Final Transcript

BLACKSTONE: Second-Quarter 2012 Earnings Call

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SPEAKERS
Stephen A. Schwarzman, Chairman, CEO, and Co-Founder
Tony James, President, and Chief Operating Officer
Laurence Tosi, Chief Financial Officer
Joan Solotar, Senior Managing Director, Head of External Relations and Strategy

ANALYSTS
Howard Chen – Credit Suisse
William Katz – Citigroup
Daniel Fannon – Jefferies & Co.
Roger Freeman – Barclays Capital
Matt Kelley – Morgan Stanley
Marc Irizarry – Goldman Sachs
Chris Kotowski- Oppenheimer
Jeffrey Hopson – Stifel Nicolaus
Michael Carrier – Deutsche Bank

PRESENTATION

Coordinator Welcome to the Blackstone Group Second Quarter 2012 Earnings Call. Our speakers today

are Stephen A. Schwarzman, Chairman, CEO and Co-Founder; Tony James, President and Chief Operating Officer; Laurence Tosi, Chief Financial Officer; and Joan Solotar, Senior Managing Director, Head of External Relations and Strategy. And now I'd like to turn the call over to Joan Solotar. Please proceed.

J. Solotar Great. Thanks. Good morning, everyone. Welcome to Blackstone's Second Quarter 2012 conference call. I'm here today with Steve Schwarzman, Chairman and CEO; Tony James, President and Chief Operating Officer; and Laurence Tosi, CFO. Earlier this morning we issued the press release and a slide presentation illustrating our results. You can get those on the Website. We'll be issuing out our 10-Q over the next few weeks.

I'd like to remind you that today's call may include forward-looking statements which are uncertain outside of the firm's control. Actual results may differ materially. For a discussion of some of the risks that could affect the firm's results, please see the risk factors section of our 10-K. We don't undertake any duty to update any forward-looking statements and will refer to non-GAAP measures on this call. For reconciliation to the GAAP measurements, also look at the press release.

I'd like to remind you that nothing on this call constitutes an offer to sell or a solicitation to purchase any interest in a Blackstone fund. This audio cast is copyrighted material of Blackstone and can't be duplicated, reproduced or rebroadcast without permission.

So you'll note the new and improved format of our earnings release. We've gotten feedback from several of you. We'd love to hear more. Hopefully you find it more useful. The idea really was to make it simpler for investors, analysts, press – everyone – to review the results and move up some frequently asked for information that we previously only had in the queue. Again, we're looking for continual feedback, so thanks for all who gave us input.

A quick recap of our results. We reported economic net income, or ENI, of $0.19 per unit for the second quarter. That's down from $0.44 in the first quarter and $0.73 in the second quarter of last year. As you recall, last year's second quarter included the performance fee catch-up in real estate.

So the second quarter this year, distributable earnings were $188 million. That's $0.16 per common unit. That compares with $0.15 to the first quarter of this year. Once again, we'll be paying out the $0.10 per unit distribution related to common unit holders of record as of August 15th. As always, if you have questions on anything in the press release, feel free to follow-up with either me or Weston Tucker after the call.

With that, I'll turn it over to Steve.

S. Schwarzman Good morning. Following a broadly positive first quarter for global markets, macro economic concerns, including the intensified eurozone worries, took precedence in the second quarter, driving a pull-back, as you know, in equities and increased in volatility. U.S. stocks did better than most other markets, only being down 3% while the global indexes declined on balance 6%. Fixed income prices were mixed, with high grade prices up and high yields flat to down. The euro weakened against virtually all currencies.

Capital flows into equity mutual funds remain highly challenged. What "highly challenged" means is it's been 14 straight months of outflows from domestic equity funds. M&A activity also declined, generally a pretty miserable situation in the second quarter.

In general, the markets have been dominated by tepid volumes and limited conviction with short term momentum trading driving the volatility. Investors remain apprehensive and hesitant to make decisions. The dominant perception is that the global economy is slowing, but not collapsing, with a drop in both confidence and activity.

The world's growth engines, such as China, India and Brazil, have been clearly slowing. In the U.S. specifically, households and large firms are holding back spending because of worries about Europe and the upcoming U.S. fiscal cliff. We expect the second half of the year to be negatively impacted by policy risks.

Europe's sovereign debt issues have remained front and center. Investors had been hoping for a degree of recontainment and a removal of the systemic overhang which they got at least temporarily following the European leaders' summit at the end of June, resulting in a plan for a centralized banking system under the supervision of the ECB, which, by the way, is basically a pretty sound idea.

The critical details of exactly how this will be executed remain to be seen and introduce more uncertainty until that's all resolved in a satisfactory way.

Blackstone's broadly diversified asset management model is built to outperform over the long-term, particularly in these types of uncertain and volatile markets with most of our capital under long-term lockup arrangements, which is very important for our business model. We are largely immune from redemptions driven by market swings and volatility, enabling us to focus our resources on building and improving companies, driving long-term solutions, and creating real and sustainable economic value.

This ultimately drives higher returns that can be achieved through the short-term orientation of the public markets or virtually any other form of investing. This value creation takes time, and through market cycles and over our 26-year history we've generated net annualized returns of our realized investments of 23% in private equity and 27% in real estate.

Our limited partner investors, which represent over half of the pensioners in the United States, among others, are increasing their capital with us, driving gross inflows of nearly $6 billion in the second quarter and over $48 billion in the past 12 months, including our acquisition of Harbourmaster.

We ended the second quarter with total assets under management of $190 billion, up 20% over a year in what's been a pretty miserable environment.

Now, moving on to a brief discussion of each of our business segments. Last quarter in this call we highlighted for you the slowdown we were seeing in our portfolio companies in private equity, and that commentary was perhaps earlier than that of our peers and others in the marketplace. I think you beat us up a little bit because we said that, but now, however, I believe they're all familiar with the general economic softening that's transpired.

I'd like to bring to your attention the fact that we knew this earlier than other people. It's part of the strength of our model here at Blackstone. This helps us make investment decisions in all of our businesses where other people might not have had this type of early warning. It enables us to avoid certain types of investments and to make others. It's a really important thing for us.

We continue to work to position our companies and insulate them against a protracted period of slow global growth, both in our current assets as well as on the investment side. Overall, despite economic headwinds, our portfolio companies are in good shape. The carrying value of our private portfolio remains mostly flat in the quarter despite big down markets. Our public holdings, however, were down 12% and this, combined with the negative impact of foreign exchange due to the weaker euro I talked about before, drove an overall decline in the carrying value of our portfolio and private equity by 4.2%. On a year-to-date basis, however, our private equity portfolio is still up slightly.

I'd like to step back for a moment and remind everybody about our approach to private equity and the power of the model over time, which was demonstrated repeatedly over the past 26 years.

We approach all of our investment opportunities as a problem solver, not a passive investor like people in the public markets. In private equity this means partnering with a management team to identify and correct underperforming assets, working with a team to inject capital and provide expertise and support of growth, or hiring an outstanding manager to build a company from scratch.

Depending on the type of asset, the region and market conditions, this could take four to five years or it could take longer. Given the long-term nature of our funds with their typical ten-year maturities, sometimes twelve, we are in no rush to sell. When the time is right, we realize the value we've created and built over several years for both our limited partners and now our public shareholders.

A more extreme example of this is Universal Orlando, the giant theme park down in Orlando, Florida, which we sold to a strategic buyer last year after holding it for 11 years. We completed this sale at a multiple of original invested capital of 3.2 times our money and a 16% IRR. I remember at one point in time after this investment was made we had this investment marked at only 10% of original cost. So from that mark until we sold it, this investment was up 32 times.

So this is just to counsel you to not get overly focused on any of these marks from quarter-to-quarter and recognize that we're in the business of building this value which over time we can pick our moment to exit and realize on that.

Looking at our historical exits in general, our average exit price is 20% to 25% higher than the prior quarter's mark-to-market as we cannot factor things in in our accounting treatment like acquisition premiums into our valuations. As such, you should expect higher increases in value during periods of greater realizations generally.

During the second quarter, challenging capital market conditions and ongoing subdued M&A activity limited our opportunity for exits. One of our peers announced a partial sale of a European drug store business to a strategic partner, which we believe is a good example of a 2007 buyout done at the absolute top of the cycle that ended with a very favorable result that at other times, as you were monitoring that investment, the market may have dismissed. This is how our industry works. We should see more of this across the sector as markets heal and M&A volumes improve.

For example, late in the quarter we did sell a portion of our interest in TeamHealth, which we had initially brought public in late 2009. The TeamHealth sale generated a multiple of investment capital 3.1 times our money and a 19% IRR and a $33 million distributable earnings contribution for our public investors. Our patient capital and superior returns over time drive our success.

We have the largest pool of dry powder in the private equity area available at $16 billion. There is a real advantage to this scale and flexibility, allowing us to move in size and with certainty anywhere in the world we see opportunities for value creation.

As a last note on our private equity business, as we announced yesterday, we've completed the leadership transition begun a couple of years ago by naming Joe Baratta head of private equity globally. Several of you met Joe at our European investor day last year. We sent him to London a decade ago to help launch our European business and he will return to New York next month.

Moving on to our real estate business, where the benefits of scale are particularly clear, we are currently operating in a unique moment in time given our size and the very favorable investing climate. As the largest player in opportunistic real estate in the world and one of the sole survivors from the financial crisis, we have the dominant franchise in this space, which I believe is very well illustrated by the success of our most recent global fundraiser.

We've raised over $12 billion in capital and are extremely confident that we'll hit our $13.3 billion cap when we have our final close in the next few months. This gives us, by far, the largest pool of dry powder capital in the industry at a time when we were seeing highly attractive investment opportunities due to the level of distress and the need to deleverage around the globe. In fact, we've deployed or committed $16 billion across our real estate platform since the fourth quarter of 2009 when we started to see early signs of market stabilization.

In virtually all recent transactions, Blackstone has faced limited competition due to the magnitude of capital required and the complexity of the transactions. Our strategy remains focused on buy it, fix it, sell it, in which we acquire good assets that need improvement at the low replacement cost and provide capital and expertise. Given our basis in investments that we've made during this period, we have high expectations for the ultimate returns we expect to generate.

During the second quarter specifically, we invested or committed $3.5 billion, which is a massive amount of money compared to everyone else in real estate. This includes our commitment to acquire Motel 6 from a public European lodging company. We paid roughly $26,000 per key, which is a substantial discount to physical replacement cost, and we see real growth potential around the franchise business similar to some of the other hospitality investments.

Our ability to move in size and swiftly access the transaction given our vast lodging knowledge was critical to our success in this case. We don't need partners to complete a large deal and we can deliver certainty in the particularly uncertain real estate and financing world.

In addition, we've started deploying capital into U.S. single family housing, which is an area we have largely avoided for years, and quite successfully so. We are now buying post-foreclosed homes, which generally need some capital improvements, and we are leasing them up. We expect this activity to drive greater housing affordability and think it will help the nation's economic recovery.

Home price appreciation has already begun with March showing the first month of year-over-year appreciation since 2007, and that's about when we started entering this business, I think more or less picking another market bottom like we've done in the hotel business.

The U.S. and Europe are still the most attractive place to deploy capital. Distress in Europe remains the highest and we are quite constructive there. European financial institutions are selling more and there aren't a lot of equity players there to absorb these assets.

In emerging markets, weaker capital markets have meant that developers that were long land and have been feeling more of a crunch and we are there to provide capital. That's going to also increasingly provide opportunities for us.

Our current portfolio rose 2.9% in the second quarter and is up 6.7% year-to-date driven by ongoing improvement in operating fundamentals and persistent low new supply.

In office, we continue to see occupancy improvement and rent growth in most of our core markets. For our key office assets in the U.S., occupancy is up 300 basis points versus the prior year, which is a big increase. Positive absorption and declining vacancy is also evident in our industrial, retail and senior living assets.

In hospitality across all U.S. hotel segments, there continues to be an improvement in both RevPAR and EBITDA, so on an operational basis virtually everything is doing well.

In terms of dispositions, you may have read that we are starting to sell small pieces of our office portfolio. We are not anticipating any large scale bulk sales imminently, but do expect the pace of realizations to pick up this year and into next year consistent with our stated plans.

During the second quarter we completed two large sales with Pearl Ridge mall in Hawaii and our U.K. student housing platform, which together generated $420 million in proceeds and a multiple of invested capital of two times, which is pretty unusual in the real estate business these days.

Our disposition activities continued in July with two partial sales signed or completed, including our 50% interest in a Manhattan office building and a small portfolio of four high quality hotels.

Moving on to BAAM, our hedge fund solutions business, even though the second and fourth quarters are primarily redemption quarters for BAAM, we had, despite what you might think, net inflows of $450 million in the quarter and another $950 million of inflows on July 1. This brings us to $2.5 billion in net inflows for the first half of the year. The focus of our growth remains on customizing specific solutions for our institutional clients and providing value-added services. We are known to our clients as a product innovator and trusted advisor. Our scale is the largest investor globally in hedge funds and our sizeable investments in risk management, technology and due diligence continue to set us apart from others in industry and drive our market share gains.

BAAM protected our investor's capital through the second quarter through our broad strategy diversification and management selection. Our composite return was a -1%, never a wonderful thing to be down, but still only 1% for the quarter despite the more severe decline in global markets. Remember, I've told you before, global markets were down 6% and we were down 1%.

On a year-to-year basis the composite is up 3%. Continued solid performance in inflows drove total assets under management $43.6 billion as of July 1, up 8% year-over-year.

Moving on to our credit business, GSO. As one of the largest owners of leveraged loans globally, we are well positioned as a leading provider of credit in a credit constrained world. This is particularly true as traditional lenders pull back, and GSO conversely has been aggressively expanding its footprint and diversifying its offerings. We are expanding up and down the capital stack, investing in the whole range of strategies from performing loans, distressed and distressed.

GSO is viewed as a solutions provider and partner to borrowers, helping them identify a financing solution, allowing them to get back to focusing on their businesses. Client demand for our investment vehicles remains strong as investors search for strategies that can deliver a higher degree of confidence and income in a low growth, low interest rate world. That is very much a reflection of what Tony said in our earlier press call, that it’s a world starved for yield and GSO can provide very high returns with a high level of safety.

GSO is capturing share in this growing market, with total assets under management of $51 billion, up 50% year-on-year. We're up 50% year-on-year in credit, driven by organic growth in our acquisition of Harbourmaster.

Our draw-down carry funds generated solid returns in the second quarter - in fact, I'd say it's more than solid – with mezzanine up 5.8%. Remember, this is against a world that was down 6% and our mezzanine funds are up 5.8% and our rescue lending fund was up 2.9%.

On a year-to-date basis, these funds have appreciated 12.6% and 10.6% respectively, which is pretty remarkable given what's happened in the world. We invested approximately $450 million in the quarter from these strategies and our first rescue lending fund is approximately two-thirds invested. While there are recall provisions that will extend the capital availability somewhat, we've commenced fundraising for our second rescue funding fund, which we believe should be quite successful.

During the second quarter we launched our third business development company, which provides direct lending to middle market borrowers as a core part of its investment strategy. We hit the equity cap on our previous BDC at $2.6 billion and our new fund is tracking at a good pace. Last week we priced our first CLO in 2012, a $500 million pool, which was one of the larger deals of the year. We plan to bring other CLOs to market later in the year as we expect this area to continue to recover as a meaningful source of capital for corporate borrowers.

In our advisory segment, second quarter revenues declined 8% from last year but were basically flat on a year-to-year basis, which is actually quite good compared to what's happening in virtually every other place on Wall Street.

In M&A, industry activity is down sharply from the first half of last year as CEO confidence, as Tony talked about, has seen a critical limiting factor in M&A recovery. Despite this, our business was basically flat year-to-year in M&A. That's actually pretty remarkable.

In restructuring, while the market remains slow due to the availability of financing and loose monetary policy, our business had a very strong quarter as several transactions closed, driving a 50% increase in revenues.

Lastly, at Park Hill, our placement business, while revenues were down year-over-year due to the lumpiness of when deals just happened to close, our pipeline is robust as fundraising market conditions are still challenging, driving demand for an experienced placement agent like Park Hill.

In summary, as public market investors analyze our business, we believe you should focus on the long-term friends supporting our life cycle capital formation. Number one, our availability to raise new funds and products. Number two, our focus on value creation or our ability to invest the capital we raise in great assets with strategy and transformation and improvement. Number three, our ability for investment realizations or the ability to harvest gains once we've created the value, driving performance fees for our public markets where we wait until we've improved the assets and we have an excellent time marketwise to exit this for the maximum value for our limited partners and as well for our public investors.

We've successfully raised substantial dry powder capital to put to work - $36 billion, which is the biggest in the industry. We have $38 billion invested that is not yet earning performance fees because it's early in the investment period or we've not yet crossed the required rate of return to the fund. We have nearly $50 billion that is invested and currently earning performance fees.

As we've seen throughout our history, Blackstone will continue to drive out-performance for our investors through this simple lifecycle of capital, resulting in meaningful past distributions for all of our partners.

With that, I'd like to turn the call over to Laurence Tosi, affectionately known here as LT, who will close with some comments on our financial results.

L. Tosi Thank you, Steve. Good morning, everyone. Thank you for joining the call. Since the time of Blackstone's IPO in 2007, a little more than five years ago, we've been focusing on setting a standard for transparency and objective clarity in all of our investor communications, particularly in our filings and on this quarterly call. As part of that ongoing process we have sought the input of respected analysts, investors and the rating agencies to come up with a view of what is the best way to report the firm's performance. We publish today, for the first time, the latest iteration of that effort.

At the time Blackstone went public we worked with analysts and investors and determined that we would have to adjust our GAAP results to show the actual operating results of the firm. That measure, derived directly from GAAP, is economic net income, or ENI.

Unfortunately, things have not been that simple. Because ENI is technically a non-GAAP measure, there is flexibility in how it is and can be defined by each firm that has followed us into the public markets and that has bred inconsistency across our industry.

The inconsistency has clearly frustrated investors and obscured direct comparability. While our details are the same, we are hoping that the new information and layout we present you with today will clear that up so that you can focus on and evaluate what is important: how we are running and growing Blackstone and what the return to you, our investors, is and could be. As always, we welcome your input and feedback. This is a process, not a conclusion.

Second quarter ENI of $212 million brings Blackstone's year-to-date earnings to $704 million, or $0.63 a unit. The second quarter was marked by volatility in our public holdings and investments held in non-U.S. currencies, particularly euros. Despite these market conditions, however, we generated $188 million in distributable earnings, bringing the year-to-date total to $351 million, or $0.31 per unit, which is a solid result in difficult markets, made possible by Blackstone's diversity and scale.

Total fee revenues were up 7% on consistently strong asset growth which drove base management fees up 20% over last year in an environment of low to negative economic growth. I should also note that this quarter's results are hurt in part by comparability to the prior year period.

The second quarter of 2011 experienced not only more favorable markets generally, but specifically to Blackstone it was also a period where we entered the catch-up phase for our largest real estate funds, which generated $450 million in performance fees in the year-ago quarter, a large part of which would have been accrued across several quarters and not just one but for the impact of that catch-up.

At the end of the second quarter the firm had $49.1 billion of assets currently earning performance fees, generating $1.75 billion, or $1.58 a unit, in accrued performance fees net of compensation. The accrued performance fees are essentially a receivable such that the entire $1.58 would convert to distributable earnings payable to unit holders if we sold those investments at the end of the quarter.

We also ended the quarter with $1.35 billion of cash and liquids and $2 billion of illiquid investments, which in addition to the performance fee receivable, equates to $5.1 billion, or $4.61 per unit of combined value on the balance sheet today.

The illiquid investments of $2 billion are largely in our private equity and real estate funds and are held at a total of 1.2 times their original capital cost, which demonstrates not only diversity and consistency of returns but also the growth of our capital base even over an extended period of disappointing market conditions.

Blackstone continued to be very busy over the quarter and has committed or deployed $8.2 billion of capital year-to-date. One-third of that capital was committed outside of the United States, which provides insight into where opportunities can be found and is made possible by the unique global reach of the firm and a strategic advantage of our patient capital fund structures, particularly in a world of turmoil.

Similarly, capital formation for Blackstone continues to be very strong and provides perhaps the clearest evidence of the growing concentration of allocations of sophisticated investors attracted to our leading track records, brand and scale. The firm had gross organic inflows of $17 billion, or 10%, in the last six months alone, and that excludes the additional $10 billion of assets that came with the Harbourmaster acquisition.

In closing, Steve started the call highlighting the strength of Blackstone's competitive positioning and performance. We continued by pointing out that we believe greater transparency will enhance investor understanding of both Blackstone's absolute and relative performance. Alternative managers are the best positioned among all asset managers to attract and manage capital.

Since 2006, Blackstone has grown AUM 174%, which is more than three times as fast as the public traditional asset managers. In addition to favorable allocation trends, the long-term commitment structure of our funds affords us the ability to navigate difficult markets globally, to adapt to market conditions, to find and create value for our investors in many more ways than other asset classes.

The firm's $121 billion of performance fee eligible assets present a unique opportunity for unit holders to participate in our value creation process, which Steve described. Even without the scale upside of performance fees, the steady cash earnings generated by our long-term fund structures produce a consistent cash distribution yield that is two times more than public asset managers. In other words, while the timing of scale realizations in performance fees are often hard to predict, our model pays you to wait and rewards patience.

Despite superior fundamentals and industry trends in Blackstone's competitive positioning today, Blackstone trades at the largest discount to the traditional managers that it ever has as a public company. While that gap is inexplicable and certainly frustrating to all of us, our focus is and always will be on providing the best returns for our investors and continuing to innovate ways to add value.

What we do know is that with today's step forward with more transparency, the value Blackstone is creating should now be more evident.

On behalf of all of us at Blackstone, we thank you for your time and welcome any questions you may have.

Moderator [*Instructions given.*] Your first question comes from the line of Howard Chen of Credit Suisse. Please proceed.

H. Chen Hello. Good morning. Thanks for the disclosure.

H. Chen With respect to performance fees, could you provide a sense of what you think is more recurring across that performance fee base, maybe things such as dividends and private equity or rents and cash flow from real estate coupon, interest from the GSO business? I think that'd be helpful. Thanks.

L. Tosi Sure. Howard, if you go back to the disclosure we gave you on page 22 – and I promise I won't keep pointing back to pages, but as it's new to all of us it's probably easier – what we did was a couple things. We broke out carried interest from incentive fees. Generally speaking, incentive fees are realized on an annualized basis. So if you maintain the level of values ... portfolio and you reach that particular marking period you get the realization. That's the first point.

The second one I would say is if you look at BREDS, which is real estate debt strategies in real estate, and if you look inside the credit businesses for all of their funds, those typically are yielding funds upon which we also get carried interest. If that's your point, it's more recurring in the sense that you're getting a 20% performance fee on asset ... yield anywhere between 10% and 12% on an annualized basis.

I would also add to that that several of the larger funds in real estate and private equity, frankly, given the decent operating environment, are also generating current income as well.

H. Chen Great. Thanks, LT. The next bigger picture question on real estate investing – given you're such a scale player in the business we've increasingly seen you invest in larger and more complex transactions than peers. I guess I see no reason for that trend to end, but I'm just curious – in terms of the exit, can you speak to how you think about exit strategy in a business where you're separating from the pack in terms of deal complexity and size?

S. Schwarzman This is Steve. You know, in real estate on the buy side there's obviously a distinct advantage and lots and lots of things to do ... all over the world. We think in that business we have a very unique advantage in terms of being able to marshal the largest funds in the world to do those transactions. Not to be underestimated that we have a high level of integrity here and when we make deals, we make them, so people choose to really like to do business with us in the real estate industry, and that has been a very strong advantage for us over the years.

In terms of exit, one of the great things about real estate is you can buy a large, highly complex pool of assets, but you can sell them one-by-one where there's no complexity at all for the buyer or you can sell them in a group of assets. We can tailor exits to market demand and it provides enormous flexibility on both timing and size.

We've just done that. We've sold four hotels out of the whole group. Somebody wanted those particular hotels. We got a very good price, we believe, for them, and our whole approach in that business is to buy properties that are either undervalued or have something that needs to be fixed. We fix them and then we sell them.

So the complexity and the scale of the buy does not limit us on the sell.

T. James — Howard, let me just add. In some cases it can be an advantage because we have the scale to set up things like our own REITs and what not that are big enough to go to access to public equity markets that smaller investors couldn't do.

S. Schwarzman — One other thing with that – not to spend all our time on this, but it's actually so much fun – is that when you buy a big complex thing you get a discount for doing that because you don't have the competition, either because of that size – nobody else can marshal that. When you sell them, the assets, in the smaller amounts you get much, much better cap rates, so not only do you fix the things up, you arbitrage the value to more normal size, which makes it inherently a very good structure for us.

H. Chen — Very interesting. Thanks, Steve and Tony. Just a final one for me, and maybe sticking with the exit theme, if the private portfolio performance was flattish and fundamentals held in, then I guess that suggests that you didn't adjust your exit timing. I know you don't want to liquidate anything prematurely and before its time, but can you discuss what drives and changes your exit timing assumptions?

S. Schwarzman It's actually the real world. We live in the real world. When the real world is slowing down, when markets last quarter, for example, were down 6% globally, that is not an ideal time to be exiting assets where we have money locked up for 10 to 12 years. In some cases the companies aren't quite ready to exit, but as to timing, that's not exactly when you'd really try to do something – in effect, jamming an exit just to get liquidity. We have no pressures at all for liquidity other than the fact that it would be great to sell everything as if we were near a market top, which we're not, as the global economy is going through a slowdown and a relative tough time.

So what we do when we look at an exit to see where we are in terms of the improvement of the asset and are we in an environment which will support a very high exit multiple either in the marketplace, which looks iffy now because of the difficulty in doing IPOs, or to strategic buyers, who tend to pay higher prices than the public markets.

I think if you look forward and if we have a change in the economy for the positive, which will happen, obviously, at some point, that with strategic buyers loaded with cash, certainly in the U.S. and Canada, Latin America and Asia, that in that part of the cycle we will be able to have very, very substantial realizations at surprisingly high prices, which is what tends to happen when the cycle really swings for you. That cycle isn't swinging now virtually anyplace in the world. So our job is just simply to wait, keep improving the companies, feeding them capital, getting them to expand as rapidly as they can, and there is a moment when we will pop these things out. Normally over our valuations it's 20% to 25%. That's with a mix of a bunch of IPOs as well as strategic sales.

I don't mean to be even vaguely defensive about this. This is really just the way the world works. We'll be able to produce very strong returns when that happens.

T. James — Just a little color on that. We have our analytics around considering an exit and we look at the return to our investors from continuing to hold versus the return versus exiting at that price regardless of where we are in terms of historic gains. We have our hurdle rates for that. Depending on the risk we'll assess are we getting paid enough to wait to justify taking the risk on the company. That's the kind of analytical decisions we make. We're analyzing it all the time.

S. Schwarzman As Tony mentioned, one other interesting thing is when you're holding a company and you're growing it, it's not like a bad thing that's happening. In addition, if you're paying down debt, it's really providing a return on your investor's equity, which you will fully realize at a future time.

H. Chen Understood. Great. Thanks for taking the questions.

Coordinator Your next question comes from the line of William Katz of Citigroup.

W. Katz Thanks very much. I appreciate new disclosure as well. In the discussion around sort of taking market share I'm sort of curios if you have any more tangible evidence of gains, I don't know, expressed maybe as number of products per LP or maybe another kind of metric you look at internally? And then, probably more broadly related to that, what are you hearing from institutions right now? Is there a slowing about allocations or any kind of change in the allocation alternatives?

J. Solotar Generally when we look at market share we're looking at our flows versus industry flows in that segment. For example, we would look at hedge fund flows, fund-to-fund flows then look at what BAAM's doing and get a feel for share, and that's how we know the share's been going up.

S. Schwarzman And we can see in each of our business lines because we manage money from the vast majority of people who are eligible to give it to us. We've got a feel of who they're giving money to. How much we're getting. Whether we're increasing in absolute terms with that account or in relative terms compared to our competition.

J. Solotar We also own Park Hill, which, as you know, raises money for the third parties and that gives a good window across real estate, hedge funds, private equity, as to what's happening in the broader industry. It's a lot of different data points.

L. Tosi The only thing too I'd add to that is that even in the market share in the markets we play in we're not really statistically significant. When you're looking at our market share in any one of the markets we play in it's less than low single digits so that's not a limiter.

What we have seen though in the two most recent fund raisings both in our Mezzanine fund and GSO and the most recent BREP fundraising is a sharp increase in the diversification of high-quality LPs. This recent BREP fund will have almost 40% new LPs over and above the ones that were already there and in the GSO fund it was almost twice as many. You can see the allocation differences or trends evidencing themselves in the new fund raisings.

S. Schwarzman So for example, in the real estate, assuming we get to our cap of $13 billion, probably the next biggest fund in the world that will be raised, and opportunity class will be several billion, and our previous fund was ten. This one would be 13. Everybody else has shrunken hugely or been eliminated so that's an easy class to measure that.

BAAM is easy also because the results are published and we're significantly larger than anybody else and we keep growing and most other people in that class are stable to shrinking because those people are public. We can see our growth in credit also compared to our principal competitors. The asset class is growing and we're growing very rapidly with that.

We have a pretty good sense of how to back that up as an assertion.

W. Katz — That's very helpful. I appreciate the comprehensive answer. Given the dry powder you have, given the diversity of the business, given where the stock is trading, how do you think about sort of cash flows, if you will? Any thoughts of reshaping that balance sheet for buy back or other uses?

L. Tosi — No, I don't think so. I think right now we're comfortable with where we've been. Actually, our level of liquidity and the make-up of the balance sheet have been consistent over, frankly, several years. As you've seen when given the opportunity we have been strategic with the balance sheet to make acquisitions to bolt on things that we think are very strategically important.

You will see in the quarter that we did re-up our revolving credit line simply taking advantage of the fact that our credit was in demand. Our bonds trade very well. We're B positive in the credit markets and the pricing was in the right place so we extended that over the last—we just finished that about a week ago for another year. It's about a $1.1 billion facility at less than our prior pricing, and it actually has some new names in it.

We feel good about where the balance sheet is. We think it's of strategic importance at this growth level. I think we're in the right place.

S. Schwarzman One question you asked that we didn't answer, which Tony I think did a very eloquent job of discussing on the press call, was your question about the increase of alternatives by the sources of capital. And you've seen the results from some of the large pension funds, which are running 12 months so I guess ending June 30th, 1% to 1.5% terms.

This is utterly unsustainable for the pension fund system, and as Tony mentioned quite correctly is that these funds increasingly need to have higher returns. The only place where you can reliably do it is not in public markets. It's really in the alternative class, and we've seen a renewed interest and emphasis. There are special accounts, separate accounts being formed. Institutions talking to us about how they get higher levels of return with safety because we really need this stuff.

This isn't like college where these are electives. This started off as an elective course, alternatives, and it's moving into core curriculum because if we can keep giving these very high returns with very low downside risk then you're going to have this continued shift to alternatives just because there's no place else for these funds to actually go on a risk adjusted basis to beat their hurdles.

As Tony said, nobody is looking for higher taxes to put money in to these funds anyway to out earn it, and so I think in that sense the alternative class is well positioned, extremely well positioned. Our firm in particular is the only one that has this very substantial representation and outperformance in all four of the major alternative areas; private equity, real estate, hedge funds, and credit.

I just wanted to loop back with you because we didn't answer that one.

W. Katz — Thank you very much. I appreciate you talking all the questions.

Coordinator — Your next question comes from the line of Michael Kim of Sandler O'Neill.

M. Kim — Hi, guys. Good afternoon. First, just given kind of the ongoing improvement in fundamentals across your real estate holdings that you talked about earlier and kind of the maturity of the portfolios what are some of the broader factors that come into play as it relates to driving either an accelerations in terms of selling some of these assets or kind of just waiting for better exit points, you know, understanding that each investment is different?

S. Schwarzman — I think one of the things to me is that because there is very little building we have a big exposure to the U.S. obviously because there's virtually no building going on in the United States. I guess we reported that occupancy's improved by 300 basis points. If you take those types of improvements as you get closer to more normal levels of occupancy you tend to get—if you're just talking about office or any of these asset classes you get rent spikes where rents start going up. And when you sell those types of assets at that time period where there's a perception that rents are going to be going up significantly above trend you can get much more for those buildings.

In effect we monitor all of these asset classes. We monitor the particular assets we own and where they're located to see where we are close to that kind of acceleration of revenue, and we get a much higher price because real estate itself is leverage. You get like a double bang on that.

T. James But, you know, Michael, as you get towards full occupancy and it's never 100% because you've always got some turnover, as you get close to that it becomes an obvious thing for you guys to think about. That would be the time we'd be sell it because that's when some of the other factors Steve's talking about kick in.

M. Kim Got it. And then, maybe just one for LT; it looks like base compensation was up a bit on a sequential basis. Was that really just mostly a function of kind of continuing to build out the franchise or was there anything lumpy in there that might have related to fund raising or anything else like that? Just trying to get a sense of that line and the trajectory going forward.

L. Tosi Michael, you're right. You're instinct is right. It's not actually related to build out. It was related to marketing activities. In some cases when you do fund raisings there's a decrease in the early time of the fund because you have an offset for basically distribution fees, and so the comp ratio will come up slightly because it's mistimed against the actual comp. And of course then there's comp with respect to marketing.

And you'll see it in real estate for example because they had fund raising in the quarter, that's just a onetime event that will then flatten out over that, but that's what it reflects. It reflects the heightened business development activity.

M. Kim Got it. Okay. Thanks for taking my questions.

Coordinator Your next question comes from the line of Dan Fannon of Jefferies.

D. Fannon Great. Thank you. I guess on the private equities side if you could talk about kind of the outlook your companies are thinking about for the remainder of this year. I think, Tony, you mentioned on the earlier call maybe stronger EBITDA growth in the second half of this year from those companies, and just trying to get a sense of what's maybe driving that or how they're viewing kind of like the current environment.

T. James Yeah. Okay. Well, I think they're thinking that sort of revenues from here have sort of bottomed out and that you get a little bit stronger revenue growth to start with. Nothing dramatic but a little bit stronger because as some of the leadership issues clarify themselves and one thing and another and Europe deals with issues in one way or another.

In addition to that, you've had kind of an interesting commodity cost cycle where it takes a while for those to work through the chain but we recently had some lower commodity costs which are starting to come through the chain now actually reducing some of the costs of the companies.

And by the way, some of them also— This might be natural optimism. We ask them to be disciplined and skeptical as they can be, but they believe for the most part they've got actions they're taking that will work and will grow their companies. There might be some extra optimism in that, but cumulatively those three factors mean that they're looking at a stronger second half than they believe.

D. Fannon Okay. Great. And then, on the credit side I think the numbers are up like $5.4 billion and credit AUM that's not earning fees currently, I guess how should we think about that kind of flow through, you know, kind of rolling up into management fees over time?

L. Tosi Dan, it's LT. I think the way to think about that, and we try to break this out to make it a little easier, if you look at the base management fees not earning fees so they're not … that's $5.4 billion. Another way to look at it as you go back to the credit business page you'll see the amount of capital deployed in the quarter. In this particular quarter we put about $450 million to work, and the way to think about that that will play through.

I would point out though that that tends to be somewhat lumpy and $450 million is actually somewhat muted relative to the run rate over the last year. By the time they finished raising their last Mezzanine fund they were 25% invested from the first closing. I would take that number and I'd roll it towards the investment period remaining on the Rescue fund. The last Rescue fund is probably the next—I think they think by the end of the year that will close, and the Mezzanine fund is in its first three years.

D. Fannon Okay. Great. Thanks.

Coordinator Your next question comes from the line of Roger Freeman of Barclays Capital.

R. Freeman — Okay. Thanks. Good morning. Just actually following up on that last question, in the Mezzanine you have a fair amount of unrealized gains. You kind of discussed this in the last question but what's the sort of typical cycle for realizing built-up gains in that?

L. Tosi — Well, it's a couple things. First of all, we realize and then pro-rate when we sell investment-by-investment, which is different than some of the structures that are out there. What you're looking at right now you're looking at the total receivable of about $176 million in that segment of which $106 is related to the Mezzanine and Rescue fund. I think that's the number you're pointing at. That will be realized as we exit some of those investments, and frankly it's a matter of time in the particular asset. It's somewhat hard to predict and that's why we decided to give you the receivable over time and you can see its fluctuations.

R. Freeman — Got it. Okay. Thanks. And then, for this next Rescue fund it sounds like there's a fair amount of demand for these sorts of products. Do you think this next one gives you guys big or bigger than that current one?

T. James That's certainly our hope and expectation.

R. Freeman Okay. On BCP5 can you—I don't know if this was in the release somewhere—can you update us on where there it relative to the hurdle rate? I think it was 11% last quarter.

L. Tosi It was 12% last quarter and it's 13% this quarter.

R. Freeman Okay. And then, just the bigger picture conceptual question; are there any businesses, capital intensive businesses within Wall Street firms that don't work for them anymore under Basel 2.5, three, potentially … that you could restructure potentially into funds that could actually generate attractive returns? I'm thinking about the fleeting story if you reach back about Morgan Stanley concerning selling … business and you being a potential buyer, and I'm not looking for a comment on that kind of thing but just conceptually thinking about whether there are opportunities there.

T. James We just hire the people and build the funds.

It's a complicated answer and it's hard to generalize but I would say that generally the capital intensive businesses part of Wall Street that are ongoing businesses are hard to fit in funds and hard to fit into our firm. We're not an asset heavy business. We don't want to be an asset heavy business. We manage other people's money, and similarly other people don't want to put money in to have it be there forever.

It's hard to have an operating business around a fund that has a sunset. However, there are certainly things we can create that supplement a base load of capital, and we look at some of those. There are also things that the Wall Street firms might sell ironically that aren't the capital intensive businesses but are the non-capital intensive businesses that have a lot of value, but that's where you really get a lot of pick-up in terms of regulatory capital and capital push. There will be some of those trades as well.

R. Freeman Okay. Thanks.

Coordinator Your next question comes from the line of Matt Kelley of Morgan Stanley.

M. Kelley Good afternoon, guys. Thanks for taking my question. Given your commentary on the conditions and the backdrop I'd be curious to get your sense for what really gets us over the hurdle for M&A. In the meantime, how selective are you with allocating capital to your portfolio companies for growth given the backdrop you mentioned?

T. James Well, on M&A I think, in general, the corporate executives around the world need to feel like confident about where the major economies of the world are going, and about what kind of regulatory environment and new regulations they're facing, and in terms of the leadership in the key countries. All those things are sort of up for grabs right now, and so I don't see a robust M&A market until those things clarify, which they will. I couldn't tell you exactly when any more than you could. You probably know them better than I would, but they will clarify that I'm pretty sure about and at that point the M&A market will swing up.

We don't actually have to feed a lot of new capital in to our portfolio companies unless they want to make acquisitions, but generally speaking on the growth initiatives they can sell fund though so we don't tend to have dribs in to the portfolio companies for those things. But if there's a transformational acquisition with, of course, a lot of outside equity we love those because we're a synergistic buyer. In an environment where there's not much M&A we can sometimes get some pretty good deals.

M. Kelley — Okay. Great. And then, coming back to the real estate exits not to beat a dead horse here, but it would be helpful to kind of get your thoughts on, by segment, of your real estate portfolio; who your potential buyers are on your potential exits.

S. Schwarzman — Real estate is such a huge and diverse asset class that one of the wonderful things about the business is you can tailor your exits to almost the size of any buyer of scale. And so in laying out what you can do in each of the areas is something that we obviously keep in touch with but it's an extremely broad group of potential buyers for virtually every one of the asset classes that we're in. If you look at the number of REITs, the number of private owners of real estate, the number of institutions who like to buy real estate (the type that we own) for income purposes as core real estate it's a huge number of potential buyers.

T. James — And in some cases they're also strategic buyers and international sort of sovereign wealth fund guys, so as Steve said it's—and then I think I, I don't know somewhere I, maybe a press call we talked about it. In some cases we can access the public market directly ourselves for the portfolios and REITs, so it's a full … play, and we'll see what's best at the time.

M. Kelley — Okay. That's very helpful, and then, one final one from me is just in terms of the momentum you're seeing in BAAM. Obviously, you're continuing to get inflows, which is why the subscription numbers are strong. Do you think you're accelerating your share gain of that industry? Is that picking up even more now, and what are the discussions you're having with your clients there?

S. Schwarzman — I would say that we are accelerating our gain there, and it's quite interesting that institutions in the liquid area really are quite downside focused. We do provide a lot of unique problem solving. We don't just issue a fund-to-fund, and we also have all kinds of state-of-the-art technology tying ourselves in to the LPs with reporting and other types of services that we provide. You can check that the industry produces, I forget whether it's quarterly or semi-annual numbers in terms of where they different groups stand, and we're continuing to put daylight between ourselves and the other managers in that asset class.

T. James Mostly our big managers are at best flat and many are declining and so, yeah, we continue, and that's in the hedge fund fund-to-funds broadly defined. In the direct hedge funds though there's quite a growth of direct hedge funds so I'm not sure the fund-to-funds industry—well, the fund-to-funds industry itself is not growing as fast as the hedge fund industry, so we're taking share in the fund-to-funds industry.

S. Schwarzman And also we benefit at the firm from the growth in the overall hedge fund area through our Park Hill area where we're a very significant marketer of hedge funds to institutions where we have a fee structure; where we get ongoing fees from those clients.

M. Kelley	Great. Thanks for taking my question.
Coordinator	Your next question comes from the line of Marc Irizarry of Goldman Sachs.
M. Irizarry	Great. Thanks, everyone. On the Hilton obviously you guys have been talking for a while about RevPAR and improvement and the outlook, and I guess you've created some equity value there. Can you just remind us where Hilton is in their portfolios and how you're thinking about sort of an exit from Hilton?
L. Tosi	Marc, it's LT. Hilton's primarily in three funds and so it's in BCP5, it's in BREP VI, and BREP V. The biggest concentration's in BREP VI and the concentrations in BCP will be the second largest and BREP V being the third.
T. James	And on the balance sheet.
L. Tosi	And on the balance sheet there would be a fourth, which is substantially smaller than the others.

J. Solotar In terms of the exits, what we've said is we would expect at some point to take that public over the next few years.

S. Schwarzman The company's doing very well and as the RevPARs keep growing and we keep opening units around the world it's— We also have a terrific management there lead by Chris … and the whole investment has got a very good feel to it.

M. Irizarry Okay. Then, Steve, this is just a big picture question and I guess it's somewhat related to fees, but if you go back to your initial comment about the 14 months of outflows from domestic equity funds, clearly the world of traditional asset manager is looking at your world more frequently and there's more of a mainstreaming of alternatives going on. Do you expect to see fee pressures in certain parts of the business or maybe more competition from—are you sensing or seeing any competition from more of the traditional players in the space?

S. Schwarzman We haven't really seen competition from traditional players. At one point there was some competition from the hedge fund industry that for the most part either blew off its left hand or its right hand trying to do this type of investing. You'll see some fee pressure just because institutions generally are having difficulty reaching their actuarial returns, and they're looking for all kinds of different areas from personnel cuts in their own organizations to consolidation of managers so they can handle things easier at lower costs, which really benefits our firm.

To see some type of fee pressure on virtually everyone they touch in the institutional money management area, that's a normal type of thing when the customer is under pressure themselves. The way that rolls through for us is that we tend to get larger market share of the business. As institutions concentrate it might hit us a little bit. With some fee pressure in some areas sometimes incentives change a bit where we can make that up with higher performance, but it is an inexorable move mark to more and more assets in this class, which is a big offset, if you will, from an earnings perspective for a superior manager picking up share.

T. James — Yes. Just one note on that I would say to the extent there's fee cutting it's in terms of greater volume of assets, and net/net it's better for us.

L. Tosi — And if I can just interrupt because I just want to correct something we said before, Marc, in the answer to your question about Hilton because I just want to make sure we're 100% accurate here. So Hilton is primarily in BREP VI. That's where the largest investment for the firm is. Second largest concentration is in BCP5. The third then is that we have a substantial amount of co-invest in that investment, and then, the last two pieces are in BREP International II and on the balance sheet. It's a very pervasive investment in Blackstone but everything else we said holds.

M. Irizarry — Okay. Great. Thanks.

Coordinator — Your next question comes from the line of Chris Kotowski of Oppenheimer.

C. Kotowski Good morning. I'm looking at Page 23 of your press release with an eye on kind of assessing the probability of BCP5 becoming a carry generating fund, and I wonder is this the same disclosure that we had in your 10-Qs of the past? Because when I look at the MOIC on the realized investment in BCP5 it's 1.7 now, at March it was 1.4, and if it's comparable it would imply like a $1.3 billion realization on only $70 million or $80 million of cost increase.

L. Tosi Chris, a couple of things. This is the same presentation. We made one change to it in response to investors, which was we used to have a category called "Unrealized Investments" and then one called "Partially Realized or Realized Investments." And the conclusion was the partially realized or realized bundled together was a little bit confusing so we break the two apart so it's either realized or it's unrealized, but in the realized portion we don't put the unrealized portion of something that's been partially realized.

By creating that kind of bright line, if you will, you're right; the updating of the numbers if you went to look at them sequentially wouldn't make sense. But we'll give you some background on that on the Q to give you some color to clear that up specifically, Chris, but that's the difference.

C. Kotowski It's not that there was a big realization in it?

L. Tosi No.

C. Kotowski Okay. And then secondly, what's the dollar amount of the catch up to cross into carry mode?

L. Tosi I think the better message on that because first of all that fluctuates somewhat with respect to where you are and where the leverage is and there's a lot of different assumptions as to how you would get to that, but I think the better measure is to look at— because things aren't sold just on the equity piece. They're sold on the total enterprise value, and so the total enterprise value chain required to get to the hurdle is 13%. It was 12% at the end of last quarter.

C. Kotowski Okay. And then, finally I realize it's hard to comment on but if we look at the real estate segment over the last 2.5 years or so

I think there's been about $1.5 billion of unrealized performance fees and about $100 million of actual realizations. Well, you're probably not going to be able to say but I mean can one scale at all what one should expect a year and a half ahead in terms of realizations or there obviously have been press reports about the $22 billion that's up for sell?

J. Solotar That report I think was inaccurate or at least characterized what's happening inaccurately so we're not actively marketing our office portfolio. In due course it will be sold over the next several years; that's consistent with what Steve said the buy, fix, and sell it model.

L. Tosi Chris, just look at the change in the balances with respect to the performance fees. They're going up at a pretty good rate so you can see that the value being created for both the investors and those funds and the shareholder is solid right now.

J. Solotar And we did sell some small properties. We distributed about $800 million in cash to investors this quarter. That included over $400 million of sell.

C. Kotowski And I'm going to assume if there is a big sell—in the back of our minds there is the fact that the last time that Blackstone sold $20-odd billion of real estate there was a worldwide economic collapse or it's usually thereafter. I assume this time it's just that the acquirers are paying good prices.

S. Schwarzman Yeah. I think it's pretty low interest rates. Money has come back in to the U.S. banking system. The system certainly with the largest bank the banks are under lent. It's an under lent system looking for earning assets, and if this will happen don't give us too much credit for prescience. That would be great if it were always—

T. James Don't expect a major disposition program here either. That's not who we are.

S. Schwarzman But we're not sitting around ticking at the moment. We're fixing the properties. We're seeing the cycle ripen, and we'll be exiting in due course. We get people call us all the time for assets and REITs, what to buy things, and so it's really a question of our choosing, not whether we can exit these types of assets.

C. Kotowski All right. Thank you. That's it for me.

Coordinator Your next question comes from the line of Jeff Hopson of Stifel Nicolaus.

J. Hopson Thanks a lot. In terms of the hedge fund-to-funds wondering if there's any, I guess, capacity limitations there in developing new ideas, et cetera. And I think I heard you talk about single family real estate, and I'm curious, it sounds like that's fairly labor intensive so do you have the infrastructure in place and how much do you have invested today? When you eventually sell would this be bigger portfolios you've put together? Finally, in terms of operating cost in I think real estate and credit we saw a fairly sizable reduction this quarter, just curious versus the first quarter which is a better run rate and any input as to what's going on there?

S. Schwarzman In terms of question number one, limitation on the hedge fund-of-funds, we keep actually customizing all the different types of strategies, and there appears to be a huge demand for different types of strategies both between equity commodities, other types of assets done either globally or regionally. When you look at all of those different types of approaches and clients with different levels of risk appetite you'll be able to see that there is a very large potential appetite for growth of our services to those institutional clients with some just getting in to the asset class for the first time.

T. James A lot of new entrants.

S. Schwarzman And a lot of new entrants with that and new entrants tend to want to work with an organization that has a top reputation because the asset class is often viewed by boards of trustees. It's a little risky and so doing it on your own has career risk potentially for people working at these institutions.

In terms of the home purchasing business, you're absolutely right that there's a limitation in terms of how you manage this thing.

T. James So it's a very labor intensive local business because obviously you've got rental units all over the place, and the furnace breaks you've got to go fix it. What we've done is first of all we've concentrated in a few regions of the country where we have the infrastructure, and that infrastructure has come primarily from strategic partners that already run a lot of rental units, most of them apartment units but not necessarily exclusively apartment units.

We've teamed up and that's how we do that, and as we build the infrastructure in new regions where we think it's attractive in terms of the home price appreciation and the availability of merchandise, some of the demographic factors and other thing we look at, we then enter new regions. This could be quite large but certainly hundreds of millions of equity.

I don't know how large it will be but it seems like all of a sudden it's getting a lot more attention and added capital is coming; when that happens pricing will adjust. We'll have to see how it plays out but so far we're quite excited about it, and we think it's really good for the economy and for the people in the homes and for a lot of things. We think it's a really exciting thing to do.

S. Schwarzman Make no mistake that the critical variable here is the one you recognized, and we are super careful about what we're doing because you don't want to have unhappy people in those homes. You don't want to have complaints. You want to make sure that you've done your diligence, which is a very micro level. It's really house by house.

Just buying huge pools to put some assets on and hope it works out is not our strategy because you can have some bad outcomes there. We're putting together a very granular way of operating approach that will work combined with the buy side but it's really having your infrastructure in place. It's like any really good entrepreneurial activity. You imagine starting a firm like ours without a back office that really works you'll blow yourself up and that will do the same thing with some people who are playing around with this asset class as well.

L. Tosi The last question I think you had, Jeff, was about the operating expenses in real estate and credit, and you're correct the run rate in the second quarter is down from the first quarter, which reflects a decrease in business development expenses related to the latest BREP fund and the closing of the Mezzanine fund in credit. The second quarter run rate is more reflective of the ongoing run rate than is the first.

J. Hopson — Great. Thank you.

Coordinator — Your next question comes from the line of Michael Carrier of Deutsche Bank.

M. Carrier — Thanks, guys. If I look at the fund raising that you guys have done that's been very successful really across the product areas in deployment and realizations, particularly in real estate but also like credit's been also successful. It seems like that's a hurdle and it's partly industry wide just on the private equity side.

When we look at the dry powder that's where you're heaviest and when we look at the rate of deployment it seems like it's been a little slower, so when I think about next year or two years do you still see attractive opportunities out there? Are you looking at things differently in terms of the types of transactions and do you need some clarity on the macro fund in order to get more active?

S. Schwarzman I think what happens is that your ability to typically set up the deals is correlated to M&A volume, and M&A volume tends to dry up when economies go down. It's like a cycle that never changes. There are always interesting things to buy. In the private equity industry there's always some country that tends to be out of cycle. There are always some assets that get sold on a distressed basis.

There are always some assets that need to be sold for liquidity reasons, and so there's always a steady stream but you have these peaks and valleys. The valleys tend to occur when economies are weak or going down because nobody typically likes to buy an asset and find out that six months to a year later because its earnings went down or the markets went down they've bought an asset that's worth a lot less than you pay.

The experience we've had over sort of 26 years doing this is that to expect investment rates to be somewhat lower in times when things are going down, and when you hit the bottom and start coming up that's the time when you want to be deploying maximum amounts of money if you are a market timer. We actually try to be a bit of market timers.

Some things you can buy when things are down that are readily buyable, more energy assets, and things of that type. People need capital and you can fulfill that need and you can buy them cheap and that's our business. But if you're looking for just a steady investment rate it does, of course, fluctuate with overall economic conditions.

T. James You know, Mike, we had $2 billion committed and invested in the first half of this year in private equity. That's a pretty good level. The fund size won't support much more than that on a sustained basis, so that's one I'd say.

Second, it's lumpy so one deal could be $800 million of equity and stuff, and so you get close to a deal and maybe you miss it. You don't invest quite so much that quarter. That quarter you might do two or three of them and all of a sudden it looks like a huge investment rate, so just remember that. It's quite lumpy. Real estate, of course, they're putting out money in sort of record pace right now that's unsustainable.

M. Carrier Yeah. Okay. That's helpful. And then, just on the exit side just focusing on fund five and private equity, are there certain investments—because obviously if the environment gets better it's going to lift all boats, which is better for most investments but are there specific investments that teams are working on that can drive greater efficiencies, drive stronger revenues? Like is there anything you can highlight that is some of like the core holdings in that fund?

S. Schwarzman Good times or bad we try to get as much efficiency and drive as much growth as we can so we've been at that. It's one of the reasons right through the downturn that our companies grew EBITDA and grew revenues. In 2008, 2009, 2010 they continued to chug along. I can't single out anything in particular that's new and different that we weren't doing.

M. Carrier Okay. All right. Thanks, guys.

Coordinator This brings us to the end of our question and answer session. I will now hand the call back over to Ms. Joan Solotar for closing.

J. Solotar Great. Thank you, everyone, and look forward to following up after the call.