Blackstone real estate on a buying spree: What the latest deals tell us about the commercial real estate market

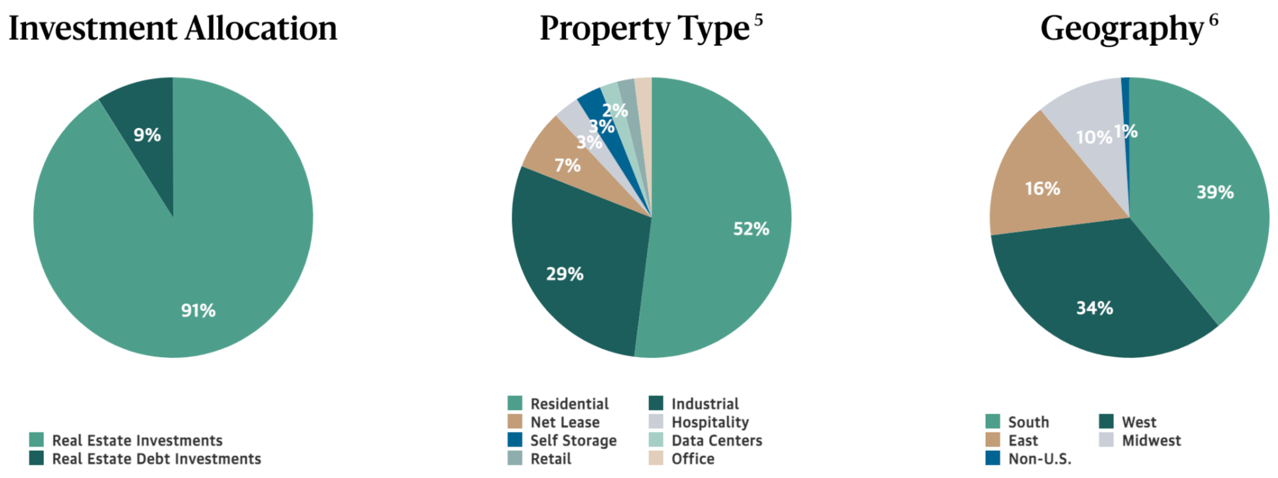
Introduction

In June 2021, the Blackstone Real Estate Income Trust (BREIT) announced the acquisition of Home Partners of America, valuing the company at $6bn. Home Partners of America is a Chicago-based real estate firm that focuses on single-family rental housing with a portfolio of 17.000 homes. A similar statement was released by BREIT on February 16th 2022, saying that the investment trust will acquire Preferred Apartment Communities in an all-cash transaction valued at about $5.8bn. Differently from Home Partners of America, Preferred Apartment Communities is a real estate investment trust (REIT) that counts investments in 107 properties, the majority of which are Class A multifamily properties and grocery-anchored retail assets. The purchase price represents a premium of around 39% on the closing stock price of February 9th and a premium of 60% to the 90-day volume-weighted average price.

The decisions taken by the management of Blackstone Real Estate Investment Trust (BREIT) reflect the trends the real estate industry is currently facing. The intensive activity BREIT is undertaking is a consequence of the increase in the attention that the real estate industry has raised over the past year. Investors are responding to the threat of rising inflation by investing in real estate as an inflation hedge. Therefore, the industry is seeing an increase in equity, which leads to higher amounts of liquidity that can be used for growth and expansion. Also, the industry has been significantly affected by the shortages in labour and raw materials the world is facing, leading to slowdowns in the construction of new properties. As a result, REITs and real estate firms are focusing more on refinancing and recapitalising already existing properties, like BREIT is doing with the two acquisitions, rather than building new ones. The choice of investing in companies that mainly focus on US residential properties is understandable as, despite the pandemic, the S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index has experienced exponential growth over the past years and has affirmed its strength and stability. As

About Blackstone Real Estate Investment Trust

Blackstone Real Estate Income Trust is a non-publicly traded REIT that brings real private real estate to income-focused investors. BREIT was launched in 2017 and is managed by a subsidiary of Blackstone [NYSE: BX]. Blackstone's real estate business was founded in 1991 and holds approximately $279bn under management. Blackstone Real Estate Income Trust currently owns 3,075 properties and the portfolio's total asset value is $96bn. 91% of BREIT's investments are allocated towards stabilised income-generating commercial real estate across several property types and the rest 9% is devoted to real estate debt investments.



Source: Blackstone Real Estate

The real asset in which BREIT allocates the majority of the funds is residential as, out of the total amount invested, 52% is in this property type. Apart from industrial, which currently accounts for 29% of the total investment, the other real assets such as retail, office, and hospitality hold a very narrow percentage of the total. It can be inferred that BREIT only focuses on US commercial real estate properties as only 1% of them are international, mainly in Canada and Europe. Interestingly, the investments of BREIT are mainly spread across the South and West regions of the country, as together they account for 73% of BREIT's total US investment properties. During the pandemic, being non-listed has significantly benefited Blackstone Real Estate Income Trust as it experienced a lower correlation to the uncertainty and volatility of the stock market compared to public REITs. In fact, Blackstone Real Estate Income Trust, like the other non-traded REITs, derives its worth from the net asset value (NAV) of their real estate investments and not from the perception and speculations of investors in the stock market. BREIT's NAV per share of $14.53 in January 2022 reached a record level as it is the highest NAV per share the BREIT has ever recorded. In January 2018, one year after Blackstone Real Estate Investment Trust's launch, its NAV per share was $10.01. Since 2017, the ratio has experienced an escalation every January. The NAVs per share of January 2019, 2020 and 2021 were respectively $10.82, $11.48 and $11.67.

Preferred Apartment Communities deal

Preferred Apartment Communities Inc. is a real estate investment trust specialising in the ownership and operation of Class A multifamily properties, as well as recently a few grocery-anchored commercial complexes. The investment goal of Preferred Apartment Communities is to provide stockholders with attractive and consistent returns by investing in income-producing assets and acquiring or originating multifamily real estate loans. The company currently owns or has investments in 107 properties in 13 states. As far as the Preferred

Apartment Communities deal, the reasoning is clear cut. The synergies of the deal are perfectly aligned with Blackstone's strategy of "planting perennials", essentially investing in perpetual capital vehicles for both appreciation and deriving consistent revenue from management fees associated with the asset to bolster earnings. This is similar to what they are doing in the insurance sector with their partial acquisitions of both AIG and Allstate allowing them to manage (and thereby reap performance fees) off of much larger parts of their respective portfolios of insurance products.

Jones Lang LaSalle Limited, BofA Securities, Lazard Frères & Co. LLC and Wells Fargo Securities LLC served as Blackstone's financial advisors, and Simpson Thacher & Bartlett LLP was acting as Blackstone's legal counsel. Goldman Sachs & Co. LLC served as PAC's lead financial advisor. KeyBanc Capital Markets, Inc., also served as financial advisor to PAC. King & Spalding LLP and Vinson & Elkins LLP served as the Company's legal counsel.

Home Partners of America deal

Home Partners of America Inc., based in Chicago, acquires and operates rental homes to democratise access to single-family living in the United States. By way of their inventive 'Lease Purchase Program', potential purchasers select an eligible property, which is subsequently purchased by Home Partners of America. Then, the potential buyer enters a 1-year renewable lease contract, which can be renewed over 5 years, and receives the right, but not the obligation to purchase the property at a predetermined price within those 5 years. Despite the innovative concept, the company has been shrouded in controversy due to their "purchase option with zero associated cost", which implies that their customers can exercise their ability to purchase the property at a non-marked up market price. However, the Financial Times discovered that lessors were on average paying 10% more than the average monthly market rate for their respective areas, something important to note as only one fifth of lessors exercise their right to purchase the property. While heavily refuted by Home Partners of America, these findings further show the economics of the project and feed into Blackstone's long-term goal of acquiring perpetual capital vehicles. As stated by Blackstone Real Estates' senior managing director Jacob Werner, "[The] fundamental premise of the Home Partners platform is to provide residents with the opportunity to live in their chosen home with the option to purchase it." Blackstone aims to further disseminate this ideology across the United States, while simultaneously "expanding the financial planning assistance program offered to all residents" on the platform. The reasoning mirrors Blackstone's reasoning for building up a similar investment that they unwound at the onset of the pandemic, Innovation Homes. Blackstone began pouring money into distressed residential real estate in the early part of the preceding decade, shortly after the 2008 foreclosure crisis, investing billions to buy foreclosures and other distressed buildings, then converting them into single-family rental units. After an IPO in 2017, Blackstone gradually began winding down their ownership percentage but not before "[investing] $10bn ... to acquire these homes and [a] subsequent $2bn in upfront renovations to improve them [to] stabilise local housing markets, spur economic growth and create jobs in communities in the wake of the financial crisis." This concept of providing equitable access to rental homes is similar to the Home Partners of America acquisition and feels like Blackstone trying to get back on the train they just so recently departed.

However, a key difference is that this time around they do not buy homes before they have a lessor, an important part of creating a secure source of revenue without taking on unnecessary debt.

BofA Securities and Wells Fargo Securities were financial advisers to Blackstone, while Simpson Thatcher and Bartlett LLP was its legal counsel. Goldman Sachs and Co LLC was the financial adviser to Home Partners of America, while Sidley Austin LLP and Fried, Frank, Harris, Shriver & Jacobson LLP acted as its legal counsel.

What comes next?

Looking forward into the future of both Blackstone and the real estate market as a whole, despite a perpetuated sentiment that we are nearing the peak of a bubble, it is important to note that the market isn't exhibiting any of the historical warning signs, such as too much leverage or too much capital. Jonathan Gray, the COO of Blackstone, believes that the market is set to continue on its track of pre-pandemic growth and that the powerhouse cities of New York & San Francisco will see a "rediscovery" fueled by "immigrants, creativity, entrepreneurship and technology." Another factor to support this is the current rampant inflation. This drives up the replacement cost of current real estate (i.e. the amount a business would have to spend to replace a piece of property), creating, to some degree, a price cushion.

One of the largest cited effects of the COVID induced real estate slowdown was the growing number of vacancies in office buildings. WFH restrictions and a general unwillingness to return the office have and will continue to cause large vacancies and discourage potential investors in the class, but Blackstone's beliefs and strategies going forward are based on the fact that even this is only temporary. Indeed, within the decade a near 100% recovery in office demand is expected, even if in a slightly different format. A practical indication of this is that in China a majority of buildings are already back to operating at full. Additionally, this development might be more rapid in Europe, as the average person in Europe does not have the same luxury of size within their abode, having on average only 100sqm in comparison to the 240sqm had by their American counterparts. When considering all of these factors as well as the opinion of Blackstone, demonstrated through words and actions, it is safe to say that we will see at minimum a gradual return to the rate of scaling in all classes of real estate going forward

TAGS: commercial real estate, Blackstone real estate, BREIT, REPE, real estate private equity, home partners of America, Preferred Apartment Communities, REIT