CONFERENCE CALL TRANSCRIPT: 3Q2013
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Leslie Wolfgang
Good morning. This is Leslie Wolfgang, Corporate Secretary for MAA. With me are Eric Bolton, our CEO, Al Campbell, our CFO and Tom Grimes, our COO.

Before we begin with our prepared comments this morning, I want to point out, that as part of the discussion, company management will be making forward-looking statements. Actual results may differ materially from our projections. We encourage you to refer to the safe-harbor language included in yesterday’s press release and our 34-Act filings with the SEC which describe risk factors that may impact future results. These reports, along with a copy of today’s prepared comments, and an audio copy of this morning’s call will be available on our website.

I’ll now turn the call over to Eric.

Eric Bolton
Thanks Leslie. I’d like to start my comments this morning by expressing my appreciation for all the hard work over the summer months by our folks at MAA and Colonial. We obviously had a busy summer as our most active leasing season was also highlighted by quite a bit of work surrounding the integration of our companies’ operating and reporting systems, ensuring we were ready to execute as a combined company upon closing our merger. Advisors for both companies did a terrific job and the merger transaction was successfully closed on October 1st. Our property associates and the entire management team, from both companies, really pulled together and we are now successfully up and running as a combined operation. As noted in our earnings release, both the MAA and Colonial portfolios ended the quarter with strong occupancy and as a result we are well positioned for the fall and winter leasing season. I’d also like to thank Tom Lowder and the entire Colonial management team for their hard work and enthusiastic support in positioning our now combined company for a strong start.

As reported in yesterday’s earnings release, MAA’s Core FFO per share for the third quarter of $1.25 was at the top-end of our guidance range. MAA’s same store NOI performance of 4.6% was in line with our expectation and the outperformance in FFO was due to a combination of better than expected lease-up in our development pipeline and lower than expected interest costs. The mid-point of our forecast range for 2013 growth in same store NOI of 5% has remained consistent all year.
As expected, during the quarter leasing conditions continued to support more robust performance from our large market segment of the portfolio. Houston, Dallas, Austin, Atlanta and Nashville all delivered solid revenue results. Sluggish employment conditions in Memphis and Little Rock held back rent growth and impacted our secondary market segment of the portfolio in the third quarter. We continue to believe that as we head into next year, as new supply deliveries are likely to generate some moderation in pricing power, our secondary market segment of the portfolio will provide a stabilizing influence on the overall portfolio performance. Next year’s outlook for the ratio of new jobs to new unit deliveries is in the 8 to 1 range for our large market segment of the portfolio, which is consistent with this year, while the secondary market segment is forecasted to move from a jobs to new units ratio of 6 to 1 this year to well over 10 to 1 in 2014.

We were encouraged with the continued low resident turnover in the quarter as we turned only 1% more units in the third quarter this year as compared to the third quarter of last year. On a rolling 12 month basis turnover remains low at 57.6%. Move outs to buy a house remain right around 20% of our overall move-outs, consistent with what we’ve seen for the last several quarters. Likewise, move-outs to rent a single-family home continue to hover in the 6% to 7% range of total move-outs. These numbers have been consistent for several quarters now.

While it wasn’t officially part of our operation in the third quarter, I wanted to also provide a little color on the Colonial same store portfolio in the third quarter. The portfolio captured year over year revenue growth of 4.7% in the third quarter with the best performances captured in Atlanta, Austin, Dallas, Charlotte and Charleston as each of these markets exceeded the average rent growth performance of the portfolio. Same store occupancy made a strong recovery from the end of the second quarter and ended the third quarter at 96.4%, a 150 basis point increase. As expected, during the third quarter there was some clean-up in final accruals and merger related closing activities in the expense area as same store operating expenses came in high at 10.3%. A combination of one-time incentives and leasing commissions put in place shortly after the merger announcement, and real estate taxes, pressured expense performance in the quarter. We expect all expense line items to normalize in the fourth quarter with the only continued pressure coming from real estate taxes.

We remain comfortable with the original assessment surrounding the expense synergies and opportunities to be harvested over the next few quarters from our merger with Colonial. We are well underway toward completing systems integration activities and reworking a number of contracts and processes that we expect will benefit both property level NOI results and overhead costs. The four development projects acquired through the merger are all on track with leasing now underway at Colonial Reserve at South End in Charlotte and Colonial Grand
at Randal Lakes in Orlando. In addition, we now have the vast majority of the remaining Colonial commercial assets and non-productive land holdings currently in the market for disposition and will be working to recycle this capital into productive multifamily assets over the next year.

As outlined in our supplemental schedules to the earnings release, leasing continues to go very well at our existing MAA development and lease-up properties. In particular our lease-up in Charleston has performed well ahead of our expectation with 174 of our 270 units delivered during the quarter and 231, or 86%, of the units already pre-leased or occupied at this time.

AI will provide you with more details on his update of the balance sheet but we were pleased to complete our inaugural public bond offering in October. The transaction was very well received and we believe our now combined balance sheet is in terrific shape. As we continue to drive higher levels of earnings productivity out of the capital on the former Colonial balance sheet we look to build on this balance sheet strength.

In summary, it was a very busy quarter. We’re excited to have the merger officially closed and are optimistic about the opportunities surrounding the combination of MAA and Colonial. As the current real estate market cycle continues to play out we believe our enhanced portfolio and full-cycle portfolio strategy, supported by a strong operating platform, puts the company in a terrific position to continue to drive higher margins and more value from our existing asset base. Additionally, we believe that over the next couple of years there are going to be some good opportunities to opportunistically deploy capital. Our planned capital recycling activities and solid balance position puts MAA in a terrific position to support this effort.

That’s all I have in the way of prepared comments and I’ll now turn the call over to Al.

Al Campbell
Thank you Eric, and good morning everyone. I’ll provide additional color on the company’s third quarter earnings performance, balance sheet activity, and on updated guidance for the fourth quarter.

As mentioned in the release, given the October 1st close of the Colonial merger, third quarter results reflect only MAA activity, with combined reporting beginning in the fourth quarter. There will of course be a good bit of noise from the merger in the fourth quarter, but we’re going to work hard to provide as much detail and clarity as we can to help project combined company performance for the remainder of the year. We’ll discuss this further in a moment, as we address revised guidance.
Core FFO for the quarter was $55.4 million, or $1.25 per share, which represents 9.6% growth over comparable results for the prior year, and was $0.04 per share above the mid-point of previous guidance.

The favorable FFO performance for the quarter was primarily produced by leasing activities running ahead of plan for the lease-up and development pipeline (adding about $0.02) and from lower interest expense for the quarter, due to timing of the planned bond transaction for the quarter (adding an additional $0.02).

As Eric mentioned, performance from the same store portfolio was in-line with our expectations, as same store NOI grew 4.6% for the quarter, based on 4.0% growth in revenues and 3.3% growth in operating expenses. Continued rent growth and strong occupancy levels drove revenue performance, with real estate taxes being the primary area of expense pressure for the quarter, as we continue to see increases in key states, such as Texas and Florida. Real estate tax expense for the third quarter grew 13.5% over the prior year, based on the 7.5% to 8% growth rate projected for the full year combined with the impact of a tough comparison to last year’s 2.5% growth in the third quarter.

Year-to-date, same store NOI increased 5.9% based on 4.4% revenue growth and 2.3% growth in operating expenses.

We closed no acquisitions during the third quarter, but following quarter-end we acquired one additional new community located in Fredericksburg, Virginia, the 251-unit Haven at Celebrate, which will be operated as Phase II of Seasons at Celebrate, one of our existing communities purchased in 2011. Following this transaction, the gross purchase price of acquisitions year-to-date is $148.8 million, including the two communities purchased from MAA’s joint venture fund.

We also sold four communities during the third quarter, for total gross proceeds of $46.9 million, and one additional community following quarter end, for $10.4 million in proceeds. These transactions bring year-to-date sales proceeds to just over $131 million for nine communities averaging 26 years of age, representing a weighted average cap rate 7.2% (on in-place NOI, after deducting a 4% management fee and $350/unit capex reserve). With these combined sales for the year, MAA has exited five secondary markets, Melbourne, FL and Athens, Thomasville, La Grange, and Valdosta, GA.

Progress on the company’s lease-up and development pipeline continued during the third quarter, with one community, Cool Springs in Nashville, fully stabilizing, and with the three remaining completed communities all achieving over 90% occupancy during the quarter, and projected to be fully stabilized in the fourth quarter (defined as > 90% occupancy for 90 days).
We now have two MAA communities remaining under construction, with an expected total cost of $74 million for 564 units. We funded an additional $5.3 million in construction costs for these communities during the third quarter. With the Colonial merger, we also acquired four additional communities under construction. The total construction pipeline now consists of 1,731 units in six communities, with a total expected development cost of $236.5 million, of which $93 million remains to be funded. We expect to fund an additional $28 million on multifamily construction during the fourth quarter.

During the third quarter we completed the renewal of our unsecured revolving credit facility. We improved the terms and increased the borrowing capacity to $500 million, with the option to expand it to $800 million, and extended the maturity date almost two years to late 2017. This expansion was an integral part of our plans to complete the Colonial merger and support the larger company in the future.

Also, immediately following the end of the quarter and closing of the Colonial merger, we completed our planned inaugural unsecured bond offering. We were very pleased with market reception and were able to execute a very successful financing, despite a volatile market backdrop. We issued $350 million of bonds with a 4.3% coupon priced at 99.047%, and we simultaneously settled the $150 million in forward interest rate swaps entered earlier this year as part of the planned transaction. The effective interest cost of the financing is 4.15% for the next ten years. The proceeds were used to pay off all borrowings under the revolving credit facility.

Our balance sheet ended the quarter in great position. Company leverage (defined as net-debt-to-gross assets) was 40.8%, total debt was 6.0 times Recurring EBITDA, and MAA’s fixed charge coverage ratio (defined as Recurring EBITDA to interest expense) was 4.7 times. With the closing of the merger and completion of the inaugural bond deal in October, MAA’s balance sheet further strengthened. Overall leverage levels remained the same, but unsecured debt, unencumbered assets, and fixed rate protection all increased. At the end of October, over 60% of MAA’s assets were unencumbered, secured debt was less than 25% of gross assets, and over 98% of outstanding debt was fixed or hedged against rising interest rates, with an average maturity of 4.8 years.

Finally, we’re providing updated guidance for the fourth quarter reflecting combined company results. The full year performance for the company will be comprised of nine months of MAA stand-alone activity and 3 months of combined activity for the fourth quarter. There will be a good bit of noise in reported earnings for the fourth quarter, so we are giving guidance on a Core FFO basis, excluding merger related and certain other items, with the goal of providing more clarity and comparability to prior period results. Also, we’ve added a fair amount of detail in our Supplemental Data schedules with the press release, to help model combined company performance.
Core FFO for the fourth quarter is projected to be $1.09 to $1.19 per share, which is $1.14 per share at the mid-point, based on average shares of about 79.3 million following the merger. This is $0.06 per Share below previous “stand-alone” guidance, which is in-line with our expectations for the combined company given the non-productive development pipeline and land acquired from Colonial, as well as the remaining synergies to be captured over the next 15 to 18 months. Full year Core FFO is projected to be $4.81 to $4.91 per share, which is $4.86 per share at the mid-point.

We’re maintaining the mid-point of full year NOI guidance for the legacy MAA same store portfolio at 5% based on revenue growth of 4% to 4.5% and expense growth of 3% to 3.5%.

We expect the legacy Colonial portfolio to produce revenue growth in the fourth quarter of 3.25% to 3.75%, which would equate to full year revenue growth of 4.25% to 4.75% which is within the previous guidance range already provided for the portfolio on a pro forma basis. NOI is projected to grow 2.5% to 3.0% for the fourth quarter, due to operating expense growth of 4.75% to 5.25%, primarily related to pressure from real estate taxes for the quarter.

We now expect acquisition volume to be $175 million to $225 million for the year, and disposition volume to be $131 (current year-to-date total) as the remaining disposition planned for the year is now expected to close in early 2014. We expect G&A and property management expenses combined for the fourth quarter to be $14.5 million to $15.5 million, excluding merger and transition costs, which reflects about half of the expected synergy capture (on a run rate basis) by year-end.

Total combined transaction costs related to the merger are still expected to be approximately $60 million in total, with around half projected to be incurred during the fourth quarter.

Also, we expect to record a mark-to-market adjustment related to the assumption of the Colonial debt balances of around $90 million, which will be amortized over the remaining life of Colonials outstanding debt (or about 4 years) and excluded from the calculation of Core FFO.

AFFO for the full year (defined as Core FFO less recurring capital expenditures), is projected to be $4.20 to $4.30 per share. Our current annual dividend rate is $2.78 per share.