



# **ARES COMMERCIAL REAL ESTATE MANAGEMENT LLC**

## **Form ADV Part 2A Firm Brochure**

**Updated: March 29, 2013**

**This brochure provides information about the qualifications and business practices of Ares Commercial Real Estate Management LLC (“ACREM” or the “Firm”). If you have any questions about the contents of this brochure, please contact us at 310-201-4100 or [adell@aresmgmt.com](mailto:adell@aresmgmt.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.**

**Additional information about ACREM also is available on the SEC’s website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)**

*Registration with the SEC as an investment adviser does not imply that ACREM or any principals or employees of ACREM possess a particular level of skill or training in the investment advisory or any other business.*

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## Item 2 - Material Changes

This brochure contains no material changes since the last annual update dated March 30, 2012.

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## Item 4 - Advisory Business

ACREM is a Delaware limited liability company that was formed in July 2011 and commenced operations in August 2011. ACREM is a wholly owned subsidiary of Ares Management LLC ("Ares Management"), a Delaware limited liability company that was initially established in 1997 and became an independent company in 2001. The indirect principal owner of Ares Management is Antony P. Ressler who, together with seven other members of Ares Management's senior management team through their ownership interests in Ares Partners Management Company LLC ("APMC"), the indirect controlling parent of Ares Management, holds indirectly a majority ownership in Ares Management. Intermediate holding companies include Ares Holdings Inc., Ares Holdings LLC and Ares Management Holdings LLC.

In August 2011, ACREM and Ares Management entered into an asset purchase agreement with Wrightwood Capital LLC ("Wrightwood"), a Delaware limited liability company, pursuant to which ACREM acquired certain assets and rights of Wrightwood used in the conduct of Wrightwood's investment management business. In connection with the foregoing acquisition, ACREM (either directly and/or indirectly through its affiliates, as described below) undertook to serve as an investment manager to three pooled investment vehicles previously sponsored and managed by Wrightwood (the "Wrightwood Funds") and to manage certain balance sheet assets and liabilities of Wrightwood and its subsidiaries and affiliated entities (the "Wrightwood Assets"), including certain assets and liabilities held by or directly related to a CDO (the "CDO") whose interests are offered to third-party investors through a Wrightwood affiliate.

ACREM provides the advisory services described below to its clients, which currently include Wrightwood, the Wrightwood Funds, the CDO and Ares Commercial Real Estate Corporation ("ACRE"), a public specialty finance company that intends to elect to be classified as a real estate investment trust for federal income tax purposes. ACRE's common stock is listed on the New York Stock Exchange, or "NYSE", under the symbol "ACRE". ACREM provides advisory services to the foregoing advisory clients directly or indirectly through Ares Commercial Real Estate Manager LLC, an affiliated entity controlled by ACREM. References to ACREM in this brochure include, as the context requires, its affiliates (including, but not limited to, Ares Commercial Real Estate Manager LLC, a wholly owned subsidiary of ACREM).

ACREM's investment advisory business is principally focused on commercial real estate lending and investing including originating, investing in and managing commercial real estate loans and other commercial real estate related investments. Its advice is primarily limited to real estate-related investments, and ACREM tailors its advisory services to the specific investment objectives and restrictions of each fund, investment vehicle and separately managed investment account that ACREM manages directly or indirectly through its affiliates.

The investors in the Wrightwood Funds and ACREM's other investment vehicles and accounts have substantial investment assets and wish to participate in privately negotiated debt, equity and equity-related investments, principally in commercial, multifamily and industrial real estate. Certain Wrightwood Funds seek capital appreciation primarily through investments in high yield, mezzanine and distressed commercial real estate debt and equity opportunities across the United States. Certain other Wrightwood Funds seek capital appreciation primarily through acquisitions

of industrial real estate properties in the greater Chicago area. Wrightwood (with respect to the Wrightwood Assets) and the CDO each seek to achieve attractive risk-adjusted returns primarily through investments in commercial mortgage loans, which are generally secured directly or indirectly by a mortgage on multifamily or commercial property. ACREM seeks to achieve attractive risk-adjusted returns primarily through dividends and distributions and secondarily through capital appreciation by originating, investing in and managing middle-market commercial real estate loans and other commercial real estate related investments. With respect to investments in certain assets, to achieve increased tax efficiency, one or more of ACREM's pooled investment vehicles may make such investments indirectly through subsidiary entities that elect to be taxed as real estate investment trusts for U.S. federal income tax purposes.

Clients and investors and prospective clients and investors in a pooled investment vehicle or other investment account managed by ACREM should refer to the public filings, confidential private placement memorandum, limited partnership agreement, investment management agreement and/or other governing documents for such pooled investment vehicle or other investment account (the "Governing Documents") for complete information on the investment objectives and investment restrictions of such pooled investment vehicle or other investment account.

In accordance with common industry practice, ACREM or a Wrightwood Fund general partner may enter into "side letters" or similar agreements with certain investors pursuant to which the general partner grants the investor specific rights, benefits, or privileges that are not made available to investors generally.

ACREM does not participate in any wrap fee programs.

ACREM manages all client account assets on a discretionary basis in accordance with the terms and conditions of each client account's Governing Documents. As of December 31, 2012, ACREM had assets under management ("AUM") of approximately \$1,880,529,000. AUM includes all amounts outstanding and available under debt facilities.

## Item 5 - Fees and Compensation

### *Compensation and Fee Schedules*

Investors should review the Governing Documents of the applicable ACREM client account in conjunction with this brochure for more complete information on the fees and compensation payable with respect thereto. With respect to a certain collective investment vehicle managed by ACREM, all investors in such investment vehicles are "qualified purchasers" ("Qualified Purchasers") as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the "Investment Company Act") and, as a result, information regarding the fees and compensation payable by such investors is not required to be provided herein. The below fees and compensation information relates solely to those collective investment vehicles and other accounts managed by ACREM where not all investors are Qualified Purchasers.

In certain circumstances, the advisory fees payable to ACREM by investors in certain collective investment vehicles managed by ACREM may be negotiable. Investors and prospective

investors in each collective investment vehicle managed by ACREM should refer to the Governing Documents of such collective investment vehicle for more complete information on the advisory fees charged by ACREM.

Investors and prospective investors in collective investment vehicles managed by ACREM should note that similar advisory services may (or may not) be available from other investment advisers for similar or lower fees.

From time to time, a collective investment vehicle or other client account managed by ACREM may purchase an interest in another collective investment vehicle managed by ACREM, provided that the sale or purchase is consistent with ACREM's fiduciary obligations to each collective investment vehicle or other client account party to such transaction and is otherwise consistent with the investment mandate of each such collective investment vehicle or other client account. While ACREM endeavors at all times to act in the best interests of all client accounts, investors should be aware that ACREM's receipt of compensation from each client account and the contribution of additional capital by one client account to another client account may create potential conflict of interest with respect to such transactions. In certain circumstances, ACREM may choose to reduce the advisory fees of a Fund or client account investing in another Fund or client account by the amount of advisory fees applicable to the Fund or client account's investment in another Fund or client account.

### **Wrightwood Funds**

None of the Wrightwood Funds is continuing to make investments. With respect to one Wrightwood Fund ("HYP II"), until August, 2011, the advisory fee payable to ACREM for each calendar quarter was 1.5% per annum of the aggregate capital contributions of partners to the fund. The advisory fee payable to ACREM for each calendar quarter from August 2011 until the termination of HYP II equals 1.5% per annum of such commitments that have been invested in or committed to portfolio investments of the fund which have not been completely disposed of. In addition, under certain circumstances, an entity separate from, and not affiliated with, ACREM may be entitled to receive an incentive allocation based on a share of capital gains on or capital appreciation of the fund's assets, as set forth in the fund's governing documents. This incentive allocation is not a fee payable to ACREM or any of its affiliates.

Another fund has the following fee structure: During the Investment Period of such fund, the advisory fee payable for each quarter was 1.5% per annum of aggregate capital commitments of partners to the fund, and thereafter (i.e., currently and until termination of the fund), the advisory fee payable to ACREM for each calendar quarter equals 1% per annum of aggregate capital commitments of the partners to the fund (reduced by any distributions made or deemed made to partners). In addition, under certain circumstances, an entity separate from, and not affiliated with, ACREM may be entitled to receive an incentive allocation based on a share of capital gains on or capital appreciation of the fund's assets, as set forth in the fund's governing documents. This incentive allocation is not a fee payable to ACREM or any of its affiliates.

The other Wrightwood Fund has the following fee structure: During such fund's Investment Period, the advisory fee payable for each quarter was 1.5% per annum of aggregate capital commitments of partners to the fund plus 0.25% per annum of the weighted-average of the total

acquisition cost of all unrealized portfolio investments. Currently and until termination of the fund, the advisory fee payable to ACREM for each calendar quarter equals 0.25% per annum of the weighted-average of the total acquisition cost of all unrealized portfolio investments. For purposes of the foregoing calculations, “total acquisition cost” means the sum of (1) the total purchase price of such unrealized investment (including capital contributed by the partners and any leverage utilized by the fund in connection with such unrealized investment) and (2) all out-of-pocket costs and expenses incurred in connection with the purchase or other acquisition of such unrealized investment, including costs and expenses incurred in connection with obtaining any debt financing. In addition, under certain circumstances, an entity separate from ACREM may be entitled to receive an incentive allocation based on a share of capital gains on or capital appreciation of the fund’s assets, as set forth in the fund’s governing documents. This incentive allocation is not a fee payable to ACREM.

### **Wrightwood Assets**

With respect to the Wrightwood Assets, the fee payable to ACREM is equal to 0.75% per annum of the net book value of the Wrightwood Assets, determined in accordance with U.S. generally accepted accounting principles. The fees are payable in advance on the first business day of each calendar quarter. In addition, as part of the asset purchase agreement between Wrightwood and ACREM, Wrightwood agreed to pay ACREM a minimum fee for a period of five years. To the extent such minimum fee threshold exceeds the fees ACREM receives from the Wrightwood Funds and the CDO during such five-year period, the amount of any shortfall will be payable out of the Wrightwood Assets.

### **ACRE**

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

ACRE will also pay ACREM an incentive fee with respect to each calendar quarter (or part thereof that the management agreement is in effect) in arrears in cash. The incentive fee will be



an amount, not less than zero, equal to the difference between: (a) the product of (i) 20% and (ii) the difference between (A) Core Earnings (as defined below) for the previous 12-month period and (B) the product of (1) the weighted average issue price per share of ACRE's common stock of all of its public offerings of common stock multiplied by the weighted average number of shares of common stock outstanding (including any restricted stock units, any restricted shares of common stock and other shares of common stock underlying awards granted under ACRE's equity incentive plan) in the previous 12-month period, and (2) 8% and (b) the sum of any incentive fees paid to ACREM with respect to the first three calendar quarters of such previous 12-month period; *provided, however*, that no incentive fee is payable with respect to any calendar quarter unless Core Earnings for the 12 most recently completed calendar quarters is greater than zero. For purposes of the foregoing calculations, Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) excluding non-cash equity compensation expense, the incentive fee, depreciation and amortization (to the extent that ACRE forecloses on any properties underlying its target investments), any unrealized gains, losses or other non-cash items recorded in net income for the period, regardless of whether such items are included in other comprehensive income or loss, or in net income. The amount will be adjusted to exclude one-time events pursuant to changes in GAAP and certain other non-cash charges.

In addition, under the management agreement, if in the future ACRE invests in, acquires or sells assets to any joint ventures with Ares Management LLC or its affiliates or if ACRE co-invests with, purchases assets from, sells assets to or arranges financing from any such transactions, it will require the approval of a majority of ACRE's independent directors. To the extent ACRE co-invests with other investment vehicles that are managed by Ares Management LLC, ACRE will not be responsible for fees other than as set forth in the management agreement, except its proportionate share of fees charged by the managers of such other investment vehicles if approved by a majority of ACRE's independent directors.

### ***Deduction of Fees; Timing of Payments; Termination***

For each client account managed by ACREM (other than the CDO), ACREM is authorized under the Governing Documents to charge and deduct advisory fees directly from the assets of such client account at the times and in the amounts set forth in the Governing Documents of such client account.

Advisory fees for certain of ACREM's client accounts are payable in arrears, generally on a quarterly basis. Since such advisory fees are payable in arrears, they are not paid until after services have been rendered. With respect to certain other ACREM client accounts, advisory fees are payable quarterly in advance. Please refer to the Governing Documents of the applicable client accounts for more complete information on the timing of advisory fee payments.

Collective investment vehicles managed by ACREM and other clients have the right to terminate ACREM's advisory services in accordance with the terms of the applicable advisory or investment management agreements. ACREM's general policy is to repay any advisory fees paid by a collective investment vehicle or other client account managed by ACREM in advance in excess of the pro rata portion earned by ACREM (based on the number of days during the

period) through the termination date. Any such refund would be implemented through a wire transfer of funds to the affected clients upon termination of ACREM's advisory services.

### ***Other Fees and Expenses***

In addition to the fees payable to ACREM, client accounts may incur certain charges imposed by third parties, including (but not limited to) any sales or other taxes, fees or government charges that may be assessed against the client; commissions, brokerage fees and similar charges incurred in connection with the purchase or sale of securities (including any merger fees payable to third parties and whether or not any such purchase or sale is consummated); the costs and expenses (including travel-related expenses) of holding meetings or conferences with an ACREM collective investment vehicle's investors; expenses relating to litigation and threatened litigation involving a client account; indemnification obligations and expenses; expenses attributable to normal and extraordinary investment banking, commercial banking, accounting, auditing, appraisal, tax advisory, tax preparation, legal, external consulting, custodial and registration services provided to a client account; premiums for liability insurance; the costs of dissolving a collective investment vehicle managed by ACREM and liquidating its assets; and the costs and expenses for tax and audit services to a client account. Please refer to the Governing Documents of the applicable client accounts for complete information on the expenses payable by such client accounts.

### ***Transaction-Based Compensation***

ACREM or its affiliates or supervised persons may receive asset management, portfolio investment transaction, monitoring, servicing, other similar advisory fees and other fees and profits interests, and/or break-up fees from portfolio investments in which one or more of ACREM's client accounts may invest or propose to invest. These types of arrangements present potential conflicts of interest and may provide ACREM's supervised persons with an incentive to recommend investments based on compensation received rather than the best interests of an ACREM client account. To mitigate potential conflicts, such benefits received by ACREM in connection with its services related to portfolio investments or transactions are generally either waived or offset against advisory fees payable by the related client account. Please refer to the Governing Documents of the applicable client account for more complete information on additional compensation that may be receivable by ACREM or its affiliates or supervised persons in connection with investments and any offsets against advisory fees.

ACREM may cause or permit a collective investment vehicle managed by ACREM to contract for the performance of certain services by ACREM or any of its affiliates that may result in the receipt of transaction-based compensation by ACREM or any of its affiliates. In such circumstances, ACREM may have an incentive to recommend securities or investment products based on compensation received by related persons, rather than on the needs of such collective investment vehicle. To mitigate such conflicts, the Governing Documents of a collective investment vehicle with respect to which such transaction-based compensation is permitted will typically require that the terms and conditions under which the related services are provided (including fees) must be at least as favorable to such collective vehicle as the terms available in an arm's-length transaction with an independent third party and that any such services must be pre-approved by the applicable collective investment vehicle's advisory committee or equivalent thereof.



## Item 6 - Performance-Based Fees and Side-by-Side Management

### *Performance-Based Fees*

For ACRE, ACREM or a related person may be entitled to receive certain allocations calculated and charged based on a share of capital gains on or capital appreciation of the assets of the applicable client accounts. See discussion above in the section entitled “*Compensation and Fee Schedules*.” Such performance-based allocation arrangements discussed above comply with Rule 205-3 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) and are separate and distinct from the advisory fees charged by ACREM or its related persons for advisory services.

Performance-based allocation arrangements received by ACREM or its related persons may create incentives for ACREM to recommend investments that may be riskier or more speculative than those that would be recommended under a different fee arrangement. Please refer to the Governing Documents of the applicable client account for more complete information on the “performance-based fee” arrangements such client account is subject to.

### *Side-by-Side Management*

As discussed above, none of the Wrightwood Funds will be making any further investments (other than follow-on investments in existing investments, additional fundings pursuant to existing commitments or investments or further advances to protect existing investments).

ACREM may provide concurrent advisory services to clients that are not charged a performance-based fee or allocation by ACREM or its related persons and clients that are charged a performance-based fee or allocation. The potential for ACREM and its related persons to receive greater fees or allocations from performance-based accounts creates potential conflicts of interest with respect to the allocation of investment opportunities, as ACREM may have incentives to direct the best investment ideas to, or to allocate investments in favor of, funds or investment accounts that pay performance fees or special allocations of profits. To mitigate potential conflicts of interest, ACREM’s investment allocation policy provides that all investment opportunities will be allocated among its client accounts on a basis that over a period of time is fair and equitable to each client account relative to other clients consistent with any fiduciary duties owed to clients and in an effort to avoid favoring one client over another, taking into account all relevant facts and circumstances, including, but not limited to the relevant investment vehicles’ available capital, diversification, their investment objectives or strategies, their risk profiles and their existing or prior positions in an issuer/security, as well as potential conflicts of interest, the nature of the opportunity and market conditions.

The members of the ACREM investment committee and the portfolio managers are generally responsible for administering transactions among the client accounts managed by ACREM. Allocations of investment opportunities are reviewed periodically by ACREM to assess the effectiveness of the procedures. ACREM and its principals may co-invest with certain client accounts, as described in the Governing Documents thereof.

## Item 7 - Types of Clients

### *Types of Clients*

ACREM provides investment advisory services to various pooled investment vehicles, including ACRE, the Wrightwood Funds and the CDO. ACREM also provides investment advisory services to Wrightwood relating to the Wrightwood Assets. Investors in ACRE, the Wrightwood Funds, the CDO and other investment vehicles managed from time to time by ACREM may include corporations (including insurance companies), endowments, foundations, trusts, estates, high-net worth individuals and pension and profit sharing plans. Each pooled investment vehicle managed by ACREM is offered exclusively to accredited investors. In addition, each such pooled investment vehicle relies on an exception from the definition of “investment company” in Section 3(c) of the Investment Company Act and is therefore not required to register as an investment company under the Investment Company Act.

### *Minimum Investment Requirements*

The minimum investment amount for each of Wrightwood Funds and other investment vehicles is stated in its Governing Documents and ranges from \$500,000 to \$10 million. ACREM or an affiliate thereof generally has the authority to waive the applicable minimum investment amount in its discretion.

## Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss

### *Methods of Analysis and Investment Strategies*

ACREM’s overarching investment strategy is implemented through a highly disciplined underwriting, investment and portfolio management process. The specific methods of analysis and investment strategies utilized by ACREM for client accounts managed by ACREM are described below. For additional details relating to the methods of analysis and investment strategies employed by a client account, please refer to the Governing Documents of such client account.

ACREM invests primarily in privately negotiated debt, equity and equity-related investments, in commercial real estate. Certain Wrightwood Funds seek capital appreciation primarily through investments in high yield, mezzanine and distressed commercial real estate debt and equity opportunities across the United States. Certain other Wrightwood Funds seek capital appreciation primarily through acquisitions of industrial real estate properties in the greater Chicago area. Wrightwood (with respect to the Wrightwood Assets) and the CDO each seek to achieve attractive risk-adjusted returns primarily through investments in commercial mortgage loans which are generally secured directly or indirectly by a mortgage on multifamily or commercial property. ACRE seeks to achieve attractive risk-adjusted returns primarily through dividends and distributions and secondarily through capital appreciation by originating, investing in and managing middle-market commercial real estate loans and other commercial real estate related investments. With respect to investments in certain assets, to achieve increased tax efficiency, one or more of ACREM’s pooled investment vehicles or accounts managed by ACREM may make such investments indirectly through subsidiary entities that elect to be taxed as real estate investment trusts for U.S. federal income tax purposes.

ACREM employs a rigorous, credit-oriented evaluation towards determining the risk/return profile of the investment opportunity and the appropriate pricing and structure for the prospective investment, with specific reference to the strength of the transaction sponsor(s), the underlying real estate and the structure of the investment. Detailed financial modeling and analysis is conducted to assess the cash flow and debt service coverage characteristics of the properties as well as interest rate and prepayment analysis.

Focus is given to current cash flows and potential risks to cash flow such as those associated with tenant credit quality, lease maturities, reversion to market level rental rates, vacancy and expenses. Cash flow analysis and market comparables are used as follows:

- to determine the current value of the underlying collateral
- to assess the capacity to repay or refinance upon maturity
- to understand sensitivities to various potential changes in asset performance, market fundamentals and real estate capital markets

ACREM performs extensive property, sponsor and market-level due diligence, including:

- a competitive analysis
- corporate profile and credit reviews for major tenants
- due diligence on the borrower and its sponsor(s), including meeting with the borrower's and sponsor's respective management teams
- checking management's backgrounds and references
- analyzing the governance structure of the borrower
- investigation into legal risks
- market and industry research, including an analysis of demographics, key economic fundamentals such as employment and population growth, and comparable transactions
- review of the borrower's business plan with respect to the property

ACREM's underwriting focuses on understanding the broader capital structure of the transaction and ensuring that it has the appropriate controls and rights with respect to its prospective investment.

If considering the acquisition of CMBS, ACREM would undertake an extensive analysis of the underlying loans and careful review of the security terms and conditions.

### ***Material Risks***

The task of identifying investment opportunities and managing such investments can be difficult. There can be no assurance that any client account managed by ACREM will be able to make and/or realize any particular investment or generate returns. Investing involves a risk of loss that investors in one or more collective investment vehicles or other accounts managed by ACREM should be prepared to bear. Investors should carefully consider, among other factors, the following material risks involved with ACREM's investment strategies. Investors are requested to refer to the Governing Documents of the applicable collective investment vehicle or account managed by ACREM for more complete information on investment strategies employed by such collective investment vehicle or account and the corresponding risks associated with such investment strategies.

**General Real Estate Considerations.** Real estate historically has experienced significant fluctuations and cycles in value that may result in reductions in the value of real estate-related investments. The marketability and value of the investments undertaken by ACREM on behalf of its client accounts depends on many factors beyond the control of ACREM. The ultimate performance of such investments is subject to the varying degrees of risk generally incident to the financing, ownership, market and operation of the underlying real property. The ultimate value of a client account's investment in the underlying real property depends upon the real property owner's ability to operate the real property in a manner sufficient to maintain or increase revenues in excess of operating expenses and debt service or, in the case of all properties, the ability of any lessees to make rental payments.

Real estate investments are subject to various risks, including:

- acts of God, including earthquakes, floods and other natural disasters, which may result in uninsured losses;
- acts of war or terrorism, including the consequences of terrorist attacks;
- adverse changes in national and local economic and market conditions, and changes in neighborhood characteristics;
- changes in governmental laws and regulations, fiscal policies (and in the availability, cost and terms of mortgage funds) and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- costs of remediation and liabilities associated with environmental conditions such as indoor mold;
- the potential for uninsured or under-insured property losses;
- the financial condition of tenants, buyers and sellers of properties; and
- competition from other properties offering the same or similar services.

The risks associated with ACREM's clients' investments will be more severe during periods of economic slowdown or recession if these periods are accompanied by declining real estate values. In addition, ACREM's investment model may be adversely affected if the current

economic recession continues longer or is deeper than anticipated. Declining real estate values would likely reduce the level of new mortgage and other real estate-related loan originations since borrowers often use appreciation in the value of their existing properties to support the purchase or investment in additional properties. Borrowers may also be less able to pay principal and interest on loans if the value of real estate declines. Further, declining real estate values significantly increase the likelihood that ACREM's client accounts will incur losses on loans in the event of default because the value of the collateral may be insufficient to cover the remaining obligation due on the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect ACREM's ability to invest in, sell and securitize loans.

The factors above could materially and adversely affect the results of the operations, financial condition, liquidity and business of ACREM's client accounts and their ability to pay returns.

**Competition for Real Estate Investments.** ACREM operates in a competitive market for investment opportunities and competition may limit its ability to originate or acquire desirable investments in its target investments and could also affect the pricing of these securities, thereby reducing returns to ACREM's client accounts, and may decrease the available supply of investment opportunities deemed suitable for such client accounts. A number of entities compete with client accounts managed by ACREM to make the types of investments that such client accounts seek to make. The profitability of ACREM's client accounts depends, in large part, on ACREM's ability to originate or acquire target investments on attractive terms. In originating or acquiring target investments, ACREM's client accounts will compete with a variety of institutional investors, including other real estate investment trusts, specialty finance companies, public and private funds, commercial and investment banks, commercial finance and insurance companies and other financial institutions.

Many of ACREM's competitors are significantly larger than it and have considerably greater financial, technical, marketing and other resources. Some competitors may have a lower cost of funds and access to funding sources that are not available to ACREM, such as the U.S. Government. Many of ACREM's competitors are not subject to the operating constraints associated with maintenance of an exemption from the Investment Company Act. In addition, some of ACREM's competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, deploy more aggressive pricing and establish more relationships than ACREM. Furthermore, competition for originations of and investments in ACREM's client accounts' target investments may lead to the price of such assets increasing, which may further limit such accounts' ability to generate desired returns. The commercial properties securing the mortgage loans in various client accounts face competition from sources outside their local real estate market. For example, retail properties must compete with catalog retailers, home shopping networks, internet retailers and outlet centers, which are often characterized by lower operating costs. Continued growth of these alternative retail outlets could adversely affect the rents collectible at the retail properties. Additionally, competition from other office properties in the same local market could decrease occupancy or rental rates at office properties that secure client investments. Decreased occupancy or rental revenues could result in realized losses on the mortgage loans. Declining real estate values significantly increase the likelihood that a client account will incur losses on its

loans in the event of default because the value of such client account collateral may be insufficient to cover the remaining obligations on such loans. ACREM cannot assure investors that the competitive pressures its client accounts face will not have a material adverse effect on their business, financial condition and results of operations. Also, as a result of this competition, desirable investments in target investments may be limited in the future and such client accounts may not be able to take advantage of attractive investment opportunities from time to time, as no assurance can be provided that investments that are consistent with ACREM's client accounts' investment objectives will be identified and made.

**Risk of Default or Insolvency by Underlying Investments.** With respect to mezzanine or other subordinate investments that may be made by various client accounts, the leveraged capital structure of the properties underlying the mezzanine products and other investments in which client accounts invest will increase their exposure to adverse economic factors (such as rising interest rates, competitive pressures, downturns in the economy or deterioration in the condition of the real estate company or property) and to the risk of unforeseen events. This leverage may result in more serious adverse consequences to such underlying properties (including to overall profitability or solvency) in the event these factors or events occur than the consequences for less leveraged entities or properties. For example, rising interest rates may significantly increase interest expense, or a significant market downturn may affect the ability to generate positive cash flow, in either case causing an inability to service outstanding debt, which may include the debt investments held by client accounts. If an underlying property cannot generate adequate cash flow to meet debt obligations, for example, because a major tenant defaults under, terminates or fails to renew its lease, the borrower may default on its loan agreements or be forced into bankruptcy. As a result, client accounts may suffer a partial or total loss of invested capital.

**Investment in Subordinate Capital.** Subordinate debt and structured equity investments may be subject to greater credit risks than investment alternatives. Real estate debt investments have special inherent risks relative to collateral value. Investments made by certain of the client accounts are subject to risk of borrower default, risk of loss from casualty or condemnation and risks generally associated with real estate investment. Except with respect to two of the Wrightwood Funds and in rare instances for other client accounts, the client accounts do not anticipate having absolute control over the underlying collateral as they are dependent upon third party borrowers and agents or co-venturers and may have rights that are subordinate to those of senior lenders. Certain client accounts intend to own subordinate capital, which is subject to loss of principal and nonpayment of interest. Certain client accounts generally originate or acquire loans that are non-recourse to the borrower. In many circumstances, clients' investments are not secured by a mortgage, but instead by partnership interests or other collateral that provide less security than a mortgage. While these clients' subordinate debt investments usually benefit from the same or similar financial and other covenants as those enjoyed by the more senior debt investments and usually benefit from cross-default provisions with the senior debt, some or all of such terms may not be part of particular investments. In any case, in the event of default, a client account's source of repayment may be limited to the value of the collateral and may be subordinate to other lien holders. Accordingly, such client accounts may not be able to take the steps necessary to protect their investments in a timely manner or at all and there can be no assurance that the rate of return objectives of the client accounts or any particular investment will be achieved. The collateral value of the property may be less than the outstanding amount of the



investments. In cases in which certain client accounts' collateral consists of partnership or similar interests, such client accounts' rights and level of security will be less than if they held a mortgage loan. To protect their original investment and to gain greater control over the underlying assets, such client accounts may need to elect to purchase the interest or cure the default of a senior creditor or take a managing member interest in the underlying assets, which may require additional investment by such accounts.

**Risks Associated with Mezzanine Loans.** Certain client accounts may originate or acquire mezzanine loans, which take the form of subordinated loans secured by second mortgages on the underlying property or loans secured by a pledge of the ownership interests of either the entity owning the property or a pledge of the ownership interests of the entity that owns the interest in the entity owning the property. These types of assets involve a higher degree of risk than long-term senior mortgage lending secured by income-producing real property, because the loan may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, a client account may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy the client account's mezzanine loan. If a borrower defaults on the client account's mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, the client account may not recover some or all of its initial investment. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.

**Risks Associated with B-Note Originations or Acquisitions.** Certain client accounts may originate or acquire B-Notes. A B-Note is a mortgage loan typically (a) secured by a first mortgage on a single large commercial property or group of related properties and (b) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. Because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes typically are secured by a single property and accordingly reflect the risks associated with significant concentration. Significant losses related to the B-Notes held by a client account would result in operating losses for such client account and may limit the account's ability to make distributions to its stockholders or investors.

**Risks Associated with Investments in Illiquid Instruments.** The illiquidity of investments made by certain client accounts may make it difficult for us to sell such investments if the need or desire arises. Certain target investments such as B-Notes, transitional, mezzanine and other loans are also particularly illiquid investments due to their short life, their potential unsuitability for securitization and the greater difficulty or recovery in the event of a borrower's default. In addition, many of the loans and securities will not be registered under the relevant securities laws, resulting in a prohibition against their transfer, sale, pledge or disposition except in a transaction that is exempt from the registration requirements of, or otherwise in accordance with, those laws. As a result, many investments made by certain client accounts will be illiquid, and if we are required to liquidate all or a portion of our portfolio quickly, such accounts may realize

significantly less than the value at which they have previously recorded investments. Further, such accounts may face other restrictions on their ability to liquidate an investment in a business entity to the extent that we have or could be attributed as having material, non-public information regarding such business entity. As a result, our ability to vary portfolios in response to changes in economic and other conditions may be relatively limited, which could adversely affect the results of operations and financial condition.

**Valuation Risk.** Certain client accounts' hold portfolio investments in the form of investments that are not publicly traded. The fair value of securities and other investments that are not publicly traded may not be readily determinable. Currently, the only financial instruments recorded at fair value on a recurring basis in the consolidated financial statements for these client accounts are cash and cash equivalents. Such client accounts 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 that are evaluated for impairment at least quarterly, we estimate the fair value of the instrument, which may include unobservable inputs. Because such valuations are subjective, the fair value of certain assets may fluctuate over short periods of time and our determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. Additionally, returns for a given period could be adversely affected if our determinations regarding the fair value of these investments were materially higher than the values that the client account ultimately realizes upon their disposal. The valuation process is particularly challenging as market events and lack of investment activity have made valuations of certain assets more difficult, unpredictable and volatile.

**Lack of Operating Control of Underlying Investments.** The day-to-day operations of the properties underlying the debt or other investments in which certain client accounts invest are the responsibility of the owners and developers of such properties. Although ACREM is responsible for monitoring the performance of each investment and invests in debt or other investments with underlying real estate properties that are operated by strong management, there can be no assurance that the owners and developers will be able to operate the underlying companies or properties in accordance with their business plans or the expectations of client accounts.

**Investment in Distressed Assets.** Certain client accounts may make investments that either are or become non-performing or otherwise troubled. These investments may experience financial difficulties that may never be overcome. Such client accounts' investments are likely to be subject to the prior interests of a mortgage lender, which could foreclose on its mortgage (and wipe out the client accounts' investment) if a mortgage default occurred. Investments in properties operating under the close supervision of a mortgage lender or under certain bankruptcy laws are, in certain circumstances, subject to certain additional potential liabilities, which may exceed the value of the client accounts' original investment. In addition, lenders who have inappropriately exercised control over the management and policies of a debtor may have their claims subordinated or disallowed or may be found liable for damages suffered by parties as a result of such actions. Under certain circumstances, payments to ACREM collective investment vehicles and distributions by such collective investment vehicles to their respective investors may be required to be returned if any such payment or distribution is later determined to have been a fraudulent conveyance or a preferential payment.

**Risks Associated with Senior CRE Loans and CMBS Mortgage Loans.** Senior commercial real estate loans made by certain client accounts will be secured by commercial property and will be subject to risks of delinquency and foreclosure. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be adversely affected by, among other things,

- tenant mix;
- success of tenant businesses;
- property management decisions;
- property location, condition and design;
- competition from comparable types of properties;
- changes in laws that increase operating expenses or limit rents that may be charged;
- changes in national, regional or local economic conditions and/or specific industry segments, including the credit and securitization markets;
- declines in regional or local real estate values;
- declines in regional or local rental or occupancy rates;
- increases in interest rates, real estate tax rates and other operating expenses;
- costs of remediation and liabilities associated with environmental conditions;
- the potential for uninsured or underinsured property losses;
- changes in governmental laws and regulations, including fiscal policies, zoning ordinances and environmental legislation and the related costs of compliance; and
- acts of God, terrorist attacks, social unrest and civil disturbances.

In the event of any default under a mortgage loan held directly by a client account, such client account will bear a risk of loss to the extent of any deficiency between the value of the collateral and the principal and accrued interest and costs of collection of the mortgage loan, which could have a material adverse effect on the client account's cash flow from operations and limit amounts available for distribution to the client account's investors. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to

the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on a client account's anticipated return on the foreclosed mortgage loan.

**Risks Associated with Loans on Properties in Transition.** Certain ACREM client accounts may originate transitional loans secured by first lien mortgages on a property to borrowers who are typically seeking short-term capital to be used in an acquisition or rehabilitation of a property. The typical borrower under a transitional loan has usually identified an asset that has not been stabilized or has been under-managed and/or is located in a recovering market. If the market in which the asset is located fails to improve according to the borrower's projections, or if the borrower fails to improve the quality of the asset's management or the value of the asset, the borrower may not receive a sufficient return on the asset to satisfy the transitional loan, and the applicable client account will bear the risk that it may not recover some or all of its investment.

In addition, borrowers usually use the proceeds of a conventional mortgage to repay a transitional loan. Transitional loans therefore are subject to risks of a borrower's inability to obtain permanent financing to repay the transitional loan. Transitional loans are also subject to risks of borrower defaults, bankruptcies, fraud, losses and special hazard losses that are not covered by standard hazard insurance. In the event of any default under transitional loans that may be held by an ACREM client account, such client account will bear the risk of loss to the extent of any deficiency between the value of the mortgage collateral and the principal amount and unpaid interest and costs of collection of the transitional loan.

Further, the renovation, refurbishment or expansion by a borrower with respect to a property in transition mortgaged by a short term senior loan involves risks of cost overruns and noncompletion. Estimates of the costs of improvements to bring an acquired property up to standards established for the market position intended for that property may prove inaccurate. Other risks may include rehabilitation costs exceeding original estimates, possibly making a project uneconomical, environmental risks and rehabilitation and subsequent leasing of the property not being completed on schedule. If such renovation is not completed in a timely manner, or if it costs more than budgeted, the borrower may experience a prolonged impairment of net operating income and may not be able to make payments on a client account's loan investment, which could result in significant losses.

**Risks Associated with Credit Rating Downgrades.** Investments made by certain client accounts may be rated by rating agencies such as Moody's Investors Service, Fitch Ratings, Standard & Poors, DBRS, Inc. or Realpoint LLC. Any credit ratings on such investments are subject to ongoing evaluation by credit rating agencies, and there can be no assurance that any such ratings will not be changed or withdrawn by a rating agency in the future if, in its judgment, circumstances warrant. If rating agencies assign a lower-than-expected rating or reduce or withdraw, or indicate that they may reduce or withdraw, their ratings of investments in the future, the value of the applicable client accounts could significantly decline, which would adversely affect the value of their investment portfolios and could result in losses upon disposition or the failure of borrowers to satisfy their debt service obligations to such client account.

**Risks Associated with Commercial Mortgage Backed Securities (“CMBS”) Investments.**

Certain client accounts may acquire CMBS. In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the “first loss” subordinated security holder (generally, the “B-Piece” buyer) and then by the holder of a higher-rated security. In the event of default and the exhaustion of any equity support, reserve fund, letter of credit, mezzanine loans or B-Notes, and any classes of securities junior to those in which a client account invests, such account will not be able to recover all of its investment in the securities it purchases. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline and, as a result, less collateral value is available to satisfy interest and principal payments due on the related mortgage-backed securities. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic downturns or individual issuer developments.

With respect to the CMBS in which a client account may invest, overall control over the special servicing of the related underlying mortgage loans will be held by a “directing certificateholder” or a “controlling class representative,” which is appointed by the holders of the most subordinated class of CMBS in such series. Because a client account may acquire classes of existing series of CMBS, such account will not have the right to appoint the directing certificateholder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificateholder, take actions with respect to the specially serviced mortgage loans that could adversely affect a client account’s interests.

**Interest Rate Changes May Adversely Affect Value.** The market value of the client accounts’ investments may be affected by changes in interest rates. In general, the market value of a debt investment changes in inverse relation to an interest rate change where a debt investment has a fixed interest rate or only limited interest rate adjustments. Accordingly, in a period of declining interest rates, debt investments without adequate call protection may benefit less than other fixed income securities due to accelerated prepayments. For example, a property securing a commercial real estate collateralized debt obligation may bear interest at a fixed rate while the commercial real estate collateralized debt obligation may bear interest at a floating rate, which can lead to a floating/fixed rate or basis mismatch. As a result of such mismatches, an increase or decrease in the level of the floating rate indices could adversely impact the ability of such property to generate positive cash flow and make payments on the commercial real estate collateralized debt obligation. Interest rate changes may also affect a client account’s return on new investments. Increases in the interest rates on debt incurred by a client account in originating or acquiring investments may not be reflected in increased rates of return on the related investments, adversely affecting the client account’s return on those investments. Accordingly, interest rate changes may adversely affect the total return on a client account’s portfolio.

**Hedging Policies/Risks.** ACRE and certain other client accounts may employ hedging techniques designed to protect them against adverse movements in interest rates and other risks. While such transactions may reduce certain risks, the transactions themselves may entail certain other risks. Thus, while such client accounts may benefit from the use of these hedging



mechanisms, unanticipated changes in interest rates or other factors may result in a poorer overall performance for such client accounts than if they had not entered into such hedging transactions. If the hedging arrangements are terminated at any time in accordance with their terms, whether as a result of an event of default thereunder or otherwise, such client accounts may be liable to make a payment to or receive a payment from the hedging provider in connection with such termination reflecting the market value of the transactions comprising such hedging arrangements (or, in certain circumstances, the loss or gain, as applicable, of the party making the relevant determination). If such client accounts are required to make such a payment, it may be required to liquidate investments to fund any such payment.

**Investments Longer than Term.** Certain client accounts, including Wrightwood Funds, may hold investments with maturity dates later than the date on which the applicable client account is expected to be dissolved. Although investments are generally disposed of prior to dissolution, such accounts may be required to sell, distribute or otherwise dispose of investments at a disadvantageous time as a result of dissolution.

**Leverage.** Certain client accounts' return on investment is dependent upon their ability to use leverage. Such client accounts' ability to obtain the leverage necessary on attractive terms depends upon many factors including market conditions and the client accounts' performance. The failure to obtain leverage at the contemplated advance rates, pricing and other terms could have a material adverse effect on such client accounts. Leverage creates an opportunity for increased returns, but at the same time creates risks. There can be no assurance that such client accounts' use of leverage will prove to be beneficial. Moreover, there can be no assurance that such client accounts will be able to meet their debt service obligations and, to the extent that they cannot, such client accounts risk the loss of some or all of their assets or a financial loss if the client accounts are required to liquidate assets at a commercially inopportune time. In addition, the debt may be recourse for such client accounts so an impairment or potential impairment of an investment may create a risk of loss of some or all of their assets.

**Concentration of Portfolio Investments.** Certain ACREM client accounts may concentrate their investment focus on certain property types that are subject to higher risk of foreclosure or loss, or on properties (or investments secured by properties) concentrated in a limited number of geographic locations. To the extent that any client account's portfolio is concentrated in any one region or type of asset, downturns relating generally to such region (which may be adversely impacted by business layoffs or downsizing, industry slowdowns, changing demographics and other factors) or type of asset (such as oversupply of or reduced demand for industrial properties) may result in defaults on a number of investments within a short time period. There can be no assurance that the economy of the targeted areas will continue to grow or that any future growth will meet historical growth rates. These factors may reduce the client accounts' net income and adversely affect the funds available for distribution to investors by such ACREM client accounts.

**Third Party Involvement.** In certain situations, certain client accounts may (i) acquire only a minority interest in a company or other asset in which they invest, (ii) rely on independent third party management or strategic partners with respect to the operations of a company or other asset in which they invest or (iii) acquire only a participation in an asset underlying an investment, and therefore may not be able to exercise control over the management of such company or



investment. Certain ACREM client accounts may also co-invest with third parties through loan participations or partnerships, joint ventures or other entities, thereby acquiring non-controlling interests in certain investments. Such accounts may not have control over these investments and therefore, may have a limited ability to protect their positions therein. Property management decisions, including responding to changing market conditions, implementing rental or pricing structures and causing maintenance and capital improvements, can affect the net operating income of an income producing property and, in turn, the ability of such real estate property to generate adequate cash flow to meet debt obligations. Though the property management experience of property managers selected by ACREM may vary, ACREM does not retain a manager unless it believes that the manager is competent to manage the property. However, there is no assurance that the third party manager retained by a client account will competently manage the property. Accordingly, such investments may involve risks not present in investments where a third party is not involved, including the possibility that the participating lender or a third party partner or co-venturer may have financial difficulties resulting in a negative impact on such investment, may have economic or business interests or goals which are inconsistent with or adverse to those of the applicable client account, or may be in a position to take action contrary to the client account's investment objectives. In addition, a client account could in certain circumstances be liable for the actions of its third party partners, loan participants or co-venturers.

**Controlling Person Liability.** If the ACREM client accounts are required to foreclose or exercise other remedies on their security to protect their investment, they may have controlling interests in some of their investments in real estate companies. Other circumstances, such as the exercise of warrants or other interests acquired as part of an investment, could cause ACREM's client accounts to hold such controlling interests. The exercise of control over an entity can impose additional risks of liability for environmental damage, failure to supervise management, violation of government regulations (including securities laws) or other types of liability in which the limited liability characteristic of business ownership may be ignored. If these liabilities were to arise, the client accounts might suffer a significant loss.

**Risks Associated with Equity Ownership.** In certain circumstances, certain client accounts may acquire fee simple title to real estate or take a preferred equity or joint venture position in a property-owning entity (client accounts may also acquire an equity position if they foreclose on a loan as lender). In such a case, such client accounts' interests may be subordinate to both general and secured creditors of the asset. This subordination could increase such client accounts' risk of loss. Moreover, acquisition of preferred equity or joint venture interests involves certain risks not present in real property loans or direct property ownership. For example, there is the possibility that other equity owners may have economic or business interests or goals which are inconsistent with those of applicable client accounts.

**Inability to Re-Sell or Re-Lease Properties.** There is no assurance that ACREM's client accounts that own real estate or equity investments in real estate can re-lease a property, or successfully reposition the property for other uses, or that a replacement tenant or a different use would support the same or higher level of lease payments. Moreover, there can be no assurance that any tenant will elect to extend a lease upon expiration of its term, which would also force ACREM's applicable client accounts to find a suitable replacement tenant. For example, there

are existing leases at certain of the properties securing certain client accounts' investments that will expire during the terms of the related loans and there can be no assurance that such leases will be renewed or that, if renewed, the terms would be similar to or more favorable than the terms of the prior lease. If a property is not occupied or if rent is not being paid or is being paid in an amount that is insufficient to cover operating expenses, ACREM's client accounts could be required (or elect) to expend funds with respect to that property, including expenses relating to taxes, insurance, utilities and maintenance of the property, as well as leasing commissions and costs to improve the property to enhance its marketability or to meet the requirements of a new tenant. ACREM's client accounts that own real estate or equity interests in real estate may or may not be able to sell a property if or when they decide to do so. ACREM cannot predict whether they would be able to sell any property for the price or on the terms they set, or whether any price or other terms offered by a prospective purchaser would be acceptable to such client accounts. ACREM cannot predict the length of time needed to find a willing purchaser and to close the sale of a property. ACREM's applicable client accounts may not be able to sell a property "as is," in other words, they may be required to expend funds to correct defects, such as defects related to the environment, health or safety or maintenance or repair. ACREM's client accounts may also be required to make improvements before a property can be sold. There is no assurance that ACREM's client accounts will have funds available to correct defects or make improvements. Furthermore, the expenditure of funds to correct defects or make improvements may adversely affect the funds available for investment by ACREM's client accounts and cash available for distribution to the partners.

**Risks Associated with Environmental Liabilities Arising from Foreclosed or other Properties.** To the extent client accounts own real estate or foreclose on properties with respect to which they have extended mortgage loans, such client accounts may be subject to environmental liabilities arising from such foreclosed properties. Under various U.S. federal, state and local laws, an owner or operator of real property may become liable for the costs of removal of certain hazardous substances released on its property. These laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances. The presence of hazardous substances may adversely affect an owner's ability to sell real estate or borrow using real estate as collateral. To the extent that an owner of a property underlying a client account's debt investments becomes liable for removal costs, the ability of the owner to make payments to us may be reduced, which in turn may adversely affect the value of the relevant mortgage asset held by such client account. The presence of hazardous substances on a property may adversely affect a client account's ability to sell foreclosed or other property and the client account may incur substantial remediation costs.

## Item 9 - Disciplinary Information

Neither ACREM nor any of its management persons has been the subject of any material legal or disciplinary proceedings that are material to a client's evaluation of our business or the integrity of our management.

## Item 10 - Other Financial Industry Activities and Affiliations

### ***Registered Broker-Dealers***

Ares Management has a wholly owned limited broker-dealer subsidiary, Ares Investor Services LLC (“AIS”) which filed its initial registration with FINRA on March 14, 2013. ACREM’s Chief Compliance Officer, will be a registered representative of AIS. The registration of such broker-dealer will not result in any relationship or arrangement that is material to ACREM or its clients.

### ***Registered Futures Commission Merchants, Commodity Pool Operators and Commodity Trading Advisors***

Neither ACREM nor any of its management persons is registered as a registered futures commission merchant, commodity pool operator or commodity trading advisor.

### ***Relationships with Related Persons***

Ares Management, the parent company of ACREM and an SEC-registered adviser, is also the parent company of Ares Capital Management LLC (“ACM”), an SEC-registered investment adviser and the investment manager of Ares Capital Corporation (“ARCC”), a closed-end, non-diversified specialty finance company that is regulated as a business development company under the Investment Company Act. ARCC directly or indirectly also owns 100% of the equity and voting interests of its portfolio company, Ivy Hill Asset Management, L.P. (“Ivy Hill”), an SEC-registered investment adviser. Ares Management is also the parent company of (i) Ares Capital Management II, LLC (“ACM II”), an SEC-registered investment adviser and the investment adviser of Ares Dynamic Credit Allocation Fund, Inc. (“ARDC”; NYSE:ARDC), a non-diversified closed-end management investment company that filed a registration statement on Form N-2 which became effective in November 2012, and (iii) Ares Management Limited (“AML”), an entity formed in the United Kingdom and authorized by the UK Financial Services Authority. AML is the investment adviser to several private funds.

ACREM’s related parties also include affiliates of Ares Management’s that are investment advisers to all of Ares Management’s clients and funds and are the general partners and, in many cases, limited partners of such funds.

ACREM and its related persons are the sponsors and, in certain cases, may also be investors in various collective investment vehicles managed by ACREM. Certain ACREM personnel may spend substantially all of their business time on one or more of the foregoing collective investment vehicles as required pursuant to the terms of the relevant Governing Documents.

In the event that an investment opportunity that ACREM evaluates for potential investment by its clients is an eligible investment for more than one client, it is ACREM’s policy that all investment opportunities will, to the extent practicable, be allocated among its clients on a basis that over a period of time is fair and equitable to each client relative to other clients, taking into account all relevant facts and circumstances. See discussion under Item 6 – “*Performance-Based Fees and Side-by-Side Management*” above for more detail on ACREM’s allocation policy.

Principals, officers and employees of ACREM (“Covered Persons”), members of their families and related persons of ACREM may participate directly or indirectly as investors in certain collective investment vehicles managed by ACREM as described in the Governing Documents of such collective investment vehicles, which investments may be in privately negotiated transactions at varying prices. ACREM may recommend to clients the purchase or sale of securities in which it, or a Covered Person or related person thereof, has a financial interest. In addition, ACREM permits its Covered Persons to engage in personal securities transactions, subject to compliance with its Code of Ethics.

For a general discussion of how we address resulting conflicts of interest, see discussion under Item 11 – “Code of Ethics” below.

### ***Selection or Recommendation of Other Advisers***

ACREM does not recommend or select other third-party investment advisers for its clients. Except for Ares Management, ACREM’s parent, ACM, ACM II, AML, each a wholly owned subsidiary of Ares Management, and Ivy Hill, ACREM does not have business relationships with other advisers that create a material conflict of interest.

## **Item 11 - Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### ***Statement of Business Ethics and Code of Ethics***

Ares Management has adopted an Ethics Policy (the “Code”) pursuant to Rule 204A-1 under the Advisers Act that applies to ACREM and sets forth standards of business and fiduciary conduct that the ACREM requires of Covered Persons. The Code is reasonably designed to minimize actual or potential conflicts of interest between Covered Persons and the interest of the ACREM, its clients and prevent violation of federal securities laws. The Code includes, among other things, a) policies and procedures regarding personal securities transactions; b) disclosure and reporting obligations of outside business activities, personal securities transactions and holdings; and c) obligations for Covered Persons to report any violations of the Code to the Chief Compliance Officer (“CCO”). Any client or prospective client or investor or prospective investor in ACRE, a Wrightwood Fund, the CDO or other client account managed by ACREM may obtain a copy of the Code upon request.

### ***Participation or Interest in Client Transactions; Personal Trading***

The Code provides that no Covered Person may, in breach of any fiduciary duty he or she owes to client accounts advised or managed by ACREM, engage directly or indirectly in any business in a manner detrimental to the clients or use confidential information gained by reason of his or her employment by or affiliation with Ares Management in a manner detrimental to clients. The Code requires that before, or at the time that, a Covered Person recommends or authorizes the purchase or sale of a covered security by a client, he or she must disclose to the CCO: a) any beneficial ownership in such covered security that he or she has or proposes to acquire; b) any interest he or she has or proposes to acquire in any third party account in which such covered security is held; c) any beneficial interest in any other security that may benefit from such

proposed purchase, sale or other action; and d) any interest in or relationship with the issuer of such covered security that he or she has or proposes to acquire.

The Code covers personal trading policies and procedures of all Covered Persons and their “covered family members” (as defined in the Code). Under the Code, Covered Persons and their covered family members are permitted to trade in securities for their own accounts so long as they follow the Code, which contains preclearance procedures, reporting requirements and other provisions that restrict trading by Covered Persons. Generally, for all “covered securities” transactions in a Covered Persons or a covered family member account, Covered Persons are required to obtain preclearance approval from the Compliance Department. Covered securities purchased by a Covered Person or a covered family member are generally subject to a minimum holding period. The Code also requires that all covered securities holdings and transaction information in covered securities accounts be disclosed to the Compliance Department. Any transactions in securities or investments that are held by one or more clients are generally subject to a blackout period of two business days after any client has traded in any security of that issuer. The Code’s personal trading procedures are administered by the Ares Management’s Compliance Department.

### *Other Potential Conflicts*

ACREM and its related persons may, directly or through one or more entities, sell securities in which they have a direct or indirect ownership interest to certain collective investment vehicles managed by ACREM in connection with certain “warehousing” transactions, provided that the sale is consistent with ACREM’s fiduciary obligations to such collective investment vehicles. Such transactions will be fully disclosed in writing, and the written consent of the appropriate collective investment vehicle (which, in certain circumstances, may be provided by a collective investment vehicle’s advisory committee) will be obtained prior to the consummation of any such transactions in accordance with Section 206(3) of the Advisers Act and all other applicable state and federal securities laws.

ACREM’s principals may invest or transact with certain collective investment vehicles managed by ACREM, as described in the applicable Governing Documents.

## **Item 12 - Brokerage Practices**

Subject to the investment objectives, policies and restrictions of each client account as set forth in the Governing Documents thereof, ACREM has discretionary authority to determine the type, amount, and price of securities and investments to be bought and sold on behalf of each client account, including the selection of, and commissions paid to, brokers.

ACREM typically originates and engages in privately negotiated transactions directly with borrowers and does not utilize broker-dealers to effect portfolio investments. However, in certain transactions, including but not limited to investments in CMBS and CRE CDO bonds, ACREM may effect transactions through a broker-dealer. In selecting broker-dealers to effect transactions, ACREM seeks to obtain best execution by considering various factors including, but not limited to, price (including the applicable brokerage commission or dealer spread), size of order,

timeliness and certainty of execution, liquidity of the securities traded, expertise as it relates to specific securities, counterparty risk and business reputation. While ACREM generally seeks reasonably competitive trade execution costs, a client account will not necessarily pay the lowest spread or commission available.

### ***Research and Other Soft Dollar Benefits***

Section 28(e) of the Securities Exchange Act of 1934 (the “Exchange Act”) provides a safe harbor that permits advisers, when selecting brokers to execute transactions for client accounts, to take into account certain research products and services provided to the adviser by brokers. ACREM does not engage in soft dollar arrangements.

ACREM will not consider, in selecting or recommending broker-dealers, whether it will receive client referrals.

ACREM does not permit clients to direct brokerage.

### ***Trade Aggregation***

To the extent ACREM invests in CMBS for its client accounts, it may aggregate orders. Under ACREM’s policy respecting aggregation of orders, orders for the same investment, including acquisition and disposition transactions, entered on behalf of more than one client may be aggregated (i.e., blocked or bunched), subject to the aggregation being in the best interests of all participating clients. The trade order must indicate the amount or percentage of the trade intended to be allocated to each participating client. If the final allocation differs from the initially indicated allocation or is not allocated on a pro rata basis for partially filled orders, except in the case of de minimus changes in the allocations, a written rationale must be provided in the allocation statement.

## **Item 13 - Review of Accounts**

### ***Review of Client Accounts***

ACREM monitors all portfolio investments on behalf of each client account on an ongoing basis. Investments are reviewed in the context of each client account’s (i) adherence to the investment objectives and guidelines as set forth in its Governing Documents and (ii) investment performance. Subsequent to an investment, each position is monitored on an ongoing basis by at least one investment professional. The monitoring may include ongoing dialogue with a borrower’s management, property management personnel, leasing agents, financing sources, rating agencies, competitors, and/or other industry sources. In addition, a client’s investments as well as a client’s overall performance and adherence to its investment mandates and restrictions are monitored on an ongoing basis by senior investment professionals, including portfolio managers.

### ***Reports to Clients***

ACREM provides periodic reports to investors in collective investment vehicles it manages as required by the applicable Governing Documents. Investors in such collective investment



vehicles should refer to the applicable Governing Documents for further information regarding the types and substance of the reports provided to such investors.

The Governing Documents of, or U.S. federal securities laws applicable to, collective investment vehicles managed by ACREM require annual audited financial statements to be distributed to the investors in such collective investment vehicles. Furthermore, ACREM also generally provides on a periodic basis (typically, quarterly), unaudited performance and financial reports written to investors in such collective investment vehicles. In connection with the delivery of such periodic reports, ACREM may be required by investors in certain investment vehicles managed by ACREM to make the appropriate personnel available to present the reports and answer questions in respect thereof, or to make additional reasonable presentations and reports.

ACREM distributes federal income tax-related schedules and information to investors, where applicable, and provides certain other reports and analyses to investors and potential investors upon request.

Finally, ACREM may hold annual investor meetings and calls and other interim calls as appropriate for certain collective investment vehicles it manages.

## Item 14 - Client Referrals and Other Compensation

### *Economic Benefits Received from Third Parties*

In connection with investments made by certain client accounts, ACREM or its related persons may receive commitment, structuring, monitoring and/or other transaction fees from portfolio investments in which ACREM and client other accounts may invest or propose to invest. The potential for ACREM and its related persons to receive such economic benefits may create conflicts of interest as ACREM and its related persons may have economic incentives to invest in portfolio investments that provide such benefits. To mitigate potential conflicts, such benefits received by ACREM in connection with its services related to portfolio companies or transactions are generally offset against advisory fees payable by the related client account.

### *Third Party Compensation for Client Referrals*

Any of the collective investment vehicles managed by ACREM may impose sales charges to compensate unaffiliated broker-dealers who assist in obtaining subscriptions. The sales charge may be payable by investors, one or more of such collective investment vehicles, the general partner (or equivalent thereof) of a collective investment vehicle, ACREM or a combination thereof. In addition, ACREM may compensate third parties who refer prospective or actual investors to any collective investment vehicle managed by ACREM.

Certain of the solicitors or placement agents utilized to market the collective investment vehicles managed by ACREM as well as individuals employed by such solicitors or placement agents, may from time to time invest in one or more such collective investment vehicles and may not pay, or pay reduced, advisory fees with respect to their investment(s) in such collective investment vehicles. In addition, ACREM may transact client orders through broker/dealers that also act as solicitors or placement agents for its collective investment vehicles.

ACREM endeavors at all times to put the interests of its client accounts first as part of ACREM's fiduciary duty. Nevertheless, the receipt of compensation by placement agents and the potential receipt of brokerage commissions by broker-dealers create potential conflicts of interest and may affect the judgment of placement agents and broker-dealers when making referrals to collective investment vehicles managed by ACREM. Moreover, potential conflicts of interest may arise between the interests of such collective investment vehicles in obtaining best price and execution and ACREM's interest in receiving future referrals to such collective investment vehicles from certain broker-dealers. ACREM addresses these potential conflicts of interest by seeking to obtain best execution by considering factors set forth in the sub-section titled "*Brokerage Practices*" above.

## Item 15 - Custody

It is ACREM's general policy to not have physical custody of any client assets. However, ACREM may be deemed to have custody of the assets of certain collective investment vehicles it manages because of the authority it or a related party has over such collective investment vehicles or their assets. It is ACREM's policy generally to cause each collective investment vehicle with assets over which ACREM is deemed to have "custody" to be audited annually and to distribute audited financial statements, prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), to investors no later than 120 days after the end of each fiscal year. In addition, upon the final liquidation of any such collective investment vehicle, ACREM will obtain a final audit and distribute audited financial statements prepared in accordance with GAAP with respect to such Fund to all investors promptly after completion of the audit.

In the alternative, where ACREM is deemed to have custody of a client account solely due to its ability to withdraw client funds to pay its advisory fees, ACREM may comply with the custody rules under the Advisers Act by having a reasonable belief that a qualified custodian will send quarterly account statements to each investor or client. ACREM urges all clients and investors to compare the reports they receive from ACREM to the statements they receive from their custodians. Any issues or discrepancies should be communicated to ACREM promptly.

## Item 16 - Investment Discretion

Subject to the investment objectives, policies and restrictions of each client account managed by ACREM, as set forth in the Governing Documents thereof, ACREM has discretionary authority to determine the type, amount and price of securities and investments to be bought and sold on behalf of each such collective investment vehicle, including the selection of, and commissions paid to, broker-dealers.

## Item 17 - Voting Client Securities

Client accounts managed by ACREM may infrequently acquire voting securities. In instances where a client account owns equity securities in which it has the right to vote via shareholder proxy (each a "Voting Security"), ACREM generally retains proxy voting authority with respect to these Voting Securities. Ares Management has adopted and implemented written Proxy

Voting Policies and Procedures (“Proxy Voting Procedures”) that are applicable to its affiliates, including ACREM, and are designed to reasonably ensure that ACREM votes proxies in the best interests of its advisory clients for whom ACREM has voting authority.

The Proxy Voting Procedures describe the positions ACREM generally takes in voting proxies on particular issues and require ACREM to keep records with respect to the votes cast.

The Proxy Voting Procedures also provide that, in the event a particular proxy vote would involve a conflict between the interests of ACREM and its affiliates, and those of one or more clients of ACREM, ACREM, if it so elects, may:

- vote in accordance with the recommendations of a disinterested third party;
- refer the voting decision to the client; or
- abstain from voting.

Clients may obtain a copy of Ares Management’s Proxy Voting Procedures or information about how ACREM voted client proxies by contacting Ares Management’s Compliance Department at (310) 201-4100.

## Item 18 - Financial Information

Not Applicable.