Blackstone Mortgage Trust Second Quarter 2022 Investor Call
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I would like to advise everyone that this conference is being recorded. And with that, I am handing over to Weston Tucker, Head of Shareholder Relations.

Weston Tucker: Terrific. Thank you and good morning and welcome to Blackstone Mortgage Trust's second quarter conference call. I am joined today by Mike Nash, Executive Chairman; Katie Keenan, Chief Executive Officer; Austin Peña, Executive Vice President, Investments; Tony Marone, Chief Financial Officer; and Tim Hayes, Shareholder Relations.

This morning we filed our 10-Q and issued a press release with a presentation of our results, which are available on our website and have been filed with the SEC. I'd like to remind everyone that today's call may include forward-looking statements which are uncertain and outside of the company's control. Actual results may differ materially. For a discussion of some of the risks that could affect results, please see the Risk Factors section of our most recent 10-K. We do not undertake any duty to update forward-looking statements. We'll also refer to certain non-GAAP measures on the call. And for reconciliations, you should refer to the press release and our 10-Q. This audio cast is copyrighted material of Blackstone Mortgage Trust and may not be duplicated without our consent.

For the second quarter, we reported GAAP net income per share of $0.55, while distributable earnings were $0.67 per share. A few weeks ago, we paid a dividend of $0.62 per share with respect to the second quarter. If you have any questions following today's call, please let Tim or I know.

And with that, I'll now turn things over to Katie.

Katie Keenan: Thanks, Weston. BXMT's standout results this quarter are a testament to the resilience of our business model, even in turbulent markets. Despite a backdrop characterized by widespread volatility, tighter financing availability, and slowing real estate transaction volume, we generated higher distributable earnings, grew our portfolio, and increased our liquidity position, all while maintaining our strong credit quality. These results underscore the four key advantages I outlined last quarter, which positioned BXMT exceptionally well to outperform in today's environment.

First, as a floating rate lender, our earnings are enhanced, not pressured, by rising rates. Second, we have defensive assets. Our low-leverage senior loans have strong downside protection and well-capitalized sponsors, supporting credit performance in a wide range of macro scenarios. Third, Blackstone's unparalleled real estate platform gives us access to the broadest pipeline of investment opportunities globally and the tools to select the most compelling among them. And fourth, our continued access to a wide variety of capital sources across asset-level and corporate markets allows us to capitalize our investments accretively and continuously enhance the diversity and stability of our balance sheet. The real-world impact of these dynamics proved out in our results this quarter and we expect they will continue to power our business forward.

Starting with earnings, we achieved $0.67 per share of distributable earnings for the second quarter, up from $0.62 last quarter. The combination of a fully-scaled portfolio and higher interest rates is yielding a strong, growing earnings stream, covering our dividend by 108%. Our business has several inherent benefits that support the stability and expansion of this income. Because our portfolio is match-funded, we lock in an attractive levered spread but also benefit as base rates increase and drive earnings higher in our floating-rate loan portfolio. And our income generation is not dependent on the pace of new deal activity. In periods when transaction volume slows like today, we see fewer originations but also fewer repayments, allowing us to remain optimally invested.

The reliability of this income stream is further underpinned by our continued credit performance, a function of our rigorous asset selection and underwriting process, informed by the deep knowledge and experience of the Blackstone real estate platform. We have long been focused on constructing a portfolio of assets that would be resilient in periods of inflation and volatility. We did this by creating multiple layers of protection for our senior loan investments. First, lending on high quality assets in sectors and markets where NOI growth can outpace rising rates. Second, lending at low leverage points, well insulated in a variety of performance scenarios. And third, lending to sophisticated, well-capitalized sponsors with the experience to execute business plans that grow cash flows over time, and the wherewithal to financially support their assets further if needed, behavior that was clearly demonstrated during the COVID period, when our sponsors invested over $500 million in new cash equity to weather the storm.

At present, though, we are far from the disruption of two years ago. While the capital markets are challenged, on-the-ground real estate fundamentals remain strong. Previous downturns were characterized by overleverage and overbuilding. Today, we have neither. Demand in our high-conviction sectors is at historically strong levels and supply is ever more constrained by rising replacement cost. In our multifamily portfolio, which represents $7.6 billion of our post-COVID originations, income growth continues to be driven by a pronounced supply-demand mismatch, which is only widening in the face of rising cost to build and higher mortgage rates for potential homebuyers. In our portfolio, this has translated to a 90bp increase in debt yield on average between closing and today, indicating robust growth in cash flows which support property values despite cap rate widening.

For hospitality assets, we continue to see improving fundamentals for drive-to and fly-to resorts, with RevPAR well above 2019 levels in our loan portfolio, consistent with broader market strength. While urban hotels still lag, the acceleration in international and corporate travel has driven RevPAR in those assets nearly back to 2019 levels, creating largely positive debt service coverage in recent months. And while headwinds in the office sector are apparent, so too is the clear outperformance of the newer well-amenitized assets we focus on.

In just one example, CBRE data shows that Class A properties nationwide have posted positive 6.7% net effective rent growth year-to-date versus negative 1.1% for Class B and C. Our 91% Class A portfolio is seeing continued tenant demand and leasing activity, with business plans progressing. This performance is also apparent on the capital market side with $3.6 billion of office loan repayments over the last 12 months, of which $2.2 billion were in New York City, San Francisco, Chicago, L.A. or D.C., core urban markets that, while challenged, continue to show tenant and investor demand for high-quality office assets.

The impact of these dynamics came through in our portfolio this quarter as we upgraded 19 loans and had no downgrades. From an interest coverage perspective, 90% of our loans have in-place cash flows that cover debt service at second quarter rate levels or have structural enhancements to provide further support, like carry guarantees or significant interest reserves. More notably, in a scenario where rates rise another 200bps, this figure is still 77%, conservatively assuming no incremental NOI growth.

And from a value perspective, we start at a well-insulated basis of 64% LTV, implying 36 points of cushion going in, with the added benefit of lending on transitional value-add business plans that should further de-risk our position over time. Indeed, for 15 loans that repaid over the last 6 months, exit valuations implied an average reduction of about 14 points in our LTV over the 3.6-year average period of our loans. While rising rates, inflation and continued macro pressures will create headwinds for overall real estate performance, we believe our portfolio of senior loans is well positioned to withstand this turbulence.

Turning to new investments, the market environment today has changed considerably since our last call but remains attractive for strong, well-capitalized lenders like BXMT. Capital markets dislocation has pushed CMBS originators, mid-sized debt funds, and even many banks out of the market, clearing the field and creating a compelling competitive dynamic. Against this backdrop, we have drawn on our global platform to identify investments that fit our stringent risk and return criteria.

Based on this approach, we originated $3 billion of new loans this quarter, headlined by two large-scale, low-leverage transactions on trophy-quality real estate. The first was a $913 million senior loan representing 24.5% of a $4 billion 54% loan-to-cost financing for Blackstone's acquisition of Crown Resorts which owns the market-dominant, highest-quality hotel casinos in Australia.

As the world reopened following COVID, leisure travel rapidly recovered, resuming the long-term positive trend of growing travel and experience spending globally. Blackstone has tremendous experience, bringing both investment and human capital to drive hospitality assets to their full potential, most recently with the Cosmopolitan in Las Vegas. And Crown represents a similar opportunity to materially improve operations and performance. The credit of the loan is similarly compelling, senior to $3.5 billion of new cash equity and a 56% discount to replacement costs in irreplaceable A+ assets.

Our second large loan of the quarter also reflects our focus on top sponsorship and asset quality. In June, we closed a 62% loan-to-cost, $675 million financing for Waller Creek, a best-in-class new development in Austin, Texas, the fastest-growing major metro area in the U.S. The mixed-use property, including multifamily, office and hotel components, will feature best-in-market amenities and strong ESG characteristics, including LEED gold and WELL bronze standards and a carbon-neutral commitment from the hotel operator, an important differentiator for tenants and institutional investors. Our loan sponsor is a partnership between PSP, a top Canadian pension fund and repeat construction loan borrower, as well as Lincoln Property Company and Kairoi Residential, experienced best-in-class developers.

Given our expertise in large-scale complex developments, we were able to structure an attractive low-leverage loan on this flagship real estate project. Altogether this quarter, our loans reflected our high bar for new investments in the current environment, targeting lower risk at compelling returns.

Second quarter new originations averaged 59% LTV and a 4.40 all-in yield over base rates, concentrated in sectors well positioned to outpace inflation such as hospitality, multifamily, industrial and new build office. Going forward, our approach remains patient and selective as we weigh current opportunities against those in the future and preserve our dry powder for particularly compelling investments. As a result, we expect the pace of our investing to slow in the near term, given our investment outlook, coupled with the overall reduction in market transaction activity. Fortunately, our earnings power is amply supported by the well-invested portfolio we have in the ground today.

Moving to the right side of our balance sheet, as always, our investing activity was supported by our strong access to asset-level financing as well as corporate capital, where we continue to execute efficiently despite significant dislocation across the market as a whole. Through our track record of credit performance and responsible borrowing, we have developed deep relationships with large banks around the world, who continue to support our business as they consolidate lending activity to their strongest clients. This quarter, we added $1.9 billion of financing capacity with both new and existing core relationships across credit facility and syndicated execution. We now have 14 credit facility lenders as well as numerous syndication partners, a diversification of financing sources that is particularly valuable in a market where liquidity is scarce.

On the corporate side, we have been active raising capital, over $800 million in the first half of the year, while also extending the overall tenor of our liability structure. In May, we retired $338 million of converts and raised $500 million of seven-year duration Term Loan B. As a result of our forward-looking approach, we ended the second quarter with over $1.5 billion of liquidity and no material corporate debt maturities until 2026, putting us on strong footing to manage our portfolio and address investment opportunities as they arise.

In closing, in an uncertain environment, BXMT remains a steadfast partner to our borrowers who trust us with their most important transactions, our lenders who know us as a reliable steward of their debt capital, and our shareholders, for whom our commitment to preservation of capital and responsible investing has produced a strong, consistent, and well-covered dividend for nearly a decade. Our low-leverage performing loan portfolio continues to generate strong income with tailwinds for growth, attractive current return which is ever more valuable amidst today's volatility. And though the backdrop will likely remain uncertain for some time, our business is sound, with well-protected assets, strong liquidity, a stable balance sheet, and a powerful earnings stream.

Before turning it over to Tony, I would also like to thank Doug Armer, who will be leaving us shortly to pursue other opportunities. Doug has been instrumental in building BXMT's business and operations since inception and has been a wonderful partner to me and the rest of the BXMT team over the years. Thank you, Doug, for your tremendous contributions to BXMT and we wish you all the best in your future endeavors. Tony?

Tony Marone: Thank you, Katie, and good morning, everyone. This quarter's results reflect the strong tailwind to BXMT's earnings in the current rising rate environment, set against the backdrop of portfolio and balance sheet stability as we enter more challenging market conditions.

We reported GAAP net income of $0.55 per share and diluted GAAP earnings of $0.54 per share. As we discussed last quarter, this diluted earnings metric is the result of a new accounting standard that requires us to assume all convertible notes will be settled in shares and therefore dilute earnings prospectively. We continue to believe that basic EPS is a better indicator of our performance than our diluted earnings. Our distributable earnings per share for the quarter was $0.67 which is up $0.05 from 1Q as a result of incremental portfolio growth and the early-stage impacts of rising interest rates on our portfolio. As an index-matched floating rate lender, we will continue to benefit from rising rates with an incremental 100bp increase in base rates, translating to $0.15 of annual earnings, assuming all else equal.

Of course, underpinning the earnings growth this quarter is the stable credit performance of our loan portfolio. We have no new impairments, nonaccrual loans, or risk rating downgrades this quarter and our portfolio LTV of 64% and average risk rating of 2.8 remains consistent with 1Q levels. As Katie noted earlier, the types of assets we lend against, with transitional business plans that can adapt to changing conditions, are well suited to perform in the current market environment.

Another point of consistency this quarter is our book value per share, which is effectively flat at $27.17, despite an $0.08 increase in our CECL reserve. The CECL adjustment reflects incremental uncertainty in a macro environment for this forward-leaning, life of loan loss reserve calculation and is not reflective of any particular credit concerns in our portfolio. A more conservative CECL reserve was offset by retained earnings generated by our strong dividend coverage which contributed to book value.

In addition, despite significant turbulence in foreign currency markets this quarter, we experienced virtually no impact on our earnings or book value. This is a result of our consistent approach to programmatically finance our investments in local currency and hedge our net foreign currency investment in each loan.

On the investment front, we closed $3 billion of new loans, funded $2.8 billion, outpacing repayments of $1.4 billion. Those metrics are roughly in line with 1Q levels, though below our 2021 run rate, as we have seen a decline in transaction volume generally and have been more selective in deploying our capital in recent months. It is important to note that our pace of originations and repayments generally trend upward or downward together, allowing us to maintain the earnings power of our large-scale portfolio. Similarly, our asset yields and borrowing costs follow similar market trends, producing stable, attractive net ROIs for our stockholders. This quarter, we closed $2.5 billion of asset-level financings, including $1.6 billion through our credit facilities and $897 million of securitization. Despite a generally less liquid banking sector, our credit facility lenders continue to finance new investments given our proven track record as a strong partner for our lenders.

Looking at our 2Q financing, banks are effectively lending at a 49% look-through LTV to the underlying real estate, providing an attractive low-risk investment opportunity for them. Our incremental syndications this quarter bring us to $1.3 billion of syndications year-to-date which are inherently stable, non-recourse, non-debt financing structures that provides structural leverage to our senior mortgage loan position.

As Katie noted, we repaid $338 million of convertible notes that matured in April, which pushes our remaining corporate debt maturities out to 2026 and beyond, other than a small $220 million of convertible notes maturing next year. Combined with our asset-level financings that are term-matched by design, we therefore have very little duration risk on our liabilities as we enter a period of potentially reduced market liquidity, providing a reliable overall capitalization for our business. In addition, we borrowed an incremental seven-year $500 million Term Loan B in May which contributed to our $1.5 billion of liquidity at quarter end. This capital provides further insulation against potential market volatility, but more importantly is available to deploy into an attractive lending environment, where we see an advantageous backdrop to achieve premium risk-adjusted returns.

Our growing earnings more than support our $0.62 dividend. And with the stability of our portfolio and capital structure, we are well positioned as we move into the latter half of 2022. In today's tougher market conditions, we believe businesses with a strong track record and positive fundamentals will outperform and we look forward to BXMT generating strong, reliable returns for our stockholders.

Lastly, I would like to echo Katie's comments of thanking Doug for his partnership over the years. Doug, best of luck to you in the future from the entire BXMT team.

With that, I'll ask the operator to open the call for questions.

Operator: Just a reminder, to ask a question, please press star-one. To withdraw a question, press star-two. Please make sure to ask one question only. If you would like to have a follow-up question, press star-one again to get into the queue.

Our first question is coming from Stephen Laws from Raymond James.

Stephen Laws: Katie, I appreciate the comments around the pipeline, the originations. I wanted to see if you could touch on kind of the relative attractiveness here in the States versus in UK and Europe, maybe how that's shifted respectively over the last few months and how you guys have responded with your originations in those regions.

Katie Keenan: Sure. Thanks, Stephen. I think that generally we're taking a very high bar sort of collective approach globally, and our goal is to create the broadest pipeline we can and be very selective within that pipeline to get the most compelling opportunities. I think in terms of relative value, the U.S. has become perhaps a little bit more attractive on a relative basis versus Europe as compared to years ago. I think that really speaks to the competitive dynamic, the CMBS dislocation, and the sort of broader impact with that in the US financing market are more pronounced because CMBS is such a more relevant part of the US market as compared to Europe, for example. So, I think that's created a lot of dislocation on the competitive side which has, as I said in the remarks, sort of cleared the field for lenders such as ourselves who are active and well-capitalized.

Stephen Laws: Great. And as a follow-up, to touch on your comments about it's pretty competitive out there for financing – you guys have recently been able to put more in place – can you talk about kind of opportunities to continue growing the non-mark-to-market financing facilities while certain securitization markets are really not an option at this point?

Katie Keenan: Absolutely. I think that we have been evolving the structure in terms of our financing structure over time. With each new deal we do, we improve the terms. That's just sort of in our nature, always trying to strive for better. So, I think that given our track record as a borrower, given our bank relationships, we've really been able to sort of push the envelope in terms of structure as a result of the fact that we have these very high-quality, well-performing, diversified facilities that we can use in different ways to create advantageous financing structures that are really attractive to the banks and also attractive from our balance sheet perspective.

Stephen Laws: Great. I appreciate the comments this morning, Katie.

Katie Keenan: Thank you.

Operator: The next question is from Don Fandetti from Wells Fargo.

Don Fandetti: Hi. Good morning. Can you talk a little bit about the – it looks like the allowance went up. Can you maybe provide some color on what assumption you're making for CECL? Is it a recession-type scenario? And then secondarily, what are you seeing on property values in commercial real estate? It seems like values are coming down at a decent clip in certain markets.

Tony Marone: Sure, Don. I'll start on your CECL question. So, as I covered in the remarks, when we were going through our CECL process this quarter, sort of looking at the market, we felt that it was prudent to nudge up the general reserve to reflect the incremental uncertainty. We're not per se modeling a recession. When you think about the different qualitative judgments you make in setting the CECL reserve and you compare what we are doing this quarter to COVID, for example, we were making more conservative assumptions around the macro environment in 2020 and sort of transitioning into early 2021. In this quarter, as we sort of looked at the world, we felt like it made sense to move back a partial step. So not anything super, super conservative like a recession but we did think it made sense to notch up the macro conservatism a little bit.

Katie Keenan: I think on property values, if you look across the overall market, clearly, the impact of rising rates is going to have an impact on property values. But I think the key is the impact isn't felt evenly across all different types of assets. If you think about where you want to be in this environment, it's hard assets with short-duration leases where you can see growth. And that growth is really sort of the third variable when you think about the impact of rising rates, rising cap rates, and property value. We're not lending on the market. We're lending on individual assets that we've selected with a view towards inflation. And I think that, combined with the insulation that our 64% LTV credit position provides, makes us feel very good about whatever volatility is happening in property values being removed from our basis in the assets. But I think in general, across the market, clearly, particularly for assets that have more long-duration cash flows with less growth, the impact in cap rates is certainly going to be negative for property values.

Don Fandetti: Thanks, Katie.

Operator: The next question is coming from Jade Rahmani from KBW. Please go ahead.

Jade Rahmani: Thank you very much. Good to speak with you. Katie, as you're approaching managing this $25 billion portfolio, can you give us some sense as to what your dashboard looks like, what your primary focus is at this point in time? Is it defense? Is it opportunistic, which was mentioned a couple of times in the slide deck? Is it even portfolio rotation into those resilient asset classes with the favorable rent growth characteristics? And finally, is it also engagement with borrowers to make sure the asset management function is performing up to your expectations? How do you approach that?

Katie Keenan: Sure. I think it will probably come as no surprise that the answer is all of the above. We are really fortunate to manage this business with the backbone of a tremendously talented and deep team on the origination side, the asset management side, portfolio management, data analytics. And we have invested tremendously in those areas over the last several years to really make sure that we have great real-time information as to what's going on in our portfolio, both to inform our new investment decisions and make sure we're accelerating in those areas where we see more growth, as well as be proactive and really understand exactly what's going on in our existing portfolio in real time.

So, I think that having the information and the organization of the information within our platform here, both on the BXMT portfolio specifically but also more broadly across the overall Blackstone real estate platform puts us in a tremendously advantaged position as things are changing because it allows us to be really up to the minute in terms of what's going on in the market and manage our investment decisions and our borrower discussions with that information in mind.

Jade Rahmani: Thank you. In terms of the transitional lending business, you did mention CMBS, the dislocation there, but is there a loan yield, a treasury yield, or a spread you think is most insightful at this point in time? CMBS spreads are near record highs, expressing dislocation in that space. The CLO market is also in turmoil, avalanched by excess supply, but also demand is weak in that space. So, there is some flow-through pricing impact to the transitional lending market that we should be aware of. But what do you think we should be looking at in terms of a yield, in terms of a spread as indicative of the health of this business?

Katie Keenan: I think that if you look at public markets generally relative to private markets, they tend to be a lot more volatile for obvious reasons. It's just a market that has more technical aspects around supply-demand. It creates more volatility in terms of the prints of deals, one after another. That's true in the REIT market; it's true in the CLO market, the CMBS market. And I think the private markets really are generally just a lot more stable on both sides of the coin.

So, I think that looking at private market dynamics, whether it's where we've been originating loans or our peers or other sort of private market data points is probably more indicative of the broader health of the real estate debt market. And again, I think it really – when we think about sort of credit performance, it really comes down to LTV's and values. I think that when we're talking about transitional lending, there have been spread moves. But when you think about the ability of business plans that are creating value and cash flow growth over time to withstand the type of spread movements we're talking about as – we provided some information on that in our portfolio, but I think in general, these are sophisticated borrowers who are creating value. And I think that that is really what matters over the long term. So, I think that's sort of the way I look at it, when I look at over the market.

Jade Rahmani: Thank you.

Operator: Our last question is coming from Rick Shane from JP Morgan. Please go ahead.

Rick Shane: Okay, everybody. Thanks for taking my question. And before I forget: Doug, thank you for all of the help over the years. We're going to miss you.

Katie, when we look at the investment opportunity and think about both funding – or about loan originations and funding, we all understand the NIM implications. But I'm curious, given your funding structure, whether or not there is opportunity to enhance spreads. So, let's imagine for a minute that loan yields – loan spreads are widening a little bit. I'm curious within your funding structure if you have sources that have tighter spreads so that you can increase financing efficiency and see spreads widen in addition to NIM.

Katie Keenan: That's a great question. And I think that's where looking at the diversity of our lending base really comes in handy. Having 14 different credit facility providers, all of them like sort of different flavors of assets at a given time, they're all in different places in terms of their desires to grow their portfolios, their funding costs. We have different counterparties globally, so obviously what's happening with banks in the US might not be the same dynamic in Europe. And that really allows us to match with whoever is most interested in extending credit to us at a given time, and having a broad-based approach really allows us to find that best match point. And I think that extends even further to our syndications which Tony mentioned. We have a big and growing stable of different syndication relationships as well. Everything from insurance companies to sovereigns to the much broader group of potential senior lending counterparties. So, all of that, I think, it's really about looking across the market to where the capital is most available and using that to drive the benefit in terms of our balance sheet and providing product that's attractive to those different banks and other lending counterparties.

I think the other interesting part of your question – or answer to your question is this is also something that happens over time, because when we finance new assets, we obviously do term-matched financing at the time of closing but we do have the opportunity to opportunistically go to the CLO market over time. That's obviously not something that we're doing at this moment because of the dislocation in the CLO market. But I think we've proven in the past history, and I would expect at some point again, we'll come back to the CLO market when the market is healthier. We'll still have the loan spreads on our asset side. And to the extent we're borrowing at somewhat wider spreads today versus historical levels, we may be able to recapture some of that in terms of doing a refinancing into the CLO market.

Rick Shane: Got it. And when I look at the spread chart on Page 31 of the Q, it looks like you guys picked up a couple of basis points in terms of spread year-to-date. Nothing huge but again, directionally, it's moving in the right way. Do you think that your brand, your relationships give you – this is the opportunity to leverage all of that?

Katie Keenan: I certainly think that our relationships, the overall scale of our platform, of our counterparties in the market, the information we have, all of that just puts us in a tremendously compelling position in this market. That applies to the deals we're able to source, our relationships with borrowers who are much more likely to trust someone that they know is going to act with high integrity in a market like this, our lenders who are trying to lend more to their best relationships. All of that inures to the benefit of our platform. I think this is an environment where the sponsorship really matters. And we have the various sort of tools in the toolkit between the experience, our investment acumen and the relationships. I think that's all going to allow us to navigate this period in a very strong and – in a manner that allows us to outperform.

Rick Shane: Got it. Okay. Katie, thank you so much.

Operator: And now I am turning it back to Weston Tucker for closing remarks.

Weston Tucker: Great. Thank you, everyone, for joining us today and I look forward to following up after the call.

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