Apollo Commercial Real Estate Finance, Inc.
Form 10-Q
November 08, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2012

¨ **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)

Maryland	**27-0467113**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

Apollo Commercial Real Estate Finance, Inc.

c/o Apollo Global Management, LLC

9 West 57th Street, 43rd Floor,

New York, New York 10019

(Address of Registrant s principal executive offices)

(212) 515 3200

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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	x
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 x

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 2, 2012, there were 28,044,106 shares, par value $0.01, of the registrant s common stock issued and outstanding.

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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, 2012	December 31, 2011
Assets:		
Cash	$ 67,994	$ 21,568
Securities available-for-sale, at estimated fair value	81,405	302,543
Securities, at estimated fair value	218,185	251,452
Commercial mortgage loans, held for investment	104,101	109,006
Subordinate loans, held for investment	196,177	149,086
Repurchase agreements, held for investment	10,975	47,439
Principal and interest receivable	4,107	8,075
Deferred financing costs, net	1,090	2,044
Other assets	207	17
Total Assets	$ 684,241	$ 891,230
Liabilities and Stockholders Equity		
Liabilities:		
Borrowings under repurchase agreements	$ 242,970	$ 290,700
TALF borrowings		251,327
Derivative instruments, net	251	478
Accounts payable and accrued expenses	1,965	1,746
Payable to related party	1,520	1,298
Dividends payable	10,114	8,703
Total Liabilities	256,820	554,252
Stockholders Equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized and 3,450,000 shares outstanding in 2012	35	
Common stock, $0.01 par value, 450,000,000 shares authorized, 20,572,112 and 20,561,032 shares issued and outstanding in 2012 and 2011, respectively	206	206
Additional paid-in-capital	422,273	336,209
Retained earnings	4,808	
Accumulated other comprehensive income	99	563
Total Stockholders Equity	427,421	336,978
Total Liabilities and Stockholders Equity	$ 684,241	$ 891,230

See notes to unaudited condensed consolidated financial statements.

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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 September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net interest income:				
Interest income from securities	$ 3,674	$ 6,316	$ 12,227	$ 19,419
Interest income from commercial mortgage loans	2,825	2,276	7,851	6,886
Interest income from subordinate loans	6,144	3,784	17,316	8,861
Interest income from repurchase agreements	2,361	1,576	5,920	3,188
Interest expense	(1,768)	(3,716)	(6,939)	(10,836)
Net interest income	13,236	10,236	36,375	27,518
Operating expenses:				
General and administrative expenses (includes $1,276 and $3,244 of non-cash stock based compensation in 2012 and $418 and $1,154 in 2011, respectively)	(2,430)	(1,297)	(7,229)	(4,089)
Management fees to related party	(1,518)	(1,241)	(4,099)	(3,430)
Total operating expenses	(3,948)	(2,538)	(11,328)	(7,519)
Interest income from cash balances		2	1	10
Realized gain on sale of securities			262	
Unrealized gain (loss) on securities	3,010	(1,511)	6,473	(118)
Loss on derivative instruments (includes $40 and $228 of unrealized gains in 2012 and $202 and $1,291 of unrealized losses in 2011, respectively)	(87)	(677)	(569)	(2,679)
Net income	12,211	5,512	31,214	17,212
Preferred dividends	(1,219)		(1,219)	
Net income available to common stockholders	$ 10,992	$ 5,512	$ 29,995	17,212
Basic and diluted net income per share of common stock	$ 0.52	$ 0.28	$ 1.43	$ 0.93
Basic and diluted weighted average common shares outstanding	20,992,312	19,647,989	20,983,429	18,261,294
Dividend declared per share of common stock	$ 0.40	$ 0.40	$ 1.20	$ 1.20

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 September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net income available to common stockholders	$ 10,992	$ 5,512	$ 29,995	$ 17,212
Change in net unrealized gain (loss) on securities available-for-sale	(876)	(2,355)	(464)	(5,872)
Comprehensive income	$ 10,116	$ 3,157	$ 29,531	$ 11,340

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)

	Preferred Stock		Common Stock				Accumulated Other	
	Shares	Par	Shares	Par	Additional Paid In Capital	Retained Earnings	Comprehensive Income	Total
Balance at January 1, 2012			20,561,032	$ 206	$ 336,209	$	$ 563	$ 336,978
Vesting of restricted stock pursuant to Equity Incentive Plan					3,244			3,244
Issuance of restricted stock			11,080	*				*
Issuance of preferred stock	3,450,000	35			86,215			86,250
Offering costs					(3,395)			(3,395)
Net income						31,214		31,214
Change in net unrealized gain on securities available-for-sale							(464)	(464)
Dividends on preferred stock						(1,219)		(1,219)
Dividends on common stock						(25,187)		(25,187)
Balance at September 30, 2012	3,450,000	$ 35	20,572,112	$ 206	$ 422,273	$ 4,808	$ 99	$ 427,421

* Rounds to zero.

See notes to unaudited condensed consolidated financial statements.

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Apollo Commercial Real Estate Finance, Inc. and Subsidiaries

Condensed Consolidated Statement of Cash Flows (Unaudited)

(in thousands)

	For nine months ended September 30, 2012	For nine months ended September 30, 2011
Cash flows provided by operating activities:		
Net income	$ 31,214	$ 17,212
Adjustments to reconcile net income to net cash provided by operating activities:		
Premium amortization and (discount accretion), net	569	5,876
Amortization of deferred financing costs	1,551	1,088
Restricted stock amortization expense	3,244	1,153
Unrealized gain (loss) on securities	(6,473)	118
Unrealized gain (loss) on derivative instruments	(228)	1,291
Realized gain on sale of security	(262)	
Changes in operating assets and liabilities:		
Accrued principal and interest receivable, less purchased interest	2,608	(3,733)
Other assets	(190)	(82)
Accounts payable and accrued expenses	405	1,064
Payable to related party	222	558
Net cash provided by operating activities	32,660	24,545
Cash flows used in investing activities:		
Proceeds from sale of securities available-for-sale	121,338	
Proceeds from sale of securities at estimated fair value	16,918	
Funding of securities at estimated fair value	(70,676)	
Funding of commercial mortgage loans	(17,883)	(8,800)
Funding of subordinate loans	(46,180)	(64,858)
Funding of repurchase agreements		(47,439)
Principal payments received on securities available-for-sale	99,191	39,666
Principal payments received on securities at estimated fair value	92,009	16,668
Principal payments received on commercial mortgage loans	24,541	9,303
Principal payments received on subordinate loans	26	26
Principal payments received on repurchase agreements	36,464	
Net cash provided by (used in) investing activities	255,748	(55,434)
Cash flows from financing activities:		
Proceeds from issuance of preferred stock	86,250	
Proceeds from issuance of common stock		49,980
Payment of offering costs	(3,083)	(1,692)
Payment of deferred underwriting fee		(10,000)
Repayments of TALF borrowings	(251,327)	(33,233)
Proceeds from repurchase agreement borrowings	313,860	69,014
Repayments of repurchase agreement borrowings	(361,590)	(14,937)
Deferred financing costs	(1,097)	(500)
Dividends on common stock	(24,995)	(21,187)

Net cash provided by (used in) financing activities		(241,982)		37,445
Net decrease in cash and cash equivalents		46,426		6,556
Cash and cash equivalents, beginning of period		21,568		37,894
Cash and cash equivalents, end of period	$	67,994	$	44,450
Supplemental disclosure of cash flow information:				
Interest paid	$	5,872	$	11,099
Supplemental disclosure of non-cash financing activities:				
Dividend declared, not yet paid	$	10,114	$	8,542
Deferred financing costs, not yet paid	$		$	500
Offering costs payable	$	338	$	529

See notes to unaudited condensed consolidated financial statements.

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 primarily originates, acquires, invests in and manages performing commerc first mortgage loans, commercial mortgage-backed securities (CMBS), subordinate 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, 2011, as filed with the Securities and Exchange Commission (the SEC). In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company s financial position, results of operations and cash flows have been included.

The Company currently operates in one business segment.

Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board (the FASB) issued guidance requiring additional disclosure information about offsetting and related arrangements. Entities will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on a basis of GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards (IFRS). The guidance is effective for periods beginning on or after January 1, 2013, and interim periods within those annual periods. While the adoption of this guidance will impact the Company s disclosure, the Company does not believe that the adoption of this guidance will have a significant effect on its consolidated financial statements.

In September 2012, the FASB decided to remove the scope exception for mortgage REITs and require a mortgage REIT that meets the requirements to be an investment company under GAAP to follow investment company guidance. The FASB is currently in the process of redeliberations and will continue to consider feedback received on this Exposure Draft. The Company is currently evaluating the potential impact that the proposal would have on the Company s consolidated financial statements. This exposure draft is not related to, nor does it impact the Company s exemption from registering as an Investment Company under the 1940 Act.

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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 the Company s securities are based on observable market parameters and are classified as Level II 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 II in the fair value hierarchy.

The following table summarizes the levels in the fair value hierarchy into which the Company s financial instruments were categorized as of September 30, 2012:

	Fair Value as of September 30, 2012			
	Level I	Level II	Level III	Total
CMBS AAA-rated (Available-for-Sale)	$	$ 81,405	$	$ 81,405
CMBS AAA-rated (Fair Value Option)		143,946		143,946
CMBS Hilton (Fair Value Option)		74,239		74,239
Interest rate swaps		(252)		(252)
Interest rate caps		1		1
Total	$	$ 299,339	$	$ 299,339

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The following table summarizes the levels in the fair value hierarchy into which the Company s financial instruments were categorized as of December 31, 2011:

	Fair Value as of December 31, 2011			
	Level I	Level II	Level III	Total
CMBS AAA-rated (Available-for-Sale)	$	$ 302,543	$	$ 302,543
CMBS AAA-rated (Fair Value Option)		251,452		251,452
Interest rate swaps		(666)		(666)
Interest rate caps		188		188
Total	$	$ 553,517	$	$ 553,517

Note 4 Debt Securities

During June 2012, the Company purchased CMBS with a face amount of $74,854 for which the obligors are certain special purpose entities formed in 2010 to hold substantially all of the assets of Hilton Worldwide, Inc. (the Hilton CMBS). The Hilton CMBS has a current interest rate of one-month LIBOR+1.75% which increases to LIBOR+2.30% on November 12, 2012, LIBOR+3.30% on November 12, 2013 and LIBOR+3.80% on November 12, 2014. The Hilton CMBS receives principal repayments according to a schedule that is approximately equivalent to a 16-year amortization schedule and has a yield of 5.6%. The Hilton CMBS was purchased for $70,655 and financed with $49,459 of borrowings under the Company s master repurchase agreement with Wells Fargo Bank, N.A. (the Wells Facility), which was amended to provide up to $100,000 of additional financing for the Hilton CMBS. See Note 8 Borrowings for a description of the Wells Facility. The Company has elected the fair value option for the Hilton CMBS.

At September 30, 2012, the Company had AAA-rated CMBS with an aggregate face value of $219,706, which were also pledged to secure borrowings under the Wells Facility.

The amortized cost and estimated fair value of the Company s debt securities at September 30, 2012 are summarized as follows:

Security Description	Face Amount	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
CMBS AAA-rated (Available-for-Sale)	$ 79,435	$ 81,306	$ 296	$ (197)	$ 81,405
CMBS AAA-rated (Fair Value Option)	140,271	142,475	1,648	(177)	143,946
CMBS Hilton (Fair Value Option)	74,054	70,521	3,718		74,239
Total	$ 293,760	$ 294,302	$ 5,662	$ (374)	$ 299,590

The gross 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, 2012 have existed for less than twelve months. As such, management does not believe any of the securities are other than temporarily impaired.

During March 2012, the Company sold CMBS with an amortized cost of $137,423 resulting in a net realized gain of $262, which was comprised of realized gains of $345 and realized losses of $83. The sale generated proceeds of $14,621 after the repayment of $123,064 of borrowings under the Wells Facility.

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

Security Description	Face Amount	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
CMBS AAA-rated (Available-for-Sale)	$ 298,598	$ 301,980	$ 810	$ (247)	$ 302,543
CMBS AAA-rated (Fair Value Option)	248,209	252,736		(1,284)	251,452
Total	$ 546,807	$ 554,716	$ 810	$ (1,531)	$ 553,995

The overall statistics for the Company s AAA-rated CMBS investments calculated on a weighted average basis assuming no early prepayments or defaults as of September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012	December 31, 2011
Credit Ratings *	AAA	AAA
Coupon	5.6%	5.6%
Yield	4.2%	4.3%
Weighted Average Life	2.1 years	1.2 years

* Ratings per Fitch, Moody s or S&P.

The percentage vintage, property type, and location of the collateral securing the Company s AAA-rated CMBS investments calculated on a weighted average basis as of September 30, 2012 and December 31, 2011 are as follows:

Vintage	September 30, 2012	December 31, 2011
2006	3%	7%
2007	97	93
Total	100%	100%

Property Type	September 30, 2012	December 31, 2011
Office	40.5%	36.5%
Retail	23.3	26.6
Multifamily	12.9	13.1
Hotel	10.4	10.8
Other *	12.9	13.0
Total	100%	100%

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

Location	September 30, 2012	December 31, 2011
South Atlantic	22.1%	23.0%

Middle Atlantic	21.3	21.9
Pacific	23.9	21.0
Other *	32.7	34.1
Total	100%	100%

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

Note 5 Commercial Mortgage Loans

The Company s commercial mortgage loan portfolio was comprised of the following at September 30, 2012:

Description	Date of Investment	Maturity Date	Original Face Amount	Current Face Amount	Carrying Value	Coupon	Amortization Schedule	Property Size	Appraised LTV (1)
Hotel - NY, NY	Jan-10	Feb-15	$ 32,000	$ 31,633	$ 31,633	8.25%	30 year	151 rooms	40%
Office Condo (Headquarters) - NY, NY	Feb-10	Feb-15	28,000	27,480	27,480	8.00	30 year	73,419 sq. ft.	53%
Hotel - Silver Spring, MD	Mar-10	Apr-15	26,000	25,351	25,351	9.00	25 year	263 rooms	56%
Mixed Use South Boston, MA (2)	Apr-12	Dec-12	23,844	23,844	19,637	1.98	Interest only	20 acres	28%
Total/Weighted Average			$ 109,844	$ 108,308	$ 104,101	6.98%			

(1) Appraised loan-to-value (LTV) represents the current debt balance (through the Company s last dollar of exposure) as a percentage of the value of the property as of the date of investment for all loans except the New York, NY hotel loan. The value of the property underlying the $32,000 New York, NY hotel loan is as of March 2011.

(2) This loan is a senior sub-participation interest in a $120,000 first mortgage that bears interest at a rate of LIBOR plus 172 basis points and includes a one-year extension option subject to repayment of $33,000 of the entire first mortgage (of which the Company will receive its pro rata portion) and the payment of a 0.50% fee of the outstanding balance of the entire first mortgage.

During April 2012, a $24,000 two-year fixed rate first mortgage loan on a 155-room boutique hotel in midtown Manhattan was repaid. The loan had an interest rate of 8.00%. The Company repaid $15,444 of borrowings under the Company s $100,000 master repurchase facility entered into with JPMorgan Chase Bank, N.A. (the JPMorgan Facility) in conjunction with this repayment.

The Company s commercial mortgage loan portfolio was comprised of the following at December 31, 2011:

Description	Date of Investment	Maturity Date	Original Face Amount	Current Face Amount	Carrying Value	Coupon	Amortization Schedule	Property Size	Appraised LTV *
Hotel - NY, NY	Jan-10	Feb-15	$ 32,000	$ 31,798	$ 31,798	8.25%	30 year	151 rooms	40%
Office Condo (Headquarters) - NY, NY	Feb-10	Feb-15	28,000	27,644	27,644	8.00	30 year	73,419 sq. ft.	53%
Hotel - Silver Spring, MD	Mar-10	Apr-15	26,000	25,564	25,564	9.00	25 year	263 rooms	57%
Hotel NY, NY	Aug-10	Aug-12	24,000	24,000	24,000	8.00	Interest only	155 rooms	40%
Total/Weighted Average			$ 110,000	$ 109,006	$ 109,006	8.31%			

* Appraised LTV represents the current debt balance (through the Company s last dollar of exposure) as a percentage of the value of the property as of the date of investment for all loans except the New York, NY hotel loan. The value of the property underlying the $32,000 New York, NY hotel loan is as of March 2011.

The Company evaluates its loans for possible impairment on a quarterly basis. The Company regularly evaluates the extent and impact of any credit deterioration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower/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

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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, 2012 and December 31, 2011.

Note 6 Subordinate Loans

The Company s subordinate loan portfolio was comprised of the following at September 30, 2012:

Description	Date of Investment	Maturity Date	Original Face Amount	Current Face Amount	Carrying Value	Coupon	Amortization Schedule	Appraised LTV (1)
Senior Mezz - Retail - Various	Dec-09	Dec-19	$ 30,000	$ 30,000	$ 30,000	12.24%	Interest only (2)	68%
Junior Mezz - Retail - Various	Dec-09	Dec-19	20,000	20,000	20,000	14.00	Interest only (2)	72%
Office - Michigan	May-10	Jun-20	9,000	8,923	8,923	13.00	25 year	68%
Ski Resort - California	Apr-11	May-17	40,000	40,000	39,808	14.00	Interest only (3)	56%
Hotel Portfolio New York (4)	Aug-11	July-13	25,000	25,000	25,000	11.49	Interest only (5)	60%
Retail Center Virginia (6)	Oct-11	Oct-14	25,000	25,953	25,953	14.00	Interest only (6)	74%
Hotel New York (7)	Jan-12	Feb-14	15,000	15,000	14,968	12.00	Interest only (7)	63%
Hotel New York (8)	Mar-12	Mar-14	15,000	15,000	15,000	11.50	Interest only (8)	65%
Mixed Use North Carolina	Jul-12	Jul-22	6,525	6,525	6,525	11.10	Interest only	77%
Office Complex - Missouri	Sept-12	Oct-22	10,000	10,000	10,000	11.75	30 year	72%
Total/Weighted Average			$ 195,525	$ 196,401	$ 196,177	12.75%		

(1) Appraised LTV represents the current debt balance (through the Company s last dollar of exposure) as a percentage of the value of the property as of the date of investment.
(2) Prepayments are prohibited prior to the fourth year of the loan and any prepayments thereafter are subject to prepayment penalties ranging from 5% to 1%.
(3) Prepayments are prohibited prior to the third year of the loan and any prepayments thereafter are subject to prepayment penalties ranging from 5% to 1%.
(4) Includes a LIBOR floor of 1% and three one-year extension options subject to certain conditions and the payment of a 0.25% fee for the fourth and fifth year extensions.
(5) Prepayments are prohibited prior to February 2013 and any prepayments thereafter are subject to spread maintenance premiums.
(6) Interest rate of 14.0% includes a 10.0% current payment with a 4.0% accrual. There are two one-year extension options subject to certain conditions.
(7) Includes a 1.00% origination fee, a one-year extension option subject to certain conditions and a 0.50% extension fee as well as a 1.50% exit fee.
(8) Includes a LIBOR floor of 0.50%, two one-year extension options subject to certain conditions and the payment of a 0.50% fee for the second extension.

During June 2012, the Company modified the $40,000 subordinate loan secured by a ski resort in California. The modification was completed in connection with a modification of both the senior and junior loans in order to provide financial covenant relief to the borrower and included the addition of a 0.5% amendment fee and a 1.0% exit fee upon repayment of the loan. In addition, the interest rate on the mezzanine loan was increased by 0.75% to 14% until the earlier of (i) the loan being back in compliance with its original covenants; or (ii) April 2014. As of September 30, 2012, the mezzanine loan was current on its interest payments to the Company. All of the additional remuneration will be recognized over the remaining life of the loan.

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The Company s subordinate loan portfolio was comprised of the following at December 31, 2011:

Description	Date of Investment	Maturity Date	Original Face Amount	Current Face Amount	Coupon	Amortization Schedule	Appraised LTV (1)
Senior Mezz - Retail - Various	Dec-09	Dec-19	$ 30,000	$ 30,000	12.24%	Interest only (2)	68%
Junior Mezz - Retail - Various	Dec-09	Dec-19	20,000	20,000	14.00	Interest only (2)	73%
Office - Michigan	May-10	Jun-20	9,000	8,950	13.00	25 year	69%
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%
Retail Center Virginia (5)	Oct-11	Oct-14	25,000	25,136	14.00	Interest only (5)	74%
Total/Weighted Average			$ 149,000	$ 149,086	13.00%		

(1) Appraised LTV represents the current debt balance (through the Company s last dollar of exposure) as a percentage of the value of the property 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 to February 2013 and any prepayments thereafter are subject to spread maintenance premiums.
(5) Interest rate of 14.0% includes a 10.0% current payment with a 4.0% accrual. There are two one-year extension options subject to certain conditions.

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, 2012 and December 31, 2011.

Note 7 Repurchase Agreement

During 2011, the Company funded a $47,439 investment structured in the form of a repurchase facility secured by a Class A-2 CDO bond. The $47,439 of borrowings provided under the facility financed 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.

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

During the nine months ended September 30, 2012, the Company received $36,464 of principal repayments related to this repurchase agreement as well as $1,817 of make-whole interest payments.

Note 8 Borrowings

At September 30, 2012 and December 31, 2011, the Company s borrowings had the following debt balances, weighted average maturities and interest rates:

	September 30, 2012			December 31, 2011		
	Debt Balance	Weighted Average Remaining	Weighted Average Rate	Debt Balance	Weighted Average Remaining	Weighted Average Rate

		Maturity			Maturity		
Wells Facility borrowings	$ 242,967	1.3 years*	1.6%	$ 221,980	1.6 years*	1.8%	*
JPMorgan Facility borrowings	3	0.3 years	2.7%	68,720	0.9 years	3.3%	**
TALF borrowings			%	251,327	1.3 years	2.8%	Fixed
Total/Weighted Average	$ 242,970	1.3 years	1.9%	$ 542,027	1.3 years	2.5%	

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* Assumes extension options on the Wells Facility with respect to the Hilton CMBS are exercised. See below for a description of the Wells Facility. Borrowings outstanding under the Wells Facility bear interest at a LIBOR plus 125 basis points, 150 basis points or 235 basis points depending on the collateral pledged.

** During April 2012, the Company amended the JPMorgan Facility to reduce the interest rate spread by 50 basis points to LIBOR + 250 basis points.

At September 30, 2012, the Company s borrowings had the following remaining maturities:

	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years	Total
Wells Facility borrowings*	$ 196,275	$ 4,914	$ 41,778	$	$ 242,967
JPMorgan Facility borrowings	3				3
Total	$ 196,278	$ 4,914	$ 41,778	$	$ 242,970

* Assumes extension options on Wells Facility with respect to the Hilton CMBS are exercised. See below for a description of the Wells Facility.

At September 30, 2012, the Company s collateralized financings were comprised of borrowings outstanding under JPMorgan Facility and the Wells Facility. The table below summarizes the outstanding balances at September 30, 2012 as well as the maximum and average balances for the nine months ended September 30, 2012.

	Balance at September 30, 2012	For the nine months ended September 30, 2012	
		Maximum Month-End Balance	Average Month-End Balance
Wells Facility borrowings	$ 242,967	$ 469,147	$ 299,061
JPMorgan Facility borrowings	3	68,720	48,699
TALF borrowings		251,327	25,133
Total	$ 242,970		

The Wells Facility was entered into in August 2010 which 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. In August 2012, the Company exercised the final one-year extension of the term of the Wells Facility and extended the maturity date to August 2013 (except with respect to $100,000 of capacity under the facility to finance the Hilton CMBS described below). During December 2011, the Company, through an indirect wholly-owned subsidiary, entered into an amendment letter related to the Wells Facility to increase its maximum permitted borrowing under the facility from $250,000 to $506,000. The Company utilized the additional capacity under the Wells Facility to refinance all of the Company s outstanding TALF debt during January 2012 at a rate of LIBOR plus 150 basis points.

Prior to the refinancing, the Company had TALF borrowings totaling $250,293 with a weighted average cost of funds of 2.8%. The increased borrowings under the Wells Facility related to this collateral totaled $264,401 and the Company entered into interest rate swap agreements with an initial aggregate notional value of $56,273 to economically hedge a portion of this floating-rate debt. During the nine months ended September 30, 2012, the Company repaid $169,809 of debt under the Wells Facility upon receiving paydowns from the Company s CMBS and $123,064 upon the sale of a portion of the Company s CMBS portfolio.

The Wells Facility was further amended during the second quarter of 2012 to provide an additional $100,000 of financing capacity for the purchase of Hilton CMBS at a rate of LIBOR plus 235 basis points with respect to borrowings secured by the Hilton CMBS. The additional $100,000 of capacity to finance the Hilton CMBS matures in November 2014 and may be extended for an additional year upon the payment of an extension fee equal to 0.50% on the then aggregate outstanding repurchase price for all such assets.

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The Company entered into the JPMorgan Facility in January 2010 to finance the Company s first mortgage loans and investment grade CMBS. During April 2012, the Company amended the JPMorgan Facility to reduce the interest rate spread by 50 basis points to LIBOR + 2.50%. The Company has borrowed under this facility from time to time as needed to fund the acquisition of additional assets. Upon the closing of the Company s 8.625% Series A Cumulative Redeemable Perpetual Preferred Stock (the Series A Preferred Stock) offering August 2012, the Company repaid $53,014 of the Company s outstanding borrowings under the JPMorgan Facility.

The Company s repurchase agreements are subject to certain financial covenants and the Company was in compliance with these covenants at September 30, 2012.

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.

The Company entered into interest rate swaps and forward-starting caps in an effort to economically hedge a portion of its floating-rate interest payments due under the Wells Facility as well as potential extensions of the collateral securing the Wells Facility borrowings. The Company s derivative instruments consist of the following at September 30, 2012 and December 31, 2011:

		September 30, 2012		December 31, 2011	
	Balance Sheet Location	Notional Value	Estimated Fair Value	Notional Value	Estimated Fair Value
Interest rate swaps	Derivative instruments	$ 90,266	$ (252)	$ 241,850	$ (666)
Interest rate caps	Derivative instruments	206,469*	1	26,189*	188
Total derivative instruments			$ (251)		$ (478)

* Represents the notional values at September 30, 2012 and December 31, 2011 but does not include forward-starting notionals.

The Company has an agreement with its derivative counterparty that contains 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, 2012 and 2011.

	Location of Loss Recognized in Income		For the three months ended September 30		For the nine months ended September 30	
			2012	2011	2012	2011
Interest rate swaps	Loss on derivative instruments	realized *	$ (127)	$ (475)	$ (796)	$ (1,388)
Interest rate swaps	Loss on derivative instruments	unrealized	50	343	414	(1,923)
Interest rate caps	Loss on derivative instruments	unrealized	(10)	(545)	(187)	632
Total			$ (87)	$ (677)	$ (569)	$ (2,679)

* Realized losses represent net amounts accrued for the Company s derivative instruments during the period.

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Note 10 Related Party Transactions

Management Agreement

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

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

The current term of the Management Agreement expires on September 29, 2013, and is automatically renewed for successive one-year terms on each anniversary thereafter. The Management Agreement may be terminated upon expiration of the one-year terms only 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. Following a meeting by the Company s independent directors on March 29, 2012 with respect to the Management Agreement, which included a discussion of the Manager s performance and the level of the management fees thereunder, the Company did not provide notice of termination of the Management Agreement to the Manager.

For the three and nine months ended September 30, 2012, respectively, the Company incurred approximately $1,518 and $4,099 in base management fees. For the three and nine months ended September 30, 2011, respectively, the Company incurred approximately $1,241 and $3,430 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, 2012, respectively, the Company recorded expenses totaling $203 and $721 related to reimbursements for certain expenses paid by the Manager on behalf of 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. 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, 2012 and December 31, 2011, respectively, is approximately $1,520 and $1,298 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 (RSUs) and other equity-based awards up to an aggregate of 7.5% of the issued and outstanding shares of the Company s common stock (on a fully diluted basis). The LTIP is administered by the compensation committee of the Company s board of directors (the Compensation Committee) and all grants under the LTIP must be approved by the Compensation Committee.

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The Company recognized stock-based compensation expense of $1,276 and $3,244 for the three and nine months ended September 30, 2012, respectively, related to restricted stock and RSU vesting. 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 RSU vesting. The following table summarizes the grants of RSUs during the nine months ended September 30, 2012:

Type	Date	Shares	RSUs	Estimate Fair Value on Grant Date	Initial Vesting	Final Vesting
Forfeiture*	February 2012		(1,875)	n/a	n/a	n/a
Grant	March 2012		20,000	$ 310	March 2013	March 2015
Grant	April 2012	9,584		$ 150	July 2012	April 2015
Grant	August 2012	1,496		$ 25	July 2013	July 2015
Total		11,080	18,125			

* Represents RSUs forfeited by a former employee of the Manager in connection with such employee s resignation from the Manager.
Below is a summary of expected restricted stock and RSU vesting dates as of September 30, 2012.

Vesting Date	Shares Vesting	RSU Vesting	Total Awards
October 2012	11,883	11,043	22,926
January 2013	2,507	93,749	96,256
March 2013		6,666	6,666
April 2013	2,505	834	3,339
July 2013	3,273	834	4,107
October 2013	1,189	416	1,605
January 2014	1,564	93,335	94,899
March 2014		6,667	6,667
April 2014	1,568	417	1,985
July 2014	2,100		2,100
January 2015	796		796
March 2015		6,667	6,667
April 2015	800		800
July 2015	500		500
	28,685	220,628	249,313

Note 12 Stockholders Equity

Dividends. For 2012, the Company declared the following dividends on its common stock:

Declaration Date	Record Date	Payment Date	Amount
February 28, 2012	March 31, 2012	April 12, 2012	$ 0.40
May 3, 2012	June 29, 2012	July 12, 2012	$ 0.40
August 6, 2012	September 28, 2012	October 12, 2012	$ 0.40

For 2012, the Company declared the following dividends on its Series A Preferred Stock:

Declaration Date	Record Date	Payment Date	Amount
September 13, 2012	September 28, 2012	October 15, 2012	$ 0.4432

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Preferred Offering. On August 1, 2012, the Company completed an underwritten public offering of 3,450,000 shares of its 8.625% Series A Cumulative Redeemable Perpetual Preferred Stock with a liquidation preference of $25.00 per share including 450,000 shares issued pursuant to the underwriters option to purchase additional shares. Net proceeds from the offering, after the underwriting discount and estimated offering expenses payable by the Company, were approximately $83,183.

Note 13 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, 2012 and December 31, 2011:

	September 30, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and cash equivalents	$ 67,994	$ 67,994	$ 21,568	$ 21,568
Commercial first mortgage loans	104,101	111,886	109,006	116,516
Subordinate loans	196,177	200,427	149,086	154,778
Repurchase agreements	10,975	10,975	47,439	47,415
TALF borrowings			(251,327)	(256,171)
Borrowings under repurchase agreements	(242,970)	(242,970)	(290,700)	(290,700)

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. The Company s commercial first mortgage loans, subordinate loans and repurchase agreements are carried at amortized cost on the condensed consolidated financial statements and are classified as Level III in the fair value hierarchy.

Note 14 Net Income per Share

GAAP requires use of the two-class method of computing earnings per share for all periods presented for each class of common stock and participating security as if all earnings for the period had been distributed. Under the two-class method, during periods of net income, the net income is first reduced for dividends declared on all classes of securities to arrive at undistributed earnings. During periods of net losses, the net loss is reduced for dividends declared on participating securities only if the security has the right to participate in the earnings of the entity and an objectively determinable contractual obligation to share in net losses of the entity.

The remaining earnings are allocated to common stockholders and participating securities to the extent that each security shares in earnings as if all of the earnings for the period had been distributed. Each total is then divided by the applicable number of shares to arrive at basic earnings per share. For the diluted earnings, the denominator includes all outstanding common shares and all potential common shares assumed issued if they are dilutive. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of these potential common shares.

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The table below presents basic and diluted net (loss) income per share of common stock using the two-class method for the three and nine months ended September 30, 2012 and 2011:

	For the three months ended September 30 2012	For the three months ended September 30 2011	For the nine months ended September 30 2012	For the nine months ended September 30 2011
Numerator:				
Net income	$ 12,211	$ 5,512	$ 31,214	$ 17,212
Preferred dividends	(1,219)		(1,219)	
Net income available to common stockholders	10,992	5,512	29,995	17,212
Dividends declared on common stock	(8,229)	(8,224)	(24,682)	(22,270)
Dividends on participating securities	(168)	(173)	(505)	(270)
Net income (loss) attributable to common stockholders	$ 2,595	$ (2,885)	$ 4,808	$ (5,328)
Denominator:				
Weighted average shares of common stock outstanding	20,992,312	19,647,989	20,983,429	18,261,294
Basic and diluted net income (loss) per weighted average share of common stock				
Distributable Earnings	$ 0.40	$ 0.42	$ 1.20	$ 1.22
Undistributed income (loss)	0.12	(0.14)	0.23	(0.29)
Basic and diluted net income (loss) per share of common stock	$ 0.52	$ 0.28	$ 1.43	$ 0.93

For the three and nine months ended September 30, 2011, respectively, unvested RSUs of 318,606 and 187,906 were excluded from the calculation of diluted net loss per share because the effect was anti-dilutive.

Note 15 Subsequent Events

Dividends. On November 1, 2012, the Company declared a dividend of $0.40 per share of common stock which is payable on January 14, 2013 to common stockholders of record on December 31, 2012.

Stockholders Equity. On October 9, 2012, the Company completed a follow-on public offering of 7,000,000 shares of its common stock at a price of $16.81 per share. On November 1, 2012, the underwriters partially exercised their option to purchase additional shares of common stock and purchased 404,640 shares of common stock at $16.81 per share. The aggregate net proceeds from the entire offering, including proceeds from the sale of the additional shares, are estimated to be approximately $124,182, after deducting estimated offering expenses payable by the Company.

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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 27A of the Securities Act of 1933, as amended (the Securities Act), and 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 identify 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; operating results and potential asset performance; 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 REIT that primarily originates, acquires, invests in and manages performing commercial first mortgage loans, CMBS, subordinate 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.

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 investment 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 approximately $105 billion as of June 30, 2012.

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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

In the first half of 2012, the commercial real estate lending market continued to slowly recover from the downturn experienced as part of the correction in the global financial markets which began in mid-2007. 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 assets at 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. The Company believes that the significant long-term opportunity still remains for lenders to capitalize on the impending maturity wall despite the fact that the volume of loan modifications has had a meaningful impact on the timing of the maturities and the related opportunity.

Recent action by the Federal Reserve has sent spreads to post-crisis lows and will likely result in a wave of refinancing and new issue during the remainder of 2012 and into the beginning of 2013. In the first nine months of 2012, approximately $31 billion of CMBS was issued in the United States, an increase of approximately 15% over the same period in 2011. In the third quarter alone, approximately $13 billion of CMBS was issued. Since early 2010, approximately $75 billion of CMBS has been issued in the United States. While this is significantly less than the $229 billion that was issued in 2007, it is clear evidence that the lending market for commercial real estate has begun to stabilize and continues to grow.

Despite the recent strength of the CMBS market, the pace of CMBS issuance is still moderate relative to the peak of the market, and lenders still appear to be more focused on stabilized cash flowing assets with lower loan-to-value ratios. This should continue to provide the Company with increased 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, 2011 under Item 7 Management Discussion and Analysis Critical Accounting Policies.

Financial Condition and Results of Operations

(in thousands except share and per share data)

Investment Activity

Commercial mortgage loans. During March 2012, the Company closed a $15,000 mezzanine loan secured by a pledge of the equity interest in a borrower that owns a 226-room hotel in midtown Manhattan. The mezzanine loan is part of a $70,000, four-year (two-year initial term with two one-year extension options) floating-rate whole loan originated on February 15, 2012 to refinance the property. The interest rate on the mezzanine loan is one-month LIBOR+11.00% with a 0.50% LIBOR floor and 0.50% fee for the second extension. The mezzanine loan has been underwritten to generate an IRR of approximately 12.8%. See Investments for a discussion of how IRR is calculated.

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During April 2012, the Company purchased two senior sub-participation interests (an aggregate face of $23,844) in a first mortgage loan (the Loan) with a current balance of $120,000 which is secured by over 20 acres of land in South Boston, Massachusetts. The land is currently used as parking with approximately 3,325 spaces, but the various parcels that comprise the site are entitled for over 5.8 million of buildable square feet. The two senior sub-participation interests have a 27.5% LTV (based on a current appraisal) and a debt yield of 8.2% (based on the Manager s underwritten net operating income for the parking operations).

The aggregate purchase price of the two senior sub-participation interests was $18,599 (including a 3% brokerage fee which will be expensed during the period ending June 30, 2012). The senior sub-participations each have an interest rate of one-month LIBOR + 1.72% and mature in December 2012. Upon the repayment of $33,000 of the Loan (of which the Company will receive its pro-rata share) and the payment of an extension fee equal to 0.50% of the outstanding balance of the Loan, the Loan, including the senior sub participation interests, can be extended through December 2013. Assuming the extension occurs, the senior sub-participation interests have been underwritten to generate an IRR of approximately 21.7%. See Investments for a discussion of how IRR is calculated.

During April 2012, a $24,000 two-year fixed rate first mortgage loan on a 155-room boutique hotel in midtown Manhattan was repaid. The loan had an interest rate of 8.00%. The Company repaid $15,444 of borrowings under the JPMorgan Facility in conjunction with this repayment.

Subordinate loans. During January 2012, the Company closed a $15,000 mezzanine loan secured by a pledge of the equity interests in a borrower that purchased a 165-room hotel in midtown Manhattan. The mezzanine loan is part of a $80,000, three-year (two year initial term with one one-year extension option) financing package split into a $65,000 first mortgage loan and a $15,000 mezzanine loan. The mezzanine loan is an interest-only fixed rate loan that bears interest at 12.00%, with a 1.00% origination fee, a 0.50% extension fee and a 1.50% exit fee. The mezzanine loan has an appraised LTV of approximately 60% and has been underwritten to generate an IRR of approximately 14.0%. See Investments for a discussion of how IRR is calculated.

During June 2012, the Company modified the $40,000 subordinate loan secured by a ski resort in California. The modification was completed in connection with a modification of both the senior and junior loans in order to provide financial covenant relief to the borrower and included the addition of a 0.5% amendment fee and a 1.0% exit fee upon repayment of the loan. In addition, the interest rate on the mezzanine loan was increased by 0.75% to 14% until the earlier of (i) the loan being back in compliance with its original covenants; or (ii) April 2014. As of September 30, 2012, the mezzanine loan was current on its interest payments to the Company. All of the additional remuneration will be recognized over the remaining life of the loan.

During July 2012, the Company closed a $6,525 mezzanine loan secured by a pledge of the equity interest in a borrower that owns a mixed use project, which consists of 55,585 square feet of Class-A retail and 114,476 square feet of Class-A office in Chapel Hill, North Carolina. The mezzanine loan is part of a new $40,000 10-year fixed-rate financing comprised of a $33,475 first mortgage and the $6,525 mezzanine loan. The whole loan amortizes on a 30-year schedule but all amortization is applied to the first mortgage. The mezzanine loan is an interest-only, fixed rate loan that has an interest rate of 11.1%. The mezzanine loan has an appraised LTV of approximately 77% and has been underwritten to generate an IRR of approximately 12%. See Investments for a discussion of how IRR is calculated.

During September 2012, the Company originated a $10,000 mezzanine loan secured by a pledge of the equity interests in a borrower that owns an 845,241 square foot Class A office tower complex in downtown Kansas City, Missouri. The office tower complex is comprised of a 34-story office tower, a 10-story office building, a two story office building, two separate parking garages comprising 2,470 parking spaces and approximately 30,000 square feet of ground-floor retail. The mezzanine loan is part of a $70,000, 10-year fixed-rate financing with 30-year amortization that will be comprised of the mezzanine loan and a $60,000 first mortgage loan. The interest rate on the mezzanine loan is 11.75%. The mezzanine loan has an appraised loan to value of 72% and has been underwritten to generate an IRR of approximately 12.6%. See Investments for a discussion of how IRR is calculated.

AAA-rated CMBS During March 2012, the Company sold AAA-rated CMBS with an amortized cost of $137,423 resulting in net realized gains of $262. The sale generated proceeds of $14,621 after the repayment of $123,064 of debt under the Wells Facility.

Hilton CMBS - During June 2012, the Company purchased CMBS with a face amount of $74,854 for which the obligors are certain special purpose entities formed to hold substantially all of the assets of Hilton Worldwide, Inc. (the Hilton CMBS). The Hilton CMBS has a current interest rate of one-month LIBOR+1.75% which increases to LIBOR+2.30% on November 12, 2012, LIBOR+3.30% on November 12, 2013 and LIBOR+3.80% on November 12, 2014, and an estimated LTV of approximately 35% to 45%. The Hilton CMBS receives principal repayments according to a schedule that is approximately equivalent to a 16-year amortization schedule. The Hilton CMBS was purchased for $70,655 and financed with $49,459 of borrowings under the Wells Facility, which was amended to provide up to $100,000 of additional financing for the Hilton CMBS. This portion of the Wells Facility matures in November 2014 and may be extended for an additional year upon the payment of an extension fee equal to 0.50% on the then aggregate outstanding repurchase price for all such assets.

Investments

The following table sets forth certain information regarding the Company s investments at September 30, 2012:

Description	Face Amount	Amortized Cost	Weighted Average Yield	Remaining Weighted Average Life (years)	Debt	Cost of Funds	Remaining Debt Term (years)*	Equity at cost	Current Weighted Average IRR **	Levered Weighted Average IRR ***
CMBS AAA	$ 219,706	$ 223,781	4.2%	2.1	$ 194,069	1.8%	0.9	$ 29,712	15.6%	15.6%
CMBS - Hilton	74,054	70,521	5.6	3.1	48,898	2.6	3.1	21,623	11.7	11.7
First mortgages	108,308	104,101	11.3	2.1	3	2.7	0.3	104,098	11.3	20.2
Subordinate loans	196,401	196,177	13.2	5.4				196,177	13.9	13.9
Repurchase agreements	10,975	10,975	13.0	1.5				10,975	13.7	13.7
Total	$ 609,444	$ 605,555	8.7%	3.3	$ 242,970	1.9%	1.3	$ 362,585	13.1%	14.9%

* Assumes extension options on Wells Facility with respect to the Hilton CMBS are exercised. See Borrowings under Various Financing Arrangements for a discussion of the Wells Facility.

** 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 dispositions, early prepayments or defaults but assumes extensions as well as the cost of borrowings and derivative instruments 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 The Company may not achieve its targeted internal rate of return on its investments which may lead to future returns that may be significantly lower than anticipated included in the Company s annual report on Form 10-K for the year ended December 31, 2011 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.

*** Substantially all of the Company s borrowings under the JPMorgan Facility were repaid upon the closing of the Company s Series A Preferred Stock offering in August 2012. The Company s ability to achieve its underwritten leveraged weighted average IRR with regard to its portfolio of first mortgage loans is additionally dependent upon the Company reborrowing approximately $53,000 under the JPMorgan Facility or any replacement facility. Without such reborrowing, the leveraged weighted average IRRs will be as indicated in the current weighted average IRR column above.

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Net Interest Income

The following table sets forth certain information regarding the Company s net investment income for the three and nine months ended September 30, 2012 and 2011:

	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Change (amount)	Change (%)	2012	2011	Change (amount)	Change (%)
Interest income from:								
Securities	$ 3,674	$ 6,316	$ (2,642)	41.8%	$ 12,227	$ 19,419	$ (7,192)	(37.0)%
Commercial mortgage loans	2,825	2,276	549	24.1%	7,851	6,886	965	14.0%
Subordinate loans	6,144	3,784	2,360	62.4%	17,316	8,861	8,455	95.4%
Repurchase agreements	2,361	1,576	785	49.8%	5,920	3,188	2,732	85.7%
Interest expense	(1,768)	(3,716)	1,948	(52.4)%	(6,939)	(10,836)	3,897	(36.0)%
Net interest income	$ 13,236	$ 10,236	$ 3,000	29.3%	$ 36,375	$ 27,518	$ 8,857	32.2%

Net interest income for the three and nine months ended September 30, 2012, respectively, increased $3,000, or 29.3%, and $8,857, or 32.2%, from the same periods in 2011. The increase is primarily the result of additional interest income from subordinate loans and repurchase agreements offset by a decline in interest income from securities. The decline in interest from securities for the three and nine months ended September 30, 2012, respectively, of $2,642, or 41.8%, and $7,192, or 37.0%, is attributable to the repayment of these securities as they near maturity. The increase in interest income for the three and nine months ended September 30, 2012, related to subordinate loans and repurchase agreements of $2,360, or 62.4%, and $8,455, or 95.4%, respectively, is primarily attributable to the full deployment of capital raised from the Company s follow-on offering in July 2011 as well as the deployment of additional investable capital generated with the refinancing of the Company s TALF debt. The increase in interest income for the three and nine months ended September 30, 2012, related to repurchase agreements of $785, or 49.8%, and $2,732, or 85.7%, respectively, is primarily attributable to $1,817 of make-whole interest payments received during the nine months ended September 30, 2012.

Interest expense for the three and nine months ended September 30, 2012, respectively, decreased $1,948, or 52.4%, and $3,897, or 36.0%, from the same periods in 2011. The decrease is primarily the result of the refinancing of the Company s TALF debt with borrowings under the Wells Facility as well as the repayment of debt as the related CMBS have been repaid. In addition, the Company repaid substantially all of the borrowings outstanding under the JPMorgan Facility upon the close of the Company s Series A Preferred Stock offering in August 2012.

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Operating Expenses

The following table sets forth the Company s operating expenses for the three and nine months ended September 30, 2012 and 2011.

	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Change (amount)	Change (%)	2012	2011	Change (amount)	Change (%)
General and administrative expense	$ 1,154	$ 879	$ 275	31.3%	$ 3,985	$ 2,935	$ 1,050	35.8%
Stock-based compensation expense	1,276	418	858	205.3%	3,244	1,154	2,090	181.1%
Management fee expense	1,518	1,241	277	22.3%	4,099	3,430	669	19.5%
Total operating expense	$ 3,948	$ 2,538	$ 1,410	55.6%	$ 11,328	$ 7,519	$ 3,809	50.7%

General and administrative expense for the three and nine months ended September 30, 2012, respectively, increased $275, or 31.3%, and $1,050 or 35.8%, from the same periods in 2011. The increase is primarily attributable one-time expenses related to the closing of loans during the three and nine months ended September 30, 2012.

Stock-based compensation expense for the three and nine months ended September 30, 2012, respectively, increased $858, or 205.3%, and $2,090, or 181.1%, from the same periods in 2011. The increase is primarily attributable to the grant of 308,750 RSUs during August 2011 as well as the increase in the price of the Company s stock since the end of 2011. Share-based payments are discussed further in the accompanying consolidated financial statements - Note 11 Share-Based Payments.

Management fee expense for the three and nine months ended September 30, 2012, respectively, increased $277, or 22.3%, and $669, or 19.5%, from the same periods in 2011. The increase is primarily attributable to increases in the Company s stockholders equity (as defined in the Management Agreement) as a result of the Company s follow-on equity offering that was completed in July 2011 and to a lesser extent the Series A Preferred Stock offering that closed in August 2012. Management fees and the relationship between the Company and its Manager are discussed further in the accompanying consolidated financial statements - Note 10 - Related Party Transactions.

Realized and unrealized gain/loss

In order to mitigate interest rate risk resulting from the Company s floating-rate borrowings under the Wells Facility, the Company has entered into interest rate swaps and caps which are intended to economically hedge the a portion of its floating-rate borrowings through the expected maturity of the underlying collateral as well as the potential extension of the underlying collateral.

The Company has elected not to pursue hedge accounting for these derivative instruments and records the change in estimated fair value related to these interest rate agreements in earnings. The Company also elected to record the change in estimated fair value related to certain CMBS securing the Wells Facility in earnings by electing the fair value option. These elections allow the Company to align the change in the estimated fair value of the Wells Facility collateral and related interest rate derivatives without having to apply complex hedge accounting provisions.

During March 2012, the Company sold CMBS with an amortized cost of $137,423 resulting in net realized gains of $262. The sale generated proceeds of $14,621 after the repayment of $123,064 of debt under the Wells Facility.

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The following amounts related to realized and unrealized gains (losses) on the Company s CMBS and derivative instruments are included in the Company s consolidated statement of operations for three and nine months ended September 30, 2012 and 2011:

	Location of Gain (Loss) Recognized in Income	For the three months ended September 30, 2012	For the three months ended September 30, 2011	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011
Securities	Realized gain on sale of securities	$	$	$ 262	$
Securities	Unrealized gain (loss) on securities	3,010	(1,511)	6,473	(118)
Interest rate swaps	Loss on derivative instruments realized *	(127)	(475)	(796)	(1,388)
Interest rate swaps	Loss on derivative instruments unrealized	50	343	414	(1,923)
Interest rate caps	Loss on derivative instruments unrealized	(10)	(545)	(187)	632
Total		$ 2,923	$ (2,188)	$ 6,166	$ (2,797)

* Realized losses represent net amounts expensed related to the exchange of fixed and floating rate cash flows for the Company s derivative instruments during the period.

Dividends

For 2012, the Company declared the following dividends:

Declaration Date	Record Date	Payment Date	Amount
February 28, 2012	March 31, 2012	April 12, 2012	$ 0.40
May 3, 2012	June 29, 2012	July 12, 2012	$ 0.40
August 6, 2012	September 28, 2012	October 12, 2012	$ 0.40

For 2012, the Company declared the following dividends on its Series A Preferred Stock:

Declaration Date	Record Date	Payment Date	Amount
September 13, 2012	September 28, 2012	October 15, 2012	$ 0.4432

Subsequent Events

Dividends. On November 1, 2012, the Company declared a dividend of $0.40 per share of common stock which is payable on January 14, 2013 to common stockholders of record on December 31, 2012.

Stockholders Equity. On October 9, 2012, the Company completed a follow-on public offering of 7,000,000 shares of its common stock at a price of $16.81 per share. On November 1, 2012, the underwriters partially exercised their option to purchase additional shares of common stock and purchased 404,640 shares of common stock at $16.81 per share. The aggregate net proceeds from the entire offering, including proceeds from the sale of the additional shares, are estimated to be approximately $124,182, after deducting estimated offering expenses payable by the Company.

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 twelve months. The Company s primary sources of short-term and long-term liquidity are as follows:

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 investment portfolio at September 30, 2012. While there are no contractual paydowns related to the Company s CMBS, periodic paydowns do occur. Repayments on the debt secured by the 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 investment grade CMBS. Prior to April 2012, amounts borrowed under the JPMorgan Facility accrued interest at a spread of 3.00% over one-month LIBOR with no floor. During April 2012, the Company amended the JPMorgan Facility to reduce the interest rate spread by 50 basis points to LIBOR + 2.50%. Advance rates under the JPMorgan Facility typically range from 65% to 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 Company s option and upon the payment of the $500 extension fee for each one-year extension. During January 2012, the Company exercised the second of the two extension options. The extended maturity date is January 4, 2013. The Company is focused on the upcoming maturity date of the JPMorgan Facility and is in early stage discussions with JPMorgan Chase Bank, N.A. and other potential lenders to extend or replace this facility. There is no assurance that this facility can be renewed on acceptable terms. 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. The Company repaid substantially all of the borrowings outstanding under the JPMorgan Facility upon the closing of the Company s Series A Preferred Stock offering in August 2012 and had $3 of borrowings outstanding under the JPMorgan Facility at September 30, 2012. The Company anticipates reborrowing under the JP Morgan Facility as additional capital is deployed. The Company s ability to achieve its underwritten levered weighted average IRRs discussed above under Investments, depends upon the Company reborrowing approximately $53,000 under the JPMorgan Facility or any replacement 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 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. In August 2012, the Company exercised the final one-year extension of the term of the Wells Facility and extended the maturity date to August 2013 (except with respect to $100,000 of capacity under the facility to finance the Hilton CMBS described below). 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% to 90% on the face amount of the underlying collateral depending on the 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.

During December 2011, the Company, through an indirect wholly-owned subsidiary entered into an amendment letter (the Amendment Letter) related to the Wells Facility to increase its maximum permitted borrowing under the facility from $250,000 to $506,000 in order to pay down its TALF borrowings and to finance the CMBS that had been financed under the TALF program. The Amendment Letter additionally adjusts the pricing margin for all assets financed under the Wells Facility occurring after December 22, 2011 from 1.25% to 1.50%, and adds a minimum liquidity covenant, requiring the Company to maintain at all times an amount in Repo Liquidity (as generally defined under the Wells Facility to include all amounts held in the collection account established under the Facility for the benefit of Wells Fargo Bank, N.A., cash, cash equivalents, super-senior CMBS rated AAA by at least two rating agencies, and total amounts immediately and unconditionally available on an unrestricted basis under all outstanding capital commitments, subscription facilities and secured revolving credit or repurchase facilities) no less than the greater of 10% of total consolidated recourse indebtedness of the Company and $12,500. Advances under the Wells Facility accrue interest at a per annum pricing rate equal to the sum of (i) 30 day LIBOR and (ii) the applicable pricing margin.

The Company refinanced its TALF borrowings with borrowings under the Wells Facility during January 2012 and subsequently sold a portion of the CMBS securing the Wells Facility borrowings and repaid the related borrowings during March 2012.

The Wells Facility was further amended during the second quarter of 2012 to provide an additional $100,000 of financing capacity for the purchase of Hilton CMBS as a rate of LIBOR plus 235 basis points. This portion of the Wells Facility matures in November 2014 and may be extended for an additional year upon the payment of an extension fee equal to 0.50% on the then aggregate outstanding repurchase price for all such assets.

At September 30, 2012, the Company had $242,967 of borrowings outstanding under the Wells Facility secured by AAA-rated CMBS held by the Company.

Cash Generated from Offerings

As of September 30, 2012, the Company has raised gross proceeds of approximately $377,052 through its IPO and concurrent private placement as well as follow-on common stock offerings. Net proceeds (after deducting underwriting fees and expenses) from these offerings were approximately $357,090.

On August 1, 2012, the Company completed an underwritten public offering of 3,450,000 shares of its 8.625% Series A Cumulative Redeemable Perpetual Preferred Stock with a liquidation preference of $25.00 per share, including 450,000 shares issued pursuant to the underwriters option to purchase additional shares. Net proceeds from the offering, after the underwriting discount and estimated offering expenses payable by the Company, were approximately $83,074.

Other Potential Sources of Financing

The Company s primary sources of cash currently consist of the $67,994 of cash available at September 30, 2012, principal and interest the Company receives on its portfolio of assets as well as available borrowings under the JPMorgan Facility and Wells Facility. The Company expects its other 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, 2012, substantially all of the $100,000 of borrowing capacity under the JPMorgan Facility was available; however, the Company would need to acquire additional commercial first mortgage loans or investment grade CMBS in order to utilize all of that capacity. Depending on market conditions the Company may utilize additional borrowings as a source of cash, which borrowings may also include additional repurchase agreements as well as other borrowings such as credit facilities.

The Company maintains policies 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 indebtedness.

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.

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 Wells Facility and the 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 its target assets will be in an amount that is approximately 35% of the value of its total loan portfolio.

Contractual obligations and commitments

The Company s contractual obligations including expected interest payments as of September 30, 2012 are summarized as follows:

	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years	Total
Wells Facility borrowings*	$ 199,900	$ 7,254	$ 41,962	$	$ 249,116
JPMorgan Facility borrowings**	3				3
Total	$ 199,903	$ 7,254	$ 41,962	$	$ 249,119

* Assumes extension options with respect to the Hilton CMBS are exercised. Interest payments include the cost of borrowings as well as derivative instruments for interest payments due under the Wells Facility. See Borrowings Under Various Financing Arrangements above for further discussion.

** Assumes current LIBOR of 0.24% for interest payments due under the JPMorgan Facility. See Borrowings Under Various Financing Arrangements above for further discussion.

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

On September 23, 2009, the Company entered into 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 current term of the Management Agreement expires on September 29, 2013 and is automatically renewed for successive one-year terms on each anniversary thereafter. The Management Agreement may be terminated upon expiration of the one-year terms only upon the affirmative vote of at least two-thirds of the Company s independent

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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. Following a meeting by the Company s independent directors on March 29, 2012 with respect to the Management Agreement, which included a discussion of the Manager s performance and the level of the management fees thereunder, the Company did not provide notice of termination of the Management Agreement to the Manager.

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.

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ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

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

Credit risk

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

Interest rate risk

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

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

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

At September 30, 2012, all of the Company s borrowings under repurchase agreements are floating-rate borrowings. The Company also has interest rate swaps with an outstanding notional amount of $90,266 and floating rate subordinate loans with a face amount of $23,844, resulting in net variable rate exposure of $128,860. A 50 basis point increase in LIBOR would increase the quarterly interest expense related to the $128,860 in variable rate exposure by $161. Any such hypothetical impact on interest rates on the Company s variable rate borrowings does not consider the effect of any change in overall economic activity that could occur in a rising interest rate environment. Further, in the event of a change in interest rates of that magnitude, the Company may take actions to further mitigate the Company s exposure to such a change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, this analysis assumes no changes in the Company s financial structure.

Prepayment risk

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

Market risk

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

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

Inflation

Virtually all of the Company s assets and liabilities will be interest rate sensitive in nature. As a result, interest rates and other factors influence the Company s performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. The Company s financial statements are prepared in accordance with GAAP and distributions are declared in order to distribute 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 Exchange Act, and the rules and regulations promulgated thereunder.

During the period ended September 30, 2012, 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, 2012, the Company was not involved in any material legal proceedings.

ITEM 1A. Risk Factors

There are no material changes to the risk factors previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, with the exception of the risk factor below.

Regulation as a commodity pool operator could subject the Company to additional regulation and compliance requirements which could materially adversely affect its business and financial condition.

The Dodd-Frank Act extended the reach of commodity regulations for the first time to include not just traditional futures contracts but also derivative contracts commonly referred to as swaps and caps. As a consequence of this change, any investment fund that trades in swaps or caps may be considered a commodity pool, which would cause its operator to be regulated as a commodity pool operator (CPO). The new requirements, which become effective on December 31, 2012 for those who become CPOs solely because of the use of swaps by the relevant commodity pool, obligate CPOs to register with the National Futures Association (the NFA), comply with NFA rules, and become regulated by the U.S. Commodity Futures Trading Commission (the CFTC), including with respect to disclosure and reporting.

Based on previous interpretations issued by the CFTC staff relating to entities that used traditional futures contracts in a limited manner and as an incidental part of their businesses, the Company intends to seek a no-action letter from the staff of the CFTC stating that neither the Manager nor its directors should be required to register as commodity pool operators and should not be subject to CPO regulation and compliance. In the event that the Company is unable to obtain the no action letter or if appropriate alternative guidance is not provided, including by the CFTC or its staff, the Company may be required to reduce or eliminate its use of interest rate swaps and/or caps or vary the manner it deploys interest rate swaps and/or caps in its business. Alternatively, the Manager or directors may be required to register with the NFA as commodity pool operators which will require compliance with NFA rules and subject the Manager or directors to regulation by the CFTC. In the event registration for the Manager or directors is required but is not obtained, the Manager or directors may be subject to fines, penalties and other civil or governmental actions or proceedings, any of which could have a material adverse effect on the Company s business, financial condition and results of operations.

In addition, the no action request to be submitted by the Company will include factual representations relating to the conduct of the Company s business, including that the amount of income the Company receives from swap transactions during any year will not exceed five percent of the Company s gross income for that year, and that the initial margin and option premiums from such swaps will not exceed one percent of the fair market value of the Company s total assets. The need to operate within these parameters could limit the use of interest rate swaps by the Company below the level that the Manager would otherwise consider optimal or may lead to the registration of the Manager or directors as commodity pool operators, which will subject the Company to additional regulatory oversight, compliance and costs.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

(a) Exhibits

Exhibit No.	Description
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*	Articles Supplementary designating Apollo Commercial Real Estate Finance, Inc. s 8.625% Series A Cumulative Redeemable Perpetual Preferred Stock, liquidation preference $25.00 per share, par value $0.01 per share, incorporated by reference to Exhibit 3.3 of the Registrant s Form 8-A filed on July 30, 2012 (File No.: 001-34452).
3.3*	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).
4.2*	Form of stock certificate evidencing the 8.625% Series A Cumulative Redeemable Perpetual Preferred Stock, liquidation reference $25.00 per share, par value $0.01 per share, incorporated by reference to Exhibit 4.1 of the Registrant s Form 8-A filed on July 30, 2012 (File No.: 001-34452).
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal 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.

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

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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 8, 2012

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

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