

BLACKSTONE MORTGAGE TRUST, INC.

Form 10-Q

April 23, 2019

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019**
OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO**
Commission File Number: 001-14788

Blackstone Mortgage Trust, Inc.

(Exact name of Registrant as specified in its charter)

Maryland

94-6181186

Edgar Filing: BLACKSTONE MORTGAGE TRUST, INC. - Form 10-Q

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

345 Park Avenue, 42nd Floor

New York, New York 10154

(Address of principal executive offices)(Zip Code)

(212) 655-0220

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of the registrant's outstanding shares of class A common stock, par value \$0.01 per share, outstanding as of April 16, 2019 was 125,666,822.

Table of Contents

TABLE OF CONTENTS

PART I.	<u>FINANCIAL INFORMATION</u>	
ITEM 1.	<u>FINANCIAL STATEMENTS</u>	2
	Consolidated Financial Statements (Unaudited):	
	<u>Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018</u>	2
	<u>Consolidated Statements of Operations for the Three Months Ended March 31, 2019 and 2018</u>	3
	<u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2019 and 2018</u>	4
	<u>Consolidated Statements of Changes in Equity for the Three Months Ended March 31, 2019 and 2018</u>	5
	<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2019 and 2018</u>	6
	<u>Notes to Consolidated Financial Statements</u>	8
ITEM 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	43
ITEM 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	63
ITEM 4.	<u>CONTROLS AND PROCEDURES</u>	65
PART II.	<u>OTHER INFORMATION</u>	
ITEM 1.	<u>LEGAL PROCEEDINGS</u>	66
ITEM 1A.	<u>RISK FACTORS</u>	66
ITEM 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	66
ITEM 3.	<u>DEFAULTS UPON SENIOR SECURITIES</u>	66
ITEM 4.	<u>MINE SAFETY DISCLOSURES</u>	66
ITEM 5.	<u>OTHER INFORMATION</u>	66
ITEM 6.	<u>EXHIBITS</u>	67
	<u>SIGNATURES</u>	68

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Blackstone Mortgage Trust, Inc.****Consolidated Balance Sheets (Unaudited)**

(in thousands, except share data)

	March 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	\$ 79,437	\$ 105,662
Loans receivable, net	14,508,735	14,191,200
Other assets	208,048	170,513
Total Assets	\$ 14,796,220	\$ 14,467,375
Liabilities and Equity		
Secured debt agreements, net	\$ 9,208,010	\$ 8,974,756
Loan participations sold, net	107,237	94,418
Securitized debt obligations, net	1,286,417	1,285,471
Convertible notes, net	610,684	609,911
Other liabilities	132,283	128,212
Total Liabilities	11,344,631	11,092,768
Commitments and contingencies		
Equity		
Class A common stock, \$0.01 par value, 200,000,000 shares authorized, 125,666,550 and 123,435,738 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	1,257	1,234
Additional paid-in capital	4,039,805	3,966,540
Accumulated other comprehensive loss	(30,756)	(34,222)
Accumulated deficit	(570,908)	(569,428)
Total Blackstone Mortgage Trust, Inc. stockholders' equity	3,439,398	3,364,124
Non-controlling interests	12,191	10,483
Total Equity	3,451,589	3,374,607
Total Liabilities and Equity	\$ 14,796,220	\$ 14,467,375

Note: The consolidated balance sheets as of March 31, 2019 and December 31, 2018 include assets of consolidated variable interest entities, or VIEs, that can only be used to settle obligations of each respective VIE, and liabilities of consolidated VIEs for which creditors do not have recourse to Blackstone Mortgage Trust, Inc. As of both March 31, 2019 and December 31, 2018, assets of the consolidated VIEs totaled \$1.5 billion and liabilities of the consolidated VIEs totaled \$1.3 billion. Refer to Note 15 for additional discussion of the VIEs.

See accompanying notes to consolidated financial statements.

Table of Contents

Blackstone Mortgage Trust, Inc.
Consolidated Statements of Operations (Unaudited)
(in thousands, except share and per share data)

	Three Months Ended March 31,	
	2019	2018
Income from loans and other investments		
Interest and related income	\$ 224,759	\$ 155,425
Less: Interest and related expenses	118,688	69,989
Income from loans and other investments, net	106,071	85,436
Other expenses		
Management and incentive fees	19,790	15,492
General and administrative expenses	9,313	8,708
Total other expenses	29,103	24,200
Income before income taxes	76,968	61,236
Income tax provision	101	120
Net income	76,867	61,116
Net income attributable to non-controlling interests	(302)	(158)
Net income attributable to Blackstone Mortgage Trust, Inc.	\$ 76,565	\$ 60,958
Net income per share of common stock basic and diluted	\$ 0.62	\$ 0.56
Weighted-average shares of common stock outstanding, basic and diluted	124,333,048	108,397,598

See accompanying notes to consolidated financial statements.

Table of Contents

Blackstone Mortgage Trust, Inc.

Consolidated Statements of Comprehensive Income (Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2019	2018
Net income	\$ 76,867	\$ 61,116
Other comprehensive income		
Unrealized gain on foreign currency translation	5,414	10,738
Realized and unrealized loss on derivative financial instruments	(1,948)	(2,935)
Other comprehensive income	3,466	7,803
Comprehensive income	80,333	68,919
Comprehensive income attributable to non-controlling interests	(302)	(158)
Comprehensive income attributable to Blackstone Mortgage Trust, Inc.	\$ 80,031	\$ 68,761

See accompanying notes to consolidated financial statements.

Table of Contents**Blackstone Mortgage Trust, Inc.****Consolidated Statements of Changes in Equity (Unaudited)**

(in thousands)

	Blackstone Mortgage Trust, Inc. Accumulated						
	Class A Common Stock	Additional Paid-In Capital	Other Comprehensive (Loss) Income	Accumulated Deficit	Stockholders Equity	Non- controlling Interests	Total Equity
Balance at December 31, 2017	\$ 1,079	\$ 3,506,861	\$ (29,706)	\$ (567,168)	\$ 2,911,066	\$ 6,340	\$ 2,917,406
Shares of class A common stock issued, net	3				3		3
Restricted class A common stock earned		6,848			6,848		6,848
Issuance of convertible notes		1,462			1,462		1,462
Dividends reinvested		122		(108)	14		14
Deferred directors' compensation		125			125		125
Other comprehensive income			7,803		7,803		7,803
Net income				60,958	60,958	158	61,116
Dividends declared on common stock, \$0.62 per share				(67,066)	(67,066)		(67,066)
Contributions from non-controlling interests						375	375
Distributions to non-controlling interests						(1,575)	(1,575)
Balance at March 31, 2018	\$ 1,082	\$ 3,515,418	\$ (21,903)	\$ (573,384)	\$ 2,921,213	\$ 5,298	\$ 2,926,511
Balance at December 31, 2018	\$ 1,234	\$ 3,966,540	\$ (34,222)	\$ (569,428)	\$ 3,364,124	\$ 10,483	\$ 3,374,607
Shares of class A common stock issued, net	23	65,358			65,381		65,381
Restricted class A common stock earned		7,639			7,639		7,639
Dividends reinvested		143		(132)	11		11
Deferred directors' compensation		125			125		125
Other comprehensive income			3,466		3,466		3,466
Net income				76,565	76,565	302	76,867
Dividends declared on common stock, \$0.62 per share				(77,913)	(77,913)		(77,913)
Contributions from non-controlling interests						1,470	1,470
Distributions to non-controlling interests						(64)	(64)
Balance at March 31, 2019	\$ 1,257	\$ 4,039,805	\$ (30,756)	\$ (570,908)	\$ 3,439,398	\$ 12,191	\$ 3,451,589

See accompanying notes to consolidated financial statements.

Table of Contents**Blackstone Mortgage Trust, Inc.****Consolidated Statements of Cash Flows (Unaudited)**

(in thousands)

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities		
Net income	\$ 76,867	\$ 61,116
Adjustments to reconcile net income to net cash provided by operating activities		
Non-cash compensation expense	7,768	6,976
Amortization of deferred fees on loans and debt securities	(13,356)	(11,229)
Amortization of deferred financing costs and premiums/discount on debt obligations	7,265	6,331
Changes in assets and liabilities, net		
Other assets	(4,780)	(354)
Other liabilities	3,808	9,739
Net cash provided by operating activities	77,572	72,579
Cash flows from investing activities		
Origination and fundings of loans receivable	(799,326)	(1,978,213)
Principal collections and sales proceeds from loans receivable and debt securities	463,483	1,001,682
Origination and exit fees received on loans receivable	5,501	18,881
Receipts under derivative financial instruments	2,956	22
Payments under derivative financial instruments	(970)	(7,397)
Return of collateral deposited under derivative agreements	4,000	10,740
Collateral deposited under derivative agreements	(9,090)	(13,210)
Net cash used in investing activities	(333,446)	(967,495)

6

continued

See accompanying notes to consolidated financial statements.

Table of Contents**Blackstone Mortgage Trust, Inc.****Consolidated Statements of Cash Flows (Unaudited)**

(in thousands)

	Three Months Ended March 31,	
	2019	2018
Cash flows from financing activities		
Borrowings under secured debt agreements	\$ 721,571	\$ 1,949,135
Repayments under secured debt agreements	(483,748)	(1,265,100)
Proceeds from sale of loan participations	12,802	37,483
Payment of deferred financing costs	(11,200)	(10,217)
Contributions from non-controlling interests	1,470	375
Distributions to non-controlling interests	(64)	(1,575)
Net proceeds from issuance of convertible notes		214,463
Net proceeds from issuance of class A common stock	65,377	
Dividends paid on class A common stock	(76,530)	(66,888)
Net cash provided by financing activities	229,678	857,676
Net decrease in cash, cash equivalents, and restricted cash	(26,196)	(37,240)
Cash, cash equivalents, and restricted cash at beginning of year	105,662	102,518
Effects of currency translation on cash, cash equivalents, and restricted cash	(29)	9,200
Cash, cash equivalents, and restricted cash at end of year	\$ 79,437	\$ 74,478
Supplemental disclosure of cash flows information		
Payments of interest	\$ (107,971)	\$ (55,582)
Payments of income taxes	\$ (74)	\$ (135)
Supplemental disclosure of non-cash investing and financing activities		
Dividends declared, not paid	\$ (77,913)	\$ (67,080)
Loan principal payments held by servicer, net	\$ 37,285	\$ 4,684

See accompanying notes to consolidated financial statements.

Table of Contents

Blackstone Mortgage Trust, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. ORGANIZATION

References herein to Blackstone Mortgage Trust, Company, we, us or our refer to Blackstone Mortgage Trust, Inc. and its subsidiaries unless context specifically requires otherwise.

Blackstone Mortgage Trust is a real estate finance company that originates senior loans collateralized by commercial real estate in North America, Europe, and Australia. Our investment objective is to preserve and protect shareholder capital while producing attractive risk-adjusted returns primarily through dividends generated from current income from our loan portfolio. We are externally managed by BXMT Advisors L.L.C., or our Manager, a subsidiary of The Blackstone Group L.P., or Blackstone, and are a real estate investment trust, or REIT, traded on the New York Stock Exchange, or NYSE, under the symbol BXMT. Our principal executive offices are located at 345 Park Avenue, 14th Floor, New York, New York 10154. We were incorporated in Maryland in 1998, when we reorganized from a California common law business trust into a Maryland corporation.

We conduct our operations as a REIT for U.S. federal income tax purposes. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute all of our net taxable income to stockholders and maintain our qualification as a REIT. We also operate our business in a manner that permits us to maintain an exclusion from registration under the Investment Company Act of 1940, as amended. We are organized as a holding company and conduct our business primarily through our various subsidiaries.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The consolidated financial statements, including the notes thereto, are unaudited and exclude some of the disclosures required in audited financial statements. We believe we have made all necessary adjustments, consisting of only normal recurring items, so that the consolidated financial statements are presented fairly and that estimates made in preparing our consolidated financial statements are reasonable and prudent. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. The accompanying unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 filed with the Securities and Exchange Commission, or the SEC.

Basis of Presentation

The accompanying consolidated financial statements include, on a consolidated basis, our accounts, the accounts of our wholly-owned subsidiaries, majority-owned subsidiaries, and variable interest entities, or VIEs, of which we are the primary beneficiary. All intercompany balances and transactions have been eliminated in consolidation.

Certain reclassifications have been made in the presentation of the prior period secured debt agreements in Note 5 to conform to the current period presentation.

Principles of Consolidation

We consolidate all entities that we control through either majority ownership or voting rights. In addition, we consolidate all VIEs of which we are considered the primary beneficiary. VIEs are defined as entities in which

Table of Contents

Blackstone Mortgage Trust, Inc.

Notes to Consolidated Financial Statements (continued)

(Unaudited)

equity investors (i) do not have the characteristics of a controlling financial interest and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The entity that consolidates a VIE is known as its primary beneficiary and is generally the entity with (i) the power to direct the activities that most significantly affect the VIE's economic performance and (ii) the right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could be significant to the VIE.

In the third quarter of 2018, we contributed a loan to a single asset securitization vehicle, or the 2018 Single Asset Securitization, which is a VIE, and invested in the related subordinate risk retention position. We are not the primary beneficiary of the VIE because we do not have the power to direct the activities that most significantly affect the VIE's economic performance and, therefore, do not consolidate the 2018 Single Asset Securitization on our balance sheet. We have classified the subordinate risk retention position as a held-to-maturity debt security that is included in other assets on our consolidated balance sheets. Refer to Note 15 for additional discussion of our VIEs.

In April 2017, we entered into a joint venture, or our Multifamily Joint Venture, with Walker & Dunlop Inc. to originate, hold, and finance multifamily bridge loans. Pursuant to the terms of the agreements governing the joint venture, Walker & Dunlop contributed 15% of the venture's equity capital and we contributed 85%. We consolidate the Multifamily Joint Venture as we have a controlling financial interest. The non-controlling interests included on our consolidated balance sheets represent the equity interests in our Multifamily Joint Venture that are owned by Walker & Dunlop. A portion of our Multifamily Joint Venture's consolidated equity and results of operations are allocated to these non-controlling interests based on Walker & Dunlop's pro rata ownership of our Multifamily Joint Venture.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may ultimately differ from those estimates.

Revenue Recognition

Interest income from our loans receivable portfolio and debt securities is recognized over the life of each investment using the effective interest method and is recorded on the accrual basis. Recognition of fees, premiums, and discounts associated with these investments is deferred and recorded over the term of the loan or debt security as an adjustment to yield. Income accrual is generally suspended for loans at the earlier of the date at which payments become 90 days past due or when, in the opinion of our Manager, recovery of income and principal becomes doubtful. Income is then recorded on the basis of cash received until accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. In addition, for loans we originate, the related origination expenses are deferred and recognized as a component of interest income, however expenses related to loans we acquire are included in general and administrative expenses as incurred.

Cash, Cash Equivalents, and Restricted Cash

Cash and cash equivalents represent cash held in banks and liquid investments with original maturities of three months or less. We may have bank balances in excess of federally insured amounts; however, we deposit our cash and cash equivalents with high credit-quality institutions to minimize credit risk exposure. We have not experienced, and do not expect, any losses on our cash or cash equivalents.

Table of Contents**Blackstone Mortgage Trust, Inc.****Notes to Consolidated Financial Statements (continued)****(Unaudited)**

Restricted cash represents cash held in a segregated bank account related to a letter of credit.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash in our consolidated balance sheets to the total amount shown in our consolidated statements of cash flows (\$ in thousands):

	March 31, 2019	March 31, 2018
Cash and cash equivalents	\$ 79,437	\$ 57,396
Restricted cash		17,082
Total cash, cash equivalents, and restricted cash shown in our consolidated statements of cash flows	\$ 79,437	\$ 74,478

Through our subsidiaries, we have oversight of certain servicing accounts held with third-party servicers, or Servicing Accounts, which relate to borrower escrows and other cash balances aggregating \$291.3 million as of March 31, 2019. This cash is maintained in segregated bank accounts, and these amounts are not included in the assets and liabilities presented in our consolidated balance sheets. Cash in these Servicing Accounts will be transferred by the respective third-party servicer to the borrower or us under the terms of the applicable loan agreement upon occurrence of certain future events. We do not generate any revenue or incur any expenses as a result of these Servicing Accounts.

Loans Receivable and Provision for Loan Losses

We originate and purchase commercial real estate debt and related instruments generally to be held as long-term investments at amortized cost. We are required to periodically evaluate each of these loans for possible impairment. Impairment is indicated when it is deemed probable that we will not be able to collect all amounts due to us pursuant to the contractual terms of the loan. If a loan is determined to be impaired, we write down the loan through a charge to the provision for loan losses. Impairment of these loans, which are collateral dependent, is measured by comparing the estimated fair value of the underlying collateral, less costs to sell, to the book value of the respective loan. These valuations require significant judgments, which include assumptions regarding capitalization rates, leasing, creditworthiness of major tenants, occupancy rates, availability of financing, exit plan, loan sponsorship, actions of other lenders, and other factors deemed necessary by our Manager. Actual losses, if any, could ultimately differ from these estimates.

Our Manager performs a quarterly review of our portfolio of loans. In conjunction with this review, our Manager assesses the risk factors of each loan, and assigns it a risk rating based on a variety of factors, including, without limitation, loan-to-value ratio, or LTV, debt yield, property type, geographic and local market dynamics, physical condition, cash flow volatility, leasing and tenant profile, loan structure and exit plan, and project sponsorship. Based on a 5-point scale, our loans are rated 1 through 5, from less risk to greater risk, which ratings are defined as follows:

1 Very Low Risk

2 Low Risk

3 Medium Risk

- 4 **High Risk/Potential for Loss:** A loan that has a risk of realizing a principal loss.

- 5 **Impaired/Loss Likely:** A loan that has a very high risk of realizing a principal loss or has otherwise incurred a principal loss.

Table of Contents

Blackstone Mortgage Trust, Inc.

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Debt Securities Held-to-Maturity

We classify our debt securities as held-to-maturity, as we have the intent and ability to hold these securities until maturity. We include our debt securities in other assets on our consolidated balance sheets at amortized cost.

If, based on current information and events, there is an adverse change in cash flows expected to be collected from the cash flows previously projected for one of our debt securities, an other-than-temporary impairment is deemed to have occurred. A change in expected cash flows is considered adverse if the present value of the revised cash flows (taking into consideration both the timing and amount of cash flows expected to be collected), discounted using the debt security's current yield, is less than the present value of the previously estimated remaining cash flows. If an other-than-temporary impairment is considered to have occurred, the debt security is written down to fair value. The total other-than-temporary impairment is bifurcated into (i) the amount related to expected credit losses, and (ii) the amount related to fair value adjustments in excess of expected credit losses. The other-than-temporary impairment related to expected credit losses is calculated by comparing the amortized cost basis of the security to the present value of cash flows expected to be collected, discounted at the security's current yield, and is recognized in earnings in the consolidated statement of operations. The remaining other-than-temporary impairment that is not related to expected credit losses is recognized in other comprehensive income (loss). A portion of other-than-temporary impairments recognized through earnings is accreted back to the amortized cost basis of the security through interest income, while amounts recognized through other comprehensive income (loss) are amortized over the life of the security with no impact on earnings.

Derivative Financial Instruments

We classify all derivative financial instruments as either other assets or other liabilities on our consolidated balance sheets at fair value.

On the date we enter into a derivative contract, we designate each contract as (i) a hedge of a net investment in a foreign operation, or net investment hedge, (ii) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability, or cash flow hedge, (iii) a hedge of a recognized asset or liability, or fair value hedge, or (iv) a derivative instrument not to be designated as a hedging derivative, or non-designated hedge. For all derivatives other than those designated as non-designated hedges, we formally document our hedge relationships and designation at the contract's inception. This documentation includes the identification of the hedging instruments and the hedged items, its risk management objectives, strategy for undertaking the hedge transaction and our evaluation of the effectiveness of its hedged transaction.

On a quarterly basis, we also formally assess whether the derivative we designated in each hedging relationship is expected to be, and has been, highly effective in offsetting changes in the value or cash flows of the hedged items. If it is determined that a derivative is not highly effective at hedging the designated exposure, hedge accounting is discontinued and the changes in fair value of the instrument are included in net income prospectively. Changes in the fair value of our derivative instruments that qualify as hedges are reported as a component of accumulated other comprehensive income (loss) on our consolidated financial statements. Deferred gains and losses are reclassified out of accumulated other comprehensive income (loss) and into net income in the same period or periods during which the hedged transaction affects earnings, and are presented in the same line item as the earnings effect of the hedged item. For cash flow hedges, this is typically when the periodic swap settlements are made, while for net investment hedges, this occurs when the hedged item is sold or substantially liquidated. To the extent a derivative does not qualify for hedge accounting and is deemed a non-designated hedge, the changes in its fair value are included in net income concurrently.

Table of Contents

Blackstone Mortgage Trust, Inc.

Notes to Consolidated Financial Statements (continued)

(Unaudited)

Secured Debt Agreements

Where applicable, we record investments financed with repurchase agreements as separate assets and the related borrowings under any repurchase agreements are recorded as separate liabilities on our consolidated balance sheets. Interest income earned on the investments and interest expense incurred on the repurchase agreements are reported separately on our consolidated statements of operations.

Senior Loan Participations

In certain instances, we finance our loans through the non-recourse syndication of a senior loan interest to a third-party. Depending on the particular structure of the syndication, the senior loan interest may remain on our GAAP balance sheet or, in other cases, the sale will be recognized and the senior loan interest will no longer be included in our consolidated financial statements. When these sales are not recognized under GAAP we reflect the transaction by recording a loan participations sold liability on our consolidated balance sheet, however this gross presentation does not impact stockholders' equity or net income. When the sales are recognized, our balance sheet only includes our remaining subordinate loan and not the non-consolidated senior interest we sold.

Convertible Notes

The Debt with Conversion and Other Options Topic of the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, requires the liability and equity components of convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, to be separately accounted for in a manner that reflects the issuer's nonconvertible debt borrowing rate. The initial proceeds from the sale of convertible notes are allocated between a liability component and an equity component in a manner that reflects interest expense at the rate of similar nonconvertible debt that could have been issued at such time. The equity component represents the excess initial proceeds received over the fair value of the liability component of the notes as of the date of issuance. We measured the estimated fair value of the debt component of our convertible notes as of the respective issuance dates based on our nonconvertible debt borrowing rate. The equity component of each series of our convertible notes is reflected within additional paid-in capital on our consolidated balance sheet, and the resulting debt discount is amortized over the period during which such convertible notes are expected to be outstanding (through the maturity date) as additional non-cash interest expense. The additional non-cash interest expense attributable to such convertible notes will increase in subsequent periods through the maturity date as the notes accrete to their par value over the same period.

Deferred Financing Costs

The deferred financing costs that are included as a reduction in the net book value of the related liability on our consolidated balance sheets include issuance and other costs related to our debt obligations. These costs are amortized as interest expense using the effective interest method over the life of the related obligations.

Fair Value of Financial Instruments

The Fair Value Measurements and Disclosures Topic of the FASB, or ASC 820, defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements under GAAP. Specifically, this guidance defines fair value based on exit price, or the price that would be received upon the sale of an asset or the transfer of a liability in an orderly transaction between market participants at the measurement date.

Table of Contents

Blackstone Mortgage Trust, Inc.

Notes to Consolidated Financial Statements (continued)

(Unaudited)

ASC 820 also establishes a fair value hierarchy that prioritizes and ranks the level of market price observability used in measuring financial instruments. Market price observability is affected by a number of factors, including the type of financial instrument, the characteristics specific to the financial instrument, and the state of the marketplace, including the existence and transparency of transactions between market participants. Financial instruments with readily available quoted prices in active markets generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Financial instruments measured and reported at fair value are classified and disclosed based on the observability of inputs used in the determination, as follows:

Level 1: Generally includes only unadjusted quoted prices that are available in active markets for identical financial instruments as of the reporting date.

Level 2: Pricing inputs include quoted prices in active markets for similar instruments, quoted prices in less active or inactive markets for identical or similar instruments where multiple price quotes can be obtained, and other observable inputs, such as interest rates, yield curves, credit risks, and default rates.

Level 3: Pricing inputs are unobservable for the financial instruments and include situations where there is little, if any, market activity for the financial instrument. These inputs require significant judgment or estimation by management of third-parties when determining fair value and generally represent anything that does not meet the criteria of Levels 1 and 2.

The estimated value of each asset reported at fair value using Level 3 inputs is determined by an internal committee composed of members of senior management of our Manager, including our Chief Executive Officer, Chief Financial Officer, and other senior officers.

Certain of our other assets are reported at fair value either (i) on a recurring basis, as of each quarter-end, or (ii) on a nonrecurring basis, as a result of impairment or other events. Our assets that are recorded at fair value are discussed further in Note 14. We generally value our assets recorded at fair value by either (i) discounting expected cash flows based on assumptions regarding the collection of principal and interest and estimated market rates, or (ii) obtaining assessments from third-party dealers. For collateral-dependent loans that are identified as impaired, we measure impairment by comparing our Manager's estimation of the fair value of the underlying collateral, less costs to sell, to the book value of the respective loan. These valuations may require significant judgments, which include assumptions regarding capitalization rates, leasing, creditworthiness of major tenants, occupancy rates, availability of financing, exit plan, loan sponsorship, actions of other lenders, and other factors deemed necessary by our Manager.

We are also required by GAAP to disclose fair value information about financial instruments, which are not otherwise reported at fair value in our consolidated balance sheet, to the extent it is practicable to estimate a fair value for those instruments. These disclosure requirements exclude certain financial instruments and all non-financial instruments.

The following methods and assumptions are used to estimate the fair value of each class of financial instruments, for which it is practicable to estimate that value:

Cash and cash equivalents: The carrying amount of cash and cash equivalents approximates fair value.

Edgar Filing: BLACKSTONE MORTGAGE TRUST, INC. - Form 10-Q

Restricted cash: The carrying amount of restricted cash approximates fair value.

Loans receivable, net: The fair values of these loans were estimated by our Manager based on a discounted cash flow methodology, taking into consideration various factors including capitalization rates,

Table of Contents

Blackstone Mortgage Trust, Inc.

Notes to Consolidated Financial Statements (continued)

(Unaudited)

discount rates, leasing, occupancy rates, availability and cost of financing, exit plan, sponsorship, actions of other lenders, and indications of market value from other market participants.

Debt securities held-to-maturity: The fair value of these instruments was estimated by utilizing third-party pricing service providers. In determining the value of a particular investment, pricing service providers may use broker-dealer quotations, reported trades, or valuation estimates from their internal pricing models to determine the reported price.

Derivative financial instruments: The fair value of our foreign currency and interest rate contracts was estimated using advice from a third-party derivative specialist, based on contractual cash flows and observable inputs comprising foreign currency rates and credit spreads.

Secured debt agreements, net: The fair value of these instruments was estimated based on the rate at which a similar credit facility would currently be priced.

Loan participations sold, net: The fair value of these instruments was estimated based on the value of the related loan receivable asset.