Mid-America Apartment Communities, Inc.
Conference Call 2Q10
August 6, 2010, 9:15 am (Central)

Leslie Wolfgang

Good morning. This is Leslie Wolfgang, Director of External Reporting for Mid-America Apartment Communities. With me are Eric Bolton, our CEO, Al Campbell, our CFO, Tom Grimes, Director of Property Management and Drew Taylor, Director of Asset Management.

Before we begin I want to point out that as part of the discussion this morning company management will make forward-looking statements. Please 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.

Bolton

Thanks Leslie and good morning everyone. As outlined in yesterday's earnings release, leasing fundamentals across our markets are quickly recovering. We're very encouraged with the improvement in pricing that's underway. Through the end of the second quarter, the trend in overall blended pricing, including rent amounts for both new residents as well as for renewing residents, was up 3.9% from where we started the year. More importantly, the pricing on leases written for new move-in customers during June increased by 6.4% since the first of the year. And this trend continued in July with new resident rents up a very strong 8.4% since January. This trend in pricing, coupled with continued high occupancy, low resident turnover, and solid expense control, supports what we expect will be robust same store performance in 2011.

A combination of stabilizing employment conditions, a significant pull-back in new development and continued low levels of resident turnover, are driving a rapidly improving leasing environment across most markets in the U.S. And while these variables should enable many markets to capture strong recovery in pricing over the next few quarters, job growth will need to improve in order to keep the pricing trends moving up. We believe that our focus on the historically strongest employment growth region of the country has the portfolio in a terrific position to capture strong performance over the emerging recovery cycle.

As Al will outline for you in his comments, and as we did with our first quarter report, we are again increasing our FFO guidance for 2010 as a result of the better than expected same store results in the second quarter and a stronger operating outlook over the remainder of the year.

Occupancy remains very strong across both our large and secondary market segments. Phoenix is our only market that I would characterize as not yet showing definitive signs of early pricing recovery. But, with occupancy improved 350 basis points on a year-over-year basis at our properties in Phoenix, we were still able to capture positive momentum in revenue performance on a sequential basis and we're optimistic that we will see momentum build for pricing recovery late this year or early next year. Houston is a market that weakened late last year as new supply came on line throughout much of 2009, but this market is also now showing early signs of recovery as our properties there closed at 96% occupancy and we generated just over 2% growth in revenue on a sequential basis. Atlanta was another sluggish market until recently and has likewise begun to show positive momentum with 1.6% sequential revenue growth from the first quarter. Both our large and secondary market segments showed solid revenue improvement and captured positive NOI growth in the second quarter as compared to the first quarter. As we work through the busy summer season and continue to re-price a larger percentage of the portfolio, we expect that year over year pricing will turn positive in the third quarter and overall revenue performance will turn positive by the first quarter of 2011.

Now, taking a quick look at new growth and the transaction area, we completed three acquisitions of newly developed properties, for a total investment of $70 million dollars, during the second quarter and deal flow is really starting to pick up. Two of the new properties acquired in the second quarter were bought directly from the developer and one was acquired out of foreclosure from the lender. We believe we made terrific buys on all three deals. Blended pricing on the deals, based on stabilized NOI, was roughly a 6.8% NOI yield and a 6.25% cap rate, but more importantly, we believe the investments will exceed our IRR hurdle requirements.

As noted, we are seeing a lot more activity and we are actively under-writing a number of additional deals. As of today, we have five additional properties, or $145 million of additional new deals under contract to acquire that we hope to close this quarter, two of which are early in their initial lease-up. As with the three properties acquired in the second quarter, assuming we satisfactorily complete due diligence and close on these additional five deals, we're confident that we are buying some great high-quality assets at very attractive pricing that will be accretive to shareholder value.

I'm now going to turn the call over to Al who will give you some additional details on the quarter's performance as well as information concerning our updated guidance. Al.

Campbell

Thank you, Eric. We reported FFO results for the second quarter of 80 cents per share, but this included two significant non-routine and non-cash items totaling 13 cents per share. Our core FFO performance, excluding these two items, was 93 cents per share, 2 cents ahead of the mid-point of our guidance given on the same basis.

In conjunction with the redemption of ½ of our preferred shares, discussed in our previous call, we wrote-off $2.6 million (or $0.08 per share) in original issuance costs during the quarter. Also during the quarter, we incurred an impairment charge of $1.6 million (or $0.05 per share) related to Cedar Mill apartments, one of our original IPO properties, as we re-evaluated our intention to hold the asset for the long term, choosing to reallocate the capital to higher growth opportunities.

Our same store performance compared to the prior year was better than expected, as NOI declined only 2.7%, verses our projection of a 5.7% decline, which produced an additional 4 cents per share in FFO for the second quarter. This outperformance was partially offset by a combined 2 cents per share reduction related to dilution from equity raised during the second quarter to redeem our preferred shares (3 cents) and favorable performance on our interest expense projections (1 cent).

Same store revenues produced about one fourth of the second quarter operating favorability, driven by continued strong occupancy and growing rental pricing trends. Property operating expenses for the second quarter were also favorable to expectations, making up the remaining portion of the outperformance. Real estate taxes made up the largest portion of the favorability due to successful prior year appeals and continued declining valuations during the period.

As previously mentioned, during the second quarter we redeemed ½ (or $77.5 million) of our outstanding preferred shares. We also called the remaining portion (an additional $77.5 million) of our outstanding preferred shares during the quarter and redeemed them yesterday at $25 per share plus accrued dividends. In conjunction with the redemption of the remaining portion, we will incur an additional $0.08 per share charge during the third quarter to write-off the remaining original issuance costs.

This transaction is yet another step in strengthening our balance sheet, further preparing us for future growth. The shares carried a relatively expensive 8.3% coupon rate, and this transaction will reduce our total leverage (often defined as debt + preferred capital to gross assets) by almost 6%, increase our fixed charge coverage ratio by almost 20%, and add nearly 6 cents per share to FFO in 2011.

During the second quarter, we raised $131.6 million from the issuance of 2.5 million common shares under our At-the-Market share offering program. The shares were issued at an average price, net of issuance costs, of $52.57 per share, with the proceeds being used to redeem the first half of our preferred shares, to fund our acquisitions, and to prepare for the redemption of the remaining preferred shares in August. At the end of the second quarter, we had just over 1 million shares remaining under our ATM program.

Also during the quarter we fixed the rate on $50 million of our Fannie Mae borrowings for 7 years at 4.73% and entered a $40 million interest rate cap maturing in 5 years with a LIBOR strike rate of 4.5% to replace interest rate swaps maturing during the year. At the end of the quarter, 88% of our total debt was fixed or hedged against rising interest rates.

Our balance sheet remains very strong. We ended the quarter with our debt to gross assets at 48% and our fixed charge coverage at 2.76 times EBITDA for the quarter, 15% above the sector average. We have no debt maturities remaining in 2010, and we ended the quarter with $158 million in combined excess cash and current borrowing capacity under our credit facilities.

As outlined in our release, we are raising our full year FFO guidance to reflect the stronger operating and transaction environment. Though there are several cross currents in our revised forecast, the two main changes from our previous guidance are our revised same store NOI growth expectations and the impact of increased acquisition activity. We now expect same store NOI to decline in a range of 2% to 4%, which compares to a decline of 3% to 5% in our prior projections. We have also increased our acquisition expectations with wholly-owned acquisitions now projected to reach $200 million for the current year (vs. $150 million previously projected), including two new lease-up properties.

Operating fundaments improved faster than we expected, which is projected to add $0.08 per share in additional FFO for the year, the $0.04 cents gained in the second quarter and another $0.04 cents projected over the remainder of the year. And though we expect the two lease-up assets that Eric mentioned are under contract to contribute strongly to future FFO, we project dilution of $0.05 per share in 2010.

So in total, we're now projecting our FFO per share, excluding non-routine items, to be in the range of $3.60 to $3.80 per share, an increase of $0.03 from the mid-point of guidance provided at the end of the first quarter. It's important to remember that we also raised our guidance $0.12 cents per share in the first quarter, bringing the total revision for the year to $0.15 per share (or about 4.25%).

Including the non-routine items for the year, totaling $0.20 related to the full preferred redemption and the asset impairment, we are now projecting FFO to be in the range $3.40 to $3.60 per share.

Bolton

Thanks Al. The summary point we believe you should take away from our report this morning is that with strong pricing trends and increasing acquisition opportunities, MAA is clearly in position to deliver solid results over the emerging recovery cycle. We believe the company's performance will continue to be very competitive in the apartment sector. Our strategy is aimed at delivering top-tier results for shareholders over the long haul, and as we begin to move into the recovery part of the cycle we believe that MAA is very well positioned. A combination of our focus on the region and markets with some of the strongest employment growth projections in the country, and little in the way of new supply pressure for the next couple of years, and growing opportunities to capture a meaningful level of new growth, all combine to put the company in a strong position.