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DEALS

Blackstone's Meghji: 'When someone calls with $4bn of capital, you answer the phone'

The US endowment's commitment into the manager's BREIT fund announced last week is a 'win-win' for both sides and an absolute 'home run' thanks to the extra liquidity and flexibility it provides, Nadeem Meghji, Blackstone's head of real estate Americas, told PERE.

The first headline-grabbing institutional real estate investment of the year was made in a fund which had also dominated headlines at the end of 2022. Last week, UC Investments, the $152 billion endowment of the University of California, announced a $4 billion commitment to Blackstone's biggest real estate fund, BREIT, via a structured transaction.

The deal in summary: UC Investments acquired $4 billion of BREIT common shares at their January 1 offering price, on terms and fees consistent with the fund's other shareholders. However, unlike other investors, the endowment is locked in for an effective six-year hold period. Concurrently, Blackstone and UC Investments have agreed to a separate venture with a waterfall return structure. That structure sees Blackstone contribute $1 billion of its current holdings in BREIT, which will support UC Investments with an 11.25 percent minimum return, annualized over an effective six-year hold period. For this performance commitment, Blackstone will be entitled to an incremental 5 percent cash promote payment from UC Investments on any returns received in excess of this specified minimum. With the fees being paid by UC Investments, as long as BREIT produces in excess of an 8.7 percent annualized net return, Blackstone expects this transaction will generate incremental profit for the firm.

Meghji: The commitment by UC Investments is a 'win-win' for both sides.

The investment was not sought by Blackstone. But the firm has welcomed the liquidity injection regardless. BREIT, which has a net asset value of $69 billion, has been in the crosshairs since redemption requests exceeded permissible limits late last year. While redemption requests have continued – the firm confirmed requests equivalent to 5.44 percent of net asset value in December – a significant investment by UC Investments has "changed the narrative" and is a "massive validation" of the vehicle, according to Nadeem Meghji, a Blackstone senior managing director and the firm's head of real estate Americas.

In an interview with Jonathan Brasse, PEI's editor-in-chief, real estate, Meghji explains how the addition of this sophisticated capital to the fund's 200,000-strong high-net-worth investor mix validates the firm's conviction in BREIT and its investment strategies. Here is an abridged version of their conversation:

Q PERE: Let's start with the approach. It is unusual to read about who approached who in statements on transactions. Yet UC Investments made a point of making the approach. What should we make of this?

Meghji: UC knows our firm well. They are a long-time investor with Blackstone and had a sense of what we've built here in terms of the portfolio quality. Interestingly, they saw Jon Gray speaking on CNBC in December and reached out to us to see if they could be helpful by deploying capital in a way that would create a win-win.

After some discussion, we reached an agreement that creates strong alignment and recognizes the scale of capital they are bringing to bear. UC deserves a lot of credit in approaching us and suggesting this. This is not something we were looking to do. But it emerged and we recognized it would be an excellent outcome for BREIT and Blackstone, and for UC.

When you take a step back, what happened here is that a very sophisticated institutional investor did a ton of diligence and spent time to fully understand our valuations and go-forward outlook. As a result of that process, they decided to invest $4 billion. At the same time, you have Blackstone committing $1 billion of its own shares into this strategic venture, demonstrating the conviction that both organizations have in BREIT.

Q PERE: So, could you characterize UC Investments' approach as opportunistic?

Meghji: I think UC saw a potential opportunity and they moved quickly to capitalize. They were familiar with the situation, and I believe they saw it as an interesting way to increase their exposure to real estate with a partner they know well and have strong confidence in. They will own what they have described as one of the best positioned portfolios in real estate, in all the right sectors, with arguably the best manager, in a structure where the downside is protected. There is also an opportunity for them to collaborate with our portfolio companies in student and affordable housing for their campuses. They have been very strategic about this.

Q PERE: Blackstone is known for structuring smart deals on behalf of its funds, not being the subject of structured deals with investors for positions in its funds. The firm is known too for not deviating on terms. Does this transaction impact those reputations?

Meghji: We do deals across all different types of structures. In this case, we had an investor willing to write a $4 billion check, which is 57,000 times larger than a typical BREIT investment. They also agreed to a six-year minimum effective hold period and full fees – all of which warranted some form of accommodation. Both parties felt a minimum return, supported not by Blackstone as a firm, but by the $1 billion of BREIT stock Blackstone owns, was an appropriate way to provide that support. And in exchange, Blackstone is entitled to receive an incremental 5 percent cash promote payment if the return exceeds 11.25 percent.

From Blackstone's perspective, given UC is paying full fees, as long as BREIT produces in excess of an 8.7 percent annualized net return, Blackstone is expected to achieve incremental profit from UC's investment. From UC's perspective, they are getting some downside protection in a great real estate portfolio. From BREIT's perspective, this is an absolute home run simply because $4 billion of fresh cash is coming into the company on the same terms as other investors. It gives the balance sheet more flexibility and BREIT more liquidity to play offense at what we believe is an opportune moment for capital deployment.

Q PERE: Is the $4 billion to be used for investments only or other items like the redemptions?

Meghji: We have full discretion. Our goal is to be flexible and best serve BREIT investors. How it is used will be a function of the environment, deployment opportunities, repurchase activity and other capital needs. With this investment, $14 billion of immediate liquidity is on the balance sheet – 20 percent of the vehicle's NAV. That much liquidity gives us the flexibility to do a lot of exciting things.

Q PERE: Do you think structuring a fund commitment with UC Investments will provoke other institutional investors to approach Blackstone for similar treatment?

Meghji: We are always going to be open to evaluating opportunities that could potentially benefit BREIT's investors. This happened to be a unique situation that resulted in a positive outcome. When someone calls with $4 billion of capital, you answer the phone. If there were other opportunities to get creative and find a win-win solution, we are open to exploring that.

Q PERE: With a $4 billion investment by a US endowment now in BREIT's investor mix, the retail proportion is diluted. Could this commitment be construed as contravening the concept of the democratization of private assets, something which Blackstone had been promoting?

Meghji: Not at all. The investment hasn't in any way limited access to our individual investors and we are raising money from individuals every month. We view this investment as adding to the capital base of a vehicle that remains fundamentally geared towards individual investors. At the same time, our goal is to bring the highest quality alternative investment products to individual investors. This transaction evidences that we've done exactly that.

We have $70 billion from over 200,000 investors in this vehicle. Some will always leave and some will always come in. The few that are redeeming are doing for their own reasons. BREIT has delivered extraordinary returns for investors since inception, and investors are quite happy with that. Notably, just 3 percent of our US investor capital base sought liquidity last month and 5 percent overall. In the fullness of time, we expect fund flows to be a function of our performance.

Q PERE: Blackstone's share price has responded positively to the update. But is the real litmus test really a fall in redemption requests in the vehicle?

Meghji: It is hard to know what redemptions would have been, or what subscriptions would have been, in the absence of the UC investment. But, to us, this has already been successful. A sophisticated institution did significant due diligence and concluded that this is where they want to invest $4 billion in today's environment. That is a massive validation for the portfolio and the business we have built. ■