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Real Estate Performance Drags Down Blackstone's Profit as Firm Looks To Invest

World's Largest Commercial Property Owner Focuses More on Logistics Properties

Blackstone Group posted a sharp drop in first-quarter profit, hurt by declines in its real estate segment. (Getty Images)

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Blackstone Group, billed as the world's largest commercial property owner, reported declining real estate performance that fueled a drop in first-quarter profit. The results came amid economic uncertainty that executives said could provide an opportunity to begin spending its nearly $200 billion of investment capital.

Distributable earnings, a closely watched profit metric that indicates amounts available for dividends to Blackstone shareholders, fell 36% to $1.25 billion year over year as businesses are hit with higher interest rates, record-high office vacancies and worries over a possible recession.

Real estate, Blackstone's biggest profit-generating segment that it has been gradually shifting from office properties to industrial, was the worst performer, with distributable earnings sliding 58% to $535 million. Blackstone President and Chief Operating Officer Jonathan Gray said on conference call Thursday that logistics rents have spiked around the world.

Private equity, the New York-based firm's second-most profitable unit after real estate, posted a 6% increase in distributable earnings to $526 million. Its credit and insurance segment was one big bright spot, with distributable earnings jumping 34% to $298 million.

"Investor sentiment for real estate is sour again" as office market vacancies reached all-time highs and industry financing is "more constrained," Stephen Schwarzman, Blackstone's chairman, CEO and co-founder, said on the call. The first quarter represented a "turbulent" period as rising interest rates "led to significant challenges for investors," he said.

Still, despite "market headwinds," Schwarzman, quoting hockey great Wayne Gretzky, said, "You have to skate to where the puck is going, not where it is."

Expounding on that, Schwarzman said Blackstone is ready to be a buyer.

"We've learned the best time to put money is where [market] sentiment is negative," he said. "We have nearly $194 billion of dry powder. We see the start of the opportunity for deployment."

Regional Bank Partnerships

Blackstone executives said the firm plans to partner with regional banks, which have been losing deposits after the fallout of Signature Bank and Silicon Valley Bank, to provide loans for uses including auto financing and home improvement.

"This is a golden moment for [Blackstone's] credit and insurance" business, Blackstone President and Chief Operating Officer Jonathan Gray said on the call. "This is a favorable environment for deployment as regional banks experience outflow. … There's massive differentiation in real estate. You see people pull back regardless of the sector. Banks are quite focused on CRE exposure that's leading to a pullback. Opportunity in real estate debt will come first."

Blackstone has experienced some outflow of its own as investors, led by those in real estate, withdrew some $10.8 billion in the quarter as the firm capped some redemption requests. But that was offset by over $40 billion of inflow capital raised.

"Ultimately it's the performance that matters," Gray said. "There's a lot of attention on redemptions. Blackstone still had in the first quarter 9% of same-store cash flow growth. … It'll be multiple months of positive performance that will give people confidence and volatility calms down. … It's a matter of time."

While Blackstone has written down some office investments and sent loans such as a $270 million floating-rate loan backed by 11 Manhattan rental properties into special servicing, Schwarzman said the default rate is less than 1% of its loan portfolio historically.

Real Estate Targets

Blackstone has a "minimum exposure to traditional U.S. office," he said, adding that the firm has cut office to less than 2% of its U.S. real estate portfolio, from 60% at the time of its initial public offering in 2007. Instead, the company has expanded logistics to 40% of its U.S. property portfolio, from none at the time of its IPO, he said.

Worldwide, in addition to logistics, Blackstone is focused on areas including data centers, life science office buildings and rental housing, Gray said, adding the company's rent in the logistics sector, for instance, has risen 50% in the United States and 30% in the United Kingdom while doubling in Canada. Blackstone also likes exposure to residential properties, including single-family homes, Gray said, adding student housing is "where there's real strength."

He added that "office is one cautionary area."

With artificial intelligence emerging as the technology of the moment, Schwarzman said Blackstone is poised to benefit.

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“The growth as a result of [AI] is going to be the substantial need for data centers,” Schwarzman said. “It’s going to explode. It’ll be a competitive advantage for us.”

Blackstone, for its part, is seeking to tap into data science and has been meeting experts to learn about AI, Schwarzman said.

“We made a huge investment on data scientists,” Gray said, adding Blackstone has 40 of them. “We realized the world is changing quickly. We want to be ahead.”

Blackstone’s total assets under management last quarter rose 8% to $991.3 billion.