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HD **Blackstone digs deeper into Australia**

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Private equity The global head of real estate for the company sees more opportunities Down Under.

New York Blackstone, the world's largest real estate private equity firm, will extend its $3 billion operation in Australia, growing its traditional "buy it, fix it, sell it" business and moving into the firm's new sectors of core property and debt funding.

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The group, which manages more than $US80 billion ($96 billion) in global real estate, arrived in Australia in the wake of the financial crisis, buying distressed debt and troubled equity, such as the Valad Property Group.

Jonathan Gray, Blackstone's global head of real estate, sees further opportunities in Australia and firmly rejects the view that commercial real estate is near another peak.

"People had a view that we had shown up [in Australia] because there was disruption, and there was. But that started our investment," he said in a wide-ranging interview with The Australian Financial Review in Manhattan on Friday. "We plan to have all three disciplines – opportunistic, core and debt – in Australia."

Blackstone, which has to return funds to investors, will continue to sell assets, including the prime Gold Fields House at Sydney's Circular Quay. "We are in advanced discussions with a party," Gray says.

At the same time Blackstone is a buyer, mentioned as a potential suitor for the Investa Property Group, which is controlled by Morgan Stanley Real Estate Funds and which manages more than $7 billion worth of property, mainly office towers.

"I don't think we have anything to say about that," Gray says.Perseverance

Gray, who joined Blackstone straight after university in 1992, heads a team of more than 200, which has brokered some of the world's largest real estate deals, including the purchase and, after the financial storm, the IPO of Hilton International. On his office wall is a large photograph of a basketball hoop and the word "PERSEVERANCE".

"You don't generate outsize returns with consensus," he told journalists earlier this year. "To do that you have to find something you believe in, find a management team to execute and go all in."

Today, he is a Blackstonebillionaire, a potential successor to president Tony James and eventually to founder, chief executive and chairman, Stephen Schwarzman.

"Stephen Schwarzman and Tony James love what they do," he says. "If something changes, there are multiple people within Blackstone who could step up to run the firm."

Blackstone has ridden a dramatic recovery in real estate since the market collapsed in the financial crisis. The firm has invested more than $US40 billion since late 2009 and investors in the flagship Blackstone Real Estate Partners VII have enjoyed a net 27 per cent return since inception.

In the 12 months to September 30, a year dominated by huge IPOs, the firm realised $US16 billion for investors. Many observers argued Blackstone was taking advantage of markets, fuelled by low interest rates, to return funds to investors as commercial property peaked.

But Blackstone also invested $US12.3 billion in the past 12 months.

From his office, Gray points to the Park Avenue Tower, bought this year in the strong New York market because its leasing profile offered opportunity.

The price, $US750 million, was marginally below that at which Gray sold the tower in 2007.International expansion

At the same time, Blackstone is raising more funds for real estate, including $US5 billion for an Asia fund, more money for a $US9 billion European fund and another flagship fund, Blackstone Real Estate Partners VIII which will be at least as large as the $US13 billion Blackstone Real Estate Partners VII. With gearing and partners, the new funds would give more than $US50 billion of investment fire power.

Gray is optimistic about the new investments. Despite the recovery, few sectors around the world appear overcooked. Some markets, such as Spain, Portugal and Italy, are delivering distressed property opportunities.

At the same time, Asia is cooling, creating opportunities, particularly if the Chinese government undertakes privatisation. "The market gets more interesting as people get less enthusiastic," Gray says.

In the 12 months to September 58 per cent of Blackstone's new real estate capital was invested outside North America.

Blackstone also has new products. A debt business was created in the vacuum of the financial crisis and now has $9 billion of funds under management. And following requests from investors for long-term assets managed by Blackstone, the group has $US4 billion under management in core real estate, buying several buildings in London, a share in the Edens shopping mall business in the US and part of the prime 1 Market Street tower in San Francisco.

"We are actively looking, including in Australia," says Gray.

He does watch interest rates. A sharp rise in bond rates could lead to a selloff in listed real estate and create opportunities in the dislocation between public and private markets.

But other fundamentals, "cranes and capital", are just as important.

"Interest rates obviously have an impact but it is more than interest rates, it is supply-demand fundamentals and the ability to buy below replacement cost," he says.

"What makes us nervous is lots of cranes" he said. An explosion of debt would no doubt worry him too.

But that is under control, with the issuance of Commercial Mortgage-Backed Securities in the US at around 40 per cent of the pre-financial crisis boom.

"We remain positive on the US because the fundamentals will exceed many peoples expectations. The rate of growth will not be as good as in the [recent] past. But people are underestimating the strength of the recovery."

Gray says with low supply, rents and cash flows would rise faster than people expect. In the early 1990s, the late 1990s and the mid-2000s, the growth in cash flows delivered capital growth despite rising interest rates.

The US housing market, in which Blackstone now has 46,000 single family homes, is similar, with supply half the long-term average despite the rising population. The firm has spent about $US30,000 on each home and the portfolio is 97 per cent leased. But Blackstone is not a seller.

"I think there is a way to go in US housing," Gray says.Good value Down Under

The view on fundamentals also underpins Blackstone's view on Australia. "Even though the economy is slowing, the supply and demand fundamentals are pretty good," he says. Though he acknowledged that the three new office towers on Sydney's Barangaroo would have an impact on the city's CBD.

At the same time, capitalisation rates on **commercial** properties are 200 to 300 basis points higher than in other comparable markets around the world, according to Gray.

"It seems like good relative value," he says.

"We think there is a likelihood of cap rates moving lower in Australia, particularly for the off-pitch **B**-grade stuff."

Australia has been good for Blackstone. As chairman of Hilton International, Gray a believer in the growth of travel.

"We had a good experience with the Sheraton Noosa," he says. "We spent a bunch of money and the performance is up dramatically."

Similarly, the towers bought from GE when 70 per cent leased, now part of the Valad platform, are now 80 per cent leased.

"Nic Lyons [Valad chief executive] is doing a terrific job," Gray says. "We like platforms."

Now the Blackstone team is looking for more.

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