CONFERENCE CALL TRANSCRIPT: 2Q2016
July 28, 2016 9:00 A.M. CDT

Tim Argo
Good morning. This is Tim Argo, SVP of Finance 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.

During this call, we will also discuss certain non-GAAP financial measures. Reconciliations to comparable GAAP measures can be found in our earnings release and supplemental financial data.

When we reach the question and answer portion of the call, I would ask for everyone to please limit their questions to no more than two, in order to give everyone ample opportunity to participate. Should you have additional questions, please re-enter the queue or you are certainly welcome to follow up with us after we conclude the call. Thank you.

I'll now turn the call over to Eric.

Eric Bolton
Thanks Tim. As outlined in yesterday's earnings release, second quarter results were ahead of expectations. Solid rent growth, supported by occupancy that matched last year's strong results, generated same store net operating income that was ahead of our forecast. Core FFO per share of $1.49 was at the top-end of our guidance with the favorable NOI performance driving the majority of the outperformance for the quarter. It's also worth noting that Core AFFO was $1.25 per share for the second quarter, or 16% ahead of the second quarter of last year.

As a result of the better than expected second quarter performance, combined with our outlook that leasing conditions over the rest of the year will support continued solid rent growth and strong occupancy, we've raised the expectation for Core FFO for the full year. As discussed in our first quarter call, it's important to keep in mind the record level of occupancy that was captured in the back half of last year, particularly in the third quarter, that will serve as this year's comparative benchmark. But, to be clear, we anticipate the current strong occupancy and pricing trends will continue. For the full year we continue to believe that we will capture average physical occupancy at 96.2%, slightly ahead of last year's record performance at 96.1%, while also driving solid rent growth that supports the year-over-year gains in revenue leading to our increased expectations for the same store NOI growth. Al will walk you through the more detailed assumptions in his comments covering our revised and increased guidance for both same store NOI and Core FFO.

Same store operating metrics remain strong with resident turnover in the second quarter down 4.6% as compared to the second quarter of last year. Daily physical occupancy averaged 96.2% throughout the quarter matching last year's strong performance. Effective rent per unit increased 4.4% over the second quarter of last year and was up 1.4% on a sequential basis, with all of our markets registering both positive year-over-year and sequential rent growth with the exception of Houston which was down slightly by 0.2%. Tom will give you some additional insights on the operating trends we are seeing as well as outline performance differences across our markets. Overall, we are encouraged with the continued levels of growing demand that is clearly keeping pace with new supply delivery across our diversified portfolio and balanced sub-market strategy.

We continue to work through a very robust acquisition pipeline with deal flow running well ahead of last year. As outlined in the earnings release, we were successful in the second quarter with the acquisition of a new property in its initial lease-up in the Phoenix, AZ MSA. This particular acquisition is a good example of the sort of opportunities we target involving a new lease-up development with a local developer and motivated capital that enables both our operating and transaction execution capabilities to capture a high-quality opportunity at a price that we believe will add to future value per share. We expect to capture a stabilized NOI yield in the 6% range on this high-end new property once we complete the lease-up and execute on other opportunities associated with onsite operations and revenue management practices. As new supply continues to come on line in a number of our markets, we're optimistic that additional opportunities will be captured later this year.

So in summary, we like the market trends we are seeing and the MAA team has the operating platform executing well, the balance sheet is in terrific shape and our transaction pipeline is very busy. With that I'll now turn the call over to Tom.

Tom Grimes

Thank you Eric and good morning everyone. Our second quarter NOI performance of 5.7% was driven by revenue growth of 4.4% over the prior year and 1.2% sequentially. We have good momentum in rents as all in place effective rents increased 4.4% from the prior year. In the second quarter, new rents and renewal rents executed during the quarter increased 5% on a blended lease over lease basis. We also matched the strong average occupancy of the prior year.

Overall same store expenses remain in line, up just 2.3%. Expense discipline has been a hallmark of our operation for years. Our industry leading initiatives, such as our vendor owned shop stocking program and our interactive marketing strategy, have allowed us to keep the expense line consistently in check.

Third quarter trends continue the positive momentum. Average daily physical occupancy of 96.2% is in line with July of last year. Our 60 day exposure, which is current vacancy plus all notices for a 60 day period is just 7%, below prior year by 50bps. New and renewal rents have built on the strong trends of the second quarter. On a blended lease over lease basis, our July rents increased 4.3% and early indications are that August will increase to 5%.

On the market front, the vibrant job growth of the large markets is driving strong revenue results. They were led by Orlando (7.3%), Fort Worth (7.1%), Phoenix (7%) and Atlanta (6.2%).

The secondary markets continued to close the effective rent growth gap with the large markets. Since the third quarter of 2015, the rent growth gap between large and secondary markets has narrowed 60bps. Revenue growth in Jacksonville (4.9%), Greenville (3.9%), and Charleston (3.7%) stood out.

As mentioned, momentum is strong across our markets with occupancy, rent growth and exposure all showing positive trends. Our only market worry bead is Houston which represents just 3.4% of our portfolio. We will continue to monitor closely and protect occupancy in this market. As we approach the end of July, our Houston market's daily occupancy is 95.2% and 60 day exposure is just 6.6%.

Move outs for the portfolio were down for the quarter by 4.6% over the prior year and turnover remained low at 51.5% on a rolling twelve month basis. Move outs to home buying were down 1%. Move outs to home rental, which represent just over 7% of our total move outs, were down 5%. Our focus on minimizing the time between occupants again paid off, and we were able to reduce by one day the average vacancy between occupants which helped drive the second quarter average physical occupancy to 96.2%.

During the quarter we completed over 1,800 interior unit upgrades, bringing our total units redeveloped this year to just over 3,200. We expect to redevelop over 5,000 units this year. Our redevelopment pipeline of 15-20,000 units remains robust. As a reminder, on average we are spending about $4,500 per unit and receiving average rent increases of approximately $100 over a comparable non renovated unit, generating a year one cash return of well over 20%.

Our active lease-up communities are performing well. Station Square at Cosner's Corner II closed the quarter at 99% occupancy. Cityscape at Market Center II is leasing well. They are currently 95.6% occupied and expected to stabilize on schedule in the third quarter of this year. Rivers Walk II in Charleston is 71% leased and Colonial Grand at Randal Lakes II in Orlando is 18% leased, both are on schedule. Our second quarter acquisition, Residences at Fountainhead in Phoenix, Arizona is currently 78% occupied.

At the mid-way point of our summer season we are on track and the portfolio is performing very well.

Al Campbell
Thank you Tom and good morning everyone. I'll provide some additional commentary on the company's second quarter earnings performance, balance sheet position, and finally on the revised earnings guidance for the full year.

Core FFO for the quarter was $1.49 per share, which represents a 10% increase over the prior year. This performance was $0.05 per share above the mid-point of our previous guidance. About 2/3rds, or $0.03 per share, of this outperformance for the quarter was related to favorable property operating results, primarily due to expenses, as both personnel and marketing costs were better than expected for the quarter. The remaining $0.02 per share was primarily related to gains on casualty insurance claims settled during the quarter, as shown on the reported income statement. Strong rental pricing and continued high occupancy levels carried through the quarter, as expected, supporting the earnings performance.

As Eric mentioned, we acquired one new community during the second quarter, Residences at Fountainhead, located in Phoenix, Arizona, for a total investment of $69.5 million. The community was in lease-up when acquired, and was 75.8% occupied at quarter-end. As Tom mentioned, lease-up continues to progress well, and we expect the community to complete its initial lease-up early next year.

During the second quarter we sold three parcels of commercial land and the remaining commercial JV property originally acquired in the Colonial merger for total proceeds of about $4.5 million, producing the small gains on sale of non-depreciable and depreciable assets reflected on the income statement for the quarter.

We had four communities, all phase II expansions of current properties, remaining under construction at the end of the quarter. We funded $16.1 million toward completion during the second quarter, and have an additional $48 million of the $97 million total projected cost remaining to be funded. We continue to expect stabilized NOI yields of 7.0% to 7.5% on average for these communities once completed and stabilized.

Our balance sheet remains in great shape. At quarter-end our, our leverage, defined as Net Debt to Gross assets, was 40.7%, 70bps below the prior year, while our Net Debt was only 5.7 times Recurring EBITDA. At quarter-end, 92% of our debt was fixed or hedged against rising interest rates at an average effective interest rate of only 3.8%, with well laddered maturities averaging 4.7 years. At quarter end we had almost $600 million of combined cash and borrowing capacity under our unsecured credit facility providing both strength and flexibility for growth. Given our current expectations for acquisitions and dispositions over the remainder of the year, along with our projection for excess cash of $90 to $95 million (representing FAD less all dividends), we do not anticipate new equity needs this year and we expect to end the year with our leverage slightly below current levels.

Finally, as Eric mentioned, we are again increasing our earnings guidance for 2016 due to the stronger than projected performance. We're increasing our Core FFO projection by $0.04 per share at the mid-point, to reflect both the $0.05 per share second quarter outperformance and our revised expectations for real estate taxes for the year, now expected to cost an additional $0.01 per share over the remainder of the year, as valuations, mainly in Texas, came in a bit higher than expected. Our forecast generally continues to be based on our current strong occupancy levels carrying through the year, with the toughest comps in the third quarter, combined with pricing performance continuing in the 4% to 4.5% range.

Core FFO is now projected to be $5.77 to $5.93 per share, or $5.85 at the mid-point, based on average shares and units outstanding of about 79.6 million. Core AFFO is now projected to be $5.07 to $5.23 per share, or $5.15 at the mid-point, which produces a strong 64% AFFO payout ratio for the year. We also increased our same store NOI guidance to an expected range of 4.75% to 5.25% for the full year, based on higher revenue growth (increased range to 4.0% to 4.5%) and lower operating expense growth (decreased range to 2.5% to 3.5%), which includes the impact of higher real estate taxes, now projected to grow 5.5% to 6.5% compared to the prior year. The other major components, including transaction and financing assumptions remain similar to our previous guidance.

That is all we have in the way of prepared comments, so Leo we will now turn the call back to you for questions.