CONFERENCE CALL TRANSCRIPT: 1Q2017
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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.

I'll now turn the call over to Eric.

Eric Bolton

Thanks Tim and good morning everyone. FFO results for the quarter were ahead of our expectations as property operating expenses, interest expense, and merger and integration costs all came in lower than expected. While leasing conditions across most markets reflect varying degrees of moderation as a result of increased levels of new supply, we continue to see strong demand across our markets with high resident retention, and MAA's balanced portfolio continues to capture solid results.

We're off to a terrific start with integration activities in our merger with Post Properties. The early results in improved operating efficiency and NOI margin enhancement are very encouraging. In the first quarter, our operating team was able to improve the NOI margin within the legacy Post same store portfolio by 130 basis points as compared to prior year. Our initial efforts on the revenue side were focused on stabilizing occupancy, lowering exposure, and reconciling practices associated with lease renewal pricing. During the quarter, our asset management group also completed the retooling of key market data within our revenue management system associated with each of the legacy Post properties and as a result, we head into the peak leasing season well positioned to optimize on pricing performance. Our operating teams have also captured some early wins on the operating expense side of the equation with renegotiated pricing and new contracts. We have much work left to accomplish and opportunity to harvest, but we're certainly encouraged with the early trends and the longer term opportunities to be captured in our merger with Post.

Our unit interior redevelopment program had a record first quarter performance with over 1,500 units redeveloped at significant rent bumps and attractive long-term return prospects that Tom will outline in his comments. During the first quarter, substantial work was completed in initially scoping out this effort at a number of the legacy Post properties, and as Tom will outline, the early indications are very promising. We expect to see this activity ramp up quite a bit at the legacy Post locations over the course of this year and throughout 2018.

Al will walk you through an update of our FFO guidance but we're encouraged with the start to the year, and while we did make some off-setting adjustments to the same store revenue and expense performance assumptions, we continue to be comfortable with our initial guidance for same store NOI. With continued steady employment trends, coupled with MAA's diversified and balanced portfolio approach, and with the upside we expect to capture from enhanced operating efficiencies and margin improvement… especially within the legacy Post portfolio…we're optimistic about our ability to drive NOI results as outlined in our guidance for the balance of this year.

Good progress continues with our lease-up and new development pipelines and we look forward to getting these properties fully earnings productive over the next several quarters. As noted in our earnings release, we did make one acquisition during the quarter…an opportunity very much in line with the sort of investments that we've captured over the past couple of years which was a newly developed property in its initial lease-up that had recently fallen out of an earlier contract. The transaction market and pricing continues to be as competitive as we've seen over the past couple of years and we will continue to be patient and disciplined in navigating through the pipeline of opportunities being presented.

We're off to a great start for the year and I appreciate the great results being generated by our MAA associates as we deliver today while also building for tomorrow.

That's all I have in the way of prepared comments and will now turn the call over to Tom.

Tom Grimes

Thank you Eric and good morning everyone. Our first quarter same store NOI performance of 3.6% was driven by revenue growth of 2.8% over the prior year and strong expense control. The top line was driven by rent growth as all in place effective rents increased 2.9% from the prior year.

All leases signed during the quarter were up 1.3%, but we have seen some persistent weakness though the first quarter on new lease pricing, so let's jump into this area first.

For the same store portfolio, new lease rates on a lease over lease basis were down 3.2% for the quarter. As expected, the submarkets incurring higher levels of supply bore the brunt of the pressure on capturing new residents during the slower winter months. We expect new lease pricing will remained challenged at a number of locations over the next few quarters as the new supply pipeline fully delivers, but we expect to see some improvement as we move into the more favorable leasing season.

Encouragingly, leasing velocity has picked up and new lease pricing has improved by 190bps for April month to date as compared to the first quarter. In addition, as Eric touched on, we have completed most of the foundational work associated with repopulating our revenue management system with updated data from the legacy Post locations and with improved occupancy and exposure positioning. We are where we should be heading into the summer

Renewals for the combined portfolio were still strong for the quarter at 6.1%. Renewals signed for MAA remained robust at 6.6%. Post renewals rates have responded well under the MAA pricing approach. In January they were up 4%, in February up 4.7%, March they increased to 5.4% and so far in April, they are coming in at 5.7%. For perspective, renewals signed on Post assets in April of last year were up just 4.8%. As a result, blended rents have improved 120 bps from 1.3% in the first quarter to 2.5% for April month to date.

Occupancy and exposure trends are strong across the board. April month to date average daily physical occupancy of 96.0% matches our very strong April of last year. Our 60 day exposure, which is current vacancy plus all notices for a 60 day period is just 7.9%, which is better than last year. The strength in this area gives us a solid foundation as we head into the busier season.

On the market front, revenues in Phoenix, Raleigh, Nashville, Jacksonville stood out from the group. In addition, it's worth noting the effective rent growth coming from markets like Charleston, Richmond, and Memphis, were all above 4%.

In both portfolios, Houston remains our only market level worry bead and represents just 3.5% of our NOI. We will continue to monitor closely and protect occupancy in this market. Currently, our combined Houston market's daily occupancy is 96.2% and 60 day exposure is just 7.6%.

Expense performance was solid and led by a few early wins in the Post portfolio. As a result of the improved scale, our national account pricing improved in both portfolios but was more impactful in the Post results. In addition, the renegotiation of in-market contract services such as interior paint vendor and pool cleaning services aided the Post results. The increased scale also improved the pricing of our casualty insurance. Driven by this expense performance, the NOI margin on the Post portfolio increased 130bps from the first quarter of last year.

Renter demand remains steady, and our current residents continue to choose to stay with us. Move outs for the portfolio were down for the quarter by 2.2% over the prior year and turnover dropped again to a low 50.5% on a rolling twelve month basis. Move outs to home buying and move outs to home renting remained consistent at 20% and 6% of move outs.

As you know, much of the Post product is the inner loop areas that are seeing the most supply. While this puts pressure on the newer product, it creates opportunity on the well located older product. There are 13,000 Post units that are in very good inner loop locations that have compelling redevelopment opportunities. We can make these great locations more competitive by updating the product. We will have room to raise rents and still be well below the rates of the new product coming on line.

The early market response to the Post redevelopment is impressive. At this point in our redevelopment, units are pre-leasing based mostly on our description of the units provided by our onsite teams. Through April month to date, we have completed 80 units but have already leased 152 units. Given the quality of the locations, the redevelopment opportunity is more significant. On average we are spending $8,600 and getting a rent increase that is 10% more than a comparable non redeveloped unit.

As Eric mentioned, we are just getting started. We originally planned on doing 1,700 units on the Post portfolio. However, if the response to the product remains strong through our busier season, we will have the opportunity to exceed this amount.

For the full MAA portfolio, during the quarter we completed over 1,500 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.

As you can tell from the release, our active lease-up communities are performing well. We moved the stabilization date for Innovation, 1201 Midtown and Colonial Grand at Randal Lakes II up a quarter and moved Post Parkside at Wade back a quarter. These timing difference are minimal and do not have an impact on our return assumptions. Our new acquisition community in Nashville is on track and

Residences at Fountainhead in Phoenix and Innovation in Greenville will stabilize on schedule in the second quarter.

We are pleased with our progress thus far on the Post merger and remain confident in the opportunities ahead to create value by continuing to reconcile practices between these two companies.

Al Campbell

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

Net income available for common shareholders was $0.36 per diluted common share for the quarter. FFO for the quarter was $1.46 per share which was $0.08 per share above the mid-point of our guidance for the quarter. We were encouraged by the solid first quarter performance, but the results included some noise related to the nature and timing of several items, which should be considered in the revised expectations for the remainder of the year. I will provide a little more color in a moment, but in summary $0.03 per share is related to favorable operating performance for the quarter (same store and non-same store combined), an additional $0.03 per share is related to lower than expected integration and interest costs combined for the quarter, and finally the quarter included $0.02 per share of non-cash income related to a required mark-to-market adjustment of an embedded derivative.

About 2/3rds of the favorable operating performance (or $0.02 per share) was related to the Combined Adjusted Same Store portfolio, primarily due to operating expense performance, with the remaining $0.01 per share related to the non-same store portfolio, as lease-up, development, and commercial properties all performed a little better than expected for the quarter.

As mentioned, integration and interest costs together produced another $0.03 per share of favorability for the quarter, a portion of which is timing related. We remain confident in our full year projected ranges for each of these items.

Finally, the first quarter results include $0.02 per share of non-cash income from an embedded derivative related to the preferred shares acquired in the Post merger. In short, accounting rules require that 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 first quarter produced a sizable non-cash adjustment, which bears no real economic benefit and will potentially reverse at some point over the remainder of the year.

I will outline our revised guidance for the remainder of the year in a moment.

During the first quarter, we acquired a newly developed community located in Nashville for $62.5 million, which was in lease-up when acquired and about 77% occupied at quarter-end.

We also funded an additional $62.5 million of development costs during the quarter. We completed the construction of two development communities slightly ahead of schedule during the quarter, leaving seven communities in our current development pipeline, with an expected total cost of just over $505 million, of which all but about $129 million has already been funded.

During the quarter, Moody's Investor Services upgraded our investment grade rating to Baa1 (stable), which reflects the strength of our balance sheet and brings all of our ratings (Moody's, Standard & Poors and Fitch) to the third level of investment grade. We expect to use these ratings this year, as we plan to access the bond markets to refinance maturities and pay down our credit facility balance.

At quarter end, our leverage (defined as Debt to Total Assets, per our public bond covenants) was 34.1%, and our unencumbered assets were over 80% of Gross Assets. We also had over $460 million of combined cash and capacity under our credit facility to provide protection and support for our business plans.

Finally, we revised our earnings guidance for the full year to reflect the first 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 $2.54 to $2.74 for the full year 2017, reflecting updated expectations of gains on planned disposition properties. FFO is now projected to be $5.74 to $5.94 per share, or $5.84 at the mid-point, which includes $0.15 per share of merger and integration costs for the full year. AFFO is projected to be $5.15 to $5.35 per share, or $5.25 at the mid-point.

We are maintaining our overall expectation for Combined Adjusted Same Store NOI growth for the year (3.0% to 3.5% range), but now expect this to be produced by revenue growth in the 2.8% to 3.2% range and expense growth in the 2.5% to 3.5% range.

In summary, we are increasing our FFO guidance for the full year by $0.02 per share. This is produced by the strong Q1 performance ($0.08 per share performance above guidance as mentioned earlier), combined with revised expectations for several items which offset $0.06 per share of this favorable performance over the remainder of the year.

First, we expect volatility from the derivative accounting to reverse the $0.02 of non-cash income over the remainder of the year. Also, we now expect our acquisitions to be a little later in the year and to comprise more lease-up opportunities, which costs an additional $0.02 per share in initial dilution for 2017 (that we expect to be more accretive over the longer term). In addition, revised guidance for real estate taxes (now expected to grow 5.5% to 6.5%) removes $0.01 over the remainder of the year. And finally, though our integration costs were $0.01 favorable in Q1, we expect our total integration costs for the year to be in line with original estimates, shifting the $0.01 per share of the cost to the remainder of the year.

Our guidance for acquisition and disposition volumes, development investment, and total merger and integration costs for the year remains unchanged.

We also remain on track to capture the full $20 million of overhead synergies, on a run-rate basis, by year-end. And we expect to continue capturing additional NOI opportunities (included in our original forecast), primarily in the later part of this year, as the operating practices and platforms become more integrated.

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