STARWOOD PROPERTY TRUST, INC.
Form 10-Q
May 06, 2014
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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 March 31, 2014

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 Incorporation or Organization)	(I.R.S. Employer Identification No.)
591 West Putnam Avenue Greenwich, Connecticut	**06830**
(Address of Principal Executive Offices)	(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 the definitions of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer 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 May 6, 2014 was 221,385,672.

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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 their dates.

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, 2013, including those set forth under the captions Risk Factors and Business ;
- defaults by borrowers in paying debt service on outstanding indebtedness;
- impairment in the value of real estate property securing our loans;
- availability of mortgage origination and acquisition opportunities acceptable to us;
- our ability to fully integrate LNR Property LLC, a Delaware limited liability company (LNR), which was acquired on April 19, 2013, into our business and achieve the benefits that we anticipate from this acquisition;
- 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 and residential 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 and securities investing activities;
- changes in interest rates; 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.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited, amounts in thousands, except share data)

	As of March 31, 2014	As of December 31, 2013
Assets:		
Cash and cash equivalents	$ 226,471	$ 317,627
Restricted cash	43,117	69,052
Loans held-for-investment, net	4,634,923	4,363,718
Loans held-for-sale, at fair value	186,837	206,672
Loans transferred as secured borrowings	143,042	180,414
Investment securities ($553,933 and $566,789 held at fair value)	923,085	935,107
Intangible assets servicing rights ($144,898 and $150,149 held at fair value)	168,056	177,173
Residential real estate, net		749,214
Non-performing residential loans		215,371
Investment in unconsolidated entities	104,520	122,954
Goodwill	140,437	140,437
Derivative assets	4,617	7,769
Accrued interest receivable	34,515	37,630
Other assets	111,223	95,813
Variable interest entity (VIE) assets, at fair value	118,451,518	103,151,624
Total Assets	**$ 125,172,361**	**$ 110,770,575**
Liabilities and Equity		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 137,831	$ 225,374
Related-party payable	29,458	17,793
Dividends payable	95,424	90,171
Derivative liabilities	18,057	24,192
Secured financing agreements, net	2,601,062	2,257,560
Convertible senior notes, net	1,000,839	997,851
Secured borrowings on transferred loans	143,038	181,238
VIE liabilities, at fair value	117,931,005	102,649,263
Total Liabilities	**121,956,714**	**106,443,442**
Commitments and contingencies (Note 21)		
Equity:		
Starwood Property Trust, Inc. Stockholders Equity:		
Preferred stock, $0.01 per share, 100,000,000 shares authorized, no shares issued and outstanding		
	1,967	1,961

Common stock, $0.01 per share, 500,000,000 shares authorized, 196,711,522 issued and 196,085,672 outstanding as of March 31, 2014 and 196,139,045 issued and 195,513,195 outstanding as of December 31, 2013				
Additional paid-in capital		3,192,245		4,300,479
Treasury stock (625,850 shares)		(10,642)		(10,642)
Accumulated other comprehensive income		80,115		75,449
Accumulated deficit		(59,542)		(84,719)
Total Starwood Property Trust, Inc. Stockholders Equity		3,204,143		4,282,528
Non-controlling interests in consolidated subsidiaries		11,504		44,605
Total Equity		**3,215,647**		**4,327,133**
Total Liabilities and Equity	**$**	**125,172,361**	**$**	**110,770,575**

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

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

	For the Three Months Ended March 31, 2014	For the Three Months Ended March 31, 2013
Revenues:		
Interest income from loans	$ 104,910	$ 67,690
Interest income from investment securities	29,454	16,240
Servicing fees	34,211	
Other revenues	3,404	79
Total revenues	**171,979**	**84,009**
Costs and expenses:		
Management fees	27,821	15,069
Interest expense	37,831	17,426
General and administrative	46,101	4,038
Business combination costs		4,196
Acquisition and investment pursuit costs	394	81
Depreciation and amortization	4,636	
Loan loss allowance	497	30
Other expense	1,689	33
Total costs and expenses	**118,969**	**40,873**
Income before other income, income taxes and non-controlling interests	**53,010**	**43,136**
Other income:		
Income of consolidated VIEs, net	56,004	
Change in fair value of servicing rights	(5,251)	
Change in fair value of investment securities, net	8,361	405
Change in fair value of mortgage loans held-for-sale, net	20,893	
Earnings from unconsolidated entities	64	741
Gain on sale of investments, net	1,555	13,524
(Loss) gain on derivative financial instruments, net	(7,866)	16,228
Foreign currency gain (loss), net	1,477	(7,665)
Total other-than-temporary impairment (OTTI)	(1,192)	(527)
Noncredit portion of OTTI recognized in other comprehensive income (loss)	979	485
Net impairment losses recognized in earnings	(213)	(42)
Other income, net	18	
Total other income	**75,042**	**23,191**
Income from continuing operations before income taxes	**128,052**	**66,327**
Income tax provision	(5,620)	(615)
Income from continuing operations	**122,432**	**65,712**
Loss from discontinued operations, net of tax (Note 3)	(1,551)	(2,288)
Net income	**120,881**	**63,424**
Net income attributable to non-controlling interests	(280)	(1,181)
Net income attributable to Starwood Property Trust, Inc.	**$ 120,601**	**$ 62,243**
Per share data:		
Basic earnings per share data:		
Income from continuing operations attributable to Starwood Property Trust, Inc.	$ 0.62	$ 0.47

Loss from discontinued operations attributable to Starwood Property Trust, Inc.		(0.01)		(0.01)
Net income attributable to Starwood Property Trust, Inc.	$	0.61	$	0.46
Diluted earnings per share data:				
Income from continuing operations attributable to Starwood Property Trust, Inc.	$	0.61	$	0.47
Loss from discontinued operations attributable to Starwood Property Trust, Inc.		(0.01)		(0.01)
Net income attributable to Starwood Property Trust, Inc.	$	0.60	$	0.46
Dividends declared per common share	$	0.48	$	0.44

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31, 2014	For the Three Months Ended March 31, 2013
Net income	**$ 120,881**	**$ 63,424**
Other comprehensive income (loss) (net change by component):		
Cash flow hedges	122	279
Available-for-sale securities	3,498	(2,349)
Foreign currency remeasurement	1,046	(7,061)
Other comprehensive income (loss)	4,666	(9,131)
Comprehensive income	**125,547**	**54,293**
Less: Comprehensive income attributable to non-controlling interests	(280)	(1,181)
Comprehensive income attributable to Starwood Property Trust, Inc.	**$ 125,267**	**$ 53,112**

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Equity

(Unaudited, amounts in thousands, except share data)

	Common stock		Additional	Treasury Stock			Accumulated Other	Total Starwood Property		
	Shares	Par Value	Paid-In Capital	Shares	Amount	Accumulated Deficit	Comprehensive Income (Loss)	Trust, Inc. Stockholders Equity	Non-Controlling Interests	Total Equity
Balance, January 1, 2014	**196,139,045**	**$ 1,961**	**$ 4,300,479**	**625,850**	**$ (10,642)**	**$ (84,719)**	**$ 75,449**	**$ 4,282,528**	**$ 44,605**	**$ 4,327,133**
Stock-based compensation	434,189	4	7,203					7,207		7,207
Manager incentive fee paid in stock	138,288	2	3,306					3,308		3,308
Net income						120,601		120,601	280	120,881
Dividends declared, $0.48 per share						(95,424)		(95,424)		(95,424)
Spin-off of Starwood Waypoint Residential Trust			(1,118,743)					(1,118,743)	(1,594)	(1,120,337)
Other comprehensive income, net							4,666	4,666		4,666
Distribution to non-controlling interests									(31,787)	(31,787)
Balance, March 31, 2014	**196,711,522**	**$ 1,967**	**$ 3,192,245**	**625,850**	**$ (10,642)**	**$ (59,542)**	**$ 80,115**	**$ 3,204,143**	**$ 11,504**	**$ 3,215,647**
Balance, January 1, 2013	**136,125,356**	**$ 1,361**	**$ 2,721,353**	**625,850**	**$ (10,642)**	**$ (72,401)**	**$ 79,675**	**$ 2,719,346**	**$ 77,859**	**$ 2,797,205**
Convertible senior notes			28,118					28,118		28,118
Stock-based compensation	187,501	2	4,654					4,656		4,656
Manager incentive fee paid in stock	13,188		366					366		366
Net income						62,243		62,243	1,181	63,424
Dividends declared, $0.44 per share						(60,147)		(60,147)		(60,147)
Other comprehensive loss, net							(9,131)	(9,131)		(9,131)
Contributions from non-controlling interests									6	6
Distribution to non-controlling interests									(44,098)	(44,098)
Balance, March 31, 2013	**136,326,045**	**$ 1,363**	**$ 2,754,491**	**625,850**	**$ (10,642)**	**$ (70,305)**	**$ 70,544**	**$ 2,745,451**	**$ 34,948**	**$ 2,780,399**

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31, 2014	2013
Cash Flows from Operating Activities:		
Net income	$ 120,881	$ 63,424
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred financing costs	2,895	3,193
Amortization of convertible debt discount and deferred fees	2,988	841
Accretion of net discount on investment securities	(7,398)	(9,180)
Accretion of net deferred loan fees and discounts	(1,806)	(7,856)
Amortization of premium from secured borrowings on transferred loans	(787)	(374)
Share-based compensation	7,207	4,656
Share-based component of incentive fees	3,308	366
Change in fair value of fair value option investment securities	(8,361)	
Change in fair value of consolidated VIEs	(21,877)	
Change in fair value of servicing rights	5,251	
Change in fair value of loans held-for-sale	(20,893)	
Change in fair value of derivatives	7,110	(16,318)
Foreign currency (gain) loss, net	(1,492)	7,390
Gain on non-performing loans and sale of investments	(2,498)	(15,004)
Other-than-temporary impairment of investment securities	213	42
Loan loss allowance	497	30
Depreciation and amortization	5,786	713
Earnings from unconsolidated entities	(64)	
Distributions of earnings from unconsolidated entities	956	
Changes in operating assets and liabilities:		
Related-party payable, net	11,665	9,307
Accrued interest receivable, less purchased interest	3,063	1,802
Other assets	(20,474)	5,839
Accounts payable, accrued expenses and other liabilities	(22,574)	35,984
Originations of loans held-for-sale, net of principal collections	(261,733)	
Proceeds from sale of loans held-for-sale	302,461	
Net cash provided by operating activities	**104,324**	**84,855**
Cash Flows from Investing Activities:		
Spin-off of Starwood Waypoint Residential Trust	(111,960)	
Purchase of investment securities	(9,890)	(37,175)
Proceeds from sales of investment securities	27,883	19,480
Proceeds from principal collections on investment securities	8,227	21,726
Origination and purchase of loans held-for-investment	(728,594)	(129,817)
Proceeds from principal collections on loans	316,428	93,651
Proceeds from loans sold	146,400	44,631
Acquisition and improvement of single family homes	(61,901)	(114,925)
Proceeds from sale of single family homes	1,784	3,360
Purchase of non-performing loans		(104,142)
Proceeds from sale of non-performing loans	1,153	

Distribution of capital from unconsolidated entities	17,834	150
Payments for purchase or termination of derivatives	(11,274)	
Proceeds from termination of derivatives	799	
Return of investment basis in purchased derivative asset	407	518
Deposit on purchase of LNR		(40,665)
Decrease (increase) in restricted cash, net	234	(38,040)
Net cash used in investing activities	**(402,470)**	**(281,248)**

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(Unaudited, amounts in thousands)

	For the Three Months Ended March 31, 2014	For the Three Months Ended March 31, 2013
Cash Flows from Financing Activities:		
Borrowings under financing agreements	$ 997,767	$ 347,521
Proceeds from issuance of convertible senior notes		587,700
Principal repayments on borrowings	(656,573)	(625,513)
Payment of deferred financing costs	(7,418)	(24)
Payment of dividends	(90,171)	(73,796)
Contributions from non-controlling interests		6
Distributions to non-controlling interests	(31,788)	(44,098)
Issuance of debt of consolidated VIEs	45,761	
Repayment of debt of consolidated VIEs	(53,385)	
Distributions of cash from consolidated VIEs	2,740	
Net cash provided by financing activities	**206,933**	**191,796**
Net decrease in cash and cash equivalents	(91,213)	(4,597)
Cash and cash equivalents, beginning of period	317,627	177,671
Effect of exchange rate changes on cash	57	
Cash and cash equivalents, end of period	$ 226,471	$ 173,074
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 44,638	$ 10,536
Income taxes paid	2,725	327
Supplemental disclosure of non-cash investing and financing activities:		
Net assets distributed in spin-off of Starwood Waypoint Residential Trust	$ 1,008,377	$
Dividends declared, but not yet paid	95,424	60,147
Unsettled trade receivable		206,608
Consolidation of VIEs (VIE asset/liability additions)	20,236,513	
Deconsolidation of VIEs (VIE asset/liability reductions)	1,289,569	
Conversion of non-performing residential loans to residential real estate	3,590	

See notes to condensed consolidated financial statements.

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Starwood Property Trust, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

As of March 31, 2014

(Unaudited)

1. Business and Organization

Starwood Property Trust, Inc. (STWD together with its subsidiaries, we or the Company) is a Maryland corporation that commenced operations in August 2009, upon the completion of our initial public offering (IPO). We are focused primarily on originating, acquiring, 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 in both the U.S. and Europe. We refer to the following as our target assets:

- commercial real estate mortgage loans, including preferred equity interests;
- CMBS; and
- other commercial real estate-related debt investments.

We may also invest in residential mortgage-backed securities (RMBS), certain residential mortgage loans, distressed or non-performing commercial loans, commercial properties subject to net leases and commercial real estate owned. 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 have three reportable business segments which include:

- Real estate investment lending (the Lending Segment) includes all business activities of the Company, excluding the single family residential and LNR businesses, which generally represents investments in real estate related loans and securities that are held-for-investment.
- LNR includes all business activities of the acquired LNR Property LLC (LNR) business excluding the consolidation of securitization VIEs.

- Single family residential (SFR) includes the business activities associated with our investments in single-family residential properties and non-performing single-family residential mortgage loans. This segment was spun off on January 31, 2014 as discussed below and in Note 3 herein.

On April 19, 2013, we acquired the equity of LNR and certain of its subsidiaries for an initial agreed upon purchase price of approximately $859 million, which was reduced for transaction expenses and distributions occurring after September 30, 2012, resulting in cash consideration of approximately $730 million. Immediately prior to the acquisition, an affiliate of the Company acquired the remaining equity comprising LNR s commercial property division for a purchase price of $194 million. The portion of the LNR business acquired by us includes the following: (i) servicing businesses in both the U.S. and Europe that manage and work out problem assets, (ii) a finance business that is focused on selectively acquiring and managing real estate finance investments, including unrated, investment grade and non-investment grade rated CMBS, including subordinated interests of securitization and resecuritization transactions, and high yielding real estate loans; and (iii) a mortgage loan business which originates conduit loans for the primary purpose of selling these loans into securitization transactions.

On January 31, 2014, we completed the spin-off of our SFR segment to our stockholders. The newly-formed real estate investment trust, Starwood Waypoint Residential Trust (SWAY), is listed on the New York Stock Exchange (NYSE) and trades under the ticker symbol SWAY. Our stockholders received one common share of SWAY for every five shares of our common stock held at the close of business on January 24, 2014. As part of the spin-off, we contributed $100 million to the unlevered balance sheet of SWAY to fund its growth and operations. As of January 31, 2014, SWAY held net assets of $1.1 billion. The net assets of SWAY consisted of approximately 7,200 units of single-family homes and residential non-performing mortgage loans as of January 31, 2014. In connection with the spin-off, 40.1 million shares of SWAY were issued. Refer to Note 3 herein for additional information regarding SFR segment financial information.

We are organized and conduct our operations to qualify as a real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended (the Code). As such, we will generally not be subject to U.S. federal corporate income tax on that portion

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of our 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.

In connection with the LNR acquisition, we established additional taxable REIT subsidiaries (TRSs). TRSs permit us to participate in certain activities from which REITs are generally precluded, as long as these activities meet specific criteria, are conducted within the parameters of certain limitations established by the Code, and are conducted in entities which elect to be treated as taxable subsidiaries under the Code. To the extent these criteria are met, we will continue to maintain our qualification as a REIT.

These TRSs engage in various real estate related operations, including special servicing of commercial real estate, originating and securitizing commercial mortgage loans, and investing in entities which engage in real estate related operations. As of March 31, 2014, $799.8 million of the LNR assets were owned by TRS entities. Our TRSs are not consolidated for federal income tax purposes, but are instead taxed as corporations. For financial reporting purposes, a provision for current and deferred taxes is established for the portion of earnings recognized by us with respect to our interest in TRSs.

We are organized as a holding company and conduct our business primarily through our various wholly-owned subsidiaries. We are externally managed and advised by SPT Management, LLC (our Manager) pursuant to the terms of a management agreement. Our Manager is controlled by Barry Sternlicht, our Chairman and Chief Executive Officer. Our Manager is an affiliate of Starwood Capital Group, a privately-held private equity firm founded and controlled by Mr. Sternlicht.

2. Summary of Significant Accounting Policies

Balance Sheet Presentation of LNR Variable Interest Entities

The acquisition of LNR substantially changed the presentation of our financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). As noted above, LNR operates a finance business that acquires unrated, investment grade and non-investment grade rated CMBS. These securities represent interests in securitization structures (commonly referred to as special purpose entities, or SPEs). These SPEs are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. Under GAAP, SPEs typically qualify as variable interest entities (VIEs). These are entities that, by design, either (1) lack sufficient equity to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) have equity investors that do not have the ability to make significant decisions relating to the entity s operations through voting rights, or do not have the obligation to absorb the expected losses, or do not have the right to receive the residual returns of the entity.

Because LNR often serves as the special servicer of the trusts in which it invests, consolidation of these structures is required pursuant to GAAP as outlined in detail below. This results in a consolidated balance sheet which presents the gross assets and liabilities of the SPEs. The assets and other instruments held by these SPEs are restricted and can only be used to fulfill the obligations of the entity. Additionally, the obligations of the SPEs do not have any recourse to the general credit of any other consolidated entities, nor to us as the consolidator of these SPEs.

The SPE liabilities initially represent investment securities on our balance sheet (pre-consolidation). Upon consolidation of these VIEs, our associated investment securities are eliminated, as is the interest income related to those securities. Similarly, the fees we earn in our roles as special servicer of the bonds issued by the consolidated VIEs or as collateral administrator of the consolidated VIEs are also eliminated. Finally, an allocable portion of the identified servicing intangible associated with the eliminated fee streams is eliminated in consolidation.

Please refer to the segment presentation in Note 22 herein for a presentation of the LNR business without consolidation of these VIEs.

Basis of Accounting and Principles of Consolidation

The accompanying condensed consolidated financial statements include our accounts and those of our consolidated subsidiaries and VIEs. Intercompany amounts have been eliminated in consolidation. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows have been included.

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 fiscal year ended December 31, 2013 (the Form 10-K), as filed with the Securities and Exchange Commission (SEC). The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the operating results for the full year.

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Refer to our Form 10-K for a description of our recurring accounting policies. We have included disclosure in this Note 2 regarding principles of consolidation and other accounting policies that are required either (i) to be disclosed quarterly, (ii) that we view as critical, or (iii) became significant since December 31, 2013 due to a corporate action or increase in the significance of the underlying business activity.

Variable Interest Entities

We evaluate all of our interests in VIEs for consolidation. When our interests are determined to be variable interests, we assess whether we are deemed to be the primary beneficiary of the VIE. The primary beneficiary of a VIE is required to consolidate the VIE. ASC 810, *Consolidation*, defines the primary beneficiary as the party that has both (i) the power to direct the activities of the VIE that most significantly impact its economic performance, and (ii) the obligation to absorb losses and the right to receive benefits from the VIE which could be potentially significant. We consider our variable interests as well as any variable interests of our related parties in making this determination. Where both of these factors are present, we are deemed to be the primary beneficiary and we consolidate the VIE. Where either one of these factors is not present, we are not the primary beneficiary and do not consolidate the VIE.

To assess whether we have the power to direct the activities of a VIE that most significantly impact the VIE s economic performance, we consider all facts and circumstances, including our role in establishing the VIE and our ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE s economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

To assess whether we have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, we consider all of our economic interests, including debt and equity investments, servicing fees, and other arrangements deemed to be variable interests in the VIE. This assessment requires that we apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE s capital structure; and the reasons why the interests are held by us.

Our purchased investment securities include CMBS which are unrated and non-investment grade rated securities issued by CMBS trusts. In certain cases, we may contract to provide special servicing activities for these CMBS trusts, or, as holder of the controlling class, we may have the right to name and remove the special servicer for these trusts. In our role as special servicer, we provide services on defaulted loans within the trusts, such as foreclosure or work-out procedures, as permitted by the underlying contractual agreements. In exchange for these services, we receive a fee. These rights give us the ability to direct activities that could significantly impact the trust s economic performance. However, in those instances where an unrelated third party has the right to unilaterally remove us as special servicer, we do not have the power to direct activities that most significantly impact the trust s economic performance. We evaluated all of our positions in such investments for consolidation.

For VIEs in which we are determined to be the primary beneficiary, all of the underlying assets, liabilities and equity of the structures are recorded on our books, and the initial investment, along with any associated unrealized holding gains and losses, are eliminated in consolidation. Similarly, the interest income earned from these structures, as well as the fees paid by these trusts to us in our capacity as special servicer, are eliminated in consolidation. Further, an allocable portion of the identified servicing intangible asset associated with the servicing fee streams, and the corresponding allocable amortization or change in fair value of the servicing intangible asset, are also eliminated in consolidation.

We perform ongoing reassessments of: (1) whether any entities previously evaluated under the majority voting interest framework have become VIEs, based on certain events, and therefore subject to the VIE consolidation framework, and (2) whether changes in the facts and circumstances regarding our involvement with a VIE causes our consolidation conclusion regarding the VIE to change.

We have elected the fair value option in measuring the assets and liabilities of any VIEs we consolidate. Fluctuations in the fair values of the VIE assets and liabilities, along with trust interest income and trust interest and administrative expenses, are presented net in income of consolidated VIEs in our consolidated statements of operations.

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Discontinued Operations

On January 31, 2014, we completed the spin-off of our SFR segment to our stockholders as discussed in Note 1. In accordance with Accounting Standards Codification (ASC) Topic 205, *Presentation of Financial Statements,* the results of the SFR segment are presented within discontinued operations in our condensed consolidated statements of operations for the three months ended March 31, 2014 and 2013.

Fair Value Option

The guidance in ASC 825, *Financial Instruments*, provides a fair value option election that allows entities to make an irrevocable election of fair value as the initial and subsequent measurement attribute for certain eligible financial assets and liabilities. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis and must be applied to an entire instrument and is irrevocable once elected. Assets and liabilities measured at fair value pursuant to this guidance are required to be reported separately in our consolidated balance sheets from those instruments using another accounting method.

We have elected the fair value option for eligible financial assets and liabilities of our consolidated VIEs, loans held-for-sale originated by LNR s conduit platform, purchased CMBS issued by VIEs we could consolidate in the future and certain investments in marketable equity securities. The fair value elections for VIE and securitization related items were made in order to mitigate accounting mismatches between the carrying value of the instruments and the related assets and liabilities that we consolidate at fair value. The fair value elections for mortgage loans held-for-sale originated by LNR s conduit platform were made due to the short-term nature of these instruments. The fair value elections for investments in marketable equity securities were made because the shares are listed on an exchange, which allows us to determine the fair value using a quoted price from an active market.

Loans Receivable and Provision for Loan Losses

In our Lending Segment we purchase and originate commercial real estate debt and related instruments generally to be held as long-term investments at amortized cost. We are required to periodically evaluate each of these loans for possible impairment. Impairment is indicated when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan. If a loan is determined to be impaired, we write down the loan through a charge to the provision for loan losses. Actual losses, if any, could ultimately differ from these estimates.

We perform a quarterly review of our portfolio of loans. In connection with this review, we assess the performance of each loan and assign a risk rating based on several factors including risk of loss, loan-to-value ratio, or LTV, collateral performance, structure, exit plan, and sponsorship. Loans are rated 1 through 5 , from less risk to greater risk in connection with this review.

Use of Estimates

The preparation of financial statements in conformity with 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 the projection of cash flows we expect to receive on our loans, investment securities and intangible assets, 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 assets and liabilities that are estimated using a discounted cash flows method is significantly impacted by the rates at which we estimate market participants would discount the expected cash flows.

Reclassifications

As a result of the LNR acquisition, certain items in our condensed consolidated statements of operations and cash flows for the three months ended March 31, 2013 have been reclassified or combined to conform to the current period s presentation. We removed the Net interest margin subtotal from our condensed consolidated statements of operations, with interest income now included in a new Revenues subtotal, and interest expense now included within the new Costs and expenses subtotal. Additionally, the results from our SFR segment have been reclassified as discontinued operations as a result of the spin-off. The reclassifications and combinations related to our condensed consolidated statement of cash flows for the three months ended March 31, 2013 had no effect on previously reported totals or subtotals.

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Recent Accounting Developments

On April 10, 2014 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, which requires only those disposals which represent a strategic shift that has or will have a major impact on an entity s operations or financial results be presented as discontinued operations. The ASU is effective for annual periods beginning on or after December 15, 2014, and interim periods within those annual periods, and requires prospective application. We do not expect the application of this ASU to materially impact the Company.

3. Acquisitions and Divestitures

SFR Spin-off

As described in Note 1, on January 31, 2014, we completed the spin-off of our SFR segment to our stockholders. The results of operations for the SFR segment are presented within discontinued operations in our condensed consolidated statements of operations for all periods presented. We have no continuing involvement with the SFR segment following the spin-off. Subsequent to the spin-off, SWAY entered into a management agreement with an affiliate of our Manager. The following table presents the summarized consolidated results of operations for the SFR segment prior to the spin-off, excluding segment allocations (in thousands):

	For the Three Months Ended March 31,			
	2014		2013	
Total revenues	$	3,876	$	1,164
Total costs and expenses		6,369		3,625
Loss before other income and income taxes		**(2,493)**		**(2,461)**
Total other income		942		335
Loss before income taxes		**(1,551)**		**(2,126)**
Income tax provision				(162)
Net loss	**$**	**(1,551)**	**$**	**(2,288)**

The following table presents the summarized consolidated balance sheet of the SFR segment as of January 31, 2014, the date of spin-off (in thousands):

	January 31, 2014	
Assets:		
Cash and cash equivalents	$	111,960
Restricted cash		189
Residential real estate, net		812,017
Non-performing residential loans		211,019
Other assets		9,498
Total Assets	**$**	**1,144,683**

Liabilities and Equity		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$	24,346
Equity:		
Additional paid-in capital		1,130,405
Accumulated deficit		(11,662)
Total Stockholders Equity		1,118,743
Non-controlling interests in consolidated subsidiaries		1,594
Total Equity		**1,120,337**
Total Liabilities and Equity	**$**	**1,144,683**

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LNR Acquisition

As described in Note 1, on April 19, 2013, we acquired the equity of LNR for an initial agreed upon purchase price of $859 million, which was reduced for transaction expenses and distributions occurring after September 30, 2012, resulting in cash consideration of approximately $730 million. We applied the provisions of ASC 805 in accounting for our acquisition of LNR. Refer to Note 3 of our Form 10-K for further discussion of the LNR acquisition including the final purchase price allocation.

4. Loans

Our loans held-for-investment are accounted for at amortized cost and our loans held-for-sale are accounted for at the lower of cost or fair value, unless we have elected the fair value option. The following tables summarize our investments in mortgages and loans by subordination class as of March 31, 2014 and December 31, 2013 (amounts in thousands):

March 31, 2014	Carrying Value	Face Amount	Weighted Average Coupon	Weighted Average Life (WAL) (years)(2)
First mortgages	$ 2,810,468	$ 2,866,252	5.8%	4.2
Subordinated mortgages(1)	501,222	536,714	8.3%	4.0
Mezzanine loans	1,327,714	1,336,832	11.2%	3.3
Total loans held-for-investment	4,639,404	4,739,798		
Loans held-for-sale, fair value option elected	186,837	181,450	5.1%	9.5
Loans transferred as secured borrowings	143,042	143,069	5.5%	3.0
Total gross loans	4,969,283	5,064,317		
Loan loss allowance (loans held-for-investment)	(4,481)			
Total net loans	$ 4,964,802	$ 5,064,317		

December 31, 2013	Carrying Value	Face Amount	Weighted Average Coupon	Weighted Average Life (WAL) (years)(2)
First mortgages	$ 2,616,441	$ 2,666,875	5.6%	4.3
Subordinated mortgages(1)	505,533	541,817	8.7%	4.2
Mezzanine loans	1,245,728	1,246,841	12.2%	3.7
Total loans held-for-investment	4,367,702	4,455,533		
Loans held-for-sale, fair value option elected	206,672	209,099	5.3%	9.6
Loans transferred as secured borrowings	180,414	180,483	5.4%	2.9
Total gross loans	4,754,788	4,845,115		
Loan loss allowance (loans held-for-investment)	(3,984)			
Total net loans	$ 4,750,804	$ 4,845,115		

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

(2) Represents the WAL of each respective group of loans as of the respective balance sheet date. The WAL of each individual 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 a denominator equal to the sum of the expected principal payments using the contractually extended maturity dates of the assets. Assumptions for the calculation of the WAL are adjusted as necessary for changes in projected principal repayments and/or maturity dates of the loan.

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As of March 31, 2014, approximately $3.6 billion, or 71.8%, of the loans were variable rate and paid interest principally at LIBOR plus a weighted-average spread of 5.18%. The following table summarizes our investments in floating rate loans (amounts in thousands):

	March 31, 2014		December 31, 2013	
Index	Base Rate	Carrying Value	Base Rate	Carrying Value
1 Month LIBOR	0.1520%	$ 630,005	0.1677%	$ 590,444
LIBOR Floor	0.19% - 3.00%(1)	2,937,015	0.19% - 3.00%(1)	2,641,162
U.S. Prime Rate	3.25%	2,197	3.25%	2,226
Total		$ 3,569,217		$ 3,233,832

(1) The weighted-average LIBOR Floor was 0.41% and 0.49% as of March 31, 2014 and December 31, 2013, respectively.

As of March 31, 2014, the risk ratings for loans subject to our rating system, which is described in our Form 10-K and excludes loans on the cost recovery method and loans for which the fair value option has been elected, by class of loan were as follows (amounts in thousands):

	Balance Sheet Classification						
	Loans Held-For-Investment						
Risk Rating Category	First Mortgages	Subordinated Mortgages	Mezzanine Loans	Cost Recovery Loans	Loans Held-For-Sale	Loans Transferred As Secured Borrowings	Total
1	$	$	$	$	$	$	$
2	100,691	104,092	226,689			12,994	444,466
3	2,552,430	360,398	986,067			130,048	4,028,943
4	147,063	36,732	114,958				298,753
5							
N/A	2,219			8,065	186,837		197,121
	$ 2,802,403	$ 501,222	$ 1,327,714	$ 8,065	$ 186,837	$ 143,042	$ 4,969,283

As of December 31, 2013, the risk ratings for loans subject to our rating system by class of loan were as follows (amounts in thousands):

	Balance Sheet Classification						
	Loans Held-For-Investment						
Risk Rating Category	First Mortgages	Subordinated Mortgages	Mezzanine Loans	Cost Recovery Loans	Loans Held-For-Sale	Loans Transferred As Secured Borrowings	Total
1	$	$	$	$	$	$	$
2	94,981	103,369	153,119			13,022	364,491
3	2,354,692	370,446	1,012,674			167,392	3,905,204
4	153,987	31,718	79,935				265,640
5							
N/A				12,781	206,672		219,453
	$ 2,603,660	$ 505,533	$ 1,245,728	$ 12,781	$ 206,672	$ 180,414	$ 4,754,788

After completing our impairment evaluation process as described in our Form 10-K, we concluded that no impairment charges were required on any individual loans held-for-investment as of March 31, 2014 or December 31, 2013. As of March 31, 2014, approximately $57.8 million of our loans held-for-investment were in default, approximately $8.0 million of which are within the LNR Segment and were acquired as non-performing loans prior to the April 19, 2013 acquisition. The remaining $49.8 million of the defaulted loan balance is comprised of a single mezzanine loan within the Lending Segment. The senior loan was in technical default as of March 31, 2014 due to a covenant breach, which caused our mezzanine loan to be in default. The loan is in the process of being refinanced, with a substantial equity investment by the borrower. No lender concessions are expected to be granted in connection with the refinancing. Additionally, none of our held-for-sale loans where we have elected the fair value option was 90 days or more past due or on nonaccrual status.

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In accordance with our policies, we record an allowance for loan losses equal to (i) 1.5% of the aggregate carrying amount of loans rated as a 4, plus (ii) 5% of the aggregate carrying amount of loans rated as a 5. These groups accounted for 6.0% and 5.6% of our loan portfolio as of March 31, 2014 and December 31, 2013, respectively. The following table presents the activity in our allowance for loan losses (amounts in thousands):

	For the Three Months Ended March 31,	
	2014	2013
Allowance for loan losses at January 1	$ 3,984	$ 2,061
Provision for loan losses	497	30
Charge-offs		
Recoveries		
Allowance for loan losses at March 31	$ 4,481	$ 2,091
Recorded investment in loans related to the allowance for loan loss	$ 298,753	$ 112,573

The activity in our loan portfolio was as follows (amounts in thousands):

	For the Three Months Ended March 31,	
	2014	2013
Balance at January 1	$ 4,750,804	$ 3,000,335
Acquisitions/originations/additional funding	981,762	129,817
Capitalized interest(1)	8,656	1,611
Basis of loans sold(2)	(448,317)	(44,631)
Loan maturities/principal repayments	(353,934)	(93,651)
Discount accretion/premium amortization	1,806	7,632
Changes in fair value	20,893	
Unrealized foreign currency remeasurement gain (loss)	3,629	(6,141)
Loan loss allowance	(497)	(30)
Balance at March 31	$ 4,964,802	$ 2,994,942

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

(2) See Note 10 for additional disclosure on these transactions.

5. Investment Securities

Investment securities were comprised of the following as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	Carrying Value as of	
	March 31, 2014	December 31, 2013

RMBS, available-for-sale	$	291,217	$	296,236
Single-borrower CMBS, available-for-sale		113,477		114,346
CMBS, fair value option (1)		564,818		550,282
Held-to-maturity (HTM) securities		369,152		368,318
Equity security, fair value option		15,115		15,247
Subtotal - Investment securities		1,353,779		1,344,429
VIE eliminations (1)		(430,694)		(409,322)
Total investment securities	$	923,085	$	935,107

(1) Certain fair value option CMBS are eliminated in consolidation against VIE liabilities pursuant to ASC 810.

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Purchases, sales and principal collections for all investment securities were as follows (amounts in thousands):

	Available-for-sale RMBS	Available-for-sale CMBS	CMBS, fair value option	HTM Securities	Equity Security	Total
Three Months ended March 31, 2014						
Purchases	$	$	$ 9,890	$	$	$ 9,890
Sales	9,309		18,574			27,883
Principal collections	7,819	408				8,227
Three Months ended March 31, 2013						
Purchases				37,190		37,190
Sales	12,711	206,608(1)			6,769	226,088
Principal collections	16,868	4,858				21,726

(1) Settlement occurred subsequent to March 31, 2013. We account for all investment securities transactions on a trade date basis.

RMBS and Single-borrower CMBS, Available-for-Sale

With the exception of one CMBS classified as HTM, the Company classified all of its RMBS and CMBS investments where the fair value option has not been elected as available-for-sale as of March 31, 2014 and December 31, 2013. These RMBS and CMBS are reported at fair value in the balance sheet with changes in fair value recorded in accumulated other comprehensive income (AOCI).

The tables below summarize various attributes of our investments in available-for-sale RMBS and single-borrower CMBS where the fair value option has not been elected as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	Purchase Amortized Cost	Credit OTTI	Recorded Amortized Cost	Non-Credit OTTI	Unrealized Gains or (Losses) Recognized in AOCI: Gross Unrealized Gains	Unrealized Gains or (Losses) Recognized in AOCI: Gross Unrealized Losses	Net Fair Value Adjustment	Fair Value
March 31, 2014								
RMBS	$ 243,354	$ (10,342)	$ 233,012	$ (979)	$ 59,419	$ (235)	$ 58,205	$ 291,217
Single-borrower CMBS	100,980		100,980		12,497		12,497	113,477
Total	$ 344,334	$ (10,342)	$ 333,992	$ (979)	$ 71,916	$ (235)	$ 70,702	$ 404,694
December 31, 2013								
RMBS	$ 253,912	$ (11,134)	$ 242,778	$ (55)	$ 55,154	$ (1,641)	$ 53,458	$ 296,236
Single-borrower CMBS	100,687		100,687		13,659		13,659	114,346
Total	$ 354,599	$ (11,134)	$ 343,465	$ (55)	$ 68,813	$ (1,641)	$ 67,117	$ 410,582

	Weighted Average Coupon(1)	Weighted Average Rating (Standard & Poor s)	WAL (Years)(3)
March 31, 2014			
RMBS	1.0%	B-	7.8
Single-borrower CMBS	11.5%	BB+(2)	4.0
December 31, 2013			
RMBS	1.0%	B-	6.8
Single-borrower CMBS	11.5%	BB+(2)	5.9

(1) Calculated using the March 31, 2014 and December 31, 2013 one-month LIBOR rate of 0.152% and 0.168%, respectively, for floating rate securities.

(2) As of March 31, 2014 and December 31, 2013, approximately 99.1% and 98.8%, respectively, of the CMBS securities were rated BB+.

(3) Represents the WAL of each respective group of securities calculated as of the respective balance sheet date. The WAL of each individual security or loan is calculated as a fraction, the numerator of which is the sum of the timing

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(in years) of each expected future principal payment multiplied by the balance of the respective payment, and with a denominator equal to the sum of the expected principal payments using the contractually extended maturity dates of the assets. Assumptions for the calculation of the WAL are adjusted as necessary for changes in projected principal repayments and/or maturity dates of the security.

As of March 31, 2014, $1.0 million, or 0.9%, of the single-borrower CMBS were variable rate. As of December 31, 2013, $1.3 million, or 1.2%, of the single-borrower CMBS were variable rate. As of March 31, 2014, approximately $252.1 million, or 86.6%, of the RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 0.38%. As of December 31, 2013, approximately $256.1 million, or 86.5%, of the RMBS were variable rate and paid interest at LIBOR plus a weighted average spread of 0.37%. 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 contains a reconciliation of aggregate principal balance to amortized cost for our RMBS and single-borrower CMBS as of March 31, 2014 and December 31, 2013, excluding CMBS where we have elected the fair value option (amounts in thousands):

	March 31, 2014		December 31, 2013	
	RMBS	CMBS	RMBS	CMBS
Principal balance	$ 388,066	$ 100,980	$ 414,020	$ 100,687
Accretable yield	(99,622)		(101,046)	
Non-accretable difference	(55,432)		(70,196)	
Total discount	(155,054)		(171,242)	
Amortized cost	$ 233,012	$ 100,980	$ 242,778	$ 100,687

The principal balance of credit deteriorated RMBS was $300.7 million and $320.4 million as of March 31, 2014 and December 31, 2013, respectively. Accretable yield related to these securities totaled $79.3 million and $78.3 million as of March 31, 2014 and December 31, 2013, respectively.

The following table discloses the changes to accretable yield and non-accretable difference for our RMBS and single-borrower CMBS during the three months ended March 31, 2014 and 2013, excluding CMBS where we have elected the fair value option (amounts in thousands):

	Accretable Yield		Non-Accretable Difference	
	RMBS	CMBS	RMBS	CMBS
Balance as of January 1, 2014	$ 101,046	$	$ 70,196	$
Accretion of discount	(6,564)			
Principal write-downs			(366)	
Purchases				
Sales	(1,962)		(7,509)	
OTTI	213			
Transfer to/from non-accretable difference	6,889		(6,889)	
Balance as of March 31, 2014	$ 99,622	$	$ 55,432	$
Balance as of January 1, 2013	$ 108,486	$ 21,511	$ 97,605	$

Accretion of discount	(6,151)	(3,029)		
Principal write-downs			(496)	
Purchases				
Sales	(2,418)	(9,873)	(2,038)	
OTTI	42			
Transfer to/from non-accretable difference	(1,002)		1,002	
Balance as of March 31, 2013	$ 98,957	$ 8,609	$ 96,073	$

Subject to certain limitations on durations, we have allocated an amount to invest in RMBS that cannot exceed 10% of our total assets excluding LNR VIEs. We have engaged a third party manager who specializes in RMBS to execute the trading of RMBS, the cost of which was $0.6 million for each of the three months ended March 31, 2014 and 2013, which has been recorded as management fees in the accompanying condensed consolidated statements of operations.

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The following table presents the gross unrealized losses and estimated fair value of the available-for-sale securities (i) where we have not elected the fair value option, (ii) that were in an unrealized loss position as of March 31, 2014 and December 31, 2013, and (iii) for which OTTIs (full or partial) have not been recognized in earnings (amounts in thousands):

	Estimated Fair Value		Unrealized Losses	
	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
As of March 31, 2014				
RMBS	$ 20,799	$ 799	$ (1,040)	$ (174)
Single-borrower CMBS				
Total	$ 20,799	$ 799	$ (1,040)	$ (174)
As of December 31, 2013				
RMBS	$ 26,344	$ 1,809	$ (1,444)	$ (252)
Single-borrower CMBS				
Total	$ 26,344	$ 1,809	$ (1,444)	$ (252)

As of March 31, 2014, there were six securities with unrealized losses reflected in the table above. After evaluating each security and recording adjustments, as necessary, for other-than-temporary impairments, the remaining unrealized losses reflected above were not considered to represent other-than-temporary impairments. 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. Credit losses, which represent most of the other-than-temporary impairments we record, are calculated by comparing (i) the 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. Significant judgment is used 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.

CMBS, Fair Value Option

As discussed in the Fair Value Option section of Note 2 herein, we elect the fair value option for LNR s CMBS in an effort to eliminate accounting mismatches resulting from the current or potential consolidation of securitization VIEs. As of March 31, 2014, the fair value and unpaid principal balance of CMBS where we have elected the fair value option, before consolidation of securitization VIEs, were $564.8 million and $3.9 billion, respectively. These balances represent our economic interests in these assets. However, as a result of our consolidation of securitization VIEs, the vast majority of this fair value ($430.7 million at March 31, 2014) is eliminated against VIE liabilities before arriving at our GAAP balance for fair value option CMBS. During the three months ended March 31, 2014, we purchased $44.7 million of CMBS for which we elected the fair value option. Due to our consolidation of securitization VIEs, $34.8 million of this amount is reflected as repayment of debt of consolidated VIEs in our condensed consolidated statement of cash flows.

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As of March 31, 2014 and December 31, 2013, none of our CMBS where we have elected the fair value option were variable rate. The table below summarizes various attributes of our investment in fair value option CMBS as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	Weighted Average Coupon	Weighted Average Rating (Standard & Poor s)	WAL (Years)(1)
March 31, 2014			
CMBS, fair value option	5.4%	C(2)	5.6
December 31, 2013			
CMBS, fair value option	5.4%	D(2)	4.4

(1) The WAL of each security is calculated based on the period of time over which we expect to receive principal cash flows. Expected principal cash flows are based on contractual payments net of expected losses.

(2) As of March 31, 2014 and December 31, 2013, includes $53.8 million and $55.5 million, respectively, in fair value option CMBS that are not rated but assigned a rating weight one level lower than NR for purposes of this calculation. As of March 31, 2014 and December 31, 2013, the remaining $80.3 million and $85.4 million, respectively, in fair value option CMBS had a weighted average rating of CC and C, respectively.

HTM Securities

The table below summarizes various attributes of our investments in HTM securities as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	Net Carrying Amount (Amortized Cost)	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
March 31, 2014				
Preferred interests	$ 284,991	$	$ (754)	$ 284,237
CMBS	84,161		(587)	83,574
Total	$ 369,152	$	$ (1,341)	$ 367,811
December 31, 2013				
Preferred interests	$ 284,087	$ 135	$	$ 284,222
CMBS	84,231			84,231
Total	$ 368,318	$ 135	$	$ 368,453

During 2013, we originated two preferred equity interests of $246.1 million and $37.2 million, respectively, in limited liability companies that own commercial real estate. These preferred equity interests mature in December 2018 and October 2014, respectively. During 2013, we also

purchased a CMBS security with a face value and purchase price of $84.1 million, which we expect to hold to maturity. The stated maturity of this security is November 2016.

Equity Security, Fair Value Option

During 2012, we acquired 9,140,000 ordinary shares from a related-party (approximately a 4% interest) in Starwood European Real Estate Finance Limited (SEREF), a debt fund that is externally managed by an affiliate of our Manager and is listed on the London Stock Exchange. We have elected to report the investment using the fair value option because the shares are listed on an exchange, which allows us to determine the fair value using a quoted price from an active market, and also due to potential lags in reporting resulting from differences in the respective regulatory requirements. The fair value of the investment remeasured in USD was $15.1 million and $15.2 million as of March 31, 2014 and December 31, 2013, respectively.

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6. Investment in Unconsolidated Entities

The below table summarizes our investments in unconsolidated entities as of March 31, 2014 and December 31, 2013 (dollar amounts in thousands):

	Participation / Ownership %(1)	Carrying value as of March 31, 2014	Carrying value as of December 31, 2013	Carrying value over (under) equity in net assets as of March 31, 2014(2)
Equity method:				
Investor entity which owns equity interests in two real estate services providers	50%	$ 19,449	$ 19,371	$
Small balance bridge loan financing venture	50%	25,947	26,121	
European investment fund	50%	9,409	23,779	(4,051)
Mezzanine loan venture	49%	23,508	23,676	
Healthcare bridge loan venture	various	10,365	14,163	
Various	25% - 50%	4,577	4,371	
		93,255	111,481	$ (4,051)
Cost method:				
Loan servicing venture	4% - 6%	8,014	8,014	
Various	2% - 10%	3,251	3,459	
		11,265	11,473	
		$ 104,520	$ 122,954	

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(1) None of these investments are publicly traded and therefore quoted market prices are not available.

(2) Differences between the carrying value of our investment and the underlying equity in net assets of the investee are accounted for as if the investee were a consolidated entity in accordance with ASC 323, *Investments Equity Method and Joint Ventures*.

7. Goodwill and Intangible Assets

Goodwill

Goodwill at March 31, 2014 and December 31, 2013 represents the excess of consideration transferred over the fair value of net assets of LNR acquired on April 19, 2013. The goodwill recognized is attributable to value embedded in LNR s existing platform, which includes an international network of commercial real estate asset managers, work-out specialists, underwriters and administrative support professionals as well as proprietary historical performance data on commercial real estate assets.

Servicing Rights Intangibles

In connection with the LNR acquisition, we identified domestic and European servicing rights that existed at the purchase date, based upon the expected future cash flows of the associated servicing contracts. All of our servicing fees are specified by these Pooling and Servicing Agreements. At March 31, 2014 and December 31, 2013, the balance of the domestic servicing intangible was net of $77.0 million and $80.6 million, respectively, that was eliminated in consolidation pursuant to ASC 810 against VIE assets in connection with our consolidation of securitization VIEs. Before VIE consolidation, as of March 31, 2014 and December 31, 2013 the domestic servicing intangible had a balance of $221.9 million and $230.7 million, respectively, which represents our economic interest in this asset.

The table below presents information about our GAAP servicing intangibles for the three months ended March 31, 2014 (in thousands):

Domestic servicing rights, at fair value		
Fair value at January 1, 2014	$	150,149
Changes in fair value due to changes in inputs and assumptions		(5,251)
Fair value at March 31, 2014		144,898
European servicing rights		
Net carrying amount at January 1, 2014 (fair value of $29.3 million)		27,024
Foreign exchange gain		145
Amortization		(4,011)
Net carrying value at March 31, 2014 (fair value of $24.4 million)		23,158
Total servicing rights at March 31, 2014	$	168,056

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8. Secured Financing Agreements

The following table is a summary of our secured financing agreements in place as of March 31, 2014 and December 31, 2013 (dollars in thousands):

	Facility Type	Revolver	Eligible Assets	Current Maturity	Extended Maturity(a)	Pricing	Pledged Asset Carrying Value	Maximum Facility Size	Carrying Value at March 31, 2014	Carrying Value at December 31, 2013
Lender 1 Repo 1	Repurchase	Yes	Identified Loans and CMBS	(b)	(b)	LIBOR + 1.85% to 5.25%	$ 1,257,467	$ 1,000,000	$ 810,081	$ 449,323
Lender 1 Repo 2	Repurchase	Yes	Identified RMBS	(c)	N/A	LIBOR + 1.90%	267,464	175,000	159,427	127,943
Lender 1 Repo 3	Repurchase	No	Identified Loans	Dec 2014	Dec 2016	LIBOR + 2.75%	209,427	153,299	153,299	154,133
Lender 2 Repo 1	Repurchase	Yes	Identified Loans	Oct 2015	Oct 2018	LIBOR + 2.00% to 2.75%	211,684	225,000	136,018	100,886
Lender 3 Repo 1	Repurchase	No	Identified Loans	Jul 2015	Jul 2017	LIBOR + 3.00%	76,847	49,862	49,862	50,871
Conduit I	Repurchase	Yes	Identified Loans	Sep 2014	Sep 2014	LIBOR + 2.20%	112,720	250,000	80,633	129,843
Conduit II	Repurchase	Yes	Identified Loans	Nov 2014	Nov 2014	LIBOR + 2.10%	37,307	150,000	27,900	
Lender 4 Repo 1	Repurchase	No	Identified Loans	Oct 2015	Oct 2017	LIBOR + 2.60%	444,793	349,902	349,902	347,697
Lender 5 Repo 1	Repurchase	No	Identified CMBS	Dec 2014	Dec 2014	LIBOR + 2.00%	84,161	58,467	58,467	58,467
Borrowing Base	Bank Credit Facility	Yes	Identified Loans	Sep 2015	Sep 2017	LIBOR + 3.25%(d)	869,527	250,000	107,769	169,104
Term Loan	Syndicated Facility	No	Specifically Identified Assets	Apr 2020	Apr 2020	LIBOR + 2.75%(d)	2,568,446	670,116	667,704(e)	669,293(e)
							$ 6,139,843	$ 3,331,646	$ 2,601,062	$ 2,257,560

(a) Subject to certain conditions as defined in the respective facility agreement.

(b) Maturity date for borrowings collateralized by loans of January 2017 before extension options and January 2019 assuming initial extension options. Maturity date for borrowings collateralized by CMBS of January 2015 before extension options and January 2016 assuming initial extension options.

(c) The date that is 180 days after the buyer delivers notice to seller, subject to a maximum date of March 13, 2015.

(d) Subject to borrower s option to choose alternative benchmark based rates pursuant to the terms of the credit agreement. The Term Loan is also subject to a 75 basis point floor.

(e) Term loan outstanding balance is net of $2.4 million and $2.5 million of unamortized discount as of March 31, 2014 and December 31, 2013.

In January 2014, we amended the Lender 1 Repo 1 facility to (i) upsize available borrowings to $1.0 billion from $550 million; (ii) extend the maturity date for loan collateral to January 2019 and for CMBS collateral to January 2016, each from August 2014, and each assuming initial extension options; (iii) allow for up to four additional one-year extension options with respect to any loan collateral that remains financed at maturity, in an effort to match the term of the maturity dates of these assets; (iv) reduce pricing and debt-yield thresholds for purchased assets; and (v) amend certain financial covenants to contemplate the spin-off of the SFR segment. STWD guarantees certain of the obligations of the consolidated subsidiary, which is the borrower under the 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.

Our secured financing agreements contain certain financial tests and covenants. As of March 31, 2014, we were in compliance with all such covenants.

The following table sets forth our five-year principal repayments schedule for the secured financings, assuming no defaults or expected extensions and excluding the loans transferred as secured borrowings. 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 reflected in each period includes principal repayments on our credit facilities that would be required if (i) we received the repayments that we expect to receive on the investments that have been pledged as collateral under the credit facilities, as applicable, and (ii) the credit facilities that are expected to have amounts outstanding at their current maturity dates are extended where extension options are available to us (amounts in thousands):

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2014 (remainder of)	$	211,941
2015		194,927
2016		373,884
2017		627,863
2018		186,817
Thereafter(1)		1,008,041
Total	$	2,603,473

(1) Principal paydown of the Term Loan through 2020 excludes $2.4 million of discount amortization.

Secured financing maturities for 2014 primarily relate to $80.6 million on the Conduit I facility, $58.5 million on the Lender 5 Repo 1 facility, $27.9 million on the Conduit II facility, and $25.7 million on the Lender 1 Repo 3 facility.

As of March 31, 2014 and December 31, 2013, we had approximately $27.1 million and $22.5 million, respectively, of deferred financing costs from secured financing agreements, net of amortization, which is included in other assets on our condensed consolidated balance sheets. For the three months ended March 31, 2014 and 2013, approximately $2.9 million, and $3.2 million, respectively, of amortization was included in interest expense on our condensed consolidated statements of operations.

9. Convertible Senior Notes

On February 15, 2013, we issued $600.0 million of 4.55% Convertible Senior Notes due 2018 (the 2018 Notes). On July 3, 2013, we issued $460.0 million of 4.00% Convertible Senior Notes due 2019 (the 2019 Notes). The following summarizes the unsecured convertible senior notes (collectively, the Convertible Notes) outstanding as of March 31, 2014 (amounts in thousands, except rates):

		Principal Amount	Coupon Rate	Effective Rate(1)	Conversion Rate(2)	Maturity Date	Remaining Period of Amortization
2018 Notes	$	600,000	4.55%	6.08%	44.4112	3/1/2018	3.9 years
2019 Notes	$	460,000	4.00%	5.37%	47.3282	1/15/2019	4.8 years

		As of March 31, 2014		As of December 31, 2013
Total principal	$	1,060,000	$	1,060,000
Net unamortized discount		(59,161)		(62,149)
Carrying amount of debt components	$	1,000,839	$	997,851
Carrying amount of conversion option equity components recorded in additional paid-in capital	$	48,502	$	48,502

(1) Effective rate includes the effects of underwriter purchase discount and the adjustment for the conversion option, the value of which reduced the initial liability and was recorded in additional paid-in-capital.

(2) The conversion rate represents the number of common shares issuable per $1,000 principal amount of Convertible Notes converted, as adjusted in accordance with the applicable indentures as a result of the spin-off of the SFR segment. The if-converted value of the 2018 Notes exceeded their principal amount by $28.6 million at March 31, 2014 since the closing market price of the Company s common stock of $23.59 per share exceeded the implicit conversion price of $22.52 per share. The if-converted value of the 2019 Notes exceeded their principal amount by $53.6 million at March 31, 2014 since the closing market price of $23.59 per share exceeded the implicit conversion price of $21.13 per share for the 2019 Notes. The Company has asserted its intent and ability to settle the principal amount of the Convertible Notes in cash. As a result, conversion of this principal amount, totaling 45.2 million shares, was not included in the computation of diluted earnings per share (EPS). However, the conversion spread value, representing 3.2 million shares, was included in the computation of diluted EPS. See further discussion at Note 16.

As of March 31, 2014 and December 31, 2013, we had approximately $1.5 million and $1.6 million, respectively, of deferred financing costs from our Convertible Senior Notes, net of amortization, which is included in other assets on our condensed consolidated balance sheets.

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Conditions for Conversion

Prior to September 1, 2017 for the 2018 Notes and July 15, 2018 for the 2019 Notes, the Convertible Notes will be convertible only upon satisfaction of one or more of the following conditions: (1) the closing market price of the Company s common stock is at least 130% of the conversion price of the respective Convertible Notes for at least 20 out of 30 trading days prior to the end of the preceding fiscal quarter, (2) the trading price of the Convertible Notes is less than 98% of the product of (i) the conversion rate and (ii) the closing price of the Company s common stock during any five consecutive trading day period, (3) the Company issues certain equity instruments at less than the 10-day average closing market price of its common stock or the per-share value of certain distributions exceeds the market price of the Company s common stock by more than 10% or (4) other specified corporate events (significant consolidation, sale, merger, share exchange, fundamental change, etc.) occur.

On or after September 1, 2017 for the 2018 Notes and July 15, 2018 for the 2019 Notes, holders may convert each of their notes at the applicable conversion rate at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date.

Impact of Spin-off on Convertible Senior Notes

As described in Note 1, on January 31, 2014, the Company distributed all of its interest in the SFR segment to the Company s stockholders of record as of January 24, 2014. As the per-share value of the of the distribution was expected to exceed 10% of the last reported market price of the Company s common stock on the trading day prior to the announcement for such distribution, holders of the Convertible Notes were eligible to surrender their notes for conversion at any time during the period beginning November 26, 2013 (the 45th trading day immediately prior to the scheduled ex-dividend date for the distribution) and ending on the close of the business day immediately preceding February 3, 2014, the ex-dividend date for such distribution. During this period, the Company received notices of conversion totaling $19 thousand and $3 thousand in principal for the 2018 Notes and 2019 Notes, respectively. The cash settlement of these conversions occurred in April 2014.

Due to the distribution, the quarterly dividend threshold amounts for the Convertible Notes were adjusted to $0.3548 and $0.3710 (from $0.44 and $0.46) per common share for the 2018 Notes and 2019 Notes, respectively, effective February 3, 2014.

Refer to Note 11 to the consolidated financial statements included in our Form 10-K for further discussion regarding our accounting for the convertible senior notes.

10. Loan Securitization/Sale Activities

As described below, we regularly sell loans and notes under various strategies. We evaluate such sales as to whether they meet the criteria for treatment as a sale legal isolation, ability of transferee to pledge or exchange the transferred assets without constraint, and transfer of control.

Within LNR, we originate commercial mortgage loans with the intent to sell these mortgage loans to SPEs for the purposes of securitization. These SPEs then issue CMBS that are collateralized in part by these assets, as well as other assets transferred to the SPE. In certain instances, we retain a subordinated interest in the SPE and serve as special servicer for the SPE. During the three months ended March 31, 2014, we sold $289.4 million par value of loans held-for-sale from our conduit platform for their fair values of $302.5 million. During the three months ended March 31, 2014, the sale proceeds were used in part to repay $217.0 million of the outstanding balance of the repurchase agreements associated with these loans.

Within the Lending Segment (refer to Note 22), we originate or acquire loans and then subsequently sell a senior portion, which can be represented in various forms including first mortgages, A-Notes and senior participations. Typically, our motivation for entering into these transactions is to effectively create leverage on the subordinated position that we will retain and hold for investment. The following table summarizes our loans sold and loans transferred as secured borrowings by the Lending Segment net of expenses (in thousands):

	Loan Transfers Accounted for as Sales		Loan Transfers Accounted for as Secured Borrowings	
	Face Amount	Proceeds	Face Amount	Proceeds
For the three months ended March 31,				
2014	$ 147,884	$ 146,400	$	$
2013	44,531	44,631		

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11. 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. Refer to Note 13 to the consolidated financial statements included in our Form 10-K for further discussion of our risk management objectives and policies.

Designated Hedges

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 eight outstanding interest rate swaps that have been designated as cash flow hedges of the interest rate risk associated with forecasted interest payments. As of March 31, 2014, the aggregate notional of our interest rate swaps designated as cash flow hedges of interest rate risk totaled $198.9 million. Under these agreements, we will pay fixed monthly coupons at fixed rates ranging from 0.56% to 2.23% 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 May 2014 to May 2021.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in AOCI 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 three months ended March 31, 2014 and 2013 we did not recognize any hedge ineffectiveness in earnings.

Amounts reported in AOCI 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 $1.2 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 86 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 gain (loss) on derivative financial instruments in our condensed consolidated statements of operations. The LNR conduit platform uses interest rate and credit index instruments to manage exposures related to commercial mortgage loans held-for-sale.

We have entered into a series of forward contracts whereby we agreed to sell an amount of GBP or EUR for an agreed upon amount of USD at various dates through March 2016. These forward contracts were executed to economically fix the USD amounts of foreign denominated cash flows expected to be received by us related to foreign denominated loan investments.

As of March 31, 2014, we had 69 foreign exchange forward derivatives to sell GBP with a total notional amount of £228.8 million and 25 foreign exchange forward derivatives to sell EUR with a total notional amount of 138.9 million that were not designated as hedges in qualifying hedging relationships. Also as of March 31, 2014, there were 23 interest rate swaps where the Company is paying fixed rates, with maturities ranging from 2 to 10 years and a total notional amount of $97.6 million, four interest rate swaps where the Company is receiving fixed rates with maturities ranging from 1 to 4 years and a total notional of $64.2 million and eight credit index instruments with a total notional amount of $50.0 million. The table below presents the fair value of our derivative financial instruments as well as their classification on the condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	Fair Value of Derivatives in an Asset Position(1) As of		**Fair Value of Derivatives in a Liability Position(2) As of**	
	March 31, 2014	**December 31, 2013**	**March 31, 2014**	**December 31, 2013**
Derivatives designated as hedging instruments:				
Interest rate swaps	$ 112	$ 125	$ 594	$ 729
Total derivatives designated as hedging instruments	112	125	594	729
Derivatives not designated as hedging instruments:				
Interest rate swaps	2,361	5,102	989	983
Foreign exchange contracts	266	269	16,474	22,480
Credit index instruments	1,878	2,273		
Total derivatives not designated as hedging instruments	4,505	7,644	17,463	23,463
Total derivatives	$ 4,617	$ 7,769	$ 18,057	$ 24,192

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(1) Classified as derivative assets in our condensed consolidated balance sheets.

(2) Classified as derivative liabilities in our condensed consolidated balance sheets.

The tables below present the effect of our derivative financial instruments on the condensed consolidated statements of operations and of comprehensive income for the three months ended March 31, 2014 and 2013:

Derivatives Designated as Hedging Instruments for the Three Months Ended March 31,	Gain (Loss) Recognized in OCI (effective portion)	Gain (Loss) Reclassified from AOCI into Income (effective portion)	Gain (Loss) Recognized in Income (ineffective portion)	Location of Gain (Loss) Recognized in Income
2014	$ (251)	$ (373)	$	Interest expense
2013	$ (167)	$ (447)	$	Interest expense

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income for the Three Months Ended March 31, 2014	2013
Interest rate swaps	Loss (gain) on derivative financial instruments	$ (4,197)	$ 150
Foreign exchange contracts	Loss (gain) on derivative financial instruments	(3,047)	16,078
Credit index instruments	Loss on derivative financial instruments	(622)	
		$ (7,866)	$ 16,228

Credit-risk-related Contingent Features

We have entered into agreements with certain of our derivative counterparties that contain provisions providing that if we were to default on any of our indebtedness, including default 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 providing that 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 March 31, 2014, we had posted collateral of $17.1 million related to our derivative financial instruments.

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12. Offsetting Assets and Liabilities

The following tables present the potential effects of netting arrangements on our financial position for financial assets and liabilities within the scope of ASC 210-20, *Balance Sheet Offsetting*, which for us are derivative assets and liabilities as well as repurchase agreement liabilities (amounts in thousands):

	(i) Gross Amounts Recognized	(ii) Gross Amounts Offset in the Statement of Financial Position	(iii) = (i) - (ii) Net Amounts Presented in the Statement of Financial Position	(iv) Gross Amounts Not Offset in the Statement of Financial Position		(v) = (iii) - (iv) Net Amount
				Financial Instruments	Cash Collateral Received / Pledged	
As of March 31, 2014						
Derivative assets	$ 4,617	$	$ 4,617	$ 493	$ 1,731	$ 2,393
Derivative liabilities	$ 18,057	$	$ 18,057	$ 493	$ 12,065	$ 5,499
Repurchase agreements	1,825,589		1,825,589	1,825,589		
	$ 1,843,646	$	$ 1,843,646	$ 1,826,082	$ 12,065	$ 5,499
As of December 31, 2013						
Derivative assets	$ 7,769	$	$ 7,769	$ 692	$ 1,916	$ 5,161
Derivative liabilities	$ 24,192	$	$ 24,192	$ 692	$ 7,150	$ 16,350
Repurchase agreements	1,419,163		1,419,163	1,419,163		
	$ 1,443,355	$	$ 1,443,355	$ 1,419,855	$ 7,150	$ 16,350

13. Variable Interest Entities

Investment Securities

As discussed in Note 2, we evaluate all of our investments and other interests in entities for consolidation, including our investments in CMBS and our retained interests in securitization transactions we initiated, all of which are generally considered to be variable interests in VIEs.

The VIEs consolidated in accordance with ASC 810 are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The assets and other instruments held by these securitization entities are restricted and can only be used to fulfill the obligations of the entity. Additionally, the obligations of the securitization entities do not have any recourse to the general credit of any other consolidated entities, nor to us as the primary beneficiary. The SPE liabilities initially represent investment securities on our balance sheet (pre-consolidation). Upon consolidation of these VIEs, our associated investment securities are eliminated, as is the interest income related to those securities. Similarly, the fees we earn in our roles as special servicer of the bonds issued by the consolidated VIEs or as collateral administrator of the consolidated VIEs are also eliminated. Finally, an allocable portion of the identified servicing intangible associated with the eliminated fee streams is eliminated in consolidation.

VIEs in which we are the Primary Beneficiary

The inclusion of the assets and liabilities of VIEs in which we are deemed the primary beneficiary has no economic effect on us. Our exposure to the obligations of VIEs is generally limited to our investment in these entities. We are not obligated to provide, nor have we provided, any financial support for any of these consolidated structures.

VIEs in which we are not the Primary Beneficiary

In certain instances, we hold a variable interest in a VIE in the form of CMBS, but either (i) we are not appointed, or do not serve as, special servicer or (ii) an unrelated third party has the rights to unilaterally remove us as special servicer. In these instances, we do not have the power to direct activities that most significantly impact the VIE s economic performance. In other cases, the variable interest we hold does not obligate us to absorb losses or provide us with the right to receive benefits from the VIE which could potentially be significant. For these structures, we are not deemed to be the primary beneficiary of the VIE, and we do not consolidate these VIEs.

As of March 31, 2014, one of our collateralized debt obligation (CDO) structures was in default, which pursuant to the underlying indentures, changes the rights of the variable interest holders. Upon default of a CDO, the trustee or senior note holders are allowed to exercise certain rights, including liquidation of the collateral, which at that time, is the activity which would most

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significantly impact the CDO s economic performance. Further, when the CDO is in default, the collateral administrator no longer has the option to purchase securities from the CDO. In cases where the CDO is in default and we do not have the ability to exercise rights which would most significantly impact the CDO s economic performance, we do not consolidate the VIE. As of March 31, 2014, this CDO structure was not consolidated. During the three months ended March 31, 2014, one of our CDOs, which was previously in default as of December 31, 2013, ceased to be in default. As such, we consolidated the CDO and its underlying assets during the three months ended March 31, 2014.

As noted above, we are not obligated to provide, nor have we provided, any financial support for any of our securitization SPEs, whether or not we are deemed to be the primary beneficiary. As such, the risk associated with our involvement in these VIEs is limited to the carrying value of our investment in the entity. As of March 31, 2014, our maximum risk of loss related to VIEs in which we were not the primary beneficiary was $134.1 million on a fair value basis.

As of March 31, 2014, the securitization SPEs which we do not consolidate had debt obligations to beneficial interest holders with unpaid principal balances of $108.4 billion. The corresponding assets are comprised primarily of commercial mortgage loans with unpaid principal balances corresponding to the amounts of the outstanding debt obligations.

14. Related-Party Transactions

Management Agreement

We are subject to a management agreement (the Management Agreement) with our Manager, 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 s personnel perform certain due diligence, legal, management and other services that outside professionals or consultants would otherwise perform. As such, in accordance with the terms of our Management Agreement, our Manager is paid or reimbursed for the documented costs of performing such tasks, provided that such costs and reimbursements are in amounts no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm s-length basis. Refer to Note 16 to the consolidated financial statements included in our Form 10-K for further discussion of this agreement.

Base Management Fee. For the three months ended March 31, 2014 and 2013, approximately $13.2 million and $9.7 million, respectively, was incurred for base management fees. As of March 31, 2014 and December 31, 2013, there were $13.2 million and $0 of unpaid base management fees, respectively, in our condensed consolidated balance sheets.

Incentive Fee. For the three months ended March 31, 2014 and 2013, approximately $7.2 million and $0, respectively, was incurred for the incentive fee. As of March 31, 2014 and December 31, 2013, approximately $7.2 million and $6.8 million, respectively, of unpaid incentive fees were included in related-party payable in our condensed consolidated balance sheets.

Expense Reimbursement. For the three months ended March 31, 2014 and 2013, approximately $1.9 million and $2.5 million was incurred, respectively, for executive compensation and other reimbursable expenses. As of both March 31, 2014 and December 31, 2013, approximately $4.4 million of unpaid reimbursable executive compensation and other expenses were included in related-party payable in our condensed consolidated balance sheets.

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Manager Equity Plan

In January 2014, we granted 2,489,281 restricted stock units to our Manager under the Starwood Property Trust, Inc. Manager Equity Plan (Manager Equity Plan). In connection with these grants and prior similar grants, we recognized share-based compensation expense of $6.7 million within management fees in our condensed consolidated statement of operations for the three months ended March 31, 2014. Refer to Note 15 herein for further discussion of these grants.

Investment in Loan

On October 2012, we co-originated $475.0 million in financing for the acquisition and redevelopment of a 10-story retail building located at 701 Seventh Avenue in the Times Square area of Manhattan through a joint venture with Starwood Distressed Opportunity Fund IX (Fund IX), an affiliate of our Manager. In January 2014, we refinanced the initial financing with an $815.0 million first mortgage and mezzanine financing to facilitate the further development of the property. Fund IX did not participate in the refinancing. As such, the joint venture distributed $31.6 million to Fund IX for the liquidation of their interest in the joint venture.

LNR Related-Party Arrangement

In connection with the LNR acquisition, we were required to cash collateralize certain obligations of LNR, including letters of credit and performance obligations. Fund IX funded $6.2 million of this obligation, but the account is within our name and is thus reflected within our restricted cash balance. We have recognized a corresponding payable to Fund IX of $4.4 million and $6.2 million within related-party payable in our condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013, respectively.

15. Stockholders Equity

On February 24, 2014, our board of directors declared a dividend of $0.48 per share for the first quarter of 2014, which was paid on April 15, 2014 to common stockholders of record as of March 31, 2014.

Subsequent to March 31, 2014, we issued additional common stock under our currently effective shelf registration. Refer to Note 23 herein for further details.

Equity Incentive Plans

The Company currently maintains the Manager Equity Plan, the Starwood Property Trust, Inc. Equity Plan (the Equity Plan), and the Starwood Property Trust, Inc. Non-Executive Director Stock Plan (Non-Executive Director Stock Plan). Refer to Note 17 to the consolidated financial statements included in our Form 10-K for further information regarding these plans.

On January 2, 2014, the Company granted 2,000,000 restricted stock units to our Manager under the Manager Equity Plan. These awards vest ratably on a quarterly basis over a three-year period beginning on March 31, 2014 and had a grant date fair value of $55.4 million. On January 31, 2014, in connection with the spin-off of the SFR segment, the Company granted our Manager 489,281 restricted stock units of the Company in consideration of the Company s currently unvested restricted stock units. Of these restricted stock units, 99,480 vest ratably on a quarterly basis over a 21-month period beginning on March 31, 2014 and 389,801 vest ratably on a quarterly basis over a three-year period beginning on March 31, 2014. These restricted stock units had a grant date fair value of $14.8 million.

As of March 31, 2014, there were 3.4 million shares available for future grants under the Manager Equity Plan and the Equity Plan.

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Schedule of Non-Vested Shares and Share Equivalents

	Non-Executive Director Stock Plan	Equity Plan	Manager Equity Plan	Total	Weighted Average Grant Date Fair Value (per share)
Balance as of December 31, 2013	11,228	22,502	510,415	544,145	$ 22.88
Granted		147,911	2,489,281	2,637,192	27.96
Vested		(14,981)	(286,278)	(301,259)	26.71
Forfeited					
Balance as of March 31, 2014	11,228	155,432	2,713,418	2,880,078	$ 27.13

16. Earnings per Share

We present both basic and diluted EPS amounts in our financial statements. Basic EPS excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the maximum potential dilution that could occur from (i) our share-based compensation, consisting of unvested restricted stock units and awards, (ii) contingently issuable shares to our Manager; and (iii) the in-the-money conversion options associated with our outstanding Convertible Notes (see further discussion below). Potential dilutive shares are excluded from the calculation if they have an anti-dilutive effect in the period.

The Company s unvested restricted share units and awards contain rights to receive non-forfeitable dividends and thus are participating securities. Due to the existence of these participating securities, the two-class method of computing EPS is required, unless another method is determined to be more dilutive. Under the two-class method, undistributed earnings are reallocated between common shares and participating securities. For the three months ended March 31, 2014 and 2013, the two-class method resulted in the most dilutive EPS calculation.

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The following table provides a reconciliation of net income from continuing operations and the number of common shares used in the computations of basic EPS and diluted EPS (in thousands, except per share amounts):

	For the Three Month Ended March 31,	
	2014	2013
Basic Earnings		
Continuing Operations:		
Income from continuing operations attributable to STWD common shareholders	$ 122,152	$ 64,531
Less: Income attributable to unvested shares	(1,748)	(454)
Basic Income from continuing operations	$ 120,404	$ 64,077
Discontinued Operations:		
Loss from discontinued operations	$ (1,551)	$ (2,288)
Basic Net income attributable to STWD common shareholders after allocation to participating securities	$ 118,853	$ 61,789
Diluted Earnings		
Continuing Operations:		
Basic Income from continuing operations attributable to STWD common shareholders	$ 122,152	$ 64,531
Less: Income attributable to unvested shares	(1,748)	(454)
Add: Undistributed earnings to unvested shares	366	18
Less: Undistributed earnings reallocated to unvested shares	(361)	(18)
Diluted Income from continuing operations	$ 120,409	$ 64,077
Discontinued Operations:		
Basic Loss from discontinued operations	$ (1,551)	$ (2,288)
Diluted Net income attributable to STWD common shareholders after allocation to participating securities	$ 118,858	$ 61,789
Number of Shares:		
Basic Average shares outstanding	195,524	135,480
Effect of dilutive securities Convertible Notes	3,196	
Effect of dilutive securities Contingently Issuable Shares	156	
Diluted Average shares outstanding	198,876	135,480
Basic Earnings Per Share:		
Income from continuing operations attributable to STWD common shareholders	$ 0.62	$ 0.47
Loss from discontinued operations attributable to STWD common shareholders	(0.01)	(0.01)
Net income attributable to STWD common shareholders	$ 0.61	$ 0.46
Diluted Earnings Per Share:		
Income from continuing operations attributable to STWD common shareholders	$ 0.61	$ 0.47
Loss from discontinued operations attributable to STWD common shareholders	(0.01)	(0.01)
Net income attributable to STWD common shareholders	$ 0.60	$ 0.46

As of March 31, 2014 and 2013, unvested restricted shares of 2.9 million and 1.0 million, respectively, were excluded from the computation of diluted EPS as their effect was determined to be anti-dilutive.

Also as of March 31, 2014, there were 48.4 million potential shares of common stock contingently issuable upon the conversion of the Convertible Notes. The Company has asserted its intent and ability to settle the principal amount of the Convertible Notes in cash. As a result, this principal amount, representing 45.2 million shares at March 31, 2014, was not included in the computation of diluted EPS. However, as discussed in Note 9, the conversion options associated with both Convertible Notes are in-the-money. The if-converted value of the 2018 Notes and the 2019 Notes exceeded their respective principal amounts by $28.6 million and $53.6 million, respectively, at March 31, 2014. The dilutive effect to EPS is determined by dividing this conversion

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spread value by the average share price. The conversion spread value is the value that would be delivered to investors in shares based on the terms of the Convertible Notes, upon an assumed conversion. In calculating the dilutive effect of these shares, the treasury stock method was used and resulted in a dilution of 3.2 million shares.

17. Accumulated Other Comprehensive Income

The changes in AOCI by component are as follows (in thousands):

	Effective Portion of Cumulative Loss on Cash Flow Hedges	Cumulative Unrealized Gain (Loss) on Available-for-Sale Securities	Foreign Currency Translation	Total
Balance at January 1, 2014	$ (604)	$ 66,566	$ 9,487	$ 75,449
OCI before reclassifications	(251)	3,983	1,046	4,778
Amounts reclassified from AOCI	373	(485)		(112)
Net period OCI	122	3,498	1,046	4,666
Balance at March 31, 2014	$ (482)	$ 70,064	$ 10,533	$ 80,115
Balance at January 1, 2013	$ (2,571)	$ 82,246	$	$ 79,675
OCI before reclassifications	(168)	11,956	(7,061)	4,727
Amounts reclassified from AOCI	447	(14,305)		(13,858)
Net period OCI	279	(2,349)	(7,061)	(9,131)
Balance at March 31, 2013	$ (2,292)	$ 79,897	$ (7,061)	$ 70,544

The reclassifications out of AOCI impacted the condensed consolidated statements of operations for the three months ended March 31, 2014 and 2013 as follows:

Details about AOCI Components	Amounts Reclassified from AOCI during the Three Months Ended March 31, 2014	2013	Affected Line Item in the Statements of Operations
Gains (losses) on cash flow hedges:			
Interest rate contracts	$ (373)	$ (447)	Interest expense
Unrealized gains (losses) on available for sale securities:			
Net realized gain (loss) on sale of investments	698	14,347	Gain on sale of investments, net
OTTI	(213)	(42)	OTTI
Total	485	14,305	
Total reclassifications for the year	$ 112	$ 13,858	

18. Benefit Plans

Change in Control Retention Arrangements

In connection with the LNR acquisition, we assumed certain performance obligations under the LNR Property LLC Change in Control Bonus Plan (the Change in Control Plan) as discussed further in Note 20 to the consolidated financial statements included in our Form 10-K. The balance of the Change in Control Plan, which was pre-funded by the sellers of LNR into a Rabbi Trust, was paid to participants during the three months ended March 31, 2014.

19. Fair Value

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

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Level I Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level II Inputs (other than quoted prices included in Level I) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument s anticipated life.

Level III Inputs reflect management s best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

Valuation Process

We have valuation control processes in place to validate the fair value of the Company s financial assets and liabilities measured at fair value including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. Refer to Note 21 to the consolidated financial statements included in our Form 10-K for further discussion of our valuation process.

We determine the fair value of our assets and liabilities measured at fair value on a recurring and nonrecurring basis in accordance with the methodology described in our Form 10-K.

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The following tables present our financial assets and liabilities carried at fair value on a recurring basis in the condensed consolidated balance sheets by their level in the fair value hierarchy as of March 31, 2014 and December 31, 2013 (amounts in thousands):

	March 31, 2014			
	Total	Level I	Level II	Level III
Financial Assets:				
Loans held-for-sale, fair value option	$ 186,837	$	$ 112,720	$ 74,117
RMBS	291,217			291,217
CMBS	247,601		6,936	240,665
Equity security	15,115	15,115		
Domestic servicing rights	144,898			144,898
Derivative assets	4,617		4,617	
VIE assets	118,451,518			118,451,518
Total	$ 119,341,803	$ 15,115	$ 124,273	$ 119,202,415
Financial Liabilities:				
Derivative liabilities	$ 18,057	$	$ 18,057	$
VIE liabilities	117,931,005		114,448,083	3,482,922
Total	$ 117,949,062	$	$ 114,466,140	$ 3,482,922

	December 31, 2013			
	Total	Level I	Level II	Level III
Financial Assets:				
Loans held-for-sale, fair value option	$ 206,672	$	$	$ 206,672
RMBS	296,236			296,236
CMBS	255,306		47,300	208,006
Equity security	15,247	15,247		
Domestic servicing rights	150,149			150,149
Derivative assets	7,769		7,769	
VIE assets	103,151,624			103,151,624
Total	$ 104,083,003	$ 15,247	$ 55,069	$ 104,012,687
Financial Liabilities:				
Derivative liabilities	$ 24,192	$	$ 24,192	$
VIE liabilities	102,649,263		101,051,279	1,597,984
Total	$ 102,673,455	$	$ 101,075,471	$ 1,597,984

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The changes in financial assets and liabilities classified as Level III were as follows for the three months ended March 31, 2014 and 2013 (amounts in thousands):

	Loans Held-for-sale	RMBS	CMBS	Domestic Servicing Rights	VIE Assets	VIE Liabilities	Total
January 1, 2014 balance	$ 206,672	$ 296,236	$ 208,006	$ 150,149	$ 103,151,624	$ (1,597,984)	$ 102,414,703
Total realized and unrealized (losses) gains:							
Included in earnings:							
Change in fair value / gain on sale	20,893	1,011	5,207	(5,251)	(3,681,541)	101,499	(3,558,182)
OTTI		(213)					(213)
Net accretion		6,564					6,564
Included in OCI		4,748	(533)				4,215
Purchases / Originations	261,825		3,831				265,656
Sales	(302,461)	(9,310)	(15,844)				(327,615)
Issuances						(45,761)	(45,761)
Cash repayments / receipts	(92)	(7,819)	(408)			35,366	27,047
Transfers into Level III			47,300			(571,612)	(524,312)
Transfers out of Level III	(112,720)		(179)			419,741	306,842
Consolidations of VIEs			(6,715)		20,270,649	(1,824,171)	18,439,763
Deconsolidations of VIEs					(1,289,214)		(1,289,214)
March 31, 2014 balance	$ 74,117	$ 291,217	$ 240,665	$ 144,898	$ 118,451,518	$ (3,482,922)	$ 115,719,493
Amount of total (losses) gains included in earnings attributable to assets still held at March 31, 2014	$ 177	$ 6,295	$ 5,207	$ (5,251)	$ (3,681,541)	$ 101,499	$ (3,573,614)
January 1, 2013 balance	$	$ 333,153	$	$	$	$	$ 333,153
Total realized and unrealized gains:							
Included in earnings:							
OTTI		(42)					(42)
Net accretion		6,151					6,151
Included in OCI		9,232					9,232
Sales		(10,582)					(10,582)
Cash repayments / receipts		(16,869)					(16,869)
March 31, 2013 balance	$	$ 321,043	$	$	$	$	$ 321,043
Amount of total gains included in earnings attributable to assets still held at March 31, 2013	$	$ 6,109	$	$	$	$	$ 6,109

During the three months ended March 31, 2014, we transferred $47.3 million of CMBS investments from Level II to Level III due to a decrease in the observable relevant market activity.

The following table presents the fair values of our financial instruments not carried at fair value on the consolidated balance sheets (amounts in thousands):

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets not carried at fair value:				
Loans held-for-investment and loans transferred as secured borrowings	$ 4,777,965	$ 4,885,290	$ 4,544,132	$ 4,609,040
Securities, held-to-maturity	369,152	367,811	368,318	368,453
European servicing rights	23,158	24,357	27,024	29,327
Non-performing residential loans			215,371	215,371
Financial liabilities not carried at fair value:				
Secured financing agreements and secured borrowings on transferred loans	$ 2,744,100	$ 2,743,969	$ 2,438,798	$ 2,436,708
Convertible senior notes	1,000,839	1,216,482	997,851	1,160,000

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The following is quantitative information about significant unobservable inputs in our Level III measurements for those assets and liabilities measured at fair value on a recurring basis (dollar amounts in thousands):

	Carrying Value at March 31, 2014	Valuation Technique	Unobservable Input	Range as of (1) March 31, 2014	December 31, 2013
Loans held-for-sale, fair value option	$ 74,117	Discounted cash flow	Yield (b)	4.8% - 6.6%	5.2% - 5.9%
			Duration(c)	5.0 - 10.0 years	5.0 - 10.0 years
RMBS	291,217	Discounted cash flow			