

Ares Commercial Real Estate Corp  
Form 10-Q  
November 07, 2012  
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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 September 30, 2012**

**OR**

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

**For the transition period to**

**Commission File No. 001-35517**

**ARES COMMERCIAL REAL ESTATE CORPORATION**

(Exact name of Registrant as specified in its charter)

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

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

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

(Address of principal executive office) (Zip Code)

**(312) 324-5900**

(Registrant's telephone number, including area code)

**N/A**

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

**Class**

**Outstanding at November 6, 2012**

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Common stock, \$0.01 par value

9,267,162

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

(in thousands, except share and per share data)

	September 30, 2012 (unaudited)	As of	December 31, 2011
<b>ASSETS</b>			
Cash and cash equivalents	\$ 23,983	\$	1,240
Restricted cash	1,922		
Loans held for investment	190,539		4,945
Accrued interest receivable	871		3
Deferred financing costs, net	2,416		1,194
Other assets	522		205
Total assets	\$ 220,253	\$	7,587
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
<b>LIABILITIES</b>			
Secured funding agreements	\$ 48,790		
Escrow liability	1,922		
Accrued expenses	812		123
Due to affiliate	1,284		827
Dividends payable	556		
Refundable deposits	175		200
Interest payable	31		
Total liabilities	53,570		1,150
Commitments and contingencies (Note 5)			
<b>STOCKHOLDERS EQUITY</b>			
Preferred stock, par value \$0.01 per share, 50,000,000 and no shares authorized at September 30, 2012 and December 31, 2011, respectively, no shares issued and outstanding at September 30, 2012 and December 31, 2011			
Common stock, par value \$0.01 per share, 450,000,000 and 100,000 shares authorized at September 30, 2012 and December 31, 2011, respectively, 9,267,162 and no shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively			
Additional paid in capital common stock	92		
Accumulated deficit	169,210		6,600
	(2,619)		(163)
Total stockholders equity	166,683		6,437
Total liabilities and stockholders equity	\$ 220,253	\$	7,587

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See accompanying notes to consolidated financial statements.

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## ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	For the three months ended September 30, 2012 (unaudited)	For the nine months ended September 30, 2012 (unaudited)
Net interest margin:		
Interest income	\$ 1,889	\$ 4,397
Interest expense	(398)	(1,090)
Net interest margin	1,491	3,307
Expenses:		
Management fees	625	1,044
Professional fees	292	706
General and administrative expenses	496	827
General and administrative expenses reimbursed to affiliate	632	951
Total expenses	2,045	3,528
Net income (loss)	(554)	(221)
Less income (loss) attributable to Series A convertible preferred stock:		
Quarterly preferred dividends		(102)
Accretion of redemption premium		(572)
Net income (loss) attributable to common stockholders	(554)	(895)
Basic and diluted earnings (loss) per common share	\$ (0.06)	\$ (0.16)
Basic and diluted weighted average shares of common stock outstanding	9,205,480	5,606,840
Basic and diluted dividends declared per share of common stock	\$ 0.06	\$ 0.17

See accompanying notes to consolidated financial statements.

Table of Contents**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY****(in thousands, except share and per share data)****(unaudited)**

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-in Capital	Deficit	Stockholders Equity
Balance at December 31, 2011		\$	\$ 6,600	\$ (163)	\$ 6,437
Authorized increase in shares of common stock	330,000		3	(3)	
Private issuance of common stock	1,170,000		23,388		23,400
Proceeds from public offering of common stock	7,700,000		142,373		142,450
Stock-based compensation	67,162		202		202
Offering costs			(3,350)		(3,350)
Net income (loss) attributable to common stockholders				(895)	(895)
Dividends declared (\$0.17 per share)				(1,561)	(1,561)
Balance at September 30, 2012	9,267,162	\$	\$ 169,210	\$ (2,619)	\$ 166,683

See accompanying notes to consolidated financial statements.



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

	<b>For the nine months ended September 30, 2012 (unaudited)</b>
Operating activities:	
Net income (loss)	\$ (221)
Adjustments to reconcile net income (loss) to cash provided by operating activities:	
Amortization of deferred financing costs	469
Accretion of deferred loan origination fees and costs	(171)
Stock based compensation	202
Changes in operating assets and liabilities:	
Interest receivable	(868)
Other assets	(514)
Due to affiliate	1,053
Refundable deposits	(25)
Accounts payable and accrued expenses	386
Net cash provided by operating activities	311
Investing activities:	
Issuance of and fundings on loans held for investment	(185,555)
Principal repayment of loans held for investment	132
Net cash used in investing activities	(185,423)
Financing activities:	
Proceeds from secured funding arrangements	113,067
Repayments of secured funding arrangements	(64,277)
Secured funding costs	(2,090)
Series A preferred dividend	(102)
Proceeds from issuance of Series A convertible preferred stock	5,723
Redemption of Series A convertible preferred stock	(6,295)
Proceeds from issuance of common stock	165,850
Payment of offering costs	(3,016)
Common dividend payment	(1,005)
Net cash provided by financing activities	207,855
Change in cash and cash equivalents	22,743
Cash and cash equivalents, beginning of period	1,240
Cash and cash equivalents, end of period	\$ 23,983
Supplemental Information:	
Interest paid during the period	\$ 589
Supplemental disclosure of noncash financing activities:	
Dividends payable	\$ 556
Accrued financing and offering costs	\$ 334

See accompanying notes to consolidated financial statements.



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**ARES COMMERCIAL REAL ESTATE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**As of September 30, 2012**

**(unaudited)**

**1. ORGANIZATION**

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

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

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

Interim financial statements are prepared in accordance with United States generally accepted accounting principles ( GAAP ) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The current period s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2012.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

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

***Cash and Cash Equivalents***

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

***Restricted Cash***

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

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***Concentration of Credit Risk***

The Company places its cash and cash equivalents with financial institutions and, at times, cash held may exceed the Federal Deposit Insurance Corporation insured limit.

***Loans Held for Investment***

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

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

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

***Underwriting Commissions and Offering Costs***

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

***Revenue Recognition***

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

### *Deferred Financing Costs*

Deferred financing costs are capitalized and amortized over the terms of the respective credit facilities.

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***Fair Value Measurements***

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

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

Level 2 Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level 3 Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

***Stock Based Compensation***

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

***Earnings per Share***

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

***Income Taxes***

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



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*Use of Estimates in the Preparation of Financial Statements*

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

*Segment Reporting*

For the nine months ended September 30, 2012, the Company operated in one business segment. The Company is primarily engaged in originating, investing in and managing commercial mortgage loans and other CRE related debt investments.

*New Accounting Pronouncements*

*Repurchase Agreements* In April 2011, the Financial Accounting Standards Board ( FASB ) issued new guidance that revises the criteria for assessing effective control for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The update was effective for the Company on January 1, 2012, and the amendment is to be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The adoption of this new guidance did not have a material impact on the Company s consolidated balance sheet, results of operations or cash flows.

*Fair Value Measurement* In May 2011, the FASB issued new guidance to achieve common fair value measurement and disclosure requirements under GAAP. The new guidance amends current fair value guidance to include increased transparency around valuation inputs and investment categorization. This new guidance is effective for fiscal years and interim periods beginning after December 15, 2011. The adoption of the new guidance did not have a significant effect on the Company s consolidated balance sheet, results of operations or cash flows.

**3. LOANS HELD FOR INVESTMENT**

The Company s investments in mortgages and loans held for investment are accounted for at amortized cost. The following tables summarize our loans held for investment as of September 30, 2012 and December 31, 2011:

\$ in thousands	September 30, 2012					
	Carrying Amount	Outstanding Principal	Weighted Average Interest Rate	Weighted Average Unleveraged Effective Yield	Weighted Average Remaining Life* (Years)	
Senior mortgage loans	\$ 168,445	\$ 170,180	6.2%	6.7%	3.1	

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Subordinated and mezzanine debt		22,094		22,300		10.9%		11.2%		4.0
Total	\$	190,539	\$	192,480		6.7%		7.2%		3.2

	December 31, 2011					
	Carrying Amount	Outstanding Principal	Interest Rate	Unleveraged Effective Yield	Remaining Life (Years)*	
Senior mortgage loan	\$ 4,945	\$ 5,055	6.5%	6.6%	3.0	

\* Remaining life is calculated based on the remaining term of the loan from the reporting date multiplied by the weighted average loan balance divided by the total weighted average loan balance for each type of loan held for investment.

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

Balance at December 31, 2011	\$	4,945
Initial funding		185,661
Receipt of origination fee		(2,002)
Additional funding		1,896
Amortizing payments		(132)
Origination fee accretion		171
Balance at September 30, 2012	\$	190,539

On January 27, 2012, we co-originated a \$37.0 million commitment for a transitional first mortgage loan on an office building located in Fort Lauderdale, FL. The loan was closed as a \$15.0 million subordinated debt B-Note, which we retained, and a \$22 million A-Note, which was fully funded by Citibank, N.A., one of our secured funding facility providers. At closing, the outstanding principal of the B-Note was \$8.0 million.

On February 8, 2012, we originated an approximately \$35.0 million stretch first mortgage loan on an office building located in Boston, MA. At closing, the outstanding principal was approximately \$35.0 million.

On February 13, 2012, we originated an approximately \$38.0 million transitional first mortgage loan on an office complex located in Austin, TX. At closing, the outstanding principal was approximately \$30.0 million.

On August 2, 2012, we originated an approximately \$14.3 million mezzanine loan collateralized by interests in an office building located in Atlanta, GA. At closing, the outstanding principal was approximately \$14.3 million.

On August 30, 2012, we originated an approximately \$22.1 million transitional first mortgage loan on an apartment complex located in Avondale, AZ. At closing, the outstanding principal was approximately \$20.6 million.

On September 25, 2012, we originated an approximately \$36.1 million transitional first mortgage loan on an apartment building located in New York, NY. At closing, the outstanding principal was approximately \$30.8 million.

On September 28, 2012, we originated an approximately \$47.0 million stretch first mortgage loan on an office building in Miami, FL. At closing, the outstanding principal was approximately \$47.0 million.

As of September 30, 2012, all loans were paying in accordance with their terms and there were no loan impairments during the nine months ended September 30, 2012.

#### 4. SECURED FUNDING AGREEMENTS

\$ in thousands	September 30, 2012		December 31, 2011	
	Outstanding Balance	Total Commitment	Outstanding Balance	Total Commitment
Wells Fargo Facility	\$ 29,961	\$ 172,450	\$ 75,000	\$ 75,000
Citibank Facility	4,409	86,225		50,000
Capital One Facility	14,420	50,000		
Total	\$ 48,790	\$ 308,675	\$	\$ 125,000

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

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

##### *Wells Fargo Facility*

On December 14, 2011, the Company entered into a \$75.0 million secured revolving funding facility arranged by Wells Fargo Bank, National Association (the Wells Fargo Facility), pursuant to which the Company (through its wholly owned subsidiary ACRC Lender W LLC) borrows funds to originate qualifying senior commercial mortgage loans and A-Notes, subject to available collateral.

Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR plus (ii) a pricing margin range of 2.50% - 2.75%. Effective May 15, 2012, the Company incurs a non-utilization fee of 25 basis points on the average available balance of the Wells Fargo Facility. The initial maturity date of the Wells Fargo Facility is December 14, 2014, subject to two 12-month extension options.

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On May 22, 2012, the agreements governing the Wells Fargo Facility were amended to, among other things, increase the total commitment under the Wells Fargo Facility from \$75.0 million to \$172.5 million. As of September 30, 2012, the outstanding balance on the Wells Fargo Facility was \$30.0 million.

***Citibank Facility***

On December 8, 2011, the Company entered into a \$50.0 million secured revolving funding facility arranged by Citibank, N.A. (the Citibank Facility), pursuant to which the Company (through its wholly owned subsidiary ACRC Lender C LLC) borrows funds to originate qualifying senior commercial mortgage loans and A-Notes, subject to available collateral.

Under the Citibank Facility, the Company borrows funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by the Company. Amounts outstanding under each individual loan accrue interest at a per annum rate based on LIBOR. The margin can vary between 3.25% and 4.00% over the greater of LIBOR and 1.0%, based on the debt yield of the assets contributed into ACRC Lender C LLC. Effective March 3, 2012, the Company incurs a non-utilization fee of 25 basis points on the average available balance of the Citibank Facility. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan.

On April 16, 2012 and May 1, 2012, the agreements governing the Citibank Facility were amended to, among other things, increase the total commitment under the Citibank Facility from \$50.0 million to \$86.2 million. The end of the funding period was automatically extended to December 8, 2013 upon the completion of the IPO, and may be further extended for an additional 12 months upon the payment of the applicable extension fee and provided that no event of default is then occurring. The completion of the IPO triggered a modification of the interest rate margin to a range of 2.50% -3.50% over the greater of LIBOR and 0.5%. As of September 30, 2012, the outstanding balance on the Citibank Facility was \$4.4 million.

***Capital One Facility***

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

Under the Capital One Facility, the Company borrows funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by us. Amounts outstanding under each individual loan will accrue interest at a per annum rate equal to LIBOR plus a spread ranging between 2.50% and 4.00%. We may request individual loans under the Capital One Facility through and including May 18, 2014, subject to successive 12-month extension options at the lender's discretion. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. As of September 30, 2012, the outstanding balance on the Capital One Facility was \$14.4 million.

*Debt Covenants*

The Wells Fargo Facility, Citibank Facility and Capital One Facility contain various affirmative and negative covenants, including financial covenants that require the Company or certain subsidiaries as guarantor or borrower to maintain minimum tangible net worth, liquidity levels and financial ratios, as defined in the respective agreements.

The agreements governing the Wells Fargo Facility and the Capital One Facility were amended effective June 29, 2012 and September 27, 2012, respectively, to provide that the required minimum fixed charge coverage ratio with respect to the Company as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which the Company reports Loans held for investment in excess of \$200.0 million on its quarterly consolidated balance sheet.

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**5. COMMITMENTS AND CONTINGENCIES**

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

As of September 30, 2012 and December 31, 2011, the Company had the following commitments to fund various stretch senior and transitional senior mortgage loans, as well as subordinated and mezzanine debt investments:

<b>\$ in thousands</b>	<b>September 30, 2012</b>	<b>As of</b>	<b>December 31, 2011</b>
Total commitments	\$ 218,400	\$	11,000
Less: funded commitments	(192,480)		(5,055)
Total unfunded commitments	\$ 25,920	\$	5,945

The Company from time to time may be party to litigation relating to claims arising in the normal course of business. As of September 30, 2012, the Company is not aware of any legal claims.

**6. SERIES A CONVERTIBLE PREFERRED STOCK**

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

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

In February 2012, we entered into subscription agreements with certain third party investors, pursuant to which such investors subscribed for commitments to purchase up to 475 shares of Series A Preferred Stock at a price of \$50 thousand per share. On April 2, 2012, a cash dividend of \$52 thousand was paid in respect of the Company's Series A Preferred Stock.

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In May 2012, upon the consummation of the IPO, we redeemed all of the shares of Series A Preferred Stock for an aggregate redemption price of approximately \$6.3 million. The redemption price for redeemed shares of Series A Preferred Stock was equal to (i) the sum of (a) the subscription price, (b) any dividends per share added thereto pursuant to the terms of the Series A Preferred Stock and (c) any accrued and unpaid dividends per share plus (ii) an amount equal to a percentage of the subscription price of the Series A Preferred Stock and 10%.

During the nine months ended September 30, 2012, we issued 114.4578 shares of Series A Preferred Stock for an aggregate subscription price of approximately \$5.7 million and recognized the accretion of \$572 thousand for the redemption premium for a total balance of approximately \$6.3 million.

### 7. STOCKHOLDERS' EQUITY

In December 2011, Ares Investments Holdings LLC ( "Ares Investments" ), an affiliate of ACREM, contributed \$6.6 million to the Company in exchange for the Company's agreement to effectively issue 330 thousand shares of our common stock upon an increase in the authorized number of shares of the Company's common stock. Although there were no shares of our common stock issued and outstanding as of December 31, 2011, the accompanying consolidated financial statements assume these shares of common stock were issued to Ares Investments during the period ending December 31, 2011 for the purposes of additional paid-in capital, accumulated deficit and total stockholders' equity.



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

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

On February 8, 2012, the charter of the Company was amended and restated to increase the number of authorized shares of our common stock and preferred stock to 95.0 million and 5.0 million shares, respectively. The par value remained at \$0.01 per share.

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

On April 23, 2012, the charter of the Company was amended to increase the number of authorized shares of common stock and preferred stock of the Company to 450.0 million and 50.0 million shares, respectively. The par value remained at \$0.01 per share.

On May 1, 2012, the Company completed its IPO of 7.7 million shares of its common stock at a price of \$18.50 per share, raising approximately \$142.5 million in gross proceeds. The underwriting commissions of approximately \$5.3 million are reflected as a reduction of additional paid-in capital on the consolidated statement of stockholders' equity. Under the underwriting agreement, our Manager was responsible for and paid directly the underwriting commissions. Because the Manager is a related party, the payment of underwriting commission of approximately \$5.3 million by our Manager is reflected as a contribution of additional paid-in capital on the consolidated statement of stockholders' equity in accordance with GAAP. The Company incurred approximately \$3.4 million of expenses in connection with the IPO, which is reflected as a reduction in additional paid-in capital. The net proceeds to the Company totaled approximately \$139.1 million. The Company used approximately \$47.3 million of the net proceeds of the IPO to repay outstanding amounts under the Wells Fargo Facility and the Citibank Facility and approximately \$6.3 million to redeem all of its issued shares of Series A Preferred Stock. The balance was used for general corporate working capital purposes and to make investments in the Company's target investments.

### ***Equity Incentive Plan***

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

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On May 1, 2012, in connection with the completion of the IPO, each of the Company's five independent directors were granted 5 thousand restricted shares of the Company's common stock as awards granted pursuant to the 2012 Equity Incentive Plan. In addition, on May 1, 2012, each of the Company's five independent directors were granted 2,027 restricted shares of the Company's common stock as 2012 annual compensation awards granted pursuant to the 2012 Equity Incentive Plan.

On June 18, 2012, Mr. Rosen, one of the Company's outside directors was granted 5 thousand restricted shares of the Company's common stock as an award granted pursuant to the 2012 Equity Incentive Plan. In addition, on June 18, 2012, Mr. Rosen was granted 2,027 restricted shares of the Company's common stock as a 2012 annual compensation award granted pursuant to the 2012 Equity Incentive Plan.

On July 9, 2012, in connection with his appointment as Chief Financial Officer of the Company, Tae-Sik Yoon was granted 25 thousand restricted shares of the Company's common stock as an award granted pursuant to the 2012 Equity Incentive Plan. These shares of restricted stock vest ratably on a quarterly basis over a four-year period, subject to certain conditions, beginning on October 1, 2012.

As of September 30, 2012, 2,478 shares of the total 30 thousand restricted shares of common stock granted to Mr. Rosen and our five independent directors, as initial grants in connection with the IPO have vested. These shares vest ratably on a quarterly basis over a three-year period that began on July 2, 2012.

As of September 30, 2012, 3,036 shares of the total 12,162 restricted shares of common stock granted to Mr. Rosen and our five independent directors in respect of 2012 annual compensation have vested. These shares vest ratably on a quarterly basis over a one-year period that began on July 2, 2012.

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	<b>Restricted Stock Grants - Directors</b>	<b>Restricted Stock Grants - Officer</b>	<b>Total</b>
Balance as of December 31, 2011			
Granted	42,162	25,000	67,162
Vested	(5,514)		(5,514)
Forfeited			
Balance as of September 30, 2012	36,648	25,000	61,648

*Vesting Schedule*

	<b>Restricted Stock Grants - Directors</b>	<b>Restricted Stock Grants - Officer</b>	<b>Total</b>
2012	11,058	1,564	12,622
2013	16,092	6,250	22,342
2014	10,008	6,250	16,258
2015	5,004	6,250	11,254
2016		4,686	4,686
Total	42,162	25,000	67,162

**8. EARNINGS PER SHARE**

The following information sets forth the computations of basic and diluted earnings (loss) per common share for the three and nine months ended September 30, 2012:

<b>\$ in thousands (except share and per share data)</b>	<b>For the three months ended September 30, 2012</b>	<b>For the nine months ended September 30, 2012</b>
Net income (loss) attributable to common stockholders:	\$ (554)	\$ (895)
Divided by:		
Basic and diluted weighted average shares of common stock outstanding (1):	9,205,480	5,606,840
Basic and diluted earnings (loss) per common share:	\$ (0.06)	\$ (0.16)

(1) The dilutive impact of the Company's restricted stock grants has not been included in the calculation of diluted earnings (loss) per share as the inclusion would have been anti-dilutive.

**9. FAIR VALUE OF FINANCIAL INSTRUMENTS**

*Financial Instruments reported at fair value*

The Company has certain assets and liabilities that are required to be recorded at fair value on a recurring basis in accordance with GAAP, including cash and cash equivalents. The Company did not have any other financial instruments at September 30, 2012 or December 31, 2011 that were required to be carried at fair value.

The carrying values of interest receivable and accrued expenses and other liabilities approximate their fair values due to their short-term nature. The carrying values of loans held for investment approximate fair value since the contractual rate approximates market rate.

*Financial Instruments reported at cost*

The Company estimates the fair value of financial instruments carried at historical cost on a quarterly basis. These instruments are recorded at fair value only if they are impaired. No impairment charges have been recognized at September 30, 2012. In cases where quoted market prices are not available, fair values are estimated using inputs such as discounted cash flow projections, market comparables, dealer quotes and other quantitative and qualitative factors. Considerable judgment is necessary to interpret market data and develop estimated fair value. The use of different assumptions or methodologies could have a material effect on the estimated fair value amounts. At September 30, 2012, the fair value of our financial instruments approximates cost using Level 3 fair value assumptions.

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**10. RELATED PARTY TRANSACTIONS**

*Management Agreements*

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

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

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

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

The incentive fee is equal to the difference between: (a) the product of (i) 20% and (ii) the difference between (A) the Company's Core Earnings (as defined below) for the previous 12-month period, and (B) the product of (1) the weighted average of the issue price per share of the Company's common stock of all of the Company's public offerings multiplied by the weighted average number of all shares of common stock outstanding (including any restricted shares of the Company's common stock, restricted units or any shares of the Company's common stock not yet issued, but underlying other awards granted under the Company's 2012 Equity Incentive Plan as further described below) in the previous 12-month period, and (2) 8%; and (b) the sum of any incentive fees earned by ACREM with respect to the first three fiscal quarters of such previous 12-month period; *provided, however*, that no incentive fee is payable with respect to any fiscal quarter unless cumulative Core Earnings for the 12 most recently completed fiscal quarters is greater than zero. Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) computed in accordance with GAAP, excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (to the extent that any of the Company's target investments are structured as debt and the Company forecloses on any properties underlying such debt), any unrealized gains, losses or other non-cash items recorded in net income (loss) for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income (loss), and one-time events pursuant to changes in GAAP and

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certain non-cash charges after discussions between ACREM and the Company's independent directors and after approval by a majority of our independent directors. For purposes of calculating the incentive fee prior to the completion of a 12-month period following this offering, Core Earnings will be calculated on the basis of the number of days that the Management Agreement has been in effect on an annualized basis. No incentive fees were earned for the nine months ended September 30, 2012.

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

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

Summarized below are the related-party costs incurred by the Company and amounts payable to the Manager:

\$ in thousands	Incurred		Payable as of	
	Three months ended September 30, 2012	Nine months ended September 30, 2012	September 30, 2012	December 31, 2011
<b><i>Affiliate Payments</i></b>				
Management fees	\$ 625	1,044	\$ 625	
Servicing fees		17		
General and administrative expenses reimbursed to affiliate	632	934	628	
<b><i>Direct third party costs either paid or owed by Manager to be reimbursed by the Company</i></b>				
Deferred financing costs		149		621
Loan origination fees	72	72	72	
Offering costs		298		
Other assets	(112)	(65)	(112)	196
General and administrative expenses	71	158	71	10
	\$ 1,288	2,607	\$ 1,284	827

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*Ares Investments*

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

As of September 30, 2012, Ares Investments owned approximately 2 million shares of the Company's common stock representing approximately 21.6% of the total shares outstanding.

**11. SUBSEQUENT EVENTS**

The Company's management has evaluated subsequent events through the date of issuance of the consolidated financial statements included herein. Other than those disclosed below, there have been no subsequent events that occurred during such period that would require disclosure in this Form 10-Q or would be required to be recognized in the accompanying consolidated financial statements as of and for the three and nine months ended September 30, 2012.

On October 9, 2012, we originated an approximately \$35.5 million transitional first mortgage loan on an office building in Cincinnati, OH. At closing the outstanding principal was approximately \$26.9 million. The loan has an interest rate of L+5.35%, origination fee of 0.5%, exit fee of 0.5%, and a term of 3 years. The initial unleveraged effective yield is 6.0%.

On October 31, 2012, our board of directors amended our investment guidelines to reflect our Manager's proposed consolidation of its Underwriting and Investment Committees into one Investment Committee.

On October 31, 2012, our board of directors declared a dividend of \$0.25 per common share for the fourth quarter of 2012. The fourth quarter 2012 dividend is payable on January 10, 2013 to common stockholders of record as of December 31, 2012.

On November 5, 2012, we originated an approximately \$13.4 million stretch first mortgage loan on an apartment complex located in Arlington, VA. At closing the outstanding principal was approximately \$13.4 million. The loan has an interest rate of L+5.15%, origination fee of 1.0%, exit fee of 0.5% and a term of 2 years. The initial unleveraged effective yield is 6.2%.



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

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

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

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

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- availability of investment opportunities in mortgage-related and real estate-related investments and securities;
- the ability of our Manager to locate suitable investments for us, monitor, service and administer our investments and execute our investment strategy;
- availability of qualified personnel;

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

We use words such as anticipate, believe, expect, estimate, plan, continue, intend, will, should, may and other similar expressions in our forward-looking statements, although not all forward-looking statements include these words. Our actual results and condition could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth in Risk Factors below and in the final prospectus relating to our IPO (the Prospectus), dated April 25, 2012, filed with the Securities and Exchange Commission (SEC) in accordance with Rule 424(b) of the Securities Act of 1933, as amended (the Securities Act), on April 27, 2012.

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

Overview

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

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

- Transitional senior mortgage loans that provide strategic, flexible, short-term financing solutions on transitional CRE middle-market assets. These assets are typically properties that are the subject of a business plan that is expected to enhance the value of the property. The mortgage loans are usually funded over time as the borrower's business plan for the property is executed. They also typically have a lower initial loan-to-value ratios as compared to stretch senior mortgage loans, with the loan-to-value ratios increasing as the loan is further funded over time;

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- Stretch senior mortgage loans that provide flexible one stop financing on quality CRE middle-market assets. These assets are typically stabilized or near-stabilized properties with healthy balance sheets and steady cash flows, with the mortgage loans having higher leverage (and thus higher loan-to-value ratios) than conventional mortgage loans and are typically fully funded at closing and non-recourse to the borrower (as compared to conventional mortgage loans, which are usually recourse to the borrower);
- Subordinate debt mortgage loans (including subordinate tranches of first lien mortgages, or B-Notes) and mezzanine loans, both of which provide subordinate financing on quality CRE middle-market assets; and
- Other CRE debt and preferred equity investments, together with selected other income-producing equity investments.

We are externally managed and advised by our Manager, a SEC registered investment adviser, pursuant to the terms of a management agreement. Our Manager is an affiliate of Ares Management LLC ( Ares Management ), a global alternative asset manager and also a SEC registered investment adviser with approximately \$56 billion of total committed capital under management as of September 30, 2012.

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We are a Maryland corporation that commenced investment operations on December 9, 2011. On May 1, 2012 we completed our IPO of 7.7 million shares of our common stock at a price of \$18.50 per share, raising \$139.1 million in net proceeds. We used approximately \$47.3 million of the net proceeds to repay outstanding amounts under our secured funding facilities and approximately \$6.3 million to redeem all of our issued and outstanding shares of Series A Convertible Preferred Stock, par value \$0.01 per share (the "Series A Preferred Stock"). The balance was used for general corporate working capital purposes and to make investments in our target investments.

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

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

We could remain an emerging growth company for up to five years, or until the earliest of (i) the last day of the first fiscal year in which our annual gross revenues exceed \$1 billion, (ii) the date that we become a large accelerated filer as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (iii) the date on which we have issued more than \$1 billion in non-convertible debt during the preceding three year period.

### **Factors Impacting Our Operating Results**

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

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

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

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As of September 30, 2012 and December 31, 2011, all loans were paying in accordance with their terms. There were no impairments during the three and nine months ended September 30, 2012.

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

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

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

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

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



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

*Market Conditions.* We believe that our target investments currently present attractive risk-adjusted return profiles. We believe that the U.S. CRE markets are currently in the initial stages of a recovery from the severe economic downturn that began in 2007. Following a dramatic decline in CRE lending in 2008 and 2009, debt capital has become more readily available for select stabilized, high quality assets in certain locations such as gateway cities, but remains limited for many other types of properties. For example, we currently anticipate a high demand for customized debt financing from borrowers or sponsors who are looking to refinance indebtedness that is maturing in the next two to five years or are seeking shorter-term debt solutions as they reposition their properties. In addition, we believe the uncertainty surrounding multifamily mortgage finance may provide us incremental lending opportunities in the future as Congress considers restructuring Fannie Mae and Freddie Mac, who have been the most significant sources of multifamily debt capital in recent years.

We believe that as a result of the aforementioned economic downturn and the subsequent banking regulatory reform, a number of lenders and finance companies who traditionally served the CRE middle-market, are burdened with legacy portfolio issues, balance sheet constraints or have otherwise exited the market. In particular, smaller and regional banks who represented a large portion of the CRE market prior to the downturn have sharply curtailed their CRE lending activities. We believe that this decreased competition will create a favorable investment environment for the foreseeable future. We also believe that we are well positioned to capitalize on the expected demand generated by the estimated \$1.8 trillion of CRE debt maturing between 2012 and 2016 (as reported in *Commercial Real Estate Outlook: Top Ten Issues in 2012* published by Deloitte & Touche LLP).

### **Results of Operations**

We commenced operations on December 9, 2011 and completed our IPO on May 1, 2012. Therefore, we have no period to compare operating results for the three or nine months ended September 30, 2012. In addition, the proceeds of our IPO were used in part to fully repay all of the outstanding balances on our various secured funding arrangements as of the date of the IPO, including all accrued interest due, and to fully redeem all of our issued and outstanding shares of Series A Convertible Preferred Stock, par value \$0.01 per share (Series A Preferred Stock), including payment of all dividends due and applicable redemption premiums. As a result, at September 30, 2012, we had no issued and outstanding Series A Preferred Stock and \$24.0 million in unrestricted cash and cash equivalents. Results for the initial period of our operations are not indicative of the results we expect when our investment strategy has been fully implemented.

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For the three and nine months ended September 30, 2012, our net income (loss) attributable to our common stockholders was \$(554) thousand and \$(895) thousand, respectively or earnings (loss) of \$(0.06) and \$(0.16) per basic and diluted common share, respectively. For the three and nine months ended September 30, 2012, we earned approximately \$1.5 million and \$3.3 million, respectively in net interest margin. For the three and nine months ended September 30, 2012, interest income of \$1.9 million and \$4.4 million, respectively, was generated by average earning assets of \$98.2 million and \$74.2 million, respectively, offset by \$398 thousand and \$1.1 million, respectively, of interest expense from average secured funding agreements of \$4.3 million and \$15.6 million, respectively.

For the three and nine months ended September 30, 2012, we incurred operating expenses of \$2.0 million and \$3.5 million, respectively. Related party expenses for the three and nine months ended September 30, 2012 include \$625 thousand and \$1.0 million, respectively, in management fees due to our Manager, and \$632 thousand and \$934 thousand, respectively, for our share of allocable general and administrative expenses for which we are required to reimburse our Manager pursuant to the management agreement, dated April 25, 2012, between us and our Manager. Also included in general and administrative expenses reimbursed to our Manager for the three and nine months ended September 30, 2012 are \$0 and \$17 thousand, respectively, of servicing fees. Servicing fees were charged to Ares Commercial Real Estate Services LLC ( ACRES ), an affiliate of our Manager, through May 1, 2012. Effective May 1, 2012, ACRES agreed that no servicing fees will be charged pursuant to these servicing agreements for so long as the management agreement remains in effect, but that ACRES will continue to receive reimbursement for overhead related to servicing and operational activities pursuant to the terms of the management agreement. Other expenses for the three and nine months ended September 30, 2012, includes professional fees of \$292 thousand and \$706 thousand, respectively, and general and administrative expenses of \$496 thousand and \$827 thousand, respectively.

For the three and nine months ended September 30, 2012, we paid \$0 and \$102 thousand, respectively, in dividends to the holders of Series A Preferred Stock. The Series A Preferred Stock was redeemed on May 1, 2012 using the proceeds of our IPO. For the nine months ended September 30, 2012, we incurred \$572 thousand in the accretion of redemption premium related to the Series A Preferred Stock.

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Our investment portfolio is comprised of the following at September 30, 2012:

Loan Type/Location	Square Footage/ Units	Origination Date	Maturity Date(1)	Remaining Life (Years)
<b><u>Transitional Senior Mortgage Loans</u></b>				
Office Complex in Austin, TX	270,000 sq. ft	Feb 2012	Mar 2015	2.4
Office Building in Denver, CO	173,000 sq. ft	Dec 2011	Jan 2015	2.3
Apartment Building in New York, NY	101 units	Sep 2012	Oct 2017	5.0
Apartment Building in Avondale, AZ	301 units	Aug 2012	Oct 2015	2.8
<b><u>Stretch Senior Mortgage Loans</u></b>				
Office Building in Boston, MA	152,000 sq. ft	Feb 2012	Mar 2015	2.4
Office Building in Miami, FL	286,000 sq. ft	Sep 2012	Oct 2015	3.0
<b><u>Subordinated Debt Investments</u></b>				
Office Building in Atlanta, GA	175,000 sq. ft	Aug 2012	Sep 2017	4.8
Office Building in Fort Lauderdale, FL	257,000 sq. ft	Jan 2012	Feb 2015	2.3
Average				3.2

(1) The Boston loan is subject to one 12-month extension option. The Miami, Austin, Avondale, and Fort Lauderdale loans are subject to two 12-month extension options.

(amounts in millions, except percentages) Loan Type/Location	Total Commitment	Outstanding Principal	Carrying Amount	LTV At Origination	Interest Rate	Origination Fee	Exit Fee	LIBOR Floor	Unleveraged Effective Yield	
<b><u>Transitional Senior Mortgage Loans</u></b>										
Office Complex in Austin, TX	\$ 38.0	\$ 30.3	\$ 29.8	70%	L+5.75%	-	1.0%	0.5%(2)	1.0%	7.5%
Office Building in Denver, CO	11.0	6.6	6.5	38%	L+5.50%	1.0%	1.0%	1.0%	1.0%	7.3%
Apartment Building in New York, NY	36.1	30.8	30.5	65%	L+5.00%	1.0%	0.5%	0.8%	0.8%	6.1%
Apartment Complex in Avondale, AZ	22.1	20.6	20.4	68%	L+4.25%	1.0%	0.8%	1.0%	1.0%	5.9%
<b><u>Stretch Senior Mortgage Loans</u></b>										
Office Building in Boston, MA	34.9	34.9	34.6	88%	L+5.65%	1.0%	0.5%	0.7%	0.7%	6.8%
Office Building in Miami, FL	47.0	47.0	46.5	76%	L+5.25%	1.0%	(1)	1.0%	1.0%	6.6%
<b><u>Subordinated Debt Investments</u></b>										
Office Building in Atlanta, GA	14.3	14.3	14.3	75%	10.5%	1.0%				10.8%

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Office Building in Fort Lauderdale, FL	15.0	8.0(3)	7.9	51%	L+10.75%-L+8.18%	1.0%	0.5%(4)	0.8%	12.1%
Total	\$ 218.4	\$ 192.5	\$ 190.5						7.2%

(1) This loan was originated with a 0.25% exit fee payable to us upon the earlier of repayment or the loan's maturity. However, such exit fee is not payable if loan is repaid within 24 months of origination.

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

(3) The total commitment we co-originated was a \$37 million first mortgage, of which a \$22 million A-Note was fully funded by Citibank, N.A. We retained a \$15 million B-Note.

(4) This loan was structured using an A-Note/B-Note structure which priced at L+5.25% on a cumulative basis with the LIBOR component subject to a minimum rate of 0.75%. The fully funded A-Note priced at L+3.25% (with the LIBOR component of the rate subject to a minimum rate of 0.75%) resulting in an interest rate on our B-Note at initial funding of \$8 million of L+10.75% (with the LIBOR component subject to a minimum rate of 0.75%). Upon the B-Note becoming fully funded at \$15 million, its effective interest rate will decrease to L+8.18% (with the LIBOR component subject to a minimum rate of 0.75%).

Table of Contents**Liquidity and Capital Resources**

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders and meet other general business needs. We will use significant cash to purchase our target investments, repay principal and pay interest on our borrowings, make distributions to our stockholders and fund our operations, including base management fees, incentive management fees and reimbursements for expenses for our share of overhead expense incurred by our Manager. Our primary sources of cash will generally consist of unused borrowing capacity under our financing sources, the net proceeds of future offerings, payments of principal and interest we receive on our portfolio of assets and cash generated from our operating results. We expect that our primary sources of financing will be, to the extent available to us, through (a) credit, secured funding and other lending facilities, (b) securitizations, (c) other sources of private financing, including warehouse and repurchase facilities and (d) offerings of our equity or debt securities. In the future, we may utilize other sources of financing to the extent available to us. See Recent Developments for information on our available capital as of November 6, 2012.

**Secured Funding Arrangements**

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

\$ in millions	September 30, 2012		December 31, 2011	
	Outstanding Balance	Total Commitment	Outstanding Balance	Total Commitment
Wells Fargo Facility	\$ 30.0	\$ 172.5	\$ 75.0	\$ 75.0
Citibank Facility	4.4	86.2		50.0
Capital One Facility	14.4	50.0		
Total	\$ 48.8	\$ 308.7	\$	\$ 125.0

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

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

***Wells Fargo Facility***

On December 14, 2011, we entered into a \$75.0 million secured revolving funding facility arranged by Wells Fargo Bank, National Association (the Wells Fargo Facility), pursuant to which we borrow funds to originate qualifying senior commercial mortgage loans and A-Notes, subject to available collateral.

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Advances under the Wells Fargo Facility accrue interest at a per annum rate equal to the sum of (i) 30 day LIBOR plus (ii) a pricing margin range of 2.50% - 2.75%. Effective May 15, 2012, the Company incurs a non-utilization fee of 25 basis points on the average available balance of the Wells Fargo Facility. The initial maturity date of the Wells Fargo Facility is December 14, 2014, subject to two 12-month extension options.

On May 22, 2012, the agreements governing the Wells Fargo Facility were amended to, among other things, increase the total commitment under the Wells Fargo Facility from \$75.0 million to \$172.5 million. As of September 30, 2012, the outstanding balance on the Wells Fargo Facility was \$30.0 million.

### *Citibank Facility*

On December 8, 2011, we entered into a \$50 million secured revolving funding facility arranged by Citibank, N.A. (the Citibank Facility), pursuant to which we borrow funds to originate qualifying senior commercial mortgage loans and A-Notes, subject to available collateral.

Under the Citibank Facility, we borrow funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by us. Amounts outstanding under each individual loan accrue interest at a per annum rate based on LIBOR. The margin can vary between 3.25% and 4.00% over the greater of LIBOR and 1.0%, based on the debt yield of the assets contributed into ACRC Lender C LLC. Effective March 3, 2012, the Company incurs a non-utilization fee of 25 basis points on the average available balance of the Citibank Facility. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan.

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On April 16, 2012 and May 1, 2012, the agreements governing the Citibank Facility were amended to, among other things, increase the total commitment under the Citibank Facility, from \$50.0 million to \$86.2 million. The end of the funding period was automatically extended to December 8, 2013 upon the completion of the IPO, and may be further extended for an additional 12 months upon the payment of the applicable extension fee and provided that no event of default is then occurring. The completion of the IPO triggered a modification of the interest rate margin to a range of 2.50% -3.50% over the greater of LIBOR and 0.5%. As of September 30, 2012, the outstanding balance on the Citibank Facility was \$4.4 million.

*Capital One Facility*

On May 18, 2012, we entered into a \$50 million secured revolving funding facility with Capital One, National Association (the Capital One Facility ), pursuant to which we borrow funds to originate qualifying senior commercial mortgage loans, subject to available collateral.

Under the Capital One Facility, we borrow funds on a revolving basis in the form of individual loans. Each individual loan is secured by an underlying loan originated by us. Amounts outstanding under each individual loan will accrue interest at a per annum rate equal to LIBOR plus a spread ranging between 2.50% and 4.00%. We may request individual loans under the Capital One Facility through and including May 18, 2014, subject to successive 12-month extension options at the lender's discretion. The maturity date of each individual loan is the same as the maturity date of the underlying loan that secures such individual loan. As of September 30, 2012, the outstanding balance on the Capital One Facility was \$14.4 million.

*Debt Covenants*

The Wells Fargo Facility, Citibank Facility and Capital One Facility contain various affirmative and negative covenants, including financial covenants that require the Company or certain subsidiaries as guarantor or borrower to maintain minimum tangible net worth, liquidity levels and financial ratios, as defined in the respective agreements.

The agreements governing the Wells Fargo Facility and the Capital One Facility were amended effective June 29, 2012 and September 27, 2012, respectively, to provide that the required minimum fixed charge coverage ratio with respect to the Company as guarantor will start to be tested upon the earlier to occur of (a) the calendar quarter ending on June 30, 2013 and (b) the first full calendar quarter following the calendar quarter in which the Company reports Loans held for investment in excess of \$200.0 million on its quarterly consolidated balance sheet.

*Other Credit Facilities, Warehouse Facilities and Repurchase Agreements*

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

## Equity Issuances

The following summarizes the total shares issued and proceeds we received in private and underwritten public offerings of our common stock net of offering costs for the nine months ended September 30, 2012:

On January 25, 2012, we entered into a subscription agreement with Ares Investment Holdings LLC ( Ares Investments ), an affiliate of our Manager, whereby Ares Investments agreed to purchase 400 thousand shares of our common stock for a total purchase price of \$8 million, after giving effect to the reverse stock split on February 22, 2012.

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

On February 8, 2012, our charter was amended and restated to increase the number of authorized shares of our common stock and preferred stock to 95.0 million and 5.0 million shares, respectively. The par value remained at \$0.01 per share.

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

On April 23, 2012, our charter was amended to increase the number of authorized shares of our common stock and preferred stock to 450.0 million and 50.0 million shares, respectively. The par value remained at \$0.01 per share.



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On May 1, 2012, we completed our IPO of 7.7 million shares of common stock at a price of \$18.50 per share, raising \$142.5 million in gross proceeds. Underwriting commissions of \$5.3 million are reflected as a reduction of additional paid-in capital on the consolidated statement of stockholders' equity. Under the underwriting agreement, our Manager was responsible for and paid directly the underwriting commissions. Because the Manager is a related party, the payment of underwriting commissions of \$5.3 million by our Manager is reflected as a contribution of additional paid-in capital on the consolidated statement of stockholders' equity in accordance with United States generally accepted accounting principles (GAAP). We incurred approximately \$3.4 million of expenses in connection with the IPO, which is reflected as a reduction in additional paid-in capital. The net proceeds to us totaled approximately \$139.1 million. We used approximately \$47.3 million of the net proceeds of the IPO to repay outstanding amounts under the Wells Fargo Facility and the Citibank Facility and \$6.3 million to redeem all of our issued shares of Series A Preferred Stock. The balance was used for general corporate working capital purposes and to make investments in our target investments.

## *Capital Markets*

In addition to borrowings, we will need to periodically raise additional capital to fund new investments. We intend to elect and qualify to be taxed as a REIT for U.S. federal income tax purposes. Among other things, in order to qualify and maintain our status as a REIT, we must annually distribute to our stockholders at least 90% of our REIT taxable income (which does not equal net income, as calculated in accordance with GAAP), determined without regard to the deduction for dividends paid and excluding net capital gain, and, as a result, such distributions will not be available to fund investments. We may also seek to enhance the returns on our senior commercial mortgage loan investments, especially loan originations, through securitizations, if available. To the extent available, we intend to securitize the senior portion of some of our loans, while retaining the subordinate securities in our investment portfolio. The securitization of this senior portion will be accounted for as either a sale and the loans will be removed from our balance sheet or as a financing and will be classified as securitized loans on our balance sheet, depending upon the structure of the securitization.

## Leverage Policies

We intend to use prudent amounts of leverage to increase potential returns to our stockholders. To that end, subject to maintaining our qualification as a REIT and our exemption from registration under the 1940 Act, we intend to use borrowings to fund the origination or acquisition of our target investments. Given current market conditions and our focus on first or senior mortgages, we currently expect that such leverage would not exceed, on a debt-to-equity basis, a 4-to-1 ratio. Our charter and bylaws do not restrict the amount of leverage that we may use. The amount of leverage we will deploy for particular investments in our target investments will depend upon our Manager's assessment of a variety of factors, which may include, among others, the anticipated liquidity and price volatility of the assets in our investment portfolio, the potential for losses and extension risk in our portfolio, the gap between the duration of our assets and liabilities, including hedges, the availability and cost of financing the assets, our opinion of the creditworthiness of our financing counterparties, the health of the U.S. economy and commercial mortgage markets, our outlook for the level and volatility of interest rates, the slope of the yield curve, the credit quality of our assets, the collateral underlying our assets, and our outlook for asset spreads relative to the LIBOR curve.

## Dividends

We intend to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT annually distribute at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and to the extent that it annually distributes less than 100% of its net taxable income in any taxable year, and that it pay tax at regular corporate rates on that undistributed portion. We intend to make regular quarterly distributions to our stockholders in an amount equal to

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or greater than our net taxable income, if and to the extent authorized by our board of directors. Before we make any distributions, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our secured funding facilities, other lending facilities, repurchase agreements and other debt payable. If our cash available for distribution is less than our net taxable income, we could be required to sell assets or borrow funds to make cash distributions or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

Table of Contents**Contractual Obligations and Commitments**

Contractual obligations as of September 30, 2012:

\$ in millions	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Wells Fargo Facility	\$ 30.0	\$	30.0	\$	\$
Citibank Facility	4.4		4.4		
Capital One Facility	14.4		14.4		
Future Loan Funding Commitments	25.9		25.9		
Total	\$ 74.7	\$	74.7	\$	\$

We may enter into certain contracts that may contain a variety of indemnification obligations, principally with underwriters and counterparties to repurchase agreements. The maximum potential future payment amount we could be required to pay under these indemnification obligations may be unlimited.

**Off-Balance Sheet Arrangements**

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

**Non-GAAP Financial Measures**

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

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

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

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Our Core Earnings (loss) for the three months and nine months ended September 30, 2012 were approximately \$(418) thousand and \$(694) thousand, respectively, \$(0.05) and \$(0.12) per weighted average share, diluted. The table below provides a reconciliation of net income (loss) to Core Earnings (loss) for this period:

<b>\$ in thousands, except per share amounts</b>	<b>For the three months ended</b>		<b>For the nine months ended</b>	
	<b>September 30, 2012</b>		<b>September 30, 2012</b>	
	<b>Amount</b>	<b>Per Share</b>	<b>Amount</b>	<b>Per share</b>
Net income (loss) attributable to common stockholders r	\$ (554)	\$ (0.06)	(895)	\$ (0.16)
Add back: non-cash stock-based compensation	136	0.01	202	0.04
Core Earnings (loss)	\$ (418)	\$ (0.05)	\$ (693)	\$ (0.12)

### Recent Developments

On October 9, 2012, we originated an approximately \$35.5 million total commitment transitional first mortgage loan on an office building in Cincinnati, OH. At closing the outstanding principal was approximately \$26.9 million. The loan has an interest rate of L+5.35%, origination fee of 0.5%, exit fee of 0.5%, and a term of 3 years. The initial unleveraged effective yield is 6.0%.

On October 31, 2012, our board of directors amended our investment guidelines to reflect our Manager's proposed consolidation of its Underwriting and Investment Committees into one Investment Committee.

On October 31, 2012, our board of directors declared a dividend of \$0.25 per common share for the fourth quarter of 2012. The fourth quarter 2012 dividend is payable on January 10, 2013 to common stockholders of record as of December 31, 2012.

On November 5, 2012, we originated an approximately \$13.4 million stretch first mortgage loan on an apartment complex located in Arlington, VA. At closing the outstanding principal was approximately \$13.4 million. The loan has an interest rate of L+5.15%, origination fee of 1.0%, exit fee of 0.5% and a term of 2 years. The initial unleveraged effective yield is 6.2%.

As of November 6, 2012, we had approximately \$29.9 million in cash and cash equivalents (excluding approximately \$3.6 million of restricted cash) and approximately \$48.7 million available, subject to the satisfaction of certain terms and conditions, in approved but undrawn capacity under its secured funding facilities based on the existing loans held for investment that have been pledged. Under the secured funding facilities, we are required, among other affirmative and negative covenants, to maintain a minimum liquidity of \$20.0 million, which we currently intend to meet by holding in reserve cash or cash equivalents equal to such amount. Accordingly, as of November 6, 2012, we had approximately \$58.6 million of capital available to fund additional investments, existing unfunded commitments and other working capital items. Assuming that we used such amount to make investments and were able to achieve a debt-to-equity ratio of between 1-to-1 and 2-to-1, we had the capacity to fund between approximately \$100 million and approximately \$150 million of additional senior loans and our existing unfunded commitments. As of November 6, 2012, the total unfunded commitments for our existing loans held for investment were approximately \$34.1 million and borrowings under our secured funding facilities were approximately \$94.5 million.

**Critical Accounting Policies and Use of Estimates**

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

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

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

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

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

**Valuation of Financial Instruments**

We determine the estimated fair value of financial assets and liabilities using the three-tier fair value hierarchy established by GAAP, which prioritizes the inputs used in measuring fair value. GAAP establishes market-based or observable inputs as the preferred source of values, followed by valuation models using management assumptions in the absence of market inputs. The only financial instruments recorded at fair value on a recurring basis in our consolidated financial statements are cash and cash equivalents. We have not elected the fair value option for the remaining financial instruments, including loans held for investment and secured funding agreements. Such financial instruments are carried at cost. For loans held for investment which are evaluated for impairment at least quarterly, we estimate the fair value of the financial instrument. If an impairment is determined, we record an expense for the difference between fair value and the carrying cost of the financial instrument. As of September 30, 2012, the fair value of our financial instruments approximates cost.

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

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

Level 2 Prices are determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level 3 Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

Unobservable inputs reflect our own assumptions about the factors that market participants would use in pricing an asset or liability, and would be based on the best information available. We anticipate that a significant portion of our assets will fall in Level 3 in the valuation hierarchy.

Any changes to the valuation methodology will be reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, we will continue to refine our valuation methodologies. The methods used by us may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we anticipate that our valuation methods will be appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We will use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

**Income Taxes**

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



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**Recent Accounting Pronouncements**

In April 2011, the Financial Accounting Standards Board ( FASB ) issued new guidance that revises the criteria for assessing effective control for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The update was effective for us on January 1, 2012, and the amendment is to be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. We adopted this new guidance beginning with the first quarter 2012 interim financial statements. This standard did not have a material impact on our consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued new guidance to achieve common fair value and disclosure requirements under GAAP. The new guidance amends current fair value guidance to include increased transparency around valuation inputs and investment categorization. This new guidance is effective for fiscal years and interim periods beginning after December 15, 2011. We adopted this new guidance beginning with the first quarter 2012 interim financial statements. This standard did not have a material impact on our consolidated financial position, results of operations or cash flows.

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

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

**Credit Risk**

We expect to be subject to varying degrees of credit risk in connection with holding a portfolio of our target investments. We will have exposure to credit risk on our CRE loans and other target investments. Our Manager will seek to manage credit risk by performing credit fundamental analysis of potential collateral assets. Credit risk will also be addressed through our Manager's on-going review.

Our investment guidelines do not limit the amount of our equity that may be invested in any type of our target investments. Our investment decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. As a result, we cannot predict the percentage of our equity that will be invested in any individual target investment at any given time.

**Interest Rate Risk**

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

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

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

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**Interest Rate Effect on Net Interest Income**

Our operating results will depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The cost of our borrowings generally will be based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase (a) while the yields earned on our leveraged fixed-rate mortgage assets will remain static and (b) in some cases, at a faster pace than the yields earned on our leveraged floating rate mortgage assets, which could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our target investments. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

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

**Interest Rate Cap Risk**

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

**Interest Rate Mismatch Risk**

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

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

**Extension Risk**

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

**Market Risk**

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

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**Real Estate Risk**

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

**Inflation**

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

**Risk Management**

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

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

- we will seek to manage credit risk through our due diligence process prior to origination or acquisition and through the use of non-recourse financing, when and where available and appropriate. In addition, with respect to any particular target investment, our Manager's investment team evaluates, among other things, relative valuation, comparable analysis, supply and demand trends, shape of yield curves, delinquency and default rates, recovery of various sectors and vintage of collateral.

**Item 4. Controls and Procedures**

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

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed below and in **Risk Factors** in our Prospectus and our quarterly report on Form 10-Q for the quarter ended March 31, 2012 which could materially affect our business, financial condition and/or operating results. The risks discussed below, in our Prospectus and our quarterly report on Form 10-Q for the quarter ended March 31, 2012 are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results.

***Our portfolio is concentrated in a limited number of loans, which subjects us to a risk of significant loss if any of these loans default.***

We are currently invested in 10 loans. The number of loans we are invested in may be higher or lower depending on the amount of our assets under management at any given time, market conditions and the extent to which we employ leverage, and will likely fluctuate over time. A consequence of this limited number of investments is that the aggregate returns we realize may be significantly adversely affected if a small number of investments perform poorly, if we need to write down the value of any one investment or if an investment is repaid prior to maturity and we are not able to promptly redeploy the proceeds. We do not have fixed guidelines for diversification, and our investments could be concentrated in relatively few loans.

While we intend to continue to diversify our portfolio of investments in the manner described in our filings with the Securities and Exchange Commission, we do not have fixed guidelines for diversification. As a result our investments could be concentrated in relatively few loans and/or relatively few property types. If our portfolio of target investments is concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations, downturns relating generally to such region or type of asset may result in defaults on a number of our investments within a short time period, which may reduce our net income and the value of our common stock and accordingly reduce our ability to pay dividends to our stockholders.

***We have experienced losses in the past and may experience similar losses in the future.***

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We incurred net operating losses for the year ended December 31, 2011 and the nine months ended September 30, 2012. Our losses have been incurred primarily because we have been in the initial stages of building our investment portfolio. As a result, our earnings have been highly sensitive to a number of variables, including the velocity and timing of new originations and our level of operating expenses. Our operating costs to date have been primarily funded with offering proceeds. We cannot assure you that we will be profitable in the future or that our target investments will produce sufficient income to fund our operating expenses and dividends.

*Our distributions may exceed our cash flow from our operations and our earnings.*

We intend to make regular quarterly distributions to holders of our common stock. The regular quarterly cash distributions we pay are expected to be principally sourced by cash flow from operating activities. However, there can be no assurance that our earnings or cash flow from operating activities will be sufficient to cover our future distributions, and we may use other sources of funds, such as from offering proceeds, borrowings and asset sales, to fund portions of our future distributions. Our distributions for the nine months ended September 30, 2012 exceeded, and future distributions may exceed, our cash flow from operating activities and earnings primarily because we have been in the initial stages of building our investment portfolio and as a result our earnings have been highly sensitive to a number of variables, including the velocity and timing of new originations and our level of operating expenses. Such distributions reduce the amount of cash we have available for investing and other purposes and could be dilutive to our financial results.

*The interests of certain control persons may be adverse to investors.*

Our board of directors has established an excepted holder limit for Ares Investments, an affiliate of our Manager, that allows Ares Investments to own, subject to certain conditions, up to 22% of the outstanding shares of our common stock. As of September 30, 2012, Ares Investments, an affiliate of Ares Management, owned 2,000,000 shares, or 21.6%, of our total shares of common stock outstanding. This significant concentration of share ownership may adversely affect the trading price of our common stock because investors often perceive a disadvantage in owning shares in a company with only one or very few controlling stockholders. Furthermore, Ares Investments has the ability to significantly influence the outcome of all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. This concentration of ownership may have the effect of delaying or preventing a change of control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if such a change of control would benefit you.

*If we invest in certain derivative instruments, failure to obtain and maintain an exemption from being regulated as a commodity pool operator could subject us to additional regulation and compliance requirements which could materially adversely affect our business and financial condition.*

Recently adopted rules under the Dodd-Frank Act establish a comprehensive new regulatory framework for derivative contracts commonly referred to as swaps. Under these recently adopted rules, any investment fund that trades in swaps may be considered a commodity pool, which would cause its directors to be regulated as commodity pool operators (CPOs). Under the new rules, unless an exemption is available, a CPO must register with the U.S. Commodity Futures Trading Commission (the CFTC) and become a member of the National Futures Association (the NFA) by the end of 2012, which will require compliance with NFA's rules, and render such CPO subject to regulation by the CFTC, including with respect to disclosure, reporting, recordkeeping and business conduct.



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We do not currently invest in any instruments that meet the definition of swap under the new rules, and we do not currently expect to engage in any speculative derivatives activities or other non-hedging transactions using swaps, futures or options on futures. However, we may use hedging instruments in conjunction with our investment portfolio and related borrowings to reduce or mitigate risks associated with changes in interest rates, mortgage spreads, yield curve shapes and market volatility. These hedging instruments could include interest rate swaps, interest rate futures and options on interest rate futures, each of which is considered a swap under CFTC rules. Prior to initiating any swap position in our portfolio, we intend to submit a no-action letter request to the CFTC seeking exemptive relief for our directors from CPO registration under these new rules. While the CFTC has recently granted interpretive relief to equity REITs that use swaps, no such relief has yet been provided to mortgage REITs. Several other mortgage REITs have submitted no-action requests to the CFTC, however there can be no assurance that any such relief will be granted before we need to make a determination regarding our status under the new rules. If exemptive relief is granted, we may be restricted to using swaps within certain specific parameters. For example, prior to the adoption of the new swaps rules, no-action relief was provided to equity REITs that used commodity interest trading to engage in hedging transactions, but such relief limited the use of such instruments such that no more than 1% of the fair market value of the assets of an equity REIT could be committed to commodity interest trading, and income derived from commodity interest trading was limited to 5% of the gross income of an equity REIT. If no exemption or no-action relief is available, our directors may be compelled to register as CPOs, or we may be required to seek other hedging instruments or techniques at increased cost to us, or that may not be as effective as the use of swaps.

The CFTC has substantial enforcement power with respect to violations of the laws over which it has jurisdiction, including their anti-fraud and anti-manipulation provisions. Among other things, the CFTC may suspend or revoke the registration of a person who fails to comply, prohibit such a person from trading or doing business with registered entities, impose civil money penalties, require restitution and seek fines or imprisonment for criminal violations. Additionally, a private right of action may exist against those who violate the laws over which CFTC has jurisdiction or who willfully aid, abet, counsel, induce or procure a violation of those laws. In the event that we fail to receive no-action relief from the CFTC on this matter and are unable to claim another exemption from registration for our directors, and our directors fail to comply with the requirements of these new rules, we may be unable to use certain types of hedging instruments or we may be subject to significant fines, penalties and other civil or governmental actions or proceedings, any of which could have a materially adverse effect on our business, financial condition and results of operations.

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

*Recent Sale of Unregistered Securities*

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

*Use of Proceeds from Registered Securities*

On April 25, 2012, the SEC declared effective our registration statement filed on Form S-11 under the Securities Act (File No. 333-176841) relating to our IPO of our common stock. A total of 7.7 million shares of our common stock were registered, and all shares were sold upon the completion of the offering on May 1, 2012, of which 500,000 shares were purchased by Ares Investments at the IPO price of \$18.50 per share. As of September 30, 2012, Ares Investments owned 2.0 million shares or 21.6% of the total common shares outstanding. The net proceeds to us from the IPO totaled approximately \$139.1 million.

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We used approximately \$47.3 million of the net proceeds of the IPO to repay outstanding amounts under the Wells Fargo Facility and the Citibank Facility and approximately \$6.3 million to redeem all of our issued and outstanding shares of Series A Preferred Stock. The balance was used for general corporate working capital purposes and to make investments in our target investments.

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

None.

### **Item 4. Mine Safety Disclosures**

Not applicable.

### **Item 5. Other Information**

None.

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**Item 6. Exhibits**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
3.1	Articles of Amendment and Restatement of Ares Commercial Real Estate Corporation (1)
3.2	Amended and Restated Bylaws of Ares Commercial Real Estate Corporation (1)
10.1*	First Amendment to Master Revolving Line of Credit Loan Agreement, dated September 27, 2012, between and among ACRC Lender One LLC, as borrower, Ares Commercial Real Estate Corporation, as guarantor, and Capital One, National Association, as lender
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

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\* Filed herewith

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

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

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**SIGNATURES**

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

**ARES COMMERCIAL REAL ESTATE CORPORATION**

Dated: November 7, 2012

By

/s/ John B. Bartling, Jr.  
John B. Bartling, Jr.  
Chief Executive Officer (Principal Executive Officer)

Dated: November 7, 2012

By

/s/ Tae-Sik Yoon  
Tae-Sik Yoon  
Chief Financial Officer (Principal Financial and  
Accounting Officer)