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ACRE - Q4 2019 Ares Commercial Real Estate Corp Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Ares Commercial Real Estate Corporation's conference call to discuss the company's fourth quarter and full year 2019 financial results. As a reminder, this conference is being recorded on February 20, 2020.

I will now turn the call over to Veronica Mayer from Investor Relations. Please go ahead.

Veronica Mendiola Mayer - *Ares Commercial Real Estate Corporation - Principal of Ares Public IR & Corporate Communications Group*

Thank you, Chad. Good morning, and thank you for joining us on today's conference call. I am joined today by our new CEO, Bryan Donohoe; David Roth, our President; and Tae-Sik Yoon, our CFO.

In addition to our press release and the 10-K that we filed with the SEC, we have posted an earnings presentation under the Investor Resources section of our website at www.arescre.com.

Before we begin, I want to remind everyone that comments made during the course of this conference call and webcast and the accompanying documents contain forward-looking statements and are subject to risks and uncertainties. Many of these forward-looking statements can be identified by the use of words, such as anticipates, believes, expects, intends, will, should, may and similar expressions. These forward-looking statements are based on management's current expectations of market conditions and management's judgment. These statements are not guarantees of future performance, condition or results and involve a number of risks and uncertainties. The company's actual results could differ materially from those expressed in the forward-looking statements as a result of a number of factors, including those listed in its SEC filings. Ares Commercial Real Estate Corporation assumes no obligation to update any such forward-looking statements.

During this conference call, we will refer to certain non-GAAP financial measures. We use these as measures of operating performance, and these measures should not be considered in isolation from or as a substitute for measures prepared in accordance with the generally accepted accounting principles. These measures may not be comparable to like-titled measures used by other companies.

And now I will turn the call over to Bryan Donohoe.

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Thanks, Veronica, and good morning, everyone. I'm happy to be speaking with you today, and I look forward to getting to know more of you in the weeks and months ahead.

I want to start with a few highlights of 2019 and then walk through our strategic priorities for 2020. As you saw in our earnings release this morning, we ended a successful 2019 on a high note with a strong fourth quarter. GAAP net income was $0.33 per share for the quarter and $1.28 per share for the full year. With respect to core earnings, we generated $0.37 per share for the fourth quarter and $1.41 per share for the full year.

Earnings benefited from strong investment activity throughout the year at attractive spreads. Throughout 2019, we originated $777 million of commitments, a 28% increase year-over-year.

We've increased our average loan size from $33 million in 2018 to $43 million in 2019, and we expect this trend to continue. By increasing our average loan size, we expect to be able to continue to generate our target ROEs and more efficiently deploy our capital.

Regarding the dividend, we paid out $1.32 per share, up $0.16 from 2018, and this marks the fourth consecutive year we have fully covered our dividend from core earnings.

As we look forward, we see U.S. commercial real estate fundamentals remaining favorable due, in large part, to the continued strength of the overall economy as well as measured supply and demand dynamics. We continue to see a tight labor market and a healthy consumer, while we are exercising appropriate caution due to the duration of the economic cycle as well as the possibility of certain event-driven risks. As a result of this, our portfolio is purposefully constructed to be diversified across asset classes and regions, with investments in 17 states.

We recognize that competition for quality loans remain strong, but we continue to find attractive situational relative value in many markets and property segments. Our national origination platform now includes offices in Los Angeles, San Francisco, Chicago, Atlanta, Denver and New York, providing us with a growing number of opportunities and allowing us to remain highly selective.

Additionally, as the Ares real estate platform has continued to scale, we've become a more attractive partner to our target borrowers and brokers who appreciate that we can provide a broader array of capital solutions.

As the number of opportunities we review continues to grow, we're remaining very disciplined with a strong focus on credit quality and loan structure.

Since the first of the year, we've executed $238 million in commitments, a record for ACRE in the first quarter, with time still left on the calendar. We're pleased to have a strong and building pipeline of investment opportunities behind these commitments, and we're seeing robust activity in each of our target markets. Based on this activity, along with our strong forward-looking investment pipeline, we elected to raise $73 million in common equity during the month of January at an accretive basis of 108% of book. This transaction increased our book value by $0.15 per share from $14.77 per share to $14.92.

The performance of the existing portfolio remains sound with no impairments. The current composition of our portfolio reflects our continued emphasis on quality. 100% of the assets are investments we originated in 2019 were structured as senior mortgage loans, and the total senior loan composition of our portfolio is 96%.

In terms of our strategic initiatives for 2020, I just want to highlight a few items. First, we are going to continue to leverage the resources of the Ares Management platform and our partners on the real estate equity team to create more opportunities for origination. These same synergies also allow us to efficiently evaluate each prospective credit. We're going to maintain a rigorous diligence in underwriting process, with specific attention paid to loan structure and real estate quality. We are going to continue to have a disciplined approach to capital efficiency in an effort to maintain high levels of invested capital and maximize profitability. We are focused on optimizing our borrowing costs and overall expense load. And lastly, we expect these initiatives will give us the opportunity to further scale our business accretively.

With that, I'm going to hand over the call to Tae-Sik to discuss our fourth quarter and full year results in more detail.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Great. Thank you, Bryan, and good morning, everyone.

Earlier today, we reported GAAP net income of $9.7 million or $0.33 per share and core earnings of $10.7 million or $0.37 per share for the fourth quarter of 2019. For full year 2019, GAAP net income was $37 million or $1.28 per share, and core earnings were $40.6 million or $1.41 per share.

In the fourth quarter, we closed 6 new loans totaling $250 million in commitments. Consistent with our current portfolio, all 6 new loans are senior positions that are in floating rates of interest income and are diversified across sectors and regions.

Total fundings for the fourth quarter were $260 million, which includes initial fundings of $205 million on the 6 new loans and $55 million on the prior existing loans. For the year, we closed 18 new loans in 2019, totaling $777 million in commitments and made fundings totaling $680 million.

Since year-end, we have closed 4 new loans totaling $238 million in commitments so far in the first quarter of 2020. Of these loans, $132 million loan that was originated in the Ares Warehouse in the fourth quarter of 2019 was purchased by ACRE in the first quarter. We continue to view that Ares Warehouse is a significant competitive advantage for us that provides ACRE with an attractive source of liquidity and allows us to better match the timing of new loan originations and loan repayments.

As of December 31, our loan portfolio included 50 loans with outstanding loan commitments of $1.9 billion and an outstanding principal balance of $1.7 billion, up approximately 10% from the end of 2018. In the fourth quarter of 2019, our portfolio continued to benefit from LIBOR floors, contributing more than $0.02 per share to our quarterly earnings. At the end of 2019, 93% of our loan portfolio consisted of floating rate loans with built-in LIBOR floors that averaged about 1.76% and, in addition, 2% of our loans are fixed rate. This means that, overall, 95% of our loans have some level of protection against declining LIBOR. Based on LIBOR of 1.76% at year-end 2019, 61% of our loans have LIBOR floors that are either in the money or are fixed rate. In contrast, at year-end 2019, although 100% of our liabilities are floating rate to match fund our assets, only about 5% of our outstanding debt were subject to LIBOR floors.

With respect to loan repayment activity, in the fourth quarter, we had $115 million of loans repay, bringing total repayments for 2019 to $482 million. This was below our expectations as the maturity dates in certain loans were pushed out, each for those specific reasons. With lower-than-expected repayments in 2019, we do expect higher-than-average repayment volume in the first half of 2020, although we have not received any repayments so far in the first quarter.

Turning to the liability side of our balance sheet. Our debt-to-equity ratio was 3.1x at year-end 2019, very much in line with our target, given that 96% of our loans are senior mortgages. Since year-end, we closed a new $150 million repurchase facility with Morgan Stanley, which provides us an attractive financing source to further expand our product offering, and this brings our total debt capacity to over $2 billion.

Now let me touch upon an upcoming and an important new accounting standard, CECL, or current expected credit losses. In our 10-K filed earlier today, we disclosed an estimated range of current expected credit losses, or CECL reserve, of $4.8 million to $6.7 million, which represents approximately 25 to 35 basis points of our total loan commitments. We will continue to finalize our CECL analysis, and we'll provide a more specific reserve number as well as further context and background in our subsequent filings and calls.

Lastly, before turning the call back over to Bryan, I want to mention that our Board declared a first quarter dividend of $0.33 per share payable on April 15, 2020, to stockholders of record as of March 31, 2020.

And so with that, I will now turn the call back over to Bryan.

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Thanks, Tae-Sik. Let me conclude by saying that since joining ACRE in December of last year, I have been incredibly impressed by our team, the strength of the platform at Ares, and I'm excited for where we're headed in the future. 2019 was a very good year for ACRE, one in which we demonstrated our ability to generate consistently strong profits and solid investment activity.

Going forward, we believe we have a significant opportunity to expand our market share and scale this business in a highly accretive manner for our shareholders.

With that, I'd like to ask the operator to open the line for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Doug Harter with Crédit Suisse.

Douglas Michael Harter - *Crédit Suisse AG, Research Division - Director*

Bryan, I guess now that you've been there in your seat a couple of months, can I -- I guess, can you just talk about kind of what kind of drove you to kind of take this role and kind of what -- kind of how you think you can leverage the Ares platform better to kind of continue to achieve the results that you're looking for?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Sure. In terms of the first part of your question, what attracted me to Ares, I think, the overall platform really speaks for itself. The breadth of product offerings and the team members that do the work day to day is as impressive as you can find. I think, specifically to the real estate space, having the synergies that exist between the debt and equity business position us very well, both to find unique opportunities and to execute on them judiciously. I think in terms of the growth path, and David Roth and I speak about this on a daily basis, we think there's some low-hanging fruit in terms of the joint execution of the business plan between debt and equity, and I think that will specifically benefit the ACRE platform.

Douglas Michael Harter - *Crédit Suisse AG, Research Division - Director*

I guess, on that, I mean, are you -- would you look to add equity to the ACRE business or anything that kind of has longer duration than the current portfolio? Or is that other ways to kind of leverage the equity business?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Yes. I think it's more the mindset and the approach to the business. I think from an underwriting perspective, we focus a great deal on the basis of the assets that we are financing. There's no intent to get into the equity business. I think our colleagues there do a great job, and we're going to maintain a disciplined approach to the debt business itself. We do think that there may be some opportunity in the future to find longer-duration assets that should be attractive both from an ROE perspective and otherwise. So really, I would think about it as specifically day-to-day underwriting help. Specific examples, we're working on a transaction now that is 2 doors down from an asset that our equity fund has underwritten and provided a bid on. So that's the type of synergy that I'm referencing.

Operator

The next question will come from Steve Delaney with JMP Securities.

Steven Cole Delaney - *JMP Securities LLC, Research Division - MD, Director of Specialty Finance Research & Senior Research Analyst*

We noticed that in the 4Q originations that you had 2 industrial loans totaling $80 million and that 4 loans in industrial for all of 2019, so you're now up to 7%. Could you just comment on those opportunities? It looks like one was Florida. One was California. And also everybody's talked about industrial over the last several years. But they say, "Yes, we'd love it, but we can't find any." Maybe comment on what Ares did differently in 2019 to find some attractive industrial loans.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. Steve, this is Tae speaking. Clearly, industrial is a sector that we do focus quite heavily on. And as Bryan mentioned, it is certainly something on the equity side of the business that we have a great deal of expertise, both in the U.S. and in Europe, and it is a sector that we have focused on. I think it has taken us a little bit longer on the debt side to get more exposure because of what we discussed before. There's a bit of a binary nature to the business. It's either fully stabilized, very institutional, long-term debt, long-term lease situation or it's one where it's highly, highly transitional right at the very beginning stages or ground-up development. And so there are, I would say, a little bit more of a limited opportunity set. Nonetheless, this is a sector that our overall real estate team is very focused on. And I think one of the benefits that we're seeing within the debt side is we're starting to see greater deal flow. And I think what you saw in 2019, in particular, fourth quarter, is a reflection of that.

Steven Cole Delaney - *JMP Securities LLC, Research Division - MD, Director of Specialty Finance Research & Senior Research Analyst*

Great. Okay. Well, that's helpful. And on the dividend policy, should we think about that? It -- you guys have ramped up your earnings nicely contribute -- part of that we attribute to maybe the Ares Warehouse. But going forward, now that you're sort of at the level and the stock has responded, are you thinking about your dividend as more of an annual decision? Or will it still be more ad-hoc as you go through the year?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. Great question. I think it is a longer-term decision. We do evaluate it quarter to quarter. However, as we've talked about, we do think of our annual earnings target, our annual production, our annual objectives on a longer-term basis than quarter to quarter. But having said all that, the dividend is reviewed by the Board, and it's certainly reviewed by the management team as well on a quarter-to-quarter basis. I think, historically, we have, particularly in the first quarter, look to our dividend and make sure that we are very comfortable with it. I think our track record, more or less, speaks for itself. We've had 4 consecutive years where we have either earned or outearned our dividend in terms of core earnings, and that is certainly something we intend to continue. And so I don't think anyone should read too much into whether we did or did not raise the dividend this quarter. It will continue to be evaluated on, I would say, a rolling 12-month basis, not on a calendar 12 -- calendar year 12-month basis. But we do take a longer-term approach to setting the dividend. Obviously, we want to make sure our dividends are both growing and stable and consistent and that we continue to fully earn or meet our dividend.

Steven Cole Delaney - *JMP Securities LLC, Research Division - MD, Director of Specialty Finance Research & Senior Research Analyst*

Got it. No, that's helpful, especially your comment about rolling 12-month outlook.

Operator

The next question is from Jade Rahmani with KBW.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

With the weighted average remaining life of 1.6 years on the portfolio, is that on a fully extended basis? And can the company redeploy capital at similar return levels, about 1.5 years from now and those loans have fully repaid?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. Jade, this is Tae-Sik. I think our remaining weighted average life has remained very consistent over the last couple of years. It's always been for the senior portfolio, in particular, anywhere from 1.5 to 2 years. So when we originate a loan, if you want to call it, the typical loan is a 3-year loan with some extensions that are built in. And typically, those extensions have certain tests that need to be met. So when we talk about the weighted average life, we're talking to the initial maturity, not the extended maturity really for that reason. But again, this is nothing new for us. This is very purposeful on the type of loans that we're pursuing. As we mentioned, we really like the shorter-term floating-rate loans because it allows us to sort of position our portfolio for a little bit more of a near-term outlook on the macro economy.

So for example, you see, today, we have virtually no retail exposure. If we had a legacy portfolio that was 5 years or 7 years older, you'd probably see a lot more retail than what you see today. So I think that's a great real-time example of how a shorter-term floating rate portfolio allows us to continue to tailor our portfolio for more current market conditions.

But to answer your question, no, I think we feel very comfortable that we'll continue to originate. We'll continue to out originate our repayments, and we are very cognizant of when repayments are coming up. We put in place the Ares Warehouse line to help better manage the timing of repayments and new originations. So we feel very comfortable that we will be able to manage the repayments that are coming up and be able to manage our returns and ROEs.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. And do you feel that levered returns are currently consistent with the last couple of quarters?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

We think so, yes.

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Yes, I think that they have been. I think, obviously, as we recognize in our -- at the beginning of the call, we recognize where the market is and the pressures that do exist. We've been able to find pockets of assets that hit our ROEs at similar risk profile to that which we've targeted previously. And we're also benefiting from more efficient capital on our liability side of the balance sheet.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. The -- in the repayments, you mentioned that maturity dates were pushed out each with specific reasons. First of all, on the schedule that you showed in the third quarter supplemental, there weren't any 2019 maturity date, so I assume that's the fully extended maturity date. But can you give color on what pushed out each maturity extension, loan modification? And I think, in addition, the 10-K disclosed that in November, ACRE did modify an $11 million loan on a residential property in California and increased the interest rate, so if you could comment on that as well.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure, absolutely. So Jade, when you look at the business of ACRE, we're obviously focused on lending against quality assets that are generally undergoing some sort of business transition, where the owner, borrower, developer, manager is repositioning the asset, so that they can enhance cash flow, they can enhance occupancy, they can grow rents. And so what we really like about our business plan is that over the course of exiting that business plan, they actually enhance cash flow and also enhance value, so that we get delevered from our perspective over the execution of that business plan.

Noting all that, business plans do take sometimes different schedules than originally planned. So business plan sometimes get executed faster. Sometimes, business plans get executed longer. And generally, when we find ourselves in a situation where we are being asked to modify or extend a loan, again, we think of that as very ordinary course of business. Again, as a transitional lender, this is what it's about, right? It's about underwriting business plan executions. And in some cases -- and again, relatively limited, but in some cases, we do expect, as part of our ordinary course of business, to modify and extend loans.

Specifically, with respect to the one loan that you pointed out, where we did modify the loan, I think that's a great example of one where not only are we modifying the loan and extending a loan, but those are situations where we can, for example, ask for fees, we can ask for higher rates of interest. So these modifications don't come for free, if you want to call it that. And in addition, and again, I won't speak specifically to any particular loan just given the sensitivity and any specific loans itself, we do also seek to get, in some cases, additional collateral, additional deposits, additional escrows, additional protection mechanisms. So I think we're very conscious of buttressing and further buttressing our security position in these type of situations where there are either extensions or modifications.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

And that California loan, it's characterized as residential, Is it multifamily? Or is it something else?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

No. I think this is the one loan that we've spoken of before. It is not multifamily. It is a single-family residential development. It's our only exposure to that sector. But I think we've talked about this before.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

It's for sale housing.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Correct.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. So what's going on with the project?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Well, again, I -- what we generally don't do is talk specifically about any individual project on a public call like this. But as I said, projects do take longer. We don't think there is an impact on collateral value. We don't certainly think there's an impairment. As I mentioned, we think this is ordinary course of business to extend and modify certain loans. In this situation, in particular, we were able to get some better economics. And in particular, we were able to get additional collateral to, again, further buttress our collateral position.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. Also wanted to ask about -- you did mention potential other asset classes that would include longer duration. What are your thoughts about the Freddie Mac K series program and if buying B-pieces within that program could be attractive?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

That specifically hasn't been a focus of ours recently. I think what I'd say is the yields around a lot of those types of securities have been compressed. And we find that our skill set and our yields that we are targeting are better matched up to bespoke originations on direct real estate rather than in a pooled format. We -- obviously, given the breadth of the platform and the different asset classes that we either invest in or tangentially cover, we're aware of it and we pay attention to what goes on, both in the K series type product and CMBS generally. Right now, we don't find it all that compelling.

Operator

The next question is from Stephen Laws with Raymond James.

Stephen Albert Laws - *Raymond James & Associates, Inc., Research Division - Research Analyst*

I guess, to follow up a little on Jade's line of questioning, but, Tae-Sik, you mentioned in your prepared remarks that no prepayments, no repayments year-to-date. From the tables in the supplement, looks like I think 5 loans were February maturities this month. Another like a condo residential loan mezz loan next month. Can you talk about discussions with those borrowers? Do you expect those prepayments to occur between now and quarter end? Have they extended? Or kind of how should we think about the repayments coming here in the next month or 2 as we build our model out?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. No, absolutely. I think you're right. I think there are 2 loans with a February 2020 maturity date and then 3 other loans with a March 2020 maturity date. Again, I think each situation is pretty different and unique. There isn't any sort of commonality, if you want to call it that, with these upcoming maturities. I would certainly say that our expectation today is that most will pay off in accordance with the expected maturities that you see here. I would also tell you that we are working on some further extensions of some of the loans as well. And again, I think, in connection with those further extensions, I think we view this again as pretty much ordinary course of business. But I think, in connection with these further extensions, we will be seeking better economics and better structure to protect us during this extended period. But I do think we'll see some repayments and we'll see some extensions, combination of the 2.

Stephen Albert Laws - *Raymond James & Associates, Inc., Research Division - Research Analyst*

And can you maybe talk a little bit about that just to pick on 2 random loans, your 2 largest multifamily loans. So loan 1 matures this month. It's at L plus 4.75%. Loan 2, you originated late few months ago at L plus 2.85%. When you do an extension of one of these loans, do you keep the same terms? Do they get better? Is it negotiated somewhere between the existing rate and market rate? Kind of can you give us any color on how that conversation goes and what adjustments to the interest income result from that?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Yes, I don't think there's a general rule. Obviously, wish there was. I think each of them is negotiated based on the outstanding principal balance of the loan relative to what we feel the collateral value is. Obviously, we feel that we're well secured in each of the situations. And we do approach each of these situations opportunistically, right? As Tae-Sik mentioned, we, from a credit standpoint, want to effectuate a deleveraging of our position one way or the other, either through a paydown or through additional collateral. And then we are opportunistic with respect to economics as well. So we're going to capitalize on that with respect to fees.

Obviously, from an IRR perspective, a paydown has a similar effect. And in certain instances, we will increase the rate. And in most instances, this is a short-term extension. But we -- across the board, we feel we're well secured and improving our position materially through the changes and through the extension.

Stephen Albert Laws - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Great. And to follow up on an earlier question, I don't remember whether it was Doug or Steve Delaney that asked. But from a capital standpoint, you just did a secondary offering. You've got an ATM, which I don't think you've been very active with, please correct me if I'm wrong. And then you've got a financing facility that sits at the parent that's at your disposable if you need to fund loans ahead of putting them in your portfolio. So how much can you leverage the Ares platform? What type of origination volume would you like to see? Or how should we think about growing the portfolio over the course of the year as far as your access to additional capital as well as redeploying the repayments that come in?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

I'll touch on it briefly, and then I'll let Tae-Sik expand upon it. But I think real estate credit is a natural extension of everything else that goes on within the Ares business lines. And given David Roth's arrival last year and the team members that we have in place, we feel we're well positioned to span the origination capacity in-house, and there's various levers we can pull to do that. The pipeline, obviously, what we've -- we have a record first quarter based on commitments to date. And we have, as we indicated in our prepared remarks, a strong pipeline behind to those commitments. And we feel we have as much transparency into the offensive side of our business as we've had in quite some time.

I think with respect to repayments, we manage them as best we can, but certain parts of that are outside of our control. We are, as we said, opportunistically working with borrowers to extend certain credits and reposition those assets in our favor.

With respect to the rest of the year, I think we're going to continue to focus on expanding our origination footprint. As we indicated in our remarks as well, I think increasing our average loan size will be very beneficial to us as we scale the platform. We can do more with less in that regard. Tae-Sik, I don't know if you want to add anything further there.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. Maybe just to add just a couple of things. So we did $777 million in 2019. Steven, as you said, we've raised more capital. We have ATM. We have the Ares Warehouse line. We have more financing capacity as well. So I think we set ourselves up very well, we think, for a growing accretive business, and we're hoping to take advantage of that. So in addition to those incremental liquidity mechanisms, as Bryan mentioned in his remarks, we continue to expand our team. We continue to add offices. We continue to further leverage the Ares platform, thanks to David and everyone else on the team.

So I think we are absolutely positioning ourselves for growing origination volume, but, at the same time, fully maintaining our credit discipline. And that's why in response to the prior question of, do we expect repayments to be an issue going forward, I think we've been able to imagine in the past. I think it will be an increasing volume of repayments going forward just given our higher loan count today. But in addition to all that, with increased loan size, I do feel very comfortable that we'll be able to continue to out originate our deployment, our repayments and that we will continue to be able to make sure that we remain as fully invested as we can.

Operator

The next question is from Rick Shane with JPMorgan.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

First of all, we really do appreciate the granularity, particularly on the floors. It's very helpful. Tae-Sik, I have one sort of technical question for you. When we look at the Ares line and loans on that line, does that count as an unfunded commitment for the REIT? And does it actually have a CECL reserve?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Rick, no. Thanks for your question. So when a loan is placed under the Ares Warehouse line, there is nothing recorded on ACRE's books. So it's not recorded as a commitment. It's not -- there's no CECL reserve because ACRE has the option, but not the obligation to purchase the loan from the Ares vehicle. So because of that, there is no reflection on the ACRE balance sheet of any loans that are on the Ares Warehouse line, until and unless ACRE actually makes that purchase. And once ACRE does make that purchase, it will certainly be reflected both in terms of outstanding balance, carrying value, commitment as well as CECL reserve, but only when it's brought on to ACRE's balance sheet.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. Okay. That's helpful. And then, Bryan, I wanted to talk a little bit. Your final comments were about the opportunity to scale this business. And for historical reason, ACRE has lacked access to the capital markets, lack the ability to scale. And it is, in fact, substantially smaller than several of its peers, which were, I guess, incubated longer before going public. When you look at the opportunity and the fact that ACRE has returned to the capital markets, what is the opportunity to enhance ROE in terms of basis points? And how much larger do you think you need to be in order to realize that?

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

It's a good question. And I guess, I'd say I think there's not necessarily a true benchmark that we have to attain in order to increase our efficiency of capital. We do -- I think based on the raise in January and the positioning of the platform through the origination pipeline, we feel pretty comfortable that we're already benefiting from the scale, both from the Ares name. And I think it becomes reflected in our borrowing cost, which we've managed down appropriately over the last quarter and before. There's not a target size for the platform. I think the disciplined approach that the firm has taken to capital raising in the past reflected in the patience of trading above book for such a long period of time before going to the market, I think we're going to continue to employ that same discipline. But the more transparency we have, vis-à-vis our origination pipeline, the more comfortable we'll be accessing various parts of the capital structure.

Richard Barry Shane - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Got it. And Tae-Sik, I'll put that same question to you. When we look at the P&L, is the opportunity for scale in the G&A expense and the professional fees, is that were -- because, again, obviously, one of the challenges for externally managed vehicles is, historically, there is less expense leverage. Is that where we would see it? And how would you expect those expenses to grow in relation to portfolio growth?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. Rick. It's a great question. And I think we've discussed this a bit before. And really, I think a terrific part of our business model is that our G&A expenses are largely fixed in terms of the dollar amount. So our audit costs, our listing fees, our D&O insurance, some of those are the bigger line items. So with this recent $73 million equity offering, which increased our capital base by about 17% or so, we certainly wouldn't expect a 17% increase in those types of fixed expenses. In fact, I would tell you that we expect virtually no change in the fixed expenses that I just mentioned, so that really the net ROE on this incremental $73 million is going to be higher than the ROE that we were earning on the capital base prior to that. So I think that is going to be one of the big benefits of scale. So even if the spreads on our loans don't change, if nothing else changes other than having a bigger equity capital base, we will realize the benefits of spreading fixed expenses over a wider capital base and grow our ROE and our earnings from there.

The second part where I think we will benefit, again, without changing the spreads, without changing the gross revenues is that we believe we will get better financing costs with a larger portfolio, with a larger capital base. I think one of the reasons you could easily see this is we can do, for example, larger, more diversified CLO financings. We will get better rates, better structures. And I think that will, again, help our ROE even if the spreads on our loans don't change.

Operator

(Operator Instructions) The next question is a follow-up from Jade Rahmani with KBW.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

I wonder if -- I'm wondering if M&A is still a priority for the company or if the emphasis has shifted more toward organic growth.

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

So I think -- again, one of the big advantages of being part of the Ares family is we continue to see, we think, just about all opportunities for M&A, whether it's in -- whether it's something brought to us or whether we see the inside track and approach potential partners and targets. And so M&A will continue to be a very viable and very attractive opportunity for us to grow. But just like, as we mentioned, in terms of raising equity or growing the business, we're only going to do it for the right reasons, which is not simply to get bigger, but really to have an enhanced synergistic growing ROE business. And so that may be a very high bar for us to hit in terms of M&A, but acquisitions and mergers is certainly something that we continue to evaluate, we continue to look at and, again, being part of the Ares family, we have great access to.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. Just a couple of quick other ones. In terms of the REO portfolio, the hotel in Westchester, the income stream has been somewhat volatile. It doesn't seem to follow a seasonal pattern. I was wondering if you give some color -- if you could give some color on the earnings contribution we should expect. Should we take the fourth quarter and annualize it? Should we take the last 3 quarters, annualize that? Anything you could say on that?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Sure. So one thing to keep in mind is that we took over ownership sort of mid-first quarter 2019, so even 2019 itself doesn't reflect a full 12-month basis. And certainly, the first quarter of 2019 is a partial quarter.

The second thing to mention as background is that hotels, where this one is located in Westchester County, is a seasonal business. So third quarter, in particular, is a very slow quarter relative to second and fourth quarters, which tend to be the busier quarters because it's not a tourist hotel. This is more of a business class hotel, so there's going to be less business travel in the months of July and August, in particular. And therefore, you did see our earnings for the third quarter really be the lowest of the year, again, excluding first quarter because that was a partial quarter. So there is some seasonality. So it's hard to annualize any particular quarter.

Having said all that, we're very pleased with the performance of this hotel. What we saw in 2019 is that we exceeded budget. EBITDA exceeded budget by about 5%, so we had shown nice year-over-year growth. We continue to outperform budget. We did finish our CapEx program on the -- on some of the common areas in the hotel, and I think we saw some increased meeting traffic towards the year-end because of that. And we'll continue to active manage -- actively manage this asset. We are not long-term holders. As Bryan mentioned, we're not in the equity business, but I think this is a great demonstration of our capability to manage a situation like this where there was virtually no interruption between the time we were a lender versus an owner. And because we work very, very closely with and part of an integrated real estate team, we're able to take situations like this, mitigate any losses and manage this hotel. And when the right time comes to sell this asset, we will do so in a very orderly manner and hopefully be out of it.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Is the third quarter a decent proxy for the first quarter? Or is 1Q lighter than 3Q?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

Again, I would tell you that second and fourth quarters tend to be the stronger quarters. And third and first quarters tend to be the lighter quarters. I'm not trying to give you an exact comparison of first versus third. It's almost month by month, but it is a seasonal business.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Okay. And just lastly on financial leverage. It was 3.1x at year-end following the recent equity raise. We believe it's somewhere in the 2.7x range. Should we be modeling it, getting back to that 3x range? And what's the long-term assumption for leverage?

Tae-Sik Yoon - *Ares Commercial Real Estate Corporation - CFO & Treasurer*

So I think we've talked about plus or minus 3, so long as we maintain a strong ratio of senior loans is about our intended target and where we come out. We do vary our financing quite a bit loan by loan, portfolio by portfolio.

So for example, the CLO transaction that we did a couple of years ago, given the attractiveness of that type of financing being nonrecourse, being match funded and the overall terms of that structure, we did choose to go higher in leverage. I think that one was a little bit more than 4:1. And in some situations, we go significantly less than 3:1. So it is a loan by loan determination. But really, our overall business ROE model is predicated upon maintaining about a 3:1 ratio. So being at 3:1 at year-end, we thought was a very good level for us.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over for closing remarks to Bryan Donohoe.

Bryan Patrick Donohoe - *Ares Commercial Real Estate Corporation - Partner & CEO*

Thank you. I want to thank everybody for their time today, and we look forward to speaking with you again in a few months on our next earnings call. Thank you.

Operator

Ladies and gentlemen, this concludes our conference call for today. If you missed any part of today's call, an archived replay of this conference call will be available approximately one hour after the end of this call through March 5, 2020, to domestic callers by dialing 1 (877) 344-7529 and to international callers by dialing 1 (412) 317-0088. For all replays, please reference conference number 10137628. An archived replay will also be available on a webcast link located on the home page of the Investor Resources section of our website. Thank you for joining today's presentation. You may now disconnect. Take care.