

Apollo Commercial Real Estate Finance, Inc.

Form 10-Q

November 04, 2011

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

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended September 30, 2011

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

Commission File Number: 001-34452

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

(Exact name of Registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction of

**27-0467113**  
(IRS Employer

incorporation or organization)

Identification Number)

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

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

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

**New York, New York 10019**

(Address of Registrant's principal executive offices)

**(212) 515 3200**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer ☐ 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 practical date.

As of November 3, 2011, there were 20,561,032 shares, par value \$0.01, of the registrant's common stock issued and outstanding.

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

|   | September 30, 2011 | December 31, 2010 |
|---|--------------------|-------------------|
| <b>Assets:</b>  |                    |                   |
| Cash and cash equivalents   | \$ 44,450          | \$ 37,894         |
| Securities available-for-sale, at estimated fair value  | 316,067            | 363,660           |
| Securities, at estimated fair value   | 258,517            | 279,124           |
| Commercial mortgage loans, held for investment  | 109,192            | 109,695           |
| Subordinate loans, held for investment  | 123,960            | 58,985            |
| Repurchase agreements, held for investment  | 47,439             |                   |
| Principal and interest receivable   | 9,143              | 5,553             |
| Deferred financing costs, net   | 1,730              | 2,818             |
| Derivative instruments, net   |                    | 387               |
| Other assets  | 113                | 31                |
| <b>Total Assets</b>   | <b>\$ 910,611</b>  | <b>\$ 858,147</b> |
| <b>Liabilities and Stockholders' Equity</b>   |                    |                   |
| <b>Liabilities:</b>   |                    |                   |
| TALF borrowings   | \$ 264,101         | \$ 297,334        |
| Borrowings under repurchase agreements  | 296,805            | 242,728           |
| Derivative instruments, net   | 904                |                   |
| Accounts payable and accrued expenses   | 2,973              | 2,375             |
| Payable to related party  | 1,241              | 683               |
| Dividends payable   | 8,542              | 7,189             |
| Deferred underwriting fee (\$8,000 of which was payable to the Manager - see Note 13)   |                    | 10,000            |
| <b>Total Liabilities</b>  | <b>574,566</b>     | <b>560,309</b>    |
| <b>Commitments and Contingencies (see Note 13)</b>  |                    |                   |
| <b>Stockholders' Equity:</b>  |                    |                   |
| Common stock, \$0.01 par value, 450,000,000 shares authorized, 20,561,032 and 17,551,828 shares issued and outstanding in 2011 and 2010, respectively | 206                | 175               |
| Additional paid-in-capital  | 335,352            | 291,304           |
| Accumulated other comprehensive income  | 487                | 6,359             |
| <b>Total Stockholders' Equity</b>   | <b>336,045</b>     | <b>297,838</b>    |
| <b>Total Liabilities and Stockholders' Equity</b>   | <b>\$ 910,611</b>  | <b>\$ 858,147</b> |

See notes to unaudited condensed consolidated financial statements.

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

|   | Three months ended |            | Nine months ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2011               | 2010       | 2011              | 2010       |
| Net interest income:  |                    |            |                   |            |
| Interest income from securities   | \$ 6,316           | \$ 4,356   | \$ 19,419         | \$ 11,643  |
| Interest income from commercial mortgage loans  | 2,276              | 2,123      | 6,886             | 4,723      |
| Interest income from subordinate loans  | 3,784              | 1,952      | 8,861             | 5,386      |
| Interest income from repurchase agreements  | 1,576              |            | 3,188             |            |
| Interest expense  | (3,716)            | (2,930)    | (10,836)          | (7,293)    |
| Net interest income   | 10,236             | 5,501      | 27,518            | 14,459     |
| Operating expenses:   |                    |            |                   |            |
| General and administrative expenses (includes \$418 and \$1,154 of non-cash stock based compensation in 2011 and \$339 and \$1,098 in 2010, respectively) | (1,297)            | (1,360)    | (4,089)           | (4,157)    |
| Management fees to related party  | (1,241)            | (761)      | (3,430)           | (2,220)    |
| Total operating expenses  | (2,538)            | (2,121)    | (7,519)           | (6,377)    |
| Interest income from cash balances  | 2                  | 1          | 10                | 9          |
| Realized loss on sale of security   |                    |            |                   | (33)       |
| Unrealized loss on securities   | (1,511)            | (286)      | (118)             | (286)      |
| Loss on derivative instruments (includes \$202 and \$1,291 of unrealized losses for the three and nine months 2011 and \$690 in 2010, respectively)       | (677)              | (739)      | (2,679)           | (739)      |
| Net income  | \$ 5,512           | \$ 2,356   | \$ 17,212         | \$ 7,033   |
| Basic and diluted net income per share of common stock  | \$ 0.28            | \$ 0.21    | \$ 0.93           | \$ 0.64    |
| Basic and diluted weighted average common shares outstanding  | 19,966,594         | 11,448,125 | 18,449,200        | 10,996,678 |
| Dividend declared per share of common stock   | \$ 0.40            | \$ 0.40    | \$ 1.20           | \$ 1.10    |

See notes to unaudited condensed consolidated financial statements.

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

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

(in thousands except share data)

|   | Common Stock |        | Additional<br>Paid In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total      |
|---|--------------|--------|----------------------------------|----------------------|---|------------|
|   | Shares       | Par    |                                  |                      |   |            |
| Balance at January 1, 2011  | 17,551,828   | \$ 175 | \$ 291,304                       | \$                   | \$ 6,359  | \$ 297,838 |
| Vesting of restricted stock pursuant to Equity Incentive Plan     |              |        | 1,153                            |                      |   | 1,153      |
| Issuance of restricted stock                                      | 9,204        | 1      |                                  |                      |   | 1          |
| Issuance of common stock  | 3,000,000    | 30     | 49,950                           |                      |   | 49,980     |
| Offering costs  |              |        | (1,727)                          |                      |   | (1,727)    |
| Net income  |              |        |                                  | 17,212               |   | 17,212     |
| Change in net unrealized gain on securities<br>available-for-sale |              |        |                                  |                      | (5,872)   | (5,872)    |
| Dividends on common stock   |              |        | (5,328)                          | (17,212)             |   | (22,540)   |
| Balance at September 30, 2011                                     | 20,561,032   | \$ 206 | \$ 335,352                       | \$                   | \$ 487  | \$ 336,045 |

See notes to unaudited condensed consolidated financial statements.

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

**Condensed Consolidated Statement of Comprehensive Income (Unaudited)**

**(in thousands)**

|   | Three months ended    |                       | Nine months ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
| Net income  | \$ 5,512              | \$ 2,356              | \$ 17,212             | \$ 7,033              |
| Change in net unrealized gain (loss) on securities available-for-sale | (2,355)               | 3,519                 | (5,872)               | 8,957                 |
| Comprehensive income  | \$ 3,157              | \$ 5,875              | \$ 11,340             | \$ 15,990             |

See notes to unaudited condensed consolidated financial statements.

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

|   | For nine months<br>ended<br>September 30,<br>2011 | For nine months<br>ended<br>September 30,<br>2010 |
|---|---|---|
| Cash flows provided by operating activities:                                      |   |   |
| Net income  | \$ 17,212   | \$ 7,033  |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |   |
| Premium amortization  | 5,876   | 2,814   |
| Amortization of deferred financing costs  | 1,088   | 803   |
| Restricted stock amortization expense   | 1,153   | 1,098   |
| Unrealized loss on securities   | 118   | 286   |
| Unrealized loss on derivative instruments   | 1,291   | 690   |
| Realized loss on sale of security   |   | 33  |
| Changes in operating assets and liabilities:                                      |   |   |
| Increase in accrued principal and interest receivable, less purchased interest    | (3,733)   | (2,743)   |
| Increase in other assets  | (82)  | (34)  |
| Increase in accounts payable and accrued expenses                                 | 1,064   | 1,308   |
| Increase in payable to related party  | 558   | 13  |
| Net cash provided by operating activities   | 24,545  | 11,301  |
| Cash flows used in investing activities:  |   |   |
| Purchase of securities available-for-sale   |   | (229,499)   |
| Proceeds from sale of securities available-for-sale                               |   | 12,188  |
| Purchase of securities at estimated fair value                                    |   | (144,964)   |
| Funding of commercial mortgage loans  | (8,800)   | (109,622)   |
| Funding of subordinate loans  | (64,858)  | (8,938)   |
| Funding of repurchase agreements  | (47,439)  |   |
| Principal payments received on securities available-for-sale                      | 39,666  | 714   |
| Principal payments received on securities at estimated fair value                 | 16,668  |   |
| Principal payments received on commercial mortgage loans                          | 9,303   | 187   |
| Principal payments received on subordinate loans                                  | 26  | 6   |
| Change in contractual deposits  |   | 75  |
| Net cash used in investing activities   | (55,434)  | (479,853)   |
| Cash flows from financing activities:   |   |   |
| Proceeds from issuance of common stock  | 49,980  | 110,400   |
| Payment of offering costs   | (1,692)   | (5,888)   |
| Payment of deferred underwriting fee  | (10,000)  |   |
| Proceeds from TALF borrowings   |   | 178,469   |
| Repayments of TALF borrowings   | (33,233)  | (1,240)   |
| Proceeds from repurchase agreement borrowings                                     | 69,014  | 266,046   |
| Repayments of repurchase agreement borrowings                                     | (14,937)  | (140,407)   |
| Deferred financing costs  | (500)   | (2,554)   |
| Dividends on common stock   | (21,187)  | (7,465)   |



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|   |           |           |
|---|-----------|-----------|
| Net cash provided by financing activities                 | 37,445    | 397,361   |
| Net increase (decrease) in cash and cash equivalents      | 6,556     | (71,191)  |
| Cash and cash equivalents, beginning of period            | 37,894    | 129,969   |
| Cash and cash equivalents, end of period                  | \$ 44,450 | \$ 58,778 |
| Supplemental disclosure of cash flow information:         |           |           |
| Interest paid   | \$ 11,099 | \$ 6,075  |
| Supplemental disclosure of non-cash financing activities: |           |           |
| Deferred underwriting fee                                 | \$        | \$ 10,000 |
| Dividend declared, not yet paid                           | \$ 8,542  | \$ 7,140  |
| Deferred financing costs, not yet paid                    | \$ 500    | \$ 1,000  |
| Offering costs payable                                    | \$ 529    | \$ 825    |

See notes to unaudited condensed consolidated financial statements.

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

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

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

**Note 1 Organization**

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

**Note 2 Summary of Significant Accounting Policies**

***Basis of Presentation***

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

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

The Company currently operates in one business segment.

***Recent Accounting Pronouncements***

In April 2011, the Financial Accounting Standards Board (the FASB ) issued ASU No. 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*. This update revises the criteria for assessing effective control for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The update will be effective for interim and annual reporting periods beginning on or after December 15, 2011, early adoption is prohibited, and the amendments will be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The Company does not believe that the adoption of this standard will have a material impact on the Company s financial position or results of operations.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). This update amends the existing fair value guidance to improve consistency in the application and disclosure of fair value measurements in U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 provides certain clarifications to the existing guidance, changes certain fair value principles, and enhances disclosure requirements. The update will be effective for interim and annual reporting periods beginning on or after December 15, 2011, early adoption is prohibited, and the amendments will be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The Company does not believe that the adoption of this standard will have a material impact on the Company s financial position or results of operations.

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In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* ( ASU 2011-05 ). Prior to the issuance of ASU 2011-05, existing GAAP allowed three alternatives for presentation of other comprehensive income ( OCI ) and its components in financial statements. ASU 2011-05 removes the option to present the components of OCI as part of the statement of changes in stockholders' equity. In addition, ASU 2011-05 requires consecutive presentation of the statement of operations and OCI and presentation of reclassification adjustments on the face of the financial statements from OCI to net income. These changes apply to both annual and interim financial statements commencing, with retrospective application, for the fiscal periods beginning after December 15, 2011, with early adoption permitted. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

### **Note 3 Fair Value Disclosure**

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

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

Level II Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level III Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

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

The estimated fair value of the AAA-rated CMBS portfolio is determined by reference to market prices provided by certain dealers who make a market in these financial instruments. Broker quotes are only indicative of fair value and may not necessarily represent what the Company would receive in an actual trade for the applicable instrument. Management performs additional analysis on prices received based on broker quotes to validate the prices and adjustments are made as deemed necessary by management to capture current market information. The estimated fair values of Company's securities are based on observable market parameters and are classified as Level 2 in the fair value hierarchy.

The estimated fair values of the Company's derivative instruments are determined using a discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The fair values of interest rate caps are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the calculation of projected cash flows are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. The Company's derivative instruments are classified as Level 2 in the fair value hierarchy.

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The following table summarizes the levels in the fair value hierarchy into which the Company's financial instruments fall as of September 30, 2011:

|                                     | Level I   | Fair Value as of September 30, 2011 |           | Total             |
|-------------------------------------|-----------|-------------------------------------|-----------|-------------------|
|                                     |           | Level II                            | Level III |                   |
| AAA-rated CMBS (Available-for-Sale) | \$        | \$ 316,067                          | \$        | \$ 316,067        |
| AAA-rated CMBS (Fair Value Option)  |           | 258,517                             |           | 258,517           |
| Interest rate swaps                 |           | (1,087)                             |           | (1,087)           |
| Interest rate caps                  |           | 183                                 |           | 183               |
| <b>Total</b>                        | <b>\$</b> | <b>\$ 573,680</b>                   | <b>\$</b> | <b>\$ 573,680</b> |

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

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

## Note 4 Debt Securities

At September 30, 2011, the Company had AAA-rated CMBS with an aggregate face value of \$566,165. Securities available-for-sale with an aggregate face amount of \$311,486 were pledged to secure its borrowings under the Term Asset-Backed Securities Loan Facility (the "TALF") program administered by the Federal Reserve Bank of New York and securities at estimated fair value with an aggregate face amount of \$254,679 were pledged to secure borrowings under the Company's master repurchase agreement with Wells Fargo Bank, N.A. (the "Wells Facility").

The amortized cost and estimated fair value of the Company's debt securities at September 30, 2011 are summarized as follows:

| Security Description                | Face Amount       | Amortized Cost    | Gross           |                   | Estimated Fair Value |
|-------------------------------------|-------------------|-------------------|-----------------|-------------------|----------------------|
|                                     |                   |                   | Unrealized Gain | Unrealized Loss   |                      |
| AAA-rated CMBS (Available-for-Sale) | \$ 311,486        | \$ 315,580        | \$ 817          | \$ (330)          | \$ 316,067           |
| AAA-rated CMBS (Fair Value Option)  | 254,679           | 260,401           |                 | (1,884)           | 258,517              |
| <b>Total</b>                        | <b>\$ 566,165</b> | <b>\$ 575,981</b> | <b>\$ 817</b>   | <b>\$ (2,214)</b> | <b>\$ 574,584</b>    |

The unrealized loss related to the available-for-sale securities results from the fair value of the securities falling below the amortized cost basis. These unrealized losses are primarily the result of market factors other than credit impairment and the Company believes the carrying value of the securities are fully recoverable over their expected holding period. Management does not intend to sell or expect to be forced to sell the securities prior to the Company recovering the amortized cost. Additionally, all unrealized losses on securities available-for-sale at September 30, 2011 have existed for less than twelve months. As such, management does not believe any of the securities are other than temporarily impaired.



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

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

The overall statistics for the Company's CMBS investments calculated on a weighted average basis assuming no early prepayments or defaults as of September 30, 2011 are as follows:

|                       |           |
|-----------------------|-----------|
| Credit Ratings *      | AAA       |
| Coupon                | 5.6%      |
| Yield                 | 4.2%      |
| Weighted Average Life | 1.3 years |

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

The percentage vintage, property type, and location of the collateral securing the Company's CMBS investments calculated on a weighted average basis as of September 30, 2011 and December 31, 2010 are as follows:

| Vintage      | September 30, 2011 | December 31, 2010 |
|--------------|--------------------|-------------------|
| 2006         | 9%                 | 10%               |
| 2007         | 91                 | 90                |
| <b>Total</b> | <b>100%</b>        | <b>100%</b>       |

| Property Type | September 30, 2011 | December 31, 2010 |
|---------------|--------------------|-------------------|
| Office        | 35.9%              | 36.7%             |
| Retail        | 26.7               | 26.6              |
| Multifamily   | 13.3               | 13.1              |
| Hotel         | 10.7               | 10.9              |
| Other *       | 13.4               | 12.7              |
| <b>Total</b>  | <b>100%</b>        | <b>100%</b>       |

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

| Location        | September 30, 2011 | December 31, 2010 |
|-----------------|--------------------|-------------------|
| South Atlantic  | 23.4%              | 23.7%             |
| Middle Atlantic | 21.5               | 21.1              |

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|         |      |      |
|---------|------|------|
| Pacific | 20.9 | 21.0 |
| Other * | 34.2 | 34.2 |
| Total   | 100% | 100% |

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

**Table of Contents****Note 5 Commercial Mortgage Loans**

The Company's commercial mortgage loan portfolio is comprised of the following at September 30, 2011:

| Description                          | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon       | Amortization Schedule | Property Size  | Appraised Loan-to-Value * |
|--------------------------------------|--------------------|---------------|----------------------|---------------------|--------------|-----------------------|----------------|---------------------------|
| Hotel - NY, NY                       | Jan-10             | Feb-15        | \$ 32,000            | \$ 31,855           | 8.25%        | 30 year               | 151 rooms      | 40%                       |
| Office Condo (Headquarters) - NY, NY | Feb-10             | Feb-15        | 28,000               | 27,701              | 8.00         | 30 year               | 73,419 sq. ft. | 54%                       |
| Hotel - Silver Spring, MD            | Mar-10             | Apr-15        | 26,000               | 25,636              | 9.00         | 25 year               | 263 rooms      | 58%                       |
| Hotel - NY, NY                       | Aug-10             | Aug-12        | 24,000               | 24,000              | 8.00         | Interest only         | 155 rooms      | 40%                       |
| <b>Total</b>                         |                    |               | <b>\$ 110,000</b>    | <b>\$ 109,192</b>   | <b>8.31%</b> |                       |                |                           |

\* Appraised loan-to-value ( LTV ) represents the LTV as of the date of investment for all loans except the \$32,000 New York, NY hotel loan. The LTV for the \$32,000 New York, N.Y. hotel loan is as of March 2011.

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

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

| Description                          | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon       | Amortization Schedule | Property Size  | Appraised Loan-to-Value * |
|--------------------------------------|--------------------|---------------|----------------------|---------------------|--------------|-----------------------|----------------|---------------------------|
| Hotel - NY, NY                       | Jan-10             | Feb-15        | \$ 32,000            | \$ 32,000           | 8.25%        | 30 year               | 151 rooms      | 55%                       |
| Office Condo (Headquarters) - NY, NY | Feb-10             | Feb-15        | 28,000               | 27,859              | 8.00         | 30 year               | 73,419 sq. ft. | 54%                       |
| Hotel - Silver Spring, MD            | Mar-10             | Apr-15        | 26,000               | 25,836              | 9.00         | 25 year               | 263 rooms      | 58%                       |
| Hotel - NY, NY                       | Aug-10             | Aug-12        | 24,000               | 24,000              | 8.00         | Interest only         | 155 rooms      | 40%                       |
| <b>Total</b>                         |                    |               | <b>\$ 110,000</b>    | <b>\$ 109,695</b>   | <b>8.31%</b> |                       |                |                           |

\* Appraised LTV represents the LTV as of the date of investment.

The Company evaluates its loans for possible impairment on a quarterly basis. The Company regularly evaluates the extent and impact of any credit migration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower/sponsor on a loan by loan basis. Specifically, a property's operating results and any cash reserves are analyzed and used to assess (i) whether cash from operations are sufficient to cover the debt service requirements currently and into the future, (ii) the ability of the borrower to refinance the loan, and/or (iii) the property's liquidation value. The Company also evaluates the financial wherewithal of any loan guarantors as well as the borrower's competency in managing and operating the properties. In addition, the Company considers the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. Such loan loss analyses are completed and reviewed by asset management and finance personnel, who utilize various data sources, including (i) periodic financial data such as debt service coverage ratio, property occupancy, tenant profile, rental rates, operating expenses, the borrower's exit plan, and capitalization and discount rates, (ii) site inspections, and (iii) current credit spreads and discussions with market participants. An allowance for loan loss is established when it is deemed probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan. The Company has determined that an allowance for loan losses was not necessary at September 30, 2011 and December 31, 2010.





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### Note 6 Subordinate Loans

The Company's subordinate loan portfolio is comprised of the following at September 30, 2011:

| Description                    | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Appraised Loan-to-Value (1) |
|--------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|-----------------------------|
| Senior Mezz - Retail - Various | Dec-09             | Dec-19        | \$ 30,000            | \$ 30,000           | 12.24% | Interest only (2)     | 69%                         |
| Junior Mezz - Retail - Various | Dec-09             | Dec-19        | 20,000               | 20,000              | 14.00  | Interest only (2)     | 74%                         |
| Office - Michigan              | May-10             | Jun-20        | 9,000                | 8,960               | 13.00  | 25 year               | 70%                         |
| Ski Resort - California        | Apr-11             | May-17        | 40,000               | 40,000              | 13.25  | Interest only (2)     | 64%                         |
| Hotel Portfolio - New York (3) | Aug-11             | July-13       | 25,000               | 25,000              | 11.49  | Interest only (4)     | 60%                         |
| Total                          |                    |               | \$ 124,000           | \$ 123,960          | 12.75% |                       |                             |

- (1) Appraised LTV represents the LTV as of the date of investment.
  - (2) Prepayments are prohibited prior to the third year of the loan and any prepayments thereafter are subject to prepayment penalties ranging from 5% to 0%.
  - (3) Includes a LIBOR floor of 1% and three one-year extension options subject to certain conditions.
  - (4) Prepayments are prohibited prior February 2013 and any prepayments thereafter are subject to spread maintenance premiums.
- The Company's subordinate loan portfolio is comprised of the following at December 31, 2010:

| Description                    | Date of Investment | Maturity Date | Original Face Amount | Current Face Amount | Coupon | Amortization Schedule | Appraised Loan-to-Value (1) |
|--------------------------------|--------------------|---------------|----------------------|---------------------|--------|-----------------------|-----------------------------|
| Senior Mezz - Retail - Various | Dec-09             | Dec-19        | \$ 30,000            | \$ 30,000           | 12.24% | Interest only (2)     | 69%                         |
| Junior Mezz - Retail - Various | Dec-09             | Dec-19        | 20,000               | 20,000              | 14.00  | Interest only (2)     | 74%                         |
| Office - Troy, MI              | May-10             | Jun-20        | 9,000                | 8,985               | 13.00  | 25 year               | 70%                         |
| Total                          |                    |               | \$ 59,000            | \$ 58,985           | 12.95% |                       |                             |

- (1) Appraised LTV represents the LTV as of the date of investment.
- (2) Prepayments are prohibited prior to the third year of the loan and any prepayments thereafter are subject to prepayment penalties ranging from 5% to 0%.

The Company evaluates its loans for possible impairment on a quarterly basis. See Note 5 Commercial Mortgage Loans for a summary of the metrics reviewed. The Company has determined that an allowance for loan loss was not necessary at September 30, 2011 and December 31, 2010.

### Note 7 Repurchase Agreement

During March 2011, the Company closed on a \$47,439 investment structured in the form of a repurchase facility secured by a Class A-2 CDO bond. The first draw under the repurchase facility totaled \$41,418 and occurred on March 28, 2011. During April 2011, the Company funded an additional \$6,021. The additional funding results in the total balance of the Company's investment in the repurchase facility being \$47,439.

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

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subject to a make-whole provision at the full 13.0% interest rate.

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

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### Note 8 Borrowings

At September 30, 2011, the Company's borrowings had the following weighted average maturities and interest rates:

|                              | Debt<br>Balance | Weighted<br>Average<br>Remaining<br>Maturity | Weighted<br>Average<br>Rate |               |
|------------------------------|-----------------|--|-----------------------------|---------------|
| TALF borrowings              | \$ 264,101      | 1.5 years                                    | 2.8%                        | Fixed         |
| Wells Facility borrowings    | 227,791         | 1.8 years*                                   | 1.5%                        | **            |
| JPMorgan Facility borrowings | 69,014          | 1.2 years*                                   | 3.2%                        | Libor+300 bps |
| Total borrowings             | \$ 560,906      | 1.6 years                                    | 2.3%                        |               |

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

\*\* The fully hedged interest rate for borrowings outstanding under the Wells Facility was 2.2% at September 30, 2011. See Note 9 Derivative Instruments for further discussion of the Company's interest rate hedging agreements.

At September 30, 2011, the Company's borrowings had the following remaining maturities:

|                                | Less<br>than 1<br>year | 1 to 3<br>years | 3 to 5<br>years | More<br>than 5<br>years | Total      |
|--------------------------------|------------------------|-----------------|-----------------|-------------------------|------------|
| TALF borrowings                | \$ 175,502             | \$ 88,599       | \$              | \$                      | \$ 264,101 |
| Wells Facility borrowings *    | 145,930                | 81,861          |                 |                         | 227,791    |
| JPMorgan Facility borrowings * | 15,877                 | 53,137          |                 |                         | 69,014     |
| Total                          | \$ 337,309             | \$ 223,597      | \$              | \$                      | \$ 560,906 |

\* Assumes extension options on Wells and JPMorgan Facilities are exercised.

The Company's collateralized financings consist of TALF borrowings and borrowings under the Company's master repurchase facility entered into with JPMorgan Chase Bank, N.A. (the "JPMorgan Facility") and Wells Facility. The table below summarizes the outstanding balances at September 30, 2011 as well as the maximum and average balances for the nine months ended September 30, 2011.

|                              | Outstanding Balance<br>at<br>September 30,<br>2011 | For the nine months ended September 30, 2011 |                              |
|------------------------------|--|--|------------------------------|
|                              |  | Maximum Month-End<br>Balance                 | Average Month-End<br>Balance |
| TALF borrowings              | \$ 264,101   | \$ 297,334                                   | \$ 283,814                   |
| Wells Facility borrowings    | 227,791  | 242,728                                      | 236,552                      |
| JPMorgan Facility borrowings | 69,014   | 69,014                                       | 47,290                       |
| Total                        | \$ 560,906   |  |                              |

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The Company borrowed under the TALF program during the period from December 2009 through March 2010 to finance the acquisition of AAA-rated CMBS. Subsequent to March 2010, TALF borrowings have declined consistent with paydowns in the underlying collateral.

The Company entered into the Wells Facility in August 2010 and deployed \$39,670 of equity, borrowing \$242,728, during the period from August 2010 to October 2010 to finance the acquisition of AAA-rated CMBS. Similar to the TALF program, borrowings under the Wells Facility have declined consistent with paydowns in the underlying collateral.

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The Company entered into the JPMorgan Facility in January 2010 to finance the Company's first mortgage loans and AAA-rated CMBS. The Company has borrowed under this facility from time to time as needed to fund the acquisition of additional assets.

The Company's repurchase agreements are subject to certain financial covenants and the Company believes it is in compliance with these covenants at September 30, 2011.

### Note 9 Derivative instruments

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

During 2010, the Company entered into interest rate swaps with an aggregate notional balance of \$242,728 in an effort to hedge floating-rate interest payments due under the Wells Facility. The Company also entered into forward-starting caps to hedge potential extensions of the collateral securing the Wells Facility borrowings. The Company's derivative instruments consist of the following at September 30, 2011 and December 31, 2010:

|                              | Balance Sheet Location | September 30, 2011 |                      | December 31, 2010 |                      |
|------------------------------|------------------------|--------------------|----------------------|-------------------|----------------------|
|                              |                        | Notional Value     | Estimated Fair Value | Notional Value    | Estimated Fair Value |
| Interest rate swaps          | Derivative instruments | \$ 242,520         | \$ (1,087)           | \$ 242,728        | \$ (1,429)           |
| Interest rate caps           | Derivative instruments | 208*               | 183                  | *                 | 1,816                |
| Total derivative instruments |                        |                    | \$ (904)             |                   | \$ 387               |

\* Represents the notional at September 30, 2011 and December 31, 2010 but does not include forward-starting notionals. The Company has agreements with each of its derivative counterparties that contain a provision where if the Company either defaults or is capable of being declared in default on any of its indebtedness, then the Company could also be declared in default on its derivative obligations.

The following table summarizes the amounts recognized on the consolidated statements of operations related to the Company's derivatives for the three and nine months ended September 30, 2011.

|                       | Location of Loss               | Amount of loss recognized in income |                           |                                     |
|-----------------------|--------------------------------|-------------------------------------|---------------------------|-------------------------------------|
|                       |                                | For the three months ended          | For the nine months ended | For the three and nine months ended |
|                       |                                | September 30, 2011                  | September 30, 2011        | September 30, 2010                  |
| Interest rate swaps * | Loss on derivative instruments | \$ (132)                            | \$ (1,046)                | \$ (1,371)                          |
| Interest rate caps    | Loss on derivative instruments | (545)                               | (1,633)                   | 632                                 |
| Total                 |                                | \$ (677)                            | \$ (2,679)                | \$ (739)                            |

\* Includes \$475 and \$1,388 of realized losses for the three and nine months 2011 and \$49 in 2010, respectively

### Note 10 Related Party Transactions

***Management Agreement***

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

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

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

For the three and nine months ended September 30, 2011, respectively, the Company incurred approximately \$1,241 and \$3,430 in base management fees. For the three and nine months ended September 30, 2010, respectively, the Company incurred approximately \$761 and \$2,220 in base management fees. In addition to the base management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company or for certain services provided by the Manager to the Company. For the three and nine months ended September 30, 2011, respectively, the Company recorded expenses totaling \$127 and \$442 related to reimbursements for certain expenses paid by the Manager on behalf of the Company. For the three and nine months ended September 30, 2010, respectively, the Company recorded expenses totaling \$176 and \$2,330 related to reimbursements for certain expenses paid by the Manager on behalf of the Company. Expenses incurred by the Manager and reimbursed by the Company are reflected in the respective consolidated statement of operations expense category or the consolidated balance sheet based on the nature of the item.

Included in payable to related party on the consolidated balance sheet at September 30, 2011 and December 31, 2010, respectively, is approximately \$1,241 and \$683 for base management fees incurred but not yet paid.

### Note 11 Share-Based Payments

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

The Company recognized stock-based compensation expense of \$418 and \$1,154 for the three and nine months ended September 30, 2011, respectively, related to restricted stock and restricted stock unit ("RSU") vesting. The Company recognized stock-based compensation expense of \$339 and \$1,089 for the three and nine months ended September 30, 2010, respectively, related to restricted stock and RSU vesting. The following table summarizes the grants of RSUs during 2011:

| Type  | Date        | Shares<br>Granted | RSUs<br>Granted | Estimate Fair Value<br>on Grant Date | Initial Vesting | Final Vesting |
|-------|-------------|-------------------|-----------------|--------------------------------------|-----------------|---------------|
| Grant | April 2011  | 9,204             |                 | \$ 150                               | April 2011      | April 2014    |
| Grant | April 2011  |                   | 5,000           | 82                                   | April 2011      | April 2014    |
| Grant | August 2011 |                   | 308,750         | 4,586                                | January 2012    | January 2014  |
| Total |             | 9,204             | 313,750         |                                      |                 |               |



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Below is a summary of expected restricted stock and RSU vesting dates as of September 30, 2011.

| Vesting Date | Shares Vesting | RSU Vesting | Total Awards |
|--------------|----------------|-------------|--------------|
| October 2011 | 11,082         | 11,666      | 22,748       |
| January 2012 | 11,083         | 114,583     | 125,666      |
| April 2012   | 11,083         | 11,666      | 22,749       |
| July 2012    | 11,079         | 11,666      | 22,745       |
| October 2012 | 11,082         | 11,668      | 22,750       |
| January 2013 | 1,707          | 103,751     | 105,458      |
| April 2013   | 1,710          | 833         | 2,543        |
| July 2013    | 1,181          | 833         | 2,014        |
| October 2013 | 1,184          | 417         | 1,601        |
| January 2014 | 768            | 103,335     | 104,103      |
| April 2014   | 768            | 416         | 1,184        |
|              | 62,727         | 370,834     | 433,561      |

## Note 12 Stockholders Equity

During July 2011, the Company sold an aggregate of 3,000,000 shares of common stock at a price of \$16.66 per share in a private offering. The shares were first sold to J.P. Morgan Securities LLC, as initial purchaser which purchased the shares for resale to Investors Insurance Corporation and Liberty Life Insurance Company, two affiliated U.S. insurance companies, and received a selling commission of \$0.33 per share, resulting in net proceeds to the Company before offering expenses of \$16.33 per share. The offering price was equal to the Company's June 30, 2011 basic book value per share and represents a premium of approximately 4.65% over the closing price of \$15.92 as of July 25, 2011. The offering closed on July 29, 2011 and generated net proceeds before offering expenses of approximately \$48,980. The investors were known to the Company's management team by virtue of being subsidiaries of a portfolio company of an Apollo fund and separate accounts.

In connection with this offering, the Company also entered into a registration rights agreement, dated July 29, 2011, with J.P. Morgan Securities LLC on behalf of Liberty Life Insurance Company and Investors Insurance Corporation. The Company agreed to indemnify Liberty Life Insurance Company and Investors Insurance Corporation, and each of their respective officers, directors, partners, employees, representatives, agents, and controlling persons, against certain losses, claims, damages, liabilities and expenses, including liabilities under the Securities Act of 1933, as amended (the "Securities Act").

In connection with this offering, our board of directors has created an excepted holder limit of 15% in the aggregate for Investors Insurance Corporation and Liberty Life Insurance Company and certain of their respective specified affiliates.

On August 12, 2011, the Company announced that its board of directors had authorized the repurchase of up to \$35 million shares of its outstanding common stock over a period of one year. The Company effected no repurchases of its shares of common stock pursuant to this program during the period covered by this report.

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

| Declaration Date | Record Date        | Payment Date     | Amount  |
|------------------|--------------------|------------------|---------|
| March 9, 2011    | March 31, 2011     | April 12, 2011   | \$ 0.40 |
| May 10, 2011     | June 30, 2011      | July 12, 2011    | \$ 0.40 |
| August 4, 2011   | September 30, 2011 | October 12, 2011 | \$ 0.40 |

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### Note 13 Commitments and Contingencies

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

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

Pursuant to the agreement with the Manager and the underwriters, the aforementioned Hurdle Rate test is considered met if during a period of four consecutive quarters the Company's Core Earnings exceeds the product of (x) the public offering price per share of the Company's common stock (\$20 per share) multiplied by the number of shares of common stock sold in the IPO and the concurrent private placement (a total of 10,500,000 shares) and (y) 8%.

Until June 30, 2011, the deferred underwriting fee was classified as a contingent liability where payment was probable and the amount estimable, and as such the \$10,000 of deferred underwriting fee was recorded as a contingent liability with a corresponding reduction in additional paid in capital.

As of June 30, 2011, the Company's Core Earnings exceeded the required Hurdle Rate and the Company paid the \$10,000 deferred underwriting fee during the third quarter of 2011.

### Note 14 Fair Value of Financial Instruments

The following table presents the carrying value and estimated fair value of the Company's financial instruments not carried at fair value on the consolidated balance sheet at September 30, 2011 and December 31, 2010:

|  | September 30, 2011 |                      | December 31, 2010 |                      |
|--|--------------------|----------------------|-------------------|----------------------|
|  | Carrying Value     | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| Cash and cash equivalents                              | \$ 44,450          | \$ 44,450            | \$ 37,894         | \$ 37,894            |
| Securities available-for-sale, at estimated fair value | 316,067            | 316,067              | 363,660           | 363,660              |
| Securities, at estimated fair value                    | 258,517            | 258,517              | 279,124           | 279,124              |
| Commercial first mortgage loans                        | 109,192            | 116,764              | 109,695           | 118,096              |
| Subordinate loans                                      | 123,960            | 136,187              | 58,985            | 70,273               |
| Repurchase agreements                                  | 47,439             | 47,436               |                   |                      |
| Derivative instruments, net                            | (904)              | (904)                | 387               | 387                  |
| TALF borrowings  | (264,101)          | (269,981)            | (297,334)         | (302,860)            |
| Borrowings under repurchase agreements                 | (296,805)          | (296,805)            | (242,728)         | (242,728)            |

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

**Table of Contents****Note 15 Net Income per Share**

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

|  | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2011                                | 2010       | 2011                               | 2010       |
| <b>Numerator:</b>  |                                     |            |                                    |            |
| Net income attributable to common stockholders and participating securities for basic and diluted earnings per share                       | \$ 5,512                            | \$ 2,356   | \$ 17,212                          | \$ 7,033   |
| <b>Denominator:</b>  |                                     |            |                                    |            |
| Weighted average common shares outstanding   | 19,647,989                          | 11,330,573 | 18,261,294                         | 10,919,333 |
| Weighted average participating securities  | 318,605                             | 117,552    | 187,906                            | 77,345     |
| Denominator for basic and diluted earnings per share - weighted average common shares outstanding and common stock equivalents outstanding | 19,966,594                          | 11,448,125 | 18,449,200                         | 10,996,678 |
| Basic and diluted net income per weighted average common stock and common stock equivalents  | \$ 0.28                             | \$ 0.21    | \$ 0.93                            | \$ 0.64    |

**Note 16 Subsequent Events**

*Investment activity.* During October 2011, the Company closed a \$25,000 preferred equity interest in a joint venture that owns a mixed-use grocery-anchored retail center in Virginia suburb of Washington DC. The preferred equity is part of a \$135,000 financing comprised of a \$110,000 senior mortgage and the \$25,000 preferred equity financing, both with a term of 3 years with two one-year extension options. The preferred equity is an interest-only fixed rate loan that bears interest at 14.0% (10.0% current pay with a 4.0% accrual) and has an appraised loan-to-value for the preferred equity of approximately 74%. The preferred equity has an IRR, underwritten by our Manager, of approximately 15.0%. See Management's Discussion and Analysis of Financial Condition and Results of Operations Investments for a discussion of how IRR is calculated.

*Dividends.* On November 3, 2011, the Company's board of directors declared a dividend of \$0.40 per share of common stock which is payable on January 12, 2012 to common stockholders of record on December 31, 2011.

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

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

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

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

#### **Overview**

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

The Company is externally managed and advised by ACREFI Management, LLC (the "Manager" ), an indirect subsidiary of Apollo Global Management, LLC, together with its subsidiaries, "Apollo" , a leading global alternative asset manager with a contrarian and value oriented investment approach in private equity, credit-oriented capital markets and real estate. Apollo had total assets under management of \$72 billion as of June 30, 2011.

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

## **Market Overview**

Throughout the first part of 2011, the commercial real estate lending market continued its recovery from the downturn experienced as part of the correction in the global financial markets which began in mid-2007. As evidenced by the re-starting of the CMBS market since early 2010, lenders were starting to return to the market. Since early 2010, approximately \$37 billion of CMBS has been issued in the United States, and while this is significantly less than the \$229 billion that was issued in 2007, it was clear evidence that the lending market for commercial real estate was in the midst of a recovery. However, beginning in July and August 2011, concerns over the global economy resulted in spread widening in the CMBS market and a reduction in the pace of new loans being originated for securitization. At present, we believe the commercial real estate lending market remains in flux. There are a number of active life insurance companies, commercial banks and conduit lenders, but recent volatility and uncertainty in the global markets has slowed the pace of transaction activity.

The Company estimates that from 2012 to 2015, there is in excess of \$1 trillion of commercial real estate debt that is scheduled to mature and this presents a compelling opportunity for the Company to invest capital in its target asset for attractive risk adjusted returns.

While the volume of impending maturities and the need for refinancing is significant, the demand for new capital to refinance maturing commercial mortgage debt continues to be somewhat tapered by the granting of extensions by lenders across the commercial mortgage loan industry. In 2009, the Internal Revenue Service and the Department of the Treasury issued guidance which provided loan servicers with increased flexibility in relation to their ability to modify commercial mortgage loans held by Real Estate Mortgage Investment Conduits, or REMICs, opening the door to previously unavailable loan restructurings, and as a result an increasing number of maturing loans have been extended. Despite this trend, the Company has been able to deploy substantially all capital it has raised in the Company's target assets.

The Company also believes that while the CMBS market has begun to reopen, the supply of capital provided by this market will not approach the levels seen from 2005-2007. The Company believes that lower levels of CMBS issuances will enhance the Company's first mortgage origination business. The Company further believes that any increase in CMBS issuances will likely be at lower loan-to-value ratios and will therefore continue to provide the Company with opportunities to originate mezzanine financings with respect to those parts of the financing capital structure which are unsuitable to be sold as part of CMBS.

## **Critical Accounting Policies**

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

## **Financial Condition and Results of Operations**

### ***Investment Activity***

*Subordinate loans.* During August 2011, the Company closed a \$25,000 junior mezzanine loan secured by a pledge of the equity interests in the borrower that owns three recently opened hotels in New York, New York. The mezzanine loan is part of a \$400,000, five-year financing package split into a \$270,000 first mortgage loan, \$105,000 senior mezzanine loan and \$25,000 junior mezzanine loan. The junior mezzanine loan is an interest-only floating rate loan that bears interest at LIBOR +10.49%, with a 1% LIBOR floor and has an appraised loan-to-value for the junior mezzanine of approximately 60%. The junior mezzanine loan has an IRR, underwritten by our Manager, of approximately 13.5%. See Investments for a discussion of how IRR is calculated.

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### Investments

The following table sets forth certain information regarding the Company's investments at September 30, 2011:

| Description                 | Face Amount | Weighted Average Coupon | Adjusted Purchase Price | Weighted Average Yield | Remaining                     |            | Cost of Funds | Debt Term (years)* | Equity at cost | Weighted Average IRR ** |
|-----------------------------|-------------|-------------------------|-------------------------|------------------------|-------------------------------|------------|---------------|--------------------|----------------|-------------------------|
|                             |             |                         |                         |                        | Weighted Average Life (years) | Debt       |               |                    |                |                         |
| AAA CMBS - TALF borrowings  | \$ 311,486  | 5.6%                    | \$ 315,580              | 4.7%                   | 1.7                           | \$ 264,101 | 2.8%          | 1.6                | \$ 51,479      | 13.4%                   |
| AAA CMBS - Wells Facility   | 254,679     | 5.6                     | 260,401                 | 3.7                    | 1.1                           | 227,791    | 2.2           | 1.9                | 32,610         | 11.7                    |
| Total first mortgages       | 109,192     | 8.3                     | 109,192                 | 8.3                    | 2.9                           | 69,014     | 3.2           | 1.3                | 40,178         | 17.8                    |
| Total subordinate loans     | 123,960     | 12.8                    | 123,960                 | 12.8                   | 6.2                           |            |               |                    | 123,960        | 13.8                    |
| Total repurchase agreements | 47,439      | 13.0                    | 47,439                  | 13.0                   | 1.1                           |            |               |                    | 47,439         | 13.7                    |
| Total                       | \$ 846,756  | 7.4%                    | \$ 856,572              | 6.5%                   | 2.3                           | \$ 560,906 | 2.6%          | 1.7                | \$ 295,666     | 14.0%                   |

\* Assumes extension options on Wells Facility are exercised.

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

### Net Interest Income

Net interest income for the three months and nine months ended September 30, 2011, respectively, increased \$4,735, or 86.1%, and \$13,059, or 90.3%, from the same periods in 2010. The increase is primarily the result of the Company's deployment of the capital raised from its IPO and the follow-on offerings. The following table sets forth certain information regarding the Company's net investment income for the three and nine months ended September 30, 2011 and 2010:

|                           | Three months ended September 30, |          |                 |            | Nine months ended September 30, |           |                 |            |
|---------------------------|----------------------------------|----------|-----------------|------------|---------------------------------|-----------|-----------------|------------|
|                           | 2011                             | 2010     | Change (amount) | Change (%) | 2011                            | 2010      | Change (amount) | Change (%) |
| Interest income from:     |                                  |          |                 |            |                                 |           |                 |            |
| Securities                | \$ 6,316                         | \$ 4,356 | \$ 1,960        | 45.0%      | \$ 19,419                       | \$ 11,643 | \$ 7,776        | 66.8%      |
| Commercial mortgage loans | 2,276                            | 2,123    | 153             | 7.2%       | 6,886                           | 4,723     | 2,163           | 45.8%      |
| Subordinate loans         | 3,784                            | 1,952    | 1,832           | 93.9%      | 8,861                           | 5,386     | 3,475           | 64.5%      |
| Repurchase agreements     | 1,576                            |          | 1,576           | n/a        | 3,188                           |           | 3,188           | n/a        |
| Interest expense          | (3,716)                          | (2,930)  | (786)           | 26.8%      | (10,836)                        | (7,293)   | (3,543)         | 48.6%      |
| Net interest income       | \$ 10,236                        | \$ 5,501 | \$ 4,735        | 86.1%      | \$ 27,518                       | \$ 14,459 | \$ 13,059       | 90.3%      |



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### Operating Expenses

The following table sets forth the Company's operating expenses for the three and nine months ending September 30, 2011 and 2010.

|                                    | Three months ended September 30, |          |                    |               | Nine months ended September 30, |          |                    |               |
|------------------------------------|----------------------------------|----------|--------------------|---------------|---------------------------------|----------|--------------------|---------------|
|                                    | 2011                             | 2010     | Change<br>(amount) | Change<br>(%) | 2011                            | 2010     | Change<br>(amount) | Change<br>(%) |
| General and administrative expense | \$ 879                           | \$ 1,021 | \$ (142)           | (13.9)%       | \$ 2,935                        | \$ 3,059 | \$ (124)           | (4.1)%        |
| Stock-based compensation expense   | 418                              | 339      | 79                 | 23.3%         | 1,154                           | 1,098    | 56                 | 5.1%          |
| Management fee expense             | 1,241                            | 761      | 480                | 63.1%         | 3,430                           | 2,220    | 1,210              | 54.5%         |
| Total operating expense            | \$ 2,538                         | \$ 2,121 | \$ 417             | 19.7%         | \$ 7,519                        | \$ 6,377 | \$ 1,142           | 17.9%         |

Management fee expense for the three and nine months ended September 30, 2011 increased \$480, or 63.1%, and \$1,210, or 54.5%, respectively, from the same periods in 2010. The increase is primarily attributable to the Company's follow-on offerings that were completed in September 2010 and July 2011. Management fees and the relationship between the Company and its Manager are discussed further in Note 10 Related Party Transactions.

Stock-based compensation expense for the three and nine months ended September 30, 2011 increased \$79, or 23.3%, and \$56, or 5.1%, respectively, from the same periods in 2010. The increase is primarily attributable to the grant of 308,750 RSUs during August 2011. Share-based payments are discussed further in Note 11 Share-Based Payments.

### Realized and unrealized gain/loss

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

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

The following amounts related to changes in fair value of the Company's CMBS and derivative instruments are included in the Company's consolidated statement of operations for the three and nine months ended September 30, 2011:

|   | For the three<br>months<br>ended<br>September 30,<br>2011 | For the nine<br>months<br>ended<br>September 30,<br>2011 | For the three and nine<br>months ended<br>September 30,<br>2010 |
|---|---|--|---|
| Unrealized loss on securities             | \$ (1,511)  | \$ (118)   | \$ 286  |
| Unrealized loss on derivative instruments | (202)   | (1,291)  | (690)   |
| Realized loss on derivative instruments   | (475)   | (1,388)  | (49)  |
| Total                                     | \$ (2,188)  | \$ (2,797)   | \$ (453)  |





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### ***Dividends***

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

| Declaration Date | Record Date        | Payment Date     | Amount  |
|------------------|--------------------|------------------|---------|
| March 9, 2011    | March 31, 2011     | April 12, 2011   | \$ 0.40 |
| May 10, 2011     | June 30, 2011      | July 12, 2011    | \$ 0.40 |
| August 4, 2011   | September 30, 2011 | October 12, 2011 | \$ 0.40 |

### ***Subsequent Events***

*Investment activity.* During October 2011, the Company closed a \$25,000 preferred equity interest in a joint venture that owns a mixed-use grocery-anchored retail center in Virginia suburb of Washington DC. The preferred equity is part of a \$135,000 financing comprised of a \$110,000 senior mortgage and the \$25,000 preferred equity financing, both with a term of 3 years with two one-year extension options. The preferred equity is an interest-only fixed rate loan that bears interest at 14.0% (10.0% current pay with a 4.0% accrual) and has an appraised loan-to-value for the preferred equity of approximately 74%. The preferred equity has an IRR, underwritten by our Manager, of approximately 15.0%. See [Investments](#) for a discussion of how IRR is calculated.

*Dividends.* On November 3, 2011, the Company's board of directors declared a dividend of \$0.40 per share of common stock which is payable on January 12, 2012 to common stockholders of record on December 31, 2011.

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### **Liquidity and capital resources**

Liquidity is a measure of the Company's ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain its assets and operations, make distributions to its stockholders and other general business needs. The Company's cash is used to purchase or originate target assets, repay principal and interest on borrowings, make distributions to stockholders and fund operations. The Company's liquidity position is closely monitored and the Company believes it has sufficient current liquidity and access to additional liquidity to meet financial obligations for at least the next 12 months. The Company's primary sources of liquidity are as follows:

#### ***Cash Generated from Offerings***

During July 2011, the Company sold an aggregate of 3,000,000 shares of common stock at a price of \$16.66 per share in a private offering. The shares were first sold to J.P. Morgan Securities LLC, as initial purchaser which purchased the shares for resale to Investors Insurance Corporation and Liberty Life Insurance Company, two affiliated U.S. insurance companies, and received a selling commission of \$0.33 per share, resulting in net proceeds to the Company before offering expenses of \$16.33 per share. The offering price was equal to the Company's June 30, 2011 basic book value per share and represents a premium of approximately 4.65% over the closing price of \$15.92 as of July 25, 2011. The offering closed on July 29, 2011 and generated gross proceeds of approximately \$49,980. Net proceeds before offering expenses were approximately \$48,980. The investors were known to the Company's management team by virtue of being subsidiaries of a portfolio company of an Apollo fund and separate accounts.

In connection with this offering, the Company also entered into a registration rights agreement, dated July 29, 2011, with J.P. Morgan Securities LLC on behalf of Liberty Life Insurance Company and Investors Insurance Corporation. The Company agreed to indemnify Liberty Life Insurance Company and Investors Insurance Corporation, and each of their respective officers, directors, partners, employees, representatives, agents, and controlling persons, against certain losses, claims, damages, liabilities and expenses, including liabilities under the Securities Act.

In connection with this offering, our board of directors has created an excepted holder limit of 15% in the aggregate for Investors Insurance Corporation and Liberty Life Insurance Company and certain of their respective specified affiliates. To date, the Company has raised aggregate equity of approximately \$373,380 through its IPO and concurrent private placement as well as follow-on offerings. Net proceeds (after deducting underwriting fees and expenses) from these offerings were approximately \$353,734.

#### ***Cash Generated from Operations***

Cash from operations is generally comprised of interest income from the Company's investments, net of any associated financing expense, principal repayments from the Company's investments, net of associated financing repayments, proceeds from the sale of investments, and changes in working capital balances. See Financial Condition and Results of Operations - Investments for a summary of interest rates and weighted average lives related to the Company's portfolio at September 30, 2011. While there are no contractual paydowns related to the Company's CMBS, periodic paydowns do occur. Repayments on the debt secured by Company's CMBS occur in conjunction with the paydowns on the collateral pledged.

#### ***Borrowings Under Various Financing Arrangements***

In January 2010, the Company entered into the JPMorgan Facility, pursuant to which the Company may borrow up to \$100,000 in order to finance the origination and acquisition of commercial first mortgage loans and AAA-rated CMBS. Amounts borrowed under the JPMorgan Facility bear interest at a spread of 3.00% over one-month LIBOR with no floor. Advance rates under the JPMorgan Facility typically range from 65%-90% on the estimated fair value of the pledged collateral depending on its loan-to-value. Margin calls will occur any time the outstanding loan balance exceeds the lender's required advance in accordance with agreed upon advance rates by more than \$250. The JPMorgan Facility has a term of one-year, with two one-year extensions available at the

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Company's option and upon the payment of the \$500 extension fee for each one-year extension. During January 2011, the Company exercised the first of the two extension options. The extended maturity date is January 4, 2012 with the ability to extend for an additional 364 days at the Company's option with a payment of the extension fee. The JPMorgan Facility contains, among others, the following restrictive covenants: (1) negative covenants relating to restrictions on the Company's operations which would cease to allow the Company to qualify as a REIT and (2) financial covenants to be met by the Company when the repurchase facility is being utilized, including a minimum consolidated tangible net worth covenant (\$125,000), maximum total debt to consolidated tangible net worth covenant (3:1), a minimum liquidity covenant (the greater of 10% of total consolidated recourse indebtedness and \$12,500 and a minimum net income covenant (\$1 during any four consecutive fiscal quarters). Additionally, beginning on the 91st day following the closing date and depending on the utilization rate of the facility, a portion of the undrawn amount may be subject to non-use fees. Subsequent to September 30, 2010, the non-use fee has been waived by the lender. At September 30, 2011, the Company had \$69,014 of borrowings outstanding under the JPMorgan Facility.

During August 2010, the Company through an indirect wholly-owned subsidiary entered into the Wells Facility pursuant to which the Company may borrow up to \$250,000 in order to finance the acquisition of AAA-rated CMBS. The Wells Facility has a term of one year, with two one-year extensions available at the Company's option, subject to certain restrictions, and upon the payment of an extension fee equal to 25 basis points on the then outstanding balance of the facility for each one-year extension. Advances under the Wells Facility accrue interest at a per annum pricing rate equal to the sum of (i) 30 day LIBOR and (ii) a pricing margin of 1.25%. The purchase price of the CMBS is determined on a per asset basis by applying an advance rate schedule agreed upon by the Company and Wells Fargo. Advance rates under the Wells Facility typically range from 85%-90% on the face amount of the underlying collateral depending weighted average life of the collateral pledged. Margin calls will occur any time the outstanding loan balance exceeds the lender's required advance in accordance with agreed upon advance rates by more than \$250. The Wells Facility contains, among others, the following restrictive covenants: (1) negative covenants intended to restrict the Company from failing to qualify as a REIT and (2) financial covenants to be met by the Company, including a minimum net asset value covenant (which shall not be less than an amount equal to (i) \$100,000, (ii) 75% of the greatest net asset value during the prior calendar quarter, and (iii) 65% of the greatest net asset value during the prior calendar year), a maximum total debt to consolidated tangible net worth covenant (8:1), a minimum liquidity covenant (\$2,500), and a minimum EBITDA to interest expense covenant (1.5:1). The Company has agreed to provide a limited guarantee of up to 15%, or a maximum of \$37,500, of the obligations of its indirect wholly-owned subsidiary under the Wells Facility. At September 30, 2011, the Company had \$227,791 of borrowings outstanding under the Wells Facility secured by AAA-rated CMBS held by the Company.

### ***Other Potential Sources of Financing***

The Company's primary sources of cash currently consist of the \$44,450 of cash available at September 30, 2011, principal and interest the Company receives on its portfolio of assets, as well as available borrowings under the JPMorgan Facility. The Company expects its primary sources of cash to consist of cash generated from operations, and the possible prepayments of principal received on the Company's portfolio of assets. Such prepayments are difficult to estimate in advance. At September 30, 2011, there is also \$30,986 of borrowing capacity under the JPMorgan Facility; however, the Company would need to acquire additional commercial first mortgage loans or AAA-rated CMBS in order to utilize that capacity. Depending on market conditions, such additional borrowings may also include additional repurchase agreements as well as other borrowings such as credit facilities.

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

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

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

### **Leverage policies**

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

**Table of Contents****Contractual obligations and commitments**

The Company's contractual obligations including expected interest payments as of September 30, 2011 are as follows:

|                                | Less<br>than 1<br>year | 1 to 3<br>years | 3 to 5<br>years | More<br>than 5<br>years | Total      |
|--------------------------------|------------------------|-----------------|-----------------|-------------------------|------------|
| TALF borrowings                | \$ 181,059             | \$ 89,441       | \$              | \$                      | \$ 270,500 |
| Wells Facility borrowings*     | 149,812                | 83,190          |                 |                         | 233,002    |
| JPMorgan Facility borrowings** | 18,091                 | 53,575          |                 |                         | 71,666     |
| Total                          | \$ 348,962             | \$ 226,206      | \$              | \$                      | \$ 575,168 |

\* Assumes extension options are exercised and fully-hedged interest rate for interest payments due under the Wells Facility. See below for further discussion.

\*\* Assumes extension options are exercised and current Libor of 0.23% for interest payments due under the JPMorgan Facility. See below for further discussion.

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

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

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

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

**Underwriting Agreement.** As part of the Company's IPO, the underwriters did not receive the underwriting fee (equal to 5% of the gross proceeds raised or \$10,000) directly from the Company. Instead, the Manager paid the



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underwriters \$8,000 and the Company's underwriters agreed to forego the receipt of \$2,000. Under the terms of the underwriting agreement and the Management Agreement, the Company has agreed to pay \$8,000 to the Manager and pay \$2,000 to the underwriters if during any period of four consecutive calendar quarters during the 16 full calendar quarters after the consummation of the IPO the Company's Core Earnings for any such four-quarter period exceeds an 8% performance Hurdle Rate (as described below).

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

Pursuant to an agreement between the Manager and the Company's underwriters, the aforementioned Hurdle Rate test is considered met if during a period of four consecutive quarters occurring during the above measurement period the Company's Core Earnings exceed the product of (x) the public offering price per share of the Company's common stock (\$20 per share) multiplied by the number of shares of common stock sold in the IPO and the concurrent private placement (a total of 10,500,000 shares) and (y) 8%.

Until June 30, 2011, the deferred underwriting fee was classified as a contingent liability where payment was probable and the amount estimable, and as such the \$10,000 of deferred underwriting fee was recorded as a contingent liability with a corresponding reduction in additional paid in capital. As of June 30, 2011, the Company's Core Earnings exceeded the required Hurdle Rate and the Company paid the \$10,000 deferred underwriting fee during the third quarter of 2011.

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

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

### **Dividends**

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

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

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



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### **Credit risk**

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

### **Interest rate risk**

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond the Company's control. The Company is subject to interest rate risk in connection with its target assets and its related financing obligations.

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

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

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

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

All of the Company's TALF borrowings are fixed rate borrowings. At September 30, 2011, the only floating-rate instruments held by the Company are the \$69,014 of borrowings outstanding under the JPMorgan Facility and the \$227,791 of borrowings outstanding under the Wells Facility. At September 30, 2010, the Company also has interest rate swaps and caps with an outstanding notional of \$242,520, resulting in net variable rate debt of \$54,285. A 50 basis point increase in LIBOR would increase the quarterly interest expense related to the \$54,285 in variable rate debt by \$68. Any such hypothetical impact on interest rates on the Company's variable rate borrowings does not consider the effect of any change in overall economic activity that could occur in a rising interest rate environment. Further, in the event of a change in interest rates of that magnitude, the Company may take actions to further mitigate the Company's exposure to such a change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, this analysis assumes no changes in the Company's financial structure.

### **Prepayment risk**

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

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### **Market risk**

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

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

### **Inflation**

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

### **ITEM 4. Controls and Procedures**

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

During the period ended September 30, 2011, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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

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### **PART II OTHER INFORMATION**

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

From time to time, the Company may be involved in various claims and legal actions arising in the ordinary course of business. As of September 30, 2011, the Company is not involved in any legal proceedings.

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

See the Company's Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to the Company's risk factors during the nine months ended September 30, 2011.

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

On July 25, 2011, the Company sold an aggregate of 3,000,000 shares of common stock at a price of \$16.66 per share in a private offering. The shares were first sold to J.P. Morgan Securities LLC, as initial purchaser, which purchased the shares for resale to Investors Insurance Corporation and Liberty Life Insurance Company, two affiliated U.S. insurance companies, and received a selling commission of \$0.33 per share, resulting in net proceeds to the Company before offering expenses of \$16.33 per share. The offering price was equal to the Company's June 30, 2011 basic book value per share and represents a premium of approximately 4.65% over the closing price of \$15.92 as of July 25, 2011. The offering closed on July 29, 2011 and generated gross proceeds of approximately \$49,980. Net proceeds before offering expenses were approximately \$48,980. The investors were known to the Company's management team by virtue of being subsidiaries of a portfolio company of an Apollo fund and separate accounts.

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

On August 12, 2011, the Company announced that its board of directors had authorized the repurchase of up to \$35 million shares of its outstanding common stock over a period of one year. The Company effected no repurchases of its shares of common stock pursuant to this program during the period covered by this report.

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

None.

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

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

None.

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

(a) Exhibits

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 3.1*               | Articles of Amendment and Restatement of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533). |
| 3.2*               | By-laws of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 3.2 of the Registrant's Form S-11, as amended (Registration No. 333-160533).                               |
| 4.1*               | Specimen Stock Certificate of Apollo Commercial Real Estate Finance, Inc., incorporated by reference to Exhibit 4.1 of the Registrant's Form S-11, as amended (Registration No. 333-160533).            |



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|         |  |
|---------|--|
| 10.1    | Purchase Agreement, dated as of July 25, 2011, among Apollo Commercial Real Estate Finance, Inc., ACREFI Management, LLC and J.P. Morgan Securities LLC.                                 |
| 10.2    | Registration Rights Agreement, dated as of July 29, 2011, between Apollo Commercial Real Estate Finance, Inc. and J.P. Morgan Securities LLC on behalf of certain holders named therein. |
| 31.1    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1    | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of 18 U.S.C. Section 1350 as adopted pursuant to the Sarbanes-Oxley Act of 2002.            |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase   |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase  |

\* Incorporated by reference

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APOLLO COMMERCIAL REAL ESTATE FINANCE, INC.

November 4, 2011

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

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

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