

Ares Commercial Real Estate Corp  
Form 10-Q  
May 15, 2013  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2013**

**OR**

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

**For the transition period            to**

**Commission File No. 001-35517**

**ARES COMMERCIAL REAL ESTATE CORPORATION**

(Exact name of Registrant as specified in its charter)

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

**45-3148087**  
(I.R.S. Employer  
Identification Number)

**Two North LaSalle Street, Suite 925, Chicago, IL 60602**

(Address of principal executive office) (Zip Code)

**(312) 324-5900**

(Registrant's telephone number, including area code)

**N/A**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

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

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**Class**  
Common stock, \$0.01 par value

**Outstanding at May 14, 2013**  
9,267,162

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

	<b>March 31, 2013</b>	<b>As of</b>	<b>December 31, 2012</b>
	<b>(unaudited)</b>		
<b>ASSETS</b>			
Cash and cash equivalents	\$ 22,550	\$	23,390
Restricted cash	3,719		3,210
Loans held for investment	409,943		353,500
Accrued interest receivable	2,464		1,746
Deferred financing costs, net	4,780		5,168
Other assets	497		845
Total assets	\$ 443,953	\$	387,859
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
<b>LIABILITIES</b>			
Secured financing agreements	\$ 200,050	\$	144,256
Convertible notes	67,411		67,289
Derivative liability	2,223		1,825
Accounts payable and accrued expenses	1,455		1,788
Due to affiliate	1,442		1,320
Dividends payable	2,317		2,316
Other liabilities	5,471		3,627
Total liabilities	280,369		222,421
Commitments and contingencies (Note 5)			
<b>STOCKHOLDERS EQUITY</b>			
Preferred stock, par value \$0.01 per share, 50,000,000 shares authorized at March 31, 2013 and December 31, 2012, no shares issued and outstanding at March 31, 2013 and December 31, 2012	-		-
Common stock, par value \$0.01 per share, 450,000,000 shares authorized at March 31, 2013 and December 31, 2012, respectively, 9,267,162 shares issued and outstanding at March 31, 2013 and December 31, 2012	92		92
Additional paid in capital	169,336		169,200
Accumulated deficit	(5,844)		(3,854)
Total stockholders equity	163,584		165,438
Total liabilities and stockholders equity	\$ 443,953	\$	387,859

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See accompanying notes to consolidated financial statements.

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## ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	For the three months ended March 31, 2013 (unaudited)	For the three months ended March 31, 2012 (unaudited)
<b>Net interest margin:</b>		
Interest income	\$ 6,711	\$ 949
Interest expense (from secured funding facilities)	(1,385)	(339)
Net interest margin	5,326	610
<b>Expenses:</b>		
Other interest expense	1,950	-
Management fees to affiliate	614	-
Professional fees	566	65
Acquisition and investment pursuit costs	640	-
General and administrative expenses	482	37
General and administrative expenses reimbursed to affiliate	747	-
Total expenses	4,999	102
<b>Net income</b>	<b>327</b>	<b>508</b>
Less income (loss) attributable to Series A Convertible Preferred Stock:		
Preferred dividends	-	(52)
Accretion of redemption premium	-	(572)
<b>Net income (loss) attributable to common stockholders</b>	<b>\$ 327</b>	<b>\$ (116)</b>
<b>Net income (loss) per common share:</b>		
Basic and diluted earnings (loss) per common share	\$ 0.04	\$ (0.12)
<b>Weighted average number of common shares outstanding:</b>		
Basic weighted average shares of common stock outstanding	9,212,644	998,571
Diluted weighted average shares of common stock outstanding	9,267,162	998,571
<b>Dividends declared per share of common stock</b>	<b>\$ 0.25</b>	<b>\$ 0.30</b>

See accompanying notes to consolidated financial statements.

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**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

(in thousands, except share and per share data)

(unaudited)

	<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Paid-in</b>	<b>Deficit</b>	<b>Stockholders</b>
			<b>Capital</b>		<b>Equity</b>
Balance at December 31, 2012	9,267,162	\$ 92	\$ 169,200	\$ (3,854)	\$ 165,438
Stock-based compensation	-	-	136	-	136
Net income attributable to common stockholders	-	-	-	327	327
Dividends declared	-	-	-	(2,317)	(2,317)
Balance at March 31, 2013	9,267,162	\$ 92	\$ 169,336	\$ (5,844)	\$ 163,584

See accompanying notes to consolidated financial statements.



Table of Contents**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CASH FLOWS**

(in thousands)

	<b>For the three months ended March 31, 2013 (unaudited)</b>	<b>For the three months ended March 31, 2012 (unaudited)</b>
Operating activities:		
Net income	\$ 327	\$ 508
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Amortization of deferred financing costs	227	125
Accretion of deferred loan origination fees and costs	(739)	(57)
Stock based compensation	136	-
Unrealized loss on derivative	398	-
Changes in operating assets and liabilities:		
Interest receivable	(718)	(518)
Other assets	323	(24)
Due to affiliate	122	(144)
Interest payable	-	71
Refundable deposits	50	(200)
Accounts payable and accrued expenses	1,100	18
Net cash provided by (used in) operating activities	1,226	(221)
Investing activities:		
Issuance of and fundings on loans held for investment	(56,299)	(73,147)
Principal repayment of loans held for investment	56	18
Receipt of origination fees	539	880
Net cash used in investing activities	(55,704)	(72,249)
Financing activities:		
Proceeds from secured funding arrangements	55,794	47,289
Secured funding costs	(10)	(596)
Convertible notes issuance costs	171	-
Proceeds from issuance of Series A Convertible Preferred Stock	-	5,723
Proceeds from issuance of common stock	-	23,400
Payment of offering costs	-	-
Common dividend payment	(2,317)	-
Net cash provided by financing activities	53,638	75,816
Change in cash and cash equivalents	(840)	3,346
Cash and cash equivalents, beginning of period	23,390	1,240
Cash and cash equivalents, end of period	\$ 22,550	\$ 4,586
Supplemental Information:		
Interest paid during the period	\$ 1,128	\$ 143
Supplemental disclosure of noncash financing activities:		
Dividends payable	\$ 2,317	\$ 502
Accretion of redemption premium	\$ -	\$ 572
Deferred financing and offering costs	\$ -	\$ 332

See accompanying notes to consolidated financial statements.



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**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**As of March 31, 2013**

**(unaudited)**

**1. ORGANIZATION**

Ares Commercial Real Estate Corporation (together with our consolidated subsidiaries, the Company, ACRE, we, us and our ) is a Maryland corporation that was incorporated on September 1, 2011, and was initially funded and commenced investment operations on December 9, 2011. The Company is focused primarily on originating, investing in and managing middle-market commercial real estate ( CRE ) loans and other CRE-related investments. ACRE completed the initial public offering (the IPO ) of its common stock on May 1, 2012. The Company is externally managed by Ares Commercial Real Estate Management LLC ( ACREM or our Manager ), a Securities and Exchange Commission ( SEC ) registered investment adviser and a wholly owned subsidiary of Ares Management LLC, a global alternative asset manager and also a SEC registered investment adviser.

The Company s target investments include: transitional senior mortgage loans, stretch senior mortgage loans, subordinate debt mortgage loans such as B-notes and mezzanine loans and other select CRE debt and preferred equity investments. Transitional senior mortgage loans provide strategic, flexible, short-term financing solutions on transitional CRE middle-market assets that are the subject of a business plan that is expected to enhance the value of the property. Stretch senior mortgage loans provide flexible one stop financing on quality CRE middle-market assets that are typically stabilized or near-stabilized properties with healthy balance sheets and steady cash flows, with the mortgage loans having higher leverage (and thus higher loan-to-value ratios) than conventional mortgage loans and are typically fully funded at closing and non-recourse to the borrower (as compared to conventional mortgage loans, which are usually full recourse to the borrower).

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

Interim financial statements are prepared in accordance with United States generally accepted accounting principles ( GAAP ) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The current period s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2013.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with GAAP and includes the accounts of the Company and its wholly owned subsidiaries. The consolidated financial statements reflect all adjustments and reclassifications that, in the opinion of management, are necessary for the fair presentation of the Company's results of its operations and financial condition as of and for the periods presented. All significant intercompany balances and transactions have been eliminated.

***Cash and Cash Equivalents***

Cash and cash equivalents include funds on deposit with financial institutions.

***Restricted Cash***

Restricted cash includes escrow deposits for taxes, insurance, leasing outlays, capital expenditures, tenant security deposits, and payments required under certain loan agreements. These escrow deposits are held on behalf of the respective borrowers and are offset by escrow liabilities included in other liabilities on the consolidated balance sheets.

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***Concentration of Credit Risk***

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents and loans held for investment. The Company places its cash and cash equivalents with financial institutions and, at times, cash held may exceed the Federal Deposit Insurance Corporation, or FDIC, insured limit. The Company has exposure to credit risk on its CRE loans and other target investments. The Company's Manager will seek to manage credit risk by performing credit fundamental analysis of potential collateral assets.

***Loans Held for Investment***

The Company originates CRE debt and related instruments generally to be held for investment and to maturity. Loans that are held for investment are carried at cost, net of unamortized loan fees and origination costs, unless the loans are deemed impaired.

Impairment occurs when it is deemed probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan. If a loan is considered to be impaired, the Company will record an allowance to reduce the carrying value of the loan to the present value of expected future cash flows discounted at the loan's contractual effective rate.

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

In addition, we evaluate the entire portfolio to determine whether the portfolio has any impairments that require a general valuation allowance on the remainder of the loan portfolio. As of March 31, 2013 and December 31, 2012, there are no impairments on the Company's loan portfolio.

***Underwriting Commissions and Offering Costs***

Underwriting commissions and offering costs incurred in connection with common stock offerings are reflected as a reduction of additional paid-in capital. Costs incurred that are not directly associated with the completion of a common stock offering are expensed. Underwriting commissions that are the responsibility of and paid by a related party, such as our Company's Manager, are reflected as a contribution of

additional paid in capital from a sponsor in the consolidated financial statements.

***Revenue Recognition***

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

***Deferred Financing Costs***

Deferred financing costs are capitalized and amortized over the terms of the respective debt instrument.

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***Fair Value Measurements***

The Company determines the estimated fair value of financial assets and liabilities using the three-tier fair value hierarchy established by GAAP, which prioritizes the inputs used in measuring fair value. GAAP establishes market-based or observable inputs as the preferred source of values, followed by valuation models using management assumptions in the absence of market inputs. The only financial instrument recorded at fair value on a recurring basis in the Company's consolidated financial statements is a derivative instrument. The Company has not elected the fair value option for the remaining financial instruments, including loans held for investment, secured funding agreements and other debt instruments. Such financial instruments are carried at cost. Fair value is separately disclosed (see Note 9). The three levels of inputs that may be used to measure fair value are as follows:

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.

***Stock Based Compensation***

The Company recognizes the cost of stock based compensation and payment transactions using the same expense category as would be charged for payments in cash. The fair value of the restricted stock or restricted stock units granted is recorded to expense on a straight-line basis over the vesting period for the award, with an offsetting increase in stockholders' equity. For grants to directors and officers, the fair value is determined based upon the market price of the stock on the grant date.

***Earnings per Share***

The Company calculates basic earnings (loss) per share by dividing net income (loss) allocable to common stockholders for the period by the weighted-average shares of common stock outstanding for that period after consideration of the earnings (loss) allocated to the Company's restricted stock and restricted stock units, which are participating securities as defined in GAAP. Diluted earnings (loss) per share takes into effect any dilutive instruments, such as restricted stock and restricted stock units and convertible debt, except when doing so would be anti-dilutive.

***Derivative Financial Instruments***

The Company does not hold or issue derivative instruments for trading purposes. The Company recognizes derivatives on its balance sheet, measures them at their estimated fair value using Level III inputs under an option pricing model and recognizes changes in their estimated fair value in the Company's results of operations for the period in which the change occurs. On December 19, 2012, the Company issued \$69.0 million aggregate principal amount of unsecured 7.000% Convertible Senior Notes due 2015 (the 2015 Convertible Notes). The conversion features of the 2015 Convertible Notes are deemed to be an embedded derivative under Accounting Standards Codification (ASC) Topic 815, Derivatives and Hedging (ASC 815). In accordance with ASC 815, the Company is required to bifurcate the embedded derivative related to the conversion features of the 2015 Convertible Notes. The Company has recognized the embedded derivative as a liability on its balance sheet, measured it at its estimated fair value and recognized changes in its estimated fair value in the Company's results of operations for the period in which the change occurs.

### *Income Taxes*

The Company intends to elect and qualify for taxation as a REIT. As a result of the Company's expected REIT qualification and its distribution policy, the Company does not generally expect to pay U.S. federal corporate level income taxes. Many of the REIT requirements, however, are highly technical and complex. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that the Company distribute annually at least 90% of the Company's REIT taxable income to the Company's stockholders. If the Company has previously qualified as a REIT and fails to qualify as a REIT in any subsequent taxable year and does not qualify for certain statutory relief provisions, the Company will be subject to U.S. federal and state income taxes at regular corporate rates (including any applicable alternative minimum tax) and may be precluded from qualifying as a REIT for the Company's four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain U.S. federal, state, local and foreign taxes on the Company's income and property and to U.S. federal income and excise taxes on the Company's undistributed REIT taxable income.

ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has analyzed its various federal and state filing positions and believes that its income tax filing positions and deductions are well documented and supported.



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As of March 31, 2013 and December 31, 2012, the Company has not recorded a reserve for any uncertain income tax positions; therefore, there has been no interest or penalties incurred to date.

*Use of Estimates in the Preparation of Financial Statements*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. Significant estimates include the valuation of derivatives.

*Segment Reporting*

For the three months ended March 31, 2013, the Company operated in one business segment. The Company is primarily engaged in originating, investing in and managing commercial mortgage loans and other CRE related debt investments.

**3. LOANS HELD FOR INVESTMENT**

As of March 31, 2013, the Company has originated or co-originated 17 loans secured by CRE middle market properties. The aggregate originated commitment under these loans at closing was approximately \$470.2 million, of which \$413.0 million in total principal remained outstanding as of March 31, 2013. During the three months ended March 31, 2013, the Company funded approximately \$56.3 million and received repayments of \$56 thousand on its net \$470.2 million of commitments at closing as described in more detail in the tables below. Such investments are referred to herein as the Company's investment portfolio. References to LIBOR are to 30-day LIBOR (unless otherwise specifically stated).

The following table presents an overview of the Company's current investment portfolio, based on information available as of March 31, 2013.

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(amounts in millions, except percentages)

Loan Type	Location	Total Commitment (at closing)	Outstanding Principal (1)	Carrying Amount (1)	Interest Rate	LIBOR Floor	Unleveraged Effective Yield (2)	Maturity Date (3)	Payment Terms (4)
<u>Transitional Senior Mortgage Loans</u>									
Apartment	Brandon, FL	\$ 49.6	\$ 44.2	\$ 43.8	L+4.80%	0.5%	5.9%	Jan 2016	I/O
Office	Austin, TX	38.0	31.4	31.1	L+5.75%-L+5.25% (5)	1.0%	7.6%	Mar 2015	I/O
Apartment	New York, NY	36.1	32.2	31.9	L+5.00%	0.8%	6.3%	Oct 2017	I/O
Office	Cincinnati, OH	35.5	27.0	26.9	L+5.35%-L+5.00% (6)	0.3%	6.1%	Nov 2015	I/O
Apartment	New York, NY	26.3	23.0	22.8	L+5.75%-L+5.00% (7)	0.2%	6.7%	Dec 2015	I/O
Office	Overland Park, KS	25.5	24.4	24.1	L+5.00%	0.3%	5.9%	Mar 2016	I/O
Apartment	Avondale, AZ	22.1	20.7	20.6	L+4.25%	1.0%	5.8%	Sep 2015	I/O
Apartment	New York, NY	21.9	18.7	18.6	L+5.75%-L+5.00% (7)	0.2%	6.7%	Dec 2015	I/O
Apartment	New York, NY	21.8	18.8	18.7	L+5.75%-L+5.00% (7)	0.2%	6.7%	Dec 2015	I/O
Office	Denver, CO	11.0	9.7	9.6	L+5.50%	1.0%	7.3%	Jan 2015	I/O
<u>Stretch Senior Mortgage Loans</u>									
Office	Miami, FL	47.0	47.0 (8)	46.9(9)	L+5.25%	1.0%	6.6%	Apr 2014	I/O
Office	Boston, MA	35.0	34.8	34.5	L+5.65%	0.7%	6.8%	Mar 2015	P&I
Apartment	Arlington, VA	13.4	13.4	13.3	L+5.15%	0.3%	6.2%	Dec 2014	I/O
<u>Subordinated Debt Investments</u>									
Apartment	Atlanta, GA	39.0	26.7	26.5	L+10.70%(10)	0.5%	12.1%	Apr 2016	I/O
Apartment	Rocklin, CA	18.7	18.7(11)	18.5	L+6.40%(11)	1.0%	9.9%	Dec 2013	I/O
Office	Fort Lauderdale, FL	15.0 (12)	8.0	7.9	(12) L+10.75%-L+8.18%	0.8%	12.7%	Feb 2015	I/O
Office	Atlanta, GA	14.3	14.3	14.2	10.50%(13)		11.0%	Aug 2017	I/O

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Total/Average	\$ 470.2	\$ 413.0	\$ 409.9	7.0%
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(1) The difference between the carrying amount and the outstanding principal face amount of the loans held for investment consists of unamortized purchase discount, deferred loan fees and loan origination costs.

(2) Unleveraged Effective Yield is the compounded effective rate of return that would be earned over the life of the investment based on the contractual interest rate (adjusted for any deferred loan fees, costs, premium or discount) and assumes no dispositions, early prepayments or defaults.

(3) The Boston, Arlington and Miami loans are subject to one 12-month extension option. The Atlanta loan with a Maturity Date of April 2016, Austin, Avondale, Brandon, Cincinnati, New York loans with a Maturity Date of December 2015 and Fort Lauderdale loans are subject to two 12-month extension options. The Rocklin loan is subject to one 6-month extension option. Certain extension options may be subject to performance based or other conditions as stipulated in the loan agreement.

(4) P&I = principal and interest; I/O = interest only.

(5) The initial interest rate for this loan of L+5.75% steps down based on performance hurdles to L+5.25%.

(6) The initial interest rate for this loan of L+5.35% steps down based on performance hurdles to L+5.00%.

(7) The initial interest rate for this loan of L+5.75% steps down based on performance hurdles to L+5.00%.

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(8) On March 8, 2013, the Company entered into a loan assumption transaction with a new sponsor group to facilitate the purchase of a Class B office building in Miami, FL that was collateralized by the Company's existing \$47.0 million first mortgage loan.

(9) The Carrying Amount of this loan is above 10%, but less than 20%, of total assets of the Company.

(10) This loan was co-originated with a third party using an A/B structure, with a cumulative interest rate of L + 4.95% and a LIBOR Floor of 0.50%. The A-Note (held by a third party) has an interest rate of L + 2.70% with no LIBOR Floor and the Company's B-Note receives the full benefit of the LIBOR Floor on the full combined balance of the A-Note and B-Note. At the initial respective funded amounts of the A-Note and B-Note (as of March 31, 2013), the interest rate on the Company's B-Note is L + 10.70% subject to a 0.50% LIBOR floor (with the benefit of any difference between actual LIBOR and the LIBOR floor on the A-Note and B-Note accruing to the B-Note). Accordingly, the interest rate on the Company's B-Note would be 12.50% if LIBOR is equal to 0.0% and L + 10.70% if LIBOR is equal to or greater than 0.50%. As the Company funds additional proceeds on the loan under the B-Note up to the full \$39 million level, the interest rate will decrease and the B-Note will have an interest rate of L + 8.90% subject to a 0.50% LIBOR floor (with the benefit of any difference between actual LIBOR and the LIBOR floor on the A-Note and B-Note accruing to the B-Note). Accordingly, the interest rate on the Company's fully funded loan under the B-Note would be 10.30% if LIBOR is equal to 0.0% and L + 8.90% if LIBOR is equal to or greater than 0.50%.

(11) This loan was co-originated with a third party using an A/B structure, with a cumulative interest rate of L + 4.10% and a LIBOR Floor of 1.00%. The fully funded A-Note (held by a third party) has an interest rate of L + 2.75% with no LIBOR Floor and the Company's B-Note receives the full benefit of the LIBOR Floor on the full \$50.5 million balance of the loan. The interest rate on the Company's B-Note is L + 6.40% subject to a 1.00% LIBOR floor (with the benefit of any difference between actual LIBOR and the LIBOR floor on the A-Note and B-Note accruing to the B-Note). Accordingly, the interest rate on the Company's B-Note would be 9.10% if LIBOR is equal to 0.0% and L + 6.40% if LIBOR is equal to or greater than 1.00%.

(12) The total commitment the Company co-originated was a \$37.0 million first mortgage, of which a \$22.0 million A-Note was fully funded by Citibank, N.A., with a cumulative interest rate of L + 5.25% and a LIBOR floor of 0.75%. The Company committed to a \$15.0 million B-Note. The fully funded A-Note (held by a third party) has an interest rate of L + 3.25% with the LIBOR Floor, resulting in an initial interest rate on the Company's B-Note of L + 10.75% with the LIBOR Floor. As the Company funds additional proceeds on the B-Note, the interest rate will decrease and the fully committed B-Note (\$15.0 million) will have an interest rate of LIBOR + 8.18% with the LIBOR Floor.

(13) The interest rate for this loan increases to 11.0% on September 1, 2014.

The Company's investments in mortgages and loans held for investment are accounted for at amortized cost. The following tables summarize our loans held for investment as of March 31, 2013:

\$ in thousands	March 31, 2013				
	Carrying Amount	Outstanding Principal	Weighted Average	Weighted Average	Weighted Average

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			<b>Interest Rate</b>	<b>Unleveraged Effective Yield</b>	<b>Remaining Life (Years)</b>
Senior mortgage loans	\$ 342,766	\$ 345,343	5.9%	6.5%	2.6
Subordinated and mezzanine loans	67,177	67,650	8.3%	10.9%	2.5
<b>Total</b>	<b>\$ 409,943</b>	<b>\$ 412,993</b>	<b>6.3%</b>	<b>7.0%</b>	<b>2.6</b>

For the three months ended March 31, 2013, the activity in our loan portfolio was as follows (\$ in thousands):

Balance at December 31, 2012	\$ 353,500
Initial funding	50,999
Receipt of origination fee, net of costs	(539)
Additional funding	5,300
Amortizing payments	(56)
Origination fee accretion	739
Balance at March 31, 2013	\$ 409,943

No impairment charges have been recognized as of March 31, 2013 or as of December 31, 2012.

Table of Contents**4. DEBT****Secured Funding Agreements**

\$ in thousands	As of March 31, 2013		As of December 31, 2012	
	Outstanding Balances	Total Commitment	Outstanding Balances	Total Commitment
Wells Fargo Facility	\$ 126,675	\$ 172,500	\$ 98,196	\$ 172,500
Citibank Facility	41,215	86,225	13,900	86,225
Capital One Facility	32,160	50,000	32,160	50,000
Total	\$ 200,050	\$ 308,725	\$ 144,256	\$ 308,725

The secured funding arrangements are generally collateralized by assignments of specific loans held for investment originated by the Company. The secured funding arrangements are guaranteed by the Company.

Generally, the Company partially offsets interest rate risk by matching the interest index of loans held for investments with the secured funding agreement used to fund them.

***Wells Fargo Facility***

On December 14, 2011, the Company entered into a \$75.0 million secured revolving funding facility arranged by Wells Fargo Bank, National Association (the Wells Fargo Facility), pursuant to which the Company borrows funds to finance qualifying senior commercial mortgage loans and A-Notes, subject to available collateral. On May 22, 2012, the agreements governing the Wells Fargo Facility were amended to, among other things, increase the total commitment under the Wells Fargo Facility from \$75.0 million to \$172.5 million. Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR plus (ii) a pricing margin range of 2.50%-2.75%. On May 15, 2012, the Company started to incur a non-utilization fee of 25 basis points on the average available balance of the Wells Fargo Facility. For the three months ended March 31, 2013, the Company incurred a non-utilization fee of \$44 thousand. The Company did not incur such non-utilization fee for the three months ended March 31, 2012. The initial maturity date of the Wells Fargo Facility is December 14, 2014 and, provided that certain conditions are met and applicable extension fees are paid, is subject to two 12-month extension options. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Wells Fargo Facility was \$126.7 million and \$98.2 million, respectively.

The Wells Fargo Facility contains various affirmative and negative covenants applicable to the Company and certain of the Company's subsidiaries, including the following: (a) limitations on the incurrence of additional indebtedness or liens, (b) limitations on how borrowed funds may be used, (c) limitations on certain distributions and dividend payments, (d) maintenance of adequate capital, (e) limitations on change of

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control, (f) maintaining a ratio of total debt to total assets of not more than 75%, (g) maintaining liquidity in an amount not less than the greater of (1) 5% of the Company's tangible net worth or (2) \$20.0 million, (h) maintaining a fixed charge coverage ratio (expressed as the ratio of EBITDA to fixed charges) of at least 1.5 to 1, and (i) maintaining a tangible net worth of at least the sum of (1) \$135.5 million, plus (2) 80% of the net proceeds raised in all future equity issuances by the Company. Effective June 29, 2012, the agreements governing the Wells Fargo Facility were further amended to provide that the required minimum fixed charge coverage ratio with respect to the Company as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which the Company reports Loans held for investment in excess of \$200.0 million on its quarterly consolidated balance sheet. As of December 31, 2012 the Company reported Loans held for investment in excess of \$200.0 million. As a result, the Company tested the minimum fixed charge coverage ratio beginning with the three months ended March 31, 2013. As of March 31, 2013, the Company was in compliance in all material respects with the terms of the Wells Fargo Facility.

### *Citibank Facility*

On December 8, 2011, the Company entered into a \$50.0 million secured revolving funding facility arranged by Citibank, N.A. (the Citibank Facility) pursuant to which the Company borrows funds to finance qualifying senior commercial mortgage loans and A-Notes, subject to available collateral. On April 16, 2012 and May 1, 2012, the agreements governing the Citibank Facility were amended to, among other things, increase the total commitment under the Citibank Facility from \$50.0 million to \$86.2 million. Under the Citibank Facility, the Company borrows funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by the Company. Advances under the Citibank Facility accrue interest at a per annum rate based on

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LIBOR. The margin can vary between 2.50% and 3.50% over the greater of LIBOR and 0.5%, based on the debt yield of the assets contributed into ACRC Lender C LLC, one of the Company's wholly owned subsidiaries and the borrower under the Citibank Facility. On March 3, 2012, the Company started to incur a non-utilization fee of 25 basis points on the average available balance of the Citibank Facility. For the three months ended March 31, 2013 and 2012, the Company incurred a non-utilization fee of \$61 thousand and \$10 thousand, respectively. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. The end of the funding period is December 8, 2013, and may be extended for an additional 12 months upon the payment of the applicable extension fee and provided that no event of default is then occurring. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Citibank Facility was \$41.2 million and \$13.9 million, respectively.

The Citibank Facility contains various affirmative and negative covenants applicable to the Company and certain of the Company's subsidiaries, including the following: (a) maintaining tangible net worth of at least the sum of (1) 80% of the Company's tangible net worth as of May 1, 2012, plus (2) 80% of the total net capital raised in all future equity issuances by the Company, (b) maintaining liquidity in an amount not less than the greater of (1) \$20.0 million or (2) 5% of the Company's tangible net worth, (c) a cap on the Company's distributions of the greater of (1) 100% of the Company's taxable net income, or (2) such amount as is necessary to maintain the Company's status as a REIT, and (d) if the Company's average debt yield across the portfolio of assets that are financed with the Citibank Facility falls below certain thresholds, the Company may be required to repay certain amounts under the Citibank Facility. The Citibank Facility also prohibits the Company from amending the management agreement with its Manager in a material respect without the prior consent of the lender. As of March 31, 2013, the Company was in compliance in all material respects with the terms of the Citibank Facility. See Note 12 for subsequent events relating to the Citibank Facility.

*Capital One Facility*

On May 18, 2012, the Company entered into a \$50.0 million secured revolving funding facility with Capital One, National Association (the Capital One Facility), pursuant to which the Company borrows funds to finance qualifying senior commercial mortgage loans, subject to available collateral.

Under the Capital One Facility, the Company borrows funds on a revolving basis in the form of individual loans evidenced by individual notes. Each individual loan is secured by an underlying loan originated by us. Amounts outstanding under each individual loan accrue interest at a per annum rate equal to LIBOR plus a spread ranging between 2.50% and 4.00%. The Company may request individual loans under the Capital One Facility through and including May 18, 2014, subject to successive 12-month extension options at the lender's discretion. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Capital One Facility was \$32.2 million. The Company does not incur a non-utilization fee under the terms of the Capital One Facility.

The Capital One Facility contains various affirmative and negative covenants applicable to the Company and certain of the Company's subsidiaries, including the following: (a) maintaining a ratio of debt to tangible net worth of not more than 3.0 to 1, (b) maintaining a tangible net worth of at least the sum of (1) 80% of the Company's tangible net worth as of May 1, 2012, plus (2) 80% of the net proceeds received from all future equity issuances by the Company, (c) maintaining a total liquidity in excess of the greater of (1) 5% of the Company's tangible net worth or (2) \$20.0 million, and (d) maintaining a fixed charge coverage ratio (expressed as the ratio of EBITDA to fixed charges) of at least 1.5 to 1. Effective September 27, 2012, the agreements governing the Capital One Facility were amended to provide that the required minimum fixed charge coverage ratio with respect to the Company as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which the Company reports Loans held for investment in excess of \$200.0 million on the Company's quarterly consolidated balance sheet. As of December 31, 2012 the Company reported Loans held for investment in excess of \$200.0 million. As a result, the Company tested the minimum fixed charge coverage ratio beginning with the three months ended March 31, 2013. As of March 31, 2013, the Company was in compliance in all material respects with the terms of the



Capital One Facility.

***2015 Convertible Notes***

On December 19, 2012, the Company issued \$69.0 million aggregate principal amount of the 2015 Convertible Notes. Of this aggregate principal amount, \$60.5 million aggregate principal amount of the 2015 Convertible Notes was sold to the initial purchasers (including \$9.0 million pursuant to the initial purchasers' exercise in full of their overallotment option) and \$8.5 million aggregate principal amount of the 2015 Convertible Notes was sold directly to certain directors, officers and affiliates of the Company in a private placement. The 2015 Convertible Notes were issued pursuant to an Indenture, dated December 19, 2012 (the "Indenture"), between the Company and U.S. Bank National Association, as trustee. The sale of the 2015 Convertible Notes generated net proceeds of approximately \$66.2 million. Aggregate estimated offering expenses in connection with the transaction, including the initial purchasers' discount of approximately \$2.1 million, were approximately \$2.8 million. As of March 31, 2013 and December 31, 2012, the carrying value of the 2015 Convertible Notes was \$67.4 million and \$67.3 million, respectively.

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The 2015 Convertible Notes bear interest at a rate of 7.000% per year, payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2013. The estimated effective interest rate of the 2015 Convertible Notes, which is equal to the stated rate of 7.000% plus the accretion of the original issue discount and associated costs, was 9.4% for the three months ended March 31, 2013. For the three months ended March 31, 2013, the interest charged on this indebtedness was \$1.6 million. The 2015 Convertible Notes will mature on December 15, 2015 (the Maturity Date), unless previously converted or repurchased in accordance with their terms. The 2015 Convertible Notes are the Company's senior unsecured obligations and rank senior in right of payment to the Company's existing and future indebtedness that is expressly subordinated in right of payment to the 2015 Convertible Notes; equal in right of payment to the Company's existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness (including existing unsecured indebtedness that the Company later secures) to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by the Company's subsidiaries, financing vehicles or similar facilities.

Prior to the close of business on the business day immediately preceding June 15, 2015 holders may convert their 2015 Convertible Notes only under certain circumstances as set forth in the Indenture. On or after June 15, 2015 until the close of business on the scheduled trading day immediately preceding the Maturity Date, holders may convert their 2015 Convertible Notes at any time. Upon conversion, the Company will pay or deliver, as the case may be, at its election, cash, shares of its common stock or a combination of cash and shares of its common stock, provided that the Company will not elect to use a settlement method that results in it issuing more than 1,853,432 shares of common stock prior to obtaining stockholder approval in accordance with certain New York Stock Exchange ( NYSE ) requirements. The conversion rate is initially 53.6107 shares of common stock per \$1,000 principal amount of 2015 Convertible Notes (equivalent to an initial conversion price of approximately \$18.65 per share of common stock). The conversion rate will be subject to adjustment in some events, including for regular quarterly dividends in excess of \$0.35 per share, but will not be adjusted for any accrued and unpaid interest. In addition, if certain corporate events occur prior to the Maturity Date, the conversion rate will be increased but will in no event exceed 61.6523 shares of common stock per \$1,000 principal amount of 2015 Convertible Notes.

The Company may not elect to issue shares of common stock upon conversion of the 2015 Convertible Notes to the extent such election would result in the issuance of 20% or more of the common stock outstanding immediately prior to the issuance of the 2015 Convertible Notes until the Company receives stockholder approval for issuances above this threshold. Until such stockholder approval is obtained, the Company may not share-settle the full conversion option. As a result, the embedded conversion option does not qualify for equity classification and instead is separately valued and accounted for as a derivative liability. The initial value allocated to the derivative liability was \$1.7 million, which represents a discount to the debt to be amortized through other interest expense using the effective interest method through the maturity of the 2015 Convertible Notes. The effective interest rate used to amortize the debt discount on the 2015 Convertible Notes is 9.4%. During each reporting period, the derivative liability is marked to fair value through earnings. As of March 31, 2013 and December 31, 2012, the derivative liability had a fair value of \$2.2 million and \$1.8 million, respectively. If the Company obtains stockholder approval for the issuance of 20% or more of the common stock outstanding immediately prior to the issuance of the 2015 Convertible Notes so the conversion option can be share-settled in full at the Company's option, the conversion option may qualify for equity classification and the bifurcated derivative liability would no longer need to be accounted for as a derivative on a prospective basis from the date of reassessment. Any remaining debt discount that arose at the date of debt issuance from the original bifurcation will continue to be amortized through other interest expense.

The Company does not have the right to redeem the 2015 Convertible Notes prior to the Maturity Date, except to the extent necessary to preserve its qualification as a REIT for U.S. federal income tax purposes. No sinking fund is provided for the 2015 Convertible Notes. In addition, if the Company undergoes certain corporate events that constitute a fundamental change, the holders of the 2015 Convertible Notes may require the Company to repurchase for cash all or part of their 2015 Convertible Notes at a repurchase price equal to 100% of the principal amount of the 2015 Convertible Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

**5. COMMITMENTS AND CONTINGENCIES**

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The Company has various commitments to fund investments in its portfolio as described below.

As of March 31, 2013 and December 31, 2012, the Company had the following commitments to fund various stretch senior and transitional senior mortgage loans, as well as subordinated and mezzanine debt investments:

<u>\$ in thousands</u>	March 31, 2013	As of	December 31, 2012
Total commitments	\$ 470,195		\$ 405,695
Less: funded commitments	(413,229)		(356,930)
Total unfunded commitments	\$ 56,966		\$ 48,765

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The Company from time to time may be party to litigation relating to claims arising in the normal course of business. As of March 31, 2013, the Company is not aware of any legal claims.

**6. SERIES A CONVERTIBLE PREFERRED STOCK**

On February 8, 2012, the Company's board of directors adopted resolutions classifying and designating 600 shares of authorized preferred stock as shares of Series A Convertible Preferred Stock, par value \$0.01 per share ( Series A Preferred Stock ). Holders of shares of Series A Preferred Stock were entitled to receive, when and as authorized by the Company's board of directors and declared by us out of funds legally available for that purpose, dividends at the Prevailing Dividend Rate, compounded quarterly. The Prevailing Dividend Rate means (a) beginning on the issue date through and including December 31, 2012, 10% per annum, (b) beginning on January 1, 2013 through and including December 31, 2013, 11% per annum, (c) beginning on January 1, 2014 through and including December 31, 2014, 12% per annum, and (d) beginning on January 1, 2015 and thereafter, 13% per annum; provided, however, that the Prevailing Dividend Rate may decrease by certain specified amounts if the Company achieves a certain coverage ratio.

Shares of Series A Preferred Stock were redeemable by the Company at any time, in whole or in part, beginning on September 30, 2012, at the applicable redemption price. Additionally, shares of Series A Preferred Stock were redeemable at the option of the holder upon an IPO, at the applicable redemption price. Holders of shares of the Series A Preferred Stock exercised this redemption in connection with the IPO.

During the year ended December 31, 2012, the Company issued 114.4578 shares of Series A Preferred Stock for an aggregate subscription price of approximately \$5.7 million, paid a cash dividend of \$102 thousand, and recognized the accretion of \$572 thousand for the redemption premium for a total balance of approximately \$6.3 million. The redemption price for redeemed shares of Series A Preferred Stock was equal to (i) the sum of (a) the subscription price, (b) any dividends per share added thereto pursuant to the terms of the Series A Preferred Stock and (c) any accrued and unpaid dividends per share plus (ii) an amount equal to a percentage of the subscription price of the Series A Preferred Stock and 10%.

**7. STOCKHOLDERS EQUITY**

On January 25, 2012, the Company entered into a subscription agreement with Ares Investments Holdings LLC ( Ares Investments ), whereby Ares Investments agreed to purchase 400,000 shares of the Company's common stock for a total purchase price of \$8.0 million, after giving effect to the reverse stock split on February 22, 2012.

On February 6, 2012, the Company entered into a subscription agreement with Ares Investments, whereby Ares Investments agreed to purchase 770,000 shares of the Company's common stock for a total purchase price of \$15.4 million, after giving effect to the reverse stock split on February 22, 2012.

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On February 8, 2012, the charter of the Company was amended and restated to increase the number of authorized shares of the Company's common stock and preferred stock to 95,000,000 and 5,000,000 shares, respectively. The par value remained at \$0.01 per share.

On February 22, 2012, the Company's board of directors and Ares Investments approved a one-for-two reverse stock split whereby every two shares of common stock that were issued and outstanding immediately prior to this date were changed into one issued and outstanding share of the Company's common stock.

On April 23, 2012, the charter of the Company was amended to increase the number of authorized shares of common stock and preferred stock of the Company to 450,000,000 and 50,000,000 shares, respectively. The par value remained at \$0.01 per share.

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On May 1, 2012, the Company completed its IPO of 7,700,000 shares of its common stock at a price of \$18.50 per share, raising approximately \$142.5 million in gross proceeds. The underwriting commissions of approximately \$5.3 million are reflected as a reduction of additional paid-in capital on the consolidated statement of stockholders' equity. Under the underwriting agreement, the Company's Manager was responsible for and paid directly the underwriting commissions. Because the Manager is a related party, the payment of underwriting commission of approximately \$5.3 million by the Company's Manager is reflected as a contribution of additional paid-in capital on the consolidated statement of stockholders' equity in accordance with GAAP. The Company incurred approximately \$3.5 million of expenses in connection with the IPO, which is reflected as a reduction in additional paid-in capital. The net proceeds to the Company totaled approximately \$139.0 million. The Company used approximately \$47.3 million of the net proceeds of the IPO to repay outstanding amounts under the Wells Fargo Facility and the Citibank Facility and approximately \$6.3 million to redeem all of its issued shares of Series A Preferred Stock. The balance was used for general corporate working capital purposes and to make investments in the Company's target investments.

***Equity Incentive Plan***

On April 23, 2012, the Company adopted an equity incentive plan (the 2012 Equity Incentive Plan). Pursuant to the 2012 Equity Incentive Plan, the Company may grant awards consisting of restricted shares of the Company's common stock, restricted stock units and/or other equity-based awards to the Company's outside directors, the Company's Chief Financial Officer, ACREM and other eligible awardees under the plan, subject to an aggregate limitation of 690,000 shares of common stock (7.5% of the issued and outstanding shares of the Company's common stock immediately after giving effect to the issuance of the shares sold in the IPO). Any restricted shares of the Company's common stock and restricted stock units will be accounted for under ASC 718, Stock Compensation, resulting in share-based compensation expense equal to the grant date fair value of the underlying restricted shares of common stock or restricted stock units.

On May 1, 2012, in connection with the IPO, the Company granted 5,000 restricted shares of common stock to each of the Company's five independent directors. In addition, on June 18, 2012, Mr. Rosen, an outside director, was granted 5,000 restricted shares of common stock as an award granted pursuant to the 2012 Equity Incentive Plan. These awards of 5,000 restricted shares vest ratably on a quarterly basis over a three year period beginning on July 1, 2012. In addition, on May 1, 2012, each of the Company's five independent directors were granted approximately 2,027 restricted shares of common stock as 2012 annual compensation awards granted pursuant to the 2012 Equity Incentive Plan. On June 18, 2012, Mr. Rosen was also granted 2,027 restricted shares of common stock as a 2012 annual compensation award granted pursuant to the 2012 Equity Incentive Plan. These awards of 2,027 restricted shares in respect of annual directors' fees vest ratably on a quarterly basis over a one year period beginning on July 1, 2012. As of March 31, 2013, 7,494 shares of the total 30,000 restricted shares of common stock granted to Mr. Rosen and the Company's five independent directors, as initial grants in connection with the IPO have vested. As of March 31, 2013, 9,126 shares of the total 12,162 restricted shares of common stock granted to Mr. Rosen and the Company's five independent directors in respect of 2012 annual compensation have vested.

On July 9, 2012, in connection with his appointment as Chief Financial Officer of the Company, Tae-Sik Yoon was granted 25,000 restricted shares of the Company's common stock as an award granted pursuant to the 2012 Equity Incentive Plan. These shares of restricted stock vest ratably on a quarterly basis over a four-year period that began on October 1, 2012, subject to certain conditions. As of March 31, 2013, 3,127 shares of the total 25,000 restricted shares of the Company's common stock granted to Mr. Yoon have vested.

The following tables summarize the non-vested shares of restricted stock and the vesting schedule of shares of restricted stock for directors and officers as of March 31, 2013.



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*Schedule of Non-Vested Share and Share Equivalents*

	<b>Restricted Stock Grants Directors</b>	<b>Restricted Stock Grants Officer</b>	<b>Total</b>
Balance as of December 31, 2012	31,080	23,436	54,516
Granted during the quarter ended March 31, 2013	-	-	-
Vested during the quarter ended March 31, 2013	(5,538)	(1,563)	(7,101)
Forfeited in 2013	-	-	-
Balance as of March 31, 2013	25,542	21,873	47,415

*Vesting Schedule*

	<b>Restricted Stock Grants Directors</b>	<b>Restricted Stock Grants Officer</b>	<b>Total</b>
2013	16,080	6,250	22,330
2014	10,002	6,250	16,252
2015	4,998	6,250	11,248
2016	-	4,686	4,686
2017	-	-	-
Total	31,080	23,436	54,516

**8. EARNINGS PER SHARE**

The following information sets forth the computations of basic and diluted earnings (loss) per common share for the three months ended March 31, 2013 and 2012:

<u>\$ in thousands (except share and per share data)</u>	<b>For the three months ended March 31, 2013</b>	<b>For the three months ended March 31, 2012</b>
Net income (loss) attributable to common stockholders:	\$ 327	\$ (116)
Divided by:		
Basic weighted average shares of common stock outstanding:	9,212,644	998,571
Diluted weighted average shares of common stock outstanding:	9,267,162	998,571
Basic and diluted earnings (loss) per common share:	\$ 0.04	\$ (0.12)

The Company has considered the impact of the 2015 Convertible Notes and the restricted shares on diluted earnings per common share. The number of shares of common stock that the 2015 Convertible Notes are convertible into were not included in the computation of diluted net income per common share because the inclusion of those shares would have been anti-dilutive for the three months ended March 31, 2013.



**9. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company follows ASC 820-10, which expands the application of fair value accounting. ASC 820-10 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosure of fair value measurements. ASC 820-10 determines fair value to be the price that would be received for an investment in a current sale, which assumes an orderly transaction between market participants on the measurement date. The only financial instrument recorded at fair value on a recurring basis in the Company's consolidated financial statements is a derivative instrument. The Company has not elected the fair value option for the remaining financial instruments, including loans held for investment, secured funding agreements and other debt instruments. Such financial instruments are carried at cost. ASC 820-10 specifies a hierarchy of valuation techniques based on the inputs used in measuring fair value. In accordance with ASC 820-10, these inputs are summarized in the three broad levels listed below:

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The three levels of inputs that may be used to measure fair value are as follows:

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.

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

### *Financial Instruments reported at fair value*

The Company has certain assets and liabilities that are required to be recorded at fair value on a recurring basis in accordance with GAAP, including a derivative instrument. The Company did not have any other financial instruments at March 31, 2013 or December 31, 2012 that were required to be carried at fair value. The carrying values of cash and cash equivalents, restricted cash, interest receivable and accrued expenses approximate their fair values due to their short-term nature.

The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments were categorized as of March 31, 2013 (in thousands):

	Fair Value as of March 31, 2013			Total
	Level I	Level II	Level III	
Derivative instrument	\$ -	\$ -	\$ 2,223	\$ 2,223

The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments were categorized as of December 31, 2012 (in thousands):

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	Fair Value as of December 31, 2012			Total
	Level I	Level II	Level III	
Derivative instrument	\$ -	\$ -	\$ 1,825	\$ 1,825

The valuation of derivative instruments are determined using widely accepted valuation techniques, including market yield analysis and discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs to the extent available, including interest rate curves, spot and market forward points.

The following table summarizes the significant unobservable inputs the Company used to value the derivative liability categorized within Level III as of March 31, 2013 (in thousands).

Asset Category	Fair Value	Primary Valuation Technique	Input	Unobservable Input	Weighted Average
				Range	
Derivative liability	\$ 2,223	Option Pricing Model	Volatility	16.3% - 17.0%	16.3%

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The following table summarizes the significant unobservable inputs the Company used to value the derivative liability categorized within Level III as of December 31, 2012 (in thousands).

Asset Category	Fair Value	Primary Valuation Technique	Input	Unobservable Input	Weighted Average
				Range	
Derivative liability	\$1,825	Option Pricing Model	Volatility	16.4% - 17.4%	16.4%

The tables above are not intended to be all-inclusive, but instead are intended to capture the significant unobservable inputs relevant to the Company's determination of fair values.

Changes in market yields, discount rates or EBITDA multiples, each in isolation, may change the fair value of the derivative liability. Generally, an increase in market yields or discount rates or decrease in EBITDA multiples may result in a decrease in the fair value of the derivative liability.

Due to the inherent uncertainty of determining the fair value of derivative liabilities that do not have a readily available market value, the fair value of the Company's derivative liability may fluctuate from period to period. Additionally, the fair value of the Company's derivative liability may differ significantly from the values that would have been used had a ready market existed for such derivative liability.

The change in the derivative instrument classified as Level III is as follows for the three months ended March 31, 2013 (in thousands):

	Level III Derivative Instrument	
Beginning balance, as of December 31, 2012	\$	(1,825)
Unrealized gain (loss) on derivative		(398)
Ending balance, as of March 31, 2013	\$	(2,223)

The unrealized gain (loss) on derivatives is included in other interest expense on the consolidated statement of operations for the three months ended March 31, 2013.

The following table presents the carrying values and fair values of the Company's financial assets and liabilities recorded at cost as of March 31, 2013 and December 31, 2012. Changes in market yields, credit quality and other variables may change the fair value of the Company's assets and liabilities. All financial assets and liabilities recorded at cost are considered Level III financial instruments (in thousands).

As of March 31, 2013		As of December 31, 2012	
Carrying Value	Fair Value	Carrying Value	Fair Value

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Financial instruments not recorded at fair value:				
Loans held for investment	\$ 409,943	\$ 409,943	\$ 353,500	\$ 353,500
Financial liabilities:				
Secured financing agreements	200,050	200,050	144,256	144,256
Convertible notes	67,411	67,411	67,289	67,289

### 10. RELATED PARTY TRANSACTIONS

#### *Management Agreements*

The Company was party to an interim management agreement with ACREM prior to the IPO. Pursuant to the interim management agreement, ACREM provided investment advisory and management services to the Company on an interim basis until the IPO. For providing these services, ACREM received only reimbursements from the Company for any third party costs that ACREM incurred on behalf of the Company.

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On April 25, 2012, in connection with the Company's IPO, the Company entered into a management agreement (the "Management Agreement") with ACREM under which ACREM, subject to the supervision and oversight of the Company's board of directors, will be responsible for, among other duties, (a) performing all of the Company's day-to-day functions, (b) determining the Company's investment strategy and guidelines in conjunction with the Company's board of directors, (c) sourcing, analyzing and executing investments, asset sales and financing and (d) performing portfolio management duties.

In addition, ACREM has an Investment Committee that oversees compliance with the Company's investment strategy and guidelines, investment portfolio holdings and financing strategy.

Effective May 1, 2012, in exchange for its services, ACREM is entitled to receive a base management fee, an incentive fee, expense reimbursements, grants of equity-based awards pursuant to the Company's 2012 Equity Incentive Plan and a termination fee, if applicable, as set forth below.

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

The incentive fee is equal to the difference between: (a) the product of (i) 20% and (ii) the difference between (A) the Company's Core Earnings (as defined below) for the previous 12-month period, and (B) the product of (1) the weighted average of the issue price per share of the Company's common stock of all of the Company's public offerings multiplied by the weighted average number of all shares of common stock outstanding (including any restricted shares of the Company's common stock, restricted units or any shares of the Company's common stock not yet issued, but underlying other awards granted under the Company's 2012 Equity Incentive Plan (See Note 7)) in the previous 12-month period, and (2) 8%; and (b) the sum of any incentive fees earned by ACREM with respect to the first three fiscal quarters of such previous 12-month period; *provided, however*, that no incentive fee is payable with respect to any fiscal quarter unless cumulative Core Earnings for the 12 most recently completed fiscal quarters is greater than zero. Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) computed in accordance with GAAP, excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (to the extent that any of the Company's target investments are structured as debt and the Company forecloses on any properties underlying such debt), any unrealized gains, losses or other non-cash items recorded in net income (loss) for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income (loss), and one-time events pursuant to changes in GAAP and certain non-cash charges after discussions between ACREM and the Company's independent directors and after approval by a majority of the Company's independent directors. For purposes of calculating the incentive fee prior to the completion of a 12-month period following the IPO, Core Earnings will be calculated on the basis of the number of days that the Management Agreement has been in effect on an annualized basis. No incentive fees were earned for the three months ended March 31, 2013 and 2012.

The Company reimburses ACREM at cost for operating expenses that ACREM incurs on the Company's behalf, including expenses relating to legal, financial, accounting, servicing, due diligence and other services. The Company's reimbursement obligation is not subject to any dollar

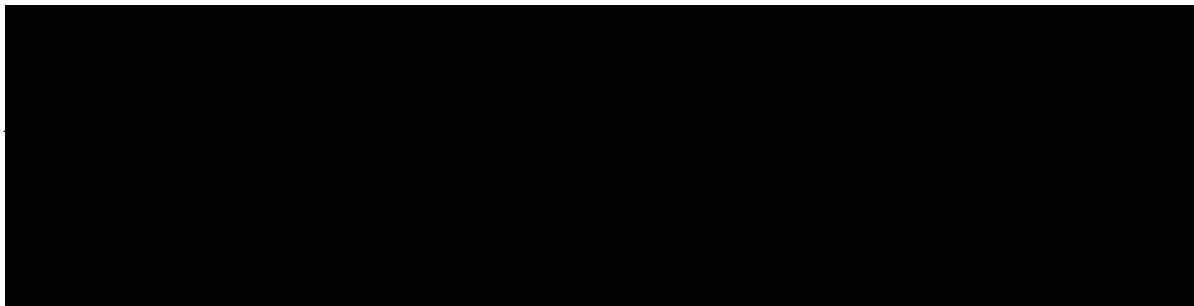
limitation.

The Company will not reimburse ACREM for the salaries and other compensation of its personnel, except for the allocable share of the salaries and other compensation of the Company's (a) Chief Financial Officer, based on the percentage of his time spent on the Company's affairs and (b) other corporate finance, tax, accounting, internal audit, legal, risk management, operations, compliance and other non-investment professional personnel of ACREM or its affiliates who spend all or a portion of their time managing the Company's affairs based on the percentage of their time spent on the Company's affairs. The Company is also required to pay its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of ACREM and its affiliates that are required for the Company's operations. The initial term of the Management Agreement will end May 1, 2015, with automatic one-year renewal terms. Except under limited circumstances, upon a termination of the Management Agreement, the Company will pay ACREM a termination fee equal to three times the average annual base management fee and incentive fee received by ACREM during the 24 month period immediately preceding the most recently completed fiscal quarter prior to the date of termination, each as described above.

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Certain of the Company's subsidiaries, along with the Company's lenders under the Wells Fargo Facility and the Citibank Facility have entered into various servicing agreements with ACREM's subsidiary servicer, Ares Commercial Real Estate Servicer LLC (ACRES), a Standard & Poor's ranked commercial primary and special servicer that is included on Standard & Poor's Select Servicer List. Effective May 1, 2012, ACRES agreed that no servicing fees pursuant to these servicing agreements would be charged to the Company or its subsidiaries for so long as the Management Agreement remains in effect, but that ACRES will continue to receive reimbursement for overhead related to servicing and operational activities pursuant to the terms of the Management Agreement.

Summarized below are the related-party costs incurred by the Company for the three months ended March 31, 2013 and amounts payable to the Manager as of March 31, 2013 and December 31, 2012:



*Ares Investments*

On February 8, 2012, the Company entered into a promissory note with Ares Investments, whereby Ares Investments loaned the Company \$2.0 million. The note was repaid with \$4 thousand in interest due under the note on March 1, 2012 with the proceeds from the sale of the Series A Preferred Stock.

As of March 31, 2013 and December 31, 2012, Ares Investments owned approximately 2,000,000 shares of the Company's common stock representing approximately 21.6% of the total shares outstanding. In addition, as of March 31, 2013 and December 31, 2012, Ares Investments owned \$1,150,000 aggregate principal amount of the 2015 Convertible Notes.

**11. DIVIDENDS AND DISTRIBUTIONS**

The following table summarizes the Company's dividends declared on its common stock during the three months ended March 31, 2013 and 2012 (amounts in thousands, except per share data):

<b>Date declared</b>	<b>Record date</b>	<b>Payment date</b>	<b>Total amount</b>
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			<b>Per share amount</b>			
<b>For the three months ended March 31, 2013</b>						
March 14, 2013	April 08, 2013	April 18, 2013	\$	0.25	\$	2,317
Total cash dividends declared for the three months ended March 31, 2013			\$	0.25	\$	2,317
<b>For the three months ended March 31, 2012</b>						
March 30, 2012	March 31, 2012	April 02, 2012	\$	0.30	\$	450(1)
Total cash dividends declared for the three months ended March 31, 2012			\$	0.30	\$	450

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(1) The dividend of \$450 was based on 1,500,000 shares of common stock outstanding as of March 31, 2012.

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**12. SUBSEQUENT EVENTS**

The Company's management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. Other than those disclosed below, there have been no subsequent events that occurred during such period that would require disclosure in this Form 10-Q or would be required to be recognized in the accompanying consolidated financial statements as of and for the three months ended March 31, 2013.

On April 29, 2013, the agreements governing the Citibank Facility were amended to provide that the limitation on the payment of dividends to the common shareholders of the Company in excess of 100% of taxable income will start to be tested on December 31, 2013.

On April 30, 2013, the Company originated an approximately \$15.0 million stretch senior mortgage loan on an office building located in Mountain View, CA. At closing the outstanding principal balance was approximately \$14.5 million. The loan has an interest rate of LIBOR + 4.75% subject to a 0.50% LIBOR floor and term of 33 months.

On May 9, 2013, the Company filed a registration statement on Form S-3 with the Securities and Exchange Commission in order to permit the Company to offer, from time to time, in one or more offerings or series of offerings, up to \$1.5 billion of the Company's common stock, preferred stock, debt securities, subscription rights to purchase shares of the Company's common stock, warrants representing rights to purchase shares of the Company's common stock, preferred stock or debt securities, or units. The Company may not sell securities pursuant to the registration statement until the registration statement is declared effective by the Securities and Exchange Commission.

On May 14, 2013, the Company entered into a Purchase and Sale Agreement (the "Agreement") with Alliant, Inc., a Florida corporation, and The Alliant Company, LLC, a Florida limited liability company (collectively, the "Sellers"). The Agreement provides that, upon the terms and subject to the conditions set forth therein, at the closing of the transaction, the Company will purchase from Sellers (the "Acquisition") all of the outstanding common units of EF&A Funding, L.L.C., d/b/a Alliant Capital LLC, a Michigan limited liability company, which houses the Sellers multi-family residential mortgage loan origination and servicing business. The Agreement provides that the Company will pay \$52.9 million in cash, subject to certain adjustments, and issue 588,235 shares of its common stock in a private placement exempt from registration under the Securities Act of 1933, as consideration for the Acquisition. The cash portion of the transaction may be financed through additional debt financing, potential issuances of common or preferred stock and/or the repayment or sale of certain assets. The Acquisition is expected to close during the second half of 2013, subject to the satisfaction or waiver of various closing conditions as described in the Agreement. There can be no assurance that the Acquisition will be completed, or if it is completed, that it will close within the anticipated time period. In connection with the Acquisition, the board of directors of the Company approved the expansion of the Company's investment guidelines to reflect the Acquisition, subject to the concurrent consummation of the Acquisition.

On May 14, 2013, the board of directors of the Company appointed Todd Schuster to join John B. Bartling, Jr., as the Company's Co-Chief Executive Officer effective June 1, 2013. As a result of Mr. Schuster's appointment as Co-Chief Executive Officer, Mr. Schuster is no longer independent for the purpose of serving on the audit committee of the Company's board of directors and, consequently, resigned from such committee.

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On May 15, 2013, the Company declared a cash dividend of \$0.25 per common share for the second quarter of 2013. The second quarter 2013 dividend is payable on July 18, 2013 to common stockholders of record as of June 28, 2013.

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

The information contained in this section should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this quarterly report. In addition, some of the statements in this quarterly report (including in the following discussion) constitute forward-looking statements, which relate to future events or the future performance or financial condition of Ares Commercial Real Estate Corporation (except where the context suggests otherwise, together with our consolidated subsidiaries, the Company, ACRE, we, us, or our ). The forward-looking statements contained in this quarterly report involve a number of risks and uncertainties, including statements concerning:

- our business and investment strategy;
- our projected operating results;
- the timing of cash flows, if any, from our investments;
- the state of the U.S. economy generally or in specific geographic regions;
- defaults by borrowers in paying debt service on outstanding items;
- actions and initiatives of the U.S. Government and changes to U.S. Government policies;
- our ability to obtain financing arrangements;
- the amount of commercial mortgage loans requiring refinancing;
- financing and advance rates for our target investments;
- our expected leverage;

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- general volatility of the securities markets in which we may invest;
- the impact of a protracted decline in the liquidity of credit markets on our business;
- the uncertainty surrounding the strength of the U.S. economic recovery;
- the return or impact of current and future investments;
- allocation of investment opportunities to us by Ares Commercial Real Estate Management LLC, or our Manager ;
- changes in interest rates and the market value of our investments;
- effects of hedging instruments on our target investments;
- rates of default or decreased recovery rates on our target investments;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- changes in governmental regulations, tax law and rates, and similar matters (including interpretation thereof);
- our ability to maintain our qualification as a real estate investment trust, or REIT ;
- our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act ;
- availability of investment opportunities in mortgage-related and real estate-related investments and securities;

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- the ability of our Manager to locate suitable investments for us, monitor, service and administer our investments and execute our investment strategy;

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- our ability to successfully complete and integrate any acquisitions;
- availability of qualified personnel;
- estimates relating to our ability to make distributions to our stockholders in the future;
- our understanding of our competition; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

We use words such as anticipates, believes, expects, intends, will, should, may and similar expressions to identify forward-looking statements. Our actual results could differ materially from those expressed in the forward-looking statements for any reason, including the factors set forth in Risk Factors and elsewhere in this quarterly report.

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

Overview

We are a specialty finance company focused on originating, investing in and managing middle-market commercial real estate loans and other commercial real estate, or CRE, related investments. We target borrowers whose capital needs are not being suitably met in the market by offering customized financing solutions. We implement a strategy focused on direct origination combined with experienced portfolio management through our Manager's servicer, which is a Standard & Poor's-ranked commercial primary servicer and commercial special servicer that is included on Standard & Poor's Select Servicer List, to meet our borrowers' and sponsors' needs.

Our investment objective is to generate attractive risk-adjusted returns for our stockholders, primarily through dividends and distributions and secondarily through capital appreciation. We believe the availability of the type of capital in the CRE middle-market we provide is limited and borrowers and sponsors have the greatest need for customized solutions in this segment of the market. We act as a single one stop financing source by providing our customers with one or more of our customized financing solutions. Our customized financing solutions are comprised of our target investments, which include the following:

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- Transitional senior mortgage loans that provide strategic, flexible, short-term financing solutions on transitional CRE middle-market assets. These assets are typically properties that are the subject of a business plan that is expected to enhance the value of the property. The mortgage loans are usually funded over time as the borrower's business plan for the property is executed. They also typically have lower initial loan-to-value ratios as compared to stretch senior mortgage loans;
- Stretch senior mortgage loans that provide flexible one stop financing on quality CRE middle-market assets. These assets are typically stabilized or near-stabilized properties with healthy balance sheets and steady cash flows, with the mortgage loans having higher leverage (and thus higher loan-to-value ratios) than conventional mortgage loans and are typically fully funded at closing and non-recourse to the borrower (as compared to conventional mortgage loans, which are often recourse to the borrower);
- Subordinate debt mortgage loans (including subordinate tranches of first lien mortgages, or B-Notes) and mezzanine loans, both of which provide subordinate financing on quality CRE middle-market assets; and
- Other CRE debt and preferred equity investments, together with selected other income producing equity investments.

We are externally managed and advised by our Manager, a Securities and Exchange Commission, or SEC, registered investment adviser, pursuant to the terms of a management agreement. Our Manager is an affiliate of Ares Management LLC, or Ares Management, a global alternative asset manager and SEC registered investment adviser.

We are a Maryland corporation that commenced investment operations on December 9, 2011. We completed our initial public offering, or IPO, on May 1, 2012. We are incorporated in Maryland and intend to elect and qualify to be taxed as a REIT, commencing with our taxable year ended December 31, 2012. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all or substantially all of our taxable income to stockholders and maintain our intended qualification as a REIT. We also intend to operate our business in a manner that will permit us to maintain our exemption



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from registration under the 1940 Act. We are an emerging growth company, as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, and we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a non-binding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We have not made a decision whether to take advantage of any or all of these exemptions. If we do take advantage of any of these exemptions, we do not know if some investors will find our common stock less attractive as a result. The result may be a less active trading market for our common stock and our stock price may be more volatile.

In addition, Section 107 of the JOBS Act also provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, for complying with new or revised accounting standards. However, we are choosing to opt out of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

We could remain an emerging growth company for up to five years, or until the earliest of (i) the last day of the first fiscal year in which our annual gross revenues exceed \$1 billion, (ii) the date that we become a large accelerated filer as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (iii) the date on which we have issued more than \$1 billion in non-convertible debt during the preceding three year period.

## **Factors Impacting Our Operating Results**

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

*Changes in Fair Value of Our Assets.* We generally hold our target investments as long-term investments. We evaluate our investments for impairment on at least a quarterly basis and impairments will be recognized when it is probable that we will not be able to collect all amounts due according to the contractual terms of the loan. If a loan is considered to be impaired, we will record an allowance to reduce the carrying value of the loan to the present value of expected future cash flows discounted at the loan's contractual effective rate, or if repayment is expected solely from the collateral, the fair value of the collateral.

Loans are collateralized by real estate and as a result, the extent and impact of any credit deterioration associated with the performance and/or value of the underlying collateral property, as well as the financial and operating capability of the borrower, are regularly evaluated. We monitor performance of our investment portfolio under the following methodology: (1) borrower review, which analyzes the borrower's ability to execute on its original business plan, reviews its financial condition, assesses pending litigation and considers its general level of responsiveness and cooperation; (2) economic review, which considers underlying collateral, i.e. leasing performance, unit sales and cash flow of the collateral and

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its ability to cover debt service as well as the residual loan balance at maturity; (3) property review, which considers current environmental risks, changes in insurance costs or coverage, current site visibility, capital expenditures and market perception; and (4) market review, which analyzes the collateral from a supply and demand perspective of similar property types, as well as from a capital markets perspective. Such impairment analyses are completed and reviewed by asset management and finance personnel who utilize various data sources, including periodic financial data such as property occupancy, tenant profile, rental rates, operating expenses, and the borrower's exit plan, among other factors.

As of March 31, 2013 and December 31, 2012, all loans were paying in accordance with their terms. There were no impairments during the three months ended March 31, 2013 and 2012.

Although we generally hold our target investments as long-term investments, we may occasionally classify some of our investments as available-for-sale; provided, that such classification would not jeopardize our ability to maintain our qualification as a REIT. Investments classified as available-for-sale will be carried at their fair value, with changes in fair value recorded through accumulated other comprehensive income, a component of stockholders' equity, rather than through earnings. We do not expect to hold any of our investments for trading purposes.

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*Changes in Market Interest Rates.* With respect to our proposed business operations, increases in interest rates, in general, may over time cause:

- the interest expense associated with our borrowings to increase, subject to any applicable ceilings;
- the value of our mortgage loans to decline;
- coupons on our mortgage loans to reset to higher interest rates; and
- to the extent we enter into interest rate swap agreements as part of our hedging strategy where we pay fixed and receive floating interest rates, the value of these agreements to increase.

Conversely, decreases in interest rates, in general, may over time cause:

- the interest expense associated with our borrowings to decrease, subject to any applicable floors;
- the value of our mortgage loan portfolio to increase, for such mortgages with applicable floors;
- to the extent we enter into interest rate swap agreements as part of our hedging strategy where we pay fixed and receive floating interest rates, the value of these agreements to decrease; and
- coupons on our floating rate mortgage loans to reset to lower interest rates.

*Credit Risk.* We are subject to varying degrees of credit risk in connection with our target investments. Our Manager seeks to mitigate this risk by seeking to originate or acquire investments of higher quality at appropriate prices given anticipated and unanticipated losses, by employing a comprehensive review and selection process and by proactively monitoring originated or acquired investments. Nevertheless, unanticipated credit losses could occur that could adversely impact our operating results and stockholders' equity.

*Market Conditions.* We believe that our target investments currently present attractive risk-adjusted return profiles, given the underlying property fundamentals and the competitive landscape for the type of capital we provide. The U.S. CRE markets are seemingly in the early to middle stages of a recovery from the severe economic downturn that began in 2007. Following a dramatic decline in CRE lending in 2008 and 2009, debt capital has become more readily available for select stabilized, high quality assets in certain locations such as gateway cities, but remains muted for many other types of properties, either because of the markets in which they are located or because the property is undergoing some form of value creation transition. More particularly, the available financing products tend to come with limited flexibility, especially with respect to prepayment. Consequently, we anticipate a high demand for the type of customized debt financing we provide from borrowers or sponsors who are looking to refinance indebtedness that is maturing in the next two to five years or are seeking shorter-term debt solutions as they reposition their properties. We also envision that demand to be strong for situations in which a property is being acquired with plans to improve the net operating income and realize the improved value through a subsequent sale or refinancing. We also see a changing landscape in which many historical debt capital providers respond to banking regulatory reform with less active participation or more rigid products, less tailored to the needs of the borrowing community. While we expect to see the emergence of new providers, we believe those with deep experience and strong backing will have the opportunity to build market share. We also believe that we are well positioned to capitalize on the expected demand generated by the estimated \$1.7 trillion of CRE debt maturing between 2012 and 2016 (as reported in *Commercial Real Estate Outlook: Top Ten Issues in 2013* published by Deloitte & Touche LLP).

**Results of Operations – Comparison of Three Months Ended March 31, 2013 and 2012**

For the three months ended March 31, 2012, we were not a public company; however, we have provided below comparative operating results for the three months ended March 31, 2013 and 2012. Results for the three months ended March 31, 2012 are not indicative of the results we expect when our investment strategy has been fully implemented.

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The following table sets forth certain information regarding our net income for the three months ended March 31, 2013 and 2012 (in thousands):

	<b>For the three months ended March 31, 2013 (unaudited)</b>	<b>For the three months ended March 31, 2012 (unaudited)</b>	
<b>Net interest margin:</b>			
Interest income	\$ 6,711	\$ 949	
Interest expense (from secured funding facilities)	(1,385)	(339)	
Net interest margin	5,326	610	
<b>Expenses:</b>			
Other interest expense	1,950	-	
Management fees to affiliate	614	-	
Professional fees	566	65	
Acquisition and investment pursuit costs	640	-	
General and administrative expenses	482	37	
General and administrative expenses reimbursed to affiliate	747	-	
Total expenses	4,999	102	
<b>Net income</b>	<b>\$ 327</b>	<b>\$ 508</b>	

### **Net Interest Margin**

For the three months ended March 31, 2013 and 2012, we earned approximately \$5.3 million and \$610 thousand in net interest margin, respectively. For the three months ended March 31, 2013 and 2012, interest income of \$6.7 million and \$949 thousand, respectively, was generated by average earning assets of \$358.0 million and \$41.9 million, respectively, offset by \$1.2 million and \$214 thousand, respectively, of interest expense from secured funding facilities and unused fees, respectively, and \$227 thousand and \$125 thousand, respectively, of interest expense from the amortization of deferred loan costs. The average borrowings under our secured funding facilities were \$149.6 million and \$26.7 million for the three months ended March 31, 2013 and 2012, respectively. The increase in net interest margin from March 31, 2012 to March 31, 2013 primarily relates to the increase in the number of loans held for investment from 4 loans to 17 loans as of March 31, 2013.

### **Operating Expenses**

For the three months ended March 31, 2013 and 2012, we incurred operating expenses of \$5.0 million and \$102 thousand, respectively.

### *Related Party Expenses*

Related party expenses for the three months ended March 31, 2013 included \$0.6 million in management fees due to our Manager and \$0.7 million for our share of allocable general and administrative expenses for which we are required to reimburse our Manager pursuant to the management agreement, dated April 25, 2012, between us and our Manager. We did not reimburse our Manager for any such related party expenses for the three months ended March 31, 2012.

*Other Expenses*

Other interest expense for three months ended March 31, 2013 of \$2.0 million related to the 2015 Convertible Notes (including \$398 thousand unrealized loss on derivatives). Professional fees for the three months ended March 31, 2013 and 2012 were \$0.6 million and \$65 thousand, respectively. Acquisition and investment pursuit costs for the three months ended March 31, 2013 were \$0.6 million related to the proposed acquisition of Alliant Capital LLC. General and administrative expenses for the three months ended March 31, 2013 and 2012 were \$0.5 million and \$37 thousand, respectively.

Table of Contents**Cash Flows**

The following table sets forth changes in cash and cash equivalents for the three months ended March 31, 2013 and 2012 (in thousands):

	<b>For the three months ended March 31, 2013 (unaudited)</b>	<b>For the three months ended March 31, 2012 (unaudited)</b>
Net income	\$ 327	\$ 508
Adjustments to reconcile net income to cash provided by operating activities:	899	(729)
Net cash provided by (used in) operating activities	1,226	(221)
Net cash used in investing activities	(55,704)	(72,249)
Net cash provided by financing activities	53,638	75,816
Change in cash and cash equivalents	\$ (840)	\$ 3,346

Cash and cash equivalents increased (decreased) by \$(0.8) million and \$3.3 million, respectively, during the three months ended March 31, 2013 and 2012. Net cash provided by (used in) operating activities totaled \$1.2 million and \$(221) thousand, respectively, during the three months ended March 31, 2013 and 2012. This net cash was primarily related to interest and fee income collected offset by interest expense. The adjustments for non-cash charges for the three months ended March 31, 2013, included stock-based compensation of \$136 thousand, accretion of deferred loan origination fees and costs of \$739 thousand, amortization of deferred financing costs of \$227 thousand and \$398 thousand of unrealized loss on the derivative (included in other interest expense). The adjustments for non-cash charges for the three months ended March 31, 2012, included interest receivable of \$518 thousand and refundable deposits of \$200 thousand.

Net cash used in investing activities for the three months ended March 31, 2013 and 2012 totaled \$(55.7) million and \$(72.2) million, respectively, and related primarily to the origination of new loans held-for-investment.

Net cash provided by financing activities for three months ended March 31, 2013 totaled \$53.6 million and related primarily to proceeds from our secured funding facilities. Net cash provided by financing activities for the three months ended March 31, 2012 totaled \$75.8 million and related primarily to proceeds from our secured funding facilities and the issuance of our common stock to Ares Investments Holdings LLC, or Ares Investments.

**Liquidity and Capital Resources**

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders and other general business needs. We will use significant cash to purchase our target investments, repay principal and interest on our borrowings, make distributions to our stockholders and fund our operations. Our primary sources of cash will generally consist of unused borrowing capacity under our financing sources, the net proceeds of future offerings, payments of principal and interest we receive on our portfolio of assets and cash generated from our operating results. We expect that our primary sources of financing will be, to the extent available to us, through (a) credit, secured funding and other lending facilities,

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(b) securitizations, (c) other sources of private financing, including warehouse and repurchase facilities, and (d) offerings of our equity or debt securities. In the future, we may utilize other sources of financing to the extent available to us. See [Recent Developments](#) for information on our available capital as of May 13, 2013 as well as our pending acquisition of Alliant Capital LLC.



Table of Contents**Secured Funding Arrangements**

The sources of financing for our target investments are described below.

\$ in millions	March 31, 2013		December 31, 2012	
	Outstanding Balance	Total Commitment	Outstanding Balance	Total Commitment
Wells Fargo Facility	\$ 126,675	\$ 172,500	\$ 98,196	\$ 172,500
Citibank Facility	41,215	86,225	13,900	86,225
Capital One Facility	32,160	50,000	32,160	50,000
Total	\$ 200,050	\$ 308,725	\$ 144,256	\$ 308,725

The secured funding arrangements are generally collateralized by assignments of specific loans held for investment originated by us. We guarantee the secured funding arrangements. Generally, we partially offset interest rate risk by matching the interest index of loans held for investments with the secured funding agreement used to fund them.

***Wells Fargo Facility***

On December 14, 2011, we entered into a \$75.0 million secured revolving funding facility arranged by Wells Fargo Bank, National Association, or the Wells Fargo Facility, pursuant to which we borrow funds to finance qualifying senior commercial mortgage loans and A-Notes, subject to available collateral. On May 22, 2012, the agreements governing the Wells Fargo Facility were amended to, among other things, increase the total commitment under the Wells Fargo Facility from \$75.0 million to \$172.5 million. Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR plus (ii) a pricing margin range of 2.50% - 2.75%. On May 15, 2012, we started to incur a non-utilization fee of 25 basis points on the average available balance of the Wells Fargo Facility. The initial maturity date of the Wells Fargo Facility is December 14, 2014 and, provided that certain conditions are met and applicable extension fees are paid, is subject to two 12-month extension options. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Wells Fargo Facility was \$126.7 million and \$98.2 million, respectively.

The Wells Fargo Facility contains various affirmative and negative covenants applicable to us and certain of our subsidiaries, including the following: (a) limitations on the incurrence of additional indebtedness or liens, (b) limitations on how borrowed funds may be used, (c) limitations on certain distributions and dividend payments, (d) maintenance of adequate capital, (e) limitations on change of control, (f) maintaining a ratio of total debt to total assets of not more than 75%, (g) maintaining liquidity in an amount not less than the greater of (1) 5% of our tangible net worth or (2) \$20.0 million, (h) maintaining a fixed charge coverage ratio (expressed as the ratio of EBITDA to fixed charges) of at least 1.5 to 1, and (i) maintaining a tangible net worth of at least the sum of (1) \$135.5 million, plus (2) 80% of the net proceeds raised in all future equity issuances by us. Effective June 29, 2012, the agreements governing the Wells Fargo Facility were further amended to provide that the required minimum fixed charge coverage ratio with respect to us as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which we report Loans held for investment in excess of \$200.0 million on our quarterly consolidated balance sheet. As of December 31, 2012 we reported Loans held for investment in excess of \$200.0 million. As a result, we tested the minimum fixed charge coverage ratio for the three months ended March 31, 2013.

*Citibank Facility*

On December 8, 2011, we entered into a \$50.0 million secured revolving funding facility arranged by Citibank, N.A., or the Citibank Facility, pursuant to which we borrow funds to finance qualifying senior commercial mortgage loans and A-Notes, subject to available collateral. On April 16, 2012 and May 1, 2012, the agreements governing the Citibank Facility were amended to, among other things, increase the total commitment under the Citibank Facility from \$50.0 million to \$86.2 million. Under the Citibank Facility, we borrow funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by us. Advances under the Citibank Facility accrue interest at a per annum rate based on LIBOR. The margin can vary between 2.50% and 3.50% over the greater of LIBOR and 0.5%, based on the debt yield of the assets contributed into ACRC Lender C LLC, one of our wholly owned subsidiaries and the borrower under the Citibank Facility. On March 3, 2012, we started to incur a non-utilization fee of 25 basis points on the average available balance of the Citibank Facility. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. The end of the funding period is December 8, 2013, and may be extended for an additional 12 months upon the payment of the applicable extension fee and provided that no event of default is then occurring. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Citibank Facility was \$41.2 million and \$13.9 million, respectively.

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The Citibank Facility contains various affirmative and negative covenants applicable to us and certain of our subsidiaries, including the following: (a) maintaining tangible net worth of at least the sum of (1) 80% of our tangible net worth as of May 1, 2012, plus (2) 80% of the total net capital raised in all future equity issuances by us, (b) maintaining liquidity in an amount not less than the greater of (1) \$20.0 million or (2) 5% of our tangible net worth, (c) a cap on our distributions of the greater of (1) 100% of our taxable net income, or (2) such amount as is necessary to maintain our status as a REIT, and (d) if our average debt yield across the portfolio of assets that are financed with the Citibank Facility falls below certain thresholds, we may be required to repay certain amounts under the Citibank Facility. The Citibank Facility also prohibits us from amending our management agreement in a material respect without the prior consent of the lender. See Note 12 for subsequent events relating to the Citibank Facility.

***Capital One Facility***

On May 18, 2012, we entered into a \$50.0 million secured funding facility with Capital One, National Association, or the Capital One Facility, pursuant to which we borrow funds to finance qualifying senior commercial mortgage loans, subject to available collateral. Under the Capital One Facility, we borrow funds on a revolving basis in the form of individual loans evidenced by individual notes. Each individual loan is secured by an underlying loan originated by us. Amounts outstanding under each individual loan accrue interest at a per annum rate equal to LIBOR plus a spread ranging between 2.50% and 4.00%. We may request individual loans under the Capital One Facility through and including May 18, 2014, subject to successive 12-month extension options at the lender's discretion. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. As of March 31, 2013 and December 31, 2012, the outstanding balance on the Capital One Facility was \$32.2 million.

The Capital One Facility contains various affirmative and negative covenants applicable to us and certain of our subsidiaries, including the following: (a) maintaining a ratio of debt to tangible net worth of not more than 3.0 to 1, (b) maintaining a tangible net worth of at least the sum of (1) 80% of our tangible net worth as of May 1, 2012, plus (2) 80% of the net proceeds received from all future equity issuances by us, (c) maintaining a total liquidity in excess of the greater of (1) 5% of our tangible net worth or (2) \$20.0 million, and (d) maintaining a fixed charge coverage ratio (expressed as the ratio of EBITDA to fixed charges) of at least 1.5 to 1. Effective September 27, 2012, the agreements governing the Capital One Facility were amended to provide that the required minimum fixed charge coverage ratio with respect to us as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which we report Loans held for investment in excess of \$200.0 million on our quarterly consolidated balance sheet. As of December 31, 2012 we reported Loans held for investment in excess of \$200.0 million. As a result, we tested the minimum fixed charge coverage ratio for the three months ended March 31, 2013.

***2015 Convertible Notes***

On December 19, 2012, we issued \$69.0 million aggregate principal amount of the 2015 Convertible Notes. Of this aggregate principal amount, \$60.5 million aggregate principal amount of the 2015 Convertible Notes was sold to the initial purchasers (including \$9.0 million pursuant to the initial purchasers' exercise in full of their overallotment option) and \$8.5 million aggregate principal amount of the 2015 Convertible Notes was sold directly to certain directors, officers and affiliates of the Company in a private placement. The 2015 Convertible Notes were issued pursuant to an Indenture, dated December 19, 2012, or the Indenture, between us and U.S. Bank National Association, as trustee. The sale of the 2015 Convertible Notes generated net proceeds of approximately \$66.2 million. Aggregate offering expenses in connection with the transaction, including the initial purchasers' discount of approximately \$2.1 million, were approximately \$2.8 million. As of March 31, 2013 and December 31, 2012, the carrying value of the 2015 Convertible Notes was \$67.4 million and \$67.3 million, respectively.

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The 2015 Convertible Notes bear interest at a rate of 7.000% per year, payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2013. The effective interest rate of the 2015 Convertible Notes, which is equal to the stated rate of 7.000% plus the accretion of the original issue discount and associated costs, was approximately 9.4% for the three months ended March 31, 2013 and the year ended December 31, 2012. For the three months ended March 31, 2013, the interest incurred on this indebtedness was \$1.6 million. The 2015 Convertible Notes will mature on December 15, 2015, or the Maturity Date, unless previously converted or repurchased in accordance with their terms. The 2015 Convertible Notes are our senior unsecured obligations and rank senior in right of payment to our existing and future indebtedness that is expressly subordinated in right of payment to the 2015 Convertible Notes; equal in right of payment to our existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness (including existing unsecured indebtedness that the Company later secures) to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by our subsidiaries, financing vehicles or similar facilities.

Prior to the close of business on the business day immediately preceding June 15, 2015 holders may convert their 2015 Convertible Notes only under certain circumstances as set forth in the Indenture. On or after June 15, 2015 until the close of business on the scheduled trading day immediately preceding the Maturity Date, holders may convert their 2015 Convertible Notes at any time. Upon conversion, we will pay or deliver, as the case may be, at our election, cash, shares of our common stock or a combination of

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cash and shares of our common stock, provided that we will not elect to use a settlement method that results in us issuing more than 1,853,432 shares of common stock prior to obtaining stockholder approval in accordance with certain New York Stock Exchange, or NYSE, requirements. The conversion rate is initially 53.6107 shares of common stock per \$1,000 principal amount of 2015 Convertible Notes (equivalent to an initial conversion price of approximately \$18.65 per share of common stock). The conversion rate will be subject to adjustment in some events, including for regular quarterly dividends in excess of \$0.35 per share, but will not be adjusted for any accrued and unpaid interest. In addition, if certain corporate events occur prior to the Maturity Date, the conversion rate will be increased but will in no event exceed 61.6523 shares of common stock per \$1,000 principal amount of 2015 Convertible Notes.

We may not elect to issue shares of common stock upon conversion of the 2015 Convertible Notes to the extent such election would result in the issuance of 20% or more of the common stock outstanding immediately prior to the issuance of the 2015 Convertible Notes until we receive stockholder approval for issuances above this threshold. Until such stockholder approval is obtained, we may not share-settle the full conversion option. As a result, the embedded conversion option does not qualify for equity classification and instead is separately valued and accounted for as a derivative liability. The initial value allocated to the derivative liability was \$1.7 million, which represents a discount to the debt to be amortized through other interest expense using the effective interest method through the maturity of the 2015 Convertible Notes. The effective interest rate used to amortize the debt discount on the 2015 Convertible Notes is 9.4%. During each reporting period, the derivative liability is marked to fair value through earnings. As of March 31, 2013 and December 31, 2012, the derivative liability had a fair value of \$2.2 million and \$1.8 million, respectively. If the Company obtains stockholder approval for the issuance of 20% or more of the common stock outstanding immediately prior to the issuance of the 2015 Convertible Notes so the conversion option can be share-settled in full at the Company's option, the conversion option may qualify for equity classification and the bifurcated derivative liability would no longer need to be accounted for as a derivative on a prospective basis from the date of reassessment. Any remaining debt discount that arose at the date of debt issuance from the original bifurcation will continue to be amortized through other interest expense.

We do not have the right to redeem the 2015 Convertible Notes prior to the Maturity Date, except to the extent necessary to preserve our qualification as a REIT for U.S. federal income tax purposes. No sinking fund is provided for the 2015 Convertible Notes. In addition, if we undergo certain corporate events that constitute a fundamental change, the holders of the 2015 Convertible Notes may require us to repurchase for cash all or part of their 2015 Convertible Notes at a repurchase price equal to 100% of the principal amount of the 2015 Convertible Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

## **Other Credit Facilities, Warehouse Facilities and Repurchase Agreements**

In the future, we may also use other sources of financing to fund the origination or acquisition of our target investments, including other credit facilities, warehouse facilities, repurchase facilities, convertible debt, retail notes and other secured and unsecured forms of borrowing. These financings may be collateralized or non-collateralized and may involve one or more lenders. We expect that these facilities will typically have maturities ranging from two to five years and may accrue interest at either fixed or floating rates.

## **Capital Markets**

In addition to borrowings, we will need to periodically raise additional capital to fund new investments. We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes. Among other things, in order to qualify and maintain our status as a REIT, we must annually distribute to our stockholders at least 90% of our REIT taxable income (which does not equal net income, as calculated in accordance with GAAP), determined without regard to the deduction for dividends paid and excluding net capital gain, and, as a result, such distributions will not be available to fund investments. We may also seek to enhance the returns on our senior commercial mortgage loan investments,

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especially loan originations, through securitizations, if available. To the extent available, we intend to securitize the senior portion of some of our loans, while retaining the subordinate securities in our investment portfolio. The securitization of this senior portion will be accounted for as either a sale and the loans will be removed from our balance sheet or as a financing and will be classified as securitized loans on our balance sheet, depending upon the structure of the securitization.

### **Leverage Policies**

We intend to use prudent amounts of leverage to increase potential returns to our stockholders. To that end, subject to maintaining our qualification as a REIT and our exemption from registration under the 1940 Act, we intend to use borrowings to fund the origination or acquisition of our target investments. Given current market conditions and our focus on first or senior mortgages, we currently expect that such leverage would not exceed, on a debt-to-equity basis, a 4-to-1 ratio. Our charter and bylaws do not restrict

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the amount of leverage that we may use. The amount of leverage we will deploy for particular investments in our target investments will depend upon our Manager's assessment of a variety of factors, which may include, among others, the anticipated liquidity and price volatility of the assets in our investment portfolio, the potential for losses and extension risk in our portfolio, the gap between the duration of our assets and liabilities, including hedges, the availability and cost of financing the assets, our opinion of the creditworthiness of our financing counterparties, the health of the U.S. economy and commercial mortgage markets, our outlook for the level and volatility of interest rates, the slope of the yield curve, the credit quality of our assets, the collateral underlying our assets, and our outlook for asset spreads relative to the LIBOR curve.

**Dividends**

We intend to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT annually distribute at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and to the extent that it annually distributes less than 100% of its net taxable income in any taxable year, and that it pay tax at regular corporate rates on that undistributed portion. We intend to make regular quarterly distributions to our stockholders in an amount equal to or greater than our net taxable income, if and to the extent authorized by our board of directors. Before we make any distributions, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our secured funding facilities, other lending facilities, repurchase agreements and other debt payable. If our cash available for distribution is less than our net taxable income, we could be required to sell assets or borrow funds to make cash distributions or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

**Off-Balance Sheet Arrangements**

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, special purpose entities or VIEs, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities or entered into any commitment or intend to provide additional funding to any such entities.

**Non-GAAP Financial Measures**

Core Earnings is a measure not prepared in accordance with GAAP and is defined as GAAP net income (loss) excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (related to targeted investments that are structured as debt to the extent that we foreclose on any properties underlying our target investments), any unrealized gains, losses or other non-cash items that are included in net income (loss) for the applicable reporting period, regardless of whether such items are included in other comprehensive income or loss, or in net income (loss). The amount will be adjusted to exclude one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between our Manager and our independent directors and after approval by a majority of our independent directors.

We believe that Core Earnings provides an additional measure of our core operating performance by eliminating the impact of certain non-cash expenses and facilitating a comparison of our financial results to those of other comparable companies with fewer or no non-cash charges and comparison of our own operating results from period to period. Our management uses Core Earnings in this way, and also uses Core Earnings to compute the incentive fee due under our Management Agreement. We believe that our investors also use Core Earnings or a comparable

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supplemental performance measure to evaluate and compare our performance and our peers, and as such, we believe that the disclosure of Core Earnings is useful to our investors.

However, we caution that Core Earnings does not represent cash generated from operating activities in accordance with GAAP and should not be considered as an alternative to net income (loss) (determined in accordance with GAAP), or an indication of our cash flow from operating activities (determined in accordance with GAAP), a measure of our liquidity, or an indication of funds available to fund our cash needs, including our ability to make cash distributions. In addition, our methodology for calculating Core Earnings may differ from the methodologies employed by other companies to calculate the same or similar supplemental performance measures, and accordingly, our reported Core Earnings may not be comparable to the Core Earnings reported by other companies.



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Our Core Earnings (loss) for the three months ended March 31, 2013 and 2012 was approximately \$0.9 million and \$(116) thousand, respectively, and \$0.09 and \$(0.12), respectively, per weighted average share, diluted. The table below provides a reconciliation of net income (loss) to Core Earnings (loss) for these periods:

<b>\$ in thousands, except per share amounts</b>	<b>For the three months ended March 31, 2013</b>		<b>For the three months ended March 31, 2012</b>	
	<b>Amount</b>	<b>Per Share</b>	<b>Amount</b>	<b>Per Share</b>
Net income (loss) attributable to common stockholders	\$ 327	\$ 0.04	\$ (116)	\$ (0.12)
Add back: non-cash stock-based compensation	136	0.01	-	-
Add back: unrealized loss on derivative	398	0.04	-	-
<b>Core Earnings (loss)</b>	<b>\$ 861</b>	<b>\$ 0.09</b>	<b>\$ (116)</b>	<b>\$ (0.12)</b>

### **Recent Developments**

On April 29, 2013, the agreements governing the Citibank Facility were amended to provide that the limitation on the payment of dividends to the common shareholders of us in excess of 100% of taxable income will start to be tested on December 31, 2013.

On April 30, 2013, we originated an approximately \$15.0 million stretch senior mortgage loan on an office building located in Mountain View, CA. At closing the outstanding principal balance was approximately \$14.5 million. The loan has an interest rate of LIBOR + 4.75% subject to a 0.50% LIBOR floor and term of 33 months.

On May 9, 2013, we filed a registration statement on Form S-3 with the Securities and Exchange Commission in order to permit us to offer, from time to time, in one or more offerings or series of offerings, up to \$1.5 billion of our common stock, preferred stock, debt securities, subscription rights to purchase shares of our common stock, warrants representing rights to purchase shares of our common stock, preferred stock or debt securities, or units. We may not sell securities pursuant to the registration statement until the registration statement is declared effective by the Securities and Exchange Commission.

As of May 13, 2013, we expect to have approximately \$40 million of remaining capital, either in cash or in approved but undrawn capacity under our secured funding facilities. After holding in reserve \$20.0 million in liquidity requirements, we have approximately \$20 million in capital available to fund additional commitments, our existing outstanding commitments and for other working capital purposes. Assuming that we use such amount as equity capital to make new investments and are able to achieve a debt-to-equity ratio of 1-to-1 to 2-to-1, we have the capacity to fund approximately \$40 million to approximately \$60 million of additional senior loan investments. As of May 13, 2013, the total unfunded commitments for our existing loans held for investment were approximately \$53.6 million and borrowings under our secured funding facilities and from the issuance of convertible senior notes were approximately \$222.1 million and \$69.0 million, respectively.

On May 14, 2013, we entered into a Purchase and Sale Agreement (the Agreement) with Alliant, Inc., a Florida corporation, and The Alliant Company, LLC, a Florida limited liability company (collectively, the Sellers). The Agreement provides that, upon the terms and subject to the conditions set forth therein, at the closing of the transaction, we will purchase from Sellers (the Acquisition) all of the outstanding common units of EF&A Funding, L.L.C., d/b/a Alliant Capital LLC, a Michigan limited liability company, which houses the Sellers multi-family residential

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mortgage loan origination and servicing business. The Agreement provides that we will pay \$52.9 million in cash, subject to certain adjustments, and issue 588,235 shares of its common stock in a private placement exempt from registration under the Securities Act of 1933, as consideration for the Acquisition. The cash portion of the transaction may be financed through additional debt financing, potential issuances of common or preferred stock and/or the repayment or sale of certain assets. The Acquisition is expected to close during the second half of 2013, subject to the satisfaction or waiver of various closing conditions as described in the Agreement. There can be no assurance that the Acquisition will be completed, or if it is completed, that it will close within the anticipated time period. In connection with the Acquisition, the board of directors of ours approved the expansion of our investment guidelines to reflect the Acquisition, subject to the concurrent consummation of the Acquisition.

On May 14, 2013, our board of directors appointed Todd Schuster to join John B. Bartling, Jr., as our Co-Chief Executive Officer effective June 1, 2013. As a result of Mr. Schuster's appointment as Co-Chief Executive Officer, Mr. Schuster is no longer independent for the purpose of serving on the audit committee of our board of directors and, consequently, resigned from such committee.

On May 15, 2013, we declared a cash dividend of \$0.25 per common share for the second quarter of 2013. The second quarter 2013 dividend is payable on July 18, 2013 to common stockholders of record as of June 28, 2013.

### **Critical Accounting Policies and Use of Estimates**

Our financial statements are prepared in accordance with GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment as to future uncertainties. In accordance with SEC guidance, the following discussion addresses the accounting policies that we believe apply to us based on the nature of our initial operations. Our most critical accounting policies involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments used to draft our financial statements are based upon reasonable assumptions given the information available to us at that time. Our critical accounting policies and accounting estimates will be expanded over time as we fully implement our strategy. Those accounting policies and estimates that we believe are most critical to an investor's understanding of our financial results and condition and require complex management judgment are discussed below. Our actual results could differ from these estimates.

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***Loans Held for Investment and Interest Income Recognition***

Our originated loans receivable will be classified as held-for-investment based upon our intent and ability to hold them until maturity. Loans that are held-for-investment are carried at cost, net of unamortized loan fees, and origination and acquisition costs, unless the loan is deemed impaired. Interest income will be recognized based on the contractual rate and the outstanding principal balance of the loans. Origination fees, contractual exit fees net of direct loan origination costs are also recognized in interest income over the loan term as a yield adjustment using the effective interest method. The objective of the effective interest method is to arrive at periodic interest income that yields a level rate of return over the original loan term inclusive of origination points and other fees.

We will evaluate each loan classified as held for investment for impairment on a periodic basis. Impairment occurs when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan. If a loan is considered to be impaired, we will record an allowance to reduce the carrying value of the loan to the present value of expected future cash flows discounted at the loan's contractual effective rate or the fair value of the collateral, if repayment is expected solely from the collateral. Our loans are collateralized by real estate. As a result, we will regularly evaluate the extent and impact of any credit deterioration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower. We monitor performance of our investment portfolio under the following methodology: (1) borrower review, which analyzes the borrower's ability to execute on its original business plan, reviews its financial condition, assesses pending litigation and considers its general level of responsiveness and cooperation; (2) economic review, which considers underlying collateral, (i.e. leasing performance, unit sales and cash flow of the collateral and its ability to cover debt service as well as the residual loan balance at maturity); (3) property review, which considers current environmental risks, changes in insurance costs or coverage, current site visibility, capital expenditures and market perception; and (4) market review, which analyzes the collateral from a supply and demand perspective of similar property types, as well as from a capital markets perspective. Such impairment analyses are completed and reviewed by asset management and finance personnel who utilize various data sources, including periodic financial data such as property occupancy, tenant profile, rental rates, operating expenses, and the borrower's exit plan, among other factors.

In addition, we evaluate the entire portfolio to determine whether the portfolio has any impairments that require a general valuation allowance on the remainder of the loan portfolio. The amount of each element of the allowance would be determined separately; however, the entire allowance for loan losses would be available to absorb losses in the loan portfolio. If impairment is indicated, a valuation write-down or write-off would be measured based upon the excess of the recorded investment amount over the net fair value of the collateral, as reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral would be charged to the allowance for loan losses. As of March 31, 2013 and December 31, 2012, there are no impairments on our loan portfolio.

Significant judgment will be required in determining impairment, including making assumptions regarding the value of a loan or loan pool, the value of the underlying collateral and other provisions such as guarantees.

***Valuation of Financial Instruments***

We determine the estimated fair value of financial assets and liabilities using the three-tier fair value hierarchy established by GAAP, which prioritizes the inputs used in measuring fair value. GAAP establishes market-based or observable inputs as the preferred source of values, followed by valuation models using management assumptions in the absence of market inputs. The only financial instrument recorded at fair value on a recurring basis in our consolidated financial statements is the derivative liability associated with our 2015 Convertible Notes (defined below). We have not elected the fair value option for the remaining financial instruments, including loans held for investment and secured funding agreements. Such financial instruments are carried at cost. For loans held for investment which are evaluated for impairment at least

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quarterly, we estimate the fair value of the financial instrument. If an impairment is determined, we record an expense for the difference between fair value and the carrying cost of the financial instrument. As of March 31, 2013 and December 31, 2012, the fair value of our financial instruments approximates cost.

The three levels of inputs that may be used to measure fair value are as follows:

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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Unobservable inputs reflect our own assumptions about the factors that market participants would use in pricing an asset or liability, and would be based on the best information available. We anticipate that a significant portion of our assets will fall in Level III in the valuation hierarchy.

Any changes to the valuation methodology will be reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, we will continue to refine our valuation methodologies. The methods used by us may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we anticipate that our 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. We 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.

***Derivative Financial Instruments***

We do not hold or issue derivative instruments for trading purposes. We recognize derivatives on our balance sheet, measure them at their estimated fair value and recognize changes in their estimated fair value in our results of operations for the period in which the change occurs. On December 19, 2012, we issued \$69.0 million aggregate principal amount of unsecured 7.000% Convertible Senior Notes due 2015, or the 2015 Convertible Notes. The conversion features of the 2015 Convertible Notes are deemed to be an embedded derivative in accordance Accounting Standards Codification, or ASC, Topic 815, Derivatives and Hedging, or ASC 815. In accordance with ASC 815, we are required to bifurcate the embedded derivative related to the conversion features of the 2015 Convertible Notes. We will recognize the embedded derivative as a liability on our balance sheet, measure it at its estimated fair value and recognize changes in its estimated fair value in our results of operations for the period in which the change occurs.

***Income Taxes***

Under our current structure, our financial results are generally not expected to reflect provisions for current or deferred income taxes. We believe that we will operate in a manner that will allow us to qualify for taxation as a REIT. As a result of our expected REIT qualification and distribution policy, we do not generally expect to pay U.S. federal corporate level income taxes. Many of the REIT requirements, however, are highly technical and complex. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement to distribute annually at least 90% of our REIT taxable income to our stockholders. If we have previously qualified as a REIT and fail to qualify as a REIT in any subsequent taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal and state income taxes at regular corporate rates (including any applicable alternative minimum tax) and may be precluded from qualifying as a REIT for four subsequent taxable years. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state, local and foreign taxes on our income and property and to U.S. federal income and excise taxes on our undistributed REIT taxable income.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of our capital stock. While we do not seek to avoid risk completely, we believe the risks can be quantified from historical experience and seek to actively manage

those risks, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

***Credit Risk***

We expect to be subject to varying degrees of credit risk in connection with holding a portfolio of our target investments. We will have exposure to credit risk on our CRE loans and other target investments. Our Manager will seek to manage credit risk by performing credit fundamental analysis of potential collateral assets. Credit risk will also be addressed through our Manager's on-going review. Our investment guidelines do not limit the amount of our equity that may be invested in any type of our target investments. Our investment decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our equity that will be invested in any individual target investment at any given time.

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***Interest Rate Risk***

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We will be subject to interest rate risk in connection with our assets and our related financing obligations. In general, we expect to finance the origination or acquisition of our target investments through financings in the form of borrowings under warehouse facilities, bank credit facilities (including term loans and revolving facilities), resecuritizations, securitizations and repurchase agreements. We may mitigate interest rate risk through utilization of hedging instruments, primarily interest rate swap agreements. Interest rate swap agreements are intended to serve as a hedge against future interest rate increases on our borrowings. For many of our investments, we may also seek to limit the exposure of our borrowers and sponsors to future fluctuations of interest rates through their use of interest-rate caps and other interest rate hedging instruments.

We regularly measure our exposure to interest rate risk. We assess interest rate risk and manage our interest rate exposure on an ongoing basis by comparing our interest rate sensitive assets to our interest rate sensitive liabilities. Based on that review, we determine whether or not any hedging transactions are necessary to mitigate exposure to changes in interest rates.

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

***Interest Rate Effect on Net Interest Margin***

Our operating results will depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The cost of our borrowings generally will be based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase (a) while the yields earned on our leveraged fixed-rate mortgage assets will remain static and (b) in some cases, at a faster pace than the yields earned on our leveraged floating rate mortgage assets, which could result in a decline in our net interest spread and net interest margin.

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

Hedging techniques are partly based on assumed levels of prepayments of our target investments. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

***Interest Rate Cap and Floor Risk***

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

***Interest Rate Mismatch Risk***

We may fund a portion of our origination or acquisition of mortgage loans with borrowings that are based on LIBOR, while the interest rates on these assets may be indexed to LIBOR or another index rate, such as the one-year Constant Maturity Treasury, or CMT, index, the Monthly Treasury Average, or MTA, index or the 11th District Cost of Funds Index, or COFI. Accordingly, any increase in LIBOR relative to one-year CMT rates, MTA or COFI will generally result in an increase in our borrowing costs that may not be matched by a corresponding increase in the interest earnings on these assets. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact distributions to our stockholders. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above.



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Our analysis of risks is based on our Manager's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and as shown in this quarterly report.

***Extension Risk***

Our Manager will compute the projected weighted-average life of our assets based on assumptions regarding the rate at which the borrowers will prepay the mortgages. If prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate assets could extend beyond the term of the interest swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the fixed-rate assets would remain fixed. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

***Market Risk***

Available-for-sale investments will be reflected at their estimated fair value, with the difference between amortized cost and estimated fair value reflected in accumulated other comprehensive income. The estimated fair value of these investments fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of the fixed-rate securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of the fixed-rate securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted. If we are unable to readily obtain independent pricing to validate our estimated fair value of any available-for-sale investment in our portfolio, the fair value gains or losses recorded in other comprehensive income may be adversely affected.

***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 loan or loans, as the case may be, which could also cause us to suffer losses.

***Inflation***

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

## Risk Management

To the extent consistent with maintaining our REIT qualification, we will seek to manage risk exposure by closely monitoring our portfolio and actively managing the financing, interest rate, credit, prepayment and convexity (a measure of the sensitivity of the duration of a debt investment to changes in interest rates) risks associated with holding a portfolio of our target investments. Generally, with the guidance and experience of our Manager:

- we will manage our portfolio through an interactive process with Ares Management and service our self-originated investments through our Manager's servicer, which is a Standard & Poor's ranked commercial primary servicer and commercial special servicer that is included on Standard & Poor's Select Servicer List;
- we intend to engage in a variety of interest rate management techniques that seek, on the one hand to mitigate the economic effect of interest rate changes on the values of, and returns on, some of our assets, and on the other hand help us achieve our risk management objectives, including utilizing derivative financial instruments, such as puts and calls on securities or indices of securities, interest rate swaps, interest rate caps, exchange-traded derivatives, U.S. Treasury securities, options on U.S. Treasury securities and interest rate floors to hedge all or a portion of the interest rate risk associated with the financing of our portfolio;

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- we intend to actively employ portfolio-wide and asset-specific risk measurement and management processes in our daily operations, including utilizing our Manager's risk management tools such as software and services licensed or purchased from third parties and proprietary analytical methods developed by Ares Management; and
- we will seek to manage credit risk through our due diligence process prior to origination or acquisition and through the use of non-recourse financing, when and where available and appropriate. In addition, with respect to any particular target investment, our Manager's investment team evaluates, among other things, relative valuation, comparable analysis, supply and demand trends, shape of yield curves, delinquency and default rates, recovery of various sectors and vintage of collateral.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 of the Exchange Act). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our current disclosure controls and procedures are effective in timely alerting them of material information relating to us that is required to be disclosed by us in the reports we file or submit under the Exchange Act.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

In the normal course of business, we may be subject to various legal proceedings from time to time. Furthermore, third parties may try to seek to impose liability on us in connection with our loans held for investment. Currently, we are not aware of any legal proceedings pending against us or any of our subsidiaries.

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**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which could materially affect our business, financial condition and/or operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results.

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

*Recent Sale of Unregistered Securities*

We did not sell any equity securities during the period covered in this report that were not registered under the Securities Act.

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**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
3.1	Articles of Amendment and Restatement of Ares Commercial Real Estate Corporation (1)
3.2	Amended and Restated Bylaws of Ares Commercial Real Estate Corporation (1)
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed herewith

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

\*\* These interactive data files are furnished and not deemed filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, and are not deemed filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those sections.

(1) Incorporated by reference to Exhibits 3.1 and 3.2, as applicable, to the Company's Form S-8 (File No. 333-181077), filed on May 1, 2012.

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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.

**ARES COMMERCIAL REAL ESTATE CORPORATION**

Dated: May 15, 2013	By	/s/ John B. Bartling, Jr. John B. Bartling, Jr. Chief Executive Officer (Principal Executive Officer)
Dated: May 15, 2013	By	/s/ Tae-Sik Yoon Tae-Sik Yoon Chief Financial Officer (Principal Financial and Accounting Officer)