Blackstone Mortgage Trust First Quarter 2024 Investor Call
April 24, 2024 at 9:00am ET

Tim Hayes: Good morning and welcome, everyone, to Blackstone Mortgage Trust's first quarter 2024 earnings conference call. I am joined today by Tim Johnson, Chair of the Board of Directors, Katie Keenan, Chief Executive Officer, Tony Marone, Chief Financial Officer, and Austin Peña, Executive Vice President of Investments.
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 subject to risks, uncertainties and other factors 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 this call, and for reconciliations, you should refer to the press release and 10-Q. This audio-cast is copyrighted material of Blackstone Mortgage Trust and may not be duplicated without our consent.

For the first quarter, we reported a GAAP net loss of $0.71 per share, while Distributable Earnings and Distributable Earnings prior to charge-offs were $0.33 and $0.65 per share, respectively. A few weeks ago, we paid a dividend of $0.62 per share with respect to the first quarter.

Please let me know if you have any questions following today's call. With that – I'll now turn things over to Katie.

Katie Keenan: Thanks Tim. A quarter into the year, we continue to see a positive direction of travel for real estate. Liquidity has returned to the market, with CMBS issuance multiples above year-ago levels. New supply is down dramatically, with starts 50-90% below peak across asset classes. While expectations for the pace of rate cuts have been tempered, overall cost of capital is lower, with spreads compressing across public and private lending markets. We believe values in commercial real estate are bottoming, creating an attractive entry point for new investment.

With this backdrop, we continue to see strong performance on the vast majority of our portfolio, providing ballast for the subset of more challenged loans. Our portfolio remains 92% performing. We produced $0.65 of Distributable Earnings prior to charge-offs, covering our $0.62 cent dividend. We collected over $1 billion dollars of repayments this quarter, including the refinancing of one our largest office loans through a CMBS transaction with deep investor demand. And we maintained near record liquidity levels, ending the quarter at $1.7 billion dollars.

We continue to address the ongoing credit cycle and reset in office values, with impacts in both our earnings and reserve build. And of course, higher-for-longer rates, while good for income as a floating rate lender, put additional pressure on borrowers. But more liquidity creates more transparency, prompting borrowers to more definitively pick a path for their assets – selling or refinancing where they see equity value, moving on where they don't. In both cases, prompting capital structure resets at more appropriate levels. This process is the necessary transition point to get to a healthier and more normalized market.

The recovery will take time, with additional reserves and losses along the way, as we've seen this quarter. But BXMT is well prepared to navigate this period. We fortified our balance sheet – with plenty of liquidity and a $1.8bn reduction in our financings over the last year. We revved up our asset management, collecting $1.5bn of incremental equity from our borrowers over the last 12 months, which enhances our credit position. And we marshalled our experts from across the Blackstone real estate platform, bringing to bear the insights and experience of the largest owner of commercial real estate globally. We are actively seeking to accelerate portfolio turnover to move through the credit cycle and return to our core lending business. Some of these conversations materialize as credit-enhancing modifications. Others as workouts, where we maintain a highly disciplined approach – no free options, quickly taking control from Sponsors if they are unwilling to demonstrate commitment. We resolved four of the 13 impairments we started the quarter with through sales, restructurings, and foreclosures, and we expect continued progress next quarter. We strongly believe our proactive approach will result in the best long-term outcome for our investors. And with Blackstone and its employees a top-3 shareholder of the company, we are firmly aligned.

Most importantly, our core performing portfolio continues to show stability and generate strong income. Of the $1.8bn of performing loans that faced interim or final maturities this quarter, 95% repaid, passed their extension tests, or were extended with new equity or enhanced economics. We closed or agreed 9 credit-positive loan modifications. We negotiated paydowns on 5 loans, representing 11% of the respective loan balance, on average. And in total, our borrowers contributed over $300 million of incremental equity across our portfolio just this quarter – real time indications of Sponsor commitment and confidence in asset values.

Included in these modifications was one of our largest multifamily loans – a newly renovated New York City asset with a minority office component, which WeWork surrendered following the recent bankruptcy. This disruption presented the opportunity for our sophisticated, well-capitalized sponsor to replace the office with 75 new apartments, enhancing the value and ultimate liquidity of their collateral. We granted time to pursue this accretive business plan in exchange for significant increased equity, both to pay down our loan and capitalize the value-add capex. In addition to the positive result for this collateral, the modification leaves us with virtually no ongoing WeWork exposure in our portfolio.

Across Blackstone, we are highly constructive on multifamily, given the long-term structural shortage of housing. Within BXMT, our multifamily portfolio ended the quarter at 100% performing. Our loans benefit from a weighted average LTV of 67% at origination and NOIs up 35% across the portfolio since then. Across $1.5bn of multi loans with first quarter rate cap expirations, 100% of our borrowers renewed caps or replaced them with guaranties – a clear demonstration of commitment. Our largest multifamily concentrations are in New York City and Dallas – markets which are performing well. We upgraded five loans in Q1 that have reached stabilization and are likely to repay in the coming quarters. Given temporary supply pressures in certain Sunbelt markets, compounded by higher rates, we also watchlisted four loans, but these together are just 1% of the portfolio. And with deep capital markets liquidity and fundamentally stable long-term demand for multifamily from users and owners alike, we believe our portfolio is largely insulated from these headwinds, and that any credit impacts will be marginal and contained.

In closing, while the timing of the cycle will remain dynamic, we believe 2024 will bring additional clarity to the market and our portfolio. And we are highly focused on placing ourselves in the best position to capture the historically attractive investment opportunity that inevitably follows a period of distress. We are not waiting for the all-clear sign: exceptional lending opportunities are available today, and given our strong liquidity position, we will selectively take advantage. We capitalized on one such opportunity post quarter end – committing to a $69 million senior loan on a resort hotel at 39% LTV and a 16% debt yield – which sets up to a double-digit unlevered return. This loan is the result of the core principles that have always underpinned our lending business – real estate knowledge, analytical expertise, intellectual creativity, and deep relationships across the market. These strengths have driven our investors to entrust the Blackstone Real Estate Debt Strategies platform with $85bn of their capital, and they will continue to drive our performance through and following this cycle.

And with that, I will now turn the call over to Tony.

Tony Marone: Thank you, Katie, and good morning, everyone. In the first quarter, BXMT reported a GAAP net loss of $0.71 per share and Distributable Earnings of $0.33 per share. Excluding realized losses, Distributable Earnings were $0.65 per share, supporting our dividend of $0.62 per share. We added this loss-adjusted metric to our disclosures this quarter, labeled as "Distributable Earnings prior to charge-offs," as we believe it is more reflective of the ongoing earnings power of the business and therefore helpful for investors to consider when assessing our cash flows and dividend coverage.

We recognized $61 million of realized losses in the first quarter as we made significant progress on asset management initiatives, resolving several impaired loans and crystalizing existing CECL reserves, which impacted DE but not GAAP earnings or our book value.

We acquired legal title to our first REO asset – a newly-renovated office campus located in a desirable submarket of Silicon Valley. This asset is currently vacant but is well-positioned to capture leasing demand over time without the need for material incremental capex investment. We are leveraging the broader resources of the Blackstone platform to manage the property, with the goal of maximizing recovery value beyond what we believe is achievable in the current market, with

liquidity for the office sector still limited. The asset is recorded at its fair value of $60 million on our balance sheet – 35% lower than our prior loan amount.

Further on loan resolutions, we expect to complete the sale of another collateral asset underlying an impaired office loan in the second quarter, with collective realized losses from the loan resolutions discussed last quarter in line with our 12/31 reserves – validating the accuracy of our CECL process.

As Katie noted earlier, loan resolutions are a focus for BXMT. They are also an important catalyst for future earnings generation. As a reminder, we currently do not recognize any income from impaired loans, but the interest expense associated with these loans continues to burden our results – impacting 1Q earnings by $0.16 per share.

Over time, we expect we will recoup these earnings as loan resolutions generate capital that can immediately be applied to repay debt and eliminate this earnings drag in advance of eventually redeploying capital into new investments. In the interim, we expect to benefit from the cash flows currently generated by many of these loans – $0.10 per share this quarter – that is not recognized in earnings but instead reduces our loan principal balance and supports book value.

In the near-term, the net impact of new cost recovery loans, loan modifications, and net portfolio contraction will contribute to more variability in BXMT's earnings, and outweigh the longer-term earnings tailwinds from impaired loan resolutions. And as we've discussed in the past, we determine our dividend each quarter with our Board of Directors, focused on the longer-term earnings power of our business, considering a variety of factors including interest rates, a range of credit outcomes, and the environment for new originations.

More broadly on credit, we upgraded nine loans this quarter, reflecting continued business plan progression within multifamily and hospitality assets, and the resolution of two impaired loans that are now once again performing. For these two loans, borrowers injected new cash equity, and capital structures were reset to improve our basis and sustain strong current income generation. We also downgraded thirteen loans during the quarter, seven of which were US office loans that were placed on cost recovery and impaired.

Our CECL reserves increased by $174 million quarter-over-quarter to $766 million, largely reflecting these new impaired loans. Our aggregate CECL reserves of $4.40 per share are embedded in our book value of $23.83 as of March 31st.

Importantly, our balance sheet remains solid, and is built to withstand the pressures we face in the current market environment. Diversified funding sources; term-matched financings; and no capital markets driven mark-to-market provisions. These are the key tenets on which we constructed our balance sheet since BXMT's business launched in 2013, and which continue to underpin our stability today.

Over the past year, BXMT increased liquidity to near-record levels of $1.7 billion, while also reducing asset-level and corporate financings by $1.8 billion. This includes $60 million of Senior Secured Note repurchases, which we executed at a significant discount to face value, generating $8 million of gains over the last four quarters, and $3 million in Q1 specifically. Debt-to-equity has increased slightly this quarter to 3.8x as a result of higher CECL reserves, but remains within our target range, and we remain in compliance with all financial covenants.

Repayments continue to exceed loan fundings – $1 billion collected vs. $353 million funded in Q1. This dynamic has yielded net cash proceeds that have fortified our balance sheet and liquidity position for five consecutive quarters, and while repayments can be lumpy, we see this overall trend continuing with clear indications of demand for our highest-quality collateral – including in office.

Looking ahead, we expect near-term results will reflect the realities of a higher interest rate environment and also the proactive portfolio management measures we are taking to pursue the best long-term outcomes for our investors. Our business is well-positioned with strong liquidity, a stable balance sheet, and the substantial current income generated by our portfolio.

Thank you for joining the call. I will now ask the operator to open the call to questions.

Operator: Thank you. We'll go first to Doug Harter with UBS.

Doug Harter: Thanks. On the loan extensions that you completed this quarter, can you talk about how long the extensions were you typically granted?

Katie Keenan: Doug, are you referring to the extensions – the sort of credit positive mods that we're doing – where we're getting paydowns and giving borrowers more time or specifically on the multifamily I referred to?

Doug Harter: Just kind of in general on that pie chart you had with the one few maturities and just kind of getting a sense as to how much additional time is being granted?

Katie Keenan: Sure. It falls into a couple of categories. So, when you look at that pie chart, the loans that are extending and passing their test, that's generally just a one-year extension that's provided for under the typical structure of the loan. For situations where borrowers are putting in more equity and we're granting them more time, it's really a continuum and it comes down to how much equity we're getting. And we're really just making an investment decision at that point about where our basis is, where our credit position is, what we see as the business plan for the asset, is it capitalized appropriately based on the new equity we're getting in, and how do we optimize our outcomes between return and recovery over that period of time. So, it's one to two years generally, we're not talking about longer than that, but within that continuum, it's really about making an investment decision at the point when we're doing the mod.

Doug Harter: Great. Thank you for that, Katie. And then just on the loans that were downgraded this quarter, kind of what changed during the quarter that led to a downgrade in 1Q versus kind of how they were positioned in 4Q?

Katie Keenan: Sure. So, each one of these loans obviously has specific situations that can change over time, but it's largely U.S. office, reflecting the well-known challenges we've seen in the market, but also some changes in occupancy and sort of tenant dynamics in the individual assets. And then on the multifamily side, as I mentioned, really looking at temporary impacts of supply in certain markets, compounded by higher rates – but there, those are watch list assets, just 1% of the overall portfolio and where we expect it to be pretty marginal.

Doug Harter: Great. Thank you, Katie.

Operator: Thank you. We'll go next to Stephen Laws with Raymond James.

Stephen Laws: Hi. Good morning. Tony, I wanted to start with a question on the numbers. I think on the positive side, you mentioned some of the resolutions, I believe, in Q1 and expected one in Q2 will help remove some drag off the financing of non-accrual assets. And then around the downgrades, I think you mentioned that seven of those are new non-accrual loans. Can you talk about the net impact and how we should see those two things, balance out in the near term?

Tony Marone: Sure. So, as we're resolving some of these, we're – without getting into specific guidance on next quarter in particular – I think you could expect to see a similar impact from moving loans to cost recovery as we've seen in the past. So, given the magnitude of that portfolio, you could think of that as, something in an $0.08 to $0.10 range is something that you might expect. And then on the resolutions, those will be dependent on how much leverage we have against them. So, it'll be a more muted impact, maybe a couple of cents per share. I think importantly, which I mentioned in remarks, when you're thinking about the earnings impact of the loans going to cost recovery, many of these loans, in particular some of the more recently impaired loans, continue to pay. So, we're still getting that cash flow and it's benefiting our basis even though it's not coming through our DE metrics.

Stephen Laws: Great. Appreciate the clarification there. And, then I know you've mentioned kind of one outlook or expectation for one resolution here in Q2, but, as you look over the balance of the year and you consider the current five-rated loans or those with specific reserves – how much of that, I think it was $1.2 billion, or maybe that was the office, but how much of that do you think you can get resolved this calendar year and how do we think about resolutions in the second half?

Katie Keenan: Yeah, it's a great question. I think from a general overall market perspective, we are very focused on taking advantage of the fact that there is more liquidity, more transparency in the market. There's capital coming back, including for office. Obviously, one of the loans we resolved this quarter, or two of the loans we resolved this quarter, from a sale and restructuring perspective, we're both office loans. We also took one REO.

And, our overall approach is going to be one of maximizing recovery for our investors, but where we see the opportunity to sell or move on from an asset in a level that makes sense when we look at our whole sell analysis from a return perspective, we are absolutely going to do that. And I think that the fact that there is more liquidity in the market, more turnover, more stuff is moving – it's going to create some noise, but it's ultimately the best thing in order to move us through this cycle and get to the other side, get back focused on our core business.

So, we have a couple of others that are in process relatively near term. We're obviously all systems go in terms of trying to make sure we resolve these things as soon as possible. So, I think it's tough to project for the second half of the year, but we're very focused on moving these assets to resolution and getting through it.

Stephen Laws: Great. I appreciate the comments this morning. Thank you.

Operator: We'll go next to Sarah Barcomb with BTIG.

Sarah Barcomb: Hi. Good morning, everyone. My question is related to leverage on watch list assets. Could you walk me through some of the resolutions of the five rated assets that are in CLOs – meaning was there an additional cash need to avoid losses at the CLO level when those resolution proceeds came in? And approximately how much leverage is on the new five rated assets? Thank you.

Katie Keenan: Sure. So, thinking about our general approach there – for most of the five rated assets, we generally have de-leveraged them along the way. So, the typical advance rate on a five rated asset is materially lower than our overall portfolio. So usually, we've already sort of put ourselves into a more stable position. On the CLO specifically, when we look at these assets, we're really looking at optimizing recovery and return for our investors and for all of our investors throughout the capital structure. Sometimes that will involve buying portions of the loan out of the CLO, or in some cases, all of the loans out of CLOs, and in other cases, we'll look at it and say the best thing really is to continue with an asset in the CLO, and it's really going to come down to a decision looking at all of the factors to maximize the outcome for the overall company.

So, in terms of capital, you have really seen for the most part, along the way impact with these loans, because obviously impaired assets are on the watchlist for a while – we know it's going on, we are talking to our lenders. This is not something that is happening overnight. So we don't see any material change in liquidity and it is really just about making sure each one of these assets is optimally capitalized to maximize sort of return and recovery value as we move through our business plan.

Sarah Barcomb: Okay. Thank you. And then just the quick modeling question. So you mentioned you are expecting one more resolution in the second quarter. Are you still expecting about $70 to $80 million total realized losses for the first half of this year? And how are those expectations shaping up for the full year?

Tony Marone: I would stick with that expectation – as I mentioned in our remarks, the losses between the first and second quarter are coming in right on top of our year-end CECL reserves, which we think is a great validation of our valuation process, so I would stick to that expectation. As it relates to the back half of the year, I think Katie covered that earlier, that it's going to be very dependent on what kind of transactions that we see in the market, what kind of liquidity there is, so I don't know if there's a specific number that I would focus on at this point.

Sarah Barcomb: Okay, thanks.

Operator: Thank you. We'll go next to Jade Rahmani with KBW.

Jade Rahmani: Thank you very much. How is the higher rate outlook impacting borrowers? I attended CREFC in January and everyone was ecstatic about the prospect for lower rates. Clearly, that's changed, and if you could address multifamily in particular?

Katie Keenan: Sure. Yeah, it's a great question. I think that obviously the expectation for the pace of rate cuts has been tempered, but I think the important things to keep in mind, we still have the view that the overall path of rates from here is downward. We're seeing that as we look across on inflation data that we see here internally, it's all happening at a slower pace, but the direction of travel has not changed. And I think that importantly, when you think about the impact of rates, a

lot of it has to do with market liquidity, spreads, overall cost of capital. And despite, a month of volatility or sort of going back and forth on expectations of rate cuts, we've continued to see liquidity continue in the market. We've seen cost of capital come down, spreads are normalizing across real estate lending markets, both public and private. And so that all has kept sort of the direction of travel in the same direction.

I think on more marginal situations, obviously higher rates and in particular the pace of rate cuts could have an impact in terms of carry costs, in terms of conversations on liquidity for sponsors. I think that's going to, you're going to see that particularly in multifamily more in the corner of the market with sponsors who were really less well-capitalized. And it's going to create a lot of headlines, but it's not indicative of the overall market. So, I think that the rate impact, obviously not helpful, but I think it's really about long-term rates, the direction of travel for rates, and critically liquidity in the market.

Jade Rahmani: Thank you. Just thinking about the dividend cash flow from operations, this quarter was below the dividend at $96.4 million. You mentioned the $16.8 million of interest that was accrued. That's now, on non-accrual. You received the cash, but that will be a decrement to earnings and there are other factors including the smaller portfolio given repayments.

Should we think about the dividend as being steady state because it's based on a long-term premise about returns or does it make sense to think about a lower dividend which would give the company some additional liquidity and also some flexibility in managing through the current turbulence? And it seems that with the 13% yield, the stock in fact is already pricing in dividend reduction. One of your peers, similar type of company, trades at around a 10% yield on its reduced dividend.

Tony Marone: Thanks for the question, Jade. So, to maybe hit the first point quickly – we would point you to the DE before charge-offs as the metric, more so than cash flow from operations. There's different things that impact the GAAP cash flow and we think the best metric for folks to look at is DE prior to charge-offs when you're contextualizing the dividend, so the $0.65 this quarter relative to the $0.62. As relates to the dividend in a longer term we've had the same dividend level $0.62 for almost nine years – sometimes we've far out earned that level, sometimes we've been slightly below that level. I think that shows that we've continued to set our dividend with a long-term view in mind. As I mentioned in the remarks, we're looking at this quarterly, we discuss it with our Board of Directors, and what we think really drives the decision is where is the long-term earnings power of this company over time and what dividend makes sense relative to that, and we're not going to overreact to one quarter or another along the way.

Jade Rahmani: Thank you.

Operator: Thank you. We'll go next – we'll take our last question from Rick Shane with J.P. Morgan.

Rick Shane: Hey. Thank you. It's actually almost a perfect segue. So if we think about setting a dividend policy on distributable earnings ex-realized losses, it essentially kind of takes credit out of the equation which I'm not really convinced is the best way to look at the business. One of the outcomes of that is that particularly given the start to '24, it looks like book value will be down for the third year in a row. You talk about sort of the sustainable dividend in the economics given where book value is today to earn that dividend would require about a 10.5% return on capital or economic return, which is a pretty high watermark for you guys. So, I really do wonder or ask I guess – I would ask the question – do you think that a 10% plus return given the near-term headwind of non-accruals and potentially, as we move into '25 lower base rates, is an achievable long-term target?

Katie Keenan: I think, it's a great question. The way we look at it is very much in that way. So, I think putting aside sort of short-term and the encumbrance of non-accruals, it really is about the long-term earnings power of the business, which relates to the equity value, the book value, and our ROE.

If you look back over the history of the business, we have very consistently generated a return that is about 900 basis points over base rates. And so base rates are a really important part of the equation. For most of the history of the business, base rates have been well below even what we see as sort of the terminal rate when we look at the SOFR curve today.

So I think that when you're thinking about where that normalized ROE could be over time, you need to think about sort of where ROE levels off. And obviously, there's other puts and takes in the overall business. But ultimately, the impact of credit is where equity value or book value ultimately ends up. And obviously, that's how we take it into account. It's just less impactful when you think about sort of this quarter or that quarter realized losses coming through the DE. It's about the long-term equity and the long-term earnings power of that equity.

Rick Shane: Got it. And given that, how should we think about the nature of the dividend for '24, given where we've started the year? Should we assume that that will be a return of capital as opposed to a true dividend?

Tony Marone: I think, it's early in the year to give tax attributes for a dividend if that's what you're asking.

Rick Shane: Okay. Fair enough. Thanks, guys.

Katie Keenan: Thanks so much.

Operator: Thank you. That will conclude our question and answer session. At this time, I would like to turn the call back over to Mr. Hayes for any additional or closing remarks.

Tim Hayes: Thank you, Katie, and to everyone joining today's call. Please reach out with any questions.