



CONFERENCE CALL TRANSCRIPT: 2Q2014

July 31, 2014 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, 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. Appreciate everyone being on our call this morning.

Second quarter results reflect good momentum on pricing with same store rents increasing 3.1% over the prior year. Overall revenue results largely reflect the impact of this pricing momentum with some off-set from slightly higher vacancy loss when compared against last year's strong performance, as well as lower transaction fees resulting from reduced resident turnover during the quarter. At the end of the quarter physical occupancy was a solid 95.7% and slightly ahead of last year's 95.6% performance. As a result of the strong occupancy position at quarter end and in July, average daily occupancy within the same store portfolio ran 35 to 40 basis points higher than last year. And importantly, pricing momentum continued in July with new lease rents increasing 4.1% year-over-year, and renewal rents increasing an average of 5.8%. We're encouraged with the pricing trends and the resulting revenue outlook for the back half of the year.

As expected, same store operating expenses were under some pressure for the quarter due to timing differences versus prior year from landscaping expenses, as well as a continued rise in real estate taxes reflecting higher valuation trends.

Other expense line items during Q2 were generally in line to slightly better than we had forecast, with some favorability in performance captured due to lower resident turnover which was down 7% as compared to last year.

Pricing and revenue performance in a few of our secondary markets lagged performance elsewhere across the portfolio as a combination of weaker job growth trends and tough prior year occupancy comparisons pressured performance in Memphis, Birmingham, Jacksonville and San Antonio. Solid results were achieved in Charleston, Savannah and Greenville. Generally, the secondary market segment of the portfolio continues to avoid the higher new supply trends that we see in a number of our larger markets, but we need to capture a stronger lift in the broader economy and employment conditions for several of these secondary markets to capture more robust rent growth.

Within our large tier market segment of the portfolio, as expected Raleigh was our weakest performer as the market there works through new supply deliveries. We continue to feel good about the long-term prospects in Raleigh and expect we'll see supply pressures peak this year and better pricing trends emerge in 2015. Strong revenue results from Nashville, Charlotte and our Texas markets contributed to solid performance for the large tier market segment of the portfolio.

As outlined in our earnings release, given the performance trends we saw in the second quarter and in July, we have adjusted our forecast assumptions for revenues and expenses which are expected to generate a solid growth in NOI in the 4.0% to 4.5% range for the full year.

Our team was very busy during the second quarter wrapping up the consolidation of the MAA and Colonial operating systems and platforms. We're now fully operational on the same property management, asset management and management reporting systems. After closing our merger in October we felt that the best opportunity for capturing the full benefits surrounding synergy and scale was to get both companies and back-office operations fully consolidated as quickly as possible and prior to the busy summer leasing season. It took quite a bit of focus and a lot of extra hours during Q2. I'm proud of the work accomplished by our folks and really appreciate their hard work.

With the vast majority of the integration work and risks now behind us, we're fully focused on harvesting the various operational opportunities surrounding our merger.

Our new development pipeline continues to lease up very well. During the second quarter we wrapped up construction on the projects in Charlotte and Orlando, leaving our projects in Nashville and Jacksonville as the only remaining construction actively underway. We expect to begin initial occupancy at these two properties later this year. Leasing continues to also go well on our lease-up

portfolio and we expect to achieve full stabilization of the majority of these units by the end of this year with full earnings production in 2015.

We continue to make good progress on selling the remaining non-core properties that were acquired as part of our merger with Colonial. We're in final due diligence with several buyers and expect to close on the sale of two more properties during the third quarter.

We were also busy during the quarter with capital recycling as planned dispositions for several of our older apartment properties were completed in the second quarter and in July. We currently have two additional apartment properties located in Mobile, AL under contract to sell and expect to complete those dispositions in the third quarter.

We continue to look at quite a bit of acquisition opportunity but as discussed last quarter, a lot of investor interest and favorable interest rates makes the buying market very competitive. Properties involving pre-stabilized new development are where we've seen the greatest increase in deal flow and I expect this area of the transaction market will remain fairly active for the next year or so. As noted in our earnings release, we closed on two such transactions during the second quarter and are currently looking at several other opportunities.

AI will recap for you the successful bond transaction that was executed during the quarter and summarize where we are with our balance sheet. We feel very good about where the balance sheet is at this point and expect that as the new development and lease-up pipelines become fully productive we will continue to see strengthening coverage ratios and continued expansion of our unencumbered asset base.

In summary, we're encouraged with the performance outlook for the balance of the year from the same store portfolio and continue to expect that we will capture solid NOI growth for the full year. Our new development and lease-up pipelines are becoming increasingly productive and we look for meaningful contribution from this component of the balance sheet in 2015. We're making good progress on cycling capital from the non-core assets acquired in the Colonial acquisition and I'm optimistic that we will capture attractive new investment opportunities for this capital.

With the heavy lifting of the merger and back-office integration now complete, we are excited to be focused on harvesting the full value surrounding our merger. The balance sheet is in a strong position and we expect to see further strengthening as the development pipeline and capital recycling from non-core assets continues. Market conditions support our plans for a higher level of capital recycling within our stabilized portfolio of properties and we expect to continue that effort over the next several quarters, mindful of maintaining coverage ratios and our strong balance sheet metrics.

That's all I have in the way of prepared comments and I'll turn the call over to Al.

Al Campbell

Thank you Eric, and good morning everyone. I'll provide some additional commentary on the company's second quarter earnings performance, balance sheet activity, and finally on updated earnings guidance for the year.

FFO for the quarter was \$95.5 million, or \$1.20 per share. Core FFO, which excludes non-routine items, primarily merger & integration costs and the FMV adjustment for debt assumed, was \$93.9 million, or \$1.18 per share, which was within our guidance range and \$0.03 per share below the mid-point. About \$0.02 per share of the variance is related to same store NOI, with another \$0.01 per share related to earlier than expected timing of our bond issuance during the second quarter.

As Eric mentioned, rent pricing trends remained good and in line with our expectations during the second quarter, but we carried about 35 bps lower effective occupancy than projected generating \$0.01 variance to the mid-point of our guidance. Fee revenue was also lower than expected for the quarter, as low resident turnover affected transaction and termination fees, generating another \$0.01 share variance.

We made a decision during the quarter to execute our planned bond financing almost a month earlier than initially projected, in order to take advantage of favorable market timing. The transaction execution proved very successful, as we issued ten year bonds at a 3.75% coupon and upsized the deal to \$400 million (from \$350 million originally planned). The earlier than planned timing cost \$0.01 per share in the second quarter as compared to our earlier projections, as we carried more debt than forecasted in the short-term.

As Eric mentioned, we were active both buying and selling assets during the second quarter. During the quarter, we purchased two new apartment communities (in Charlottesville and Dallas) for a total price of about \$118 million, and sold two older communities (in Fort Worth) for combined proceeds of \$32 million. Fund II, our joint venture, also sold one community (Macon, GA) during the second quarter for gross proceeds of \$25.8 million, one-third of which was owned by MAA. Activity continued in July, as we sold three additional communities (located in Memphis, Birmingham and Charlotte) for combined proceeds of \$95.6 million, and acquired the remaining 2/3rds interest in the final Fund II property, closing Fund II.

Construction and lease-up of our development pipeline continue to progress well. We funded an additional \$13.1 million of development costs during the second quarter and fully completed two communities, Colonial Reserve at South End, in Charlotte, and Colonial Grand at Lake Mary Phase II, in Orlando. We now have

two communities remaining under construction, with a total remaining funding commitment of only \$33.7 million. Total construction costs and lease-up targets, in the aggregate, remain on track, and we expect stabilized yields in the 7.5% range for the current development/lease-up pipeline.

During the second quarter we continued to strengthen our balance sheet by using the proceeds from the issuance of \$400 million of ten year unsecured senior notes (mentioned earlier), to repay \$198 million of secured Freddie Mac debt and a \$192 million maturing bond series, acquired from Colonial. As mentioned, we executed the deal a little earlier than planned, capitalizing on market demand to achieve a credit spread of 125 bps above ten year Treasury, which exhibits the strength of our balance sheet. The ten year unsecured financing increased our unencumbered asset pool, our interest rate protection, and the duration of our debt maturities. At quarter-end, over 66% of our gross assets are unencumbered, and over 98% of our debt is fixed or hedged against rising interest rates, with an average duration of about 5 years.

Also at the end of the quarter, company leverage, based on market cap, was 37.5%, and our fixed charge coverage ratio was 3.6 times. Our total debt to Recurring EBITDA was 6.4 times, and we had \$487.7 million of cash and credit available under our unsecured line of credit at quarter-end.

Finally, as expected there are many cross-currents included in our earnings this year as we work through the integration and consolidation with Colonial, along with a related higher level of both non-core and core capital recycling transactions. Based on the second quarter performance and updated expectations for the remainder of the year, we are revising Core FFO guidance for the full year to an expected range of \$4.79 to \$4.95 per share. At the midpoint of our range (\$4.87) and based on year-to-date results, this represents a revision of \$0.04 per share, for the remainder of the year. We are narrowing our NOI guidance for the full year to 4% to 4.5% which translates into a \$0.01 revision to core FFO for back half of the year. Additionally, we now expect to achieve our full year multifamily disposition target by mid- third quarter, which is earlier than originally projected, costing about \$0.01 per share versus the earlier forecast. Also, we upsized our bond deal in the second quarter (issuing \$400 million vs. \$350 planned), which increased our interest rate protection for the long-term, but costs about \$0.01 per share over the remainder of 2014. And finally, after filing our franchise tax returns for 2013 we increased our franchise tax accrual rate (primarily due to changes in the tax base from the Colonial merger), which will cost us an additional \$0.01 per share over the remainder of this year. Together, these items account for the \$0.04 revision to the forecast for the back-half of the year.

Also, during the third quarter we expect to record gains on the sale of several properties of around \$34 million, along with a \$2.5 million prepayment charge on

a related loan, all of which are excluded from Core FFO for the quarter, but may be important for modeling purposes.

Quarterly Core FFO per share is expected to be \$1.15 to \$1.27 for the third quarter and \$1.21 to \$1.33 for the fourth quarter.

Core AFFO for the full year is expected to be \$4.04 to \$4.20 per share, which represents a 71% dividend payout at the mid-point.

We expect to end the year with our balance sheet in very good shape: leverage at the low end of our range (42% debt/gross assets), unencumbered assets at historic levels (greater than 65%), and with coverage ratios very strong (greater than 3.5x); positioned well to support 2015.