



CONFERENCE CALL TRANSCRIPT: 3Q2017

October 26, 2017 9:00 AM 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, Tom Grimes, our COO, and Rob DelPriore, General Counsel.

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.

I'll now turn the call over to Eric.

Eric Bolton

Thanks Tim. FFO results for the third quarter, ignoring the credit associated with the mark-to-market adjustment on our preferred stock derivative, were ahead of our expectation. This result was achieved despite the unexpected expenses incurred during the quarter associated with the two hurricanes that affected our operations in Houston and in Florida.

Leasing conditions in the third quarter, particularly in our larger markets, reflect the impact of elevated new supply levels and is more evident at the higher-end priced point and more urban-oriented locations in the portfolio. On a comparative basis, we continue to see better pricing performance across the majority of our secondary markets and more suburban locations. Most importantly, job growth and the resulting demand across the overall portfolio, continue to hold up. While it varies somewhat by market, the ratio of job growth to new supply across the overall portfolio is in the range of 5 to 1, representing a generally healthy supply-demand scenario which enables us to capture strong occupancy and low resident turnover while generating solid growth in lease renewal pricing.

We remain positive on internal earnings growth prospects over the next few quarters for several reasons.

First, projections continue to support a pull-back in the permitting of new construction. As a result we expect the current new delivery pressures to show some moderation over the back half of 2018. Our early projections of job growth to new supply across the total portfolio in 2018 reflect a slight improvement as compared to the trends in 2017. As a result of our balanced portfolio, with investments across a wide range of markets and submarkets, we believe that overall market fundamentals as they apply to our markets will remain supportive of good demand, strong occupancy and solid overall pricing opportunities with renewal pricing outpacing new lease pricing.

Secondly, as Tom will outline in his comments, we are seeing some early benefits associated with reconciling the Post portfolio operation to MAA's practices and we're confident this momentum will carry well into next year as a lot of the foundation was laid this year, especially on the revenue management side, and will be more impactful on leasing activity in 2018. We have both the legacy MAA portfolio and the legacy Post portfolio well positioned for the slower winter leasing season and start to next year.

Thirdly, we will see a steady and growing contribution from our development and lease-up pipelines in 2018. One of the real value-add components we captured through our merger with Post was the development pipeline. While it was at its most dilutive point in 2017, we will see this become a net positive contributor to earnings in 2018.

As we've seen over the last couple of quarters, supply pressures continue to be more evident in the legacy Post portfolio. Despite these pressures, we continue to make progress in reconciling revenue management practices. The performance differences between the legacy Post and MAA portfolios continue to narrow. During the quarter, within the legacy Post portfolio we captured average daily occupancy of 95.7% which was within 50 basis points of the average daily occupancy generated by the legacy MAA portfolio. This is the best comparative result since our merger. In addition, the legacy Post portfolio captured strong growth in lease renewal pricing during the quarter, equaling the results captured from the legacy MAA portfolio. New lease pricing moderated in August and September from the trends we saw in July as new supply pressures picked up in several submarkets in the latter part of the third quarter. We will have to work through new supply challenges in several submarkets before rents on leases written to new move-in residents meaningfully improves, but we're encouraged with the continued strong performance in renewal lease pricing while at the same time seeing resident turnover remaining low. With new construction permitting trending down, as well as great progress having been made over the year in

repositioning the legacy Post portfolio to our revenue management protocols, we're optimistic that new lease pricing will show improvement in 2018.

Our most persistent challenge continues to be external growth. Despite an increase in new supply and the associated pressure on new lease pricing, cap rates and market pricing on acquisition opportunities remains robust. We continue to underwrite and actively review a number of opportunities. Absent some combination of attributes that creates a highly motivated seller, it's been a challenge to achieve pricing on acquisitions that we believe meet our disciplined protocols governing capital deployment. We are also analyzing several new development opportunities, but likewise find that upward pressure on construction labor and materials costs is challenging our willingness to commit capital at the moment. I expect we will get some activity underway on both the acquisition and development fronts over the coming year, but certainly the buying bonanza, or a rise in cap rates, that sometimes accompanies supply induced moderation in leasing conditions hasn't shown up in this cycle...at least not yet. We have the balance sheet in a very strong position with ample capacity to support this opportunity when it appears.

Our team continues to make great progress in working through the many tasks associated with integrating the legacy Post platform with our MAA operating practices. As we've seen over the course of this year, the early wins surrounding reductions in property operating expenses continued in the third quarter. As noted, in the third quarter growth in same store expenses was impacted by hurricane related expenditures and we fully expect the fourth quarter to reflect the positive trends we saw earlier this year. We remain excited about the additional opportunities remaining to capture in 2018 surrounding revenue management protocols, maintenance operations and the significant unit interior redevelopment opportunity that will carry forward well past next year.

I want to send my thanks and appreciation to our team for their hard work over the busy summer season and the extra effort that was required from this year's active hurricane season.

MAA has completed a significant amount of growth and change over the past few years and the platform is in a significantly stronger position. We hope to see many of you at our upcoming Investor Day on November 13th where we plan to lay out the strengths of the platform and our outlook for the company.

That is all I had in the way of prepared comments and will now turn the call over to Tom.

Tom Grimes

Thank you Eric and good morning everyone. Same store revenues for the quarter were up 1.7% over prior year with 96.1% average daily occupancy.

Looking at this by portfolio, the legacy MAA portfolio revenues were up 2.4% with 96.2% average daily occupancy and effective rent growth of 2.8%. The legacy Post portfolio had revenue growth of -0.5% with 95.7% average daily occupancy and effective rent growth of 0.2%.

The performance gap between the two portfolios is driven by higher new supply in the Post submarkets as well as differences in operating practices. We have of course been focused on achieving full alignment in operating practices between the two portfolios. We have made good progress and results are starting to show up. This momentum will carry into 2018. We have improved Post occupancy by 50 basis points since the beginning of the year and feel we have another 40 basis points to go. October to date, Post blended rents are up 2% on a lease over lease basis. This is 40 basis points better than October of 2016. Said another way, we have increased the Post blended lease over lease rate by 310 basis points from the first quarter and have driven the average daily occupancy rate up by 50 basis points. This has occurred as the Post submarkets have faced growing competition from new deliveries. We believe that the data cleanup and resetting of the many variables within the revenue management system will drive enhanced performance as we work through releasing the portfolio over the coming year.

While it takes time for the improvement in pricing to show up in portfolio revenue performance, the expense progress has been immediate. Excluding the hurricane related expenses, total expenses for the quarter were up just 1.4% and year to date expense growth for the Post portfolio is down -0.7%. That is driven by improvements in personnel, repair and maintenance as well as property and casualty insurance. As a result, the Post NOI margin is expected to improve 40 basis points this year. We expect this to grow as we see the benefits from the completed foundational work of our revenue management systems and continue to harvest opportunities on the expense side of the equation.

Looking forward, we are well positioned for the slower winter months. October occupancy is expected to close at 96% and 60 day exposure, which is all vacant units plus notices though a 60 day period, is below 7%. The early read on the fourth quarter renewals is encouraging as we are averaging 5.7% increases achieved and January offers went out at 7%.

While elevated supply levels moderated overall revenue growth, we are still seeing good growth in many markets. Fort Worth, Raleigh, Charleston, and Richmond stood out from the group.

Houston has been our market level worry bead, but it appears to be stabilizing. After hurricane Harvey, our occupancy increased from 96.2% to 97%. Our 60 day exposure is just 4.2%. We have held pricing at pre-storm levels but expect them to climb as normal operations return. On the supply front, Dallas and Austin are facing the most pressure. Expected deliveries for 2017 are 16,000 for Dallas and

7,000 for Austin. These deliveries represent 3% of inventory in both markets. We are encouraged that job growth has remained strong in both Austin and Dallas. For 2017, Dallas job growth is 2.2% and Austin job growth is 2.1%, which compares favorably to the 2017 national average of just 1.4%. This improves in 2018 with both markets expected to grow at 2.4% versus the national average of 1.5%.

Renter demand remains steady and our current residents continue to choose to stay with us. Move outs for the portfolio were down 3.2% for the quarter. Turnover remained at a low 50.4% on a rolling twelve month basis. Move outs to home buying and move outs to home renting were both down, 5.5% and 3% respectively.

As you know, much of the Post product is in the inner loop areas that are seeing the most supply. While this puts pressure on the newer product, it creates opportunity on the older product in excellent locations. We plan to invest \$112 million to redevelop units in the Post communities over the next three to four years. This is our most accretive method to allocate capital. There are 13,000 Post units that have compelling redevelopment opportunities. We can make these great locations more competitive by updating the product. We have room to raise rents and still be well below the rates of the new product coming on line.

We are just getting underway on the Post redevelopment program. Through the quarter we have completed \$9.5 million in renovations on over 1,100 units. On average we are spending \$8,600 and getting a rent increase that is 12% more than a comparable non-redeveloped unit.

For the full MAA portfolio, year to date, we have completed over 6,500 interior unit upgrades. On legacy MAA, our redevelopment pipeline of 15,000 to 20,000 units remains robust. On a combined basis, our total redevelopment pipeline is in the neighborhood of 30,000 units. That translates into a total pipeline of \$170 million of very accretive capital deployment.

As you can tell from the release, our active lease-up communities are performing well. Leasing has gone better than expected at Charlotte at Midtown in Nashville and that stabilization date was moved up a quarter to fourth quarter of this year. The Retreat at West Creek II, Colonial Grand at Randall Lakes II, Post Parkside at Wade II and 1201 Midtown I all stabilized on schedule this quarter.

We are actively leasing The Denton II, Post South Lamar II, Post Midtown, River North and they are progressing well.

It has been a busy quarter for our teams and we are pleased with our progress. The building momentum in the Post portfolio is particularly encouraging. We look forward to continuing to capture value creation opportunities on both the revenue and expense sides of the equation.

Al Campbell

Thank you Tom and good morning everyone. I'll provide some additional commentary on the company's third quarter earnings performance, balance sheet activity, and finally on guidance for the remainder of 2017.

Net income available for common shareholders was \$1.00 per diluted common share for the quarter. FFO for the quarter was \$1.50 per share, which was \$0.06 above the midpoint of our previous guidance. The third quarter performance included \$0.035 per share of non-cash income from the valuation of an embedded derivative included with the preferred shares acquired from Post, which I will discuss more in just a moment. Before considering a \$0.02 per share impact from hurricane related costs, total property NOI for the third quarter (including Non-Same Store) was in-line with expectations. Favorable G&A, interest, and other income produced the majority of remaining outperformance for the quarter, offsetting the storm costs and producing \$0.02 per share of additional favorability.

As briefly discussed in prior releases, the \$0.035 per share of non-cash income related to the preferred shares acquired is, in short, due to accounting rules that require we bifurcate an assumed embedded derivative related to the call option on the shares. The derivative must be recorded as an asset and marked-to-market each period through earnings. Volatile trading during the third quarter produced a sizable non-cash adjustment, which bears no real economic benefit and will potentially reverse at some point in the future.

Higher supply pressures in many of our urban oriented locations did pressure our revenue performance more than expected for the third quarter, primarily in the legacy Post portfolio. Overall blended pricing of 2.6% for the quarter was below our projection of just over 3%. Also, average occupancy performance of 96.1% for the quarter, while strong, did not reach the high prior year level of 96.3% as projected, which drove the bulk of the difference from our projections for the quarter.

However, pricing trends for the Post portfolio continued to improve over the previous quarter, and we remain excited about the opportunity to capture stronger performance from operating practices over the next several quarters.

Partially offsetting the revenue moderation was continued strong expense performance during the quarter. Same store operating expenses for the legacy Post portfolio (excluding real estate taxes) declined almost 5% compared to the prior year, as we continue to capture savings from both operating practices and scale.

During the quarter, four communities within our lease-up portfolio were fully stabilized and one development community, Post Midtown, was completed and moved into the lease-up portfolio. Our current lease-up portfolio now contains three communities totaling 999 units with an average occupancy of 61.5% at quarter end. One community is expected to stabilize during the fourth quarter, with the final two projected to stabilize mid to late 2018.

During the third quarter, we funded an additional \$33 million of development costs, bringing our year-to-date funding to \$143 million. Our current development pipeline now contains five projects with a total projected cost of \$305 million, with only \$70 million remaining to be funded. These five projects are expected to produce an average 6.3% stabilized NOI yield once completed and leased-up, with three of the projects projected to be completed by the first quarter of 2018, and the remaining two completed in the back half of 2018.

During the quarter we sold three wholly-owned communities, located in Lakeland, Florida, Montgomery, Alabama, and Fort Worth, Texas. The total proceeds of \$88.4 million represented strong pricing for 28 year old assets (on average), and produced a 5.3% economic cap rate. We also exited two tertiary markets with these sales. We currently have two additional communities located in Atlanta under contract for sale which are expected to close during the fourth quarter for gross proceeds of approximately \$98 million.

Our balance sheet remains in great shape. During the third quarter, we paid off \$150 million of senior unsecured notes assumed from Post, as well as a \$14 million secured mortgage with our unsecured line of credit. At quarter end, our leverage, as defined by our bond covenants, was 33.2%, while our Net Debt was only 5.3 times Recurring EBITDA. At quarter end, 85% of our debt was fixed or hedged against rising interest rates at an average effective interest rate of only 3.5%, with well laddered maturities averaging 4.4 years. At quarter end we had over \$795 million of combined cash and borrowing capacity under our unsecured credit facility providing liquidity and support for our business plans. Given our current expectations for acquisitions and dispositions over the remainder of the year, along with our projection for excess cash approaching \$100 million, we do not anticipate new equity needs this year and expect to end the year with our leverage around current levels.

Finally, we updated our earnings guidance for the full year to reflect the third quarter performance and updated expectations for the remainder of the year. We are updating guidance for net income per diluted common share, which is reconciled to updated FFO and AFFO guidance in the supplement.

Net income per diluted common share is now projected to be \$2.76 to \$2.86 for the full year 2017. FFO is now projected to be \$5.84 to \$5.94 per share, or \$5.89 at the midpoint, which includes \$0.15 per share of merger and integration costs

for the full year. AFFO is projected to be \$5.25 to \$5.35 per share, or \$5.30 at the midpoint.

We adjusted our FFO guidance for the full year by adding \$0.02 per share at the midpoint. We expect continued volatility in the non-cash earnings related to the embedded option acquired with the Post preferred shares, and we have allowed for \$0.02 of the recent favorability to reverse during the fourth quarter. We have also extended the recent operating trends through the remainder of the year, with projected fourth quarter revenue performance based on an expectation of continued stable occupancy (at current levels) and blended pricing on move-ins and renewals during the fourth quarter reflecting normal seasonality, averaging 1.5% higher on a lease over lease basis, in-line with prior year. The combination of these factors, as well as a more favorable prior year comparison in occupancy, is expected to produce fourth quarter revenues above the third quarter.

As you saw in our supplement, we are revising our guidance expectations for the Combined Adjusted Same Store portfolio. We now project revenues to grow 2.0% to 2.5% for the full year and operating expenses to grow 1.75% to 2.25%. This is expected to produce NOI growth for the year in the 2.0% to 2.5% range, including a 30 basis points impact from the storm costs incurred in the third quarter.

We also revised guidance for acquisition volume for the remainder of the year to reflect the competitive landscape. The top end of our acquisition range now includes closing one additional deal prior to year end. We also tightened our range for development investment for the year, reflecting revised timing of funding.

We remain on track to capture the full \$20 million of overhead synergies related to the Post merger, on a run-rate basis by year end, and we are a little ahead of timing expectations for the year, as reflected in our revised guidance. And we also expect to continue capturing additional NOI opportunities over the next several quarters, as the operating practices and platforms become fully integrated.

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