Mortgage Finance

After surprisingly sweet ’23, CRE mREITs face rocky road ahead

Rating Change

Rate headwinds, weaker fundamentals prompt downgrade

We are taking a cautious view on the CRE mREITs as we think book values will trend lower over the coming quarters and investor sentiment will remain soft. Generally, CRE faces headwinds due to weak office property fundamentals (which makes up ~30% of CRE mREIT portfolios, on average) and higher-for-longer rates that weigh on valuations. Until rates move materially lower and/or CRE fundamentals improve, we think the sector will lag; as a result, we downgrade several mREITs, including 4 to Underperform (links in sidebar). Shares have lagged in 2024 (Exhibit 7) but have generated positive returns since 2022 (Exhibit 1) and even outperformed the S&P Financials index by 7.6% in 2023.

Upcoming maturities add uncertainty, barring rate relief

CRE fundamentals remain shaky and as rates stay higher for longer, we think pressure will mount on CRE mREIT portfolios. Unlike residential mortgages, CRE loans tend to be floating rate. As rates have risen from historic lows (and seem poised to stay “higher-for-longer” in 1H24), properties have likely seen material declines in value, which impact borrowers’ ability to refinance loans. While troubled loans can be extended or modified to avoid a default, mREITs often require “rate caps” to be purchased at origination which hedge against rate moves. As rates have risen sharply, these caps have helped keep interest costs low for borrowers. However, as loans mature, the rate caps also mature causing borrowers to buy new rate caps at prohibitively expensive prices. This creates a natural opportunity for borrowers to weigh the cost of adding equity into the property or to default and hand back the keys to the lender.

Risk framework: collateral, vintages, maturities

Most CRE mREITs provide disclosures about the collateral type / geography, vintages, and maturities of their loans. We build our comparative risk analysis of each mREIT around these factors. **1) Collateral type / geography**: US office fundamentals have weakened, while international offices have fared better. Higher quality offices (trophy or Class A) have had better vacancy trends than lower quality properties (Class B and below) (Exhibits 7-9). **2) Vintage**: Pre-COVID vintage loans benefit from an increased equity build-up, despite being underwritten at lower rates. We are most concerned with loans originated post-COVID when rates were at record lows (Exhibits 10 & 11). **3) Maturities:** As previously discussed, portfolios with many 2024 maturities may have higher risks, due to rate cap expirations; loans with later maturities may benefit as rates decline and CRE fundamentals rebound in the future (Exhibit 12).

Downgrading 6 CRE mREITs: 0 buys, 3 Neutrals, 4 U/Ps

We are downgrading Starwood (STWD) and Blackstone Mortgage (BXMT) to Neutral and Ares Commercial (ACRE), Apollo Residential (ARI), BrightSpire Capital (BRSP) and TPG Real Estate (TRTX) to Underperform (Exhibit 2). We are maintaining our Neutral rating on Ladder Capital (LADR). Our dividend ratings are now “8” (same/lower) for all CRE mREITs. We think the CRE headwinds and negative sentiment make owning any CRE mREITs risky at current valuations. We detail the reasons to be more upbeat on STWD and BXMT than peers on page 6.

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Related Research:

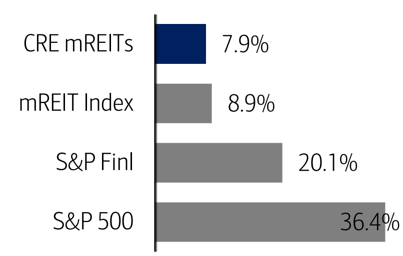
ACRE

ARI

BRSP

TRTX

Exhibit 1: CRE mREITs have generated positive returns since ‘22
Total returns, YE22-present



Source: Bloomberg, BofA Global Research
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Exhibit 2: CRE mREIT rating distribution
Downgrading sector

	New		Prior	
	Rating	PO	Rating	PO
STWD	Neutral	$21.50	Buy	$22.50
BXMT	Neutral	$21.00	Buy	$22.00
LADR	Neutral	$10.50	Neutral	$10.50
ARI	U/P	$10.50	Neutral	$10.50
ACRE	U/P	$7.00	Buy	$11.00
BRSP	U/P	$6.50	Neutral	$6.50
TRTX	U/P	$6.50	Neutral	$6.00

Source: BofA Global Research
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CRE: Commercial Real Estate

mREIT: mortgage REIT

CRE mREITs are trading below long-term average…

CRE mREITs trade at ~0.7x book value per share (BVPS), below the long-term average of ~1.0x (Exhibit 3). Current valuation implies loan losses of ~7% beyond current reserves (reserves were ~3% of loan portfolio on average, as of 4Q). An average CRE mREIT loan is originated with a 65%-70% LTV, meaning property values would need to decline 30%-35% before reserves would be used and additional losses would be incurred. While we do not think most properties will see this type of loss level, loan performance will vary based on sponsor quality, property location, and collateral type. Specifically, office vacancy trends and slowing rent growth (Exhibits 5 & 6) make us cautious.

…but may not be cheap enough to reflect risks

Despite the current discount, we still think risks skew to the downside. Weaknesses in CRE fundamentals have begun to show over the last few quarters, specifically in office which has seen deteriorating fundamentals (Exhibits 5 + 6). Because CRE mREITs use substantial leverage (average of ~2.8x as of 4Q), problem loans can have an outsized impact on book value. Given our view that CRE fundamentals will remain challenged in the near-term, we expect sentiment to remain weak. taken together, we think among stocks we cover have downside risk and investor sentiment will remain weak, keeping multiples below historic averages until rates soften and fundamentals strengthen.

Exhibit 3: Entire sector currently trades at ~0.7x BVPS, below LT average of ~1.0x

CRE mREIT comp sheet

	Tick. Sym.	Self advised?	Market Cap. ($M)	Total Assets ($M)	Gross loans ($M)	Stock Price 3/3/24	BV MRQ	P / BV Current	BV Undeprec.	Current Div. Yield	2023 ROE	2024E ROE	52 Week High	52 Week Low	Undeprec. P / BV Current
Starwood Property Trust Inc	STWD	No	$6,446	$19,561	$20,108	$20.57	$20.18	1.02x	$20.93	9.3%	9.8%	9.3%	$22.29	$16.06	0.98x
Blackstone Mortgage Trust Inc	BXMT	No	$3,552	$24,043	$23,716	$20.45	$25.95	0.79x	NA	12.1%	11.8%	7.9%	$23.82	$16.61	0.79x
Arbor Realty Trust Inc	ABR	Yes	$2,646	$15,903	$13,441	$12.92	$12.49	1.03x	NA	13.4%	18.0%	14.0%	$17.74	$10.10	1.03x
Claros Mortgage Trust Inc	CMTG	No	$1,367	$8,048	$7,156	$9.85	$16.56	0.59x	NA	9.9%	0.3%	5.2%	$15.25	$9.06	0.59x
Apollo Commercial Real Estate Finance Inc	ARI	No	$1,603	$9,157	$8,327	$11.28	$14.45	0.78x	NA	12.2%	7.5%	8.8%	$12.74	$8.58	0.78x
Ladder Capital Corp	LADR	Yes	$1,371	$5,503	$3,398	$10.83	$12.13	0.89x	$13.79	8.6%	9.7%	9.0%	$12.00	$8.76	0.79x
Franklin BSP Realty Trust Inc	FBRT	No	$1,063	$5,875	$4,968	$12.95	$15.76	0.82x	NA	11.0%	12.2%	9.5%	$14.70	$11.08	0.82x
KKR Real Estate Finance Trust Inc	KREF	No	$683	$7,625	$7,528	$9.85	$16.29	0.60x	NA	11.2%	5.1%	4.0%	$14.37	$9.09	0.60x
BrightSpire Capital Inc	BRSP	Yes	$903	$4,353	$3,145	$6.95	$10.11	0.69x	$11.35	11.5%	9.3%	8.3%	$8.01	$5.20	0.61x
TPG RE Finance Trust Inc	TRTX	No	$588	$4,457	$4,190	$7.55	$11.86	0.64x	NA	11.2%	9.4%	9.5%	$8.81	$4.65	0.64x
Ares Commercial Real Estate Corp	ACRE	No	$422	$2,363	$2,180	$7.76	$11.56	0.67x	NA	13.8%	9.2%	4.6%	$11.74	$7.15	0.67x
Granite Point Mortgage Trust Inc	GPMT	Yes	$243	$3,131	$2,924	$4.78	$13.28	0.36x	NA	15.3%	6.7%	5.6%	$6.41	$3.97	0.36x
Peer average								**0.74x**		**11.6%**	**9.1%**	**8.0%**			**0.72x**

Source: Company filings, Bloomberg, BofA Global Research

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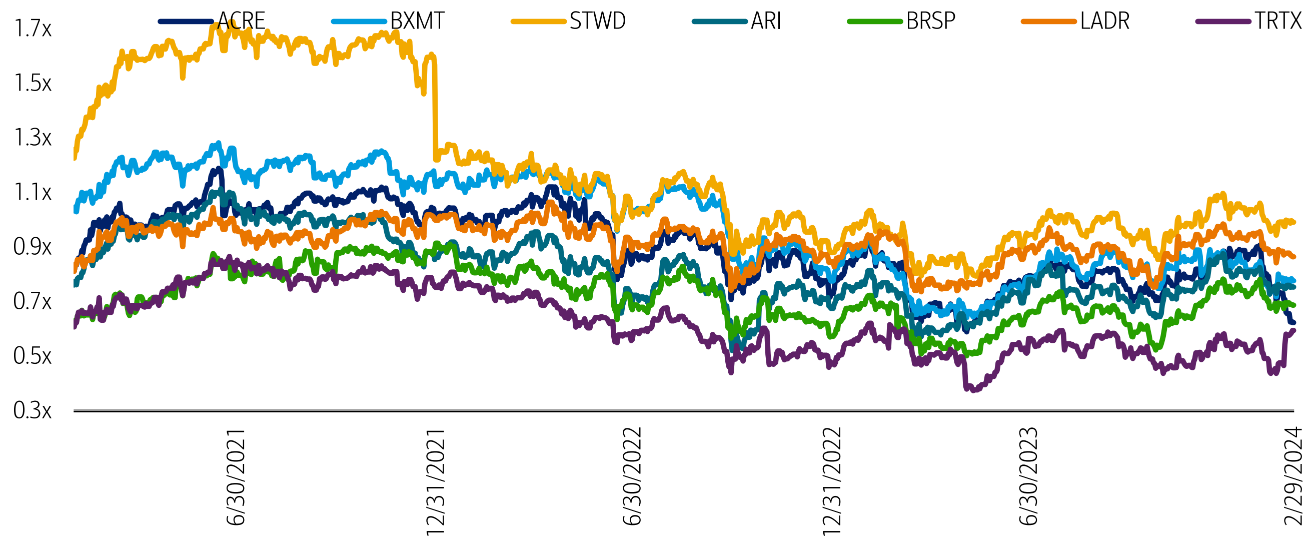
Exhibit 4: Valuations below LT avgs, but we don't think fully reflect fundamental issues ahead
CRE mREIT P/BV ratio, 2021-present



Source: Bloomberg, company reports, BofA Global Research

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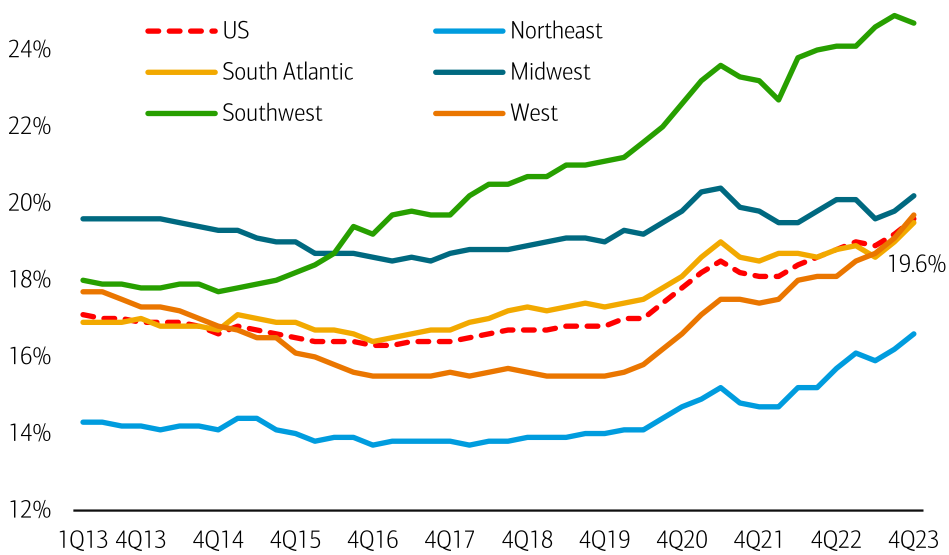
Exhibit 5: Office vacancy rates hit record levels in 4Q23 at 19.6%...
Post-COVID office vacancy rates have risen across all geographies



Source: REIS

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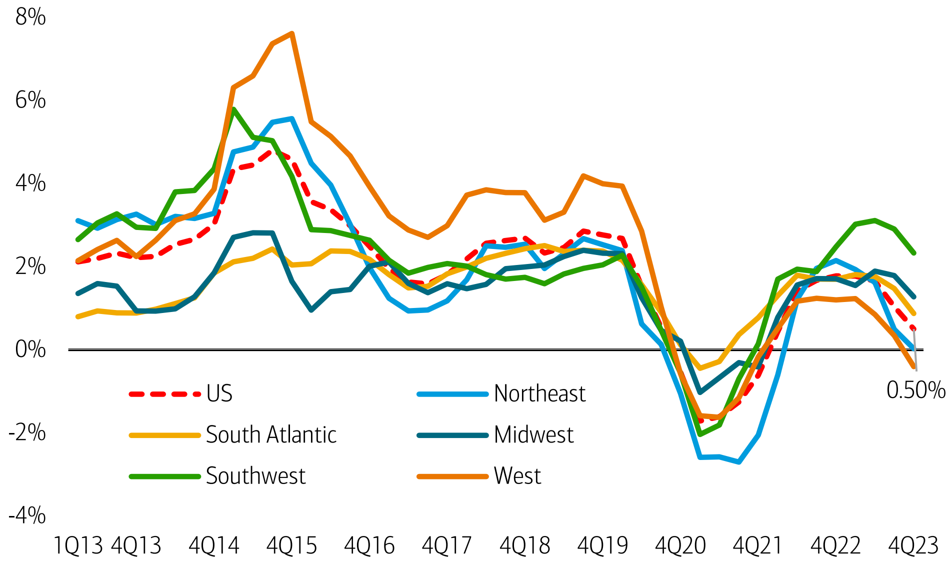
Exhibit 6: ...while y/y rent growth rates dropped to 0.5%
Post-COVID inflation drove rental increases in 22/23, but has slowed in 2H23



Source: REIS

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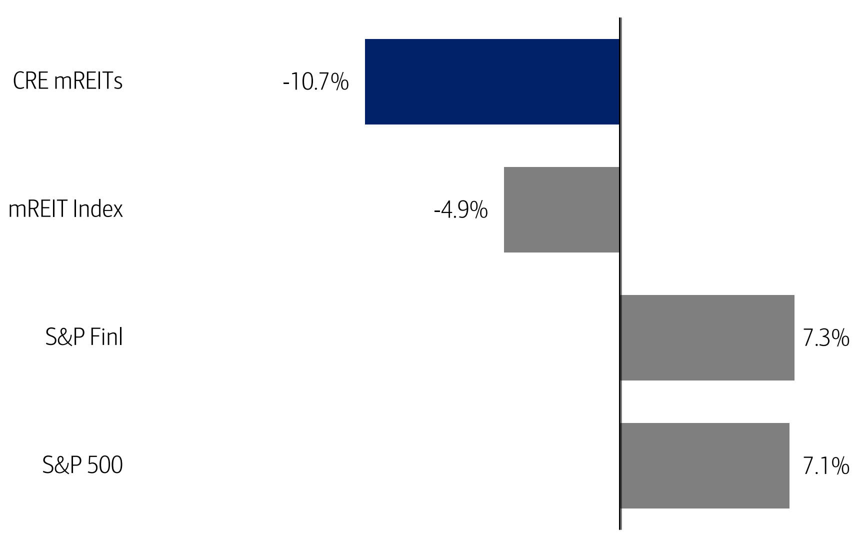
How do CRE mREITs rebound? It's all about rates

In our view, CRE mREITs outperformed in 2023 due to an expectation of sharp rate cuts that were to come in 2024 (ie an expectation of 6+ Fed funds cuts at 12/31). Year-to-date, shares have lagged the S&P Financials index by 19% and are down 12% on a total return basis as the prospect of higher-for-longer rates has become more broadly accepted. Our conversations with management teams indicate that for CRE transaction volumes to pick back up, the front end of the yield curve needs to come down 150+bps. Additionally, rate cuts would move asset valuations higher and provide relief on rate cap pricing.

Exhibit 7: CRE mREIT performance in 2024 YTD has lagged
Total return, 1/1/2024 – 3/1/2024



Source: Bloomberg, BofA Global Research

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Q4 Earnings showed some cracks in credit

CRE mREIT Q4 results were bifurcated. Some CRE mREITs reported large credit issues and announced dividend cuts (ACRE, KREF) which drove sharp sell-offs (shares down ~22% in Feb). On the other hand, many showed very limited signs of credit stress (BXMT, STWD) which led to relief rallies (shares up ~1% in Feb). Our primary takeaway from Q4 results was that we are entering the early innings of a credit cycle, and that despite many mREITs emerging unscathed in 4Q, coming quarters will be increasingly difficult to navigate. Management commentary was cautious, with many expecting the tough backdrop to persist until rates move materially lower (ie, short end of the curve below 4%). We prefer mREITs with scaled platforms and a history of managing through past cycles (like STWD and BXMT) but are cautious on CRE broadly.

Comparing portfolios

While it is simple to make broad claims on real estate asset classes and geographies, the reality is the ultimate outcome on real estate loans is determined by quality of the sponsor, the specific geography, and individual traits of the property. Unfortunately, CRE mREITs tend to be guarded when it comes to disclosing information about the properties collateralizing their loans. We do track these limited disclosures and have established a relative risk framework using this information to provide a useful dataset for investors to evaluate exposures to geographies, property types, and loan vintages / maturities.

Broadly, we prefer portfolios…

…with low levels of US office exposure (Exhibit 8): The office sector has faced headwinds from slow return-to-office in the US. In 4Q23, effective rent growth was just 0.5% y/y and vacancy rates rose to 19.6% (Exhibits 5 & 6). Our conversations with management teams indicate that international office has fared better than US and that vacancy rates at the highest quality of office properties (Class A / "trophy" properties) have held up better than lower quality office (Class B and below).

Most exposed: ACRE, BXMT, BRSP

Exhibit 8: US office under stress, and represents the 2nd largest property type for CRE mREITs
% of loan portfolio in office loans, by geographic region

	Office % of loan portfolio						
	US office					Int'l Office	Total % of Portfolio
	Northeast	Sunbelt	West	Midwest	Diversified		
ACRE	7%	12%	2%	13%	6%	0%	39%
BXMT**	12%	6%	9%	3%	0%	5%	34%
STWD*				*Not disclosed*			22%
ARI	5%	0%	0%	2%	0%	10%	19%
BRSP*	7%	12%	13%	0%	0%	0%	33%
LADR*				*Not disclosed*			28%
TRTX	11%	6%	3%	0%	0%	0%	20%

Source: Company reports. BofA Global Research
* Loan portfolio only
** Based on 150 largest loans

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...that did not originate most of their loans in the low-rate environment post-COVID (Exhibits 9-11): Post-COVID saw an origination boom driven by lower rates and a strong economy. These loans were originated at historically low rates and many deals were completed at higher LTVs, given elevated competition. Specifically, sunbelt multifamily has a supply glut, which is weighing on rental growth. Our concern is that as rates have settled higher and CRE fundamentals have softened, origination valuations were far too high and need to be reset meaningfully lower.

Most exposed: BRSP, TRTX, ACRE

Exhibit 9: Majority of portfolios were originated post-COVID
% of portfolio by vintage

	Vintage by year						
	2017 or prior	2018	2019	2020	2021	2022	2023
ACRE	2%	5%	10%	14%	35%	28%	5%
BXMT	2%	17%	17%	4%	39%	21%	0%
STWD				*Not disclosed*			
ARI	7%	3%	19%	7%	27%	32%	5%
BRSP*	2%	12%	10%	2%	43%	31%	0%
LADR*		14%		0%	57%	29%	0%
TRTX	1%	4%	17%	3%	42%	27%	6%

Source: Company reports. BofA Global Research
* Loan portfolio only

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Exhibit 10: Majority of portfolios were originated when Fed Funds were below 1.0%
% of portfolio originated below given Fed Funds rate

	FF Rate below...			
	1.00%	2.00%	3.00%	4.00%
ACRE	68%	82%	92%	95%
BXMT	52%	75%	94%	94%
STWD		Not disclosed		
ARI	55%	74%	92%	92%
BRSP*	63%	82%	100%	100%
LADR		Not disclosed		
TRTX	47%	60%	95%	96%

Source: Company reports. Bloomberg, BofA Global Research
* Loan portfolio only

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Exhibit 11: Multifamily is the largest property type for CRE mREITs
% of portfolio in multifamily loans, by geographic region

	Multifamily % of portfolio						
	Northeast	Sunbelt	West	Midwest	International	Diversified	Total % of Portfolio
ACRE	7%	13%	3%	3%	0%	0%	26%
BXMT**	4%	10%	4%	1%	3%	0%	22%
STWD*				Not disclosed			37%
ARI	7%	0%	0%	1%	3%	2%	13%
BRSP*	1%	41%	11%	0%	0%	0%	53%
LADR*				Not disclosed			37%
TRTX	13%	22%	10%	5%	0%	0%	49%

Source: Company reports. BofA Global Research
* Loan portfolio only
** Based on 150 largest loans

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…that do not have large levels of 2024 maturities (Exhibit 12): As discussed on the front page, CRE mREITs can extend a loan to wait out CRE weakness and avoid re-payment problems that could arise if the borrower has trouble refinancing. However, most borrowers buy "rate caps" at loan origination to hedge against rate moves. We have limited details about the "rate caps", but we assume they would expire when the loan matures. Any loan extension would then either require the purchase of new "rate caps" at the prior rate or to pay today's rates, neither of which may be tenable for the borrower given the high cost and weaker CRE fundamentals.

Most exposed: ACRE, ARI, BXMT

Exhibit 12: Maturities in 2024 bring added risk, in our view
% of portfolio maturing in 2024 and 2025

	Maturities in…							
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
ACRE	5%	11%	13%	17%	18%	9%	9%	7%
BXMT	3%	2%	6%	7%	1%	7%	4%	7%
STWD	Not disclosed				Not disclosed			
ARI	0%	2%	15%	4%	3%	6%	4%	2%
BRSP	0%	3%	4%	5%	4%	3%	3%	6%
LADR	Not disclosed				Not disclosed			
TRTX	1%	3%	5%	8%	1%	0%	0%	2%

Source: Company reports. BofA Global Research

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Downgrading STWD, BXMT to Neutral

In addition to downgrading ACRE, ARI, BRSP and TRTX to Underperform (links to reports on page 1 & summaries below), we downgrade Starwood Property Trust (STWD) and Blackstone Mortgage Trust (BXMT) to Neutral from Buy. We think the CRE headwinds and negative sentiment make owning any CRE mREITs in 2024 risky. That said, we think STWD and BXMT are two of the best operators in the sector and will navigate this tough backdrop better than peers.

Starwood Property Trust – STWD

We reduce our PO to $21.50 ($22.50 prior) based on an approximate 1.0x multiple to book value (1.05x prior). We reduce our core EPS ests for 2024/2025 to $1.82/$1.92 ($1.99 / $2.01 prior) and introduce 2026 core EPS ests of $2.00. We reduce our dividend rating to "8" (same/lower) from "7" (same/higher).

Positives:

- STWD has a diversified portfolio with limited office exposure (just 10% of the total portfolio is US Office, an additional 3% is international office).
- Despite the limited office exposure, STWD has conservatively built reserves for ~3% of its commercial loan book, in-line with peers.
- STWD's Special Servicing segment has experience working out problem loans. They have done this historically with many properties and have never realized a loss on REO (real estate owned).
- As of 4Q had near-record liquidity of ~$1.1B and leverage of 2.5x, below peer average of ~2.8x.

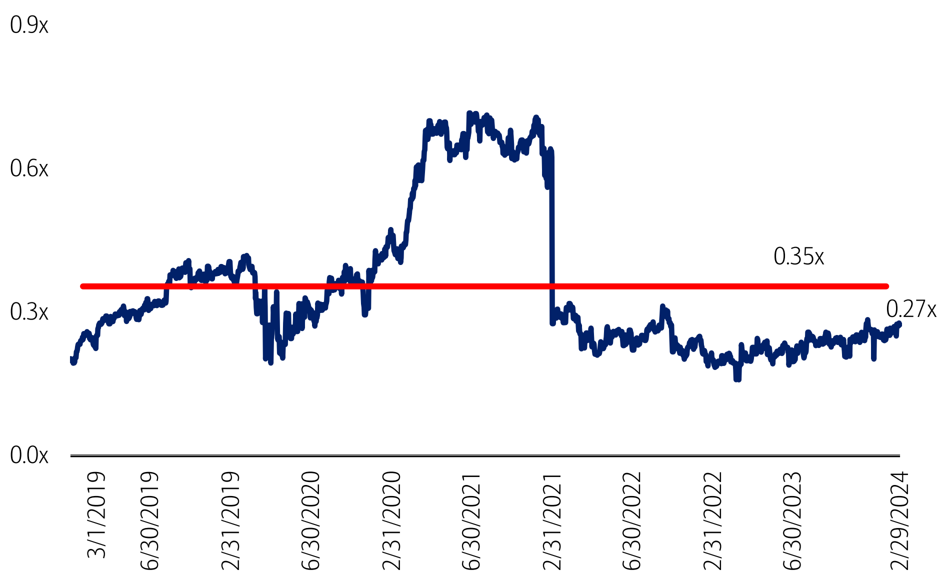
- While shares do trade at a premium to the peer group, today's premium (0.27x) is below the 5-yr average of 0.35x (Exhibit 13).

Negatives:

- STWD provides very limited portfolio disclosures which makes it difficult for investors to feel confident about the contents of their loan book. We do not have insight into vintages or upcoming maturities as shown in Exhibits 8-12.

- While their scale is a benefit for diversification and ability to underwrite larger loans, this same scale makes them a potential target for institutional investors wanting to take a negative view on CRE debt.

Exhibit 13: STWD premium to peers is below 5-yr avg, despite more diversified & defensive portfolio
STWD P/BVPS current premium vs rest of CRE mREIT peer group and 5-yr avg



Source: Company Reports, Bloomberg, BofA Global Research

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Blackstone Mortgage Trust – BXMT

We reduce our PO to $21 ($22 prior) based on an approximate 0.8x multiple to book value (0.9x prior). We reduce our core EPS ests for 2024/2025 to $2.46/$2.52 ($2.70 / $2.60 prior) and introduce 2026 core EPS ests of $2.53. We reduce our dividend rating to "8" (same/lower) from "7" (same/higher).

Positives:

- Portfolio to date is performing (93% at 4Q) with very limited levels of paid-in-kind (PIK) interest paid (0.3% of interest income).

- Borrowers and sponsors have continued to invest in the properties, committing $1.6B of incremental equity to $16.6B of BXMT loans (66% of portfolio) in 2023.

- Interest rate caps have begun to roll, with limited portfolio disruptions to date. $14.7B of loans had interest rate caps expire in 2023 and 93% were replaced with new caps/guarantees.

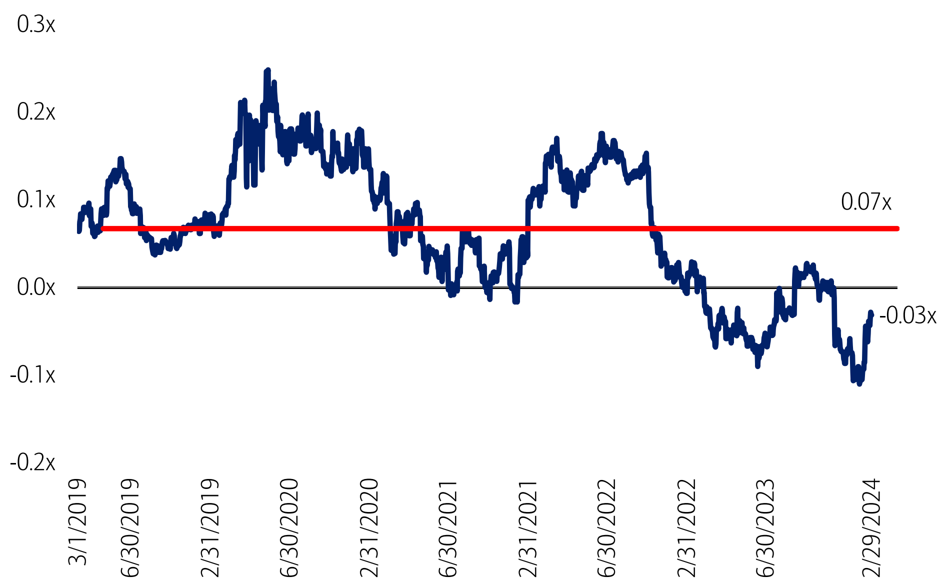
- Near-record liquidity levels ($1.7B) at year-end.

- Shares currently trade at a 0.03x discount (on P/BVPS basis) to the peer group. Over the past 5 years, BXMT has traded at a 0.07x premium, on average (Exhibit 14).

Negatives:

- High level of office exposure at 36% of the loan portfolio; positively, many of these are classified as "Trophy" or Class A, which have had stronger vacancy trends.
- Leverage levels elevated at 3.7x at year-end vs peers average of ~2.8x.
- 18% of the portfolio is slated to mature in 2024
- While their scale is a benefit for diversification and ability to underwrite larger loans, this same scale makes them a potential target for institutional investors wanting to take a negative view on CRE debt.

Exhibit 14: BXMT currently trades at a discount to peers, 0.1x below LT average
BXMT P/BVPS current premium vs rest of CRE mREIT peer group and 5-yr avg



Source: Company Reports, Bloomberg, BofA Global Research

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Exhibit 15: STWD summary income statement
2021A-2026E

($000s)	2021A	2022A	2023A	1Q24E	2Q24E	3Q24E	4Q24E	2024E	2025E	2026E
Interest income	845,459	1,283,579	1,880,628	484,386	486,256	481,386	479,121	1,931,149	1,948,325	1,964,287
Servicing Fees	38,739	40,359	33,121	11,150	11,150	11,150	11,150	44,601	44,601	44,601
Other Revenue	7,059	12,515	8,493	2,500	2,500	2,500	2,500	10,000	10,000	10,000
Rental Income	278,831	128,263	127,666	26,808	28,030	29,253	30,475	114,566	134,127	153,687
Total Revenue	1,170,088	1,464,716	2,049,908	524,844	527,936	524,289	523,247	2,100,316	2,137,053	2,172,576
Total Management Fees	167,773	155,551	141,543	29,663	30,819	29,176	48,310	137,968	136,866	136,235
Interest expense	445,087	797,121	1,436,107	359,412	367,264	363,032	359,716	1,449,424	1,460,926	1,488,612
Depreciation	83,001	49,293	49,141	10,848	11,342	11,837	12,332	46,359	54,274	62,190
Credit loss (reversal)	8,335	46,657	243,728	-	-	-	-	-	-	-
Cost of rental operations	111,667	44,115	44,842	12,000	12,000	12,000	12,000	48,000	48,000	48,000
Other reimbursable expense	1,892	4,714	2,745	630	630	630	630	2,520	2,520	2,520
General and Administrative	171,302	175,500	180,212	47,626	47,501	47,357	47,191	189,675	187,690	186,553
Total OpEx	989,057	1,272,951	2,098,318	460,179	469,556	464,033	480,178	1,873,946	1,890,277	1,924,110
	-	-	-					-	-	-
Non interest income	320,064	805,773	465,885	72,860	72,860	72,860	72,860	291,440	299,440	317,440
Pre-tax operating income	501,095	997,538	417,475	137,525	131,241	133,116	115,928	517,810	546,215	565,906
Tax	(8,669)	61,523	682	(2,446)	(2,335)	(2,368)	(2,062)	(9,211)	(9,717)	(10,067)
Net Income	492,426	1,059,061	418,157	135,079	128,906	130,748	113,866	508,599	536,498	555,839
Net Income, Non-controlling Int.	(44,687)	(187,586)	(78,944)	(3,708)	(3,708)	(3,708)	(3,708)	(14,832)	(16,480)	(18,128)
Income to participating shares	(6,808)	(6,808)	(5,216)	(680)	(680)	(680)	(680)	(5,216)	(5,216)	(5,216)
GAAP Income	**440,931**	**854,362**	**332,801**	**130,691**	**124,518**	**126,360**	**109,478**	**491,047**	**517,298**	**534,991**
Memo: interest on convertible	11,619	11,632	-	-	-	-	-	-	-	-
Adjustments	353,185	(128,066)	329,765	18,756	20,465	19,382	39,087	97,689	105,410	113,213
Core Earnings (Reported)	**794,116**	**726,296**	**662,566**	**149,447**	**144,983**	**145,742**	**148,565**	**588,736**	**622,708**	**648,204**
GAAP EPS	**1.52**	**2.74**	**1.07**	**0.42**	**0.40**	**0.41**	**0.35**	**1.58**	**1.67**	**1.72**
Core EPS	**2.63**	**2.28**	**2.05**	**0.46**	**0.45**	**0.45**	**0.46**	**1.82**	**1.92**	**2.00**
DPS	**1.92**	**1.92**	**1.92**	**0.48**	**0.48**	**0.48**	**0.48**	**1.92**	**1.92**	**1.92**
Payout ratio	126%	70%	179%	114%	120%	118%	136%	121%	115%	111%
Core payout ratio	73%	84%	94%					106%	100%	96%
EOP O/S shares (basic)	304,820	310,675	313,366	313,366	313,366	313,366	313,366	313,366	313,366	313,366
WA O/S shares (diluted)	296,826	315,614	310,507	310,507	310,507	310,507	310,507	310,507	310,507	310,507
WA O/S shares (diluted) - For Core Earnings	301,438	319,221	323,641	323,975	323,975	323,975	323,975	323,975	323,975	323,975
BV p.s. (Diluted)	**$19.92**	**$20.80**	**$19.95**	**$19.90**	**$19.84**	**$19.78**	**$19.70**	**$19.70**	**$19.55**	**$19.45**
Undepreciated Book Value	**$20.74**	**$21.71**	**$20.93**	**$20.92**	**$20.89**	**$20.87**	**$20.83**	**$20.83**	**$20.85**	**$20.95**

Source: Company filings, BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 16: BXMT summary income statement
2021A-2026E

($000s)	2021A	2022A	2023A	Q1'24-E	Q2'24-E	Q3'24-E	Q4'24-E	2024E	2025-E	2026-E
Income statement										
Interest income	854,690	1,338,954	2,037,621	483,843	476,044	462,888	450,628	1,873,401	1,707,011	1,695,263
Interest expense	340,223	710,904	1,366,956	347,366	336,649	321,995	306,862	1,312,872	1,134,334	1,126,466
Net interest income	514,467	628,050	670,665	136,477	139,395	140,892	143,766	560,529	572,676	568,796
Other income	39,864	(211,505)	(245,175)	(50,000)	(25,000)	-	-	(75,000)	-	-
Total expenses	131,634	162,485	170,231	34,381	38,085	40,406	40,673	153,545	155,799	152,485
Income before income taxes	422,697	254,060	255,259	52,096	76,310	100,486	103,093	331,985	416,877	416,311
Income tax provision	423	3,002	5,361	698	698	698	698	2,792	2,792	2,792
Income from Cont. Ops.	422,274	251,058	249,898	51,398	75,612	99,788	102,395	329,193	414,085	413,519
Income (loss) from Discont.Ops	-	-	-	-	-	-	-	-	-	-
Net income	422,274	251,058	249,898	51,398	75,612	99,788	102,395	329,193	414,085	413,519
Net Income to noncontrolling interests	(3,080)	(2,415)	(3,342)	(661)	(661)	(661)	(661)	(2,644)	(2,644)	(2,644)
Net income available to common	419,194	248,643	246,556	50,737	74,951	99,127	101,734	326,549	411,441	410,875
Core net income	396,683	489,834	526,273	107,105	106,319	105,495	108,102	427,021	437,913	438,347
Diluted shares (EOP)	168,543	172,107	173,569	173,569	173,569	173,569	173,569	173,569	173,569	173,569
Diluted shares (WAvg)	151,488	179,383	176,807	172,824	172,824	172,824	172,824	172,824	173,569	173,569
Diluted EPS	**$2.77**	**$1.45**	**$1.41**	**$0.29**	**$0.43**	**$0.57**	**$0.59**	**$1.89**	**$2.37**	**$2.37**
Core EPS	**$2.62**	**$2.87**	**$3.05**	**$0.62**	**$0.61**	**$0.61**	**$0.62**	**$2.46**	**$2.52**	**$2.53**
Dividends (PS)	**$2.48**	**$2.48**	**$2.48**	**$0.62**	**$0.62**	**$0.62**	**$0.62**	**$2.48**	**$2.48**	**$2.48**
BV (PS)	**$27.22**	**$26.26**	**$25.16**	**$24.88**	**$24.74**	**$24.74**	**$24.75**	**$24.75**	**$24.83**	**$24.91**

Source: Company filings, BofA Global Research estimates

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Underperform downgrades

We detail these in more depth in their individual reports, but summaries are below.

ACRE – Underperform, $7 PO

- ACRE has high levels of office exposure (39% of the portfolio as of 4Q)
- 46% of ACRE's portfolio is slated to mature in 2024, with an additional 43% in 2025
- 4Q print had several new credit issues (6 new non-accruals which now represent ~19% of the portfolio) and a 25% dividend cut
- With shares trading only slightly below peers at 0.67x book value, we do not think shares are fully accounting for the risks in the portfolio

ARI – Underperform, $10.50 PO

- ARI faces several high profile maturities in 2024 which we think are at risk of requiring extensions and
- 4Q earnings were solid, but core earnings covered the dividend by just a penny; we think any credit issues could require a dividend cut
- With shares trading at a premium to peers (~0.8x book value), we think downside risks are not properly discounted

BRSP – Underperform, $6.50 PO

- Portfolio is highly exposed to US office (33% as of 4Q) and sunbelt multifamily (41%) two areas we think are under more pressure
- 4Q earnings were good, and BRSP has made progressing improving its portfolio credit but sector overweights make us cautious
- Shares trade about in-line with post-COVID average P/BV (~0.65x book value) while peers are ~30% below (~0.7x vs 1.0x)

TRTX – Underperform, $6.50 PO

- TRTX was active in resolving portfolio credit issues in 2023; as of 4Q, all credit impaired loans had been sold, paid off, or foreclosed on
- This came at a price though – the portfolio today is 30% smaller than it was at YE2022
- Given the tough macro, we want to see consistent credit results before we declare the credit turnaround a success
- With a smaller portfolio, we think the current dividend is at risk and forecast a cut in 2024

Investment Rationale

Apollo Commercial Real Estate Finance

We rate ARI as Underperform. We are constructive on ARI's longer-term profitability and BVPS stability. That said, we think the risk associated with higher defaults/foreclosures and concerns about CRE values are not fully offset by a high current yield, and a valuation that does not fully reflect the more challenging commercial real estate macro backdrop.

Ares Commercial Real Estate Corporation

We rate ACRE Underperform. We are taking a cautious outlook on CRE mREITs given the secular headwinds the sector faces due to elevated rates and weakening CRE fundamentals. While ACRE trades roughly in line with peers, we think its high level of office exposure, large amount of upcoming maturities, and number of loans originated at historically low rates adds risk.

Blackstone Mortgage Trust Inc

We rate BXMT as Neutral. BXMT is a high-quality way for investors to participate in the CRE markets, which should generate a relatively high dividend yield for investors. We think investors will appreciate BXMT's first-mortgage focus. That said, we are cautious on the backdrop for CRE and BXMT's high level of office exposure.

BrightSpire Capital Inc.

We rate BRSP as Neutral. BRSP is a way for investors to participate in the CRE markets, which should generate relatively high risk-adjusted returns for investors. BRSP has undergone a portfolio transformation to clean up its portfolio and simplify itself into a pure-play commercial mortgage REIT. That said, at current valuation and with the headwinds CRE faces, we believe risk/reward skews negative and look to see improving fundamentals, consistent operating results and growing profitability.

Starwood Property Trust

We rate STWD Neutral. STWD is more than a balance sheet commercial real estate lender. By combining a high-quality commercial mREIT with attractive operating businesses, STWD has created a flexible, differentiated and scalable franchise. We think STWD can deliver robust returns through a variety of market conditions and its special servicing business provides a natural hedge to credit exposure. That said, the challenging backdrop for CRE makes us cautious on the near-term outlook for earnings.

TPG RE Finance Trust, Inc.
We rate TRTX as Underperform. We think the risks associated with credit, elevated defaults, and concerns about CRE values more than offsets a high current yield, the current CECL reserve, and a discount valuation.

Price objective basis & risk

Apollo Commercial Real Estate Finance (ARI)
Our $10.50 price objective is based on a roughly 0.75x multiple to BVPS, which is roughly in line with commercial mortgage REITs peers.

Downside/upside risks to our price objective are: delays in/faster-than-anticipated capital deployment, unfavorable/favorable price movements in the target asset classes, credit deterioration/improvement in commercial real estate mortgages, disruptions/strengthening in the capital markets and unexpected changes in government regulations of the financial markets.

Ares Commercial Real Estate Corporation (ACRE)
Our $7 Price Objective is based on an approximate 0.6x multiple to current book value. In our view, ACRE should trade at a discount to the peer average given its high exposure to office CRE and wall of upcoming maturities. Valuations for the comparable mortgage REIT peers are around 0.7x BV. We think our PO is achievable as ACRE delivers modest growth, improving margins, and stable credit performance.

Upside/Downside risks to our achieving our price objective are: 1) faster/slower than expected origination volumes could increase/reduce earnings, 2) Widening/tightening assets spreads could increase/reduce returns on incremental investments, 3) Ability/inability to access capital at reasonable prices could accelerate/limit portfolio growth and impact earnings, 4) material strengthening/weakening in real estate fundamentals could lead to stronger/weaker asset values and potentially lead to gains/losses and 5) material decrease/increase in interest rates could inflate/impair the value of underlying assets.

Blackstone Mortgage Trust Inc (BXMT)
Our $21 price objective is based on about 0.8x our forward BVPS forecast. Peers are trading at roughly 0.7x BVPS. BXMT shares will likely continue to be valued at a premium to peers, based on its HQ earnings and its history of strong credit performance

Risks to our achieving our price objective are: 1) slower than expected origination volumes could create capital drag and reduce earnings, 2) tighter assets spreads could reduce returns on incremental investments, 3) failure to access capital at reasonable prices could limit portfolio growth and impact earnings, 4) material weakening in real estate fundamentals could lead to underperformance in related assets and potentially lead to credit losses, and 5) material increases in interest rates could impair the value of underlying investments and BXMT's shares.

BrightSpire Capital Inc. (BRSP)
Our $6.50 PO is based on an approximate 0.6x multiple to undepreciated book value per share (BVPS). Commercial mREIT peers trade at approximately 0.7x undepreciated BVPS. BRSP should trade at a discount to peers until it is able to demonstrate consistent operating results and improves profitability.

Upside/downside risks to achieving our price objective are 1) faster/slower-than-expected origination volumes could result in faster/slower capital deployment and increase/reduce earnings, 2) wider/tighter assets spreads could increase/reduce returns on incremental investments, 3) improving/deteriorating access to capital at reasonable prices could increase/limit portfolio growth, 4) material strengthening/weakening in real estate fundamentals could lead to over/underperformance in related assets and potentially lead to reduced/increased credit losses, and 5) material decreases/increases in interest rates could improve/impair the value of underlying investments and BRSP's shares.

Ladder Capital Corp (LADR)
Our $10.50 PO is based on roughly 0.75x LADR's undepreciated BV. Commercial mREIT peers trade at approximately 0.7x BV. We think LADR should trade at a modest premium to peers given strong operating history.

Downside risks to achieving our price objective are: 1) material weakening in the CRE market, 2) a significant slowdown in investment activity, 3) a deteriorating macroeconomic environment, 4) disruptions in the capital markets, and 5) weaker-than-expected investment performance.

Starwood Property Trust (STWD)
Our $21.50 PO is based on an approximate 1.0x multiple to undepreciated book value per share. We believe STWD deserves a premium multiple to peers (who currently trade around 0.7x book value) due to its best in class profitability, diversified lending platform, and history of outperforming peers across the business cycle. That said, CRE faces secular headwinds due to weakening fundamentals and elevated rates, which we think makes owning CRE mREITs at this point in time, risky.

Downside risks to achieving our price objective or EPS and DPS forecast are a delay in capital deployment, unfavorable price movement in the target asset classes, volatile interest rates, continued credit deterioration in commercial mortgages, further disruption in the capital markets and unexpected changes in government policies.

TPG RE Finance Trust, Inc. (TRTX)
Our $6.50 PO is based on an approximate 0.55x multiple to BV, which, in our opinion, is justified given credit concerns and questions around run-rate earnings potential. Peers are currently trading at about 0.7x book value, and we believe TRTX should trade at a discount to peers given credit concerns.

Upside risks to achieving our price objective are: 1) material strengthening in the CRE market, 2) a significant pickup in investment activity, 3) an improving macroeconomic environment, and 4) stronger-than-expected investment performance.

Analyst Certification

I, Eric Dray, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Ares Capital Corporation	ARCC	ARCC US	Derek Hewett
	Bank of Montreal	BMO	BMO US	Ebrahim H. Poonawala
	Bank of Montreal	YBMO	BMO CN	Ebrahim H. Poonawala
	Barings BDC Inc	BBDC	BBDC US	Derek Hewett
	Blue Owl Capital Corporation	OBDC	OBDC US	Derek Hewett
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	Cullen/Frost Bankers Inc	CFR	CFR US	Ebrahim H. Poonawala
	East West Bancorp, Incorporated	EWBC	EWBC US	Ebrahim H. Poonawala
	Fifth Third Bank	FITB	FITB US	Ebrahim H. Poonawala
	First Bancorp Puerto Rico	FBP	FBP US	Brandon Berman
	First Horizon Corporation	FHN	FHN US	Ebrahim H. Poonawala
	FNB Corporation of Pennsylvania	FNB	FNB US	Brandon Berman
	Goldman Sachs	GS	GS US	Ebrahim H. Poonawala
	JPMorgan Chase & Co.	JPM	JPM US	Ebrahim H. Poonawala
	KeyCorp	KEY	KEY US	Ebrahim H. Poonawala
	M&T Bank	MTB	MTB US	Ebrahim H. Poonawala
	Morgan Stanley	MS	MS US	Ebrahim H. Poonawala
	New Mountain Finance Corporation	NMFC	NMFC US	Derek Hewett
	Northern Trust Corporation	NTRS	NTRS US	Ebrahim H. Poonawala
	Nuveen Churchill Direct Lending	NCDL	NCDL US	Derek Hewett
	Royal Bank of Canada	RY	RY US	Ebrahim H. Poonawala
	Royal Bank of Canada	YRY	RY CN	Ebrahim H. Poonawala
	Safehold, Inc	SAFE	SAFE US	Derek Hewett
	Sixth Street Specialty Lending, Inc	TSLX	TSLX US	Derek Hewett
	Synovus Financial Corp.	SNV	SNV US	Ebrahim H. Poonawala
	The Bank of New York Mellon Corporation	BK	BK US	Ebrahim H. Poonawala
	Truist Financial	TFC	TFC US	Ebrahim H. Poonawala
	U.S. Bancorp	USB	USB US	Ebrahim H. Poonawala
	Webster Financial Corp.	WBS	WBS US	Brandon Berman
	Wells Fargo & Company	WFC	WFC US	Ebrahim H. Poonawala
	Western Alliance Bancorp	WAL	WAL US	Ebrahim H. Poonawala
NEUTRAL				
	AGNC Investment Corp	AGNC	AGNC US	Derek Hewett
	Ally Financial	ALLY	ALLY US	Brandon Berman
	Annaly Capital Management	NLY	NLY US	Derek Hewett
	Associated Banc-Corp	ASB	ASB US	Brandon Berman
	Bain Capital Specialty Finance, Inc.	BCSF	BCSF US	Derek Hewett
	Bank of Nova Scotia	YBNS	BNS CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	BNS	BNS US	Ebrahim H. Poonawala
	Blackstone Mortgage Trust Inc	BXMT	BXMT US	Eric Dray, CFA
	Blackstone Secured Lending Fund	BXSL	BXSL US	Derek Hewett
	Canadian Imperial Bank of Commerce	CM	CM US	Ebrahim H. Poonawala
	Canadian Imperial Bank of Commerce	YCM	CM CN	Ebrahim H. Poonawala
	Citizens Financial Group	CFG	CFG US	Ebrahim H. Poonawala
	Comerica Incorporated	CMA	CMA US	Brandon Berman
	Commerce Bancshares Inc.	CBSH	CBSH US	Brandon Berman
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Ladder Capital Corp	LADR	LADR US	Eric Dray, CFA
	New York Community Bancorp	NYCB	NYCB US	Ebrahim H. Poonawala
	Palmer Square Capital BDC	PSBD	PSBD US	Derek Hewett
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	Popular Inc	BPOP	BPOP US	Brandon Berman
	Regions Financial	RF	RF US	Ebrahim H. Poonawala
	Starwood Property Trust	STWD	STWD US	Eric Dray, CFA
	The PNC Financial Services Group, Inc.	PNC	PNC US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	TD	TD US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	YTD	TD CN	Ebrahim H. Poonawala

North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Apollo Commercial Real Estate Finance	ARI	ARI US	Eric Dray, CFA
	Ares Commercial Real Estate Corporation	ACRE	ACRE US	Eric Dray, CFA
	Bank of Hawaii Corp.	BOH	BOH US	Brandon Berman
	BrightSpire Capital Inc.	BRSP	BRSP US	Eric Dray, CFA
	First Hawaiian Inc.	FHB	FHB US	Brandon Berman
	Guild Holdings Company	GHLD	GHLD US	Derek Hewett
	Invesco Mortgage Capital, Inc.	IVR	IVR US	Derek Hewett
	loanDepot Inc	LDI	LDI US	Derek Hewett
	MidCap Financial Investment Co	MFIC	MFIC US	Derek Hewett
	Prosperity Bancshares Inc	PB	PB US	Ebrahim H. Poonawala
	State Street Corporation	STT	STT US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	TPG RE Finance Trust, Inc.	TRTX	TRTX US	Eric Dray, CFA
	Zions Bancorp	ZION	ZION US	Brandon Berman

Disclosures

Important Disclosures

Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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The date and time of completion of the production of any recommendation in this report shall be the date and time of dissemination of this report as recorded in the report timestamp.

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