	\$ 43,307	\$ 7,433
Earnings per common share:				
Basic earnings per common share	\$ 0.21	\$ 0.45	\$ 1.06	\$ 0.23
Diluted earnings per common share	\$ 0.21	\$ 0.44	\$ 1.05	\$ 0.22
Weighted average number of common shares outstanding:				
Basic weighted average shares of common stock outstanding	46,957,339	33,337,445	40,840,453	32,852,553
Diluted weighted average shares of common stock outstanding	47,209,469	33,550,444	41,120,751	33,072,085
Dividends declared per share of common stock	\$ 0.35	\$ 0.33	\$ 1.05	\$ 0.99

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2021	2020	2021	2020
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net income attributable to common stockholders	\$ 9,951	\$ 14,928	\$ 43,307	\$ 7,433
Other comprehensive income:				
Unrealized gains (losses) on derivative financial instruments	(98)	—	19	—
Comprehensive income	<u>\$ 9,853</u>	<u>\$ 14,928</u>	<u>\$ 43,326</u>	<u>\$ 7,433</u>

See accompanying notes to consolidated financial statements.

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

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Earnings (Deficit)	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2019	28,865,610	\$ 283	\$ 423,619	\$ —	\$ 2,437	\$ 426,339
Sale of common stock	4,600,000	46	73,186	—	—	73,232
Offering costs	—	—	(341)	—	—	(341)
Stock-based compensation	(66,658)	—	225	—	—	225
Net loss	—	—	—	—	(17,263)	(17,263)
Dividends declared	—	—	—	—	(11,076)	(11,076)
Impact of adoption of CECL (Note 2)	—	—	—	—	(5,051)	(5,051)
Balance at March 31, 2020	33,398,952	\$ 329	\$ 496,689	\$ —	\$ (30,953)	\$ 466,065
Stock-based compensation	42,985	—	365	—	—	365
Net income	—	—	—	—	9,768	9,768
Dividends declared	—	—	—	—	(11,072)	(11,072)
Balance at June 30, 2020	33,441,937	\$ 329	\$ 497,054	\$ —	\$ (32,257)	\$ 465,126
Stock-based compensation	—	—	367	—	—	367
Net income	—	—	—	—	14,928	14,928
Dividends declared	—	—	—	—	(11,072)	(11,072)
Balance at September 30, 2020	33,441,937	\$ 329	\$ 497,421	\$ —	\$ (28,401)	\$ 469,349
Stock-based compensation	395	—	382	—	—	382
Net income	—	—	—	—	14,407	14,407
Dividends declared	—	—	—	—	(11,123)	(11,123)
Balance at December 31, 2020	33,442,332	\$ 329	\$ 497,803	\$ —	\$ (25,117)	\$ 473,015
Sale of common stock	7,000,000	70	100,800	—	—	100,870
Offering costs	—	—	(188)	—	—	(188)
Stock-based compensation	35,509	—	521	—	—	521
Other comprehensive income	—	—	—	263	—	263
Net income	—	—	—	—	15,740	15,740
Dividends declared	—	—	—	—	(14,248)	(14,248)
Balance at March 31, 2021	40,477,841	\$ 399	\$ 598,936	\$ 263	\$ (23,625)	\$ 575,973
Sale of common stock	6,500,000	65	101,725	—	—	101,790
Offering costs	—	—	(164)	—	—	(164)
Stock-based compensation	23,280	—	497	—	—	497
Other comprehensive income	—	—	—	(146)	—	(146)
Net income	—	—	—	—	17,615	17,615
Dividends declared	—	—	—	—	(16,528)	(16,528)
Balance at June 30, 2021	47,001,121	\$ 464	\$ 700,994	\$ 117	\$ (22,538)	\$ 679,037
Offering costs	—	—	(52)	—	—	(52)
Stock-based compensation	700	—	428	—	—	428
Other comprehensive income	—	—	—	(98)	—	(98)
Net income	—	—	—	—	9,951	9,951
Dividends declared	—	—	—	—	(16,523)	(16,523)
Balance at September 30, 2021	47,001,821	\$ 464	\$ 701,370	\$ 19	\$ (29,110)	\$ 672,743

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,	
	2021 (unaudited)	2020 (unaudited)
Operating activities:		
Net income	\$ 43,307	\$ 7,433
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of deferred financing costs	7,111	4,906
Accretion of deferred loan origination fees and costs	(5,979)	(5,732)
Stock-based compensation	1,446	956
Depreciation of real estate owned	674	668
Provision for current expected credit losses	(756)	22,063
Realized losses on loans sold	—	4,008
Changes in operating assets and liabilities:		
Other assets	(16,728)	(9,302)
Due to affiliate	797	(91)
Other liabilities	408	(2,165)
Net cash provided by (used in) operating activities	30,280	22,744
Investing activities:		
Issuance of and fundings on loans held for investment	(877,950)	(485,913)
Principal repayment of loans held for investment	299,021	280,318
Proceeds from sale of loans held for sale	—	96,597
Receipt of origination fees	4,636	3,978
Purchases of capitalized additions to real estate owned	(86)	(243)
Payments under derivative financial instruments	(700)	—
Net cash provided by (used in) investing activities	(575,079)	(105,263)
Financing activities:		
Proceeds from secured funding agreements	611,515	466,778
Repayments of secured funding agreements	(711,054)	(404,231)
Proceeds from notes payable	13,008	3,000
Repayments of notes payable	(27,880)	—
Repayments of secured term loan	(50,000)	—
Proceeds from secured borrowings	—	55,095
Payment of secured funding costs	(9,734)	(3,700)
Proceeds from issuance of debt of consolidated VIEs	540,471	—
Repayments of debt of consolidated VIEs	(40,982)	—
Dividends paid	(41,901)	(31,694)
Proceeds from sale of common stock	202,660	73,232
Payment of offering costs	(293)	(301)
Net cash provided by (used in) financing activities	485,810	158,179
Change in cash and cash equivalents	(58,989)	75,660
Cash and cash equivalents, beginning of period	74,776	5,635
Cash and cash equivalents, end of period	\$ 15,787	\$ 81,295

See accompanying notes to consolidated financial statements.

ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of September 30, 2021
(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 Corporation (NYSE: ARES) (“Ares Management” or “Ares”), a publicly traded, leading global alternative investment 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 operates as one operating segment and 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, self storage, student housing, residential, senior-living and other commercial real estate properties, or by ownership interests therein.

The Company has elected and qualified to be taxed as a real estate investment trust (“REIT”) for United States 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 United States federal income taxes on its REIT taxable income as long as it annually distributes all of its REIT taxable income prior to the deduction for dividends paid 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, 2020 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, 2021.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. As of the filing date of this Quarterly Report, there is a continued outbreak of the novel coronavirus (“COVID-19”) pandemic, for which the World Health Organization has declared a global pandemic, the United States has declared a national emergency and every state in the United States is under a federal disaster declaration. Many states, including those in which the Company and its borrowers operate, have issued orders requiring the closure of, or certain restrictions on the operation of, non-essential businesses and/or requiring residents to stay at home. The COVID-19 pandemic and preventative measures taken to contain or mitigate its spread have caused, and are continuing to cause, business shutdowns or the re-introduction of business shutdowns, cancellations of events and restrictions on travel, significant reductions in demand for certain goods and services, reductions in business activity and financial transactions and overall economic and financial market instability both globally and in the United States. The COVID-19 pandemic continues to disrupt global supply chains, has caused labor shortages and has added broad inflationary pressures, which has the potential to negatively impact the Company and its borrowers. While several countries, as well as certain states in the United States, have relaxed the public health restrictions with a view to partially or fully reopen their economies, recurring COVID-19 outbreaks, including outbreaks of several variants of COVID-19, such as the Delta variant, have led to the re-introduction of such restrictions in certain states in the United States and globally and could continue to lead to the re-introduction of such restrictions elsewhere.

Additionally, in December 2020, the U.S. Food and Drug Administration authorized certain vaccines for emergency use, which are currently being distributed nationwide and globally. However, it remains unclear how quickly “herd immunity” will be achieved and the restrictions that were imposed to slow the spread of the virus will be lifted entirely. These uncertainties could lead the public to continue to self-isolate and not participate in the economy at pre-pandemic levels for a prolonged period of time. Additionally, concerns about the long-term effects of the vaccines could discourage people from obtaining a vaccine. Even after the COVID-19 pandemic subsides, the U.S. economy and most other major global economies may experience a recession, and we anticipate our business and operations could be materially adversely affected by a prolonged recession in the United States. The Company believes the estimates and assumptions underlying its consolidated financial statements are reasonable and supportable based on the information available as of September 30, 2021, however, uncertainty over the ultimate impact the COVID-19 pandemic will have on the global economy and the Company’s business, makes any estimates and assumptions as of September 30, 2021 inherently less certain than they would be absent the current and potential impacts of the COVID-19 pandemic. Actual results could differ from those estimates.

Variable Interest Entities

The Company evaluates all of its interests in VIEs for consolidation. When the Company’s interests are determined to be variable interests, the Company assesses whether it is deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 810, *Consolidation*, 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 16 included in these consolidated financial statements for further discussion of the Company's VIEs.

Cash and Cash Equivalents

Cash and cash equivalents include funds on deposit with financial institutions, including demand deposits with financial institutions. Cash and short-term investments with an original maturity of three months or less when acquired are considered cash and cash equivalents for the purpose of the consolidated balance sheets and statements of cash flows.

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 (the "carrying value"). Loans are generally 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 loans held for 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 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.

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.

Loan balances that are deemed to be uncollectible are written off as a realized loss and are deducted from the current expected credit loss reserve. The write-offs are recorded in the period in which the loan balance is deemed uncollectible based on management's judgment.

Current Expected Credit Losses

Accounting Standards Update (“ASU”) No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, requires the Company to reflect current expected credit losses (“CECL”) on both the outstanding balances and unfunded commitments on loans held for investment and requires consideration of a broad range of historical experience adjusted for current conditions and reasonable and supportable forecast information to inform credit loss estimates (the “CECL Reserve”). ASU No. 2016-13 was effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. ASU No. 2016-13 was adopted by the Company on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of January 1, 2020. Subsequent period increases and decreases to expected credit losses impact earnings and are recorded within provision for current expected credit losses in the Company’s consolidated statements of operations. The CECL Reserve related to outstanding balances on loans held for investment required under ASU No. 2016-13 is a valuation account that is deducted from the amortized cost basis of the Company’s loans held for investment in the Company’s consolidated balance sheets. The CECL Reserve related to unfunded commitments on loans held for investment is recorded within other liabilities in the Company’s consolidated balance sheets. See Note 4 included in these consolidated financial statements for CECL related disclosures.

Real Estate Owned

Real estate assets are carried at their estimated fair value at acquisition and are presented net of accumulated depreciation and impairment charges. The Company allocates the purchase price of acquired real estate assets based on the fair value of the acquired land, building, furniture, fixtures and equipment.

Real estate assets are depreciated using the straight-line method over estimated useful lives of up to 40 years for buildings and improvements and up to 15 years for furniture, fixtures and equipment. Renovations and/or replacements that improve or extend the life of the real estate asset are capitalized and depreciated over their estimated useful lives. The cost of ordinary repairs and maintenance are expensed as incurred.

Real estate assets are evaluated for indicators of impairment on a quarterly basis. Factors that the Company may consider in its impairment analysis include, among others: (1) significant underperformance relative to historical or anticipated operating results; (2) significant negative industry or economic trends; (3) costs necessary to extend the life or improve the real estate asset; (4) significant increase in competition; and (5) ability to hold and dispose of the real estate asset in the ordinary course of business. A real estate asset is considered impaired when the sum of estimated future undiscounted cash flows expected to be generated by the real estate asset over the estimated remaining holding period is less than the carrying amount of such real estate asset. Cash flows include operating cash flows and anticipated capital proceeds generated by the real estate asset. An impairment charge is recorded equal to the excess of the carrying value of the real estate asset over the fair value. When determining the fair value of a real estate asset, the Company makes certain assumptions including, but not limited to, consideration of projected operating cash flows, comparable selling prices and projected cash flows from the eventual disposition of the real estate asset based upon the Company’s estimate of a capitalization rate and discount rate.

The Company reviews its real estate assets, from time to time, in order to determine whether to sell such assets. Real estate assets are classified as held for sale when the Company commits to a plan to sell the asset, when the asset is being actively marketed for sale at a reasonable price and the sale of the asset is probable and the transfer of the asset is expected to qualify for recognition as a completed sale within one year. Real estate assets that are held for sale are carried at the lower of the asset’s carrying amount or its fair value less costs to sell.

Debt Issuance Costs

Debt issuance costs under the Company’s indebtedness are capitalized and amortized over the term of the respective debt instrument. Unamortized debt issuance costs are expensed when the associated debt is repaid prior to maturity. 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, except as noted below, in the Company’s consolidated statements of operations while the unamortized balance on (i) Secured Funding Agreements (each individually defined in Note 6 included in these consolidated financial statements) is included within other assets and (ii) Notes Payable, the Secured Term Loan (each defined in Note 6 included in these consolidated financial statements) and Secured Borrowings (defined in Note 7 included in these consolidated financial statements) and debt securitizations are each included as a reduction to the carrying amount of the liability, in the Company’s consolidated balance sheets. Amortization of debt issuance costs for the note payable on the hotel property that is recognized as

real estate owned in the Company's consolidated balance sheets (see Note 6 included in these consolidated financial statements for additional information on the note payable) is included within expenses from real estate owned in the Company's consolidated statements of operations.

Derivative Financial Instruments

Derivative financial instruments are classified as either other assets (gain positions) or other liabilities (loss positions) in the Company's consolidated balance sheets at fair value. These amounts may be offset to the extent that there is a legal right to offset and if elected by management.

On the date the Company enters into a derivative contract, the Company designates each contract as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability, or cash flow hedge, or as a derivative instrument not to be designated as a hedging derivative, or non-designated hedge. For all derivatives other than those designated as non-designated hedges, the Company formally documents the hedge relationships and designation at the contract's inception. This documentation includes the identification of the hedging instruments and the hedged items, its risk management objectives, strategy for undertaking the hedge transaction and an evaluation of the effectiveness of its hedged transaction.

The Company performs a formal assessment on a quarterly basis on whether the derivative designated in each hedging relationship is expected to be, and has been, highly effective in offsetting changes in the value or cash flows of the hedged items. Changes in the fair value of derivative contracts are recorded each period in either current earnings or other comprehensive income ("OCI"), depending on whether the derivative is designated as part of a hedge transaction and, if so, the type of hedge transaction. For derivatives that are designated as cash flow hedges, the effective portion of the unrealized gains or losses on these contracts is recorded in OCI. If it is determined that a derivative is not highly effective at hedging the designated exposure, hedge accounting is discontinued and the changes in fair value of the instrument are included in current earnings prospectively. The Company does not enter into derivatives for trading or speculative purposes.

Revenue Recognition

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

Revenue from real estate owned represents revenue associated with the operations of a hotel property classified as real estate owned. Revenue from the operation of the hotel property is recognized when guestrooms are occupied, services have been rendered or fees have been earned. Revenues are recorded net of any discounts and sales and other taxes collected from customers. Revenues consist of room sales, food and beverage sales and other hotel revenues.

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 as compared to its use of debt leverage. The Company includes interest income from its loans and interest expense related to its Secured Funding Agreements, Notes Payable, securitization debt, the Secured Term Loan (each individually defined in Note 6 included in these consolidated financial statements) and Secured Borrowings (defined in Note 7 included in these consolidated financial statements) in net interest margin. For the three and nine months ended September 30, 2021 and 2020, interest expense is comprised of the following (\$ in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Secured funding agreements	\$ 4,308	\$ 6,000	\$ 11,327	\$ 22,447
Notes payable (1)	368	337	1,841	952
Securitization debt	5,414	2,518	14,858	9,879
Secured term loan	844	1,668	2,982	5,469
Secured borrowings	1,469	1,352	4,350	1,703
Other (2)	266	—	542	—
Interest expense	\$ 12,669	\$ 11,875	\$ 35,900	\$ 40,450

(1) Excludes interest expense on the \$28.3 million note payable, which is secured by a hotel property that is recognized as real estate owned in the Company's consolidated balance sheets (see Note 6 included in these consolidated financial statements for additional information on the note payable). Interest expense on the \$28.3 million note payable is included within expenses from real estate owned in the Company's consolidated statements of operations.

(2) Represents the net interest expense recognized from the Company's derivative financial instruments upon periodic settlement.

Comprehensive Income

Comprehensive income consists of net income and OCI that are excluded from net income.

Recent Accounting Pronouncements

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, which provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The amendments apply only to contracts, hedging relationships, and other transactions that reference the London Interbank Offered Rate ("LIBOR") or another reference rate expected to be discontinued because of reference rate reform. In January 2021, the FASB issued ASU No. 2021-01, *Reference Rate Reform (Topic 848)*, to clarify that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivative instruments that use an interest rate for margining, discounting, or contract price alignment that is modified as a result of reference rate reform. ASU No. 2020-04 and ASU No. 2021-01 are effective for all entities and may be adopted retrospectively as of any date from the beginning of any interim period that includes or is subsequent to March 12, 2020 or prospectively to new modifications through December 31, 2022. The Company is currently evaluating the impact of adopting these ASUs on its consolidated financial statements.

3. LOANS HELD FOR INVESTMENT

As of September 30, 2021, the Company's portfolio included 64 loans held for investment, excluding 108 loans that were repaid, sold or converted to real estate owned since inception. The aggregate originated commitment under these loans at closing was approximately \$2.7 billion and outstanding principal was \$2.4 billion as of September 30, 2021. During the nine months ended September 30, 2021, the Company funded approximately \$891.3 million of outstanding principal and received repayments of \$340.4 million of outstanding principal as described in more detail in the tables below. As of September 30, 2021, 94.8% of the Company's loans have LIBOR floors, with a weighted average floor of 1.17%, 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, 2021 and December 31, 2020 (\$ in thousands):

	As of September 30, 2021				
	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Unleveraged Effective Yield		Weighted Average Remaining Life (Years)
Senior mortgage loans	\$ 2,332,686	\$ 2,345,569	5.6 % (2)	5.7 % (3)	1.4
Subordinated debt and preferred equity investments	30,813	31,511	15.3 % (2)	15.3 % (3)	2.3
Total loans held for investment portfolio	\$ 2,363,499	\$ 2,377,080	5.7 % (2)	5.8 % (3)	1.4

	As of December 31, 2020						
	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Unleveraged Effective Yield			Weighted Average Remaining Life (Years)	
Senior mortgage loans	\$ 1,713,601	\$ 1,723,638	5.9%	(2)	6.2 %	(3)	1.2
Subordinated debt and preferred equity investments	101,618	102,603	13.4%	(2)	13.4 %	(3)	1.9
Total loans held for investment portfolio	\$ 1,815,219	\$ 1,826,241	6.3%	(2)	6.6 %	(3)	1.2

- (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.
- (2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premiums or discounts) 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, 2021 and December 31, 2020 as weighted by the outstanding principal balance of each loan.
- (3) 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, premiums or discounts) 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 interest accruing loans held by the Company as of September 30, 2021 and December 31, 2020 as weighted by the total outstanding principal balance of each interest accruing loan (excludes loans on non-accrual status as of September 30, 2021 and December 31, 2020).

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A more detailed listing of the Company's loans held for investment portfolio based on information available as of September 30, 2021 is as follows (\$ in millions, except percentages):

Loan Type	Location	Outstanding Principal (1)	Carrying Amount (1)	Interest Rate	Unleveraged Effective Yield (2)	Maturity Date (3)	Payment Terms (4)
Senior Mortgage Loans:							
Office	IL	\$150.5	\$149.8	L+3.61%	5.5%	Mar 2023	I/O
Office	Diversified	112.5	112.2	L+3.65%	5.7%	Jan 2023	I/O
Multifamily	FL	91.3	91.0	L+5.00%	6.7%	Jun 2022	I/O
Mixed-use	FL	84.0	84.0	L+4.25%	5.7%	Feb 2023	(5) I/O
Office	AZ	77.4	76.5	L+3.50%	4.0%	Oct 2024	I/O
Mixed-use	NY	75.0	74.3	L+3.65%	4.1%	Jul 2024	I/O
Multifamily	TX	75.0	74.8	L+3.25%	3.5%	Oct 2024	I/O
Industrial	IL	70.1	69.4	L+4.55%	5.2%	May 2024	I/O
Industrial	NY	69.4	69.2	L+5.00%	7.1%	Feb 2022	(7) I/O
Hotel	OR/WA	68.1	67.3	L+3.45%	7.4%	May 2022	(6) I/O
Office	IL	67.8	67.8	L+3.75%	5.3%	Dec 2021	I/O
Residential Condominium	FL	65.7	65.1	L+5.25%	5.9%	Jul 2023	I/O
Office	NC	64.6	63.8	L+3.55%	4.2%	Aug 2024	I/O
Office	NC	63.5	63.5	L+4.25%	6.7%	Mar 2022	(8) I/O
Hotel	Diversified	60.8	60.6	L+3.60%	6.0%	Sep 2022	(9) I/O
Office	NY	60.4	59.7	L+3.85%	4.3%	Aug 2025	I/O
Office	IL	57.4	57.3	L+3.95%	6.2%	Jun 2022	(10) P/I (14)
Mixed-use	CA	56.8	56.6	(11)	5.4%	Jan 2024	I/O
Self Storage	NJ	55.5	55.6	L+3.80%	4.1%	Feb 2024	I/O
Residential Condominium	NY	53.6	53.6	(12)	10.9%	May 2021	(12) I/O
Office	GA	46.3	46.1	L+3.05%	5.7%	Dec 2022	I/O
Multifamily	FL	46.2	46.1	L+5.00%	6.6%	Jun 2022	I/O
Hotel	CA	40.0	40.0	L+4.12%	5.8%	Jan 2022	I/O
Student Housing	TX	39.5	39.5	L+4.75%	5.5%	Jan 2022	(13) P/I (14)
Multifamily	SC	37.5	37.2	L+2.75%	3.4%	Jun 2023	I/O
Student Housing	CA	36.5	36.5	L+3.95%	4.3%	Jul 2022	I/O
Mixed-use	TX	35.8	35.6	(15)	4.7%	Sep 2022	I/O
Mixed-use	CA	35.2	34.9	L+4.10%	6.3%	Mar 2023	I/O
Hotel	MI	33.2	33.2	L+3.95%	4.3%	Jul 2022	I/O
Hotel	IL	32.9	31.0	L+4.40%	—%	(16) May 2022	(16) I/O
Office	CA	32.2	32.1	L+3.35%	6.0%	Nov 2022	I/O
Multifamily	SC	30.9	30.7	L+6.50%	10.2%	Sep 2022	I/O
Student Housing	NC	30.0	30.0	L+3.15%	5.9%	Feb 2022	I/O
Multifamily	PA	29.4	29.3	L+3.00%	5.9%	Dec 2021	I/O
Office	IL	28.5	28.4	L+3.80%	6.2%	Jan 2023	I/O
Office	NC	28.5	28.1	L+3.53%	6.8%	May 2023	I/O
Student Housing	TX	24.6	24.4	L+3.45%	5.5%	Feb 2023	I/O
Industrial	NJ	23.2	22.9	L+3.75%	4.5%	May 2024	I/O
Office	CA	22.9	22.8	L+3.40%	6.2%	Nov 2022	(17) I/O
Industrial	CA	23.0	23.0	L+4.50%	7.4%	Dec 2021	I/O
Student Housing	FL	22.0	21.9	L+3.25%	5.9%	Aug 2022	I/O
Industrial	CO	20.8	20.6	L+6.75%	7.7%	Feb 2023	I/O
Student Housing	AL	19.5	19.3	L+3.85%	4.3%	May 2024	I/O
Self Storage	FL	19.5	19.5	L+3.50%	6.0%	Mar 2022	I/O
Multifamily	WA	18.7	18.6	L+3.00%	5.1%	Mar 2023	I/O
Industrial	CA	16.7	16.6	L+3.75%	6.3%	Mar 2023	I/O
Residential	CA	14.3	14.3	13.00%	—%	(18) May 2021	(18) I/O
Self Storage	FL	10.8	10.7	L+2.90%	4.4%	Dec 2023	I/O
Office	NC	9.4	9.4	L+4.00%	6.6%	Nov 2022	I/O
Self Storage	AZ	8.3	8.3	L+2.90%	4.0%	May 2024	I/O
Self Storage	AZ	7.4	7.3	L+2.90%	4.1%	May 2024	I/O
Self Storage	FL	7.0	6.9	L+2.90%	4.3%	Dec 2023	I/O
Self Storage	FL	6.4	6.4	L+2.90%	4.3%	Dec 2023	I/O
Self Storage	MO	6.1	6.1	L+3.00%	4.4%	Dec 2023	I/O
Self Storage	IL	5.5	5.5	L+3.00%	4.3%	Dec 2023	I/O
Self Storage	FL	4.4	4.4	L+2.90%	4.2%	Dec 2023	I/O
Self Storage	CO	3.2	3.2	L+2.90%	3.8%	Apr 2024	I/O

Industrial	PA	3.0	2.9	L+5.50%	6.1%	Sep 2024	I/O
Industrial	CO	2.9	2.9	L+6.25%	6.9%	Sep 2024	I/O
Industrial	AZ	2.7	2.7	L+5.90%	6.5%	Oct 2024	I/O
Industrial	GA	1.3	1.3	L+5.25%	5.9%	Sep 2024	I/O
Subordinated Debt and Preferred Equity Investments:							
Office	NJ	17.0	16.3	12.00%	13.7%	Jan 2026	I/O
Residential Condominium	HI	11.5	11.5	14.00%	19.0%	Aug 2021	(19) I/O
Office	CA	3.0	3.0	L+8.25%	9.7%	Nov 2021	I/O
Total/Weighted Average		<u>\$2,377.1</u>	<u>\$2,363.5</u>		<u>5.7%</u>		

- (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. For the loans held for investment that represent co-investments with other investment vehicles managed by Ares Management (see Note 14 included in these consolidated financial statements for additional information on co-investments), only the portion of Carrying Amount and Outstanding Principal held by the Company is reflected.
- (2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premiums or discounts) and assumes no dispositions, early prepayments or defaults. Unleveraged Effective Yield for each loan is calculated based on LIBOR as of September 30, 2021 or the LIBOR floor, as applicable. 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, 2021 as weighted by the outstanding principal balance of each loan.
- (3) Certain loans are subject to contractual extension options that generally vary between one and two 12-month extensions and may be subject to performance based or other conditions as stipulated in the loan agreement. Actual maturities may differ from contractual maturities 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.
- (5) In March 2021, the Company and the borrower entered into a modification and extension agreement to, among other things, extend the maturity date on the senior Florida loan to February 2023.
- (6) In March 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the Oregon/Washington loan to May 2022. At origination, the Oregon/Washington loan was structured as both a senior and mezzanine loan with the Company holding both positions. The mezzanine position of this loan, which had an outstanding principal balance of \$13.1 million as of September 30, 2021, was previously on non-accrual status. During the three months ended June 30, 2021, the mezzanine position was restored to accrual status as, based on management's judgment, there is no longer reasonable doubt that principal or interest will be collected in full.
- (7) In August 2021, the borrower exercised a six-month extension option in accordance with the loan agreement, which extended the maturity date on the senior New York loan to February 2022.
- (8) In February 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior North Carolina loan to March 2022.
- (9) In September 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior diversified loan to September 2022.
- (10) In April 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior Illinois loan to June 2022.
- (11) At origination, the California loan was structured as both a senior and mezzanine loan with the Company holding both positions. The senior loan, which had an outstanding principal balance of \$45.0 million as of September 30, 2021, accrues interest at a per annum rate of L + 3.80% and the mezzanine loan, which had an outstanding principal balance of \$11.8 million as of September 30, 2021, accrues interest at a per annum rate of 10.00%.
- (12) At origination, the New York loan was structured as both a senior and mezzanine loan with the Company holding the mezzanine loan and a third party holding the senior loan. In April 2021, the Company purchased the senior loan from the third party at par. The senior loan, which had an outstanding principal balance of \$35.0 million as of September 30, 2021, accrues interest at a per annum rate of L + 6.00% and the mezzanine loan, which had an outstanding principal balance of \$15.9 million as of September 30, 2021, accrues interest at a per annum rate of L + 14.00%. The mezzanine loan includes a \$2.6 million loan to the borrower, for which such amount accrues interest at a per annum rate of 20.00%. As of September 30, 2021, the New York loan, which is collateralized by a residential condominium property located in New York, is in maturity default due to the failure of the borrower to repay the outstanding principal balance

of the loan by the May 2021 maturity date. The Company evaluated this loan for impairment and concluded that no impairment charge should be recognized as of September 30, 2021 and that this loan should not be placed on non-accrual status as of September 30, 2021. This conclusion was based in part on: (1) the current estimated fair market value of the underlying collateral property and applicable reserves and (2) the estimated cash flows from the sale of units of the underlying collateral property. The estimated fair market value of the underlying collateral property was determined using the comparable market sales approach.

- (13) In January 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior Texas loan to January 2022.
- (14) Amortization began on the senior Texas loan, which had an outstanding principal balance of \$39.5 million as of September 30, 2021 and the senior Illinois loan, which had an outstanding principal balance of \$57.4 million as of September 30, 2021, in February 2021 and July 2021, respectively. The remainder of the loans in the Company's portfolio are non-amortizing through their primary terms.
- (15) In March 2021, the Company and the borrower entered into a modification agreement to, among other things, split the original senior Texas loan into two separate notes. Note A, which had an outstanding principal balance of \$35.3 million as of September 30, 2021, accrues interest at a per annum rate of L + 3.75% and Note B, which had an outstanding principal balance of \$0.4 million as of September 30, 2021, accrues interest at a per annum rate of L+10.00%.
- (16) Loan was on non-accrual status as of September 30, 2021 and therefore, there is no Unleveraged Effective Yield as the loan is non-interest accruing. In May 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior Illinois loan to May 2022.
- (17) In September 2021, the borrower exercised a one-year extension option in accordance with the loan agreement, which extended the maturity date on the senior California loan to November 2022.
- (18) Loan was on non-accrual status as of September 30, 2021 and therefore, there is no Unleveraged Effective Yield as the loan is non-interest accruing. As of September 30, 2021, the senior California loan, which is collateralized by a residential property, is in maturity default due to the failure of the borrower to repay the outstanding principal balance of the loan by the May 2021 maturity date. The Company evaluated this loan for impairment and concluded that no impairment charge should be recognized as of September 30, 2021. This conclusion was based in part on: (1) the current estimated fair market value of the underlying collateral property, (2) the estimated value of the contractual right to residual proceeds from the sale of a second residential property and (3) the recourse payment guarantee from two individuals that are the owners of the underlying collateral. The estimated fair market value of the underlying collateral property was determined using the comparable market sales approach.
- (19) As of September 30, 2021, the subordinated Hawaii loan, which is collateralized by a residential condominium property, is in maturity default due to the failure of the borrower to repay the outstanding principal balance of the loan by the August 2021 maturity date. The Company evaluated this loan for impairment and concluded that no impairment charge should be recognized as of September 30, 2021 and that this loan should not be placed on non-accrual status as of September 30, 2021. This conclusion was based in part on the current estimated fair market value of the underlying collateral property, which was determined using the comparable market sales approach and land residual method.

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. The Company's Manager monitors and evaluates each of the Company's loans held for investment and has maintained regular communications with borrowers and sponsors regarding the potential impacts of the COVID-19 pandemic on the Company's loans. Some of the Company's borrowers, in particular, borrowers with properties exposed to the hospitality, student housing and retail industries, have indicated that due to the impact of the COVID-19 pandemic, they may be unable to timely execute their business plans, are experiencing cash flow pressure, have had to temporarily close their businesses or have experienced other negative business consequences. Certain borrowers have requested temporary interest deferral or forbearance or other modifications of their loans. Based on these discussions with borrowers, the Company has made three loan modifications, representing an aggregate principal balance of \$110.7 million, during the three months ended September 30, 2021. These modifications included deferrals or capitalization of interest, amendments in extension, future funding or performance tests, extension of the maturity date, repurposing of reserves or covenant waivers on loans secured by properties directly or indirectly impacted by the COVID-19 pandemic. Loan modifications during the period were conducted pursuant to the relief granted via the Coronavirus Aid, Relief, and Economic Security Act and therefore are not evaluated for or accounted for as troubled debt restructurings.

For the nine months ended September 30, 2021, the activity in the Company's loan portfolio was as follows (\$ in thousands):

Balance at December 31, 2020	\$ 1,815,219
Initial funding	822,684
Origination fees and discounts, net of costs	(8,851)
Additional funding	68,581
Amortizing payments	(1,848)
Loan payoffs	(338,265)
Origination fee accretion	5,979
Balance at September 30, 2021	\$ 2,363,499

Except as described above, as of September 30, 2021, all loans held for investment were paying in accordance with their contractual terms. As of September 30, 2021, the Company had two loans held for investment on non-accrual status with a carrying value of \$45.3 million.

4. CURRENT EXPECTED CREDIT LOSSES

The Company estimates its CECL Reserve primarily using a probability-weighted model that considers the likelihood of default and expected loss given default for each individual loan. Calculation of the CECL Reserve requires loan specific data, which includes capital senior to the Company when the Company is the subordinate lender, changes in net operating income, debt service coverage ratio, loan-to-value, occupancy, property type and geographic location. Estimating the CECL Reserve also requires significant judgment with respect to various factors, including (i) the appropriate historical loan loss reference data, (ii) the expected timing of loan repayments, (iii) calibration of the likelihood of default to reflect the risk characteristics of the Company's floating-rate loan portfolio and (iv) the Company's current and future view of the macroeconomic environment. The Company may consider loan-specific qualitative factors on certain loans to estimate its CECL Reserve. In order to estimate the future expected loan losses relevant to the Company's portfolio, the Company utilizes historical market loan loss data licensed from a third party data service. The third party's loan database includes historical loss data for commercial mortgage-backed securities, or CMBS, issued dating back to 1998, which the Company believes is a reasonably comparable and available data set to its type of loans. The Company utilized macroeconomic data that reflects a current recession; however, the short and long-term economic implications of the COVID-19 pandemic and its financial impact on the Company are highly uncertain. For periods beyond the reasonable and supportable forecast period, the Company reverts back to historical loss data. Management's current estimate of expected credit losses increased from June 30, 2021 to September 30, 2021 primarily due to growth in the loan portfolio and other changes to the loan portfolio, partially offset by forecasted improvement in macroeconomic factors, shorter average remaining loan term and loan payoffs, during the three months ended September 30, 2021. The CECL Reserve takes into consideration the macroeconomic impact of the COVID-19 pandemic on CRE properties and is not specific to any loan losses or impairments on the Company's loans held for investment.

As of September 30, 2021, the Company's CECL Reserve for its loans held for investment portfolio is \$24.5 million or 93 basis points of the Company's total loans held for investment commitment balance of \$2.6 billion and is bifurcated between the CECL reserve (contra-asset) related to outstanding balances on loans held for investment of \$22.7 million and a liability for unfunded commitments of \$1.8 million. The liability was based on the unfunded portion of the loan commitment over the full contractual period over which the Company is exposed to credit risk through a current obligation to extend credit. Management considered the likelihood that funding will occur, and if funded, the expected credit loss on the funded portion.

Current Expected Credit Loss Reserve for Funded Loan Commitments

Activity related to the CECL Reserve for outstanding balances on the Company's loans held for investment as of and for the three and nine months ended September 30, 2021 was as follows (\$ in thousands):

Balance at June 30, 2021 ⁽¹⁾	\$	16,892
Provision for current expected credit losses		5,799
Write-offs		—
Recoveries		—
Balance at September 30, 2021 ⁽¹⁾	\$	22,691
Balance at December 31, 2020 ⁽¹⁾	\$	23,604
Provision for current expected credit losses		(913)
Write-offs		—
Recoveries		—
Balance at September 30, 2021 ⁽¹⁾	\$	22,691

- (1) The CECL Reserve related to outstanding balances on loans held for investment is recorded within current expected credit loss reserve in the Company's consolidated balance sheets.

Current Expected Credit Loss Reserve for Unfunded Loan Commitments

Activity related to the CECL Reserve for unfunded commitments on the Company's loans held for investment as of and for the three and nine months ended September 30, 2021 was as follows (\$ in thousands):

Balance at June 30, 2021 ⁽¹⁾	\$	1,221
Provision for current expected credit losses		568
Write-offs		—
Recoveries		—
Balance at September 30, 2021 ⁽¹⁾	\$	1,789
Balance at December 31, 2020 ⁽¹⁾	\$	1,632
Provision for current expected credit losses		157
Write-offs		—
Recoveries		—
Balance at September 30, 2021 ⁽¹⁾	\$	1,789

- (1) The CECL Reserve related to unfunded commitments on loans held for investment is recorded within other liabilities in the Company's consolidated balance sheets.

The Company continuously evaluates the credit quality of each loan by assessing the risk factors of each loan and assigning a risk rating based on a variety of factors. Risk factors include property type, geographic and local market dynamics, physical condition, leasing and tenant profile, projected cash flow, loan structure and exit plan, loan-to-value ratio, debt service coverage ratio, project sponsorship, and other factors deemed necessary. Based on a 5-point scale, the Company's loans are rated "1" through "5," from less risk to greater risk, which ratings are defined as follows:

Ratings	Definition
1	Very Low Risk
2	Low Risk
3	Medium Risk
4	High Risk/Potential for Loss: Asset performance is trailing underwritten expectations. Loan at risk of impairment without material improvement to performance
5	Impaired/Loss Likely: A loan that has a significantly increased probability of default and principal loss

The risk ratings are primarily based on historical data as well as taking into account future economic conditions.

As of September 30, 2021, the carrying value, excluding the CECL Reserve, of the Company's loans held for investment within each risk rating by year of origination is as follows (\$ in thousands):

	2021	2020	2019	2018	2017	Prior	Total
Risk rating:							
1	\$ 28,436	\$ —	\$ —	\$ 9,374	\$ —	\$ —	\$ 37,810
2	312,909	—	104,805	—	39,528	—	457,242
3	348,175	521,897	429,477	191,642	171,586	16,307	1,679,084
4	35,025	—	2,649	118,525	—	33,164	189,363
5	—	—	—	—	—	—	—
Total	<u>\$ 724,545</u>	<u>\$ 521,897</u>	<u>\$ 536,931</u>	<u>\$ 319,541</u>	<u>\$ 211,114</u>	<u>\$ 49,471</u>	<u>\$ 2,363,499</u>

Accrued Interest Receivable

The Company elected not to measure a CECL Reserve on accrued interest receivable due to the Company's policy of writing off uncollectible accrued interest receivable balances in a timely manner. As of September 30, 2021, interest receivable of \$17.2 million is included within other assets in the Company's consolidated balance sheets and is excluded from the carrying value of loans held for investment. If the Company were to have uncollectible accrued interest receivable, it generally would reverse accrued and unpaid interest against interest income and no longer accrue for these amounts.

5. REAL ESTATE OWNED

On March 8, 2019, the Company acquired legal title to a hotel property located in New York through a deed in lieu of foreclosure. Prior to March 8, 2019, the hotel property collateralized a \$38.6 million senior mortgage loan held by the Company that was in maturity default due to the failure of the borrower to repay the outstanding principal balance of the loan by the December 2018 maturity date. In conjunction with the deed in lieu of foreclosure, the Company derecognized the \$38.6 million senior mortgage loan and recognized the hotel property as real estate owned. As the Company does not expect to complete a sale of the hotel property within the next twelve months, the hotel property is considered held for use, and is carried at its estimated fair value at acquisition and is presented net of accumulated depreciation and impairment charges. The Company did not recognize any gain or loss on the derecognition of the senior mortgage loan as the fair value of the hotel property of \$36.9 million and the net assets held at the hotel property of \$1.7 million at acquisition approximated the \$38.6 million carrying value of the senior mortgage loan. The assets and liabilities of the hotel property are included within other assets and other liabilities, respectively, in the Company's consolidated balance sheets and include items such as cash, restricted cash, trade receivables and payables and advance deposits.

The following table summarizes the Company's real estate owned as of September 30, 2021 and December 31, 2020 (\$ in thousands):

	As of	
	September 30, 2021	December 31, 2020
Land	\$ 10,200	\$ 10,200
Buildings and improvements	24,281	24,281
Furniture, fixtures and equipment	4,448	4,362
	38,929	38,843
Less: Accumulated depreciation	(2,234)	(1,560)
Real estate owned, net	\$ 36,695	\$ 37,283

As of September 30, 2021, no impairment charges have been recognized for real estate owned.

For the three and nine months ended September 30, 2021, the Company incurred depreciation expense of \$225 thousand and \$674 thousand, respectively. For the three and nine months ended September 30, 2020, the Company incurred depreciation expense of \$224 thousand and \$668 thousand, respectively. Depreciation expense is included within expenses from real estate owned in the Company's consolidated statements of operations.

6. DEBT

Financing Agreements

The Company borrows funds, as applicable in a given period, under the Wells Fargo Facility, the Citibank Facility, the CNB Facility, the MetLife Facility and the Morgan Stanley Facility (individually defined below and collectively, the "Secured Funding Agreements"), Notes Payable (as defined below) and the Secured Term Loan (as defined below). The Company refers to the Secured Funding Agreements, Notes Payable 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, 2021 and December 31, 2020, the outstanding balances and total commitments under the Financing Agreements consisted of the following (\$ in thousands):

	September 30, 2021		December 31, 2020	
	Outstanding Balance	Total Commitment	Outstanding Balance	Total Commitment
Secured Funding Agreements:				
Wells Fargo Facility	\$ 281,150	\$ 350,000 (1)	\$ 336,001	\$ 350,000 (1)
Citibank Facility	147,982	325,000	117,506	325,000
CNB Facility	—	50,000 (2)	50,000	50,000 (2)
MetLife Facility	20,648	180,000	104,124	180,000
Morgan Stanley Facility	206,234	250,000	147,921	150,000
Subtotal	\$ 656,014	\$ 1,155,000	\$ 755,552	\$ 1,055,000
Notes Payable	\$ 48,250	\$ 51,755	\$ 63,122	\$ 84,155
Secured Term Loan	\$ 60,000	\$ 60,000	\$ 110,000	\$ 110,000
Total	\$ 764,264	\$ 1,266,755	\$ 928,674	\$ 1,249,155

- (1) The maximum commitment for the Wells Fargo Facility (as defined below) may be increased to up to \$500.0 million at the Company's option, subject to the satisfaction of certain conditions, including payment of an upsize fee.
- (2) The CNB Facility (as defined below) has an accordion feature that provides for, subject to approval by City National Bank in its sole discretion, an increase in the commitment amount from \$50.0 million to \$75.0 million for up to a period of 120 days once per calendar year.

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 \$350.0 million. The maximum commitment may be increased to up to \$500.0 million at the Company's option, subject to the satisfaction of certain conditions, including payment of an upsize fee. 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. The funding period of the Wells Fargo Facility expires on December 14, 2022, subject to one 12-month extension at the Company's option, which, if exercised, would extend the funding period to December 14, 2023. The initial maturity date of the Wells Fargo Facility is December 14, 2022, subject to three 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 all three were exercised, would extend the maturity date of the Wells Fargo Facility to December 14, 2025. Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a pricing margin range of 1.50% to 2.75%, subject to certain exceptions. In December 2020, the Company amended the Wells Fargo Facility to, among other things, eliminate the non-utilization fee on the Wells Fargo Facility. Prior to the amendment, the Company incurred 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 was utilized. For the three months ended September 30, 2020, the Company did not incur a non-utilization fee. For the nine months ended September 30, 2020, the Company incurred a non-utilization fee of \$19 thousand. 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 \$325.0 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 initial maturity date of the Citibank Facility is December 13, 2021, subject to two 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 both were exercised, would extend the maturity date of the Citibank Facility to December 13, 2023. Advances under the Citibank Facility accrue interest at a per annum rate equal to the sum of one-month LIBOR plus an indicative pricing margin range of 1.50% to 2.25%, subject to certain exceptions. The Company incurs a non-utilization fee of 25 basis points per annum on the average daily available balance of the Citibank Facility to the extent less than 75% of the Citibank Facility is utilized. For the three and nine months ended September 30, 2021, the Company incurred a non-utilization fee of \$162 thousand and \$496 thousand, respectively. For the three and nine months ended September 30, 2020, the Company incurred a non-utilization fee of \$129 thousand and \$386 thousand, respectively. The non-utilization fee is included within interest expense in the Company's consolidated statements of operations.

CNB Facility

The Company is party to a \$50.0 million secured revolving funding facility with City National Bank (the "CNB Facility"), which has an accordion feature that provides for, subject to approval by City National Bank in its sole discretion, an increase in the commitment amount from \$50.0 million to \$75.0 million for up to a period of 120 days once per calendar year. 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 2021, the Company exercised a 12-month extension option on the CNB Facility to extend the maturity date to March 10, 2022. 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 2.65% 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 1.00%; provided that in no event shall the interest rate be less than 2.65%. Unless at least 75% of the CNB Facility is used on average, unused commitments under the CNB Facility accrue non-utilization fees at the rate of 0.375% per annum.

For the three and nine months ended September 30, 2021, the Company incurred a non-utilization fee of \$28 thousand and \$96 thousand, respectively. For the three and nine months ended September 30, 2020, the Company incurred a non-utilization fee of \$6 thousand and \$38 thousand, respectively. The non-utilization fee is included within interest expense in the Company's consolidated statements of operations.

MetLife Facility

The Company is 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. The initial maturity date of the MetLife Facility is August 13, 2022, 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 13, 2024. Advances under the MetLife Facility accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 2.50%, subject to certain exceptions. For a period of nine months subsequent to August 2020, the non-utilization fee of 25 basis points per annum on the average daily available balance of the MetLife Facility, which is owed if less than 65% of the MetLife Facility is utilized, was waived. For the three and nine months ended September 30, 2021, the Company incurred a non-utilization fee of \$62 thousand and \$100 thousand, respectively. For the three and nine months ended September 30, 2020, the Company incurred a non-utilization fee of \$5 thousand and \$7 thousand, respectively. The non-utilization fee is included within interest expense in the Company's consolidated statements of operations.

Morgan Stanley Facility

The Company is party to a \$250.0 million master repurchase and securities contract with Morgan Stanley Bank, N.A. ("Morgan Stanley") (the "Morgan Stanley Facility"). Under the Morgan Stanley Facility, the Company is permitted to sell, and later repurchase, certain qualifying commercial mortgage loans collateralized by retail, office, mixed-use, multifamily, industrial, hospitality, student housing or self-storage properties. Morgan Stanley may approve the mortgage loans that are subject to the Morgan Stanley Facility in its sole discretion. The Morgan Stanley Facility has an accordion feature that provides for a \$100.0 million permanent increase in the commitment amount from \$150.0 million to \$250.0 million, which may be exercised at the Company's option, subject to the satisfaction of certain conditions, including payment of an upsized commitment fee. In June 2021, the Company exercised the option to increase the commitment amount from \$150.0 million to \$250.0 million. The initial maturity date of the Morgan Stanley Facility is January 16, 2023, 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 Morgan Stanley Facility to January 16, 2025. Advances under the Morgan Stanley Facility generally accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a spread ranging from 1.75% to 2.25%, determined by Morgan Stanley, depending upon the mortgage loan sold to Morgan Stanley in the applicable transaction.

Notes Payable

Certain of the Company's subsidiaries are party to two separate non-recourse note agreements (the "Notes Payable") with the lenders referred to therein, consisting of (1) a \$28.3 million note that was closed in June 2019, which is secured by a hotel property located in New York that is recognized as real estate owned in the Company's consolidated balance sheets and (2) a \$23.5 million note that was closed in November 2019, which is secured by a \$34.6 million senior mortgage loan held by the Company on a multifamily property located in South Carolina.

The maturity date of the \$28.3 million note is June 10, 2024, subject to one 6-month extension, which may be exercised at the Company's option, subject to the satisfaction of certain conditions, which, if exercised, would extend the maturity date to December 10, 2024. The loan may be prepaid at any time subject to the payment of a prepayment fee, if applicable. Initial advances under the \$28.3 million note accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 3.00%. If the hotel property that collateralizes the \$28.3 million note achieves certain financial performance hurdles, the interest rate on advances will decrease to a per annum rate equal to the sum of one-month LIBOR plus a spread of 2.50%. The \$28.3 million loan amount may be increased to up to \$30.0 million to fund certain construction costs of improvements at the hotel, subject to the satisfaction of certain conditions and the payment of a commitment fee. As of September 30, 2021, the total outstanding principal balance of the note was \$28.3 million.

The initial maturity date of the \$23.5 million note is September 5, 2022, 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 to September 5, 2024. Advances under the \$23.5

million note accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 3.75%. As of September 30, 2021, the total outstanding principal balance of the note was \$20.0 million.

Secured Term Loan

The Company and certain of its subsidiaries are party to a \$60.0 million Credit and Guaranty Agreement with the lenders referred to therein and Cortland Capital Market Services LLC, as administrative agent and collateral agent for the lenders (the “Secured Term Loan”). In December 2020, the Company exercised a 12-month extension option on the Secured Term Loan to extend the maturity date to December 22, 2021. Advances under the Secured Term Loan accrue interest at a per annum rate equal to the sum of, at the Company’s option, one, two, three or six-month LIBOR plus a spread of 5.00%. During the extension period, the spread on advances under the Secured Term Loan increases every three months by 0.125%, 0.375% and 0.750% per annum, respectively, beginning after the third-month of the extension period. In March 2021, the Company voluntarily elected to repay \$50.0 million of outstanding principal on the Secured Term Loan at par prior to the scheduled maturity as permitted by the contractual terms of the Secured Term Loan. As of September 30, 2021, the Secured Term Loan has a remaining outstanding principal balance of \$60.0 million.

The total original issue discount on the Secured Term Loan draws was \$2.6 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. For the three and nine months ended September 30, 2021, the estimated per annum effective interest rate of the Secured Term Loan, which is equal to LIBOR plus the spread plus the accretion of the original issue discount and associated costs, was 5.5% and 5.3%, respectively. For the three and nine months ended September 30, 2020, the estimated per annum effective interest rate of the Secured Term Loan was 5.9% and 6.5%, respectively.

7. SECURED BORROWINGS

Certain of the Company’s subsidiaries are party to three separate secured borrowing arrangements related to transferred loans, consisting of (1) a secured borrowing that was closed in February 2020, which is secured by a \$24.4 million senior mortgage loan on an office property located in North Carolina that was originated by the Company, (2) a secured borrowing that was closed in June 2020, which is secured by a \$24.9 million subordinated loan on a multifamily property located in Florida that was originated by the Company and (3) a secured borrowing that was closed in June 2020, which is secured by a \$12.6 million subordinated loan on a multifamily property located in Florida that was originated by the Company (collectively, the “Secured Borrowings”).

In April 2019, the Company originated a \$30.5 million loan on an office property located in North Carolina, which was bifurcated between a \$24.4 million senior mortgage loan and a \$6.1 million mezzanine loan. In February 2020, the Company transferred its interest in the \$24.4 million senior mortgage loan to a third party and retained the \$6.1 million mezzanine loan. The Company evaluated whether the transfer of the \$24.4 million senior mortgage loan met the criteria in FASB ASC Topic 860, *Transfers and Servicing*, for treatment as a sale – legal isolation, ability of transferee to pledge or exchange the transferred assets without constraint and transfer of effective control – and determined that the transfer did not qualify as a sale and thus, is treated as a financing transaction. As such, the Company did not derecognize the \$24.4 million senior mortgage loan asset and recorded a secured borrowing liability in the consolidated balance sheets. The initial maturity date of the \$24.4 million secured borrowing is May 5, 2023, subject to one 12-month extension, which may be exercised at the transferee’s option, which, if exercised, would extend the maturity date to May 5, 2024. Advances under the \$24.4 million secured borrowing accrue interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 2.50%. As of September 30, 2021, the total outstanding principal balance of the secured borrowing was \$22.7 million.

In June 2020, the Company originated a \$91.8 million senior mortgage loan on a multifamily property located in Florida, which the Company subsequently bifurcated between a \$66.9 million senior participation, which accrues interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 2.94% and a \$24.9 million subordinated participation, which accrues interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 10.50%. In June 2020, the Company transferred its interest in the \$24.9 million subordinated participation to a third party and retained the \$66.9 million senior participation. The Company evaluated whether the transfer of the \$24.9 million subordinated participation met the criteria in FASB ASC Topic 860, *Transfers and Servicing*, for treatment as a sale. As the \$66.9 million senior participation and the \$24.9 million subordinated participation failed to meet the participating interest requirements in FASB ASC Topic 860, *Transfers and Servicing*, since the cash flows from the original \$91.8 million senior mortgage loan are not allocated pro rata to the participation holders and there is a subordination of interest amongst the holders, it was determined that the transfer did not qualify as a sale and thus, is treated as a financing transaction. As such, the Company did not derecognize the \$24.9 million subordinated participation and recorded a secured borrowing liability in the consolidated balance sheets. The initial maturity date of the \$24.9 million secured borrowing is June 5, 2022, subject to one 12-month extension, which may be exercised at the

borrower's option, which, if exercised, would extend the maturity date to June 5, 2023. As of September 30, 2021, the total outstanding principal balance of the secured borrowing was \$24.9 million.

In June 2020, the Company closed the purchase of a \$46.7 million senior mortgage loan on a multifamily property located in Florida, which the Company subsequently bifurcated between a \$34.1 million senior participation, which accrues interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 2.94% and a \$12.6 million subordinated participation, which accrues interest at a per annum rate equal to the sum of one-month LIBOR plus a spread of 10.50%. In June 2020, the Company transferred its interest in the \$12.6 million subordinated participation to a third party and retained the \$34.1 million senior participation. The Company evaluated whether the transfer of the \$12.6 million subordinated participation met the criteria in FASB ASC Topic 860, *Transfers and Servicing*, for treatment as a sale. As the \$34.1 million senior participation and the \$12.6 million subordinated participation failed to meet the participating interest requirements in FASB ASC Topic 860, *Transfers and Servicing*, since the cash flows from the original \$46.7 million senior mortgage loan are not allocated pro rata to the participation holders and there is a subordination of interest amongst the holders, it was determined that the transfer did not qualify as a sale and thus, is treated as a financing transaction. As such, the Company did not derecognize the \$12.6 million subordinated participation and recorded a secured borrowing liability in the consolidated balance sheets. The initial maturity date of the \$12.6 million secured borrowing is June 5, 2022, subject to one 12-month extension, which may be exercised at the borrower's option, which, if exercised, would extend the maturity date to June 5, 2023. As of September 30, 2021, the total outstanding principal balance of the secured borrowing was \$12.6 million.

8. DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments, which includes interest rate swaps and interest rate caps, on certain borrowing transactions to manage its net exposure to interest rate changes and to reduce its overall cost of borrowing. These derivatives may or may not qualify as cash flow hedges under the hedge accounting requirements of FASB ASC Topic 815, *Derivatives and Hedging*. Derivatives not designated as cash flow hedges are not speculative and are used to manage our exposure to interest rate movements. See Note 2 included in these consolidated financial statements for additional discussion of the accounting for designated and non-designated hedges.

The use of derivative financial instruments involves certain risks, including the risk that the counterparties to these contractual arrangements do not perform as agreed. To mitigate this risk, the Company only enters into derivative financial instruments with counterparties that have appropriate credit ratings and are major financial institutions with which the Company and its affiliates may also have other financial relationships.

The following tables detail our outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk as of September 30, 2021 (notional amount in thousands):

Interest Rate Derivatives	Number of Instruments	Notional Amount	Rate⁽¹⁾	Index	Weighted Average Maturity (Years)
Interest rate swaps	1	\$ 870,000	0.2075 %	LIBOR ⁽²⁾	1.0
Interest rate caps	1	\$ 275,000	0.5000 %	LIBOR	1.0

(1) Represents fixed rate for interest rate swaps and strike rate for interest rate caps.

(2) Subject to a 0.00% floor.

The following table summarizes the fair value of our derivative financial instruments (\$ in thousands):

	Fair Value of Derivatives in an Asset Position⁽¹⁾ as of		Fair Value of Derivatives in a Liability Position⁽²⁾ as of	
	September 30, 2021	December 31, 2020	September 30, 2021	December 31, 2020
Derivatives designated as hedging instruments:				
Interest rate derivatives	\$ 165	—	—	—

(1) Included in other assets in the Company's consolidated balance sheets.

(2) Included in other liabilities in the Company's consolidated balance sheets.

9. COMMITMENTS AND CONTINGENCIES

As further discussed in Note 2, the full extent of the impact of the COVID-19 pandemic on the global economy and the Company's business is uncertain. As of September 30, 2021, there were no contingencies recorded on the Company's consolidated balance sheets as a result of the COVID-19 pandemic, however, if the global pandemic continues and market conditions worsen, it could adversely affect the Company's business, financial condition and results of operations.

As of September 30, 2021 and December 31, 2020, 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, 2021	December 31, 2020
Total commitments	\$ 2,633,877	\$ 2,013,993
Less: funded commitments	(2,377,080)	(1,826,241)
Total unfunded commitments	\$ 256,797	\$ 187,752

The Company from time to time may be a party to litigation relating to claims arising in the normal course of business. As of September 30, 2021, the Company is not aware of any legal claims that could materially impact its business, financial condition or results of operations.

10. STOCKHOLDERS' EQUITY

At the Market Stock Offering Program

On November 22, 2019, the Company entered into an equity distribution agreement (the "Equity Distribution Agreement"), pursuant to which the Company may offer and sell, from time to time, shares of the Company's common stock, par value \$0.01 per share, having an aggregate offering price of up to \$100.0 million. Subject to the terms and conditions of the Equity Distribution Agreement, sales of common stock, if any, may be made in transactions that are deemed to be an "at the market offering" as defined in Rule 415(a)(4) under the Securities Act of 1933, as amended. During the nine months ended September 30, 2021, the Company did not issue or sell any shares of common stock under the Equity Distribution Agreement.

Equity Offerings

On March 15, 2021, the Company entered into an underwriting agreement (the "March 2021 Underwriting Agreement"), by and among the Company, ACREM, and Morgan Stanley & Co. LLC, Wells Fargo Securities, LLC, and BofA Securities, Inc., as representatives of the several underwriters listed therein (collectively, the "March 2021 Underwriters"). Pursuant to the terms of the March 2021 Underwriting Agreement, the Company agreed to sell, and the March 2021 Underwriters agreed to purchase, subject to the terms and conditions set forth in the March 2021 Underwriting Agreement, an aggregate of 7,000,000 shares of the Company's common stock, par value \$0.01 per share. The public offering closed on March 18, 2021 and generated net proceeds of approximately \$100.7 million, after deducting transaction expenses.

On June 17, 2021, the Company entered into an underwriting agreement (the "June 2021 Underwriting Agreement"), by and among the Company, ACREM, and Morgan Stanley & Co. LLC, Wells Fargo Securities, LLC, and BofA Securities, Inc., as representatives of the several underwriters listed therein (collectively, the "June 2021 Underwriters"). Pursuant to the terms of the June 2021 Underwriting Agreement, the Company agreed to sell, and the June 2021 Underwriters agreed to purchase, subject to the terms and conditions set forth in the June 2021 Underwriting Agreement, an aggregate of 6,500,000 shares of the Company's common stock, par value \$0.01 per share. The public offering closed on June 22, 2021 and generated net proceeds of approximately \$101.6 million, after deducting transaction expenses.

Equity Incentive Plan

On April 23, 2012, the Company adopted an equity incentive plan. In April 2018, the Company's board of directors authorized, and in June 2018, the Company's stockholders approved, an amended and restated equity incentive plan that increased the total amount of shares of common stock the Company may grant thereunder to 1,390,000 shares (the "Amended and Restated 2012 Equity Incentive Plan"). Pursuant to the Amended and Restated 2012 Equity Incentive Plan, the Company may grant awards consisting of restricted shares of the Company's common stock, restricted stock units ("RSUs") and/or other

equity-based awards to the Company's outside directors, employees of the Manager, officers, ACREM and other eligible awardees under the plan. Any restricted shares of the Company's common stock and RSUs will be accounted for under FASB ASC Topic 718, *Compensation—Stock Compensation*, resulting in stock-based compensation expense equal to the grant date fair value of the underlying restricted shares of common stock or RSUs.

Restricted stock and RSU 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 or RSU grant, classified as dividends paid, equal to the per-share dividends received by common stockholders.

The following tables summarize the (i) non-vested shares of restricted stock and RSUs and (ii) vesting schedule of shares of restricted stock and RSUs for the Company's directors and officers and employees of the Manager as of September 30, 2021:

Schedule of Non-Vested Share and Share Equivalents

	Restricted Stock Grants—Directors	Restricted Stock Grants —Officers and Employees of the Manager	RSUs—Officers and Employees of the Manager	Total
Balance at December 31, 2020	22,324	68,851	267,507	358,682
Granted	23,280	—	3,439	26,719
Vested	(28,144)	(40,122)	(38,176)	(106,442)
Forfeited	—	(1,967)	(24,665)	(26,632)
Balance at September 30, 2021	<u>17,460</u>	<u>26,762</u>	<u>208,105</u>	<u>252,327</u>

Future Anticipated Vesting Schedule

	Restricted Stock Grants—Directors	Restricted Stock Grants —Officers and Employees of the Manager	RSUs—Officers and Employees of the Manager	Total
2021	5,820	1,389	—	7,209
2022	11,640	25,373	79,156	116,169
2023	—	—	79,141	79,141
2024	—	—	49,808	49,808
2025	—	—	—	—
Total	<u>17,460</u>	<u>26,762</u>	<u>208,105</u>	<u>252,327</u>

11. EARNINGS PER SHARE

The following information sets forth the computations of basic and diluted earnings per common share for the three and nine months ended September 30, 2021 and 2020 (\$ in thousands, except share and per share data):

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Net income attributable to common stockholders	\$ 9,951	\$ 14,928	\$ 43,307	\$ 7,433
Divided by:				
Basic weighted average shares of common stock outstanding:	46,957,339	33,337,445	40,840,453	32,852,553
Weighted average non-vested restricted stock and RSUs	252,130	212,999	280,298	219,532
Diluted weighted average shares of common stock outstanding:	<u>47,209,469</u>	<u>33,550,444</u>	<u>41,120,751</u>	<u>33,072,085</u>
Basic earnings per common share	<u>\$ 0.21</u>	<u>\$ 0.45</u>	<u>\$ 1.06</u>	<u>\$ 0.23</u>
Diluted earnings per common share	<u>\$ 0.21</u>	<u>\$ 0.44</u>	<u>\$ 1.05</u>	<u>\$ 0.22</u>

12. INCOME TAX

The Company wholly owns ACRC Lender W TRS LLC, which is a taxable REIT subsidiary (“TRS”) formed to issue and hold certain loans intended for sale. The Company also wholly owns ACRC 2017-FL3 TRS LLC, which is a TRS formed to hold a portion of the FL3 CLO Securitization and FL4 CLO Securitization (as defined below), including the portion that generates excess inclusion income. Additionally, the Company wholly owns ACRC WM Tenant LLC, which is a TRS formed to lease from an affiliate the hotel property classified as real estate owned acquired on March 8, 2019. ACRC WM Tenant LLC engaged a third-party hotel management company to operate the hotel under a management contract.

The income tax provision for the Company and the TRSs consisted of the following for the three and nine months ended September 30, 2021 and 2020 (\$ in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Current	\$ (35)	\$ 76	\$ 437	\$ 179
Deferred	—	—	—	(99)
Excise tax	35	105	156	270
Total income tax expense, including excise tax	<u>\$ —</u>	<u>\$ 181</u>	<u>\$ 593</u>	<u>\$ 350</u>

For the three and nine months ended September 30, 2021, the Company incurred an expense of \$35 thousand and \$156 thousand, respectively, for U.S. federal excise tax. For the three and nine months ended September 30, 2020, the Company incurred an expense of \$105 thousand and \$270 thousand, respectively, for U.S. federal excise tax. Excise tax represents a 4% tax on the sum of a portion of the Company’s ordinary income and net capital gains not distributed during the calendar year (including any distribution declared in the fourth quarter and paid following January) plus any prior year shortfall. If it is determined that an excise tax liability exists 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 Company’s consolidated statements of operations. Accrued interest and penalties, if any, are included within other liabilities in the Company’s consolidated balance sheets.

As of September 30, 2021, tax years 2017 through 2021 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.

13. FAIR VALUE

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 to sell an asset or paid to transfer a liability in 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 and nonfinancial assets and liabilities, 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 and nonfinancial assets and liabilities 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.

Recurring Fair Value Measurements

The Company is required to record derivative financial instruments at fair value on a recurring basis in accordance with GAAP. The fair value of interest rate derivatives was estimated using a third-party specialist, based on contractual cash flows and observable inputs comprising credit spreads.

The following table summarizes the financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2021:

	Level 1	Level 2	Level 3	Total
Financial assets:				
Interest rate derivatives	\$ —	\$ 165	\$ —	\$ 165
Financial liabilities:				
Interest rate derivatives	\$ —	\$ —	\$ —	\$ —

As of September 30, 2021, the Company did not have any nonfinancial assets or liabilities required to be recorded at fair value on a recurring basis. As of December 31, 2020, the Company did not have any financial and nonfinancial assets or liabilities required to be recorded at fair value on a recurring basis.

Nonrecurring Fair Value Measurements

The Company is required to record real estate owned, a nonfinancial asset, at fair value on a nonrecurring basis in accordance with GAAP. Real estate owned consists of a hotel property that was acquired by the Company on March 8, 2019 through a deed in lieu of foreclosure. See Note 5 included in these consolidated financial statements for more information on

real estate owned. Real estate owned is recorded at fair value at acquisition using Level 3 inputs and is evaluated for indicators of impairment on a quarterly basis. Real estate owned is considered impaired when the sum of estimated future undiscounted cash flows expected to be generated by the real estate owned over the estimated remaining holding period is less than the carrying amount of such real estate owned. Cash flows include operating cash flows and anticipated capital proceeds generated by the real estate owned. An impairment charge is recorded equal to the excess of the carrying value of the real estate owned over the fair value. The fair value of the hotel property at acquisition was estimated using a third-party appraisal, which utilized standard industry valuation techniques such as the income and market approach. When determining the fair value of a hotel, certain assumptions are made including, but not limited to: (1) projected operating cash flows, including factors such as booking pace, growth rates, occupancy, daily room rates, hotel specific operating costs and future capital expenditures; and (2) projected cash flows from the eventual disposition of the hotel based upon the Company's estimation of a hotel specific capitalization rate, hotel specific discount rates and comparable selling prices in the market.

As of September 30, 2021 and December 31, 2020, the Company did not have any financial assets or liabilities or nonfinancial liabilities required to be recorded at fair value on a nonrecurring basis.

Financial Assets and Liabilities Not Measured at Fair Value

As of September 30, 2021 and December 31, 2020, 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, 2021		December 31, 2020	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:					
Loans held for investment	3	\$ 2,363,499	\$ 2,355,551	\$ 1,815,219	\$ 1,800,003
Financial liabilities:					
Secured funding agreements	2	\$ 656,014	\$ 656,014	\$ 755,552	\$ 755,552
Notes payable	3	47,381	48,250	61,837	63,122
Secured term loan	3	60,000	60,000	110,000	110,000
Collateralized loan obligation securitization debt (consolidated VIEs)	3	940,133	945,089	443,871	443,467
Secured borrowings	3	59,962	60,215	59,790	60,215

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. To determine the fair value of the collateral, the Company may employ different approaches depending on the type of collateral. The Company determined the fair value of loans held for investment based on a discounted cash flow methodology, taking into consideration various factors including capitalization rates, discount rates, leasing, occupancy rates, availability and cost of financing, exit plan, sponsorship, actions of other lenders, and comparable selling prices in the market. The Secured Funding Agreements are recorded at outstanding principal, which is the Company's best estimate of the fair value. The Company determined the fair value of the Notes Payable, Secured Term Loan, collateralized loan obligation ("CLO") securitization debt and Secured Borrowings based on a discounted cash flow methodology, taking into consideration various factors including discount rates, actions of other lenders and comparable market quotes and recent trades for similar products.

14. 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, loans held for investment portfolio holdings and financing strategy.

In exchange for its services, ACREM is entitled to receive a base management fee, an incentive fee and expense reimbursements. In addition, ACREM and its personnel may receive grants of equity-based awards pursuant to the Company's Amended and Restated 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, RSUs, or any shares of the Company's common stock not yet issued, but underlying other awards granted under the Company's Amended and Restated 2012 Equity Incentive Plan (see Note 10 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 defined in the Management Agreement 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 and nine months ended September 30, 2021, the Company incurred incentive fees of \$572 thousand and \$1.9 million, respectively. For the three months ended September 30, 2020, no incentive fees were incurred. For the nine months ended September 30, 2020, the Company incurred incentive fees of \$303 thousand.

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, expenses in connection with the origination and financing of the Company's investments, communications with the Company's stockholders, information technology systems, software and data services used for the Company, travel, complying with legal and regulatory requirements, taxes, insurance maintained for the benefit of the Company as well as all other expenses actually incurred by ACREM that are reasonably necessary for the performance by ACREM of its duties and functions under the Management Agreement. Ares Management, from time to time, incurs fees, costs and expenses on behalf of more than one investment vehicle. To the extent such fees, costs and expenses are incurred for the account or benefit of more than one fund, each such investment vehicle, including the Company, will typically bear an allocable portion of any such fees, costs and expenses in proportion to the size of its investment in the activity or entity to which such expense relates (subject to the terms of each fund's governing documents) or in such other manner as Ares Management considers fair and equitable under the circumstances, such

as the relative fund size or capital available to be invested by such investment vehicles. Where an investment vehicle's governing documents do not permit the payment of a particular expense, Ares Management will generally pay such investment vehicle's allocable portion of such expense. In addition, the Company is responsible for its proportionate share of certain fees and expenses, including due diligence costs, as determined by ACREM and Ares Management, including legal, accounting and financial advisor fees and related costs, incurred in connection with evaluating and consummating investment opportunities, regardless of whether such transactions are ultimately consummated by the parties thereto.

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.

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 term of the Management Agreement ends on May 1, 2022, 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.

The following table summarizes the related party costs incurred by the Company for the three and nine months ended September 30, 2021 and 2020 and amounts payable to the Company's Manager as of September 30, 2021 and December 31, 2020 (\$ in thousands):

	Incurred				Payable	
	For the three months ended September 30,		For the nine months ended September 30,		As of	
	2021	2020	2021	2020	September 30, 2021	December 31, 2020
<i>Affiliate Payments</i>						
Management fees	\$ 2,602	\$ 1,847	\$ 6,770	\$ 5,468	\$ 2,602	\$ 1,854
Incentive fees	572	—	1,923	303	572	533
General and administrative expenses	773	802	2,313	2,890	773	762
Direct costs (1)	4	31	(3)	99	—	1
Total	<u>\$ 3,951</u>	<u>\$ 2,680</u>	<u>\$ 11,003</u>	<u>\$ 8,760</u>	<u>\$ 3,947</u>	<u>\$ 3,150</u>

- (1) For the three and nine months ended September 30, 2021 and 2020, direct costs incurred are included within general and administrative expenses in the Company's consolidated statements of operations.

Investments in Loans

From time to time, the Company may co-invest with other investment vehicles managed by Ares Management or its affiliates, including the Manager, and their portfolio companies, including by means of splitting investments, participating in investments or other means of syndication of investments. For such co-investments, the Company expects to act as the administrative agent for the holders of such investments provided that the Company maintains a majority of the aggregate investment. No fees will be received by the Company for performing such service. The Company will be responsible for its pro-rata share of costs and expenses for such co-investments, including due diligence costs for transactions which fail to close. The

Company's investment in such co-investments are made on a pari-passu basis with the other Ares managed investment vehicles and the Company is not obligated to provide, nor has it provided, any financial support to the other Ares managed investment vehicles. As such, the Company's risk is limited to the carrying value of its investment and the Company recognizes only the carrying value of its investment in its consolidated balance sheets. As of September 30, 2021 and December 31, 2020, the total outstanding principal balance for co-investments held by the Company was \$169.7 million and \$45.1 million, respectively.

Loan Purchases From Affiliate

An affiliate of the Company's Manager maintains a \$200 million real estate debt warehouse investment vehicle (the "Ares Warehouse Vehicle") that holds Ares Management originated commercial real estate loans, which are made available to purchase by other investment vehicles, including the Company and other Ares Management managed investment vehicles. From time to time, the Company may purchase loans from the Ares Warehouse Vehicle. The Company's Manager will approve the purchase of such loans only on terms, including the consideration to be paid, that are determined by the Company's Manager in good faith to be appropriate for the Company once the Company has sufficient liquidity. The Company is not obligated to purchase any loans originated by the Ares Warehouse Vehicle. In addition, from time to time, the Company may purchase loans, including participations in loans, from other Ares Management managed investment vehicles. Loans purchased by the Company from the Ares Warehouse Vehicle or other Ares Management managed investment vehicles are purchased at fair value as determined by an independent third-party valuation expert and are subject to approval by a majority of the Company's independent directors.

In January 2021, the Company purchased a \$105.5 million senior mortgage loan on an office property located in Illinois from the Ares Warehouse Vehicle. At the January 2021 purchase date, the outstanding principal balance was \$103.6 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a \$5.6 million senior mortgage loan on a self storage property located in Illinois from the Ares Warehouse Vehicle. At the January 2021 purchase date, the outstanding principal balance was \$5.4 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a fully funded \$6.4 million senior mortgage loan on a self storage property located in Florida from the Ares Warehouse Vehicle, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a fully funded \$4.4 million senior mortgage loan on a self storage property located in Florida from the Ares Warehouse Vehicle, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a fully funded \$7.0 million senior mortgage loan on a self storage property located in Florida from the Ares Warehouse Vehicle, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a fully funded \$10.8 million senior mortgage loan on a self storage property located in Florida from the Ares Warehouse Vehicle, which is included within loans held for investment in the Company's consolidated balance sheets.

In January 2021, the Company purchased a \$6.5 million senior mortgage loan on a self storage property located in Missouri from the Ares Warehouse Vehicle. At the January 2021 purchase date, the outstanding principal balance was \$5.9 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In May 2021, the Company purchased a \$100.7 million senior mortgage loan on an industrial property located in Illinois from the Ares Warehouse Vehicle. At the May 2021 purchase date, the outstanding principal balance was \$62.1 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In June 2021, the Company purchased a fully funded \$40.5 million senior mortgage loan on a portfolio of self storage properties located in New Jersey from the Ares Warehouse Vehicle, which is included within loans held for investment in the Company's consolidated balance sheets.

In June 2021, the Company purchased a \$44.7 million senior mortgage loan on an industrial property located in New Jersey from the Ares Warehouse Vehicle. At the June 2021 purchase date, the outstanding principal balance was \$23.2 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In July 2021, the Company purchased a \$78.3 million pari-passu participation in a \$227.1 million senior mortgage loan on a mixed use property located in New York from an Ares Management managed investment vehicle. At the July 2021 purchase date, the outstanding principal balance was \$75.0 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In August 2021, the Company purchased an \$85.0 million pari-passu note in a senior mortgage loan on an office property located in North Carolina from an Ares Management managed investment vehicle. At the August 2021 purchase date, the outstanding principal balance was \$64.6 million, which is included within loans held for investment in the Company's consolidated balance sheets.

In September 2021, the Company purchased a \$26.0 million pari-passu participation in a \$115.7 million senior mortgage loan on an office property located in Arizona from the Ares Warehouse Vehicle. At the September 2021 purchase date, the outstanding principal balance of the purchased participation was \$17.4 million, which is included within loans held for investment in the Company's consolidated balance sheets. At origination, the Arizona office senior mortgage loan was bifurcated between an \$89.7 million senior participation, which was originated by the Company, and a \$26.0 million senior participation, which was originated by the Ares Warehouse Vehicle.

15. DIVIDENDS AND DISTRIBUTIONS

The following table summarizes the Company's dividends declared during the nine months ended September 30, 2021 and 2020 (\$ in thousands, except per share data):

Date Declared	Record Date	Payment Date	Per Share Amount	Total Amount
July 30, 2021	September 30, 2021	October 15, 2021	\$ 0.35 (1)	\$ 16,523
May 4, 2021	June 30, 2021	July 15, 2021	0.35 (1)	16,528
February 17, 2021	March 31, 2021	April 15, 2021	0.35 (1)	14,248
Total cash dividends declared for the nine months ended September 30, 2021			\$ 1.05	\$ 47,299
September 16, 2020	September 30, 2020	October 15, 2020	\$ 0.33	\$ 11,072
June 19, 2020	June 30, 2020	July 15, 2020	0.33	11,072
February 20, 2020	March 31, 2020	April 15, 2020	0.33	11,057
Total cash dividends declared for the nine months ended September 30, 2020			\$ 0.99	\$ 33,201

(1) Consists of a regular cash dividend of \$0.33 and a supplemental cash dividend of \$0.02.

16. 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 the CLO Securitizations (as defined below), which are considered to be variable interests in VIEs.

CLO Securitizations

On January 11, 2019, ACRE Commercial Mortgage 2017-FL3 Ltd. (the "FL3 Issuer") and ACRE Commercial Mortgage 2017-FL3 LLC (the "FL3 Co-Issuer"), both wholly-owned indirect subsidiaries of the Company, entered into an Amended and Restated Indenture (the "FL3 Amended Indenture") with Wells Fargo Bank, National Association, as advancing agent and note administrator, and Wilmington Trust, National Association, as trustee, which governs the approximately \$504.1 million principal balance of secured floating rate notes (the "FL3 Notes") issued by the FL3 Issuer and \$52.9 million of preferred equity in the FL3 Issuer (the "FL3 CLO Securitization"). The FL3 Amended Indenture amends and restates, and replaces in its entirety, the indenture for the CLO securitization issued in March 2017, which governed the issuance of

approximately \$308.8 million principal balance of secured floating rate notes and \$32.4 million of preferred equity in the FL3 Issuer.

As of September 30, 2021, the FL3 Notes were collateralized by interests in a pool of 17 mortgage assets having a total principal balance of \$509.6 million (the “FL3 Mortgage Assets”) that were closed by a wholly-owned subsidiary of the Company and approximately \$47.4 million of receivables related to repayments of outstanding principal on previous mortgage assets. As of December 31, 2020, the FL3 Notes were collateralized by interests in a pool of 15 mortgage assets having a total principal balance of approximately \$550.6 million that were closed by a wholly-owned subsidiary of the Company and approximately \$6.4 million of receivables related to repayments of outstanding principal on previous mortgage assets. On April 13, 2021, the FL3 Issuer and the FL3 Co-Issuer entered into a First Supplement to Amended and Restated Indenture (the “2021 Amended Indenture”) with Wells Fargo Bank, National Association, as advancing agent and note administrator, and Wilmington Trust, National Association, as trustee, which governs the FL3 CLO Securitization. The purpose of the 2021 Amended Indenture was to, among other things, extend the reinvestment period to March 31, 2024. During the reinvestment period, the Company may direct the FL3 Issuer to acquire additional mortgage assets meeting applicable reinvestment criteria using the principal repayments from the FL3 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 FL3 Mortgage Assets to the Issuer is governed by a Mortgage Asset Purchase Agreement between the Seller and the FL3 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 FL3 Issuer and FL3 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 “FL3 Offered Notes”) to a third party. The Company retained (through one of its wholly-owned subsidiaries) approximately \$58.5 million of the FL3 Notes and all of the \$52.9 million of preferred equity in the FL3 Issuer, which totaled \$111.4 million. The Company, as the holder of the subordinated FL3 Notes and all of the preferred equity in the FL3 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.

On January 28, 2021, ACRE Commercial Mortgage 2021-FL4 Ltd. (the “FL4 Issuer”) and ACRE Commercial Mortgage 2021-FL4 LLC (the “FL4 Co-Issuer”), both wholly owned indirect subsidiaries of the Company, entered into an Indenture (the “FL4 Indenture”) with ACRC Lender LLC, a wholly owned subsidiary of the Company (the “Seller”), as advancing agent, Wells Fargo Bank, National Association, as note administrator, and Wilmington Trust, National Association, as trustee, which governs the issuance of approximately \$603.0 million principal balance secured floating rate notes (the “FL4 Notes”) and \$64.3 million of preferred equity in the FL4 Issuer (the “FL4 CLO Securitization”). For U.S. federal income tax purposes, the FL4 Issuer and FL4 Co-Issuer are disregarded entities.

As of September 30, 2021, the FL4 Notes were collateralized by interests in a pool of 21 mortgage assets having a total principal balance of approximately \$626.0 million (the “FL4 Mortgage Assets”) that were closed by a wholly-owned subsidiary of the Company and approximately \$0.3 million of receivables related to repayments of outstanding principal on current mortgage assets. During the period ending in April 2024 (the “Companion Participation Acquisition Period”), the FL4 Issuer may use certain principal proceeds from the FL4 Mortgage Assets to acquire additional funded pari-passu participations related to the FL4 Mortgage Assets that meet certain acquisition criteria.

The sale of the FL4 Mortgage Assets to the FL4 Issuer is governed by a FL4 Mortgage Asset Purchase Agreement between the Seller and the FL4 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 FL4 CLO Securitization, the FL4 Issuer and FL4 Co-Issuer offered and issued the following classes of FL4 Notes to third party investors: Class A, Class A-S, Class B, Class C, Class D and Class E Notes (collectively, the “FL4 Offered Notes”). A wholly owned subsidiary of the Company retained approximately \$62.5 million of the FL4 Notes and all of the \$64.3 million of preferred equity in the FL4 Issuer, which totaled \$126.8 million. The Company, as the holder of the subordinated FL4 Notes and all of the preferred equity in the FL4 Issuer, has the obligation to absorb losses of the FL4 CLO Securitization, since the Company has a first loss position in the capital structure of the FL4 CLO Securitization. During the three months ended September 30, 2021, the Company paid down \$41.0 million of the FL4 Offered Notes.

The FL3 CLO Securitization and the FL4 CLO Securitization are collectively referred to as the “CLO Securitizations.” As the directing holder of the CLO Securitizations, the Company has the ability to direct activities that could significantly impact the CLO Securitizations’ economic performance. ACRES is designated as special servicer of the CLO Securitizations 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 Securitizations' 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 Securitizations' 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 each of the CLO Securitizations; thus, the CLO Securitizations are consolidated into the Company's consolidated financial statements.

The CLO Securitizations are consolidated in accordance with FASB ASC Topic 810 and are structured as pass through entities that receive 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 Securitizations are restricted and can only be used to fulfill the obligations of the respective CLO Securitizations. Additionally, the obligations of the CLO Securitizations 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 Securitizations 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 Securitizations are 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 structures. As such, the risk associated with the Company's involvement in the CLO Securitizations are limited to the carrying value of its investment in each of the entities. As of September 30, 2021, the Company's maximum risk of loss was \$238.2 million, which represents the carrying value of its investments in the CLO Securitizations.

17. 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, 2021, except as disclosed below.

On October 7, 2021, the Company originated a \$23.1 million senior mortgage loan on a multifamily property located in Texas. At closing, the outstanding principal balance was approximately \$21.9 million. The loan has a per annum interest rate of LIBOR plus 2.50%.

On October 19, 2021, the Company originated and fully funded a \$6.7 million senior mortgage loan on an industrial property located in Tennessee. The loan has a per annum interest rate of LIBOR plus 5.50%.

On October 27, 2021, the Company originated and fully funded a \$7.0 million senior mortgage loan on an industrial property located in Pennsylvania. The loan has a per annum interest rate of LIBOR plus 5.90%.

The Company's Board of Directors declared a regular cash dividend of \$0.33 per common share and a supplemental cash dividend of \$0.02 per common share for the fourth quarter of 2021. The fourth quarter 2021 and supplemental cash dividends will be payable on January 19, 2022 to common stockholders of record as of December 31, 2021.

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

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 Corporation (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 United States 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 United States federal income taxes on our REIT taxable income as long as we annually distribute to stockholders an amount at least equal to our REIT taxable income prior to the deduction for dividends paid and comply with various other requirements as a REIT. We also operate our business in a manner that is intended to permit us to maintain our exemption from registration under the 1940 Act.

Developments During the Third Quarter of 2021:

- ACRE purchased a \$78.3 million pari-passu participation in a \$227.1 million senior mortgage loan on a mixed use property located in New York from an Ares Management managed investment vehicle.
- ACRE originated a \$75.0 million senior mortgage loan on a residential condominium property located in Florida.
- ACRE originated an \$81.0 million senior mortgage loan on an office property located in New York.
- ACRE purchased a \$3.2 million senior mortgage loan on a self storage property located in Colorado from a third party.
- ACRE purchased an \$8.6 million senior mortgage loan on a self storage property located in Arizona from a third party.
- ACRE purchased a \$7.4 million senior mortgage loan on a self storage property located in Arizona from a third party.
- ACRE originated a \$20.8 million senior mortgage loan on an industrial property located in Colorado.
- ACRE purchased an \$85.0 million pari-passu note in a senior mortgage loan on an office property located in North Carolina from an Ares Management managed investment vehicle.
- ACRE originated a \$1.3 million senior mortgage loan on an industrial property located in Georgia.
- ACRE originated a \$3.0 million senior mortgage loan on an industrial property located in Pennsylvania.
- ACRE originated a \$2.9 million senior mortgage loan on an industrial property located in Colorado.
- ACRE originated an \$89.7 million pari-passu participation in a \$115.7 million senior mortgage loan on an office property located in Arizona. Subsequent to the origination of the \$89.7 million participation, ACRE purchased the remaining \$26.0 million pari-passu participation from the Ares Warehouse Vehicle.
- ACRE originated a \$2.7 million senior mortgage loan on an industrial property located in Arizona.

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, creditworthiness 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.

Loans Held for Investment Portfolio

As of September 30, 2021, our portfolio included 64 loans held for investment, excluding 108 loans that were repaid, sold or converted to real estate owned since inception. As of September 30, 2021, the aggregate originated commitment under these loans at closing was approximately \$2.7 billion and outstanding principal was \$2.4 billion. During the nine months ended September 30, 2021, we funded approximately \$891.3 million of outstanding principal and received repayments of \$340.4 million of outstanding principal. As of September 30, 2021, 94.8% of our loans have LIBOR floors, with a weighted average floor of 1.17%, 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, 2021, all loans held for investment were paying in accordance with their contractual terms.

Our loans held for investment are accounted for at amortized cost. The following table summarizes our loans held for investment as of September 30, 2021 (\$ in thousands):

	As of September 30, 2021				
	Carrying Amount (1)	Outstanding Principal (1)	Weighted Average Unleveraged Effective Yield		Weighted Average Remaining Life (Years)
Senior mortgage loans	\$ 2,332,686	\$ 2,345,569	5.6 % (2)	5.7 % (3)	1.4
Subordinated debt and preferred equity investments	30,813	31,511	15.3 % (2)	15.3 % (3)	2.3
Total loans held for investment portfolio	\$ 2,363,499	\$ 2,377,080	5.7 % (2)	5.8 % (3)	1.4

- (1) The difference between the Carrying Amount and the Outstanding Principal amount of the loans held for investment consists of unamortized purchase discount, deferred loan fees and loan origination costs.
- (2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premiums or discounts) 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, 2021 as weighted by the outstanding principal balance of each loan.
- (3) 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, premiums or discounts) 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 interest accruing loans held by us as of September 30, 2021 as weighted by the total outstanding principal balance of each interest accruing loan (excludes loans on non-accrual status as of September 30, 2021).

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”), 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. See Note 2 to our consolidated financial statements included in this quarterly report on Form 10-Q, which describes factors which may impact management’s estimates and assumptions and the recently issued accounting pronouncements that were adopted or not yet required to be adopted by us.

RECENT DEVELOPMENTS

On October 7, 2021, we originated a \$23.1 million senior mortgage loan on a multifamily property located in Texas. At closing, the outstanding principal balance was approximately \$21.9 million. The loan has a per annum interest rate of LIBOR plus 2.50%.

On October 19, 2021, we originated and fully funded a \$6.7 million senior mortgage loan on an industrial property located in Tennessee. The loan has a per annum interest rate of LIBOR plus 5.50%.

On October 27, 2021, we originated and fully funded a \$7.0 million senior mortgage loan on an industrial property located in Pennsylvania. The loan has a per annum interest rate of LIBOR plus 5.90%.

Our Board of Directors declared a regular cash dividend of \$0.33 per common share and a supplemental cash dividend of \$0.02 per common share for the fourth quarter of 2021. The fourth quarter 2021 and supplemental cash dividends will be payable on January 19, 2022 to common stockholders of record as of December 31, 2021.

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, 2021 and 2020 (\$ in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Total revenue	\$ 27,204	\$ 22,374	\$ 71,958	\$ 61,490
Total expenses	10,886	8,303	28,814	27,636
Provision for current expected credit losses	6,367	(1,048)	(756)	22,063
Realized losses on loans sold	—	4,008	—	4,008
Change in unrealized losses on loans held for sale	—	(3,998)	—	—
Income before income taxes	9,951	15,109	43,900	7,783
Income tax expense, including excise tax	—	181	593	350
Net income attributable to common stockholders	\$ 9,951	\$ 14,928	\$ 43,307	\$ 7,433

The following tables set forth select details of our consolidated results of operations for the three and nine months ended September 30, 2021 and 2020 (\$ in thousands):

Net Interest Margin

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Interest income	\$ 34,023	\$ 30,626	\$ 95,587	\$ 91,908
Interest expense	(12,669)	(11,875)	(35,900)	(40,450)
Net interest margin	\$ 21,354	\$ 18,751	\$ 59,687	\$ 51,458

For the three months ended September 30, 2021 and 2020, net interest margin was approximately \$21.4 million and \$18.8 million, respectively. For the three months ended September 30, 2021 and 2020, interest income of \$34.0 million and \$30.6 million, respectively, was generated by weighted average earning assets of \$2.3 billion and \$1.8 billion, respectively, offset by \$12.7 million and \$11.9 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 CNB Facility, the MetLife Facility and the Morgan Stanley Facility (individually defined below and collectively, the “Secured Funding Agreements”), Notes Payable (as defined below and excluding the Note Payable on the hotel property that is recognized as real estate owned in our consolidated balance sheets), the Secured Term Loan, Secured Borrowings and securitization debt (as defined below) were \$1.7 billion for the three months ended September 30, 2021 and \$1.5 billion for the three months ended September 30, 2020. The increase in net interest margin for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 primarily relates to an increase in our weighted average earning assets and weighted average borrowings for the three months ended September 30, 2021. In addition, in January 2021, we issued \$540.5 million of securitization debt, a portion of the proceeds of which were used to pay down debt with a higher cost of funds than the issued securitization debt.

For the nine months ended September 30, 2021 and 2020, net interest margin was approximately \$59.7 million and \$51.5 million, respectively. For the nine months ended September 30, 2021 and 2020, interest income of \$95.6 million and \$91.9 million, respectively, was generated by weighted average earning assets of \$2.1 billion and \$1.9 billion, respectively, offset by \$35.9 million and \$40.5 million, respectively, of interest expense, unused fees and amortization of deferred loan costs. The weighted average borrowings under the Secured Funding Agreements, Notes Payable (excluding the Note Payable on the hotel property that is recognized as real estate owned in our consolidated balance sheets), the Secured Term Loan, Secured Borrowings and securitization debt were \$1.6 billion for the nine months ended September 30, 2021 and \$1.5 billion for the nine months ended September 30, 2020. The increase in net interest margin for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 primarily relates to an increase in our weighted average earning assets and weighted average borrowings for the nine months ended September 30, 2021. In addition, in January 2021, we issued \$540.5 million of securitization debt, a portion of the proceeds of which were used to pay down debt with a higher cost of funds than the issued securitization debt.

Revenue From Real Estate Owned

On March 8, 2019, we acquired legal title to a hotel property through a deed in lieu of foreclosure. Prior to March 8, 2019, the hotel property collateralized a \$38.6 million senior mortgage loan that we held that was in maturity default due to the failure of the borrower to repay the outstanding principal balance of the loan by the December 2018 maturity date. In conjunction with the deed in lieu of foreclosure, we derecognized the \$38.6 million senior mortgage loan and recognized the hotel property as real estate owned. For the three months ended September 30, 2021 and 2020, revenue from real estate owned was \$5.9 million and \$3.6 million, respectively. Revenues consist of room sales, food and beverage sales and other hotel revenues. The increase in revenue from real estate owned for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 is primarily due to the ongoing recovery from the impact of the COVID-19 pandemic as occupancy and overall revenue at the hotel property increased for the three months ended September 30, 2021. For the nine months ended September 30, 2021 and 2020, revenue from real estate owned was \$12.3 million and \$10.0 million, respectively. The increase in revenue from real estate owned for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 is primarily due to the ongoing recovery from the impact of the COVID-19 pandemic as occupancy and overall revenue at the hotel property increased for the nine months ended September 30, 2021.

Operating Expenses

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Management and incentive fees to affiliate	\$ 3,175	\$ 1,847	\$ 8,693	\$ 5,771
Professional fees	480	639	1,880	2,202
General and administrative expenses	1,119	969	3,470	2,797
General and administrative expenses reimbursed to affiliate	773	802	2,313	2,890
Expenses from real estate owned	5,339	4,046	12,458	13,976
Total expenses	\$ 10,886	\$ 8,303	\$ 28,814	\$ 27,636

See the Related Party Expenses, Other Expenses and Expenses from Real Estate Owned discussions below for the cause of the increase in operating expenses for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 and the cause of the increase in operating expenses for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020.

Related Party Expenses

For the three months ended September 30, 2021, related party expenses included \$3.2 million in management and incentive fees due to our Manager pursuant to the Management Agreement, which consisted of \$2.6 million in management fees and \$0.6 million in incentive fees. For the three months ended September 30, 2021, related party expenses also included \$0.8 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, 2020, related party expenses included \$1.8 million in management fees due to our Manager pursuant to the Management Agreement. No incentive fees were incurred for the three months ended September 30, 2020. For the three months ended September 30, 2020, related party expenses also included \$0.8 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 for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 primarily relates to an increase in our weighted average stockholders' equity for the three months ended September 30, 2021 as a result of the public offering of 7,000,000 shares of our common stock in March 2021, which generated net proceeds of approximately \$100.7 million, and the public offering of 6,500,000 shares of our common stock in June 2021, which generated net proceeds of approximately \$101.6 million. The increase in incentive fees for the three months ended September 30, 2021 compared to the three months ended September 30, 2020, primarily relates to our Core Earnings (as defined below) for the twelve months ended September 30, 2021 exceeding the 8% minimum return by a higher margin than the twelve months ended September 30, 2020. "Core Earnings" is defined in the Management Agreement 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 our target investments are structured as debt and we foreclose 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 our Manager and our independent directors and after approval by a majority of our independent directors.

For the nine months ended September 30, 2021, related party expenses included \$8.7 million in management and incentive fees due to our Manager pursuant to the Management Agreement, which consisted of \$6.8 million in management fees and \$1.9 million in incentive fees. For the nine months ended September 30, 2021, related party expenses also included \$2.3 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, 2020, related party expenses included \$5.8 million in management and incentive fees due to our Manager pursuant to the Management Agreement, which consisted of \$5.5 million in management fees and \$0.3 million in incentive fees. For the nine months ended September 30, 2020, related party expenses also included \$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. The increase in management fees for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 primarily relates to an increase in our weighted average stockholders' equity for the nine months ended September 30, 2021 as a result of the public offering of 7,000,000 shares of our common stock in March 2021, which generated net proceeds of approximately \$100.7 million, and the public offering of 6,500,000 shares of our common stock in June 2021, which generated net proceeds of approximately \$101.6 million. The increase in incentive fees for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 primarily relates to our Core Earnings for the twelve months ended September 30, 2021 exceeding the 8% minimum return by a higher margin than the twelve months ended September 30, 2020. The decrease in allocable general and administrative expenses due to our Manager for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 primarily relates to a decrease in the percentage of time allocated to us by employees of our Manager due to changes in transaction activity year over year.

Other Expenses

For the three months ended September 30, 2021 and 2020, professional fees were \$0.5 million and \$0.6 million, respectively. The decrease in professional fees for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 primarily relates to a decrease in our use of third-party professionals due to changes in transaction activity year over year. For the three months ended September 30, 2021 and 2020, general and administrative expenses were \$1.1 million and \$1.0 million, respectively. The increase in general and administrative expenses for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 primarily relates to an increase in stock-based compensation expense due to new restricted stock and restricted stock unit grants awarded after September 30, 2020.

For the nine months ended September 30, 2021 and 2020, professional fees were \$1.9 million and \$2.2 million, respectively. The decrease in professional fees for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 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, 2021 and 2020, general and administrative expenses were \$3.5 million and \$2.8 million, respectively. The increase in general and administrative expenses for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 primarily relates to an increase in stock-based compensation expense due to new restricted stock and restricted stock unit grants awarded after September 30, 2020.

Expenses From Real Estate Owned

For the three and nine months ended September 30, 2021 and 2020, expenses from real estate owned was comprised of the following (\$ in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2021	2020	2021	2020
Hotel operating expenses	\$ 4,694	\$ 3,404	\$ 10,539	\$ 12,059
Interest expense on note payable	420	418	1,245	1,249
Depreciation expense	225	224	674	668
Expenses from real estate owned	\$ 5,339	\$ 4,046	\$ 12,458	\$ 13,976

For the three months ended September 30, 2021 and 2020, hotel operating expenses were \$4.7 million and \$3.4 million, respectively. Hotel operating expenses consist primarily of expenses incurred in the day-to-day operation of our hotel property, including room expense, food and beverage expense and other operating expenses. Room expense includes housekeeping and front office wages and payroll taxes, reservation systems, room supplies, laundry services and other costs. Food and beverage expense primarily includes the cost of food, the cost of beverages and associated labor costs. Other operating expenses include labor and other costs associated with administrative departments, sales and marketing, repairs and

maintenance, real estate taxes, insurance, utility costs and management and incentive fees paid to the hotel property manager. The increase in hotel operating expenses for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 is primarily due to the ongoing recovery from the impact of the COVID-19 pandemic as occupancy and overall expenses at the hotel property increased for the three months ended September 30, 2021. For both the three months ended September 30, 2021 and 2020, interest expense on our note payable was \$0.4 million. For both the three months ended September 30, 2021 and 2020, depreciation expense was \$0.2 million.

For the nine months ended September 30, 2021 and 2020, hotel operating expenses were \$10.5 million and \$12.1 million, respectively. The decrease in hotel operating expenses for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 is primarily due to the nine months ended September 30, 2020 including two months of hotel operations that were not significantly impacted by the COVID-19 pandemic, which significantly reduced occupancy and forced us to implement plans to reduce overall operating expenses at the hotel property. For both the nine months ended September 30, 2021 and 2020, interest expense on our note payable was \$1.2 million. For both the nine months ended September 30, 2021 and 2020, depreciation expense was \$0.7 million.

Provision for Current Expected Credit Losses

For the three months ended September 30, 2021 and 2020, the provision for current expected credit losses was \$6.4 million and \$(1.0) million, respectively. The increase in the provision for current expected credit losses for the three months ended September 30, 2021 compared to the three months ended September 30, 2020 is primarily due to growth in the loan portfolio and other changes to the loan portfolio, partially offset by forecasted improvement in macroeconomic factors, shorter average remaining loan term and loan payoffs, during the three months ended September 30, 2021.

For the nine months ended September 30, 2021 and 2020, the provision for current expected credit losses was \$(0.8) million and \$22.1 million, respectively. The decrease in the provision for current expected credit losses for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 is primarily due to forecasted improvement in macroeconomic factors during the nine months ended September 30, 2021.

The current expected credit loss reserve (the "CECL Reserve") takes into consideration the macroeconomic impact of the COVID-19 pandemic on CRE properties and is not specific to any loan losses or impairments on our loans held for investment. Additionally, the CECL Reserve is not an indicator of what we expect our CECL Reserve would have been absent the current and potential future impacts of the COVID-19 pandemic.

Realized Losses on Loans Sold and Change in Unrealized Losses on Loans Held for Sale

In July 2020, we closed the sale of a senior mortgage loan with outstanding principal of \$31.5 million, which was collateralized by a hotel property located in Minnesota, to a third party. In addition, in August 2020, we closed the sale of two senior mortgage loans to a third party with outstanding principal of \$39.9 million and \$29.6 million, respectively, which were collateralized by multifamily properties located in Illinois and Texas, respectively. As of June 30, 2020, it was our intent to sell these three senior mortgage loans and thus, the three loans were reclassified from held for investment to held for sale and were carried at fair value in our consolidated balance sheets. For the three months ended June 30, 2020, we recognized an aggregate net unrealized loss of \$4.0 million in our consolidated statements of operations upon reclassifying the three loans from held for investment to held for sale as the carrying value exceeded fair value as determined by the sale prices of the loans. This aggregate net unrealized loss was realized during the three months ended September 30, 2020. For the three months ended September 30, 2020, the \$4.0 million net realized loss recognized upon the sale of the loans is included within realized losses on loans sold in our consolidated statements of operations while the reversal of the net unrealized loss is included within change in unrealized losses on loans held for sale in our consolidated statements of operations.

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. 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.

Due to the impact of the COVID-19 pandemic, we may experience borrowers who are unable to pay interest and principal payments timely, including at the maturity date of the borrower's loan, if at all, and expected prepayments by our borrowers may not occur, which could impact our liquidity. Our Secured Funding Agreements contains margin call provisions following the occurrence of certain mortgage loan credit events. If we are unable to make the required payment or if we fail to meet or satisfy any of the covenants in our Financing Agreements, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral, including cash to satisfy margin calls, and enforce their interests against existing collateral. We are also subject to cross-default and acceleration rights with respect to our Financing Agreements. Given the impact of the COVID-19 pandemic on the real estate industry and the potential impact on our borrowers, to mitigate the risk of future margin calls, we proactively engaged in discussions with certain of our lenders to modify the terms of our borrowings on certain assets within these facilities, in order to, among other things, reduce the amounts we are borrowing against such assets and/or increase the borrowing spreads. We may not receive financing from our Secured Funding Agreements with respect to our commitments to fund our loans held for investment in the future. See "Summary of Financing Agreements" below for a description of our Financing Agreements.

Subject to maintaining our qualification as a REIT and our exemption from the 1940 Act, we expect that our primary sources of enhancing our liquidity will be financing, to the extent available to us, through credit, secured funding and other lending facilities, other sources of private financing, including warehouse and repurchase facilities, and public or private offerings of our equity or debt securities. On July 19, 2019, we filed a registration statement on Form S-3 with the SEC, which became effective on August 2, 2019, 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. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering. We may also access liquidity through our "At the Market Stock Offering Program" which was established in November 2019 pursuant to which we may sell, from time to time, up to \$100.0 million of shares of our common stock. Furthermore, we have sold, and may continue to sell certain of our mortgage loans, or interests therein, in order to manage liquidity needs. Subject to maintaining our qualification as a REIT, we may also change our dividend practice, including by reducing the amount of, or temporarily suspending, our future dividends or making dividends that are payable in cash and shares of our common stock for some period of time. We are also able to access additional liquidity through the (i) reinvestment provisions in our FL3 CLO Securitization, which allows us to replace mortgage assets in our FL3 CLO Securitization which have repaid and (ii) future funding acquisition provisions in our FL4 collateralized loan obligation securitization debt ("FL4 CLO Securitization", together with our FL3 CLO Securitization, our "CLO Securitizations"), which allows us to use mortgage asset repayment funds to acquire additional funded pari-passu participations related to the mortgage assets then-remaining in our FL4 CLO Securitization; each subject to the satisfaction of certain reinvestment or acquisition conditions, which may include receipt of Rating Agency Confirmation and investor approval. There can be no assurance that the conditions for reinvestment or acquisition will be satisfied and whether our CLO Securitizations will acquire any additional mortgage assets or funded pari-passu participations. In addition, our CLO Securitizations contains certain senior note overcollateralization ratio tests. To the extent we fail to meet these tests, amounts that would otherwise be used to make payments on the subordinate securities that we hold will be used to repay principal on the more senior securities to the extent necessary to satisfy any senior note overcollateralization ratio and we may incur significant losses. Our sources of liquidity may be impacted to the extent we do not receive cash payments that we would otherwise expect to receive from the CLO Securitizations if these tests were met.

Ares Management or one of its investment vehicles, including the Ares Warehouse Vehicle, may originate mortgage loans and we may have the opportunity to purchase such loans that are determined by our Manager in good faith to be appropriate for us, once we have sufficient available liquidity. Ares Management or one of its investment vehicles may also acquire mortgage loans from us.

As of November 2, 2021, we had approximately \$62 million in liquidity including \$3 million of unrestricted cash and \$59 million of availability under secured funding agreements.

Equity Offerings

On March 15, 2021, we entered into an underwriting agreement (the "March 2021 Underwriting Agreement"), by and among us, ACREM, and Wells Fargo Securities, LLC, BofA Securities, Inc. and Morgan Stanley & Co. LLC, as representatives of the several underwriters listed therein (collectively, the "March 2021 Underwriters"). Pursuant to the terms of the March

2021 Underwriting Agreement, we agreed to sell, and the March 2021 Underwriters agreed to purchase, subject to the terms and conditions set forth in the March 2021 Underwriting Agreement, an aggregate of 7,000,000 shares of our common stock, par value \$0.01 per share. The public offering closed on March 18, 2021 and generated net proceeds of approximately \$100.7 million, after deducting transaction expenses. We used the net proceeds from the public offering to repay indebtedness and to invest in mortgage loans and other target assets and investments consistent with our investment strategies and investment guidelines.

On June 17, 2021, we entered into an underwriting agreement (the “June 2021 Underwriting Agreement”), by and among us, ACREM, and Wells Fargo Securities, LLC, BofA Securities, Inc. and Morgan Stanley & Co. LLC, as representatives of the several underwriters listed therein (collectively, the “June 2021 Underwriters”). Pursuant to the terms of the June 2021 Underwriting Agreement, we agreed to sell, and the June 2021 Underwriters agreed to purchase, subject to the terms and conditions set forth in the June 2021 Underwriting Agreement, an aggregate of 6,500,000 shares of the Company’s common stock, par value \$0.01 per share. The public offering closed on June 22, 2021 and generated net proceeds of approximately \$101.6 million, after deducting transaction expenses. We used the net proceeds from the public offering to repay indebtedness and to invest in mortgage loans and other target assets and investments consistent with our investment strategies and investment guidelines.

Cash Flows

The following table sets forth changes in cash and cash equivalents for the nine months ended September 30, 2021 and 2020 (\$ in thousands):

	For the nine months ended September 30,	
	2021	2020
Net income	\$ 43,307	\$ 7,433
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	(13,027)	15,311
Net cash provided by (used in) operating activities	30,280	22,744
Net cash provided by (used in) investing activities	(575,079)	(105,263)
Net cash provided by (used in) financing activities	485,810	158,179
Change in cash and cash equivalents	\$ (58,989)	\$ 75,660

During the nine months ended September 30, 2021 and 2020, cash and cash equivalents increased (decreased) by \$(59.0) million and \$75.7 million, respectively.

Operating Activities

For the nine months ended September 30, 2021 and 2020, net cash provided by operating activities totaled \$30.3 million and \$22.7 million, respectively. For the nine months ended September 30, 2021, adjustments to net income related to operating activities primarily included the provision for current expected credit losses of \$0.8 million, accretion of deferred loan origination fees and costs of \$6.0 million, amortization of deferred financing costs of \$7.1 million and change in other assets of \$16.7 million. For the nine months ended September 30, 2020, adjustments to net income related to operating activities primarily included the provision for current expected credit losses of \$22.1 million, accretion of deferred loan origination fees and costs of \$5.7 million, amortization of deferred financing costs of \$4.9 million and change in other assets of \$9.3 million.

Investing Activities

For the nine months ended September 30, 2021 and 2020, net cash used in investing activities totaled \$575.1 million and \$105.3 million, respectively. This change in net cash used in investing activities was primarily as a result of the cash used for the origination and funding of loans held for investment exceeding the cash received from principal repayment of loans held for investment for the nine months ended September 30, 2021.

Financing Activities

For the nine months ended September 30, 2021, net cash provided by financing activities totaled \$485.8 million and primarily related to proceeds from our Secured Funding Agreements of \$611.5 million, proceeds from the issuance of debt of consolidated VIEs of \$540.5 million and proceeds from the sale of our common stock of \$202.7 million, partially offset by

repayments of our Secured Funding Agreements of \$711.1 million, repayments of our Notes Payable of \$27.9 million, repayments of our Secured Term Loan of \$50.0 million, repayments of debt of consolidated VIEs of \$41.0 million and dividends paid of \$41.9 million. For the nine months ended September 30, 2020, net cash provided by financing activities totaled \$158.2 million and primarily related to proceeds from our Secured Funding Agreements of \$466.8 million, proceeds from Secured Borrowings of \$55.1 million and proceeds from the sale of our common stock of \$73.2 million, partially offset by repayments of our Secured Funding Agreements of \$404.2 million and dividends paid of \$31.7 million.

Summary of Financing Agreements

The sources of financing, as applicable in a given period, under our Secured Funding Agreements, Notes Payable and the Secured Term Loan (collectively, the “Financing Agreements”) are described in the following table (\$ in thousands):

	September 30, 2021				December 31, 2020			
	Total Commitment	Outstanding Balance	Interest Rate	Maturity Date	Total Commitment	Outstanding Balance	Interest Rate	Maturity Date
Secured Funding Agreements:								
Wells Fargo Facility	\$ 350,000	\$ 281,150	LIBOR+1.50 to 2.75%	December 14, 2022 (1)	\$ 350,000	\$ 336,001	LIBOR+1.45 to 2.75%	December 14, 2022 (1)
Citibank Facility	325,000	147,982	LIBOR+1.50 to 2.25%	December 13, 2021 (2)	325,000	117,506	LIBOR+1.50 to 2.25%	December 13, 2021 (2)
CNB Facility	50,000	—	LIBOR+2.65%	March 10, 2022 (3)	50,000	50,000	LIBOR+2.65%	March 10, 2021 (3)
MetLife Facility	180,000	20,648	LIBOR+2.10 to 2.50%	August 13, 2022 (4)	180,000	104,124	LIBOR+2.10 to 2.50%	August 13, 2022 (4)
Morgan Stanley Facility	250,000	206,234	LIBOR+1.75 to 2.85%	January 16, 2023 (5)	150,000	147,921	LIBOR+1.75 to 2.85%	January 16, 2023 (5)
Subtotal	\$ 1,155,000	\$ 656,014			\$ 1,055,000	\$ 755,552		
Notes Payable	\$ 51,755	\$ 48,250	LIBOR+3.00 to 3.75%	(6)	\$ 84,155	\$ 63,122	LIBOR+2.50 to 3.75%	(6)
Secured Term Loan	\$ 60,000	\$ 60,000	LIBOR+5.75%	December 22, 2021 (7)	\$ 110,000	\$ 110,000	LIBOR+5.00%	December 22, 2021 (7)
Total	\$ 1,266,755	\$ 764,264			\$ 1,249,155	\$ 928,674		

- (1) The maturity date of the master repurchase funding facility with Wells Fargo Bank, National Association (the “Wells Fargo Facility”) is subject to three 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid. The maximum commitment may be increased to up to \$500.0 million at our option, subject to the satisfaction of certain conditions, including payment of an upside fee.
- (2) The maturity date of the master repurchase facility with Citibank, N.A. (the “Citibank Facility”) is subject to two 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid.
- (3) In March 2021, we exercised a 12-month extension option on the secured revolving funding facility with City National Bank (the “CNB Facility”). The CNB Facility has an accordion feature that provides for, subject to approval by City National Bank in its sole discretion, an increase in the commitment amount from \$50.0 million to \$75.0 million for up to a period of 120 days once per calendar year.
- (4) 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 applicable extension fees are paid.
- (5) The maturity date of the master repurchase and securities contract with Morgan Stanley (the “Morgan Stanley Facility”) is subject to two 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid. The Morgan Stanley Facility has an accordion feature that provides for a \$100.0 million permanent increase in the commitment amount from \$150.0 million to \$250.0 million, which may be exercised at our option, subject to the satisfaction of certain conditions, including payment of an upsized commitment fee. In June 2021, we exercised the option to increase the commitment amount from \$150.0 million to \$250.0 million.
- (6) Certain of our consolidated subsidiaries are party to two separate note agreements (the “Notes Payable”) with the lenders referred to therein, consisting of (1) a \$28.3 million note that has a maturity date of June 10, 2024 and (2) a \$23.5 million note that has an initial maturity date of September 5, 2022, subject to two 12-month extensions at our option provided that certain conditions are met and applicable extension fees are paid. In March 2021, the \$32.4 million note, which was secured by a \$40.5 million senior mortgage loan held by us on an industrial property located in North Carolina, was repaid in full and not extended. The outstanding principal on the note at the time of repayment was \$27.9 million.

- (7) In December 2020, we exercised the 12-month extension option on the Credit and Guaranty Agreement with the lenders referred to therein and Cortland Capital Market Services LLC, as administrative agent and collateral agent for the lenders (the “Secured Term Loan”). During the extension period, the spread on advances under the Secured Term Loan increases every three months by 0.125%, 0.375% and 0.750% per annum, respectively, beginning after the third-month of the extension period. In March 2021, we voluntarily elected to repay \$50.0 million of outstanding principal at par on the Secured Term Loan prior to the scheduled maturity as permitted by the contractual terms of the Secured Term Loan.

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, 2021, we were in compliance with all financial covenants of each respective Financing Agreement. We may be required to fund commitments on our loans held for investment in the future and we may not receive funding from our Secured Funding Agreements with respect to these commitments. See Note 6 to our consolidated financial statements included in this quarterly report on Form 10-Q for more information on our Financing Agreements.

Securitizations

As of September 30, 2021, the carrying amount and outstanding principal of our CLO Securitizations was \$940.1 million and \$945.1 million, respectively. See Note 16 to our consolidated financial statements included in this quarterly report on Form 10-Q for additional terms and details of our CLO Securitizations.

Secured Borrowings

As of September 30, 2021, the carrying amount and outstanding principal of our secured borrowings was \$60.0 million and \$60.2 million, respectively. See Note 7 to our consolidated financial statements included in this quarterly report on Form 10-Q for additional terms and details of our secured borrowings.

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, our liquidity position, the anticipated liquidity and price volatility of the assets in our loans held for 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 impact of the COVID-19 pandemic on the United States 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 United States federal income tax purposes and, as such, anticipate annually distributing to our stockholders at least 90% of our REIT taxable income, prior to the deduction for dividends paid. If 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 we distribute less than the sum of 1) 85% of our ordinary income for the calendar year, 2) 95% of our capital gain net income for the calendar year and 3) any undistributed shortfall from our prior calendar year (the “Required Distribution”) to our stockholders during any calendar year (including any distributions declared by the last day of the calendar year but paid in the subsequent year), then we are 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 we elect to retain any of our net capital gain for any tax year, we must notify our 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 United States 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. As a result of the COVID-19 pandemic, the progress of capital expenditures, construction and leasing is anticipated to be slower than otherwise expected, and the pace of the funding of our unfunded commitments may be slower.

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 variable interest entities, 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.

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, loans held for investment portfolio holdings and financing strategy.

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 loans held for 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.

In this current environment, prepayments may slow down, borrowers may not be able to repay principal upon the loan maturity or qualify for loan extensions. Additionally, if tenants are not able to pay rent to their landlords, property owners may not be able to make payments to their lenders. We have been in regular dialogue with our borrowers and our financing providers to assess this credit risk. See Note 3 to our consolidated financial statements included in this quarterly report on Form 10-Q for a more detailed description of the potential impacts of the COVID-19 pandemic on our loan investments.

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 have entered into or 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 Income

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. During a period of declining interest rates, our borrowing costs generally decrease while the yields earned on our leveraged fixed-rate mortgage assets remain static, which could result in an increase in our net interest spread and net interest margin. The impact of rising or declining interest rates may be mitigated by certain hedging transactions that we have entered into or may enter into in the future.

The following table estimates the hypothetical increases/(decreases) in net income for a twelve month period, assuming (1) an immediate increase or decrease in 30-day LIBOR as of September 30, 2021, (2) no change in the outstanding principal balance of our loans held for investment portfolio and borrowings as of September 30, 2021 and (3) no changes in the notional amount of the interest rate swap and interest rate cap agreements entered into as of September 30, 2021 (\$ in millions):

Change in 30-Day LIBOR	Increase/(Decrease) in Net Income
Up 100 basis points	\$2.2
Up 50 basis points	\$(0.1)
LIBOR at 0 basis points	\$0.5

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. The impact of rising or declining interest rates may be mitigated by certain hedging transactions that we have entered into or may enter into in the future.

Market Risk

The estimated fair values of our investments fluctuate primarily due to changes in interest rates, changes in credit 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. If prepayment rates decrease in a rising interest rate environment, borrowers exercise extension options on CRE loans or we extend the term of CRE loans, the life of the loans could extend beyond the term of the Financing Agreements that we borrow on to fund our CRE loans. This could have a negative impact on our results of operations. In some situations, we may be forced to fund additional cash collateral in connection with the Financing Agreements or sell assets to maintain adequate liquidity, which could cause us to incur losses. Additionally, principal repayment proceeds from mortgage loans in the CLO Securitizations are applied sequentially, first used to pay down the senior notes in the CLO Securitizations. We will not receive any proceeds from the repayment of loans in the CLO Securitizations until all senior notes are repaid in full.

Financing Risk

We borrow funds under our Financing Agreements to finance our target assets. The COVID-19 pandemic has resulted in extreme volatility in a variety of global markets, including the real estate-related debt markets. In reaction to market conditions, banks and other lenders have generally restricted lending activity and, in some cases, have requested margin posting or repayments where applicable for secured loans collateralized by assets with depressed valuations. Our Secured Funding Agreements contain margin call provisions following the occurrence of certain mortgage loan credit events. If we are unable to make the required payment or if we fail to meet or satisfy any of the covenants in our Financing Agreements, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral, including cash to satisfy margin calls, and enforce their interests against existing collateral. We are also subject to cross-default and acceleration rights with respect to our Financing Agreements. Given the impact of the COVID-19 pandemic on the real estate industry and the potential impact on our borrowers, to mitigate the risk of future margin calls, we have proactively engaged in discussions with certain of our lenders to modify the terms of our borrowings on certain assets within these facilities, including reducing the amounts we are borrowing against such assets and/or increasing the borrowing spreads. In addition, our CLO Securitizations contain certain senior note overcollateralization ratio tests. To the extent we fail to meet these tests, amounts that would otherwise be used to make payments on the subordinate securities that we hold will be used to repay principal on the more senior securities to the extent necessary to satisfy any senior note overcollateralization ratio and we may incur significant losses. Our sources of liquidity may be impacted to the extent we do not receive cash payments that we would otherwise expect to receive from the CLO Securitizations if these tests were met. 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

Our real estate investments 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. The COVID-19 pandemic is having a particularly adverse impact on industries whose properties serve as collateral for some of our portfolio of loan investments. 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 but adverse changes in inflation or changes in inflation expectations can lead to lower returns on our investments than originally anticipated. 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

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2021. Based upon that evaluation and subject to the foregoing, our principal executive officer and principal financial officer concluded that, as of September 30, 2021, the design and operation of our disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2021 that have materially affected, or that are 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, 2021, we were not subject to any material pending legal proceedings. If the COVID-19 pandemic continues and market conditions worsen, litigation may increase to the extent we find it necessary to foreclose or otherwise enforce remedies with respect to loans that are in default, which borrowers may seek to resist by asserting counterclaims and defenses against us.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors described below and in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2020, which could materially affect our business, financial condition and/or operating results. The risks described below and in our Annual Report on Form 10-K for the year ended December 31, 2020 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. The fluidity of the ongoing COVID-19 pandemic precludes any prediction as to the ultimate adverse impact of COVID-19 on economic and market conditions. In addition to the foregoing, COVID-19 may exacerbate the potential adverse effects on our business, financial performance, operating results, cash flows and financial condition described in the risk factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020 filed with the Securities and Exchange Commission.

The COVID-19 pandemic has caused severe disruptions in the global economy, which has had, and may continue to have, a negative impact on our business and operations.

As of the filing date of this Quarterly Report, there is a continued outbreak of the COVID-19 pandemic, which the World Health Organization has declared a global pandemic, the United States has declared a national emergency and every state in the United States is under a federal disaster declaration. The COVID-19 pandemic has resulted in numerous deaths, adversely impacted global commercial activity and contributed to significant volatility in equity and debt markets. Many states, including those in which we and our borrowers operate, have issued orders requiring the closure of, or certain restrictions on the operation of, non-essential businesses and/or requiring residents to stay at home. The COVID-19 pandemic and preventative measures taken to contain or mitigate its spread have caused, and are continuing to cause, business shutdowns, the re-introduction of

business shutdowns, cancellations of events and restrictions on travel, significant reductions in demand for certain goods and services, reductions in business activity and financial transactions, supply chain interruptions and overall economic and financial market instability both globally and in the United States. Such effects will likely continue for the duration of the pandemic, which is uncertain, and for some period thereafter. While several countries, as well as certain states in the United States, relaxed the early public health restrictions with a view to partially or fully reopen their economies, recurring COVID-19 outbreaks led to the re-introduction of such restrictions in certain states in the United States and globally and could continue to lead to such restrictions elsewhere. Additionally, in December 2020, the U.S. Food and Drug Administration authorized certain vaccines for emergency use, which are currently being distributed nationwide and globally. However, it remains unclear how quickly “herd immunity” will be achieved and the restrictions that were imposed to slow the spread of the virus will be lifted entirely. These uncertainties could lead the public to continue to refrain from participating in the economy at pre-pandemic levels for a prolonged period of time. Even after the COVID-19 pandemic subsides, the U.S. economy and most other major global economies may continue to experience the lingering effects of the economic shock caused by COVID-19 containment measures including a prolonged recessionary environment in the United States.

The COVID-19 pandemic is having a particularly adverse impact on industries whose properties serve as collateral for some of our portfolio of loan investments. Certain of our investments in loans collateralized by properties within other industries have also been significantly impacted by the COVID-19 pandemic. The inability of our borrowers’ tenants to pay rent on their leases, or our borrowers’ inability to re-lease space that becomes vacant, may adversely impact the ability of the borrowers to which we lend to continue to meet loan covenants or to make payments on their loans on a timely basis or at all. We may seek to restructure our loan investments and amend the terms, including the payment terms, which could cause us to incur losses. Potential declines in value and net operating income at properties that serve as collateral for our portfolio of loan investments significantly increase the likelihood that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our cost on the loan. Although the U.S. government enacted the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) on March 27, 2020, which contains provisions intended to mitigate the adverse economic effects of the COVID-19 pandemic, and a second and third stimulus package on December 27, 2020 and March 11, 2021, respectively, which provided \$900 billion and \$1.9 trillion, respectively, in resources to small businesses and individuals as well as certain industries and state and local governments that have been adversely affected by the COVID-19 pandemic, it is uncertain whether, or how much, we or certain of our borrowers have benefited or may benefit from such legislation or any other subsequent legislation intended to provide financial relief or assistance.

The impact of the COVID-19 pandemic on our borrowers may reduce the availability of our liquidity sources, but our requirements for liquidity, future commitments to fund on our loans, make interest, principal and other payments pursuant to our financing obligations, including potential margin calls, likely will not be reduced. If we do not have funds available to meet our obligations, we will have to raise capital from alternative sources, which may be on unfavorable terms or may not be available to us due to the impacts of the COVID-19 pandemic. To the extent there is a resurgence of the COVID-19 pandemic, we may experience an adverse impact on our liquidity position and the execution of our business strategy.

Provisions in our financing agreements require us to pay margin call provisions following the occurrence of certain mortgage loan credit events. We may not have the funds available to satisfy such margin calls or repay our debt at that time, which would likely result in defaults unless we are able to raise the funds from alternative sources, which we may not be able to achieve on favorable terms or at all. Posting additional collateral would reduce our liquidity. If we are unable to make the required payment or if we fail to meet or satisfy any of the covenants in our financing agreements, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments and enforce their interests against existing collateral. We are also subject to cross-default and acceleration rights, which could materially and adversely affect our financial condition and ability to implement our investment strategy. See “Risk Factors—The Financing Agreements and any bank credit facilities and repurchase agreements that we may use in the future to finance our assets may require us to provide additional collateral or pay down debt” included in our Annual Report on Form 10-K for the year ended December 31, 2020.

The effects on our portfolio of loan investments described above may require us to increase the CECL Reserve in our consolidated balance sheets related to certain of our investments. Our loans held for investment are carried at cost, net of unamortized loan fees and origination costs, however, under the CECL methodology we adopted pursuant to Accounting Standards Update No. 2016-13, we are required to estimate expected credit losses on such loans using a range of historical experience adjusted for current and future conditions. Based on certain factors, our current estimate of expected credit losses has decreased from December 31, 2020 to September 30, 2021 and may continue to fluctuate as the impact of the COVID-19 pandemic develops and we receive additional collateral financial data.

In response to the COVID-19 pandemic, Ares Management Corporation instituted a work from home policy until it is deemed safe to return to the office. Such policy of an extended period of remote working by our Manager’s and/or its affiliate’s

employees could strain our technology resources and introduce operational risks, including heightened cybersecurity risk. Remote working environments may be less secure and more susceptible to hacking attacks, including phishing and social engineering attempts that seek to exploit the COVID-19 pandemic.

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

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 and Section 13(r) of the Exchange Act, require an issuer to disclose in its annual and quarterly reports whether it or any of its affiliates have knowingly engaged in specified activities or transactions relating to Iran. We are required to include certain disclosures in our periodic reports if we or any of our “affiliates” (as defined in Rule 12b-2 under the Exchange Act) knowingly engaged in certain specified activities, transactions or dealings relating to Iran or with certain individuals or entities targeted by United States' economic sanctions during the period covered by the report. Disclosure is generally required even where the activities, transactions or dealings were conducted in compliance with applicable law. Neither we nor any of our controlled affiliates or subsidiaries knowingly engaged in any of the specified activities relating to Iran or otherwise engaged in any activities associated with Iran during the reporting period. However, because the SEC defines the term “affiliate” broadly, it includes any person or entity that is under common control with us as well as any entity that controls us or is controlled by us. The description that follows has been provided to us by Ares Management.

On January 31, 2019, funds and accounts managed by Ares Management’s European direct lending strategy (together, the “Ares funds”) collectively acquired a 32% equity stake in Daisy Group Limited (“Daisy”). Daisy is a provider of communication services to businesses based in the United Kingdom. The Ares funds do not hold a majority equity interest in Daisy and do not have the right to appoint a majority of directors to Daisy’s board of directors.

Subsequent to completion of the Ares funds’ investment in Daisy, in connection with Ares Management’s routine quarterly survey of its investment funds’ portfolio companies, Daisy informed the Ares funds that it has customer contracts with Melli Bank Plc, Persia International Bank Plc and Bank Saderat Plc. Melli Bank Plc, Persia International Bank Plc and Bank Saderat Plc have been designated by the Office of Foreign Assets Control within the U.S. Department of Treasury pursuant to Executive Order 13324. Daisy generated a total of £84,806 in annual revenues (less than 0.02% of Daisy’s annual revenues) from its dealings with Melli Bank Plc, Persia International Bank Plc and Bank Saderat Plc and de minimis net profits. Daisy entered into the customer contracts with Melli Bank Plc, Persia International Bank Plc and Bank Saderat Plc prior to the Ares funds’ investment in Daisy.

Daisy has given notice of termination of the contracts to Melli Bank Plc, Persia International Bank Plc and Bank Saderat Plc. Following termination of the contracts, Daisy does not intend to engage in any further dealings or transactions with Melli Bank Plc, Persia International Bank Plc or Bank Saderat Plc.

Item 6. Exhibits
EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1 *	Articles of Amendment and Restatement of Ares Commercial Real Estate Corporation. (1)
3.2 *	Amended and Restated Bylaws of Ares Commercial Real Estate Corporation. (2)
31.1	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
31.2	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
32.1	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
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
104	Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)

* Previously filed

(1) Incorporated by reference to Exhibit 3.1 to the Company's Form 10-K (File No. 001-35517), filed on March 1, 2016.

(2) Incorporated by reference to Exhibit 3.2 to the Company's Form S-8 (File No. 333-181077), filed on May 1, 2012.

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 3, 2021

By: /s/ Bryan Donohoe

Bryan Donohoe
Chief Executive Officer
(Principal Executive Officer)

Date: November 3, 2021

By: /s/ Tae-Sik Yoon

Tae-Sik Yoon
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

**Certification of Chief Executive Officer
of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a)**

I, Bryan Donohoe, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ares Commercial Real Estate Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2021

/s/ Bryan Donohoe

Bryan Donohoe
Chief Executive Officer

**Certification of Chief Financial Officer
of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a)**

I, Tae-Sik Yoon, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ares Commercial Real Estate Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2021

/s/ Tae-Sik Yoon

Tae-Sik Yoon

Chief Financial Officer and Treasurer

Certification of Chief Executive Officer and Chief Financial Officer
Pursuant to
18 U.S.C Section 1350

In connection with the Quarterly Report on Form 10-Q of Ares Commercial Real Estate Corporation (the “Company”) for the quarter ended September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), Bryan Donohoe, as Chief Executive Officer of the Company, and Tae-Sik Yoon, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 3, 2021

/s/ Bryan Donohoe

Bryan Donohoe
Chief Executive Officer

/s/ Tae-Sik Yoon

Tae-Sik Yoon
Chief Financial Officer and Treasurer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.