Blackstone Mortgage Trust

Final Transcript

Blackstone Mortgage Trust, Inc.: 4Q 2018 Earnings Call

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SPEAKERS

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Douglas N. Armer – Managing Director and Head of Capital Markets

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ANALYSTS

Douglas Harter - Credit Suisse

Don Fandetti - Wells Fargo

Rick Shane - JP Morgan

Steve Delaney - JMP Securities

Arren Cyganovich - Citi

Ben Zucker - BTIG

Jade Rahmani – KBW

Stephen Laws - Raymond James

Coordinator Good day, and welcome everyone to the Blackstone Mortgage Trust Fourth Quarter and Full Year 2018 Investor Call, hosted by Weston Tucker, head of Investor Relations. My name is Matthew, and I'm your operator today. [Operator Instructions] I would like to hand over to Weston. Please proceed.

W. Tucker Great. Thanks, Matthew, and welcome to Blackstone Mortgage Trust's Fourth Quarter conference call. I'm joined today by Stephen Plavin, President and CEO; Jonathan Pollack, Global Head of Blackstone Real Estate Debt Strategies; Tony Marone, Chief Financial Officer; Doug Armer, Managing Director and Head of Capital Markets; and Katie Keenan, Managing Director of Blackstone Real Estate Debt Strategies.

Last night we filed our 10-K 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 these statements and we will also refer to certain non-GAAP measures on this call, and for reconciliations, you should refer to the press release and our 10-K. 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 $0.61 for the fourth quarter, and $2.50 for the full year, core earnings were $0.69 per share for the quarter and $2.90 for the year, up from $2.55 in the prior year. A few weeks ago we paid a dividend of $0.62 with respect to the quarter reflecting an attractive annualized yield of 7.2% based on yesterday's closing stock price. 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. An excellent fourth quarter capped an extraordinary year for BXMT. We originated $3.5 billion of loans in the quarter and $10.7 billion for the year, our most active ever.

In 2018, we grew our portfolio by $4.7 billion to $15.8 billion, while maintaining an origination LTV of 62%.

The portfolio growth helped drive core earnings to $2.90 per share which produced 117% dividend coverage. The strong coverage reflects our focus on the quality of the dividend, which is generated solely from our pure-play, senior lending business. We were able to retain the excess earnings, which contributed to our increase in book value during the year.

In 4Q we closed 21 loans, our highest ever quarterly loan count exclusive of the GE portfolio acquisition in 2015. We had several originations during the quarter that highlight the power of our platform. The biggest was a 65% of cost, $652 million acquisition bridge loan for Terminal Stores, a historic New York City asset acquired for redevelopment by a joint venture of two strong BX relationship clients. The large loan size and transitional nature greatly reduced competition for the loan as did the confidence the borrowers needed in a lender's ability to execute- so a great example of our competitive advantage.

Also during the quarter, we separately financed the purchases of the Park Central New York and the Park Central San Francisco for existing relationship borrowers that also needed a quick and definitive loan closing. The hotels were sold by Pebblebrook at the closing of its acquisition of the LaSalle Hotel REIT and our loan proceeds were a necessary component of the M&A deal. Because one of Blackstone's real estate equity investment vehicles had also pursued the acquisition of LaSalle, the hotels had been recently underwritten. That experience, along with our borrower relationships and the investment scale, was critical in tying up the two loans totaling $545 million with limited competition.

Also during the fourth quarter, we financed other acquisitions in Midtown Atlanta, Washington DC, San Francisco, Chicago, London and Sydney as well as construction in New York and Fort Lauderdale. As this quarter exemplified, we achieve our best economic results when we can leverage our scale and real estate expertise, especially on larger loans, special situations where speed and certainty matter most, construction loans and loans in markets outside North America where Blackstone has extensive real estate holdings.

Late in the quarter, the significant debt and equity market volatility led to a slowdown in real estate transaction activity. Our 4Q transactions were already well advanced, but the 1Q origination pipeline slowed. We also saw an offsetting slowing of repayments. To date in 2019, we have $855 million of loans closed or in the closing process.

The capital markets are now quickly recovering and we expect transaction volume to pick up as the year progresses. Also, the real estate opportunity funds that comprise the most active segment of our client base, have reported over $110 billion of dry powder in their investment vehicles with even more capital commitments being raised. The deployment of that equity should continue to help propel our business.

Keeping pace with the extraordinary performance of our originations group, our capital markets team also had a fantastic year helping to drive strong BXMT returns and balance sheet stability. To fund our 2018 portfolio growth, we raised $483 million of equity during the year at an average book multiple of 1.22x and added $5 billion of debt capacity. We now have 11 credit facility providers, $13.6 billion of capacity, and an array of great term, index and currency matched financing options for our senior loan originations.

Post quarter end, we successfully completed the non-recourse, syndicated financing of the senior loan component of the Spiral, the $1.8 billion construction loan for Tishman Speyer in Hudson Yards, enabling us to significantly mitigate the future funding obligation while preserving very substantial, positive economics going forward for BXMT. We are very pleased with the result, which is consistent with our business plan when we originated the loan and our overall financing strategy.

With the very significant growth in 2018 originations, BXMT's competitive positioning and market recognition have never been stronger. The majority of our loans are with repeat borrowers, the greatest endorsement of the way we do business and our differentiated, client-centric approach.

We remain focused on dividend quality and stability and continuing to introduce investors to our Blackstone sponsored, senior mortgage company. Since the inception of BXMT, we have delivered a 13% return for our shareholders and the stock still yields a very attractive 7.2%.

Before I turn the call over to Tony, I also want to let you know of an important step that we took at year-end. We named Doug Armer and Katie Keenan BXMT Executive Vice Presidents for Capital Markets and Investments, respectively. Katie and Doug work closely with me on the day-to-day and strategic management of BXMT and are great contributors to the success of the business. In addition to her BXMT responsibilities, Katie also continues to originate loans and she led the deal team for the Spiral, among many others. And with that, I will turn the call over to Tony.

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

This quarter's results cap-off an outstanding year for BXMT, characterized by continued strong earnings, supporting an attractive and steady dividend; growth in our loan portfolio, while maintaining healthy credit metrics; and a stable balance sheet, producing a solid book value.

I will review each of these aspects of our 4Q results, as well as BXMT's performance for the 2018 fiscal year.

We generated GAAP net income of $0.61 per share and Core Earnings of $0.69 during 4Q, bringing our 2018 full-year GAAP earnings to $2.50 per share with a record $2.90 of Core Earnings. Looking at 2018 fiscal results, in particular 2Q and 3Q, our earnings included a significant amount of prepayment-related income, totaling $0.22 per share over those two quarters, net of incentive fees. This is outside of the $0.01 to $0.03 quarterly run-rate we would expect in a typical period, and contributed to our earnings power during the year. In 4Q we experienced relatively fewer such fees as the pace of loan repayment slowed, so our $0.69 of Core Earnings is almost entirely driven by run rate net interest income, positioning us well as we move into 2019. We maintained a stable and high-quality $0.62 dividend throughout 2018, which was well covered by our $2.90 of Core Earnings for the year.

During the quarter, we closed 21 loans totaling $3.5 billion of originations, our second largest quarter of direct originations, bringing our 2018 total to $10.7 billion across 52 loans, more than double our 2017 volume. We had net fundings of $2.1 billion during 4Q and $4.3 billion during 2018, bringing our total loan portfolio to $15.8 billion, up 42% from last year. Our 2018 loan originations had an average size of $201 million reflecting our continued focus on larger loans where we have a competitive advantage. We also funded $630 million under previously originated loans during 2018, generating additional value for our shareholders from these investments. Importantly, we have not sacrificed credit as our business continues to grow, and our 2018 originations have a weighted-average LTV of 61%, right in line with our overall portfolio origination LTV of 62% as of year-end. We have no loans with a risk rating above 3, with our last "4" rated loan repaid early this year, and currently have fully performing loans across all geographic segments and asset classes in our portfolio.

We supported this growth of our loan book by expanding our credit capacity and raising additional equity capital. We added $3.0 billion of credit capacity in 4Q and $6.5 billion throughout 2018, highlighted by closing six new or upsized credit facilities and the CorePoint securitization we closed in 3Q. We remain focused on financing our assets with term, currency, and index-matched liabilities with no capital markets mark-to-market provisions, which ensures the stability of our balance sheet throughout the course of a market cycle. We raised $108 million of common equity during the quarter at an average price of 1.27x our 3Q book value, and a total of $483 million of equity during 2018, which drove our book value up to $27.20 per share…a 10% increase from the beginning of the year.

Our focus remains on originating floating-rate assets, currently 96% of our total portfolio, which is another aspect of our balance sheet stability as these assets are not marked-to-market and insulated from any implied valuation changes due to interest rate movements. We closed the year with a debt to equity ratio of only 2.8x, and liquidity of $470 million available to deploy into additional loan originations.

As I mentioned earlier, we view the fourth quarter, and 2018 overall, as a success for BXMT and, more importantly, our shareholders. We generate a consistent, reliable dividend by originating well-structured loans to quality assets, with a six-year track record of healthy loan performance, and a stable balance sheet supporting continued growth.

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 Douglas Harter of Credit Suisse. Please go ahead.

D. Harter Steve, I am hoping you could talk about the pace of spread compression that you saw in the fourth quarter, or the second half [of the year], whatever you think is the more relevant time period, and what is your outlook for your asset yields, now that LIBOR is expected to be flat for the near-term?

S. Plavin I think we saw a moderating of spread compression in the second half of the year. We still saw some spread compression and we still think that moves on the short end and LIBOR increasing. I do think that with the LIBOR curve flattening out and the likelihood there will be either be no or just one or two more Fed increases, that we do expect to see spread compression continue to moderate.

As it relates to our fourth quarter originations, I think they are consistent from a return standpoint, compared to what we did earlier in the year. As I mentioned in my remarks, we did originate a number of deals that were unique opportunities for us, and we were very satisfied with the economic results. I think we are dealing with spread compression pretty well on the origination side. On the liability side, we continue to grind a little bit tighter in terms of all of our capital. Every time we go back to our lenders we try and reduce spread and improve terms. All of those help from an ROI standpoint in the competitive environment.

Operator Our next question comes from the line of Don Fandetti. Please go ahead.

D. Fandetti Steve, it sounds like across the industry things slowed in December and then there was a bounce back in January. I was just curious, as you talk to private real estate investors, if you think that they have been shaken, was that more of a flip to where you would expect them to continue the appetite for transactional-type acquisitions, if you can comment on that?

S. Plavin So I think the impact from the debt market volatility was pretty much a blip, sort of a 60 to 90 day event, and we are moving quickly beyond that already. As it relates to investor activity and transactions, when investors move to the sidelines and then move back to the point where they are willing to transact again, there is 60 or 90 days delay just from when somebody resumes working on our deals to when it can reasonably expect to close. So we are seeing resumption of a more active pipeline. It has gotten a little slow in December and January. So, I think we expect to see it continue to pick up during the year. There is a general view that assets in the U.S. are more fully valued, so the fund sponsors are being a little bit more cautious in their acquisitions, but they also have a lot of dry powder on a lot of capital deployed in their investment vehicles. We do expect that to happen, so we are anticipating an increasing flow of opportunities during the year, and we do think that the funds will find opportunities to deploy their vehicles.

Operator Our next question comes from the line of Rick Shane of J.P. Morgan. Please go ahead.

R. Shane First of all congratulations to Doug and Katie. I did want to talk a little bit about geography. Historically, you have been highly concentrated in California and New York, that certainly made sense and been a great strategy. The question we are starting to ask a little bit more with some of the tax driven shifts in terms of demographics, are you concentrating on more of the states where there is expected to be migration related to the elimination of the SALT deduction?

S. Plavin Interesting question. I think we are certainly mindful of the forces of demand for space, whether they are tax driven or otherwise. We have been active in Florida. One of our deals in the quarter was a construction loan that was in part for multi-family in Fort Lauderdale, which has been a very strong market and getting stronger as a result of migration of people from the Northeast. All this does provide some headwinds for some of the major markets, but we are still seeing a lot of demand for space, a lot is driven by the technology companies and where they want to locate. And we are still seeing a lot of migration to New York. We saw Amazon, it looks like Long Island City will remain HQ2, and we are seeing also California, Southern California, as well as Northern California, with a lot of demand for space, and the greatest array of large scale opportunities for our business. We remain optimistic that the major markets are still the place to be, but I do think there will be some interesting impacts in some states that will benefit from more favorable tax regimes.

Operator Your next question is from the line of Steve Delaney of JMP Securities. Please go ahead.

S. Delaney Good morning and congrats on the quarter. A lot of hotel activity in the fourth quarter and obviously that's an area that BX has significant expertise. I'm just curious, Steve, you are up to 23% of the portfolio. Is there any arbitrary limit there? Is there still room to grow? And also when you get into that more specialized sector do you find that there are fewer lenders that you are competing with in the hotel space?

S. Plavin Blackstone has typically been among the largest owners of hotels in the world, and we have obviously great insight into the markets. We had been, and continue to be, a cautious hotel lender, and I think one of the things that did change a little bit in 2018 for us was that rolling into '18 we had no New York City hotels at all. And ordinarily that probably would have been at least 5%, maybe as much as 10% of our overall portfolio, given the scale of the market and the opportunities that typically exist in that market for lenders of our profile.

As the market strengthened a little bit in '18 and we got through more and more of the supply, we did see some opportunities to add some loans that we think are great opportunities for us, low basis and a little bit higher in spread than some of the other property sectors. And obviously it increased our hotel percentage as a result. Our hotel percentage was very low going into 2018. Generally in our business we see the most opportunity in office buildings and hotels. We own a lot of those all over the world and we have great insight into where we think and how they will perform and that really does dictate where we allocate most of our origination resources. So, I think hotels will remain in the 20s in terms of the overall percentage of allocation across property sectors, and we feel great about the hotel portfolio that we have on the books today.

Operator Your next question is from the line of Arren Cyganovich of Citi. Please go ahead.

A. Cyganovich I was wondering if you could just give a little more detail about the Terminal Stores bridge loan. What was the thought process behind that? I'm not familiar with the property, but it looks kind of like an old warehouse. I would imagine good retail components to that, and with the risk associated with having retail loans, obviously, in this environment, why that might be a differentiator in the investment? And then the other question is on the quarter to quarter decline in book value as investors are asking questions about that. I know it's related to the settlement of the convert, but if you could give a little more detail around that for investors too.

S. Plavin I'll take the first one and maybe Tony could take the second. Terminal Stores is a very cool, historic structure between 10th and 11th Avenue, sort of the back door to Hudson Yards. There is obviously a huge influx of office and residential tenants moving into Hudson Yards, and we think that will be a huge source of new demand for the retail component of Terminal. Terminal will still be primarily office once it's transformed. Our loan is really the bridge to the construction loan. During the two to three years we hope to have this loan the sponsors are working on that final plan getting approvals and the landmarks and all the things they need to execute their plan. This is a 65% loan capitalized for the bridge period between acquisition and construction. Now, I'm sure we will be vying for the construction loan when the time comes. But at the moment it's really in planning stages and the thought of converting what now has a lot of storage space and the more traditional office and the ground floor to retail. The retail, I think, will do great. There are a ton of offices around it with not a lot of retail like it, in a market where we see a ton of growth.

T. Marone On the book value question, I think you have already answered it to some degree, but I'll unpack it a little bit. If we look at what happened to book value during the year, and obviously the quarter, we are up $0.27 on the year, that's driven by a couple of positive movers. We've issued equity above book, which was accretive and increased our book value. We've also been retaining earnings as we had a great earnings year and a stable dividend, that was offset by some share dilution for shares we issued under our equity plan, similar to what we've done in prior years, and really a one-time event of the convert premium.

What you see in the fourth quarter is, really, the two negatives that happened during the year happened to land in the fourth quarter and less of the positive activity around retained earnings and accretive value of the equity offerings in the fourth quarter. So, it's a little bit of a timing element. The convert overall over its five-year life was quite valuable, and generated value in terms of incremental earnings. It's just the way the accounting comes through that option value really comes through the books on the last day so it's more of a timing thing.

Operator Your next question is from the line of Ben Zucker of BTIG. Please go ahead.

B. Zucker I have a high level question around the WD joint venture. Do you guys have any interest in acquiring Walker & Dunlop? I know you won't go ahead and answer that outright, but what are your thoughts from a high level on the GSE origination and servicing business? And then as a follow-up, could that business model and revenue mix fit within your REIT structure?

S. Plavin The Walker & Dunlop joint venture has really been a positive development for us and I think for Walker & Dunlop as well. We provide capital, both equity and financing capabilities, to Walker on a pool of assets that they originate and we jointly approve. And we have managed the portfolios. But we have done about $700 million worth of volume through the program since inception. And I think the results have been great. It provides us access to multifamily assets and borrowers that we wouldn't ordinarily see.

They are smaller and more granular. And so it's just additive to what we are doing. We are not in the GSE origination business today, and they are, so it's very complementary in that we provide the bridge to their take-out.

As it relates to the agency origination business, we have no plans to make any agency origination acquisitions or any other acquisitions. We do, however, contemplate all possibilities to expand our platform and all the adjacent areas, whether it would be in loan originations or other assets that would be complementary and additive to our company. And so again, I think the way we look at the business now is that we have the Walker & Dunlop JV, which has been very beneficial for us to take advantage of that opportunity in terms of agency originations.

Operator Your next question is from the line of Jade Rahmani of KBW. Please go ahead.

J. Rahmani Could you give any color on the percentage of your loans that are or your originations that are bridge-to-bridge financing? Are you seeing that as an increasing trend, and is it something you're looking to avoid or embrace as an opportunity?

S. Plavin Jade, I'm not, could you, what type of loans? You said bridge to bridge? I'm not sure I understand your question.

J. Rahmani Yes, basically bridge lenders providing capital to take out other bridge loans, essentially business plans that have not hit their benchmarks that have reached maturity and the lender, rather than granting extensions, or the borrower rather than being able to have the extension granted, is getting taken out by another bridge lender.

S. Plavin I think typically what we see in terms of the bridge lending space is, I think, a little bit of the opposite end of the spectrum. We typically see business plans that have performed and then the original loan being perhaps light on leverage or low on spread or no longer on point relative to the real underlying real estate assets. Most of the refinancing opportunities that we see really relates to trying to maintain loans that performed very well and are far advanced in their business plans. And we do active asset management and try and hold on to those loans through the lifecycle of the business plan. Ultimately, most of our loans get repaid with the property sale, again, because our client base is primarily managers of a finite life investment vehicles. They are ultimately buying, fixing and selling assets. We do occasionally see assets that no longer work for other lenders for reasons, other than outperformance, but it’s a really small minority of what we see.

Operator Your final question is from the line of Stephen Laws of Raymond James. Please go ahead.

S. Laws A lot have been hit on, but maybe you could talk about how large do you think your portfolio can grow? You continue to post significant growth. Do you have an additional need for capital this year? I guess probably that depends on your origination versus repayment expectations, but have we gotten to the point, or are we close to the point, where it's really the full time job just to recycle capital with the new investment, or do you think you will continue to post net growth on the portfolio size going forward?

S. Plavin I think we have had a great run of posting really significant growth and so I don’t think we feel that we are really at the end of the business plan. We continue to see opportunities to do more interesting things. The platform is expanding internationally as well as increasing its penetration in the U.S. We created eight new repeat borrowers in this past year, and that's been our most productive source of new transactions. We expect we will develop more of those in 2019 and further grow the portfolio. So I'm optimistic that, looking at the magnitude of growth we had last year, I don't know if we'll continue at that pace, but I certainly expect that we will continue to grow the portfolio.

D. Armer It's Doug here. On the capitalization point, I'd say we have great capital markets access both in terms of debt and equity products to fund future growth and the portfolio. We saw a lot of growth during 2018 and we continue to have a very efficient cost of capital and a wide array of options in terms of capitalizing a larger portfolio going forward.

Operator Thank you for your questions everyone. I will now turn the call over to Weston Tucker for the closing remarks.

W. Tucker Great, thanks everyone for joining us. And if you have any questions please follow-up after the call.

Operator Thank you, sir. That concludes your conference call today everyone, you may now disconnect. Thank you very much for joining today.