STARWOOD PROPERTY TRUST, INC.
Form 10-Q
November 07, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

OR

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

Commission file number 001-34436

Starwood Property Trust, Inc.

(Exact name of registrant as specified in its charter)

Maryland	**27-0247747**
(State or Other Jurisdiction of	(I.R.S. Employer

Incorporation or Organization)	Identification No.)
591 West Putnam Avenue **Greenwich, Connecticut** (Address of Principal Executive Offices)	**06830** (Zip Code)

Registrant s telephone number, including area code:

(203) 422-8100

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 o

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) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 definition of accelerated filer, large accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the issuer s common stock, $0.01 par value, outstanding as of November 6, 2012 was 135,290,351.

Special Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements, including without limitation, statements concerning our operations, economic performance and financial condition. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are developed by combining currently available information with our beliefs and assumptions and are generally identified by the words believe, expect, anticipate and other similar expressions. Forward-looking statements do not guarantee future performance, which may be materially different from that expressed in, or implied by, any such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date made.

These forward-looking statements are based largely on our current beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us or within our control, and which could materially affect actual results, performance or achievements. Factors that may cause actual results to vary from our forward-looking statements include, but are not limited to:

- factors described in our Annual Report on Form 10-K for the year ended December 31, 2011 and in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012, including those set forth under the captions Risk Factors and Business ;
- defaults by borrowers in paying debt service on outstanding items;
- impairment in the value of real estate property securing our loans;
- availability of mortgage origination and acquisition opportunities acceptable to us;
- potential mismatches in the timing of asset repayments and the maturity of the associated financing agreements;
- national and local economic and business conditions;
- general and local commercial real estate property conditions;
- changes in federal government policies;

- changes in federal, state and local governmental laws and regulations;
- increased competition from entities engaged in mortgage lending;
- changes in interest rates;
- changes in the exchange rates between the U.S. dollar and the respective currencies for our non-dollar denominated investments; and
- the availability of and costs associated with sources of liquidity.

In light of these risks and uncertainties, there can be no assurances that the results referred to in the forward-looking statements contained in this Quarterly Report on Form 10-Q will in fact occur. Except to the extent required by applicable law or regulation, we undertake no obligation to, and expressly disclaim any such obligation to, update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, changes to future results over time or otherwise.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited, amounts in thousands, except share and per share data)

	As of September 30, 2012,		As of December 31, 2011,	
Assets:				
Cash and cash equivalents	$	144,199	$	114,027
Loans held for investment		2,580,789		2,268,599
Loans held-for-sale at fair value				128,593
Loans transferred as secured borrowings		86,021		50,316
Mortgage-backed securities, available-for-sale, at fair value		866,865		341,734
Other investments		75,750		44,379
Accrued interest receivable		18,314		15,176
Derivative assets		11,024		12,816
Other assets		22,385		21,807
Total Assets	**$**	**3,805,347**	**$**	**2,997,447**
Liabilities and Equity				
Liabilities:				
Accounts payable and accrued expenses	$	8,869	$	5,051
Related-party payable		12,545		8,348
Dividends payable		51,629		41,431
Derivative liabilities		25,591		19,652
Secured financing agreements, net		1,309,450		1,103,517
Loan transfer secured borrowings		88,268		53,199
Other liabilities		7,757		1,102
Total Liabilities		**1,504,109**		**1,232,300**
Commitments and contingencies (Note 14)				
Equity:				
Starwood Property Trust, Inc. Stockholders Equity:				
Preferred stock, $0.01 per share, 100,000,000 shares authorized, no shares issued and outstanding				
Common stock, $0.01 per share, 500,000,000 shares authorized, and 117,516,201 issued and 116,890,351 outstanding as of September 30, 2012 and 93,811,351 issued and 93,185,501 outstanding as of December 31, 2011		1,175		938
Additional paid-in capital		2,297,971		1,828,319
Treasury stock (625,850 shares as of September 30, 2012 and December 31, 2011, respectively)		(10,642)		(10,642)
Accumulated other comprehensive income (loss)		62,183		(3,998)
Accumulated deficit		(54,938)		(55,129)
Total Starwood Property Trust, Inc. Stockholders Equity		2,295,749		1,759,488
Non-controlling interests in consolidated subsidiaries		5,489		5,659
Total Equity		2,301,238		1,765,147

Total Liabilities and Equity	**$**	**3,805,347**	**$**	**2,997,447**

See notes to condensed consolidated financial statements.

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited, amounts in thousands, except per share data)

	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
Net interest margin:				
Interest income from mortgage-backed securities	$ 16,585	$ 6,195	$ 40,404	$ 20,176
Interest income from loans	56,261	51,879	179,078	125,643
Interest expense	(12,030)	(7,321)	(34,345)	(21,723)
Net interest margin	**60,816**	**50,753**	**185,137**	**124,096**
Expenses:				
Management fees (including $4,097 and $2,922 for the three months ended September 30, 2012 and 2011 and $11,926 and $10,268 for the nine months ended September 30, 2012 and 2011 of non-cash stock-based compensation)	14,659	10,004	42,673	29,014
Acquisition and investment pursuit costs	622	1,201	2,737	1,820
General and administrative (including $139 and $69 for the three months ended September 30, 2012 and 2011 and $370 and $164 for the nine months ended September 30, 2012 and 2011 of non-cash stock-based compensation)	3,084	2,177	8,838	7,041
Total expenses	**18,365**	**13,382**	**54,248**	**37,875**
Income before other income (expense) and income taxes	**42,451**	**37,371**	**130,889**	**86,221**
Interest income from cash balances	66	63	180	326
Other income (expense)	621	975	2,923	1,422
Other-than-temporary impairment (OTTI), net of $61 and $435 recognized in other comprehensive income (loss) for the three months ended September 30, 2012 and 2011 and $2,854 and $435 for the nine months ended September 30, 2012 and 2011	(676)	(892)	(2,728)	(2,621)
Net gains on sales of investments	9,017	4,961	19,147	20,836
Net realized foreign currency gains (losses)	(337)	(61)	8,515	(63)
Net gains (losses) on currency derivatives	(7,510)	8,617	(10,392)	2,382
Net gains (losses) on interest rate derivatives	(51)	(19,171)	608	(25,982)
Net gains on credit derivatives		2,259		3,730
Net change in unrealized gains (losses) on loans held-for-sale at fair value		(10,679)	(5,760)	(1,725)
Unrealized foreign currency remeasurement gains (losses)	7,062	(9,403)	2,707	(4,245)
Income before income taxes	50,643	14,040	146,089	80,281
Income tax provision (benefit)	301	(463)	840	741
Net Income	**50,342**	**14,503**	**145,249**	**79,540**
Net income attributable to non-controlling interests	(130)	(25)	(388)	(1,191)

Net income attributable to Starwood Property Trust, Inc.	**$**	**50,212**	**$**	**14,478**	**$**	**144,861**	**$**	**78,349**
Net income per share of common stock:								
Basic	$	0.43	$	0.16	$	1.34	$	0.95
Diluted		0.43		0.15		1.34		0.94
Distributions declared per common share	$	0.44	$	0.44	$	1.32	$	1.30

See notes to condensed consolidated financial statements.

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(Unaudited, amounts in thousands)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net Income	$ 50,342	$ 14,503	$ 145,249	$ 79,540
Other comprehensive income:				
Change in fair value of cash flow hedges	(411)	(17)	(1,623)	14
Unrealized gain (loss) in fair value of available-for-sale securities	47,895	(15,819)	64,307	(11,137)
Reclassification adjustment for net realized gains (losses) on sale of securities	1,736		769	(10,305)
Reclassification for OTTI	676	892	2,728	2,621
Comprehensive income (loss)	100,238	(441)	211,430	60,733
Less: Comprehensive income attributable to non-controlling interests	(130)	(25)	(388)	(52)
Comprehensive income (loss) attributable to Starwood Property Trust, Inc.	$ 100,108	$ (466)	$ 211,042	$ 60,681

See notes to condensed consolidated financial statements.

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statement of Equity

(Unaudited, amounts in thousands, except share data)

	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Starwood Property Trust, Inc. Stockholders Equity	Non-Controlling Interests	Total Equity
Balance, January 1, 2012	**93,811,351**	**$ 938**	**$ 1,828,319**	**625,850**	**$ (10,642)**	**$ (55,129)**	**$ (3,998)**	**$ 1,759,488**	**$ 5,659**	**$ 1,765,147**
Proceeds from public offering of common stock	23,000,000	230	457,091					457,321		457,321
Underwriting and offering costs			(2,250)					(2,250)		(2,250)
Stock-based compensation	584,427	6	12,290					12,296		12,296
Manager incentive fee paid in stock	120,423	1	2,521					2,522		2,522
Treasury stock purchased										
Net income						144,861		144,861	388	145,249
Dividends declared, $1.32 per share						(144,670)		(144,670)		(144,670)
Other comprehensive income, net							66,181	66,181		66,181
Distribution to non-controlling interests									(558)	(558)
Balance, September 30, 2012	**117,516,201**	**$ 1,175**	**$ 2,297,971**	**625,850**	**$ (10,642)**	**$ (54,938)**	**$ 62,183**	**$ 2,295,749**	**$ 5,489**	**$ 2,301,238**

See notes to condensed consolidated financial statements

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited, amounts in thousands)

	For the Nine Months ended September 30, 2012	2011
Cash Flows from Operating Activities:		
Net income	$ 145,249	$ 79,540
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred financing costs	3,896	2,390
Accretion of net discount on mortgage-backed securities	(25,064)	(12,452)
Accretion of net deferred loan fees and discounts	(35,026)	(18,461)
Amortization of premium from collateralized debt obligations	(669)	(665)
Stock-based compensation	12,296	10,432
Incentive-fee compensation	2,522	1,206
Gain on sale of available-for-sale securities	(12,097)	(10,472)
Gain on sale of loans	(7,177)	(10,337)
Gain on foreign currency remeasurement	(8,809)	
Gain on sale of other investments		(27)
Net change in unrealized (gains) losses on loans held-for-sale at fair value	5,760	1,725
Unrealized (gains) losses on interest rate hedges	(9,991)	11,099
Unrealized gains on credit hedges		(161)
Unrealized (gains) losses on currency hedges	13,319	(2,674)
Unrealized foreign currency remeasurement losses (gains)	(2,707)	4,245
OTTI	2,728	2,621
Changes in operating assets and liabilities:		
Related-party payable	4,197	2,704
Accrued interest receivable, less purchased interest	(5,280)	(8,034)
Other assets	5,819	(6,221)
Accounts payable and accrued expenses	3,818	(345)
Other liabilities	6,655	732
Origination of held-for-sale loans		(270,066)
Proceeds from sale of held-for-sale loans	132,012	294,149
Net cash provided by operating activities	**231,451**	**70,928**
Cash Flows from Investing Activities:		
Purchase of mortgage-backed securities	(575,690)	(187,133)
Proceeds from sale of mortgage-backed securities	199,510	283,778
Proceeds from mortgage-backed securities maturities		11,765
Mortgage-backed securities principal repayments	67,452	94,827
Origination and purchase of loans held for investment	(942,692)	(1,018,480)
Loan maturities	460,789	264,615
Proceeds from sale of loans held for investment	28,740	5,000
Loan investment principal repayments	33,518	13,092
Purchased interest on investments	(638)	(915)
Purchase of other investments	(30,496)	(37,088)
Return of investment from other investments	892	235
Proceeds from sale of other investments	874	2,844
Return of investment basis in purchased derivative asset	2,780	
Purchase of treasury securities		(112,619)
Proceeds from sale of treasury securities		112,741
Cash deposited as collateral under treasury securities loan agreement		(112,741)
Return of collateral under treasury securities loan agreement		112,741
Net cash used in investing activities	**(754,961)**	**(567,338)**

Cash Flows from Financing Activities:				
Borrowings under secured financing agreements		1,370,306		1,016,488
Principal repayments on borrowings under secured financing arrangements		(1,164,373)		(991,812)
Proceeds from secured borrowings		35,738		
Payment of deferred financing costs		(8,029)		(2,192)
Proceeds from common stock offering		457,321		476,740
Payment of underwriting and offering costs		(2,250)		(28,287)
Treasury stock purchased				(5,981)
Payment of dividends		(134,473)		(101,298)
Distributions to non-controlling interest owners		(558)		(9,267)
Net cash provided by financing activities		**553,682**		**354,391**
Net increase (decrease) in cash and cash equivalents		30,172		(142,019)
Cash and cash equivalents, beginning of period		114,027		226,854
Cash and cash equivalents, end of period	**$**	**144,199**	**$**	**84,835**
Supplemental disclosure of cash flow information:				
Cash paid for interest	$	34,640	$	19,475
Income taxes paid	$	990	$	1,074
Supplemental disclosure of non-cash financing activity:				
Dividends declared, but not yet paid	$	51,629	$	41,556

See notes to condensed consolidated financial statements.

Starwood Property Trust, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

As of September 30, 2012

(Unaudited)

1. Business and Organization

Starwood Property Trust, Inc. (the Trust together with its subsidiaries, we or the Company) is a Maryland corporation that commenced operations on August 17, 2009 (Inception) upon the completion of its initial public offering (IPO). We are focused on originating, investing in, financing and managing commercial mortgage loans and other commercial real estate debt investments, commercial mortgage-backed securities (CMBS), and other commercial real estate-related debt investments. We collectively refer to commercial mortgage loans, other commercial real estate debt investments, CMBS, and other commercial real estate-related debt investments as our target assets. We also invest in residential mortgage-backed securities (RMBS) and residential REO, and may invest in distressed or non-performing loans, commercial properties subject to net leases and residential mortgage loans. As market conditions change over time, we may adjust our strategy to take advantage of changes in interest rates and credit spreads as well as economic and credit conditions.

We are organized and conduct our operations such that the Trust qualifies as a real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended (the Code). As such, the Trust will generally not be subject to U.S. federal corporate income tax on that portion of net income that is distributed to stockholders if we distribute at least 90% of our taxable income to our stockholders by prescribed dates and comply with various other requirements.

We are organized as a holding company that conducts our business primarily through four wholly-owned subsidiaries. In 2009, we formed joint ventures (the Joint Ventures) with Starwood Hospitality Fund II (Hotel II) and Starwood Opportunity Fund VIII (SOF VIII) in accordance with the co-investment and allocation agreement with SPT Management, LLC, our Manager (the Manager). The Joint Ventures are owned 75% (and controlled) by us and are therefore consolidated into our condensed consolidated financial statements. As of June 30, 2011, the last of the investments held by the Joint Ventures had been sold, and the entities were dissolved during the three months ended September 30, 2012.

As of September 30, 2012, investments with collateral in the hospitality, office, residential, and retail sectors represented 49.3%, 18.8%, 9.6%, and 8.8% of our investment portfolio, respectively. Such allocations could materially change in the future.

2. Summary of Significant Accounting Policies

Basis of Accounting and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include our accounts and those of our consolidated subsidiaries. Intercompany amounts have been eliminated. All adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and changes in cash flow have been made. 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, as well as the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The most significant and subjective estimate that we make is projecting the cash flows to be received on our investments, which has a significant impact on the amounts of interest income, credit losses (if any), and fair values that we record and/or disclose. In addition, the fair value of financial instruments that are estimated using a discounted cash flows method are significantly impacted by the rates at which we estimate market participants would discount the cash flows.

A non-controlling interest in a consolidated subsidiary is defined as the portion of the equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent . Non-controlling interests are presented as a separate component of equity in the condensed consolidated balance sheets. In addition, the presentation of net income attributes earnings to controlling and non-controlling interests.

These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the period ended December 31, 2011, as filed with the Securities and Exchange Commission (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.

Deferred Financing Costs

Costs incurred in connection with obtaining secured financing arrangements are capitalized and amortized over the initial terms of the respective facilities as a component of interest expense. As of September 30, 2012 and December 31, 2011, we had approximately $9.4 million and $5.0 million, respectively, of capitalized financing costs, net of amortization. For the three and nine months ended September 30, 2012, approximately $1.5 million and $3.9 million, respectively, of amortization was included in interest expense on the statement of operations. For the three and nine months ended September 30, 2011, approximately $1.0 million and $2.4 million, respectively, of amortization was included in interest expense on the statement of operations.

Income Taxes

The Trust has elected to be taxed as a REIT and intends to comply with the Code with respect thereto. Accordingly, we will not be subject to federal income tax as long as certain asset, income, dividend distribution and stock ownership tests are met. Many of these requirements are technical and complex and if we fail to meet these requirements we may be subject to federal, state, and local income tax and penalties. In addition, a REIT s income from prohibited transactions is subject to a 100% penalty tax. We have three taxable REIT subsidiaries (the TRSs) where certain investments may be made and activities conducted that (i) may have otherwise been subject to the prohibited transaction tax and (ii) may not be favorably treated for purposes of complying with the various requirements for REIT qualification. The income, if any, within the TRSs is subject to federal and state income taxes as a domestic C corporation based upon the TRSs net income. For the three and nine months ended September 30, 2012, we recorded a provision for income taxes of $0.3 million and $0.8 million related to the activities in our TRSs. These provisions were determined using a federal income tax rate of 34% and state income tax rate of 7.5%. For the three and nine months ended September 30, 2011, we recorded an income tax benefit of $0.5 million and a provision for income taxes of $0.7 million related to the activities in our TRSs. These provisions were determined using a federal income tax rate of 34% and state income tax rate of 7.5%.

Underwriting Commissions and Offering Costs

Underwriting and offering costs related to our equity offering activities, which consist primarily of our equity offerings in April and early October 2012 as well as our at-the-market offering program (refer to disclosure in Note 10), aggregated $2.3 million during the nine months ended September 30, 2012. We incurred approximately $1.1 million in connection with our equity offering in May 2011. Underwriting and offering costs are reflected as a reduction of additional paid-in capital in the consolidated statement of equity.

Recent Accounting Pronouncements

In December 2011, the FASB issued amended guidance which will enhance disclosures required by GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset. This information will enable users of an entity s financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. We will be required to apply the amendments beginning with our first quarter, 2013 financial statements by providing the disclosures required by those amendments retrospectively for all comparative periods presented. We are in the process of evaluating the impact that this guidance will have on our financial statement disclosures.

3. Debt Securities

We classified all CMBS and RMBS investments as available-for-sale as of September 30, 2012 and December 31, 2011. The CMBS and RMBS classified as available-for-sale are reported at fair value in the balance sheet with changes in fair value recorded in accumulated other comprehensive (loss) income. The tables below summarize various attributes of our investments in mortgage-backed securities (MBS) available-for-sale as of September 30, 2012 and December 31, 2011 (amounts in thousands):

				Unrealized Gains or (Losses) Recognized in Accumulated Other Comprehensive Income (Loss)				
September 30, 2012	**Purchased Amortized Cost**	**Credit OTTI**	**Recorded Amortized Cost**	**Non-Credit OTTI**	**Unrealized Gains**	**Unrealized Losses**	**Net Fair Value Adjustment**	**Fair Value**
CMBS	$ 498,740	$	$ 498,740	$	$ 30,225	$	$ 30,225	$ 528,965
RMBS	311,590	(8,585)	303,005	(61)	36,704	(1,748)	34,895	337,900
Total	$ 810,330	$ (8,585)	$ 801,745	$ (61)	$ 66,929	$ (1,748)	$ 65,120	$ 866,865

September 30, 2012	Weighted Average Coupon (1)	Weighted Average Rating	Weighted Average Life (WAL) (Years) (3)	Weighted Average Yield (4)
CMBS	3.8%	(2)	3.5	7.0%
RMBS	1.5%	B-	5.3	10.5%

(1) The weighted average coupon of the MBS is calculated as a fraction, with the numerator as the sum of (i) the stated interest rate for each individual security as of quarter-end, multiplied with (ii) the current face amount of each individual security, and the denominator as the sum of the total current face amount of the MBS. For floating rate MBS, the interest rate used is comprised of the stated spread plus the applicable LIBOR rate which is 0.21425%, as of September 30, 2012.

(2) Includes a $425.2 million investment in senior securities that were not rated, that are secured by substantially all of the assets of a worldwide operator of hotels, resorts, and timeshare properties, and which had an estimated loan-to-value ratio as of September 30, 2012 in the range of 39%-44%. The remaining $103.8 million CMBS investment position is rated BB+.

(3) Represents the WAL of each respective group of MBS. The WAL of each individual security is calculated as a fraction, the numerator of which is the sum of the timing (in years) of each expected future principal payment multiplied by the balance of the respective payment, and with the denominator equal to the sum of the expected principal payments. This calculation was made as of September 30, 2012. Assumptions for the calculation of the WAL are adjusted as necessary for changes in projected principal repayments and/or maturity dates of the security.

(4) Most of the CMBS and all of the RMBS were purchased at a discount, some of which will be accreted into income over the expected remaining life of the security. The majority of the income from these securities is earned from the accretion of these discounts.

Within the hospitality sector, as of September 30, 2012 we had an aggregate investment of $425.2 million in senior debt secured by substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. As of March 31, 2012 the debt investment was comprised of $115.5 million in loans and $387.6 million in securities. On April 16, 2012 the remaining $115.5 million of loans were converted to securities. On August 23, 2012 we sold $165.0 million of these CMBS resulting in a gain of $8.2 million. As of September 30, 2012, the aggregate face value of $426.5 million represented 5.8% of the total face value of this operator s senior debt outstanding, and the aggregate carrying value of our investment represented 11.2% of our total assets.

				Unrealized Gains or (Losses) Recognized in Accumulated Other Comprehensive Income (Loss)				
December 31, 2011	**Purchased Amortized Cost**	**Credit OTTI**	**Recorded Amortized Cost**	**Non-Credit OTTI**	**Unrealized Gains**	**Unrealized Losses**	**Net Fair Value Adjustment**	**Fair Value**
CMBS	$ 177,353	$	$ 177,353	$	$	$ (567)	$ (567)	$ 176,786
RMBS	170,424	(6,001)	164,423	(1,310)	3,367	(1,532)	525	164,948
Total	$ 347,777	$ (6,001)	$ 341,776	$ (1,310)	$ 3,367	$ (2,099)	$ (42)	$ 341,734

December 31, 2011	Weighted Average Coupon(1)	Weighted Average Rating	WAL (3)
CMBS	2.1%	(2)	3.5
RMBS	1.0%	B-	4.8

(1) The weighted average coupon of the MBS is calculated as a fraction, with the numerator as the sum of (i) the stated interest rate for each individual security as of quarter-end, multiplied with (ii) the current face amount of each individual security, and the denominator as the sum of the total current face amount of the MBS. For floating rate MBS, the interest rate used is comprised of the stated spread plus the greater of the applicable LIBOR rate at each respective quarter-end. The one-month LIBOR rate as of December 31, 2011 was 0.2953%.

(2) Represents senior securities that were not rated, that are secured by substantially all of the assets of a worldwide operator of hotels, resorts, and timeshare properties, and which had an estimated loan-to-value ratio as of December 31, 2011 in the range of 39%-44%.

(3) Represents the WAL of each respective group of MBS. The WAL of each individual security or loan is calculated as a fraction, the numerator of which is the sum of the timing (in years) of each expected future principal payment multiplied by the balance of the respective payment, and with the denominator equal to the sum of the expected principal payments. This calculation was made as of December 31, 2011. Assumptions for the calculation of the WAL are adjusted as necessary for changes in projected principal repayments and/or maturity dates of the security.

During the nine months ended September 30, 2012, purchases and sales executed, as well as the principal payments received, were as follows (amounts in thousands):

	RMBS	CMBS
Purchases	$ 203,438	$ 372,252
Sales/Maturities	26,049	173,461
Principal payments received	52,310	15,142

During the nine months ended September 30, 2012, we sold $165.0 million of CMBS resulting in a gain of $8.2 million. There have been no CMBS maturities during the nine months ended September 30, 2012.

During the nine months ended September 30, 2011, purchases and sales executed, as well as the principal payments received, were as follows (amounts in thousands):

	RMBS	CMBS
Purchases	$ 139,953	$
Sales/Maturities	49,951	223,378
Principal payments received	52,607	42,220

As of September 30, 2012, 80.4%, of the CMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 1.75%. As of December 31, 2011, all of the CMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 1.75%.

Subject to certain limitations on durations, we have allocated an amount to invest in RMBS that cannot exceed 10% of our total assets. We have engaged a third party manager who specializes in RMBS to execute the trading of RMBS, the cost of which was $1.5 million and $0.5 million for the nine months ended September 30, 2012 and September 30, 2011, respectively, which has been recorded as an offset to interest income in the accompanying condensed consolidated statements of operations. As of September 30, 2012, approximately $298.7 million, or 88.4%, of the RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 0.38%. As of December 31, 2011, approximately $154.7 million, or 93.8%, of the RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 0.43%. We purchased all of the RMBS at a discount that will be accreted into income over the expected remaining life of the security. The majority of the income from this strategy is earned from the accretion of these discounts.

The following table presents the gross unrealized losses and estimated fair value of our securities that were in an unrealized loss position as of September 30, 2012 and for which OTTI charges have not been recognized in earnings, fully or partially (amounts in thousands):

	Estimated Fair Value		Unrealized Losses	
As of September 30, 2012	**Securities with a loss less than 12 months**	**Securities with a loss greater than 12 months**	**Securities with a loss less than 12 months**	**Securities with a loss greater than 12 months**
CMBS	$	$	$	$
RMBS	17,826	854	(1,714)	(34)
Total	$ 17,826	$ 854	$ (1,714)	$ (34)

As of September 30, 2012 there were 11 securities with unrealized losses. After evaluating each security we determined that the impairments on two of these securities, both of which are non-agency and whose impairments totaled $0.7 million, were other-than-temporary. All of this impairment was attributable to credit losses, which we calculated by comparing (i) the revised estimated future cash flows of each security discounted at the yield determined as of the initial acquisition date or, if since revised, as of the last date previously revised to (ii) our amortized cost basis. For the three months ended September 30, 2012, our aggregate MBS credit losses (as reported in the condensed consolidated statement of operations) were $0.7 million. We further determined that none of the nine remaining securities was other-than-temporarily impaired. We considered a number of factors in reaching this conclusion, including that we did not intend to sell any individual security, it was not considered more likely than not that we would be forced to sell any individual security prior to recovering our amortized cost, and there were no material credit events that would have caused us to otherwise conclude that we would not recover our cost. Significant judgment is required in projecting cash flows for our impaired RMBS, all of which were non-agency and none of which we expect to sell or be forced to sell before recovering our current cost basis. Actual cash flows income and/or realized impairments could be materially different from what is currently projected and/or reported.

The following table presents the gross unrealized losses and estimated fair value of our securities that were in an unrealized loss position as of December 31, 2011 and for which OTTI charges have not been recognized in earnings, fully or partially (amounts in thousands):

	Estimated Fair Value		Unrealized Losses	
As of December 31, 2011	Securities with a loss less than 12 months	Securities with a loss greater than 12 months	Securities with a loss less than 12 months	Securities with a loss greater than 12 months
CMBS	$ 176,786	$	$ (567)	$
RMBS	70,103	2,684	(2,444)	(399)
Total	$ 246,889	$ 2,684	$ (3,011)	$ (399)

As of December 31, 2011 there were 42 securities with unrealized losses. After evaluating each security we determined that the impairments on 25 of these securities, all of which are non-agency and whose impairments totaled $4.7 million, were other-than-temporary. Credit losses represented $3.4 million of this total, which we calculated by comparing (i) the revised estimated future cash flows of each security discounted at the yield determined as of the initial acquisition date or, if since revised, as of the last date previously revised, to (ii) our amortized cost basis. For the year ended December 31, 2011, our aggregate MBS credit losses (as reported in the statement of operations) were $6.0 million. We further determined that none of the 17 remaining securities were other-than-temporarily impaired. We considered a number of factors in reaching this conclusion, including that we did not intend to sell any individual security, it was not considered more likely than not that we would be forced to sell any individual security prior to recovering our amortized cost, and there were no material credit events that would have caused us to otherwise conclude that we would not recover our cost. Significant judgment is required in projecting cash flows for our non-agency RMBS. As a result, actual income and/or impairments could be materially different from what is currently projected and/or reported.

4. Loans

Our investments in loans held-for-investment are accounted for at amortized cost and the loans held-for-sale are accounted for at the lower of cost or fair value, unless we elect (upon origination or acquisition) to record such loans at fair value. The following table summarizes our investments in mortgages and loans by subordination class as of September 30, 2012 and December 31, 2011 (amounts in thousands):

September 30, 2012	Carrying Value	Face Amount	Weighted Average Coupon (2)	Weighted Average Life (years) (3)
First Mortgages	1,362,605	1,402,755	6.5 %	3.5
Subordinated Mortgages **(1)**	356,762	390,376	9.7 %	4.2
Mezzanine Loans	861,422	885,450	8.6 %	3.5
Total loans held for investment	2,580,789	2,678,581		
Loans held in securitization trust	86,021	86,514	4.7 %	3.5
Total loans	2,666,810	2,765,095		

December 31, 2011	Carrying Value	Face Amount	Weighted Average Coupon (2)	Weighted Average Life (years) (3)
First mortgages	$ 1,202,611	$ 1,248,549	6.6%	3.2
Subordinated mortgages **(1)**	437,163	487,175	7.4%	4.1
Mezzanine loans	628,825	642,831	8.4%	3.0
Total loans held for investment	2,268,599	2,378,555		
First mortgages held-for-sale at fair value	128,593	122,833	5.9%	8.9
Loans transferred as secured borrowings	50,316	50,632	5.0%	3.7
Total Loans	$ 2,447,508	$ 2,552,020		

(1) Subordinated mortgages includes (i) subordinated mortgages that we retain after having sold first mortgage positions related to the same collateral, (ii) B-Notes, and (iii) subordinated loan participations.

(2) The weighted average coupon of each respective group of loans is calculated as a fraction, with the numerator as the sum of (i) the stated interest rate for each individual loan as of quarter-end, converted to a 30/360 interest accrual basis, multiplied with (ii) the face amount of each individual loan, and the denominator as the sum of each respective group of loans. For floating rate loans, the interest rate used is comprised of the stated spread plus the greater of the (i) LIBOR floor or (ii) applicable LIBOR rate at each respective quarter-end.

(3) Represents the WAL of each respective group of loans. The WAL is calculated as a fraction, the numerator of which is the sum of the timing (in years) of each expected future principal payment multiplied by the balance of the respective payment, and with the denominator equal to the sum of the expected principal payments. Assumptions for the calculation of the WAL are adjusted as necessary for changes in projected principal repayments and/or maturity dates of the loan.

As of September 30, 2012, approximately $1.5 billion, or 56.7% of the loans were variable rate and pay interest at LIBOR plus a weighted-average spread of 5.45%. The following table summarizes our investments in floating rate loans (amounts in thousands):

	September 30, 2012		December 31, 2011	
Index	**Rate**	**Carrying Value**	**Rate**	**Carrying Value**
1 Month LIBOR	0.2143%	$ 484,371	0.2953%	$ 264,030
3 Month LIBOR	0.3585%	14,843	0.5810%	143,371
1 Month Citibank LIBOR(1)	0.2025%	101,448	0.2700%	134,041
3 Month Citibank LIBOR(1)	0.3475%	7,187	0.5600%	7,102
6 Month Citibank LIBOR(1)	0.6300%		0.7800%	6,039
LIBOR Floor	0.5%-2.00%	903,610	0.5% - 2.0%	551,275
Total		$ 1,511,459		$ 1,105,858

(1) The Citibank LIBOR rate is equal to the rate per annum at which deposits in United States dollars are offered by the principal office of Citibank, N.A. in London, England to prime banks in the London interbank market.

We evaluate each of our loans for impairment at least quarterly. Our loans are typically collateralized by real estate. As a result, we regularly evaluate the extent and impact of any credit deterioration associated with the performance and/or value of the underlying collateral property, as well as the financial and operating capability of the borrower. Specifically, a property s operating results and any cash reserves are analyzed and used to assess (i) whether cash flow from operations is sufficient to cover the debt service requirements currently and into the future, (ii) the ability of the borrower to refinance the loan at maturity, and/or (iii) the property s liquidation value. We also evaluate the financial wherewithal of any loan guarantors as well as the borrower s competency in managing and operating the properties. In addition, we consider the overall economic environment, real estate sector, and geographic sub-market in which the borrower operates. Such impairment analyses are completed and reviewed by asset management and finance personnel who utilize various data sources, including (i) periodic financial data such as property operating statements, occupancy, tenant profile, rental rates, operating expenses, the borrower s exit plan, and capitalization and discount rates, (ii) site inspections, and (iii) current credit spreads and discussions with market participants.

Our evaluation process as described above produces an internal risk rating between 1 and 5, which is a weighted-average of the numerical ratings in the following categories: (i) sponsor capability and financial condition, (ii) loan and collateral performance relative to underwriting, (iii) quality and stability of collateral cash flows, and (iv) loan structure. We utilize the overall risk ratings as a concise means to monitor any credit migration on a loan as well as on the whole portfolio. While the overall risk rating is generally not the sole factor we use in determining whether a loan is impaired, a loan with a higher overall risk rating would tend to have more adverse indicators of impairment, and therefore would be more likely to experience a credit loss. For any loans rated as a 5, we would record a loan loss allowance in an amount equal to the greater of (i) 1.5% of the aggregate net carrying amount and (ii) the loss amount measured by the excess of the loan s carrying amount over the estimated collateral value.

The rating categories generally include the characteristics described below, but these are utilized as guidelines and therefore not every loan will have all of the characteristics described in each category:

Rating		Characteristics
1	•	Sponsor capability and financial condition Sponsor is highly rated or investment grade or, if private, the equivalent thereof with significant management experience.
	•	Loan collateral and performance relative to underwriting The collateral has surpassed underwritten expectations.
	•	Quality and stability of collateral cash flows Occupancy is stabilized, the property has had a history of consistently high occupancy, and the property has a diverse and high quality tenant mix.
	•	Loan structure Loan-to-collateral value ratio (LTV) does not exceed 65%. The loan has structural features that enhance the credit profile.
2	•	Sponsor capability and financial condition Strong sponsorship with experienced management team and a responsibly leveraged portfolio.
	•	Loan collateral and performance relative to underwriting Collateral performance equals or exceeds underwritten expectations and covenants and performance criteria are being met or exceeded.
	•	Quality and stability of collateral cash flows Occupancy is stabilized with a diverse tenant mix.

	•	Loan structure LTV does not exceed 70% and unique property risks are mitigated by structural features.
3	•	Sponsor capability and financial condition Sponsor has historically met its credit obligations, routinely pays off loans at maturity, and has a capable management team.
	•	Loan collateral and performance relative to underwriting Property performance is consistent with underwritten expectations.
	•	Quality and stability of collateral cash flows Occupancy is stabilized, near stabilized, or is on track with underwriting.
	•	Loan structure LTV does not exceed 80%.
4	•	Sponsor capability and financial condition Sponsor credit history includes missed payments, past due payment, and maturity extensions. Management team is capable but thin.
	•	Loan collateral and performance relative to underwriting Property performance lags behind underwritten expectations. Performance criteria and loan covenants have required occasional waivers. A sale of the property may be necessary in order for the borrower to pay off the loan at maturity.
	•	Quality and stability of collateral cash flows Occupancy is not stabilized and the property has a large amount of rollover.
	•	Loan structure LTV is 80% to 90%.
5	•	Sponsor capability and financial condition Credit history includes defaults, deeds-in-lieu, foreclosures, and/or bankruptcies.
	•	Loan collateral and performance relative to underwriting Property performance is significantly worse than underwritten expectations. The loan is not in compliance with loan covenants and performance criteria and may be in default. Sale proceeds would not be sufficient to pay off the loan at maturity.
	•	Quality and stability of collateral cash flows The property has material vacancy and significant rollover of remaining tenants.
	•	Loan structure LTV exceeds 90%.

As of September 30, 2012, the risk ratings by class of loan were as follows (amounts in thousands):

	Balance Sheet Classification at September 30, 2012				
Risk Rating Category	Loans Held for Investment First Mortgages	Loans Held for Investment Subordinated Mortgages	Mezzanine Loans	Loans Transferred As Secured Borrowings	Total
1	$	$	$	$	$
2	134,006	2,438	393,908	13,135	543,487
3	1,146,779	309,389	459,880	72,886	1,988,934
4	81,820	44,935	7,634		134,389
5					
	$ 1,362,605	$ 356,762	$ 861,422	$ 86,021	$ 2,666,810

As of December 31, 2011, the risk ratings by class of loan were as follows (amounts in thousands):

	Balance Sheet Classification at December 31, 2011					
Risk Rating Category	Loans Held for Investment First Mortgages	Loans Held for Investment Subordinated Mortgages	Mezzanine Loans	Loans Held for Sale First Mortgages	Loans Transferred As Secured Borrowings	Total
1	$	$	$	$	$	$
2	108,900	131,281	139,167	89,760	13,193	482,301
3	1,054,717	251,788	481,982	38,833	37,123	1,864,443
4	38,994	54,094	7,676			100,764
5						
	$ 1,202,611	$ 437,163	$ 628,825	$ 128,593	$ 50,316	$ 2,447,508

After completing our analysis of each loan, including the resulting risk ratings as described above, we concluded that no allowance for loan losses was necessary as of September 30, 2012 and December 31, 2011.

For the three months ended September 30, 2012, the activity in our loan portfolio was as follows (amounts in thousands):

Balance June 30, 2012	$	2,220,826
Acquisitions/originations		497,253
Additional funding		1,349
Capitalized interest (1)		314
Basis of loans sold		52
Basis of loans prepaid/matured		(51,068)
Principal repayments		(18,237)
Discount accretion/premium amortization		5,702
Foreign currency remeasurement gain		12,819
Receivable loan payoffs		(2,200)
Balance September 30, 2012	$	2,666,810

For the nine months ended September 30, 2012, the activity in our loan portfolio (including loans held-for-sale) was as follows (amounts in thousands):

Balance December 31, 2011	$	2,447,508
Acquisitions/originations		930,598
Additional funding		12,096
Capitalized interest (1)		2,864
Basis of loans sold		(153,575)
Basis of loans prepaid/matured		(460,789)
Transfer out- Loan converted to a security		(115,100)
Principal repayments		(33,518)
Discount accretion/premium amortization		35,026
Foreign currency remeasurement gain		9,660
Net change in unrealized loss on loans held-for-sale at fair value		(5,760)
Receivable loan payoffs		(2,200)
Balance September 30, 2012	$	2,666,810

(1) Represents accrued interest income on loans whose terms do not require current payment of interest.

We acquired or originated $943.4 million (face value of loans, net of $32.3 million in discounts and upfront fees collected at closing) in loans during the nine months ended September 30, 2012, which included: (1) a $125.0 million participation in a senior loan, converted to a CMBS in the second quarter, secured by all the material assets of a worldwide operator of hotels, resorts, and timeshare properties for a discounted purchase price of $115.7 million; (2) an origination of a $63.0 million first mortgage, of which $59.0 million was funded at closing, collateralized by 10 office buildings located in California; (3) an origination of a $40.0 million mezzanine loan secured by a 10-property portfolio of full-service and extended-stay hotels located in eight different states; (4) an origination of a $73.0 million junior mezzanine loan, of which $45.0 million was initially funded, collateralized by six office buildings in Virginia; (5) an origination of a $170.0 million first mortgage loan, of which $135.0 million was initially funded, collateralized by two office buildings in midtown Manhattan; (6) an origination of a $30.0 million mezzanine loan collateralized by an office building in Pennsylvania; (7) an origination of a $51.5 million first mortgage collateralized by three hotels in North Carolina, New Jersey, and Virginia; (8) a purchase of a 50% undivided participation interest in a EUR-denominated mezzanine loan for $68.4 million, collateralized by three hotels in France and Germany; (9) an acquisition of a $250.0 million participation in a mezzanine loan at a discounted price of $233.75 million, secured by indirect equity interests in subsidiaries that own substantially all the assets of a worldwide operator of hotels, resorts and timeshare properties; (10) an origination of a $46.0 million first mortgage collateralized by a 351 key hotel in Maryland; (11) an origination of a $61.0 million first mortgage, of which $48.5 million was funded at closing, collateralized by two office buildings in California; and (12) approximately $12.1 million in additional funding on existing loan investments.

We sold $156.0 million of loans during the nine months ended September 30, 2012, which included: (1) six loans with a carrying value of $122.7 million to an independent third party resulting in proceeds, net of financing repayments, of $40.6 million and (2) 50% of our Euro denominated loan to a strategic partner resulting in proceeds of $28.8 million. The transaction was neutral from an earnings perspective net of the associated currency hedge gain. Additionally, 15 loans matured or were prepaid during the nine months ended September 30, 2012, which resulted in proceeds of $460.3 million (net of realized foreign currency remeasurement gain of $9.1 million) and accelerated accretion of purchase discounts of $15.2 million.

5. Other Investments

From May 24, 2012 through September 30, 2012, we acquired 272 residential real estate owned (REO) properties at an aggregate cost of $30.5 million. At acquisition, substantially all of the properties were either vacant or had occupants that were not subject to a lease and/or were not paying rent to the previous owner. Upon acquisition, we began actively preparing the properties to be either rented or sold, as applicable. From the date of acquisition through September 30, 2012, we incurred approximately $0.5 million in costs of getting these properties ready for their intended use, and such costs were added to our investment basis. During the three and nine months ended September 30, 2012, we had revenues of $0.1 million and $0.1 million and losses from operations of $0.3 million and $0.8 million, respectively. The losses from operations were due primarily to the costs incurred in connection with various REO start-up activities, including the negotiation of management agreements with third parties and the structuring of acquisitions. Through September 30, 2012, we had engaged three third party entities to perform REO acquisition, development and management services. In addition, through September 30, 2012, we had sold 21 properties for aggregate net proceeds of $1.3 million and an aggregate net loss of $2 thousand, and had rented 28 properties. The net losses of $0.3 million and $0.8 million for the three and nine months ended September 30, 2012 are included in other income (expense) in the consolidated statement of operations.

As of September 30, 2012 and December 31, 2011, we had an aggregate cost basis of $12.9 million and $13.8 million invested in the publicly traded equity securities of certain REITs that were classified as available-for-sale and carried at fair value with changes in fair value recorded to other comprehensive income (loss). As of September 30, 2012 and December 31, 2011, the aggregate fair value of such securities was $13.0 million and $12.3 million, respectively, resulting in a net unrealized gain of $0.1 million and a net unrealized loss of $2.5 million, respectively. For the three and nine months ended September 30, 2012 we recognized dividend income related to these investments of $0.2 million and $0.6 million, respectively, that is included as a component of other income in the condensed consolidated statement of operations. During the three months ended September 30, 2012, we sold securities with an aggregate cost basis of $0.9 million. The transaction was neutral from an earnings perspective. During the nine months ended September 30, 2011, we purchased securities with an aggregate cost basis of $9.3 million.

In June 2011, we acquired a non-controlling 49% interest in a privately-held limited liability company for $25.5 million, which is accounted for under the equity method. In December 2011 we sold 20% of this investment for an amount that approximated our carrying amount. The limited liability company owns a mezzanine loan participation, and our share of earnings for the three and nine months ended September 30, 2012 was $0.6 million and $1.7 million, respectively, which is included in other income on the condensed consolidated statements of operations.

Prior to 2011, we had committed $9.7 million to acquire at least a 5% interest in a privately-held limited liability company formed to acquire assets of a commercial real estate debt management and servicing business primarily for the opportunity to participate in debt opportunities arising from the venture s special servicing business (the Participation Right). As of September 30, 2012, we had funded $8.0 million of our commitment. We recognized $0.2 million and $1.0 million for the three and nine months ended September 30, 2012, respectively, related to this investment, which is included in other income on the condensed consolidated statements of operations.

6. Secured Financing Agreements

On March 31, 2010, Starwood Property Mortgage Sub-1, L.L.C. (SPM Sub-1), our indirect wholly-owned subsidiary, entered into a Master Repurchase and Securities Contract (the Wells Repurchase Agreement) with Wells Fargo Bank, National Association (Wells Fargo). The Wells Repurchase Agreement is secured by approximately $104.4 million of the diversified loan portfolio purchased from Teachers Insurance and Annuity Association of America on February 26, 2010 (the TIAA Portfolio). Advances under the Wells Repurchase Agreement accrue interest at a per annum pricing rate equal to the sum of one-month LIBOR plus the pricing margin of 3.0%. If an event of default (as such term is defined in the Wells Repurchase Agreement) occurs and is continuing, amounts borrowed may become due and payable and interest accrues at the default rate, which is equal to the pricing rate plus 4.0%. The maturity date of the Wells Repurchase Agreement is May 31, 2013. The Wells Repurchase Agreement allowed for advances through May 31, 2010. As of September 30, 2012, $69.0 million was outstanding under the Wells Repurchase Agreement and the carrying value of the pledged collateral was $104.4 million. The Company guarantees certain of the obligations of SPM Sub-1 under the Wells Repurchase Agreement up to maximum liability of 25% of the then currently outstanding repurchase price of all purchased assets.

On August 6, 2010, Starwood Property Mortgage Sub-2, L.L.C. (SPM Sub-2), our indirect wholly-owned subsidiary, entered into a second Master Repurchase and Securities Contract with Wells Fargo, which second repurchase facility was amended and restated by SPM Sub-2 and Starwood Property Mortgage Sub-2-A, L.L.C. (SPM Sub-2-A), our indirect wholly-owned subsidiary, on February 28, 2011, pursuant to an Amended and Restated Master Repurchase and Securities Contract (the Second Wells Repurchase Agreement). The Second Wells Repurchase Agreement was amended on May 24, 2011 and November 3, 2011 (Amendment No. 2), and is being used by SPM Sub-2 and SPM Sub-2-A to finance the acquisition or origination of commercial mortgage loans (and participations therein) and mezzanine loans. In connection with Amendment No. 2, available borrowings under the facility increased by $200 million to $550 million. Advances under the Second Wells Repurchase Agreement accrue interest at a per annum pricing rate equal to the sum of one-month LIBOR plus a margin of between 1.75% and 6.0% depending on the type of asset being financed. If an event of default (as such term is defined in the Second Wells Repurchase Agreement) occurs and is continuing, amounts borrowed may become due and payable immediately and interest accrues at the default rate, which is equal to the pricing rate plus 4.0%. The initial maturity date of the Second Wells Repurchase Agreement is August 5, 2013, subject to two one-year extension options, each of which may be exercised by us upon the satisfaction of certain conditions and the payment of an extension fee. The Company guarantees certain of the obligations of SPM Sub-2 and SPM Sub-2-A under the Second Wells Repurchase Agreement up to a maximum liability of either 25% or 100% of the then-currently outstanding repurchase price of purchased assets, depending upon the type of asset being financed. As of September 30, 2012, $335.0 million was outstanding under the Second Wells Repurchase Agreement and the carrying value of the pledged collateral was $712.7 million.

On December 2, 2010, Starwood Property Mortgage Sub-3, L.L.C. (SPM Sub-3), our indirect wholly-owned subsidiary, entered into a Master Repurchase Agreement with Goldman Sachs Mortgage Company, which repurchase facility was amended and restated by SPM Sub-3 and Starwood Property Mortgage Sub-3-A, L.L.C. (SPM Sub-3-A), our indirect wholly-owned subsidiary, on February 28, 2011, pursuant to an Amended and Restated Master Repurchase Agreement (the Goldman Repurchase Agreement). The Goldman Repurchase Agreement will be used to finance the acquisition or origination by SPM Sub-3 and SPM Sub-3-A of commercial mortgage loans that are eligible for CMBS securitization. The Goldman Repurchase Agreement provides for asset purchases of up to $150 million. The Company guarantees certain of the obligations of SPM Sub-3 and SPM Sub-3-A under the Goldman Repurchase Agreement up to a maximum liability of 25% of the then-currently outstanding repurchase price of all purchased loans. Advances under the Goldman Repurchase Agreement accrue interest at a per annum pricing rate equal to the sum of one-month LIBOR plus a margin of between 1.95% and 2.25% depending on the loan-to-value ratio of the purchased mortgage loan. If an event of default (as such term is defined in the Goldman Repurchase Agreement) occurs and is continuing, amounts borrowed may become due and payable immediately and interest accrues at the default rate, which is equal to the pricing rate plus 2.0%. The maturity date of the Goldman Repurchase Agreement is December 3, 2012. As of September 30, 2012, there were no borrowings under the Goldman Repurchase Agreement.

On March 18, 2011, Starwood Property Mortgage, L.L.C. (SPM), our indirect wholly-owned subsidiary, entered into a third Master Repurchase and Securities Contract with Wells Fargo (the Third Wells Repurchase Agreement). The Third Wells Repurchase Agreement is being used by SPM to finance the acquisition and ownership of RMBS and provides for asset purchases up to $175 million. Advances under the Third Wells Repurchase Agreement generally accrue interest at a per annum pricing rate equal to one-month LIBOR plus a margin of 2.10%. If an event of default (as such term is defined in the Third Wells Repurchase Agreement) occurs and is continuing, amounts borrowed may become due and payable immediately and interest accrues at the default rate, which is equal to the pricing rate plus 4.0%. The facility was scheduled to terminate on March 16, 2012. We extended the facility for an additional year and the new facility termination date is March 16, 2013. The Company has guaranteed certain of the obligations of SPM under the Third Wells Repurchase Agreement. As of September 30, 2012, $145.0 million was outstanding and the carrying value of the pledged collateral was $254.5 million.

On December 30, 2011, Starwood Property Mortgage Sub-5, L.L.C. (SPM Sub-5) and Starwood Property Mortgage Sub-5-A, L.L.C. (SPM Sub-5-A), our indirect wholly-owned subsidiaries, entered into a fourth Master Repurchase and Securities Contract with Wells Fargo (the Fourth Wells Repurchase Agreement). The Fourth Wells Repurchase Agreement provides for advances up to $189.9 million and is secured by a loan portfolio of 21 separate commercial mortgage loans. As of September 30, 2012, advances under the Fourth Wells Repurchase Agreement accrued interest at one-month LIBOR plus a pricing margin of 2.75%. The availability of additional advances, as well as the pricing margin on all outstanding borrowings at any given time, is determined by the current operating cash flows and fair values of the underlying collateral, both in relation to the existing collateral loan receivable balances outstanding, and all as approved by Wells Fargo. The overall term of the Fourth Wells Repurchase Agreement is three years, with two one-year conditional extensions. As of September 30, 2012, SPM Sub-5-A had borrowed $189.9 million under this facility and the carrying value of the pledged collateral was $252.0 million. At closing, we paid a 0.50% commitment fee based upon the total committed proceeds. If the overall facility is extended beginning in December 2014, we would pay a 0.25% extension fee for each year. The Company guarantees 60% of the currently outstanding repurchase price for all purchased assets; however, the Company guarantees 100% of the outstanding balance of any individual repurchase transaction involving a collateral property with operating cash flows that at any time is less than 15% of the related collateral loan receivable balance.

On March 6, 2012, Starwood Property Mortgage Sub-7, LLC (SPM Sub-7), our indirect wholly-owned subsidiary, entered into a Master Repurchase Agreement with Goldman Sachs International (the Second Goldman Repurchase Agreement). At closing, we borrowed $155.4 million under the Second Goldman Repurchase Agreement to finance the acquisition of $222.8 million in senior debt securities that are expected to mature on November 15, 2015. The senior debt securities were issued by certain special purpose entities that were formed to hold substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. Advances under the Second Goldman Repurchase Agreement accrue interest at a per annum rate of one-month LIBOR plus a spread of 2.90%. The maturity date of the Second Goldman Repurchase Agreement is August 15, 2015. The carrying value of the collateral senior debt securities was $215.9 million and the amount outstanding under the facility was $151.1 million at September 30, 2012.

On March 26, 2012, Starwood Property Mortgage Sub-6, LLC (SPM Sub-6) and Starwood Property Mortgage Sub-6-A (SPM Sub-6-A), our indirect wholly-owned subsidiaries, entered into a Master Repurchase Agreement with Citibank, N.A. (the Citi Repurchase Agreement). The Citi Repurchase Agreement provides for asset purchases of up to $125.0 million to finance commercial mortgage loans and senior interests in commercial mortgage loans originated or acquired by us and including loans and interests intended to be included in commercial mortgage loan securitizations as well as those not intended to be securitized. Advances under the Citi Repurchase Agreement accrue interest at a per annum interest rate equal to the sum of (i) 30-day LIBOR plus (ii) a margin of between 1.75% and 3.75% depending on (A) asset type, (B) the amount advanced and (C) the debt yield and loan-to-value ratios of the purchased mortgage loan, provided that the aggregate weighted average interest rate shall not at any time be less than the sum of one-month LIBOR plus 2.25%. The facility has an initial maturity date of March 29, 2014, subject to three one-year extension options, which may be exercised by us upon the satisfaction of certain conditions. We have guaranteed the obligations of our subsidiaries under the facility up to a maximum liability of 25% of the then-currently outstanding repurchase price of assets financed. As of September 30, 2012, SPM Sub-6-A had borrowed $40.1 million under this facility and the carrying value of the pledged collateral was $56.7 million.

Under the Wells Repurchase Agreement, the Second Wells Repurchase Agreement, the Goldman Repurchase Agreement, the Third Wells Repurchase Agreement, the Fourth Wells Repurchase Agreement, the Second Goldman Repurchase Agreement, and the Citi Repurchase Agreement, the counterparty retains the sole discretion over both whether to purchase the loan or security from us and, subject to certain conditions, the market value of such loan or security for purposes of determining whether we are required to pay margin to the counterparty.

On December 3, 2010, SPT Real Estate Sub II, LLC (SPT II), our wholly-owned subsidiary, entered into a term loan credit agreement (the BAML Credit Agreement) with Bank of America, N.A. (Bank of America) as administrative agent and as lender, and us and certain of our subsidiaries as guarantors. The BAML Credit Agreement, amended and restated on March 9, 2012 (Amended BAML Credit Agreement), provides for loans of up to $143.2 million as of September 30, 2012. The initial draw under the BAML Credit Agreement in December 2010 was used, in part, to finance the acquisition of a $205.0 million participation (the Participation) in a senior secured loan due November 15, 2015 from Bank of America. The Participation was converted into a security in June 2011 and is due from certain special purpose entities that were formed to hold substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. In connection with the March 9, 2012 amendment, we borrowed an additional $81.0 million to partially finance the $125.0 million acquisition of additional participation interest in the senior secured loan.

Advances under the Amended BAML Credit Agreement accrue interest at a per annum rate based on LIBOR or a base rate, at the election of SPT II. The margin can vary between 2.35% and 2.50% over LIBOR, and between 1.35% and 1.50% over base rate, based on the performance of the underlying hospitality collateral. The initial maturity date of the Amended BAML Credit Agreement is November 30, 2014, subject to a 12 month extension option, exercisable by SPT II upon satisfaction of certain conditions set forth in the Amended BAML Credit Agreement. Bank of America retains the sole discretion, subject to certain conditions, over the market value of collateral assets for purposes of determining whether we are required to pay margin to Bank of America. As of September 30, 2012, $143.2 million was outstanding under the BAML Credit Agreement. The carrying value of the CMBS pledged as collateral under the Credit agreement was $209.2 million as of September 30, 2012. If an event of default (as such term is defined in the Amended BAML Credit Agreement) occurs and is continuing, amounts borrowed may become due and payable immediately and interest would accrue at an additional 2% per annum over the applicable rate.

On July 3, 2012, Starwood Property Mortgage Sub-9, L.L.C. (SPM Sub-9) and Starwood Property Mortgage Sub-9-A, L.L.C. (SPM Sub-9-A), our indirect wholly-owned subsidiaries, entered into a Purchase and Repurchase Agreement and Securities Contract (OneWest Repurchase Agreement) with OneWest Bank, FSB (OneWest). At closing, SPM Sub-9 transferred loan investments to OneWest in exchange for a $78.3 million advance. Borrowings under the OneWest Repurchase Agreement accrue interest at a pricing rate of one-month LIBOR plus a margin of 3.0%. If an event of default (as such term is defined in the OneWest Repurchase Agreement) occurs and is continuing, amounts borrowed may become due and payable immediately and interest accrues at the default rate, which is equal to the pricing rate plus 5.0%. The initial maturity date of the facility is July 3, 2015 with two one-year extension options, subject to certain conditions. As of September 30, 2012, $77.4 million was outstanding under the OneWest Bank Repurchase Agreement and the carrying value of the pledged collateral was $112.6 million.

On August 3, 2012, Starwood Property Mortgage Sub-10, LLC (SPM Sub-10) and Starwood Property Mortgage Sub-10A (SPM Sub 10-A), our indirect wholly-owned subsidiaries, jointly entered into a $250.0 million Senior Secured Revolving Credit Facility (Borrowing Base) arranged by Merrill Lynch, Pierce, Fenner & Smith Incorporated (MLPFS). Lender participants in the facility include Bank of America, Citibank, Barclays Bank PLC, Deutsche Bank Trust Company Americas, Goldman Sachs Bank

USA, and Stifel Bank & Trust. The facility matures 364 days from closing, may be extended from time to time, provided the aggregate tenor shall not exceed four years. Outstanding borrowings under the facility will be priced at LIBOR + 325 bps, with an unused fee of 30 to 35 bps per annum depending upon the usage of the facility. The facility will be used primarily to finance our purchase or origination of commercial mortgage loans for the time period between transaction closing and the time in which a financing of the loan can be closed with one of our existing secured warehouse facilities or the loan is sold/syndicated in whole or in part. The term of financing provided under the facility for any individual loan is limited in most instances to the lesser of six months or the maturity of the facility. The facility will be secured by each loan for which financing has been provided as well as a no less than $500.0 million in market value of additional preapproved unencumbered senior, subordinate, and mezzanine loan assets. The facility is full recourse to us. As of September 30, 2012, there were no borrowings under the Borrowing Base and the carrying value of the pledged collateral was $505.3 million.

On August 17, 2012, Starwood Property Trust, Inc. (SPT), entered into a Master Repurchase Agreement with Goldman Sachs Lending Partners, LLC (the Third Goldman Repurchase Agreement). At closing, we borrowed $158.8 million under the Third Goldman Repurchase Agreement to finance the acquisition of $250.0 million participation interest in a mezzanine note that is expected to mature on November 15, 2015. The mezzanine note was issued by certain special purpose entities that were formed to hold substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. Advances under the Third Goldman Repurchase Agreement accrue interest at a per annum rate of one-month LIBOR plus a spread of 3.70%. The maturity date of the Third Goldman Repurchase Agreement is September 15, 2015. The carrying value of the mezzanine note was $234.6 million and the amount outstanding under the facility was $158.8 million at September 30, 2012.

The following table sets forth our five-year principal repayments schedule for the secured financings, assuming no defaults or expected extensions and excluding the loan transfer secured borrowings (amounts in thousands). Our credit facilities generally require principal to be paid down prior to the facilities respective maturities if and when we receive principal payments on, or sell, the investment collateral that we have pledged. The amount for the remainder of 2012 generally represents the principal repayments that are scheduled or otherwise expected to be received on our loan and MBS investments:

2012 (remaining)	$	32,178
2013		749,257
2014		340,844
2015		187,171
2016 and thereafter		
Total	$	1,309,450

7. Loan Transfer Activities

During 2010, we participated in a commercial mortgage securitization which generated non-recourse match funded financing with an effective cost of funds of approximately 3.5%. We separated five mortgage loans with an aggregate face value of $178.0 million into senior and junior loans. We contributed the five senior loans, or A Notes (the Contributed Loans), with a face value of approximately $84.0 million to the securitization trust and received approximately $92.0 million in proceeds, while retaining $94.0 million of junior interests. The Contributed Loans are secured by office, retail and industrial properties. Each of the five Contributed Loans was either originated or acquired by us as part of a first mortgage loan. In connection with the securitization, two of the first mortgage loans were each split by us into an A Note and a B Note and three of the first mortgage loans had each been previously split into A Notes, B Notes and C Notes. The secured financing liability relates to two of the Contributed Loans, which mature in 2014 and 2015 that did not qualify for sale treatment under GAAP. As of September 30, 2012 and December 31, 2011, the balance of the loans pledged to the securitization trust was $50.3 million and $50.3 million, respectively, and the related liability of the securitization trust was $52.5 million and $53.2 million, respectively.

During the first quarter of 2011, we contributed three loans to a securitization trust for approximately $56.0 million in gross proceeds. Control of the loans was surrendered in the loan transfer and it was therefore treated as a sale under GAAP, resulting in a gain of $1.9 million. We effectively realized a net gain of $1.8 million on this transaction after considering the realized losses on the interest rate hedges of $0.1 million that was terminated in connection with the sale.

During the first quarter of 2012, we sold six loans with a carrying value of $122.7 million to an independent third party resulting in proceeds, net of financing repayments, of $40.6 million. Control of the loans was surrendered in the loan transfer and it was therefore treated as a sale under GAAP, resulting in a realized gain of $9.4 million. The net economic gain of this transaction, including a realized loss of $8.4 million on the termination of the corresponding interest rate hedge, was $1.0 million. Additionally, we sold 50% of our Euro denominated loan to a strategic partner resulting in proceeds of $28.8 million and a realized loss of $2.1 million; however, this transaction was earnings neutral after considering the realized gains on the related currency hedges of $2.1 million that were terminated in connection with the sale. We have no continuing involvement in the loans.

During the third quarter of 2012, we sold the $36.1 million A-Note of a $51.5 million first mortgage loan that we had closed in July 2012, and retained the $15.4 million B-Note. The loan is collateralized by a portfolio of three hotels. The cash proceeds received from the sale approximated our carrying value in the A-Note. We retained the $15.4 million B-Note. The A-Note and B-Note bear interest at one-month LIBOR plus 3.5% and 11.83%, respectively. The buyer has an option to require us to repurchase the A-Note unless and until a default condition is cured with respect to one of the collateral properties, at which time the put option would terminate. In exchange for providing this put option, we receive 0.5% of the interest otherwise due to the buyer under the A-Note unless and until the put option terminates. The buyer has not exercised its option to date. While we fully expect the franchise agreement default condition will be cured as it was caused by a short-term construction project at the property that has since been completed, our participation in the interest accruing under the A-Note represents an element of continuing involvement that requires us to account for the sale as a secured borrowing. The carrying amount of the A-Note and secured borrowing were $35.7 million at September 30, 2012, and are classified in loans transferred as secured borrowings and loan transfer secured borrowings, respectively.

8. Derivatives and Hedging Activity

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from both our business operations and economic conditions. We principally manage our exposures to a wide variety of business and operational risks through management of our core business activities. We manage economic risks, including interest rate, foreign exchange, liquidity, and credit risk primarily by managing the amount, sources, and duration of our debt funding and the use of derivative financial instruments. Specifically, we enter into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates, credit spreads, and foreign exchange rates. Our derivative financial instruments are used to manage differences in the amount, timing, and duration of the known or expected cash receipts and known or expected cash payments principally related to our investments, anticipated level of loan sales, and borrowings.

Cash Flow Hedges of Forecasted Interest Payments

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements. To accomplish this objective, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for us making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

In connection with our repurchase agreements, we have entered into ten interest rate swaps that have been designated as cash flow hedges of the interest rate risk associated with forecasted interest payments. As of September 30, 2012, the aggregate notional of our interest rate swaps designated as cash flow hedges of interest rate risk totaled $322.6 million. Under these agreements, we will pay fixed monthly coupons at fixed rates ranging from 0.557% to 2.228% of the notional amount to the counterparty and receive floating rate LIBOR. Our interest rate swaps designated as cash flow hedges of interest rate risk have maturities ranging from November 2012 to October 2018.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the nine months ended September 30, 2012 we recorded no hedge ineffectiveness in earnings. During the three and nine months ended September 30, 2011 we record $0 and $45 thousand, respectively, as hedge ineffectiveness in earnings, which is included in interest expense on the condensed consolidated statements of operations.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the associated variable-rate debt. Over the next twelve months, we estimate that an additional $1.7 million will be reclassified as an increase to interest expense. We are hedging our exposure to the variability in future cash flows for forecasted transactions over a maximum period of 105 months.

Non-designated Hedges

Derivatives not designated as hedges are derivatives that do not meet the criteria for hedge accounting under GAAP or for which we have not elected to designate as hedges. We do not use these derivatives for speculative purposes but instead they are used to manage our exposure to foreign exchange rates, interest rate changes, and certain credit spreads. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in net (losses) gains on interest rate, currency or credit hedges in the condensed consolidated statements of operations.

During 2010, we entered into a series of forward contracts whereby we agree to sell an amount of GBP for agreed upon amounts of USD at various dates through October 2013. These forward contracts were executed to economically fix the USD amounts of GBP-denominated cash flows expected to be received by us related to our GBP-denominated loan investment. During 2011, we entered into a series of forward contracts whereby we agreed to sell an amount of EUR for an agreed upon amount of USD at various dates through June of 2014. These forward contracts were executed to economically fix the USD amount of EUR-denominated cash flows expected to be received by us related to a mezzanine loan investment in Germany. During the three months ended March 31, 2012, we terminated a portion of our contracts to sell EUR. The purpose of the terminations was to reduce the amount of EUR we were to sell at future dates as a result of the refinancing of our EUR-denominated loan investment. During the three months ended September 30, 2012, we entered into a series of forward contracts whereby we agreed to sell an amount of EUR for an agreed upon amount of USD at various dates through January of 2014. These forward contracts were executed to economically fix the USD amount of EUR-denominated cash flows expected to be received by us related to a second EUR denominated mezzanine loan. During the three months ended March 31, 2012, we entered into positions to buy GBP for an agreed upon amount of USD at various dates through October 2013 to fix the future value of our losses on pre-existing GBP forward positions. We also entered into a new series of forward contracts whereby we agreed to sell GBP for an agreed upon amount of USD at various dates through March 2016.

As of September 30, 2012, we had 13 foreign exchange forward derivatives to sell GBP with a total notional amount of GBP 180.9 million, 6 foreign exchange forward derivatives to buy GBP with a total notional amount of GBP 96.5 million and 14 foreign exchange forward derivatives to sell EUR with a total notional of EUR 94 million.

During 2010 and 2011, we entered into five interest rate swaps that were not designated as hedges. Under these agreements, we pay fixed coupons at fixed rates ranging from 0.716% to 2.505% of the notional amount to the counterparty and receive floating rate LIBOR. These interest rate swaps are used to limit the price exposure of certain assets due to changes in benchmark USD-LIBOR swap rates from which the pricing of these assets is derived. As of September 30, 2012, the aggregate notional amount of these interest rate swaps totaled $165.0 million. Changes in the fair value of these interest rate swaps are recorded directly in earnings.

In connection with our acquisition of a loan portfolio during the fourth quarter of 2011, we entered into nine interest rate swaps whereby we receive fixed coupons ranging from 2.86% to 6.28% of the notional amount and pay floating rate LIBOR. We acquired these swaps at a cost of $7.5 million. The premium paid reflects the fact that these swaps had above market rates which we receive. These swaps effectively convert certain floating rate loans we acquired to fixed rate loans. As of September 30, 2012, the aggregate notional amount of these swaps totaled $76.7 million. Changes in the fair value of these interest rate swaps are recorded directly in earnings.

During the nine months ended September 30, 2011 we entered into a series of derivatives that are intended to hedge against increases in market credit spreads of CMBS. Such movements would have a negative impact on the proceeds we expect to receive from contributing loans into commercial mortgage loan securitizations. The aggregate notional amount of the derivative was $25.0 million and it matured in December 2011. Under the terms of the contract, a market credit spread index was defined at the contract s inception by reference to a portfolio of specific independent CMBS. To the extent the referenced credit spread index increases, our counterparty pays us. To the extent the referenced credit spread index decreases, we pay our counterparty. We pay/receive approximately every 30 days based upon the movement in the referenced index during such period. The net gain from inception of the hedge through September 30, 2011 was $2.4 million. There were no credit hedges in place during the nine months ended September 30, 2012.

The table below presents the fair value of our derivative financial instruments as well as their classification on the balance sheet as of September 30, 2012 and December 31, 2011 (amounts in thousands).

Tabular Disclosure of Fair Values of Derivative Instruments (amounts in thousands)

	Derivatives in an Asset Position				Derivatives in a Liability Position			
	As of September 30, 2012		As of December 31, 2011		As of September 30, 2012		As of December 31, 2011	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives designated as hedging instruments								
Interest rate swaps	Derivative Assets	$	N/A	$	Derivative Liabilities	$ 3,043	Derivative Liabilities	$ 1,420
Total derivatives designated as hedging instruments		$		$		$ 3,043		$ 1,420
Derivatives not designated as hedging instruments								
Interest rate swaps	Derivative Assets	$ 5,488	Derivative Assets	$ 7,555	Derivative Liabilities	$ 2,064	Derivative Liabilities	$ 11,342
Foreign exchange contracts	Derivative Assets	5,536	Derivative Assets	5,261	Derivative Liabilities	20,484	Derivative Liabilities	6,890
Total derivatives *not* designated as hedging instruments		$ 11,024		$ 12,816		$ 22,548		$ 18,232

Cash flow hedges impact for the three months ended September 30, 2012 (amounts in thousands):

Derivative type for cash flow hedge	**Amount of loss recognized in OCI on derivative (effective portion)**	**Location of loss reclassified from accumulated OCI into income (effective portion)**	**Amount of loss reclassified from accumulated OCI into income (effective portion)**	**Location of loss recognized in income on derivative (ineffective portion)**	**Amount of loss recognized in income on derivative (ineffective portion)**
Interest Rate Swaps	$ 1,072	Interest Expense	$ 661	Interest Expense	$

Cash flow hedges impact for the three months ended September 30, 2011 (amounts in thousands):

Derivative type for cash flow hedge	**Amount of loss recognized in OCI on derivative (effective portion)**	**Location of loss reclassified from accumulated OCI into income (effective portion)**	**Amount of loss reclassified from accumulated OCI into income (effective portion)**	**Location of gain recognized in income on derivative (ineffective portion)**	**Amount of gain recognized in income on derivative (ineffective portion)**
Interest Rate Swaps	$ 544	Interest Expense	$ 527	Interest Expense	$

Cash flow hedges impact for the nine months ended September 30, 2012 (amounts in thousands):

Derivative type for cash flow hedge	**Amount of loss recognized in OCI on derivative (effective portion)**	**Location of loss reclassified from accumulated OCI into income (effective portion)**	**Amount of loss reclassified from accumulated OCI into income (effective portion)**	**Location of loss recognized in income on derivative (ineffective portion)**	**Amount of loss recognized in income on derivative (ineffective portion)**
Interest Rate Swaps	$ 3,534	Interest Expense	$ 1,912	Interest Expense	$

Cash flow hedges impact for the nine months ended September 30, 2011 (amounts in thousands):

Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of gain recognized in income on derivative (ineffective portion)	Amount of gain recognized in income on derivative (ineffective portion)
Interest Rate Swaps	$ 1,759	Interest Expense	$ 1,730	Interest Expense	$ 45

Non-designated derivatives impact for the three months ended September 30, 2012 and September 30, 2011 (amounts in thousands):

Derivatives Not Designated as Hedging Instruments		Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative 2012	2011
Interest Rate Swaps	Realized losses	Gains (losses) on interest rate hedges	$ 26	$ (12,302)
Interest Rate Swaps	Net change in unrealized gains (losses)	Gains (losses) on interest rate hedges	$ (77)	$ (6,869)
Foreign Exchange	Realized losses	Gains (losses) on currency hedges	$ 663	$ (86)
Foreign Exchange	Net change in unrealized gains (losses)	Gains (losses) on currency hedges	$ (8,173)	$ 8,703
Credit Spread Derivative	Realized losses	Gains (losses) on credit spread hedges	$	$ 4,539
Credit Spread Derivative	Net change in unrealized gains	Gains (losses) on credit spread hedges	$	$ (2,280)

Non-Designated derivatives impact for the nine months ended September 30, 2012 and September 30, 2011 (amounts in thousands):

Derivatives Not Designated as Hedging Instruments		Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative 2012	2011
Interest Rate Swaps	Realized losses	Gains (losses) on interest rate hedges	$ (9,383)	$ (14,883)
Interest Rate Swaps	Net change in unrealized gains (losses)	Gains (losses) on interest rate hedges	$ 9,991	$ (11,099)
Foreign Exchange	Realized gains (losses)	Gains (losses) on currency hedges	$ 2,928	$ (292)
Foreign Exchange	Net change in unrealized losses	Gains (losses) on currency hedges	$ (13,320)	$ 2,674
Credit Spread Derivative	Realized losses	Gains (losses) on credit spread hedges	$	$ 3,569
Credit Spread Derivative	Net change in unrealized gains	Gains (losses) on credit spread hedges	$	$ 161

Credit-risk-related Contingent Features

We have entered into agreements with certain of our derivative counterparties that contain provisions where if we were to default on any of our indebtedness, including defaults where repayment of the indebtedness has not been accelerated by the lender, we may also be declared in default on our derivative obligations. We also have certain agreements that contain provisions where if our ratio of principal amount of indebtedness to total assets at any time exceeds 75%, then we could be declared in default of our derivative obligations.

As of September 30, 2012 the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk related to these agreements, was $22.3 million. As of September 30, 2012, we have posted collateral of $3.6 million related to these agreements. If we had breached any of these provisions at September 30, 2012, we could have been required to settle our obligations under the agreements at their termination liability value of $22.3 million.

9. Related-Party Transactions

Management Agreement

We entered into a Management Agreement with our Manager upon closing of our IPO, which provides for an initial term of three years with automatic one-year extensions thereafter unless terminated as described below. Under the Management Agreement, our Manager, subject to the oversight of our board of directors, is required to manage our day-to-day activities, for which our Manager receives a base management fee and is eligible for an incentive fee and stock awards. Our Manager is also entitled to charge us for certain expenses incurred on our behalf, as described below.

Base Management Fee The base management fee is 1.5% of our stockholders equity per annum and is calculated and payable quarterly in arrears in cash. For purposes of calculating the management fee, our stockholders equity is defined as: (a) the sum of (1) the net proceeds from all issuances of our equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus (2) our retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less (b) any amount that we pay to repurchase our common stock since inception. It also excludes (1) any unrealized gains and losses and other non-cash items that have impacted stockholders equity as reported in our financial statements prepared in accordance with GAAP, and (2) one-time events pursuant to changes in GAAP, and certain non-cash adjustments not otherwise described above, in each case after discussions between our Manager and our independent directors and approval by a majority of our independent directors. As a result, our stockholders equity, for purposes of calculating the management fee, could be greater or less than the amount of stockholders equity shown in our condensed consolidated financial statements.

For the three and nine months ended September 30, 2012 approximately $8.5 million and $23.3 million was incurred for base management fees, respectively, of which $8.5 million was payable at September 30, 2012. For the three and nine months ended September 30, 2011, approximately $6.7 million and $17.6 million was incurred for base management fees, respectively. The management fee payable as of December 31, 2011 was $6.7 million.

Incentive Fee Our Manager is entitled to be paid the incentive fee described below with respect to each calendar quarter (or part thereof that the Management Agreement is in effect) if (1) our Core Earnings (as defined below) for the previous 12-month period (or part thereof that the Management Agreement is in effect) exceeds an 8% threshold, and (2) our Core Earnings for the 12 most recently completed calendar quarters (or part thereof that the Management Agreement is in effect) is greater than zero.

The incentive fee will be an amount, not less than zero, equal to the difference between (1) the product of (x) 20% and (y) the difference between (i) our Core Earnings (as defined below) for the previous 12-month period (or part thereof that the Management Agreement is in effect), and (ii) the product of (A) the weighted average of the issue price per share of our common stock of all of our public offerings multiplied by the weighted average number of all shares of common stock outstanding (including any restricted stock units, any restricted shares of common stock and other shares of common stock underlying awards granted under our equity incentive plans) in such previous 12-month period (or part thereof that the Management Agreement is in effect), and (B) 8%, and (2) the sum of any incentive fee paid to our Manager with respect to the first three calendar quarters of such previous 12-month period (or part thereof that the Management Agreement is in effect). One half of each quarterly installment of the incentive fee is payable in shares of our common stock so long as the ownership of such additional number of shares by our Manager would not violate the 9.8% stock ownership limit set forth in our articles of incorporation, after giving effect to any waiver from such limit that our board of directors may grant in the future. The remainder of the incentive fee is payable in cash. The number of shares to be issued to our Manager is equal to the dollar amount of the portion of the quarterly installment of the incentive fee payable in shares divided by the average of the closing prices of our common stock on the New York Stock Exchange for the five trading days prior to the date on which such quarterly installment is paid.

Core Earnings is a non-GAAP financial measure. We calculate Core Earnings as GAAP net income (loss) excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization of real estate (to the extent that we own properties), and any unrealized gains, losses or other non-cash items recorded in net income for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income. The amount is adjusted to exclude one-time events pursuant to changes in GAAP and certain other non-cash adjustments, in each case after discussions between our Manager and our independent directors and as approved by a majority of our independent directors.

For the three and nine months ended September 30, 2012, we incurred approximately $2.1 million and $7.5 million in incentive fee. During the quarter ended September 30, 2012, we paid the manager $2.3 million of the incentive fee earned, 50% in cash and the remaining 50% in stock through the issuance of 50,203 shares of common stock at a price of $22.61 per share. As of September 30, 2012, the incentive fee payable was $2.4 million, which is included in related party payable in the condensed consolidated balance sheet. For the three and nine months ended

September 30, 2011, we incurred approximately $0.4 million and $1.2 million in incentive fee, 50% in cash and the remaining 50% in stock through the issuance of 9,021 shares of common stock at a price of $22.08 per share.

Expense Reimbursement We are required to reimburse our Manager for operating expenses incurred by our Manager on our behalf. In addition, pursuant to the terms of the Management Agreement, we are required to reimburse our Manager for the cost of legal, tax, consulting, auditing and other similar services rendered for us by our Manager s personnel provided that such costs are no greater than those that would be payable if the services were provided by an independent third party. The expense reimbursement is not subject to any dollar limitations but is subject to review by our independent directors. For the three and nine months ended September 30, 2012, approximately $1.7 million and $4.6 million were incurred, respectively, for executive compensation and other reimbursable expenses of which approximately $1.7 million was payable as of September 30, 2012. For the three and nine months ended September 30, 2011, approximately $1.0 million and $2.8 million were incurred, respectively, for executive compensation and other reimbursable expenses of which approximately $1.1 million was payable as of September 30, 2011.

Termination Fee After the initial three-year term, we can terminate the Management Agreement without cause, as defined in the Management Agreement, with an affirmative two-thirds vote by our independent directors and 180 days written notice to our Manager. Upon termination without cause, our Manager is due a termination fee equal to three times the sum of the average annual base management fee and incentive fee earned by our Manager over the preceding eight calendar quarters. No termination fee is payable if our Manager is terminated for cause, as defined in the Management Agreement, which can be done at any time with 30 days written notice from our board of directors.

Loan Investments

In April 2011 we purchased a $35 million *pari passu* participation interest (the Mammoth Participation Interest) in a $75 million subordinate loan (the Mammoth Loan) from an independent third party and a syndicate of financial institutions and other entities acting as subordinate lenders to Mammoth Mountain Ski Area, LLC (Mammoth). Mammoth is a single-purpose, bankruptcy remote entity that is owned and controlled by Starwood Global Opportunity Fund VII-A, L.P., Starwood Global Opportunity Fund VII-B, L.P., Starwood U.S. Opportunity Fund VII-D, L.P. and Starwood U.S. Opportunity Fund VII-D-2, L.P. (collectively, the Sponsors). Each of the Sponsors is indirectly wholly-owned by Starwood Capital Group Global I, L.L.C., and an affiliate of our Chief Executive Officer. The Mammoth Loan was approved by our independent directors in accordance with our related party transaction policy. The Mammoth Loan has a term of up to six years and an interest rate of 14.0% through April 2014 and 13.25% thereafter. We acquired the Mammoth Participation Interest in the Mammoth Loan from an independent third party and own such Mammoth Participation Interest subject to a participation agreement between us and the independent third party (the Mammoth Participation Agreement). The Mammoth Participation Agreement provides for the payment to us, on a pro rata basis with an independent third party, of customary payments in respect of the Mammoth Participation Interest and affords us customary voting, approval and consent rights so long as no event of default is continuing under the Mammoth Loan.

On July 20, 2012, we purchased a 50% undivided participation interest (the Le Meridien Participation Interest) in a EUR-denominated mezzanine loan for $68.4 million (Le Méridien Loan) from an independent third party. The borrower is Starman Luxembourg Holdings S.À R.L. (Holdings), an entity that indirectly owns and operates a portfolio of hotels in France and Germany. Holdings is owned 50% by an independent third party and 50% by several private investment funds previously sponsored by Starwood Capital Group Global I, L.L.C., an affiliate of our Manager. The Le Méridien Loan has an initial term of two years with an option to extend for an additional year, subject to certain conditions, an interest rate of 12.5%, an upfront fee of 2.0% and a prepayment fee of 1.0%. We acquired the Le Meridien Participation Interest from an independent third party and own the Le Meridien Participation Interest subject to a participation agreement between us and the independent third party (the Le Meridien Participation Agreement). The Le Meridien Participation Agreement provides for the payment to us, on a pro rata basis with an independent third party, of customary payments in respect of our Le Meridien Participation Interest and affords us customary voting, approval and consent rights.

Refer to Note 15 to the condensed consolidated financial statements for disclosure of a related party loan investment that closed subsequent to September 30, 2012.

10. Stockholders Equity

The Company s authorized capital stock consists of 100,000,000 shares of preferred stock, $0.01 par value per share, and 500,000,000 shares of common stock, $0.01 par value per share.

In May 2011, we completed a follow-on offering of 22,000,000 shares of our common stock at a price of $21.67 per share.

In April 2012, we completed another follow-on offering of 23,000,000 shares of our common stock at a price of $19.88 per share.

In June 2012 we entered into an ATM Equity Offering Sales Agreement with Merrill Lynch, Pierce, Fenner & Smith Incorporated, (the Agent), relating to our shares of common stock. In accordance with the terms of the agreement, we may offer and sell shares of our common stock having an aggregate gross sales price of up to $250 million from time to time through the agent, as our sales Agent. Sales of the shares, if any, will be made by means of ordinary brokers transactions or otherwise at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices. Through November 7, 2012, we had not directed our Agent to sell any shares.

At the time of our IPO in 2009, the underwriters for the IPO agreed to defer and condition the receipt of a portion of their underwriting fees on our future achievement of certain minimum investment returns. Similarly, at the time of the IPO our Manager agreed to pay to the underwriters a separate portion of the underwriting fees on our behalf, with our reimbursement of our Manager of those amounts conditioned upon our achievement of the same investment returns. In the absence of the achievement of such investment returns, we would not pay the underwriters the deferred portion of the underwriting fees nor would our Manager be reimbursed for the portion of the underwriting fees that it paid on our behalf. Specifically, pursuant to the IPO underwriting agreement among the underwriters, our Manager and us, we were required to pay to the underwriters $18.1 million of underwriting fees if during any full four calendar quarter period during the 24 full calendar quarters after the consummation of the IPO our Core Earnings for any such four-quarter period exceeded the product of (x) the weighted-average of the issue price per share of all public offerings of our common stock, multiplied by the weighted-average number of shares outstanding (including any restricted stock units, any restricted shares of common stock and any other shares of common stock underlying awards granted under our equity incentive plans) in such four-quarter period and (y) 8%. Additionally, because at the time of our IPO our Manager paid $9.1 million of underwriting fees on our behalf, pursuant to our Management Agreement with our Manager, we agreed to reimburse our Manager for such payments to the extent the same 8% performance threshold was exceeded. For the four calendar quarter periods ended March 31, 2011 we exceeded the threshold and therefore paid $27.2 million related to these contingent arrangements during the second quarter of 2011. Prior to 2011, we had recorded a deferred liability and an offsetting reduction to additional paid-in-capital for the full $27.2 million based upon actual and forecasted operating results at the time.

In August 2011, our board of directors authorized us to repurchase up to $100 million of our outstanding common shares over a one-year period. Purchases made pursuant to the program are to be made in either the open market or in privately negotiated transactions from time to time as permitted by federal securities laws and other legal requirements. The timing, manner, price and amount of any repurchases are determined by us and are subject to economic and market conditions, stock price, applicable legal requirements and other factors. The program may be suspended or discontinued at any time. Through December 31, 2011, we purchased 625,850 common shares on the open market at an aggregate cost of approximately $10.6 million, resulting in a weighted average share cost of $17.00. No additional shares were purchased during the nine months ended September 30, 2012.

Our board of directors declared the following dividends in 2011 and 2012:

Ex-Dividend Date	**Record Date**	**Announce Date**	**Pay Date**		**Amount**	**Frequency**
9/26/2012	9/28/2012	8/3/2012	10/15/2012	$	0.44	Quarterly
6/27/2012	6/29/2012	5/8/2012	7/13/2012	$	0.44	Quarterly
3/28/2012	3/30/2012	2/29/2012	4/13/2012	$	0.44	Quarterly
12/28/2011	12/31/2011	11/4/2011	1/13/2012	$	0.44	Quarterly
9/28/2011	9/30/2011	8/2/2011	10/14/2011	$	0.44	Quarterly
6/28/2011	6/30/2011	5/10/2011	7/15/2011	$	0.44	Quarterly
3/29/2011	3/31/2011	3/1/2011	4/15/2011	$	0.42	Quarterly

Equity Incentive Plans

We have reserved an aggregate of 3,112,500 shares of common stock for issuance under the Starwood Property Trust, Inc. Equity Plan and Starwood Property Trust, Inc. Manager Equity Plan and an additional 100,000 shares of common stock for issuance under the Starwood Property Trust, Inc. Non-Executive Director Stock Plan. These plans provide for the issuance of restricted stock or restricted stock units. The holders of awards of restricted stock or restricted stock units will be entitled to receive dividends or distribution equivalents, which will be payable at such time dividends are paid on our outstanding shares of common stock.

We granted each of our four independent directors 2,200 shares of restricted stock concurrently with our IPO, with a total fair value of approximately $175 thousand. The grants vested ratably in three annual installments on each of the first, second, and third anniversaries of the grant date, respectively, subject to the director s continued service. Effective August 19, 2010, we granted each of our four independent directors an additional 1,000 shares of restricted stock, with a total fair value of approximately $75 thousand. The grants vested in one annual installment on the first anniversary of the grant. Effective August 19, 2011, we granted each of our four independent directors an additional 2,877 shares of restricted stock, with a total fair value of approximately $200 thousand. The grants vested in one annual installment on the first anniversary of the grant. On August 16, 2012, we granted each of our four independent directors 2,201 restricted common shares with an aggregate fair value of approximately $200 thousand. The grants will vest on August 16, 2013. For the three and nine months ended September 30, 2012, approximately $87 thousand and $216 thousand were included in general and administrative expense, respectively, related to the grants. For the three and nine months ended September 30, 2011, approximately $48 thousand and $114 thousand were included in general and administrative expense, respectively, related to the grants.

In August 2009, we granted 1,037,500 restricted stock units with a fair value of approximately $20.8 million at the grant date to our Manager under the Manager Equity Plan. The grants vest ratably in quarterly installments over three years beginning on October 1, 2009, with 86,458 shares vesting each quarter, respectively. In connection with the supplemental equity offering in December 2010, we granted 1,075,000 restricted stock units with a fair value of approximately $21.8 million at the grant date to our Manager under the Manager Equity Plan. The grants vest ratably in quarterly installments over three years beginning on March 31, 2011, with 89,583 shares vesting each quarter. In May 2012, we granted 30,000 restricted common shares with a fair value of $602 thousand to the Manager under the Manager Equity Plan. As of the grant date, 25,000 of these shares vested and the remaining shares vest in quarterly installments at a rate of 2,500 shares per quarter beginning on September 30, 2012. For the three and nine months ended September 30, 2012, approximately 178,542 and 555,625 shares have vested, respectively, and approximately $4.1 million and $11.9 million has been included in management fees related to these grants, respectively. For the three and nine months ended September 30, 2011, approximately 176,041 and 528,123 shares have vested, respectively, and approximately $2.9 million and $10.3 million has been included in management fees related to these grants, respectively. Refer to Note 15 for disclosure of an additional grant of restricted stock units to our Manager subsequent to September 30, 2012.

In May 2011, we issued 9,021 shares of common stock to the Manager at a price of $22.08 per share. In August 2011, we issued 54,234 shares of common stock to the Manager at a price of $18.58 per share. In May 2012, we issued 70,220 shares of common stock to the Manager at a price of $19.76 and in August 2009 we issued shares of common stock to the Manager at a price of $22.61. These shares were issued to the Manager as satisfaction of 50% of the incentive compensation due to the Manager as required under the Management Agreement, refer to Note 9 in the consolidated financial statements.

In February 2011, we granted 11,082 restricted stock units with a fair value of $250 thousand to an employee under the Starwood Property Trust, Inc. Equity Plan. The award vests ratably in quarterly installments over three years beginning on March 31, 2011. In March 2012, we granted 17,500 restricted common shares with a fair value of $368 thousand to employees under the Starwood Property Trust, Inc. Equity Plan. Of the total award, 12,500 restricted shares vest in quarterly installments over three years beginning on March 31, 2012 and 5,000 shares vest in annual installments over three years beginning on December 31, 2012. For the three and nine months ended September 30, 2012, 1,965 and 5,896 shares, respectively, have vested, and approximately $52 thousand and $154 thousand, respectively, was included in general and administrative expense related to these grants. For the three and nine months ended September 30, 2011, 924 and 2,771 shares have vested, respectively, and approximately $21 thousand and $50 thousand, respectively, was included in general and administrative expense related to these grants.

Schedule of Non-Vested Share and Share Equivalents

	Restricted Stock Grants to Independent Directors	Restricted Stock and Restricted Stock Unit Grants to Employees	Restricted Stock and Restricted Stock Unit Grants to Manager	Total
Balance as of December 31, 2011	15,175	7,385	976,044	998,604
Granted	8,804	17,500	30,000	56,304
Vested	(14,441)	(5,896)	(555,624)	(575,961)
Forfeited				
Balance as of September 30, 2012	9,538	18,989	450,420	478,947

Vesting Schedule

	Restricted Stock Grants to Independent Directors	Restricted Stock Unit Grants to Employees	Restricted Stock Unit Grants to Manager	Total
2012 (remainder of)		3,631	92,087	95,718
2013	9,538	9,527	358,333	377,398
2014		5,831		5,831
Total	9,538	18,989	450,420	478,947

11. Accumulated Other Comprehensive Income

Accumulated other comprehensive income is comprised of the following, net of non-controlling interests in consolidated subsidiaries (amounts in thousands):

	September 30, 2012	September 30, 2011
Cumulative unrealized gain on available-for-sale securities	$ 65,226	$ (7,854)
Effective portion of cumulative loss on cash flow hedges	(3,043)	(1,611)
Total	$ 62,183	$ (9,465)

12. Net Income per Share

The following table provides a reconciliation of both net income and the number of common shares used in the computation of basic and diluted income per share. We use the two-class method in calculating both basic and diluted earnings per share as our unvested restricted stock units (refer to Note 10) are participating securities as defined in GAAP (amounts in thousands, except share and per share amounts):

		Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012
Net income attributable to Starwood Property Trust, Inc.	$	50,212	$	144,861
Net (loss) allocated to participating securities		(275)		(980)
Numerator for basic and diluted net income per share	$	49,937	$	143,881
Basic weighted average shares outstanding		116,673,477		107,077,837
Weighted average number of diluted shares outstanding(1)		117,381,559		107,958,047
Basic income per share	$	0.43	$	1.34
Diluted income per share	$	0.43	$	1.34

(1) The weighted average number of diluted shares outstanding includes the impact as of September 30, 2012 of (i) unvested restricted stock units totaling 478,947, and (ii) 47,736 shares that would be hypothetically issuable as part of the incentive fee payable to the Manager if we assume that September 30, 2012 was the end of the measurement period, respectively.

		Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011
Net income attributable to Starwood Property Trust, Inc.	$	14,478	$	78,349
Net (loss) allocated to participating securities		(507)		(1,796)
Numerator for basic and diluted net income per share	$	13,971	$	76,553
Basic weighted average shares outstanding		93,249,249		82,234,976
Weighted average number of diluted shares outstanding(2)		94,596,978		83,755,295
Basic income per share	$	0.16	$	0.95
Diluted income per share	$	0.15	$	0.94

(2) The weighted average number of diluted shares outstanding includes the impact of (i) unvested restricted stock units totaling 1,175,572 as of, and (ii) 48,742 shares that would be hypothetically issuable as part of the incentive fee payable to the Manager if we assume that September 30, 2011 was the end of the measurement period, respectively.

13. Fair Value of Financial Instruments

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

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - 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 3 - 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) unobservable inputs may be used. Unobservable inputs reflect our own assumptions about the factors that market participants would use in pricing an asset or liability, and would be based on the best information available.

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

Our Level III financial instruments are privately-held transactions and/or not actively traded in a marketplace. For each such instrument, we strive to reasonably estimate the expected cash flows and the current rate of return an investor would demand for the same, or more often, similar type financial instruments. We also obtain third-party information, such as broker quotes on MBS from market participants, when they are available and considered relevant. At least quarterly, we review our process for estimating the fair value of our Level III instruments and make adjustments as necessary.

We determine the fair value of our financial instruments as follows:

Available-for-sale debt securities

Available-for-sale debt securities are valued utilizing observable and unobservable market inputs. The observable market inputs may include recent transactions, broker quotes and vendor prices (market data). However, to the extent there is material price dispersion amongst the market data, the fair value determination for these securities significantly utilizes unobservable inputs in discounted cash flow models including prepayments, default and severity estimates based on the recent performance of the collateral, the underlying collateral characteristics, industry trends, as well as expectations of macro-economic events (e.g. housing price curves, interest rate curves, etc.). At each measurement date, we consider both the observable and unobservable valuation inputs in the determination of fair value, as applicable, and securities are classified as Level III when unobservable inputs have the most significant impact.

Available-for-sale equity securities

The available-for-sale equity securities are publicly registered in the United States and listed on the New York Stock Exchange.

Derivatives

The valuation of derivative contracts are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, spot and market forward points. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. The fair value of the foreign currency forward contracts is based on interest differentials between the currencies being traded, spot and market forward points.

We incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although we have determined that the majority of the inputs used to value our derivatives fall within Level II of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize Level III inputs, such as estimates of current credit spreads to evaluate the likelihood of default by ourselves and our counterparties. As of September 30, 2012 and December 31, 2011, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and have determined that the credit valuation adjustments are not significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified in Level II of the fair value hierarchy.

Loans

We estimate the fair values of our loans by using market prices, when available, or discounting their expected cash flows at a rate we estimate would be demanded by the market participants that would be most likely to buy our loans. The expected cash flows used are the same as those used to calculate our level yield income in the financial statements.

The following table presents our financial instruments carried at fair value on a recurring basis in the condensed consolidated balance sheet as of September 30, 2012 (amounts in thousands):

	Fair Value at Reporting Date Using Inputs: September 30, 2012			
	Total	Level I	Level II	Level III
Available-for-sale debt securities:				
RMBS	$ 337,900			$ 337,900
CMBS	528,965		$ 528,965	
Total available-for-sale debt securities	866,865		528,965	337,900
Available-for-sale equity securities:				
Real estate industry	13,035	$ 13,035		
Total available-for-sale equity securities	13,035	13,035		
Total available-for-sale securities	879,900	13,035	528,965	337,900
Derivative Assets:				
Foreign exchange contracts	5,536		5,536	
Interest rate contracts	5,488		5,488	
Derivatives Liabilities:				
Interest rate contracts	(5,106)		(5,106)	
Foreign exchange contracts	(20,485)		(20,485)	
Total derivatives	(14,567)		(14,567)	
Total	$ 865,333	$ 13,035	$ 514,398	$ 337,900

The changes in investments classified as Level III are as follows for the three months ended September 30, 2012 (amounts in thousands):

Fair Value Measurements Using Significant Unobservable Inputs

(Level III)

	Loans held-for-sale, at fair value	RMBS available-for-sale, at fair value	Total
Beginning balance, June 30, 2012	$	$ 233,456	$ 233,456
Purchases		95,814	95,814
Originations			
Sales		(9,425)	(9,425)
Maturities			
Principal amortization		(18,542)	(18,542)
Net decrease in assets		67,847	67,847
Gain (loss) amounts from Level III investments:			
Unrealized (loss) gain on assets		30,575	30,575
Realized gain on assets		730	730
Accretion of discount		5,924	5,924
OTTI		(637)	(637)
Other		5	5
Net gain on assets		36,597	36,597
Ending balance, as of September 30, 2012	**$**	$ 337,900	$ 337,900

The changes in investments classified as Level III are as follows for the nine months ended September 30, 2012 (amounts in thousands):

Fair Value Measurements Using Significant Unobservable Inputs

(Level III)

	Loans held-for-sale, at fair value	RMBS available-for-sale, at fair value	Total
Beginning balance, January 1, 2012	$ 128,593	$ 341,734	$ 470,327
Purchases		203,433	203,433
Originations			
Transfer out		(176,786)	(176,786)
Sales	(132,128)	(26,049)	(158,177)
Maturities			
Principal amortization	(122)	(52,310)	(52,432)
Net increase (decrease) in assets	(132,250)	(51,712)	(183,962)
Gain (loss) amounts from Level III investments:			
Unrealized (loss) gain on assets	(5,760)	34,371	28,611
Realized gain on assets	9,417	3,643	13,060
Accretion of discount		12,548	12,548
OTTI		(2,689)	(2,689)
Other		5	5
Net gain on assets	3,657	47,878	51,535

Ending balance, as of September 30, 2012	**$**	$ 337,900	$ 337,900

Due to an increase in the observable, relevant market activity for the CMBS investment position that we owned as of January 1, 2012, we transferred a $176,786 MBS investment from Level III to Level II during the three months ended March 31, 2012.

The following table presents our financial instruments carried at fair value on a recurring basis in the consolidated balance sheet as of December 31, 2011 (amounts in thousands):

		Fair Value at Reporting Date Using Inputs: December 31, 2011		
	Total	Level I	Level II	Level III
Loans held-for-sale at fair value	$ 128,593			$ 128,593
Available-for-sale debt securities:				
RMBS	164,948			164,948
CMBS	176,786			176,786
Total available-for-sale debt securities	341,734			341,734
Available-for-sale equity securities:				
Real estate industry	11,269	$ 11,269		
Total available-for-sale equity securities:	11,269	11,269		
Total investments	481,596	11,269		470,327
Derivative Assets:				
Foreign exchange contracts	5,261		$ 5,261	
Interest rate contracts	7,555		7,555	
Derivatives Liabilities:				
Interest rate contracts	(12,762)		(12,762)	
Foreign exchange contracts	(6,890)		(6,890)	
Total Derivatives:	(6,836)		(6,836)	
Total:	$ 474,760	$ 11,269	$ (6,836)	$ 470,327

The changes in investments classified as Level III and carried at fair value are as follows for the year ended December 31, 2011 (amounts in thousands):

	Loans held-for-sale, at fair value	MBS available-for-sale, at fair value	Total
Beginning balance, January 1, 2011	$ 144,163	$	$ 144,163
Purchases		115,795	115,795
Originations	270,066		270,066
Transfer in	(7,000)	282,763	275,763
Sales	(294,126)	(3,600)	(297,726)
Maturities		(15,408)	(15,408)
Principal amortization	(252)	(36,562)	(36,814)
Net increase on assets	(31,312)	342,988	311,676
Gain (loss) on loans held-for-sale, at fair value:			
Unrealized gain on assets	5,760	(7,961)	(2,201)
Realized gain on assets	10,314	249	10,563
Accretion of discount		10,730	10,730
OTTI		(4,272)	(4,272)
Other	(332)		(332)
Net gain on assets	15,742	(1,254)	14,488
Ending balance, as of December 31, 2011	**$** 128,593	$ 341,734	$ 470,327

The following table presents the fair value of our Level III financial instruments, not carried at fair value on the condensed consolidated balance sheet (amounts in thousands):

	Carrying Value as of September 30, 2012	Fair Value as of September 30, 2012	Carrying Value as of December 31, 2011	Fair Value as of December 31, 2011
Financial Instruments not carried at Fair Value:				
Loans held for investment	$ 2,580,789	$ 2,647,656	$ 2,268,599	$ 2,308,300
Loans transferred as secured obligations	$ 86,021	$ 87,321	$ 50,316	$ 50,958
Other Investments	$ 32,317	$ 32,317	$ 33,110	$ 33,110
Financial Liabilities:				
Secured financing agreements	$ 1,309,450	$ 1,310,668	$ 1,103,517	$ 1,104,612
Loans transfer secured borrowings	$ 88,268	$ 88,411	$ 53,199	$ 53,199

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The following is quantitative information about significant unobservable inputs in our Level III Measurements (dollar amounts in thousands):

Quantitative Information about Level III Fair Value Measurements

	Fair Value at September 30, 2012	Valuation Technique	Unobservable Input	Range
RMBS	$ 337,900	Discounted cash flow	Constant prepayment rate	(0.4%) - 10.2%
			Constant default rate	2.2% - 17.2%
			Loss severity	34% - 102% (b)
			Delinquency Rate	5% - 60%
			Servicer Advances	14% - 100%
			Annual Coupon Deterioration	0% - 0.31%
Loans held for investment	$ 2,647,656	Discounted cash flow	Projected cash flows (a) Discount rates	3.8% -15.6%
Loans transferred as secured borrowings	$ 87,321	Discounted cash flow	Projected cash flows (a) Discount rates	3.8% - 4.6%
Other investments	$ 32,317	Discounted cash flow	Projected cash flows (a) Discount rates	9.5%
Secured financing agreements	$ 1,310,668	Discounted cash flow	Projected cash flows (a) Discount rates	2.4% - 5.4%
Loan transfer secured borrowings	$ 88,411	Discounted cash flow	Projected cash flows (a) Discount rates	3.5% - 3.8%

(a) As of September 30, 2012, management expects to collect all amounts contractually due.

(b) 90% of the portfolio falls within a range of 40-85%.

14. Commitments and Contingencies

As described in Note 5, as of September 30, 2012, we had unfunded commitments totaling $1.7 million related to an investment.

As of September 30, 2012, we had future funding commitments on 17 loans totaling $128.2 million. The funding commitments relate primarily to development, leasing commissions and tenant improvements to the extent new leases on the underlying collateral are signed.

Management is not aware of any other contractual obligations, legal proceedings, or any other contingent obligations incurred in the normal course of business that would have a material adverse effect on our financial statements.

15. Subsequent Events

On October 3, 2012, we sold the $94.5 million A-Note component of a $135.0 million first mortgage loan on two Class B office buildings located in the SoHo district of Midtown Manhattan. We retained the $40.5 million B-Note. We originated the first mortgage loan during the second quarter of 2012.

On October 10, 2012, we completed an underwritten public offering of 18,400,000 shares of our common stock at a price of $22.74 for total gross proceeds of approximately $418.4 million. In addition, on October 10, 2012 we granted 875,000 restricted stock units with a fair value of approximately $19.9 million at the grant date to our Manager under the Manager Equity Plan. This award will vest ratably in quarterly installments over a three-year period beginning on December 31, 2012, subject to the Manager s continued service as our manager.

On October 16, 2012, through a newly-formed venture with Starwood Distressed Opportunity Fund IX (Fund IX), an affiliate of our Manager, we co-originated a $475 million first mortgage and mezzanine financing for the acquisition and redevelopment of a 10-story retail building located at 701 Seventh Avenue in the Times Square area of Manhattan. Of the total loan amount, $375 million was funded at closing, $281.2 million of which was funded by us and $93.8 million that was funded by Fund IX. In addition, $100 million will be funded upon reaching certain milestones during the transformation of the property. On October 22, 2012, the venture sold a 25 percent participation in both the first mortgage and mezzanine loan to Vornado Realty Trust (Vornado). Upon settling this sale, the Company, Starwood Distressed Opportunity Fund IX, and Vornado had funded $210.9 million, $70.3 million and $93.8 million, respectively, and each party will fund their pro rata share of any future fundings. Following the sale to Vornado, the Starwood entities retained the controlling position in both the first mortgage and mezzanine loans.

On October 26, 2012, we originated a $126 million first mortgage secured by a 25 story Class A office tower located at 100 Montgomery Street, San Francisco, CA. The loan has an initial funding of $115. 5 million with a future funding obligation of $10.5 million for tenant improvements and leasing commissions. The loan bears interest at one-month LIBOR plus 3.95%, subject to a 0.25% LIBOR floor. The loan has a three-year term with two one-year extensions, subject to certain conditions.

On November 5, 2012, we purchased the senior participation in a whole loan secured by an office building located in Washington DC for $45.6 million. The loan has a three-year term with two one-year extensions.

On November 6, 2012 our board of directors declared a dividend of $0.44 per share for the fourth quarter of 2012, which is payable on January 15, 2013 to common stockholders of record on December 31, 2012.

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

The following Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the information included elsewhere in this Quarterly Report on Form 10-Q and in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. This description contains forward-looking statements that involve risks and uncertainties. Actual results could differ significantly from the results discussed in the forward-looking statements due to the factors set forth in   Risk Factors   and elsewhere in the Quarterly Reports on Form 10-Q for the quarters ended March 31, 2012, June 30, 2012, and September, 30 2012, and in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Overview

Starwood Property Trust, Inc. (together with its subsidiaries,   we   or the   Company) is a Maryland corporation that commenced operations on August 17, 2009 upon completion of our initial public offering. We are focused on originating, investing in, financing and managing commercial mortgage loans and other commercial real estate debt investments, commercial mortgage-backed securities (CMBS), and other commercial real estate-related debt investments. We collectively refer to commercial mortgage loans, other commercial real estate debt investments, CMBS, and other commercial real estate-related debt investments as our target assets. We also invest in residential mortgage-backed securities (RMBS) and residential REO, and may invest in distressed or non-performing loans, commercial properties subject to net leases and residential mortgage loans. As market conditions change over time, we may adjust our strategy to take advantage of changes in interest rates and credit spreads as well as economic and credit conditions.

Our objective is to provide attractive risk-adjusted global returns to our investors over the long term, primarily through dividends and secondarily through capital appreciation. We employ leverage, to the extent available, to fund the acquisition of our target assets and to increase potential returns to our stockholders. In order to achieve these objectives, we are focusing on asset selection and the relative value of various sectors within the debt market to construct a diversified investment portfolio designed to produce attractive returns across a variety of market conditions and economic cycles. We are organized as a holding company that conducts its business primarily through its various subsidiaries.

We have elected to be taxed as a real estate investment trust (REIT) for U.S. federal income tax purposes, commencing with our initial taxable year ended December 31, 2009. We also operate our business in a manner that will permit us to maintain our exemption from registration under the Investment Company Act of 1940, as amended.

Recent Developments

The significant developments during 2012 include the following:

Three months ended March 31, 2012

- Sold 50% of our Euro-denominated loan to a strategic partner, which resulted in proceeds of $28.8 million and a realized loss of $2.1 million. However, the transactions were earnings neutral after considering the realized gains on currency hedges of $2.1 million that were terminated in connection with the sale.

- Acquired $95.4 million of GBP-denominated B-Notes secured by four resorts in the United Kingdom. The newly issued B-Notes are part of an overall corporate refinancing in which we had a $143.9 million pre-existing GBP-denominated investment. The pre-existing investment was originally purchased at a discount and, due to the early prepayment, we recognized additional income of approximately $12.2 million during the first quarter of 2012, which is considered to be a non-recurring event.

- Acquired $222.8 million of CMBS at a discounted price of $206.4 million, where the obligors are certain special purpose entities that were formed to hold substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. The acquisition was financed using a new $155.4 million facility provided by the seller.

- Originated a $40.0 million mezzanine loan secured by a 10-property portfolio of full-service and extended-stay hotels located in eight different states.

- Our subsidiary extended the maturity date of its $100 million master repurchase and securities contract with an affiliate of Wells Fargo Securities, LLC used to finance the acquisition and ownership of RMBS, from March 16, 2012 to March 15, 2013. Advances under the facility accrue interest at a per annum interest rate equal to the sum of (i) 30-day LIBOR plus (ii) a margin of 2.10%. We have guaranteed the obligations of our subsidiary under the facility. The facility and related guarantee contain various affirmative and negative covenants applicable to us that are similar in nature to covenants contained in our other financing agreements.

- Acquired a $125.0 million participation in a senior loan secured by all the material assets of a worldwide operator of hotels, resorts and timeshare properties for a discounted purchase price of approximately $115.7 million. The acquisition was financed with an $81.0 million increase in a financing facility previously provided by the seller.

- We, through certain of our subsidiaries, entered into a new $125.0 million financing facility with an affiliate of Citigroup Global Markets Inc., to finance commercial mortgage loans and senior interests in commercial mortgage loans originated or acquired by us and including loans and interests intended to be included in commercial mortgage loan securitizations as well as those not intended to be securitized. Advances under the facility accrue interest at a per annum interest rate equal to the sum of (i) 30-day LIBOR plus (ii) a margin of between 1.75% and 3.75% depending on (A) asset type, (B) the amount advanced and (C) the debt yield and loan-to-value ratios of the purchased mortgage loan. The facility has an initial maturity date of March 29, 2014, subject to three one-year extension options, which may be exercised by us upon the satisfaction of certain conditions. We have guaranteed the obligations of our subsidiaries under the facility up to a maximum liability of 25% of the then-currently outstanding repurchase price of assets financed there under. The facility and related guarantee contain various affirmative and negative covenants applicable to us that are similar in nature to covenants contained in our other financing agreements.

- On February 29, 2012, our board of directors declared a dividend of $0.44 per share for the first quarter of 2012, which was payable on April 13, 2012 to shareholders of record on March 30, 2012.

- Funded a $59.0 million mortgage loan secured by an office campus located in Northern California. The terms of the loan provide for up to $4.0 million of future advances upon the satisfaction of specified conditions.

- Sold the remainder of our held-for-sale first mortgage loans targeted for securitization. As of December 31, 2011, our net equity investment in these six loans was $36.5 million and the loans had a carrying value of $128.6 million. We realized an aggregate profit of approximately $1.0 million on the held-for-sale loans and associated interest rate hedges.

Three months ended June 30, 2012

- Acquired $75.6 million of CMBS at a discounted price of $70.7 million, where the obligors are certain special purpose entities that were formed to hold substantially all of the assets of a worldwide operator of hotels, resorts and timeshare properties. The acquisition was partially financed using a $49.3 million increase in a financing facility previously provided by the seller.

- Sold 20,000,000 shares of common stock at a net price of $19.88 per share, resulting in gross proceeds of $397.7 million. On April 30, 2012, the underwriters exercised their option to purchase 3,000,000 additional shares of common stock at $19.88 per share, resulting in additional gross proceeds of $59.6 million.

- Originated a $73.0 million junior mezzanine loan, of which $45.0 million was initially funded, collateralized by a portfolio of six office buildings located in Rosslyn, Virginia. The loan provides for up to $28.0 million in future funding for projected capital improvements and leasing costs. Our junior mezzanine loan was co-originated with a $125.0 million first mortgage loan and a $40.0 million senior mezzanine loan, which were separately funded by third party lenders at closing.

- Originated a $170.0 million first mortgage loan on two Class B office buildings located in the SoHo district of Midtown Manhattan. Collectively known as One SoHo Square, the two properties located at 161 Avenue of the Americas and 233 Spring Street comprise over 600,000 square feet of office and retail space, which is currently 96% occupied. The first mortgage loan had an initial funding of $135.0 million, with $35.0 million available for future advances to pay for tenant improvements, leasing commissions and redevelopment costs.

- Originated an $11.6 million first mortgage loan collateralized by a collection of office, retail and parking properties in downtown San Diego, California.

- On May 8, 2012, our board of directors declared a dividend of $0.44 per share for the second quarter of 2012, which was payable on July 13, 2012 to common stockholders of record as of June 30, 2012.

- On May 24 and June 28, 2012 we acquired 226 and 26 residential real estate owned (REO) properties from a major bank at a cost of $24.5 million and $2.8 million, respectively. Most of the properties were vacant at acquisition, and we are actively preparing the properties to be either rented or sold, as applicable. From the date of acquisition through June 30, 2012, we incurred approximately $0.3 million in costs of getting the properties ready for their intended use, and such costs were added to our investment basis.

- Originated a $30.0 million mezzanine loan collateralized by an office building in Philadelphia, Pennsylvania.

- During the second quarter 2012 we acquired $173.0 million of RMBS (face value) at a $65.2 million discount.

<u>Three months ended September 30, 2012:</u>

- On July 3, 2012, we entered into a Purchase and Repurchase Agreement and Securities Contract (Onewest Repurchase Agreement) with Onewest Bank, FSB (Onewest). At closing, we transferred loan investments to Onewest in exchange for a $78.3 million advance. Borrowings under the Onewest Repurchase Agreement accrue interest at a pricing rate of one-month LIBOR plus a margin of 3.0%. The initial maturity date of the facility is July 3, 2015 with two one-year extension options, subject to certain conditions.

- On July 6, 2012, we originated a $51.5 million first mortgage collateralized by three hotels located in North Carolina, New Jersey, and Virginia. The initial term for the loan is two years, with three one-year extension options.

- On July 20, 2012, we purchased a 50% undivided participation interest (the Le Meridien Participation Interest) in a EUR-denominated mezzanine loan for $68.4 million (Le Méridien Loan) from an independent third party. The borrower is Starman Luxembourg Holdings S.À R.L. (Holdings), an entity that indirectly owns and operates a portfolio of hotels in France and Germany. Holdings is owned 50% by an independent third party and 50% by several private investment funds that were previously sponsored by Starwood Capital Group Global I, L.L.C., an affiliate of our Manager. The Le Méridien Loan has an initial term of two years with an option to extend for an additional year, subject to certain conditions, an interest rate of 12.5%, an upfront fee of 2.0% and a prepayment fee of 1.0%. We acquired the Le Meridien Participation Interest from an independent third party and own the Le Meridien Participation Interest subject to a participation agreement between us and the independent third party (the Le Meridien Participation Agreement). The Le Meridien Participation Agreement provides for the payment to us, on a pro rata basis with an independent third party, of customary payments in respect of the Le Meridien Participation Interest and affords us customary voting, approval and consent rights.

- On August 3, 2012, Starwood Property Mortgage Sub-10, LLC (SPM Sub-10) and Starwood Property Mortgage Sub-10A (SPM Sub 10-A), our indirect wholly-owned subsidiaries, jointly entered into a $250.0 million Senior Secured Revolving Credit Facility arranged by Merrill Lynch, Pierce, Fenner & Smith Incorporated (MLPFS). Lender participants in the facility include Bank of America, Citibank, Barclays Bank PLC, Deutsche Bank Trust Company Americas, Goldman Sachs Bank USA, and Stifel Bank & Trust. The facility matures 364 days from closing, and may be extended from time to time, provided the aggregate tenure shall not exceed four years. Outstanding borrowings under the facility will be priced at LIBOR + 325 bps, with an unused fee of 30 to 35 bps per annum depending upon the usage of the facility. The facility will be used primarily to finance our purchase or origination of commercial mortgage loans for the time period between transaction closing and the time in which a financing of the loan can be closed with one of our existing secured warehouse facilities or the loan is sold/syndicated in whole or in part. The term of financing provided under the facility for any individual loan is limited in most instances to the lesser of six months or the maturity of the facility. The facility will be secured by each loan for which financing has been provided as well at least $500,000,000 in market value of additional preapproved unencumbered senior, subordinate, and mezzanine loan assets. The facility is full recourse to us.

- On August 2, 2012, our board of directors declared a dividend of $0.44 per share for the third quarter of 2012, which was payable on October 15, 2012 to common stockholders of record on September 28, 2012.

- On August 17, 2012, we originated a $46.0 million first mortgage collateralized by a 315-room Hilton hotel in Rockville, Maryland. The term of the loan is three years, with two one-year extension options.

- On August 21, 2012, we acquired a $250.0 million participation in a mezzanine loan that is secured primarily by indirect equity interests in subsidiaries that own substantially all of the assets of a worldwide operator of hotels, resorts, and timeshare properties. We acquired this investment at a discounted price of $233.75 million, with $158.75 million being financed by the seller. The maturity date of the mezzanine loan is November 12, 2012, with three one-year extensions remaining, subject to a 0.5% fee for the second and third remaining extensions. Coincident with this purchase, we sold $165 million in face value of the securitized first mortgage loan component of the same financing transaction, which resulted in a gain of $8.2 million. This sale was undertaken to manage our overall credit exposure to the borrower.

- On September 18, 2012, we originated a $61.0 million first mortgage collateralized by two Class B+/A- office buildings located in Glendale, California. The term of the loan is three years, with two one-year extension options.

<u>Subsequent to September 30, 2012</u>

- On October 3, 2012, we sold the $94.5 million A-Note component of a $135.0 million first mortgage loan on two Class B office buildings located in the SoHo district of Midtown Manhattan. We retained the $40.5 million B-Note. We originated the first mortgage loan during the second quarter of 2012.

- On October 10, 2012, we completed an underwritten public offering of 18,400,000 shares of our common stock at a price of $22.74 for total estimated gross proceeds of approximately $418.4 million. In addition, on October 10, 2012 we granted 875,000 restricted stock units with a fair value of approximately $19.9 million at the grant date to our Manager under the Manager Equity Plan. This award will vest ratably in quarterly installments over a three-year period beginning on December 31, 2012, subject to the Manager s continued service as our manager.

- On October 16, 2012, through a newly-formed venture with Starwood Distressed Opportunity Fund IX (Fund IX), an affiliate of our Manager, we co-originated a $475 million first mortgage and mezzanine financing for the acquisition and redevelopment of a 10-story retail building located at 701 Seventh Avenue in the Times Square area of Manhattan. Of the total loan amount, $375 million was funded at closing, $281.2 million of which was funded by us and $93.8 million that was funded by Fund IX. In addition, $100 million will be funded upon reaching certain milestones during the transformation of the property. On October 22, 2012, the venture sold a 25 percent participation in both the first mortgage and mezzanine loan to Vornado Realty Trust (Vornado). Upon settling this sale, the Company, Starwood Distressed Opportunity Fund IX, and Vornado had funded $210.9 million, $70.3 million and $93.8 million, respectively, and each party will fund their pro rata share of any future fundings. Following the sale to Vornado, the Starwood entities retained the controlling position in both the first mortgage and mezzanine loans.

- On October 26, 2012, we originated a $126 million first mortgage secured by a 25 story Class A office tower located at 100 Montgomery Street, San Francisco, CA. The loan has an initial funding of $115.5 million with a future funding obligation of $10.5 million for tenant improvements and leasing commissions. The loan bears interest at one-month LIBOR plus 3.95%, subject to a 0.25% LIBOR floor. The loan has a three-year term with two one-year extensions, subject to certain conditions.

- On November 5, 2012, we purchased the senior participation in a whole loan secured by an office building located in Washington DC for $45.6 million. The loan has a three-year term with two one-year extensions.

- On November 6, 2012 our board of directors declared a dividend of $0.44 per share for the fourth quarter of 2012, which is payable on January 15, 2013 to common stockholders of record on December 31, 2012.

Our investment portfolio was comprised of the following at September 30, 2012 (dollar amounts in thousands):

	Property Type	**Carrying Value**	**Face Amount**	**% Owned**	**Financing (1)**	**Net Investment**	**Vintage**

Loan Originations	Assorted	$ 1,555,141	$ 1,562,406	100%	$ 384,503	$ 1,170,638	2009-2012
Loan Acquisitions	Assorted	1,111,669	1,202,688	100%	571,902	539,767	1989-2012
CMBS	Assorted	528,965	523,619	100%	294,284	234,681	2010-2012
RMBS	Residential	337,900	510,917	100%	145,089	192,811	2003-2007
Other Investments	Assorted	75,750	75,750	94%		75,750	N/A
		$ 3,609,425	$ 3,875,380		$ 1,395,778	$ 2,213,647	

(1) Excludes financing of $1.9 million related to the prepayment of a loan in September 2012. Amounts were remitted in October 2012. The $2.2 million loan receivable is recorded in Other Assets and the corresponding financing is recorded in secured financing agreements on the condensed consolidated balance sheet.

Our total investment portfolio, excluding other investments, has the following characteristics based on carrying values:

Collateral Property Type	**As of September 30, 2012**	**As of December 31, 2011**
Hospitality	49.3%	39.9%
Office	18.8	20.1
Retail	8.8	21.0
Residential	9.6	5.9
Industrial	3.0	3.8
Mixed Use	3.5	5.6
Multi-family	1.9	3.3
Other	5.1	0.4
	100.0%	100.0%

Geographic Location	As of September 30, 2012	As of December 31, 2011
West	25.9%	23.5%
Northeast	19.8	12.5
Southeast	17.3	19.0
Mid-Atlantic	14.0	19.7
Midwest	10.3	12.9
International	8.5	7.6
Southwest	4.2	4.8
	100.0%	100.0%

Critical Accounting Policies and Use of Estimates

Refer to the section of our Annual Report on Form 10-K for the year ended December 31, 2011 entitled Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies for full discussion of our critical accounting policies. Our critical accounting policies have not materially changed during 2012.

Recent Accounting Pronouncements

In December 2011, the FASB issued amended guidance which will enhance disclosures required by GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset. This information will enable users of an entity s financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. We will be required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, by providing the disclosures required by those amendments retrospectively for all comparative periods presented. We are in the process of evaluating the impact that this guidance will have on our financial statement disclosures.

Results of Operations

Net income attributable to Starwood Property Trust, Inc. for the three and nine months ended September 30, 2012 was approximately $50.2 million and $144.9 million, respectively, or $0.43 and $1.34 per weighted average share of basic common stock and $0.43 and $1.34 per weighted average share of diluted common stock, respectively, up from $14.5 million and $78.3 million, respectively, or $0.16 and $0.95 per weighted average share of basic common stock and $0.15 and $0.94 per weighted average share of diluted common stock, respectively for the same periods in 2011. For the three and nine months ended September 30, 2012, net interest margin increased by approximately $10.1 million and $61.0 million from the prior comparable periods, resulting from increases in interest income of $14.8 million and $73.7 million, respectively, and increases in interest expense of $4.7 million and $12.6 million, respectively. The increase in net interest margin is primarily due to increased investment activity and the prepayment of our GBP-denominated loan during the three months ended March 31, 2012, which resulted in $13.1 million of accelerated discount accretion. The increase in interest expense is a result of increased borrowing under the nine financing facilities we have drawn upon as of September 30, 2012. From September 30, 2011 to September 30, 2012 other investments increased $32.2 million, MBS securities increased by $514.8 million and investments in loans increased $679.2 million. As of September 30, 2012, the weighted average cost of the secured financings was 3.7%, including the impact of interest rate hedges.

For the three and nine months ended September 30, 2012, non-investment expenses increased by $5.0 million and $16.4 million, respectively, from the same periods in 2011. The year over year period increases were due to increases (decreases) in the base management fee of $4.7 million and $13.7 million, respectively, stock compensation expense of $1.2 million and $1.8 million, respectively, investment pursuit costs of ($0.6) million and $0.9 million, respectively, general and administrative expenses of $0.9 million and $1.8 million, respectively, and the accrued incentive fee of $2.1 million and $2.4 million, respectively. The increase in the base management fee was due primarily to our supplemental equity raises in May 2011 with net proceeds of $475.4 million and April 2012 with net proceeds of $454.8 million. The increase in the incentive fee was primarily attributable to the prepayment of our GBP denominated loan, resulting in $13.1 million of accelerated accretion of the purchase discount. In May 2012, the Manager was granted an additional 30,000 restricted stock units, resulting in higher stock compensation expense in the subsequent periods. Lastly, the increase in general and administrative expense is primarily attributed to increased professional fees, such as legal, audit and consulting, in connection with growing the investment portfolio.

For the three and nine months ended September 30, 2012, we had realized gains (losses) from the sale of investments of $9.0 million and $19.1 million, respectively, of which $0 and $7.1 million, respectively, related to the sale of loans and $9.0 million and $12.0 million, respectively related to the sale of MBS securities. The gain on sale of loans primarily related to the sale of our loans held-for-sale and partial sale of our EUR-denominated loan and the sale of CMBS with a face value of $190 million and a realized gain of $8.0 million. Refer to Note 7 of the condensed consolidated financial statements for more information on loan sales and securitization activity. For the three and nine months ended September 30, 2011, we had realized gains from the sale of investments of $5.0 million and $20.8 million, of which $0.0 million and $10.5 million related to the sale of MBS securities and other investments and, $5.0 million and $10.3 million related to the sale of loans. For the three and nine months ended September 30, 2012, we had net losses on currency hedges of ($7.5) million and ($10.4) million, respectively, compared to gains of $8.6 million and $2.4 million, respectively, from the prior comparable periods. For the three and nine months ended September 30, 2012, we had unrealized foreign currency remeasurement gains of $7.1 million and $2.7 million, respectively, compared to unrealized foreign currency remeasurement losses of ($9.4) million and ($4.2) million, respectively, from the prior comparable periods. The fluctuation in the currency hedge and foreign currency remeasurement gains and losses year over year was primarily due to the movement in the EUR and GBP to USD exchange rates, as well as derivative contracts that matured or were effectively settled. Additionally, the pre-payment of our GBP denominated loan resulted in effective currency hedge losses of $10.0 million and realized foreign currency remeasurement gains of $8.8 million. The partial sale of our EUR denominated loan resulted in realized gains on foreign currency hedges of $2.1 million. For the three and nine months ended September 30, 2012, we had realized gains (losses) on interest rate hedges of ($51) thousand and $0.6 million, compared realized gains on interest rate hedges of $12.3 million and $9.4 million, respectively, from the comparable prior periods. We had no credit hedges for the three and nine months ended September 30, 2012, compared to net gains on credit hedges of $2.3 million and $3.7 million, respectively, from the prior comparable periods.

The reported and diluted per share amounts of our interest margin and expenses for the three months ended September 30, 2012 and 2011 were as follows (amounts in thousands except per share data):

	For the three month period ended September 30,			
	2012		2011	
	Reported Amount	Per Diluted Share	Reported Amount	Per Diluted Share
Net interest margin:				
Cash coupon received from loans	$ 50,559	$ 0.43	$ 45,088	$ 0.48
Constant yield adjustments on loans(1)	5,702	0.05	6,791	0.07
Cash coupon received from mortgage-backed securities (MBS)	6,017	0.05	1,084	0.01
Constant yield adjustments on mortgage-backed securities(2)	10,568	0.09	5,111	0.05
Cash interest expense	(9,929)	(0.08)	(5,917)	(0.06)
Amortization of debt issuance costs	(2,101)	(0.02)	(1,404)	(0.01)
Net interest margin	60,816	0.52	50,753	0.54
Expenses:				
Base management fee	8,461	0.07	6,650	0.07
Management incentive fee	2,101	0.02	432	0.01
Stock compensation - Manager	4,097	0.03	2,922	0.03
Total management fees	14,659	0.12	10,004	0.11
Transaction and dead deal costs	622	0.01	1,201	0.01
General and administrative	3,084	0.03	2,177	0.02
Total expenses	18,365	0.16	13,382	0.14
Income before other income (expenses) and income taxes	$ 42,451	$ 0.36	$ 37,371	$ 0.40

(1) Represents the aggregate adjustments necessary to recognize income from loans on a constant yield basis, which is comprised primarily of discount accretion, but also includes the amortization of loan fees and costs.

(2) Represents the aggregate adjustments necessary to recognize income from MBS on a constant yield basis, which is comprised primarily of discount accretion.

The reported and diluted per share amounts of our interest margin and expenses for the nine months ended September 30, 2012 and 2011 were as follows (amounts in thousands except per share data):

	For the nine month period ended September 30,			
	2012		2011	
	Reported Amount	Per Diluted Share	Reported Amount	Per Diluted Share
Net interest margin:				
Cash coupon received from loans	$ 144,052	$ 1.33	$ 107,182	$ 1.28
Constant yield adjustments on loans(1)	35,026	0.32	18,461	0.22
Cash coupon received from mortgage-backed securities (MBS)	15,340	0.14	7,724	0.09
Constant yield adjustments on mortgage-backed securities(2)	25,064	0.24	12,452	0.15
Cash interest expense	(28,900)	(0.27)	(17,991)	(0.22)
Amortization of debt issuance costs	(5,445)	(0.05)	(3,732)	(0.04)

Net interest margin	185,137	1.71	124,096	1.48
Expenses:				
Base management fee	23,260	0.22	17,568	0.21
Management incentive fee	7,487	0.07	1,178	0.01
Stock compensation - Manager	11,926	0.11	10,268	0.13
Total management fees	42,673	0.40	29,014	0.35
Transaction and dead deal costs	2,737	0.02	1,820	0.02
General and administrative	8,838	0.08	7,041	0.08
Total expenses	54,248	0.50		