

Apollo Commercial Real Estate Finance, Inc.

Form 10-Q

May 10, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended March 31, 2011

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-34452

**Apollo Commercial Real Estate Finance, Inc.**

(Exact name of Registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**27-0467113**  
(IRS Employer  
Identification Number)

**Apollo Commercial Real Estate Finance, Inc.**

**c/o Apollo Global Management, LLC**

**9 West 57th Street, 43rd Floor,**

**New York, New York 10019**

(Address of Registrant's principal executive offices)

**(212) 515 3200**

(Registrant's telephone number, including area code)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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"/> (Do not check if a smaller reporting company) | Smaller Reporting Company <input type="checkbox"/>    |

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 practical date.

As of May 10, 2011, there were 17,561,032 shares, par value \$0.01, of the registrant's common stock issued and outstanding.

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**Table of Contents****Part I FINANCIAL INFORMATION****ITEM 1. Financial Statements****Apollo Commercial Real Estate Finance, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets (Unaudited)****(in thousands except share and per share data)**

|                                                                                                                          | March 31, 2011    | December 31, 2010 |
|--------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| <b>Assets:</b>                                                                                                           |                   |                   |
| Cash and cash equivalents                                                                                                | \$ 48,075         | \$ 37,894         |
| Contractual deposits                                                                                                     | 144               |                   |
| Securities available-for-sale, at estimated fair value                                                                   | 349,662           | 363,660           |
| Securities at estimated fair value                                                                                       | 274,322           | 279,124           |
| Commercial mortgage loans, held for investment                                                                           | 118,313           | 109,695           |
| Subordinate loans, held for investment                                                                                   | 58,973            | 58,985            |
| Repurchase agreements, held for investment                                                                               | 41,418            |                   |
| Principal and interest receivable                                                                                        | 8,250             | 5,553             |
| Deferred financing costs, net                                                                                            | 2,459             | 2,818             |
| Derivative instruments, net                                                                                              | 846               | 387               |
| Other assets                                                                                                             | 28                | 31                |
| <b>Total Assets</b>                                                                                                      | <b>\$ 902,490</b> | <b>\$ 858,147</b> |
| <b>Liabilities and Stockholders' Equity</b>                                                                              |                   |                   |
| <b>Liabilities:</b>                                                                                                      |                   |                   |
| TALF borrowings                                                                                                          | \$ 289,439        | \$ 297,334        |
| Borrowings under repurchase agreements                                                                                   | 298,392           | 242,728           |
| Accounts payable and accrued expenses                                                                                    | 2,031             | 2,375             |
| Payable to related party                                                                                                 | 1,088             | 683               |
| Dividends payable                                                                                                        | 7,116             | 7,189             |
| Deferred underwriting fee (\$8,000 of which is payable to the Manager)                                                   | 10,000            | 10,000            |
| <b>Total Liabilities</b>                                                                                                 | <b>608,066</b>    | <b>560,309</b>    |
| <b>Commitments and Contingencies (see Note 13)</b>                                                                       |                   |                   |
| <b>Stockholders' Equity:</b>                                                                                             |                   |                   |
| Common stock, \$0.01 par value, 450,000,000 shares authorized, 17,551,828 shares issued and outstanding in 2011 and 2010 | 175               | 175               |
| Additional paid-in-capital                                                                                               | 289,767           | 291,304           |
| Accumulated other comprehensive income                                                                                   | 4,482             | 6,359             |
| <b>Total Stockholders' Equity</b>                                                                                        | <b>294,424</b>    | <b>297,838</b>    |
| <b>Total Liabilities and Stockholders' Equity</b>                                                                        | <b>\$ 902,490</b> | <b>\$ 858,147</b> |

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****Apollo Commercial Real Estate Finance, Inc. and Subsidiaries****Condensed Consolidated Statement of Operations (Unaudited)****(in thousands except share and per share data)**

|                                                                                                                                    | Three months<br>ended March 31,<br>2011 | Three months<br>ended March 31,<br>2010 |
|------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|-----------------------------------------|
| Net interest income:                                                                                                               |                                         |                                         |
| Interest income from securities                                                                                                    | \$ 6,656                                | \$ 3,174                                |
| Interest income from commercial mortgage loans                                                                                     | 2,313                                   | 798                                     |
| Interest income from subordinate loans                                                                                             | 1,909                                   | 1,639                                   |
| Interest income from repurchase agreements                                                                                         | 60                                      |                                         |
| Interest expense                                                                                                                   | (3,339)                                 | (1,709)                                 |
| Net interest income                                                                                                                | 7,599                                   | 3,902                                   |
| Operating expenses:                                                                                                                |                                         |                                         |
| General and administrative expenses (includes \$351 and \$390 of non-cash stock based compensation in 2011 and 2010, respectively) | (1,380)                                 | (1,407)                                 |
| Management fees to related party                                                                                                   | (1,088)                                 | (726)                                   |
| Total operating expenses                                                                                                           | (2,468)                                 | (2,133)                                 |
| Interest income from cash balances                                                                                                 | 5                                       | 6                                       |
| Realized loss on sale of security                                                                                                  |                                         | (33)                                    |
| Unrealized gain on securities                                                                                                      | 26                                      |                                         |
| Unrealized gain on derivative instruments                                                                                          | 459                                     |                                         |
| Realized loss on derivative instruments                                                                                            | (441)                                   |                                         |
| Net income                                                                                                                         | \$ 5,180                                | \$ 1,742                                |
| Basic net income per share of common stock                                                                                         | \$ 0.30                                 | \$ 0.16                                 |
| Diluted net income per share of common stock                                                                                       | \$ 0.29                                 | \$ 0.16                                 |
| Basic weighted average common shares outstanding                                                                                   | 17,551,828                              | 10,752,292                              |
| Diluted weighted average common shares outstanding                                                                                 | 17,670,787                              | 10,762,500                              |
| Dividend declared per share of common stock                                                                                        | \$ 0.40                                 | \$ 0.35                                 |

See notes to unaudited condensed consolidated financial statements.

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## Apollo Commercial Real Estate Finance, Inc. and Subsidiaries

### Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

(in thousands except share data)

|                                                                   | Common Stock |        | Additional<br>Paid In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss |         | Comprehensive<br>Loss | Total      |
|-------------------------------------------------------------------|--------------|--------|----------------------------------|----------------------|-----------------------------------------------|---------|-----------------------|------------|
|                                                                   | Shares       | Par    |                                  |                      |                                               |         |                       |            |
| Balance at December 31, 2010                                      | 17,551,828   | \$ 175 | \$ 291,304                       | \$                   | \$                                            | 6,359   |                       | \$ 297,838 |
| Vesting of restricted stock pursuant to Equity<br>Incentive Plan  |              |        | 351                              |                      |                                               |         |                       | 351        |
| Net income                                                        |              |        |                                  | 5,180                |                                               |         | \$ 5,180              | 5,180      |
| Change in net unrealized gain on securities<br>available-for-sale |              |        |                                  |                      |                                               | (1,877) | (1,877)               | (1,877)    |
| Comprehensive income                                              |              |        |                                  |                      |                                               |         | \$ 3,303              |            |
| Dividends on common stock                                         |              |        | (1,888)                          | (5,180)              |                                               |         |                       | (7,068)    |
| Balance at March 31, 2011                                         | 17,551,828   | \$ 175 | \$ 289,767                       | \$                   | \$                                            | 4,482   |                       | \$ 294,424 |

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****Apollo Commercial Real Estate Finance, Inc. and Subsidiaries****Condensed Consolidated Statement of Cash Flows (Unaudited)**

(in thousands)

|                                                                                   | For three months<br>ended<br>March 31, 2011 | For three months<br>ended<br>March 31, 2010 |
|-----------------------------------------------------------------------------------|---------------------------------------------|---------------------------------------------|
| Cash flows provided by operating activities:                                      |                                             |                                             |
| Net income                                                                        | \$ 5,180                                    | \$ 1,742                                    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                             |                                             |
| Premium amortization                                                              | 1,998                                       | 662                                         |
| Amortization of deferred financing costs                                          | 358                                         | 209                                         |
| Restricted stock amortization expense                                             | 351                                         | 390                                         |
| Unrealized gain on securities available-for-sale                                  | (26)                                        |                                             |
| Unrealized gain on derivative instruments                                         | (459)                                       |                                             |
| Realized loss on sale of security                                                 |                                             | 33                                          |
| Changes in operating assets and liabilities:                                      |                                             |                                             |
| Increase in accrued principal and interest receivable, less purchased interest    | (2,696)                                     | (1,571)                                     |
| Decrease in other assets                                                          | 3                                           |                                             |
| Increase in accounts payable and accrued expenses                                 | 651                                         | 507                                         |
| Increase (decrease) in payable to related party                                   | 405                                         | (22)                                        |
| Net cash provided by operating activities                                         | 5,765                                       | 1,950                                       |
| Cash flows used in investing activities:                                          |                                             |                                             |
| Purchase of securities available-for-sale                                         |                                             | (229,498)                                   |
| Proceeds from sale of securities available-for-sale                               |                                             | 12,188                                      |
| Funding of commercial mortgage loans                                              | (8,800)                                     | (86,000)                                    |
| Funding of repurchase agreements                                                  | (41,418)                                    |                                             |
| Principal payments received on securities available-for-sale                      | 11,446                                      | 77                                          |
| Principal payments received on securities at estimated fair value                 | 3,505                                       |                                             |
| Principal payments received on commercial mortgage loans                          | 182                                         |                                             |
| Principal payments received on subordinate loans                                  | 12                                          |                                             |
| Change in contractual deposits                                                    | (144)                                       | 90                                          |
| Net cash used in investing activities                                             | (35,217)                                    | (303,143)                                   |
| Cash flows from financing activities:                                             |                                             |                                             |
| Payment of offering costs                                                         | (494)                                       | (222)                                       |
| Proceeds from TALF borrowings                                                     |                                             | 178,470                                     |
| Repayments of TALF borrowings                                                     | (7,895)                                     | (127)                                       |
| Proceeds from repurchase agreement borrowings                                     | 58,819                                      | 88,905                                      |
| Repayments of repurchase agreement borrowings                                     | (3,155)                                     | (88,905)                                    |
| Deferred financing costs                                                          | (500)                                       | (1,359)                                     |
| Dividends on common stock                                                         | (7,142)                                     |                                             |
| Net cash provided by financing activities                                         | 39,633                                      | 176,762                                     |
| Net increase (decrease) in cash and cash equivalents                              | 10,181                                      | (124,431)                                   |
| Cash and cash equivalents, beginning of period                                    | 37,894                                      | 129,969                                     |

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|                                                           |    |        |    |        |
|-----------------------------------------------------------|----|--------|----|--------|
| Cash and cash equivalents, end of period                  | \$ | 48,075 | \$ | 5,538  |
| Supplemental disclosure of cash flow information:         |    |        |    |        |
| Interest paid                                             | \$ | 3,391  | \$ | 1,290  |
| Supplemental disclosure of non-cash financing activities: |    |        |    |        |
| Deferred underwriting fee                                 | \$ |        | \$ | 10,000 |
| Offering costs payable                                    | \$ |        | \$ | 415    |
| Dividend declared, not yet paid                           | \$ | 7,116  | \$ | 3,766  |
| Deferred financing costs, not yet paid                    | \$ | 500    | \$ | 1,294  |

See notes to unaudited condensed consolidated financial statements.

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**Apollo Commercial Real Estate Finance Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(in thousands except share and per share data)**

**Note 1 Organization**

Apollo Commercial Real Estate Finance, Inc. (together with its consolidated subsidiaries, is referred to throughout this report as the Company, ARI, we, us and our ) is a real estate investment trust ( REIT ) that originates, acquires, invests in and manages performing commercial first mortgage loans, commercial mortgage-backed securities ( CMBS ), mezzanine financings and other commercial real estate-related debt investments in the U.S. These asset classes are referred to as the Company's target assets.

**Note 2 Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying consolidated financial statements include the Company's accounts and those of its consolidated subsidiaries. All significant intercompany amounts have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company's most significant estimates include the fair value of financial instruments, share-based payments and deferred underwriting fees. Actual results could differ from those estimates.

These unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission (the SEC ).

The Company currently operates in one business segment.

***Recent Accounting Pronouncements***

There have been no accounting pronouncements that have been issued but are not yet effective that would have a material impact on our financial position or results of operations.

**Note 3 Fair Value Disclosure**

GAAP establishes a hierarchy of valuation techniques based on observable inputs utilized in measuring financial instruments at fair values. Market based or observable inputs are the preferred source of values, followed by valuation models using management assumptions in the absence of market inputs. The three levels of the hierarchy are described below:

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

Level II 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 III 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.

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While the Company anticipates that its valuation methods will be appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company will use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

The estimated fair value of the AAA-rated CMBS portfolio is determined by reference to market prices provided by certain dealers who make a market in these financial instruments. Broker quotes are only indicative of fair value and may not necessarily represent what the Company would receive in an actual trade for the applicable instrument. Management performs additional analysis on prices received based on broker quotes to validate the prices and adjustments are made as deemed necessary by management to capture current market information.

The estimated fair values of the Company's derivative instruments are determined using a discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The fair values of interest rate caps are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the calculation of projected cash flows are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities.

The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments fall as of March 31, 2011:

|                                     | Level I   | Fair Value as of March 31, 2011<br>Level II | Level III | Total             |
|-------------------------------------|-----------|---------------------------------------------|-----------|-------------------|
| AAA-rated CMBS (Available-for-Sale) | \$        | \$ 349,662                                  | \$        | \$ 349,662        |
| AAA-rated CMBS (Fair Value Option)  |           | 274,322                                     |           | 274,322           |
| Interest rate swaps                 |           | (1,123)                                     |           | (1,123)           |
| Interest rate caps                  |           | 1,969                                       |           | 1,969             |
| <b>Total</b>                        | <b>\$</b> | <b>\$ 624,830</b>                           | <b>\$</b> | <b>\$ 624,830</b> |

The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments fall as of December 31, 2010:

|                                     | Level I   | Fair Value as of December 31, 2010<br>Level II | Level III | Total             |
|-------------------------------------|-----------|------------------------------------------------|-----------|-------------------|
| AAA-rated CMBS (Available-for-Sale) | \$        | \$ 363,660                                     | \$        | \$ 363,660        |
| AAA-rated CMBS (Fair Value Option)  |           | 279,124                                        |           | 279,124           |
| Interest rate swaps                 |           | (1,429)                                        |           | (1,429)           |
| Interest rate caps                  |           | 1,816                                          |           | 1,816             |
| <b>Total</b>                        | <b>\$</b> | <b>\$ 643,171</b>                              | <b>\$</b> | <b>\$ 643,171</b> |

## Note 4 Debt Securities

At March 31, 2011, the Company had AAA-rated CMBS with an aggregate face value of \$607,548. Securities available-for-sale with an aggregate face amount of \$339,706 were pledged to secure its borrowings under the Term Asset-Backed Securities Loan Facility program administered by the Federal Reserve Bank of New York (the "TALF") and securities at estimated fair value with an aggregate face amount of \$267,842 were pledged to secure its borrowings under the Company's master repurchase agreement with Wells Fargo Bank, N.A. (the "Wells Facility").

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The amortized cost and estimated fair value of the Company's debt securities at March 31, 2011 are summarized as follows:

| Security Description                | Face Amount       | Amortized Cost    | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|-------------------------------------|-------------------|-------------------|-----------------------|-----------------------|----------------------|
| AAA-rated CMBS (Available-for-Sale) | \$ 339,706        | \$ 345,180        | \$ 4,517              | \$ (35)               | \$ 349,662           |
| AAA-rated CMBS (Fair Value Option)  | 267,842           | 276,061           | 9                     | (1,748)               | 274,322              |
| <b>Total</b>                        | <b>\$ 607,548</b> | <b>\$ 621,241</b> | <b>\$ 4,526</b>       | <b>\$ (1,783)</b>     | <b>\$ 623,984</b>    |

The temporary impairment of the available-for-sale securities results from the fair value of the securities falling below the amortized cost basis. These unrealized losses are primarily the result of market factors other than credit impairment and the Company believes the carrying value of the securities are fully recoverable over their expected holding period. Management does not intend to sell or expect to be forced to sell the securities prior to the Company recovering the amortized cost. Additionally, all unrealized losses on securities available-for-sale at March 31, 2011 have existed for less than twelve months. As such, management does not believe any of the securities are other than temporarily impaired.

The amortized cost and estimated fair value of the Company's debt securities at December 31, 2010 are summarized as follows:

| Security Description                | Face Amount       | Amortized Cost    | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|-------------------------------------|-------------------|-------------------|-----------------------|-----------------------|----------------------|
| AAA-rated CMBS (Available-for-Sale) | \$ 351,152        | \$ 357,301        | \$ 6,403              | \$ (44)               | \$ 363,660           |
| AAA-rated CMBS (Fair Value Option)  | 271,347           | 280,890           |                       | (1,766)               | 279,124              |
| <b>Total</b>                        | <b>\$ 622,499</b> | <b>\$ 638,191</b> | <b>\$ 6,403</b>       | <b>\$ (1,810)</b>     | <b>\$ 642,784</b>    |

The overall statistics for the Company's CMBS investments calculated on a weighted average basis assuming no early prepayments or defaults as of March 31, 2011 are as follows:

|                       |           |
|-----------------------|-----------|
| Credit Ratings *      | AAA       |
| Coupon                | 5.6%      |
| Yield                 | 4.2%      |
| Weighted Average Life | 1.8 years |

\* Ratings per Fitch, Moody's or S&P

The vintage, property type, and location of the collateral securing the Company's CMBS investments calculated on a weighted average basis as of March 31, 2011 are as follows:

|              |             |
|--------------|-------------|
| Vintage      | Percentage  |
| 2006         | 10%         |
| 2007         | 90          |
| <b>Total</b> | <b>100%</b> |



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| Property Type | Percentage |
|---------------|------------|
| Retail        | 36.6%      |
| Office        | 26.5       |
| Hotel         | 13.2       |
| Multifamily   | 10.9       |
| Other *       | 12.8       |
| Total         | 100%       |

\* No other individual category comprises more than 10% of the total.

| Location        | Percentage |
|-----------------|------------|
| South Atlantic  | 23.4%      |
| Middle Atlantic | 21.3       |
| Pacific         | 21.0       |
| Other *         | 34.3       |
| Total           | 100%       |

\* No other individual category comprises more than 10% of the total.

### Note 5 Commercial Mortgage Loans

The Company's commercial mortgage loan portfolio is comprised of the following at March 31, 2011:

| Description                          | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Property Size  | Appraised Loan-to-Value |
|--------------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|----------------|-------------------------|
| Hotel - NY, NY                       | Jan-10             | Feb-15        | \$ 32,000            | \$ 31,952           | 8.25%  | 30 year               | 151 rooms      | 40%                     |
| Office Condo (Headquarters) - NY, NY | Feb-10             | Feb-15        | 28,000               | 27,799              | 8.00   | 30 year               | 73,419 sq. ft. | 54%                     |
| Hotel - Silver Spring, MD            | Mar-10             | Apr-15        | 26,000               | 25,762              | 9.00   | 25 year               | 263 rooms      | 58%                     |
| Hotel NY, NY                         | Aug-10             | Aug-12        | 24,000               | 24,000              | 8.00   | Interest only         | 155 rooms      | 40%                     |
| Multifamily Los Angeles, CA          | Mar-11             | Jun-11        | 8,800                | 8,800               | 7.50   | Interest only         | 89 units       | 52%                     |
| Total                                |                    |               | \$ 118,800           | \$ 118,313          | 8.25%  |                       |                |                         |

The Company's commercial mortgage loan portfolio is comprised of the following at December 31, 2010:

| Description                          | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Property Size  | Appraised Loan-to-Value |
|--------------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|----------------|-------------------------|
| Hotel - NY, NY                       | Jan-10             | Feb-15        | \$ 32,000            | \$ 32,000           | 8.25%  | 30 year               | 151 rooms      | 55%                     |
| Office Condo (Headquarters) - NY, NY | Feb-10             | Feb-15        | 28,000               | 27,859              | 8.00   | 30 year               | 73,419 sq. ft. | 54%                     |
| Hotel - Silver Spring, MD            | Mar-10             | Apr-15        | 26,000               | 25,836              | 9.00   | 25 year               | 263 rooms      | 58%                     |
| Hotel NY, NY                         | Aug-10             | Aug-12        | 24,000               | 24,000              | 8.00   | Interest only         | 155 rooms      | 40%                     |

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|       |            |            |       |
|-------|------------|------------|-------|
| Total | \$ 110,000 | \$ 109,695 | 8.31% |
|-------|------------|------------|-------|

The Company evaluates its loans for possible impairment on a quarterly basis. The Company regularly evaluates the extent and impact of any credit migration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower/sponsor on a loan by loan basis. Specifically, a property's operating results and any cash reserves are analyzed and used to assess (i) whether cash from operations are sufficient to cover the debt service requirements currently and into the future, (ii) the ability of the borrower to refinance the loan, and/or (iii) the property's liquidation value. The Company also evaluates the financial wherewithal of any loan guarantors as well as the borrower's competency in managing and operating the properties. In addition, the Company considers the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. Such impairment analyses are completed and reviewed by asset management and finance personnel, who utilize various data sources, including (i) periodic financial data such as debt service coverage ratio, property occupancy, tenant profile, rental rates, operating expenses, the borrower's exit plan, and capitalization and discount rates, (ii) site inspections, and (iii) current credit spreads and discussions with market participants. Impairment occurs when it is deemed probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan. The Company has determined that an impairment was not necessary at March 31, 2011 and 2010.

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### Note 6 Subordinate Loans

The Company's subordinate loan portfolio is comprised of the following at March 31, 2011:

| Description                    | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Appraised Loan-to-Value |
|--------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|-------------------------|
| Senior Mezz - Retail - Various | Dec-09             | Dec-19        | \$ 30,000            | \$ 30,000           | 12.24% | Interest only         | 69%                     |
| Junior Mezz - Retail - Various | Dec-09             | Dec-19        | 20,000               | 20,000              | 14.00  | Interest only         | 74%                     |
| Office - Troy, MI              | May-10             | Jun-20        | 9,000                | 8,973               | 13.00  | 25 year               | 70%                     |
| Total                          |                    |               | \$ 59,000            | \$ 58,973           | 12.95% |                       |                         |

The Company's subordinate loan portfolio is comprised of the following at December 31, 2010:

| Description                    | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Appraised Loan-to-Value |
|--------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|-------------------------|
| Senior Mezz - Retail - Various | Dec-09             | Dec-19        | \$ 30,000            | \$ 30,000           | 12.24% | Interest only         | 69%                     |
| Junior Mezz - Retail - Various | Dec-09             | Dec-19        | 20,000               | 20,000              | 14.00  | Interest only         | 74%                     |
| Office - Troy, MI              | May-10             | Jun-20        | 9,000                | 8,985               | 13.00  | 25 year               | 70%                     |
| Total                          |                    |               | \$ 59,000            | \$ 58,985           | 12.95% |                       |                         |

The Company evaluates its loans for possible impairment on a quarterly basis. See Note 5 Commercial Mortgage Loans for a summary of the metrics reviewed. The Company has determined that an impairment was not necessary at March 31, 2011 and 2010.

### Note 7 Repurchase Agreements

During March 2011, the Company closed on a \$47,439 investment structured in the form of a repurchase facility secured by a Class A-2 CDO bond. The first draw under the repurchase facility totaled \$41,418 and occurred on March 28, 2011.

The repurchase facility bears interest at 13.0% (10.0% current pay with a 3.0% accrual) on amounts outstanding and has an initial term of 18 months with three six-month extensions options available to the borrower. Any principal repayments that occur prior to the 21st month are subject to a make-whole provision at the full 13.0% interest rate.

In aggregate, the \$47,439 of borrowings provided under the facility will finance the purchase of a CDO bond with an aggregate face amount of \$68,726, representing an advance rate of 69% on the CDO bond's face amount. The Class A-2 CDO bond, originally rated AAA/Aaa, is currently rated A-/Baa1. The CDO is comprised of 58 senior and subordinate commercial real estate debt positions and commercial real estate securities with the majority of the debt and securities underlying the CDO being first mortgages.

**Table of Contents****Note 8 Borrowings**

At March 31, 2011, the Company's borrowings had the following weighted average maturities and interest rates:

|                              | Debt<br>Balance | Weighted<br>Average<br>Remaining<br>Maturity | Weighted<br>Average<br>Rate |           |
|------------------------------|-----------------|----------------------------------------------|-----------------------------|-----------|
| TALF borrowings              | \$ 289,439      | 2.0 years                                    | 2.8%                        | Fixed     |
| Wells Facility borrowings    | 239,573         | 2.3 years*                                   | 1.5%                        | **        |
| JPMorgan Facility borrowings | 58,819          | 2.0 years*                                   | 3.2%                        | Libor+300 |
| Total borrowings             | \$ 587,831      | 2.1 years                                    | 2.3%                        |           |

\* Assumes extension options on Wells and JPMorgan Facilities are exercised. See below for further discussion.

\*\* The fully hedged interest rate for borrowings outstanding under the Wells Facility was 2.6% at March 31, 2011. See Note 9 Derivative Instruments for further discussion of the Company's interest rate hedging agreements.

At March 31, 2011, the Company's borrowings had the following remaining maturities:

|                              | Less<br>than 1<br>year | 1 to 3<br>years | 3 to 5<br>years | More<br>than 5<br>years | Total      |
|------------------------------|------------------------|-----------------|-----------------|-------------------------|------------|
| TALF borrowings              | \$                     | \$ 268,481      | \$ 20,958       | \$                      | \$ 289,439 |
| Wells Facility borrowings    |                        | 239,573*        |                 |                         | 239,573    |
| JPMorgan Facility borrowings |                        | 58,819*         |                 |                         | 58,819     |
| Total                        | \$                     | \$ 566,873      | \$ 20,958       | \$                      | \$ 587,831 |

\* Assumes extension options on Wells and JPMorgan Facilities are exercised. See below for further discussion.

**Note 9 Derivative instruments**

The Company uses interest rate swaps and caps to manage exposure to variable cash flows on portions of its borrowings under repurchase agreements. The Company's repurchase agreements bear interest at a LIBOR-based variable rate and increases in LIBOR could negatively impact earnings. Interest rate swap and cap agreements allow the Company to receive a variable rate cash flow based on LIBOR and pay a fixed rate cash flow, mitigating the impact of this exposure.

During 2010, the Company entered into interest rate swaps with an aggregate notional balance of \$242,728 in an effort to hedge floating-rate interest payments due under the Wells Facility. The Company also entered into forward-starting caps to hedge potential extensions of the collateral securing the Wells Facility borrowings. The Company's derivative instruments consist of the following at March 31, 2011:

|                     | Notional<br>Value | Estimated<br>Fair Value |
|---------------------|-------------------|-------------------------|
| Interest rate swaps | \$ 242,728        | \$ (1,123)              |
| Interest rate caps  | *                 | 1,969                   |

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|                              |    |     |
|------------------------------|----|-----|
| Total derivative instruments | \$ | 846 |
|------------------------------|----|-----|

\* Because the interest rate caps are forward-starting, there is no notional value at March 31, 2011.

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The following table summarizes the amounts recognized on the consolidated statements of operations related to the Company's derivatives for the year ended March 31, 2011.

|                     | Location of Gain/(Loss)<br>Recognized in Income * | Amount of<br>gain/<br>(loss)<br>recognized<br>in income for<br>the<br>three months ended<br>March 31, 2011 |
|---------------------|---------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| Interest rate swaps | Other gain/(loss)                                 | \$ (135)                                                                                                   |
| Interest rate caps  | Other gain/(loss)                                 | 153                                                                                                        |
| <b>Total</b>        |                                                   | <b>\$ 18</b>                                                                                               |

\* The change in estimated fair value related to the Company's derivative instruments is recorded in unrealized loss on derivative instruments on the consolidated statements of operations. Interest expense related to the Company's derivative instruments is recorded in realized loss on derivative instruments on the consolidated statements of operations.

**Note 10 Related Party Transactions****Management Agreement**

In connection with the Company's initial public offering (IPO) in September 2009, the Company entered into a management agreement (the Management Agreement) with ACREFI Management, LLC (the Manager), which describes the services to be provided by the Manager and its compensation for those services. The Manager is responsible for managing the Company's day-to-day operations, subject to the direction and oversight of the Company's board of directors.

Pursuant to the terms of the Management Agreement, the Manager is paid a base management fee equal to 1.5% per annum of the Company's stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears.

The initial term of the Management Agreement expires on September 29, 2012 (the third anniversary of the closing of the IPO), and it is automatically renewed for one-year terms on each anniversary thereafter. Following the initial term, the Management Agreement may be terminated upon the affirmative vote of at least two-thirds of the Company's independent directors, based upon (1) unsatisfactory performance by the Manager that is materially detrimental to the Company or (2) a determination that the management fee payable to the Manager is not fair, subject to the Manager's right to prevent such a termination based on unfair fees by accepting a mutually acceptable reduction of management fees agreed to by at least two-thirds of the Company's independent directors. The Manager must be provided with written notice of any such termination at least 180 days prior to the expiration of the then existing term and will be paid a termination fee equal to three times the sum of the average annual base management fee during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

For the three months ended March 31, 2011 and 2010, respectively, the Company incurred approximately \$1,088 and \$726 in base management fees. In addition to the base management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company or for certain services provided by the Manager to the Company. For the three months ended March 31, 2011 and 2010, respectively, the Company recorded expenses totaling \$186 and \$1,331 related to reimbursements for certain expenses paid by the Manager on behalf of the Company. Expenses incurred by the Manager and reimbursed by the Company are reflected in the respective consolidated statement of operations expense category or the consolidated balance sheet based on the nature of the item. At March 31, 2011, included in payable to related party on the consolidated balance sheet is approximately \$1,088 for base management fees incurred but not yet paid. In addition, the Company has recorded a contingent liability in the amount of \$8,000 for underwriting fees paid by the Manager on behalf of the Company (see Note 13 Commitments and Contingencies).

**Note 11 Share-Based Payments**

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On September 23, 2009, the Company's board of directors approved the Apollo Commercial Real Estate Finance, Inc., 2009 Equity Incentive Plan (the "LTIP"). The LTIP provides for grants of restricted common stock, restricted stock units and other equity-based awards up to an aggregate of 7.5% of the issued and outstanding shares of the Company's common stock (on a fully diluted basis). The LTIP is administered by the compensation committee of the Company's board of directors (the "Compensation Committee") and all grants under the LTIP must be approved by the Compensation Committee.

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The Company recognized stock-based compensation expense of \$351 and \$390 for the three months ended March 31, 2011 and 2010, respectively, related to restricted stock and restricted stock unit ( RSU ) vesting.

Below is a summary of restricted stock and RSU vesting dates as of March 31, 2011.

| Vesting Date | Shares Vesting | RSU Vesting | Total Awards |
|--------------|----------------|-------------|--------------|
| January 2010 | 21,871         |             | 21,871       |
| April 2010   | 21,877         |             | 21,877       |
| July 2010    | 12,364         | 10,209      | 22,573       |
| October 2010 | 10,485         | 12,499      | 22,984       |
| January 2011 | 10,314         | 11,875      | 22,189       |
| April 2011   | 10,318         | 11,876      | 22,194       |
| July 2011    | 10,312         | 11,874      | 22,186       |
| October 2011 | 10,314         | 11,875      | 22,189       |
| January 2012 | 10,315         | 11,876      | 22,191       |
| April 2012   | 10,315         | 11,874      | 22,189       |
| July 2012    | 10,315         | 11,875      | 22,190       |
| October 2012 | 10,314         | 11,876      | 22,190       |
| January 2013 | 939            | 417         | 1,356        |
| April 2013   | 942            | 417         | 1,359        |
| July 2013    | 417            | 416         | 833          |
| October 2013 | 416            |             | 416          |
|              | 151,828        | 118,959     | 270,787      |

## Note 12 Stockholders Equity

*Dividends.* For 2011, the Company's board of directors has declared the following dividends:

| Declaration Date | Record Date    | Payment Date   | Amount  |
|------------------|----------------|----------------|---------|
| March 9, 2011    | March 31, 2011 | April 12, 2011 | \$ 0.40 |

## Note 13 Commitments and Contingencies

*Deferred Underwriting Fee.* At the closing of the IPO, the Company's underwriters did not receive any payment directly from the Company for the underwriting fee equal to 5% of the gross proceeds raised in the IPO, or \$10,000 in total. The Manager paid the underwriters \$8,000 on the Company's behalf at closing (4% of the gross proceeds raised in the IPO) and the underwriters agreed to defer the receipt of \$2,000 (1% of the gross proceeds raised in the IPO). The Company has agreed to pay \$8,000 to its Manager and pay \$2,000 to the underwriters if during any period of four consecutive calendar quarters during the 16 full calendar quarters after the consummation of the IPO (as described below) the Company's Core Earnings (as defined below) for any such four-quarter period exceeds an 8% performance Hurdle Rate (as described below).

Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) as adjusted, excluding: (i) non-cash equity compensation expense; (ii) depreciation and amortization (to the extent the Company forecloses on any properties underlying the Company's target assets); (iii) any unrealized gains, losses or other non-cash items, regardless of whether such items are included in other comprehensive income or loss, or in net income; and (iv) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company's independent directors and after approval by a majority of the Company's independent directors.

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Pursuant to the agreement with the Manager and the underwriters, the aforementioned Hurdle Rate test is considered met if during a period of four consecutive quarters the Company's Core Earnings exceeds the product of (x) the public offering price per share of the Company's common stock (\$20 per share) multiplied by the number of shares of common stock sold in the IPO and the concurrent private placement (a total of 10,500,000 shares) and (y) 8%. In addition, if the Management Agreement is terminated and the Company is required to pay its Manager the termination fee described in Note 8, the Company would also be required to refund its Manager for its payment of the initial underwriting discount irrespective of whether the Company has met the Hurdle Rate described above.

The deferred underwriting fee is considered a contingent liability where payment is probable and the amount is estimable, and as such the \$10,000 of deferred underwriting fee is recorded as a contingent liability with a corresponding reduction in additional paid in capital.

### Note 14 Fair Value of Financial Instruments

The following table presents the carrying value and estimated fair value of the Company's financial instruments not carried at fair value on the consolidated balance sheet at March 31, 2011 and December 31, 2010:

|                                        | March 31, 2011 |                      | December 31, 2010 |                      |
|----------------------------------------|----------------|----------------------|-------------------|----------------------|
|                                        | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| Commercial first mortgage loans        | \$ 118,313     | \$ 127,046           | \$ 109,695        | \$ 118,096           |
| Subordinate loans                      | 58,973         | 71,356               | 58,985            | 70,273               |
| Repurchase agreements                  | 41,418         | 41,418               |                   |                      |
| TALF borrowings                        | (289,439)      | (293,118)            | (297,334)         | (302,860)            |
| Borrowings under repurchase agreements | (298,392)      | (298,392)            | (242,728)         | (242,728)            |

To determine estimated fair values of the financial instruments listed above, market rates of interest, which include credit assumptions, are used to discount contractual cash flows. The estimated fair values are not necessarily indicative of the amount the Company could realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

### Note 15 Net Income per Share

GAAP requires use of the two-class method of computing earnings per share for all periods presented. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security as if all earnings for the period had been distributed. Unvested RSUs that earn non-forfeitable dividend rights qualify as participating securities and, accordingly, are included in the basic and diluted computations. Calculations of earnings per share under the two-class method exclude any dividends declared for each class of common stock and participating security. The Company's unvested RSUs participate in dividends on an equal basis with common stock; therefore, there is no difference in earnings allocated to each participating security. Accordingly, the presentation below is prepared on a combined basis and is presented as earnings per share of common stock.

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|                                                                                                                                          | Three months<br>ended<br>March 31,<br>2011 | Three months<br>ended<br>March 31,<br>2010 |
|------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|--------------------------------------------|
| <b>Numerator:</b>                                                                                                                        |                                            |                                            |
| Net income attributable to common stockholders and participating securities for basic and diluted earnings per share                     | \$ 5,180                                   | \$ 1,742                                   |
| <b>Denominator:</b>                                                                                                                      |                                            |                                            |
| Weighted average common shares outstanding                                                                                               | 17,551,828                                 | 10,752,292                                 |
| Weighted average participating securities                                                                                                | 118,959                                    | 10,208                                     |
| Denominator for basic and diluted earnings per share weighted average common shares outstanding and common stock equivalents outstanding | 17,670,787                                 | 10,762,500                                 |
| Basic net income per weighted average common stock                                                                                       | \$ 0.30                                    | \$ 0.16                                    |
| Diluted net income per weighted average common stock and common stock equivalents                                                        | \$ 0.29                                    | \$ 0.16                                    |

### Note 16 Subsequent Events

*Dividends.* On May 9, 2011, the Company's board of directors declared a dividend of \$0.40 per share of common stock which is payable on July 12, 2011 to common stockholders of record on June 30, 2011.

*Investment activity.* During April 2011, the Company funded an additional \$6,021 under its \$47,439 repurchase facility. This additional funding brings the total balance of the Company's investment in the repurchase facility to \$47,439. The facility bears interest at 13.0% (10.0% current pay with a 3.0% accrual) on amounts outstanding and has an initial term of 18 months with three six-month extensions options available to the borrower. Any principal repayments that occur prior to the 21<sup>st</sup> month are subject to a make-whole provision at the full 13.0% interest rate.

During April 2011, the Company also closed a \$40,000 subordinate loan. The subordinated loan is part of a \$245,000 newly originated financing that consists of \$170,000 of senior financing and a total of \$75,000 of subordinate financing, all of which is secured by a ski resort in California.

The subordinate loan bears interest at a rate of 13.25% and has a term of six years. Prepayments on the subordinate loan are prohibited prior to the third year of the loan and any prepayments prior to the fifth year of the loan are subject to prepayment penalties ranging from 5% to 1%. The entire \$245,000 financing represents an appraised loan-to-value of approximately 64% and a debt yield of 17.1% based on trailing twelve month financials.

During April 2011, the Company's \$8,800 commercial mortgage loan secured by a multifamily property in Los Angeles, California was repaid.

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### **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **FORWARD-LOOKING INFORMATION**

The Company makes forward-looking statements herein and will make forward-looking statements in future filings with the Securities and Exchange Commission ( "SEC" ), press releases or other written or oral communications within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, (the "Exchange Act" ). For these statements, the Company claims the protections of the safe harbor for forward-looking statements contained in such Section. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the Company's control. These forward-looking statements include information about possible or assumed future results of the Company's business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may" or similar expressions, it intends to make forward-looking statements. Statements regarding the following subjects, among others, may be forward-looking: market trends in the Company's industry; interest rates, real estate values, the debt securities markets or the general economy or the demand for commercial real estate loans; the Company's business and investment strategy; projected operating results; actions and initiatives of the U.S. government and changes to U.S. government policies and the execution and impact of these actions, initiatives and policies; the state of the U.S. economy generally or in specific geographic regions; economic trends and economic recoveries; the Company's ability to obtain and maintain financing arrangements, including securitizations; the anticipated shortfall of debt financing from traditional lenders; the volume of short-term loan extensions; the demand for new capital to replace maturing loans; expected leverage; general volatility of the securities markets in which the Company participates; changes in the value of the Company's assets; the scope of the Company's target assets; interest rate mismatches between the Company's target assets and any borrowings used to fund such assets; changes in interest rates and the market value of the Company's target assets; changes in prepayment rates on the Company's target assets; effects of hedging instruments on the Company's target assets; rates of default or decreased recovery rates on the Company's target assets; the degree to which hedging strategies may or may not protect the Company from interest rate volatility; impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters; the Company's ability to maintain its qualification as a real estate investment trust ( "REIT" ) for U.S. federal income tax purposes; the Company's ability to maintain its exemption from registration under the Investment Company Act of 1940 (the "1940 Act" ); the availability of opportunities to acquire commercial mortgage-related, real estate-related and other securities; the availability of qualified personnel; estimates relating to the Company's ability to make distributions to its stockholders in the future; and the Company's understanding of its competition.

The forward-looking statements are based on the Company's beliefs, assumptions and expectations of its future performance, taking into account all information currently available to it. Forward-looking statements are not predictions of future events. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to the Company. See Item 1A - Risk Factors of the Company's annual report on Form 10-K. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that the Company files with the SEC, could cause its actual results to differ materially from those included in any forward-looking statements the Company makes. All forward-looking statements speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, the Company is not obligated to, and does not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

#### **Overview**

The Company is a commercial real estate finance company that originates, acquires, invests in and manages performing commercial first mortgage loans, CMBS, mezzanine financings and other commercial real estate-related debt investments in the U.S. The Company refers to these asset classes as its target assets.

The Company is externally managed and advised by ACREFI Management, LLC (the "Manager" ), an indirect subsidiary of Apollo Global Management, LLC, together with its subsidiaries, "Apollo" , a leading global alternative asset manager with a contrarian and value oriented investment approach in private equity, credit-oriented capital markets and real estate. Apollo had total assets under management of \$67.6 billion as of December 31, 2010.

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The Manager is led by an experienced team of senior real estate professionals who have significant experience in commercial property investing, financing and ownership. The Manager benefits from the investment, finance and managerial expertise of Apollo's private equity, credit-oriented capital markets and real estate investment professionals. The Company believes its relationship with Apollo provides the Company with significant advantages in sourcing, evaluating, underwriting and managing investments in the Company's target assets.

### **Market conditions**

The Company believes that the current market environment presents a compelling opportunity to achieve attractive risk adjusted returns in senior performing commercial real estate debt investments. Beginning in mid-2007, global financial markets encountered a series of events from the collapse of the sub-prime mortgage market to the ensuing dramatic widening of credit spreads and corresponding broad-scale freezing of corporate lending. These events led to a significant dislocation in capital markets and created a severe shortage of debt capital across markets, a deleveraging of the entire global financial system and a severe decline in the market values of mortgage, real estate-related and other financial assets. As a result of these conditions, many traditional commercial real estate mortgage loan and securities investors withdrew from the market or significantly curtailed their lending activities, resulting in a severe contraction in market liquidity and a sharp reduction in the availability of credit for real estate-related assets. The resulting illiquidity has negatively affected both the terms and the availability of financing for all real estate-related assets, and has generally resulted in real estate-related assets trading at significantly lower prices and higher yields compared to prior periods.

The Company estimates that from 2011 to 2015, approximately \$1.5 trillion of commercial real estate loans are scheduled to mature and that markets are likely to face a void of several hundred billion dollars over this period that must be filled by new mortgage lenders since the supply of debt from traditional lending sources is anticipated to be less than the volume necessary to refinance maturing real estate loans.

During 2009 and 2010, the demand for new capital to refinance maturing commercial mortgage debt was tapered by the volume of extensions that were granted by lenders across the commercial mortgage loan industry. In addition, in 2009, the Internal Revenue Service and the Department of the Treasury issued guidance which provided loan servicers with increased flexibility in relation to their ability to modify commercial mortgage loans held by Real Estate Mortgage Investment Conduits, or REMICs, opening the door to previously unavailable loan restructurings. Despite this trend, the Company was able to deploy substantially all of the IPO and the concurrent private placement proceeds in our target asset classes. In addition, the Company believes that as the economic recovery continues the volume of short-term loan extensions and restructurings will be reduced, resulting in increased demand for new capital to replace maturing loans and opportunities for us to originate first mortgage loans in the market.

The Company also believes that the supply of new capital to meet this increasing demand will continue to be constrained by the historically low activity levels in the CMBS market. The volume of issuances of newly created CMBS dropped from \$230 billion in 2007 to \$2.7 billion in 2009 and \$12.0 billion for 2010. This decline has had a concomitant impact on the supply of capital for new commercial mortgage lending since the net proceeds from newly created CMBS issuances are applied to purchase commercial mortgage loans from loan originators. The Company believes that lower levels of CMBS issuances will enhance our first mortgage origination business. The Company further believes that any increase in CMBS issuances will likely be at lower loan-to-value ratios and will therefore continue to provide the Company with opportunities to originate mezzanine financings with respect to those parts of the financing capital structure which are unsuitable to be sold as part of CMBS.

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Bill) was passed by Congress. The Dodd-Frank Bill aims to restore responsibility and accountability to the financial system by reforming the legal and regulatory framework governing financial institutions. It is difficult to predict at this time how the legislation may impact the borrowing environment, the investing environment for the Company's target assets, interest rate swaps and other derivatives in that many of the regulations mandated by the Dodd-Frank Bill are yet to be proposed or implemented.

**Table of Contents****Critical Accounting Policies**

A summary of the Company's accounting policies is set forth in its annual report on Form 10-K for the year ended December 31, 2010 under Note 2 – Summary of Significant Accounting Policies.

**Financial Condition and Results of Operations****Investments**

The following table sets forth certain information regarding the Company's investments at March 31, 2011:

| Description                                   | Face Amount    | Carrying Value | Remaining Weighted Average Life (years) | Debt           | Cost of Funds | Remaining Debt Term (years)* |
|-----------------------------------------------|----------------|----------------|-----------------------------------------|----------------|---------------|------------------------------|
| <b>CMBS - TALF collateral:</b>                |                |                |                                         |                |               |                              |
| BSCMS 07-PW16 A2                              | \$ 41,506      | 42,837         | 3.7                                     | 35,251         | 2.8%          | 1.8                          |
| BSCMS 2007-PW18 A2                            | 13,493         | 13,990         | 2.2                                     | 11,449         | 2.7%          | 2.0                          |
| CD 2007-CD4 A2B                               | 28,000         | 28,654         | 1.4                                     | 23,778         | 2.8%          | 1.8                          |
| JPMCC 2006-LDP8 A2                            | 26,131         | 26,974         | 1.6                                     | 22,177         | 2.7%          | 2.0                          |
| JPMCC 07-LD11 A2                              | 25,000         | 25,752         | 1.1                                     | 20,958         | 3.6%          | 3.7                          |
| JPMCC 2007-LD12 A2                            | 34,800         | 35,827         | 1.3                                     | 29,521         | 2.7%          | 2.0                          |
| LBUBS 06-C7 A2                                | 33,810         | 34,237         | 0.5                                     | 28,559         | 2.7%          | 1.7                          |
| LBUBS 07-C6 A2                                | 22,313         | 23,073         | 1.5                                     | 18,834         | 2.8%          | 1.8                          |
| MSC 06-HQ10 A2                                | 2,360          | 2,376          | 0.3                                     | 2,006          | 2.7%          | 1.7                          |
| MSC 07-IQ14 A2                                | 36,377         | 37,433         | 3.9                                     | 30,878         | 2.8%          | 1.8                          |
| WBCMT 07-C33 A2                               | 24,083         | 24,986         | 1.2                                     | 20,308         | 2.7%          | 1.7                          |
| WBCMT 07-C32 A2                               | 51,833         | 53,523         | 3.0                                     | 45,720         | 2.7%          | 1.9                          |
| <b>Total CMBS - TALF collateral</b>           | <b>339,706</b> | <b>349,662</b> | <b>2.1</b>                              | <b>289,439</b> | <b>2.8%</b>   | <b>2.0</b>                   |
| <b>CMBS - Wells Facility collateral:</b>      |                |                |                                         |                |               |                              |
| BSCMS 2007-PW18 A2                            | 30,575         | 31,701         | 2.2                                     | 26,753         | 2.2%          | 2.0                          |
| GSMS 2007-GG10 A2                             | 126,171        | 128,910        | 1.2                                     | 113,554        | 2.2%          | 2.4                          |
| JPMCC 2007-LDPX A2S                           | 41,000         | 41,717         | 1.1                                     | 36,900         | 2.4%          | 2.4                          |
| JPMCC 2007-CB19 A2                            | 13,606         | 13,935         | 1.0                                     | 12,245         | 2.3%          | 2.4                          |
| JPMCC 2007-CB20 A2                            | 10,942         | 11,212         | 1.3                                     | 9,847          | 2.2%          | 2.4                          |
| MSC 2007-HQ11 A31                             | 28,786         | 29,749         | 2.5                                     | 25,188         | 2.1%          | 2.4                          |
| WBCMT 2007-C31 A2                             | 16,762         | 17,098         | 2.8                                     | 15,086         | 2.3%          | 2.4                          |
| <b>Total CMBS - Wells Facility collateral</b> | <b>267,842</b> | <b>274,322</b> | <b>1.5</b>                              | <b>239,573</b> | <b>2.2%</b>   | <b>2.3</b>                   |
| <b>First mortgages</b>                        |                |                |                                         |                |               |                              |
| Hotel -NY, NY                                 | 31,952         | 31,952         | 3.9                                     | 25,306         | 3.2%          | 1.8                          |
| Office Condo (Headquarters) NY, NY            | 27,799         | 27,799         | 3.8                                     | 18,069         | 3.2%          | 1.8                          |
| Hotel - Silver Spring, MD                     | 25,762         | 25,762         | 4.0                                     |                |               |                              |
| Hotel - NY, NY                                | 24,000         | 24,000         | 1.4                                     | 15,444         | 3.2%          | 1.4                          |
| Multifamily - Los Angeles, CA                 | 8,800          | 8,800          | 0.3                                     |                |               |                              |
| <b>Total first mortgages</b>                  | <b>118,313</b> | <b>118,313</b> | <b>3.1</b>                              | <b>58,819</b>  | <b>3.2%</b>   | <b>1.7</b>                   |
| <b>Subordinate loans</b>                      |                |                |                                         |                |               |                              |
| Retail portfolio (Senior) - Various           | \$ 30,000      | \$ 30,000      | 8.7                                     |                |               |                              |
| Retail portfolio (Junior) - Various           | 20,000         | 20,000         | 8.7                                     |                |               |                              |

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|                             |          |            |            |     |            |      |     |
|-----------------------------|----------|------------|------------|-----|------------|------|-----|
| Office                      | Troy, MI | 8,973      | 8,973      | 9.2 |            |      |     |
| Total subordinate loans     |          | 58,973     | 58,973     | 8.8 |            |      |     |
| Total repurchase agreements |          | 41,418     | 41,418     | 1.5 |            |      |     |
| Total                       |          | \$ 826,252 | \$ 842,688 | 2.0 | \$ 587,831 | 2.6% | 2.1 |

\* Assumes extension options on Wells Facility are exercised.

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### Investment Activity

**Repurchase Agreements.** During March 2011, the Company closed a \$47,439 investment structured in the form of a repurchase facility secured by a Class A-2 CDO bond. The first draw under the repurchase facility totaled \$41,418 and occurred on March 28, 2011.

The repurchase facility bears interest at 13.0% (10.0% current pay with a 3.0% accrual) on amounts outstanding and has an initial term of 18 months with three six-month extensions options available to the borrower. Any principal repayments that occur prior to the 21st month are subject to a make-whole provision at the full 13.0% interest rate.

In aggregate, the \$47,439 of borrowings provided under the facility will finance the purchase of a CDO bond with an aggregate face amount of \$68,726, representing an advance rate of 69% on the CDO bond's face amount. The Class A-2 CDO bond, originally rated AAA/Aaa, is currently rated A-/Baa1. The CDO is comprised of 58 senior and subordinate commercial real estate debt positions and commercial real estate securities with the majority of the debt and securities underlying the CDO being first mortgages.

### Net Investment Income

Net interest income for the three months ended March 31, 2011 was \$7,599 as compared with \$3,902 for the same period in 2010. The increase of \$3,697 is attributable to the investments the Company has added to its portfolio over the last twelve months. The following table sets forth certain information regarding the Company's investments at March 31, 2011:

| Asset type                                         | Cost       |              | Invested<br>equity at cost | Weighted<br>Average<br>IRR * |
|----------------------------------------------------|------------|--------------|----------------------------|------------------------------|
|                                                    | Basis      | Borrowings   |                            |                              |
| Commercial mortgage loans                          | \$ 118,313 | \$ (58,819)  | \$ 59,494                  | 12.0%                        |
| Subordinate loans                                  | 58,973     |              | 58,973                     | 13.0%                        |
| Repurchase agreements                              | 41,418     |              | 41,418                     | 13.0%                        |
| AAA CMBS - financed with TALF borrowings           | 345,180    | (289,439)    | 55,741                     | 13.3%                        |
| AAA CMBS - financed with Wells Facility borrowings | 276,061    | (239,573)    | 36,488                     | 11.6%                        |
| Total invested equity at cost                      | \$ 839,945 | \$ (587,831) | \$ 252,114                 | 12.6%                        |

\* The internal rate of return ( IRR ) for the investments shown in the above table reflect the returns underwritten by the Manager, calculated on a weighted average basis assuming no extensions, dispositions, early prepayments or defaults and include the fully hedged cost of borrowings under the Wells Facility. The Company has also assumed that the cost of financing each investment will remain constant over the life of the investment. IRR is the annualized effective compounded return rate that accounts for the time-value of money and represents the rate of return on an investment over a holding period expressed as a percentage of the investment. It is the discount rate that makes the net present value of all cash outflows (the costs of investment) equal to the net present value of cash inflows (returns on investment). It is derived from the negative and positive cash flows resulting from or produced by each transaction (or for a transaction involving more than one investment, cash flows resulting from or produced by each of the investments), whether positive, such as investment returns, or negative, such as transaction expenses or other costs of investment, taking into account the dates on which such cash flows occurred or are expected to occur, and compounding interest accordingly. There can be no assurance that the actual IRRs will equal the underwritten IRRs shown in the table. See Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for a discussion of some of the factors that could adversely impact the returns received by the Company from the investments shown in the table over time.

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### ***Operating Expenses***

**Management Fee Expense.** The Company recorded a management fee expense for the three months ended March 31, 2011 and 2010, respectively, of approximately \$1,088 and \$726 payable to its Manager under the Management Agreement. The Company pays its Manager a quarterly management fee equal to 1.5% per annum of the Company's stockholders' equity (as defined in the Management Agreement).

**General and Administrative Expenses.** The Company recorded general and administrative expenses of approximately \$1,029 and \$1,017, respectively, for the three months ended March 31, 2011 and 2010, which represent professional fees, insurance, and overhead costs of the Company. The Company also incurred stock-based compensation expense of \$351 and \$390, respectively, related to restricted stock and RSU vesting for the three months ended March 31, 2011 and 2010.

The management fees, expense reimbursements and the relationship between the Company and its Manager are discussed further in Note 10 - Related Party Transactions.

### ***Realized and unrealized gain/loss***

In order to mitigate interest rate risk resulting from the Company's floating-rate borrowings under the Wells Facility, the Company entered into interest rate swaps and caps during 2010 with an aggregate notional equal to the borrowings outstanding under the Wells Facility. The interest rate swaps are intended to hedge the floating-rate borrowings through the expected maturity of the underlying collateral and the interest rate caps are intended to hedge the floating-rate borrowings related to the potential extension of the underlying collateral.

The Company chose not to pursue hedge accounting for these derivative instruments and will record the change in estimated fair value related to interest rate agreements in earnings. The Company also elected to record the change in estimated fair value related to the AAA-rated CMBS securing the Wells Facility in earnings by electing the fair value option. This election allows the Company to align the change in the estimated fair value of the Wells Facility collateral and related interest rate hedges without having to apply complex hedge accounting provisions.

The following amounts related to changes in fair value of the Company's CMBS and derivative instruments are included in the Company's consolidated statement of operations for the year ended March 31, 2011:

|                                           | For the three<br>months ended<br>March 31, 2011 |
|-------------------------------------------|-------------------------------------------------|
| Unrealized gain on securities             | \$ 26                                           |
| Unrealized gain on derivative instruments | 459                                             |
| Realized loss on derivative instruments   | (441)                                           |
| Total                                     | \$ (44)                                         |

### ***Dividends***

For 2011, the Company has declared and paid the following dividends:

| Declaration Date | Record Date    | Payment Date   | Amount |
|------------------|----------------|----------------|--------|
| March 9, 2011    | March 31, 2011 | April 12, 2011 | \$0.40 |

### ***Subsequent Events***

**Dividends.** On May 9, 2011, the Company's board of directors declared a dividend of \$0.40 per share of common stock which is payable on July 12, 2011 to common stockholders of record on June 30, 2011.



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*Investment activity.* During April 2011, the Company funded an additional \$6,021 under its \$47,439 repurchase facility. This additional funding brings the total balance of the Company's investment in the repurchase facility to \$47,439. The facility bears interest at 13.0% (10.0% current pay with a 3.0% accrual) on amounts outstanding and has an initial term of 18 months with three six-month extensions options available to the borrower. Any principal repayments that occur prior to the 21<sup>st</sup> month are subject to a make-whole provision at the full 13.0% interest rate.

During April 2011, the Company also closed a \$40,000 subordinate loan. The subordinated loan is part of a \$245,000 newly originated financing that consists of \$170,000 of senior financing and a total of \$75,000 of subordinate financing, all of which is secured by a ski resort in California, which is one of the most visited ski resorts in the United States.

The subordinate loan bears interest at a rate of 13.25% and has a term of six years. Prepayments on the subordinate loan are prohibited prior to the third year of the loan and any prepayments prior to the fifth year of the loan are subject to prepayment penalties ranging from 5% to 1%. The entire \$245,000 financing represents an appraised loan-to-value of approximately 64% and a debt yield of 17.1% based on trailing twelve month financials.

During April 2011, the Company's \$8,800 commercial mortgage loan secured by a multifamily property in Los Angeles, California was repaid.

## **Liquidity and capital resources**

Liquidity is a measure of the Company's ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain its assets and operations, make distributions to its stockholders and other general business needs. To date, the Company has raised aggregate equity of approximately \$320,400 through its IPO and Private Placement on September 29, 2009 as well as a follow-on public offering on September 22, 2010. Net proceeds (after deducting underwriting fees and expenses) from these offerings were approximately \$302,474.

In January 2010, the Company entered into the \$100,000 master repurchase agreement with JPMorgan Chase Bank, N.A. (the "JPMorgan Facility"), pursuant to which the Company may borrow up to \$100,000 in order to finance the origination and acquisition of commercial first mortgage loans and AAA-rated CMBS. Amounts borrowed under the JPMorgan Facility bear interest at a spread of 3.00% over one-month LIBOR with no floor. The JPMorgan Facility has a term of one-year, with two one-year extensions available at the Company's option and upon the payment of the \$500,000 extension fee for each one-year extension. During January 2011, the Company utilized the first of the two extension options. The extended maturity date is January 4, 2012 with the ability to extend for an additional 364 days at the Company's option. The JPMorgan Facility contains, among others, the following restrictive covenants: (1) negative covenants relating to restrictions on the Company's operations which would cease to allow the Company to qualify as a REIT and (2) financial covenants to be met by the Company when the repurchase facility is being utilized, including a minimum consolidated tangible net worth covenant (\$125,000), maximum total debt to consolidated tangible net worth covenant (3:1), a minimum liquidity covenant (the greater of 10% of total consolidated recourse indebtedness and \$12,500 and a minimum net income covenant (\$1 during any four consecutive fiscal quarters). Additionally, beginning on the 91st day following the closing date and depending on the utilization rate of the facility, a portion of the undrawn amount may be subject to non-use fees. Subsequent to September 30, 2010, the non-use fee has been waived by the lender. At March 31, 2011, the Company had \$58,819 of borrowings outstanding under the JPMorgan Facility.

During August 2010, the Company through an indirect wholly-owned subsidiary entered into the Wells Facility pursuant to which the Company may borrow up to \$250,000 in order to finance the acquisition of AAA-rated CMBS. The Wells Facility has a term of one year, with two one-year extensions available at the Company's option, subject to certain restrictions, and upon the payment of an extension fee equal to 25 basis points on the then outstanding balance of the facility for each one-year extension. Advances under the Wells Facility accrue interest at a per annum pricing rate equal to the sum of (i) 30 day LIBOR and (ii) a pricing margin of 1.25%. The purchase price of the CMBS is determined on a per asset basis by applying an advance rate schedule agreed upon by the Company and Wells Fargo. The Wells Facility contains, among others, the following restrictive covenants: (1) negative covenants intended to restrict the Company from failing to qualify as a REIT and (2) financial covenants to

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be met by the Company, including a minimum net asset value covenant (which shall not be less than an amount equal to (i) \$100,000, (ii) 75% of the greatest net asset value during the prior calendar quarter, and (iii) 65% of the greatest net asset value during the prior calendar year), a maximum total debt to consolidated tangible net worth covenant (8:1), a minimum liquidity covenant (\$2,500), and a minimum EBITDA to interest expense covenant (1.5:1). The Company has agreed to provide a limited guarantee of up to 15%, or a maximum of \$37,500, of the obligations of its indirect wholly-owned subsidiary under the Wells Facility. At March 31, 2011, the Company had \$239,573 of borrowings outstanding under the Wells Facility secured by AAA-rated CMBS held by the Company.

The Company's primary sources of cash currently consist of the cash available at March 31, 2011, principal and interest the Company receives on its portfolio of assets, as well as available borrowings under the JPMorgan Facility. The Company expects its primary sources of cash to consist of payments of principal and interest the Company receives on its portfolio of assets, cash generated from operations, borrowing capacity under its repurchase agreements and other financing sources. Depending on market conditions, such borrowings may include additional repurchase agreements as well as other borrowings such as credit facilities.

The Company maintains policies, described below, relating to its borrowings and use of leverage. See **Leverage Policies** below. In the future, the Company may seek to raise further equity capital, issue debt securities or engage in other forms of borrowings in order to fund future investments or to refinance expiring credit facilities.

The Company generally intends to hold its target assets as long-term investments, although it may sell certain of its investments in order to manage its interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions.

To maintain its status as a REIT under the Code, the Company must distribute annually at least 90% of its taxable income. These distribution requirements limit the Company's ability to retain earnings and thereby replenish or increase capital for operations. However, management believes that when the credit markets return to normal conditions, the Company's significant capital resources and access to financing will provide it with financial flexibility at levels sufficient to meet current and anticipated capital requirements, including funding new lending and investment opportunities, paying distributions to stockholders and servicing debt obligations.

## Leverage policies

The Company uses leverage for the sole purpose of financing its portfolio and not for the purpose of speculating on changes in interest rates. In addition to the Company's current TALF financings and the Wells Facility and JPMorgan Facility, in the future the Company may access additional sources of borrowings. The Company's charter and bylaws do not limit the amount of indebtedness the Company can incur; however, the Company is limited by certain financial covenants under its repurchase agreements. Consistent with the Company's strategy of keeping leverage within a conservative range, the Company expects that its total borrowings on loans will be in an amount that is approximately 35% of the value of its total loans portfolio.

## Contractual obligations and commitments

The Company's contractual obligations as of March 31, 2011 are as follows:

|                              | Less<br>than 1<br>year | 1 to 3<br>years | 3 to 5<br>years | More<br>than 5<br>years | Total      |
|------------------------------|------------------------|-----------------|-----------------|-------------------------|------------|
| TALF borrowings              | \$                     | \$ 268,481      | \$ 20,958       | \$                      | \$ 289,439 |
| Wells Facility borrowings    |                        | 239,573*        |                 |                         | 239,573    |
| JPMorgan Facility borrowings |                        | 58,819*         |                 |                         | 58,819     |
| Total                        | \$                     | \$ 566,873      | \$ 20,958       | \$                      | \$ 587,831 |

\* Assumes extension options on Wells and JPMorgan Facilities are exercised. See below for further discussion.

The table above does not include amounts due under the Company's Management Agreement or underwriting agreement as those obligations, discussed below, do not have fixed and determinable payments.



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On September 23, 2009, the Company entered into (i) an underwriting agreement with a group of underwriters to sell 10,000,000 shares of the Company's common stock for \$20.00 per share for an aggregate offering price of \$200,000, and (ii) the Management Agreement with the Manager pursuant to which the Manager is entitled to receive a management fee and the reimbursement of certain expenses.

*Underwriting Agreement.* As part of the Company's IPO, the underwriters did not receive the underwriting fee (equal to 5% of the gross proceeds raised or \$10,000) directly from the Company. Instead, the Manager paid the underwriters \$8,000 and the Company's underwriters agreed to forego the receipt of \$2,000. Under the terms of the underwriting agreement and the Management Agreement, the Company has agreed to pay \$8,000 to the Manager and pay \$2,000 to the underwriters if during any period of four consecutive calendar quarters during the 16 full calendar quarters after the consummation of the IPO the Company's Core Earnings for any such four-quarter period exceeds an 8% performance Hurdle Rate (as described below).

Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) as adjusted, excluding (i) non-cash equity compensation expense; (ii) depreciation and amortization (to the extent the Company forecloses on any properties underlying its target assets); (iii) any unrealized gains, losses or other non-cash items, regardless of whether such items are included in other comprehensive income or loss, or in net income; and (iv) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Company and its Manager and the Company's independent directors and after approval by a majority of the Company's independent directors.

Pursuant to an agreement between the Manager and the Company's underwriters, the aforementioned Hurdle Rate test is considered met if during a period of four consecutive quarters occurring during the above measurement period the Company's Core Earnings exceed the product of (x) the public offering price per share of the Company's common stock (\$20 per share) multiplied by the number of shares of common stock sold in the IPO and the concurrent private placement (a total of 10,500,000 shares) and (y) 8%. In addition, if the Management Agreement is terminated before the end of the above measurement period and the Company is required to pay its Manager the termination fee described in the Management Agreement, the Company would also be required to refund its Manager for its payment of the initial underwriting discount irrespective of whether the Company has met the Hurdle Rate described above.

*Management Agreement.* Pursuant to the Management Agreement, the Manager is entitled to a base management fee calculated and payable quarterly in arrears in an amount equal to 1.5% of the Company's stockholders' equity (as defined in the Management Agreement), per annum. The Manager will use the proceeds from its management fee in part to pay compensation to its officers and personnel. The Company does not reimburse its Manager or its affiliates for the salaries and other compensation of their personnel, except for the allocable share of the compensation of (1) the Company's Chief Financial Officer based on the percentage of his time spent on the Company's affairs and (2) other corporate finance, tax, accounting, internal audit, legal, risk management, operations, compliance and other non-investment professional personnel of the Manager or its affiliates who spend all or a portion of their time managing the Company's affairs based on the percentage of time devoted by such personnel to the Company's affairs. The Company is also required to reimburse its Manager for operating expenses related to the Company incurred by its Manager, including expenses relating to legal, accounting, due diligence and other services. Expense reimbursements to the Manager are made in cash on a monthly basis following the end of each month. The Company's reimbursement obligation is not subject to any dollar limitation.

The initial term of the Management Agreement expires on September 29, 2012 (the third anniversary of the closing of the IPO), and is automatically renewed for one-year terms on each anniversary thereafter. Following the initial term, the Management Agreement may be terminated upon the affirmative vote of at least two-thirds of the Company's independent directors, based upon (1) unsatisfactory performance by the Manager that is materially detrimental to the Company or (2) a determination that the management fee payable to the Manager is not fair, subject to the Manager's right to prevent such a termination based on unfair fees by accepting a mutually acceptable reduction of management fees agreed to by at least two-thirds of the Company's independent directors. The Manager must be provided with written notice of any such termination at least 180 days prior to the expiration of the then existing term and will be paid a termination fee equal to three times the sum of the average annual base management fee during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination. Amounts payable under the Company's underwriting agreement and Management Agreement are not fixed and determinable.

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### **Off-balance sheet arrangements**

The Company does not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, or special purpose or variable interest entities, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Further, the Company has not guaranteed any obligations of unconsolidated entities or entered into any commitment to provide additional funding to any such entities.

### **Dividends**

The Company intends to continue to make regular quarterly distributions to holders of its common stock. U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its net taxable income. The Company generally intends over time to pay dividends to its stockholders in an amount equal to its net taxable income, if and to the extent authorized by its board of directors. Any distributions the Company makes will be at the discretion of its board of directors and will depend upon, among other things, its actual results of operations. These results and the Company's ability to pay distributions will be affected by various factors, including the net interest and other income from its portfolio, its operating expenses and any other expenditures. If the Company's cash available for distribution is less than its net taxable income, the Company could be required to sell assets or borrow funds to make cash distributions or the Company may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company seeks to manage its risks related to the credit quality of its assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of its capital stock. While risks are inherent in any business enterprise, the Company seeks to quantify and justify risks in light of available returns and to maintain capital levels consistent with the risks the Company undertakes.

#### **Credit risk**

One of the Company's strategic focuses is acquiring assets that it believes to be of high credit quality. The Company believes this strategy will generally keep its credit losses and financing costs low. However, the Company is subject to varying degrees of credit risk in connection with its other target assets. The Company seeks to mitigate this risk by seeking to acquire high quality assets, at appropriate prices given anticipated and unanticipated losses, and by deploying a value-driven approach to underwriting and diligence, consistent with the Manager's historical investment strategy, with a focus on current cash flows and potential risks to cash flow. The Company enhances its due diligence and underwriting efforts by accessing the Manager's knowledge base and industry contacts. Nevertheless, unanticipated credit losses could occur which could adversely impact the Company's operating results.

#### **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 the Company's control. The Company is subject to interest rate risk in connection with its target assets and its related financing obligations.

To the extent consistent with maintaining the Company's REIT qualification, the Company seeks to manage risk exposure to protect its portfolio of financial assets against the effects of major interest rate changes. The Company generally seeks to manage this risk by:

attempting to structure its financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;

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using hedging instruments, interest rate swaps and interest rate caps; and

to the extent available, using securitization financing to better match the maturity of the Company's financing with the duration of its assets.

All of the Company's TALF borrowings are fixed rate borrowings. At March 31, 2011, the Company the only floating-rate instruments held by the Company are the \$58,819 of borrowings outstanding under the JPMorgan Facility and the \$242,728 of borrowings outstanding under the Wells Facility. The Company has entered into interest rate swaps and caps in order to convert the floating-rate borrowings outstanding under the Wells Facility to fixed-rate borrowings. A 50 basis point increase in LIBOR would increase the quarterly interest expense related to the \$58,819 in variable rate debt outstanding at March 31, 2011 by \$74. Any such hypothetical impact on interest rates on the Company's variable rate borrowings does not consider the effect of any change in overall economic activity that could occur in a rising interest rate environment. Further, in the event of a change in interest rates of that magnitude, the Company may take actions to further mitigate the Company's exposure to such a change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, this analysis assumes no changes in the Company's financial structure.

### **Prepayment risk**

Prepayment risk is the risk that principal will be repaid at a different rate than anticipated, causing the return on an asset to be less than expected. The Company does not anticipate facing prepayment risk on most of its portfolio of assets since the Company anticipates that most of the commercial loans held directly by the Company or securing the Company's CMBS assets will contain provisions preventing prepayment or imposing prepayment penalties in the event of loan prepayments.

### **Market risk**

*Market value risk.* The Company's available-for-sale securities and securities at estimated fair value are reflected at their estimated fair value. The change in estimated fair value of securities available-for-sale is reflected in accumulated other comprehensive income while the change in estimated fair value of securities at estimated fair value is reflected as a component of net income. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of the Company's assets may be adversely impacted.

*Real estate risk.* Commercial mortgage assets are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions; changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay the underlying loans or loans, as the case may be, which could also cause the Company to suffer losses.

### **Inflation**

Virtually all of the Company's assets and liabilities will be interest rate sensitive in nature. As a result, interest rates and other factors influence the Company's performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. The Company's financial statements are prepared in accordance with GAAP and distributions will be determined by the Company's board of directors consistent with the Company's obligation to distribute to its stockholders at least 90% of its REIT taxable income on an annual basis in order to maintain the Company's REIT qualification. In each case, the Company's activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

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**ITEM 4. Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer, based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that as of September 30, 2010, the Company's disclosure controls and procedures were effective to give reasonable assurances to the timely collection, evaluation and disclosure of information relating to the Company that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

During the period ended March 31, 2011, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

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### **PART II OTHER INFORMATION**

#### **ITEM 1. Legal Proceedings**

From time to time, the Company may be involved in various claims and legal actions arising in the ordinary course of business. As of March 31, 2011, the Company is not involved in any legal proceedings.

#### **ITEM 1A. Risk Factors**

See the Company's Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to the Company's risk factors during the three months ended March 31, 2011.

#### **ITEM 2(a). Unregistered Sales of Equity Securities and Use of Proceeds**

None.

#### **ITEM 2(c). Issuer Purchases of Equity Securities**

None.

#### **ITEM 3. Defaults Upon Senior Securities**

None.

#### **ITEM 4. (Removed and Reserved)**

#### **ITEM 5. Other Information**

None.

#### **ITEM 6. Exhibits**

(a) Exhibits

| <b>Exhibit No.</b> | <b>Description</b>                                                                                                                                                                                      |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1*               | Articles of Amendment and Restatement of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533). |
| 3.2*               | By-laws of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.2 of the Registrant's Form S-11, as amended (Registration No. 333-160533).                               |
| 4.1*               | Specimen Stock Certificate of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 4.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533).            |
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                     |
| 31.2               | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                     |
| 32.1               | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of 18 U.S.C. Section 1350 as adopted pursuant to the Sarbanes-Oxley Act of 2002.                           |

\* Incorporated by reference

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**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.

APOLLO COMMERCIAL REAL ESTATE FINANCE, INC.

May 10, 2011

By: /s/ Joseph F. Azrack  
Joseph F. Azrack  
President and Chief Executive Officer

By: /s/ Stuart A. Rothstein  
Stuart A. Rothstein  
Chief Financial Officer, Treasurer and Secretary  
(Principal Financial Officer and Principal Accounting Officer)

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**EXHIBIT INDEX**

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                      |
|------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1*                   | Articles of Amendment and Restatement of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533). |
| 3.2*                   | By-laws of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.2 of the Registrant's Form S-11, as amended (Registration No. 333-160533).                               |
| 4.1*                   | Specimen Stock Certificate of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 4.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533).            |
| 31.1                   | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                     |
| 31.2                   | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                     |
| 32.1                   | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of 18 U.S.C. Section 1350 as adopted pursuant to the Sarbanes-Oxley Act of 2002.                           |

\* Incorporated by reference