CONFERENCE CALL TRANSCRIPT: 4Q2018
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Tim Argo, SVP, Finance
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, our General Counsel.

Before we begin with our prepared comments this morning, I would like 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 forward looking statements section in yesterday's earnings 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. A presentation of the most directly comparable GAAP financial measures, as well as reconciliations of the differences between non-GAAP and comparable GAAP measures, can be found in our earnings release and supplemental financial data, which are available on the "For Investors" page of our website at www.maac.com.

I'll now turn the call over to Eric.

Eric Bolton, Chairman and CEO
Thanks Tim. We wrapped up 2018 slightly ahead of where we expected with FFO per share of $6.06 excluding the non-cash mark-to-market accounting adjustment related to the preferred shares. We're encouraged with our fourth quarter results as the positive trends in rent growth and high occupancy are clearly evident. While the new supply pipeline in several markets will challenge near-term rent growth, we're encouraged with the continued strong demand for apartment housing across our markets. Our portfolio continues to benefit from strong job growth and an overall high demand for apartment housing.

We continue to believe that new supply pressure in 2019 will remain elevated, but down slightly from 2018. Tom will cover more details concerning our higher concentration markets, but broadly when weighting our market exposures by percentage of NOI and refining the analysis to neighborhood specific assessments of new supply, our latest update is very similar to the information we shared at NAREIT in November. In summary, we expect 48% of our portfolio's market exposure will show some level of improvement in 2019 with lower supply as compared to prior year, 44% of our market exposure is expected to see slightly higher levels of new delivery in 2019 and 8% of the portfolio exposure will see current year deliveries in line with prior year new deliveries. Assuming the demand side of the equation remains strong we expect the positive pricing momentum we've seen over the back half of 2018 to continue through calendar year 2019.

As we continue to work through the later stages of the current cycle, we do expect to see developers get a little more aggressive with their lease-up tactics and have dialed that into our expectations for 2019. With a goal of maximizing long-term revenue results, we remain focused on continuing to capture the encouraging trends in rent growth and given where we are in the cycle, we expect that it might come at the cost of a little current occupancy. Let me be clear though, as Al will outline in his comments, we do expect to post strong occupancy in 2019 of 95.9% average daily occupancy throughout the year, which represents a slight 20 basis point moderation from the record high 96.1% performance in average daily occupancy throughout 2018.

As commented on in our third quarter earnings release, our merger integration activities are now complete. We're very pleased with the results over the last couple of years in harvesting the synergies we had previously identified surrounding property level operating expenses and G&A overhead costs. We do expect to see year-over-year growth in expenses begin to normalize in 2019. As expected, the opportunities on the revenue side of the equation surrounding various revenue management practices and significant redevelopment opportunities within the legacy Post portfolio have been slower to capture than the expense side given the new supply pressures in a number of markets. However, despite this pressure, the improving pricing trends within the legacy Post portfolio over the past couple of quarters are encouraging and in addition we will be executing on a higher number of redevelopment opportunities this year within that part of the portfolio.

Our four projects in lease-up continue to become increasingly productive and in line with our expectations. We expect to see all four properties stabilize over the course of this year. We expect to see our new development projects in Raleigh and Denver begin initial leasing and occupancy over the back half of this year with our newest project in the Frisco submarket of north Dallas coming on line early next year. We started a new expansion project at our Copper Ridge community in north Fort Worth this month on existing owned land. At this point we are also working pre-development at new development projects in Phoenix, Denver, Orlando and Houston that we expect to start later this year.

In summary, we're encouraged with the continued momentum in pricing that we're capturing despite the new supply headwinds in several of our larger markets. We believe our portfolio focused on the strong job growth Sunbelt region, diversified across markets, submarkets and price points, appealing to the largest segments of the rental market, continues to position MAA for solid performance during this phase of the real estate cycle. Our balance sheet is in a strong position and certainly able to support the external growth opportunities we are currently executing on and any others that may emerge. After two years of merger activities that are now complete, our platform is stable and stronger. We look forward to the performance opportunities in 2019.

I'm going to turn the call over to Tom now.

Tom Grimes, EVP, COO
Thank you Eric and good morning everyone. Our operating performance for the fourth quarter came in as expected with building momentum in rent growth, continued strong average daily occupancy and improving trends that set us up well for 2019.

The results of integration work on the operating platform were evident in our leasing momentum during the quarter. We saw the blended lease over lease performance of the combined portfolio grow 1.6% in the fourth quarter which is 150 basis points higher than the same time last year. Average daily occupancy remained strong at 96.1%

As a result of the steady positive trend in blended pricing we saw revenues buck seasonal trends and accelerated from 2% in the third quarter to 2.3% in the fourth quarter.

While elevated supply levels have pressured rent growth in several of our markets, particularly Dallas and Austin, we are still seeing good revenue growth in a number of our other markets. Among our highest concentration markets, Phoenix, Richmond, Tampa and Orlando were our strongest revenue growth markets.

Expense performance was steady for the fourth quarter at 3%. This includes 5.8% growth in real estate taxes which was partially offset by reductions in Building Repair and Maintenance as well as Marketing. For the year our total expense growth was just 2%. While we have captured the scale and labor opportunities available during this merger we still expect to continue our disciplined expense practices. Our annual operating expense growth rate since 2012 has been just 2.4%, well below the sector average.

The favorable trends continued into January. All pricing indicators are trending ahead of last year. Currently, same store January blended lease over lease rates are up a healthy 3.1% which is 260 basis points better than January of last year. Average daily occupancy for the month is a strong 96.0%.Our 60 day exposure, which represents all vacant units and move out notices for a 60 day period, is a low 7.2%. We are well positioned for 2019.

Our focus on customer service and retention coupled with social trends supporting steady renter demand continue to drive down resident turnover. Move outs for the overall same store portfolio were down 7% for the quarter. Move outs to home buying and move outs to home renting were down 5% and 12% respectively. On a rolling 12 month basis, turnover was a historic low of 48.5%. This low level of turnover was achieved while increasing renewal rents by a notable 6.1%.

On the redevelopment front during in the fourth quarter we completed 1600 units which brought us to a total of 8,200 unit interior upgrades for the year. For 2019 we again expect to complete close to 8,000 unit interior upgrades. As a reminder on average we spend $6,100 per unit and charge an additional 11% in rent which generates year-one cash-on-cash return in excess of 20%. Our total redevelopment pipeline now stands in the neighborhood of 17,500 to 20,500 units.

Our active lease-up communities Sync 36 and Post River North in Denver, Post Centennial Park in Atlanta and Phase II of 1201 Midtown in the Mount Pleasant submarket of Charleston are all leasing up in line with our expectations.

Looking forward, as Eric mentioned, overall supply in our markets is expected to improve modestly in 2019. We take the third party data and then cross check this supply data with our own asset by asset information. Performance by market will vary, but at this point we believe overall we will see some decline in deliveries.

Our Dallas and Austin assets are expected to remain challenging with supply levels continuing in the 3% to 4% of inventory range. We expect Charlotte to soften as supply picks up near our assets. We expect the strength in Jacksonville, Orlando, Tampa and Phoenix to continue as all currently show supply decreasing.

We are pleased to have the merger integration wrapped up. I greatly appreciate the tireless efforts of our associates as we retooled the company over the last 2 years. We are starting 2019 in a much better position than 2018 and we look forward to the coming year.

Al Campbell, EVP, CFO

Thank you Tom and good morning everyone. I'll provide some additional commentary on the company's fourth quarter earnings performance, balance sheet activity, and finally on the key components of our initial guidance for 2019.

FFO for the fourth quarter was $1.55 per share, which included $0.02 per share of non-cash expense related to the accounting adjustment of the preferred shares acquired during the Post merger. Excluding this adjustment, our FFO per share for the fourth quarter was a penny above the midpoint of our prior guidance, with the majority of the outperformance produced by favorable interest expense during the quarter.

Our overall Same Store performance for the fourth quarter was in line with our expectations as continued pricing momentum produced the 2.3% year-over-year growth in total revenues for the quarter, which accelerated as Tom mentioned from the 2.0% growth achieved in the third quarter. Overall blended lease pricing growth (combined new and renewal lease pricing) finished the full year at 2.5%, which was 80 basis points above the prior year.

Same store expense growth of 3.0% for the fourth quarter was primarily driven by a 5.8% growth in real estate tax expense (which represents 36% of total SS operating expenses), as pressure late in the year from certain municipalities, primarily Atlanta and Dallas, impacted the fourth quarter. For the full year, real estate tax expenses grew 4.2%, as compared to our initial guidance of 3.5% to 4.5% for the year.

During the fourth quarter, we completed construction of one development community, an expansion phase of a community in Charleston, SC, which leaves three communities under development at year-end, with a total projected cost of $118.5 million, of which about $87.5 million remained to be funded as of year-end. We also acquired two land parcels during the fourth quarter (in Denver and Houston); both related to planned new development projects expected to begin during 2019. Given our current pipeline and planned new projects, we expect total construction funding to increase in 2019, ranging between $100 and $150 million. We continue to expect NOI yields of 6.0% to 6.5% on average from our development portfolio, once completed and fully stabilized.

During the fourth quarter we had two communities complete lease-up and reach stabilization (which we measure as 90% occupancy for greater than 90 days), which left four communities in lease-up at year-end, including the recently completed community mentioned earlier. Average occupancy for our lease-up portfolio ended the year at 62.4%, and as Tom mentioned, leasing is going well for the group and we expect growing earnings contribution during 2019 and into 2020, as two of these communities are projected to stabilize in the first half of 2019, with the final two stabilizing later in the year.

Our balance sheet remains in great shape at year-end. During the fourth quarter we had a fairly significant amount of financing activity, as we paid off the final $80 million of our Fannie Mae secured credit facility, which matured in December, and an additional $530 million of secured mortgages maturing in early 2019. Given the volatility of the credit markets during the fourth quarter, we revised our financing plans and entered a 30 year fixed rate secured mortgage for $172 million and a $300 million variable rate unsecured six month term loan, which we expect to replace in 2019 with additional fixed rate financing. At the end of the year we had over $490 million of combined cash and capacity under our credit facility. Our leverage, as defined by our bond covenants, was only 32.6%, while our Net Debt to Recurring EBITDA*re* was just below 5 times.

Finally, we are providing initial earnings guidance for 2019 with the release (which is detailed in our supplemental information package). We're providing guidance for net income per diluted common share, which is reconciled to FFO and AFFO per share in the supplement. We're also providing guidance on other key business metrics expected to drive performance for 2019.

Also, though we do expect continued volatility in our NAREIT reported FFO results related to the non-cash accounting adjustment on the preferred shares, we do not include any adjustments in our forecast, as these are both non-cash and really impractical to predict.

Net income per diluted common share is projected to be $2.11 to $2.35 for the full year 2019. FFO is projected to be $6.03 to $6.27 per share, or $6.15 at the midpoint. AFFO is projected to be $5.39 to $5.63 per share, or $5.51 at the midpoint.

The main driver of our full year 2019 performance is our same store guidance. Revenue growth, projected to be 2.3% at the midpoint, is based on continued strong average daily occupancy of 95.9% at the mid point, and projected average blended rental pricing (new leases and renewals combined) of 2.7% at the midpoint, which is a modest improvement over 2018. We expect operating expense growth of 3.1% at the midpoint, coming off of two years of very low expense growth. We expect real estate taxes to continue to produce the most pressure, increasing 4.25% at the midpoint. This expected same store revenue and operating expense performance produces same store NOI growth of 1.8% at the midpoint.

We expect the acquisition environment to remain competitive. We project total acquisition volume for 2019 to range between $125 and $175 million and to consist primarily of non-stabilized deals. We also plan to resume our portfolio recycling efforts, with projected disposition volume of $75 to $125 million, likely closing in the second half of the year.

We expect to end 2019 with our leverage near current levels, as a percentage of gross assets, producing an average effective interest rate of 3.9% to 4.1%, which is about 20 basis points above the prior year at the midpoint (representing an $0.08 per share impact to earnings). A portion of this projected increase is related to the continued impact of rising short-term interest rates, with the remaining portion primarily due to the declining mark-to-market adjustment related to the debt acquired from the Colonial and Post mergers, as the favorable fair market value debt adjustment related to both mergers essentially burned off during 2018.

Our guidance also assumes total overhead costs (which we include G&A and Property Management Expenses combined) will range between $96.5 and $98.5 million, reflecting a more normalized run-rate for 2019 which includes a full year carry of investments made in our people, facilities, systems, and web presence to improve our operating platform capabilities, scalability, and cyber-security, all planned as part of the merger integration efforts. Our total overhead costs for 2018 were below our original estimates for the year and actually declined from 2017, primarily due to the timing of some of these planned investments and the impact of several non-recurring items during the year, impacting legal, casualty insurance, and medical insurance for the year. We expect our total overhead growth rate over the longer term to be around 5% annually, which is well in line with the sector average.

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