Blackstone

Mortgage Trust

Final Transcript

Blackstone Mortgage Trust, Inc.: 3Q 2018 Earnings Call

October 24, 2018/10:00 a.m. ET

SPEAKERS

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Douglas N. Armer – Head of Capital Markets

Anthony F. Marone – Chief Financial Officer

Weston Tucker – Head of Investor Relations

ANALYSTS

Steve Delaney – JMP Securities

Stephen Laws – Raymond James

Benjamin Zucker – BTIG

Rick Shane – JP Morgan

Jade Rahmani – KBW

Don Fandetti – Wells Fargo

George Bahamondes – Deutsche Bank

Coordinator Good day, and welcome everyone to the Blackstone Mortgage Trust Third Quarter 2018 Investor Call. My name is Derina, and I'm your event manager. [Operator Instructions] And with that, I would like to hand over to Weston Tucker, Head of Investor Relations. Please proceed.

W. Tucker Great. Thanks, Derina, and good morning to everyone, and welcome to Blackstone Mortgage Trust's Third Quarter conference call. I'm joined today by Steve Plavin, President and CEO; Tony Marone, Chief Financial Officer; and Doug Armer, Head of Capital Markets.

Last night, 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 will 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 audiocast is copyrighted material of Blackstone Mortgage Trust and may not be duplicated without our consent.

So a quick recap of our results: We reported GAAP net income per share of $0.67 for the third quarter, while Core Earnings were $0.75 per share, up from the prior year comparable period. Last week, we paid a dividend of $0.62 with respect to the third quarter and based on yesterday's closing price, the dividend reflects an attractive yield of 7.6%. If you have any questions following today's call, please let me know.And with that, I'll now turn things over to Steve.

S. Plavin Thanks Weston. Continuing the momentum from the first half, BXMT reported strong third quarter results with Core Earnings of $0.75 per share. Our originations team maintained its high productivity, closing $1.4 billion of loans in the quarter, and continuing to build our pipeline. We now have another $2.0 billion of originations in the closing process, or closed since quarter end.

We have grown our portfolio more than 20% year-to-date to $13.8 billion with a combination of new originations and fundings on existing loans, far exceeding repayments.

Our quarterly originations include office, multifamily and hotel loans in California, Hawaii and Australia. We also had our single best quarter of Walker & Dunlop originations since we formed the JV, with almost $200 million of closings, a nice addition to our productivity. Prepayment penalties again boosted our baseline earnings this quarter, contributing to our outperformance.

The largest contributions came from two construction loans that were repaid soon after build and completion, one from the sale and another from the recapitalization of high quality underlying real estate, while call protection was still in effect. These prepayment penalties totaled $9.2 million. While prepayment fees tend to be unpredictable in timing and magnitude, over time, they provide a consistent source of supplemental earnings.

BXMT continues to benefit from the power of the Blackstone global real estate franchise. BXMT originations ramped up this year in Spain, the UK and Australia, where the Blackstone equity business is driving with strong teams of investment and asset management professionals on the ground. We also have loan originators in the BX offices in London and Sydney, which have been able to export our low cost debt capital to regions that have not seen the same magnitude of spread compression as in the US.

So, origination ROIs in these markets are higher. Deal flow is still episodic outside the U.S., where our ability to source and lend internationally and take advantage of global market inefficiencies adds to the scale, dynamism and quality of BXMT overall. In the U.S., our year-to-date originations were up 50% over the same period last year. Our real estate private equity fund sponsored clients have been active and the CRE equity fund universe still has more than $175 billion of dry powder, so we expect to see continued strong demand as that equity is invested in new acquisitions that will require financing. We are still seeing refinance opportunities as well.

The market remains competitive with spreads trending tighter. Fundamentals and demand generally are stable, especially in the major markets that we target. We achieve our best economic results when we can leverage our scale and target in real estate expertise, especially on larger loans, special situations where speed and certainty matter most, construction loans and loans in markets outside North America.

The credit quality of our 113 loan $13.8 billion portfolio remains high. The average LTV of 2Q direct originations was 59% and the overall origination LTV stands at 62%. To help fund the growth in our portfolio, we issued $270 million of premium equity in the quarter and year-to-date, we've also added $2.2 billion of efficiently priced senior secured credit capacity with more in process. We continue to expand our multi-currency capability to cover the origination potential outside the US. The scale and quality of our capital markets initiatives matches our origination capability and it also benefits from the global Blackstone Real Estate platform and its great track records of borrower and banking client.

We've built a market-leading global senior mortgage lending business with a $13.8 billion portfolio, almost $4.0 billion of equity capital and a highly efficient match-funded liability structure. Our focus remains on dividend, quality and stability and continuing to introduce investors to BXMT and the opportunity to invest in this Blackstone sponsored company with highly compelling 7.6% dividend yield. And with that, I'll turn the call over to Tony.

T. Marone Thank you Steve, and good morning everyone.

This quarter we again delivered compelling results, with GAAP net income of $0.67 per share and Core Earnings of $0.75 per share. For the second consecutive quarter, we recognized significant prepayment fees and fee acceleration income, a benefit of our loan structures which capture significant economics upon an early prepayment. In 3Q, we recorded $0.10 per share of such prepayment-related income, while our 2Q results included $0.13 as compared to a range of $0.01 to $0.03 in a typical quarter.

Adjusting for these outsized income items, as well as the GE reserve reversal we discussed in the second quarter, our run-rate earnings remained stable at $0.65 per share for 3Q, up slightly from the comparable $0.64 in 2Q, notwithstanding the dilution from the incremental shares we issued during the quarter, which Steve mentioned earlier. We are proud of this strong performance, which demonstrates the consistent earnings generation of our business, with material upside potential to earnings and book value in periods with loan prepayments or other events. At $0.65 and $0.64 in 3Q and 2Q, respectively, our $0.62 dividend is well-covered, and we are able to retain the additional earnings generated from prepayment income as additional book value.

One further note on earnings before I move-on: one of the larger prepayment fees we recognized this quarter relates to a loan we previously syndicated, but still record “gross” on our balance sheet, with the whole loan included as an asset and the senior loan recorded as a participation sold liability. As a result of this gross accounting, we recorded additional interest income of $0.15 and interest expense of $0.08, for a net impact of $0.05 per share, net of incentive fees. I highlight this to provide clarity as this accounting makes our interest expense look higher than one would expect this quarter, given our relatively low cost of capital, but is really just a gross-up of the fees we earned on our net loan position.

Turning to book value, this quarter we issued 6.9 million shares of common stock through an underwritten offering in July, as well as 1.3 million shares through our at-the-market program, at an average price of 1.21x our 2Q book value. These accretive stock offerings raised $270 million of fresh capital for our growing business, and contributed to a $0.45 increase in book value per share.

As Steve mentioned earlier, we closed $1.4 billion of new loans this quarter, bringing our total year-to-date originations to $7.2 billion, slightly more than double the same time last year. This quarter includes our first two loans in Australia, increasing our loans outside of North America to 19% of our total portfolio and further diversifying our business, and pipeline of future origination opportunities. As with our existing foreign-currency investments, we expect to address Australian currency exposure through a combination of Australian-dollar financing, which provides a natural hedge by lending and borrowing in the same currency, and foreign currency forward contracts, which mitigate our remaining net currency exposure, and effectively swap the local-currency index to USD LIBOR through the forward points imbedded in the hedge contracts. These forward points are recorded in Other Comprehensive Income for GAAP accounting, and so are included as an additional component of Core Earnings.

We closed the quarter with a total loan portfolio of $12.7 billion, which is roughly in-line with 2Q, however excludes the CorePoint investment originated last quarter.

During the third quarter, we contributed our $518 million CorePoint loan to a single-asset securitization, alongside JPMorgan who owned the other 50% pari-passu participation in the loan. We retained a $99 million subordinate risk-retention investment in the securitization, which generates an attractive L + 10% return. We do not consolidate this securitization in our GAAP financial statements, and instead only reflect the net $99 million investment as a component of Other Assets on our balance sheet. Including the $1 billion loan that is underlying our net security position, our total investment portfolio grew to $13.8 billion as of 9/30, another record for our business.

This securitization transaction, as well as the common stock we issued during the quarter, drove our debt-to-equity ratio down to only 2.3x as of September 30th from 2.6x last quarter. As always, we remain focused on the stability of our balance sheet and pursuing accretive capital sources to finance our low-leverage, senior loan investments. We closed the quarter with available liquidity of $664 million, which we expect to deploy into the robust pipeline Steve mentioned earlier, as we move into year-end.

Thank you for your support, and with that I will ask the operator to open the call to questions.

Coordinator [Operator Instructions]. Our first question will come from the line of Steven Delaney.

S. Delaney Good morning and congratulations on another strong quarter. I noticed when we were reviewing the 10-Q, specifically your risk rating section, there was an increase in the number of two rated loans by about seven, from 36 to 43, but it appears most of the new loans were 3 rated. It appears there are some upgrades. Could you comment on that and confirm if that was the case?

S. Plavin Sure, Steve. Yes, I think those seven loans that were upgraded from 3 to 2 as part of our process. Every quarter we revisit every loan in the portfolio, in an in-depth portfolio review that includes an updated risk rating. In this past quarter, we had seven upgrades and no downgrades. The loans are typically originated at a 3, and as they progress through the business plans, are often upgraded to a 2, and typically they're repaid at the 2 level.

You have to be careful in terms of looking at what that information means, but in this case, as I mentioned in my script, the credit quality of the portfolio is very strong and the upgrade trend that we saw during the quarter is reflective of that.

S. Delaney So you would suggest, I think, that at least with that specific project, the real estate fundamentals are better in terms of absorption or projected revenue, and not just some sort of fair value mark on the asset. Am I hearing you right?

S. Plavin Well, what you're really seeing is that it's progressed along the business plans of the transitional assets that that we finance. We might finance a building that’s 50% or 60% leased, and when it gets to 70% or 80% or 90% leased, when we review it again the credit rating could be upgraded from 3 to 2. So it's really our view of credit and credit quality in our portfolio and a lot of times, it’s the anticipated migration or improvement of assets as they progress along the business plans.

S. Delaney To follow-up on the two new loans in Australia, they were about A$300 million combined I believe. In terms of property type, they were both indicated as Other. Could you just provide some color on that?

S. Plavin In general, the loans we're making in Australia, and everywhere in the world, are similar in concept. They are moderate LTV transitional loans, better markets, and better sponsors. Of the first two loans in Australia, one was a 68% LTV portfolio of office and hotel assets, 9.5% debt yield, strong performing and good local sponsor.

The other was a construction loan. It was the expansion of two existing facilities. It's 100% pre-leased to AAA credit. It's a hyper-scaled data center, equity-sponsored by TPG and Goldman, and really an outstanding project, one that, again, the credit risk is completely mitigated by the pre-releasing.

Operator The next question is from Stephen Laws.

S. Laws You've done a good job about opportunistically raising capital and deploying that. Can you maybe talk about how you look at maturities from here against your pipeline as far as keeping capital deployed? Particularly, your investments are prepayment protected for a period of time, as you do provide their maximum maturity. Can you talk to what you expect the payoffs to be like over the next two-to-four quarters?

S. Plavin Yes. Steve, it's really tough to predict the prepayments in advance. The borrowers are usually required to notice us 30 days out. A lot of the loans are outside of call protection. We've had a lot of success in maintaining loans well beyond the call protection period, through very active asset management, making sure that we're continuing to amend our loans, as necessary, to reflect improvements in performance of underlying real estate, or changes in market conditions. The prepayments in this quarter were relatively light compared to our originations.

Going forward, we do expect significant prepayments, but we have been able to originate in excess of those and grow our portfolio. All these loans are going to repay, it's just a matter of when. What doesn't get repaid now, we expect will repay, sometime probably in 2019. As part of that process where we go and review credit quality, we do try and think about prepayment dates, but it's really just our estimation of when we think it might be a sponsor's best interest to repay. Again, we don't get a lot of visibility on it until they're very close to actually committing to a sale or a replacement loan.

D. Armer The one thing I would add to that, Steven, is that by comparison to 2015 and 2016, when we took on a lot of very seasoned loans from GE, we've now built the balance sheet up beyond that level with, by definition, newly originated loans. And so, we're, on average, a little bit earlier in the lifecycle of a loan, which of course is a random walk, as Steve mentioned. But we're on average, from a portfolio point of view, a little bit earlier in the lifecycle of the loans than we were by comparison in 2016, with a larger balance sheet. That growth in the balance sheet contributes to a sort of "youth effect" in the portfolio, which will make the weighted average life seem a little bit longer than it did, certainly in the 2015-16 period.

S. Laws As you're building the pipeline of new investments, can you maybe talk a little bit about competition, what you're seeing from others out there? Are they competing on price? Is it fewer covenants, less prepayment protection? Maybe what you're seeing in the industry as you continue to look for new investment opportunities.

S. Plavin Well, we continue to look for new investment opportunities obviously in the markets that we like. We really have a focus on the bigger deals that are less competitive, because fewer lenders are able to do them, unless they are very big vehicles. Some of the deals that I talked about that require certainty or speed, or maybe in jurisdictions where we're not everybody's active, also help get us out of the competitive fray.

On the more commodity deals, maybe a U.S. deal that is $100 million or $150 million in loan size, there's more competition. We see it from banks, from the other mortgage REITs, and from private debt funds. It depends upon the situation, the sponsors and who the relationships are with. We're generally able to compete favorably given our cost of capital and our history now with a lot of borrowers in the U.S., especially the fund sponsors. But it is competitive, and we're seeing the impact of the competition, primarily in rate. Most of the sponsors want to get their equity invested, so we haven't seen meaningful leverage creep. Terms are on the margin a basis of competition, but irresponsible lending, nothing like what we saw in the 2006-2007 timeframe. And some of the spread competition really does reflect the increase in base rates and the anticipated decreases in spreads as a result of absolute rates increasing with base rates.

It is, overall, competitive for us, but we're winning a fair amount and finding good opportunities to make accretive investments.

S. Laws One last question, if I may. Can you talk to property types that you find attractive or less attractive? I am curious to get your higher level view on hotels here, as well as maybe luxury condos in Manhattan seem to be a softening market. But maybe any asset types you like or don't like at this point in the cycle?

S. Plavin We've avoided luxury condos, we don't have any in BXMT. We don't have any suburban regional malls. Our retail percentage is down to 2%, reflective of our general view that logistics and the Internet are the near term winners, and physical retail real estate is more challenged.

We tend to avoid, in general, suburban assets, especially suburban full-service hotels and office buildings, and are much more constructive on multifamily and in some of those markets. We like housing, almost everywhere in the world. We like the innovation cities, the cities with dynamic demand and have typically have tech tendency that have real growth in terms of a tenant demand. And those tend to be the coastal gateway cities. And so, that's where you see us most active, in these major cities and larger assets.

On hotels, where there are barriers to competition, we think that there are some good opportunities for hotels. The performance has generally improved with increased economic activity in a lot of markets. We're a huge owner of hotels worldwide, so we have great insight into where we want to be and where we don't. And so you've seen, hotels are still a minority percentage of our portfolio compared to office, which continues to be the largest percentage, typically between 45% and 50% of what we're seeing and doing.

Operator The next question is coming from the line of Ben Zucker from BTIG.

B. Zucker I wanted to go back to the international landscape. I heard you that the loans you're making abroad are pretty much the same type of loan that you would make in the U.S., but can you talk about the market environment and underlying fundamentals, and how they differ between markets like Australia, Europe, and then comparing them to the United States?

S. Plavin The dynamics in the major markets are all generally favorable, certainly the ones that we're interested in investing: high quality real estate, good solid underlying fundamentals, and demand for real estate. The biggest difference is that the markets outside the U.S. are much more episodic. We just don't see the regular flow that we see in the U.S. There's less consistent demand.

We do see, across a very broad palette, opportunities that do meet our mandate, and from a quality standpoint, look as good or better than what we're seeing in the U.S., certainly better from a spread standpoint and an ROI standpoint. We wish there was more of it.

The major international markets are generally pretty good. In Australia, specifically, the banks have gotten a little bit more conservative, so some of the deals that might have gone to the bank market are available to us now. These were our first two loans, but we have other loans we're looking at in Australia. In the U.K. the banks are not as aggressive as they were in the last cycle, and so we're seeing more opportunity there and we tend to follow our clients. A lot of the private equity clients are more active in Australia now than they had been, same with Europe. It's a great client base for us to fall into these regions, where we have people on the ground that own real estate, and get the full benefit of the Blackstone franchise, like we do in the U.S.

B. Zucker That's very helpful and obviously this is a more unique capability of your broader platform’s reach. Turning to the liability structure, I think I noticed that your 2013 notes are coming due in the beginning of December of this year, in just over a month. Would you be willing to speak to what your plans are for that? Do you think you're going to just redeem those or are you looking at doing a refinancing with those?

D. Armer Hey, Ben. It’s Doug. We will redeem those and we've been clear that we’ll be paying those off in cash, which I think is an important distinction for the market. We've done a good deal of convertible note issuance in the summer last year and at the beginning of this year. So in that sense, you can consider those notes already refinanced, but we have great access to the capital markets and we will continue to evaluate our options in terms of managing leverage on the balance sheet. It's a relatively small number, given how our balance sheet has grown since 2013, when we issued the notes. So, it's not a real needle mover in terms of our capital structure. It's the end of a five year road with those notes. They've performed very well. We were very happy with the transaction. We're happy with the product type in general and it's certainly one of the arrows in our quiver going forward.

B. Zucker Speaking about that, while we're on the debt side, that risk retention security that you picked up, that's a nice yielding piece of paper. I don't think that you can put bank debt on that, but you'd be able to use the convertible note as quasi-equity to help finance that and make it more accretive. Is that correct?

D. Armer That's true, and you can say that about any of the investments that we make. The convertible notes lever our balance sheet as a corporate obligation and that capital is fungible. So, we invest that [capital] in our entire portfolio, which is levered separately at the asset level, but you can think of it as sort of a paired trade, relative to a specific investment, episodically. That's a perfectly good way to think about it. Although that securitization is accounted for on a net basis, it represents a very large and structurally sound financing of our investment in the loan. It's a SASB CMBS deal, and so it's non-recourse and non-mark-to-market and very efficiently priced, resulting in that attractive yield on our retained position.

B. Zucker Lastly, it seems like your pipeline for 4Q is pretty healthy and obviously the fourth quarter is normally the most seasonally active. I'm curious though, because my understanding is it takes a little bit of time for the loan process to go through. Since the rates really started to move at the end of 3Q in September, do you think there's been, or going to be, any impact on the incremental borrower going forward through the remainder of fourth quarter, or even out into first quarter, maybe making next year a little soft to get started? What are you guys feeling and seeing on the street now that rates are a little bit higher than when we last spoke?

S. Plavin I think we haven't seen that impact from rates thus far. Most of our borrowers are just floating rate borrowers and aren't looking at fixed rates and what the impact of a fixed rate cost of borrowing might be on their deal. I do think though that if rates continue to move, then you will see some deals get re-traded, and maybe impacts some deals that, on the margin, may not close that would have closed from an acquisition standpoint. So anytime there's a sharp movement in rates, you certainly have the ability to have a little bit more deal fall out. Hopefully, we'll be the beneficiary of that, and maybe we'll pick up some financing opportunities that might have gone fixed rate, or that there will be some more opportunistic things to get some contracts of that, but we haven't seen it yet, but I wouldn't be surprised to see a little bit of that going forward.

Operator The next question is from Rick Shane from JPMorgan.

R. Shane To follow up on the borrower behavior related to the movement in base rates, obviously this has an impact on your counterparty risk if rates continue to rise. Is there any protection that you get or require the borrowers to take in terms of swaps or any sort of protection in that way?

S. Plavin We typically require, in almost all cases, that our borrowers purchase interest rate caps. That's really an insurance policy on rates rising above a pre-determined level, and those interest rate caps are provided by credit-worthy banks and posted to us as additional collateral for the loans. We have those in almost all instances. So, it does provide us with a little bit of insurance in the event that LIBOR continues to move at a rapid pace and potentially for us with those caps, which are typically 3% LIBOR or higher.

R. Shane Got it. Okay. And then just to continue that, you talked about the potential for some fallout in the fixed rate market and the opportunity there. Is the other implication that the duration on your loans could expand, not only will it impact originations, but it actually could delay refinancing from the transitions?

S. Plavin I think it's possible. Any sort of market volatility or market dislocation typically results in some period of transaction parties going to the sidelines and deals being delayed or less likely to occur and so yes, we could definitely benefit from getting a little bit more duration on our loans. We saw a little bit of that in the first quarter of 2016, where we saw a lot of CMBS deals re-priced, and a lot of borrowers walking away from those, and some in a lot of sale transactions put on hold or cancelled. We move forward with our funding commitments during that time with some great loans. So, we do think that we benefit from these kinds of periods of volatility, and we'll see how it plays out.

Operator The next question is coming from the line of Jade Rahmani from KBW.

J. Rahmani What drove the moderation in the quarter's loan repayment? It seems at odds with what the banks are seeing in terms of loan growth, their portfolios are actually declining modestly.

S. Plavin It's really difficult to explain our repayments in any one quarter. I think over the extended period of time, we're going to see all of our loans repay, and it was nice to see that the average duration of the loans extend out a little bit longer than what we had anticipated. It's definitely beneficial for us. And so I think we'll see the other prepayments that maybe could have occurred in the second half of this year, maybe some of those will get pushed into 2019, but I don't see anything that is anything other than an adjustment of the timetable. There are no loans that we've seen that, for some reason now, are less likely to get repaid or aren't going to get repaid for anything other than strategic decision making made by our borrowers. We've talked a lot about our asset management initiatives in terms of trying to hold on to the loans, and so we do amend loans when their terms are no longer reflective of where an asset is in its evolution. So if we made a loan when an asset was not very significantly leased, and it becomes very leased, if we want to hold on to that asset, we need to make an adjustment to the loan. We do that on a proactive basis, and that definitely defers some of the prepayment activity and that's part of the reason why you saw repayments in our portfolio a little bit lighter in the third quarter. Hopefully, they’ll stay light. We like that, but we'll see how it goes going forward.

J. Rahmani On that note, just one thing we noticed in the 10-Q, the Hawaii hotel loan in Maui, it looks like that loan was upsized and the term extended with some adjustment in spread. Is that one of the loans you’re referring to in this quarter that could have otherwise prepaid?

S. Plavin Yes. That loan had dramatic improvement in performance from when it went to the contract by a borrower to-date, probably 18 months or two years later. 30%+ NOI improvement in the hotel, and so they were essentially looking for a new five-year loan on the hotel. We were able to hedge that off at the pass and maintain a loan to provide the equivalent of a new five year loan, but structured as an amendment of the existing loan. We were able to, because of our call protection, get a rate on that loan that was the midpoint between where our loan rate was and where a new loan would be on that asset. So, we were still able to win on rate because of our incumbency on the existing loan, and provide the sponsor with a nice solution.

J. Rahmani And were there any modification fees or unusual fees associated with that in the quarter?

S. Plavin I don't remember the exact fee dynamics, but we were very pleased with the overall economic package that we got. I would say, in general, somewhere in between where we were previously and where a new loan would get would be reflected.

J. Rahmani Switching to the initial commentary about the impact of early prepayment fees on the quarter at about $0.10. Is that $0.10 all inclusive of any outsized not unusual items, because it's part of the business, but sort of above normal fees? For example, acceleration of amortization of origination fees, was that $0.10 inclusive of accelerated amortization?

D. Armer Yes, it was. So the $0.10 is the total number. It's hard to characterize them as recurring, non-recurring or extraordinary or not. I think of prepayment penalties as distinct from the amortization of deferred origination fees. Prepayments tend to be a little bit lumpier by definition. So, you need to normalize for those at some level, but we always experience some degree of prepayment income, because there are loans that, as a general matter, don't go to full term. So, it's a gray area as to how much of that you consider recurring or non-recurring. We've broken out the total amount. If you look back historically, you'll see that obviously in the last two quarters, we've had some real lumpy numbers. But if you look back historically, you'll see a few pennies every quarter coming from that on a fairly regular basis.

J. Rahmani Could you just discuss your approach to asset management more broadly? I'm sure you saw Bank of the Ozarks took two large impairments in the quarter and I think it surprised investors, because the loans have been on the books for so long. I think these were originated in '07 or '08. So, just wondering what you can say about the level of proactiveness with respect to discussions with borrowers? And also, can you give an update on, for example, the Spanish NPL deal, how performance is going there?

S. Plavin Sure. I would just say in general, we're extremely proactive in our asset management. It's critical, both in an offensive and defensive way. Given that we have few credit issues or no credit issues on our portfolio, we're extremely mindful of anything that might be going the wrong way in our loans and early identification of issues is absolutely critical in terms of achieving success in asset management. And so if there are issues in our portfolio, we're going to identify them. We're not going to wait to see them. And again, we have our quarterly risk rating process. We have historically had two loans that we rated high-risk. They've both been repaid, and they were both GE loans. So you've seen us identify loans in the past and resolve them, and that will continue to be our practice going forward.

As it relates to the Spanish deal, it's really gone well so far. We are expecting a total of $950 million of sales in the underlying portfolio. For those who aren't familiar, it's a very large portfolio, secured by mostly REO and NPLs in Spain. A lot of it is housing related. And the underlying performance of the portfolio has been right on our underwriting. We're seeing a lot of activity in the portfolio, the sales performance is in line with our spot values, our underwriting. There has been good progress in the NPL book, which is about a third of the collateral. We've seen 30% of those NPLs already results in closing. So we're very pleased with the progress so far, and we'll continue to report about it as we get more updates in the future.

J. Rahmani Just lastly, in terms of the dividend to date, Core Earnings is clearly running in excess of that. Assuming you maintain the dividend, would there be a need for a special dividend based on taxable income?

D. Armer There wouldn't be a need for a special dividend, in terms of our distribution requirement as a REIT. I think what we're very focused on there is the benefit of those retained earnings in terms of accretion to book value. But our distribution requirement as a REIT doesn't put any pressure on us, relative to the difference in Core Earnings and the dividend.

Operator The next question is coming from the line of Don Fandetti from Wells Fargo.

D. Fandetti If you look at valuations for financial and other companies in the equity markets, it seems like the market is suggesting an economic slowdown or recession, and I was just curious what you guys would do, if you became convinced that we are moving more in that direction, any portfolio moves, leverage? And then secondly, around that, Blackstone obviously has a very good insight and window into commercial real estate. Is the message a little more cautious internally over the last three to six months in terms of risk, or has it been more steady?

S. Plavin I think, it was sort of always -- in the lending business, especially, we're always a little bit more cautious. We're typically making loans that have a fully extended term of five years. The possibility of there being a recession during that five year term seems quite possible. We presume that rates and cap rates will trend higher during our loan term, or at least, if we have to underwrite the possibility that they might. And we've been looking at the world this way for a while now.

I don't think we see a near term recession. The fundamentals and the economy feel strong to us and we're not seeing anything on the ground that will lead us to believe there is a near term issue, but our loans are, in our company, definitely built to endure a slowdown and we're conservatively capitalized with term-matched debt to make sure that we get through any kind of credit event that may occur, whether it be on any individual loan or across the portfolio as a result of recession. So it just has to be in your calculus all the time, but we're not seeing any real near-term indicators based upon our lending or ownership footprint.

D. Fandetti Is there sort of the internal view as you sit around the committees and talk about the market, is there sort of a growing sense of caution? Maybe your point is you've got to operate that anyway, so hasn't been incrementally different?

S. Plavin I don't know if there's a growing sense of caution. I think that we feel it's been a little bit harder to make acquisitions and investments on the equity side in North America than it has been in prior years. I think it is really the market being a bit more fully valued than it has in the past, maybe more so than the fear of any near term economic event. We're certainly really mindful, but I don't know that we're really looking at where we think value is and where value will go over time because again, we're not seeing anything that will lead us to believe that there's a near term recession.

Operator And our final question is coming from the line of George Bahamondes from Deutsche Bank.

G. Bahamondes Just wanted to ask a follow up question on your last point, really around the U.S. market and potentially being at or near-peak levels. You referenced earlier in the call that your international exposure is now 19%. Do you have a sense for how large your international exposure can get, as you see opportunities abroad? And can you provide any color around what spreads may look like for loans abroad versus what you might typically be seeing in the primary markets if you focus on the United States?

S. Plavin I think from an international standpoint, again the flow internationally is harder to predict than it is in the U.S. It definitely has been more episodic. We're fortunate in that we have such a strong presence in so many of the international markets that when interesting deals come, or when our sponsors go to these markets, that we get an early call and have the ability to transact. Doug and the Capital Markets team have done a nice job of exporting our cost of capital to these markets, creating a multi-currency capability in our borrowings that gives us a big advantage to transact. Spreads are a little wider in the deals that we're seeing in these markets.

It’s really, I think, a function of there not being as much spread compression in the last 18 months there as we've seen here in the U.S., because there is less competition. Spreads are probably 25 to 75 basis points wider on the opportunities that we're seeing outside of the U.S. Hopefully, we will see more of them. I don't know that our portfolio will grow a lot beyond the 20% international exposure that we have today. If we see more opportunity, then perhaps we will, but we don't allocate, so we're just looking for the best opportunities to capitalize on, whether it be in the U.S. or in the international markets that we cover.

Operator Thank you very much. And let me hand back over to Weston Tucker.

W. Tucker Thanks everyone for joining us this morning. If you have any questions, please follow up with me after the call.

Operator Thank you very much ladies and gentleman. That concludes your conference call for today. Thank you for joining. You may now disconnect.