CONFERENCE CALL TRANSCRIPT: 1Q2018
May 3, 2018 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 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. 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.

First quarter results were slightly ahead of our expectation and reflect the continued solid demand for apartment housing across our markets. Occupancy is high and rent growth on renewing leases is strong. However, elevated levels of new supply continue to weigh on our ability to drive rent growth on leases written for new residents. We expect the supply pressures will persist through most of this year with trends moderating in 2019. But as we enter this busy summer leasing season, we're encouraged with a number of trends that we are capturing and continue to believe that revenue trends have bottomed out for the cycle. Our expectations moving forward are supported by favorable trends in several important variables. These include: the continued strong demand for apartment housing across our markets, our high occupancy levels, the strong performance being captured on renewal lease pricing, the improving pricing trends within the legacy Post portfolio, and, finally, the continued strong performance on same store operating expenses and continued improvement in operating margins.

While supply pressure will remain evident in several of our markets for the next few quarters, continued favorable results in these key areas support belief that we should see some incremental improvement in NOI moving forward with better momentum in 2019 as supply pressures moderate.

Resident turnover remains very low at 49.6% on a running 12-month basis. This is despite continued healthy growth in renewal lease pricing of 5.5% during the first quarter. This level of strong pricing performance in the face of higher new supply is a testament to not only the continued healthy demand for apartment housing in our markets, but is also a very positive statement about the quality of service provided by our on-site associates; and I really appreciate their efforts.

The leasing pressures associated with higher levels of new development continue to mostly impact the higher rent properties and more urban oriented submarkets with the portfolio. However, it's worth noting that the overall blended rent growth on leases signed in the first quarter within the more urban-oriented legacy Post portfolio did improve by 190 basis points as compared to the first quarter of last year. As new supply pressures moderate, we believe the opportunity within the legacy Post portfolio for accelerated rent growth, as a result of both the execution of our revenue management practices and the meaningful redevelopment opportunities in the portfoio, will support much improved performance trends.

As noted in the earnings release, our programs associated with managing operating expenses continue to drive strong results. Tom will cover more details in his comments but we have been particularly pleased with the early results within the legacy Post portfolio as our various operating practices are fully implemented, and the efficiencies associated with our larger scale are making a positive impact on overall portfolio operating margins.

Over the course of the summer we expect to wrap up the work associated with the back-office and systems integration associated with our merger with Post. As we continue to refine and capture the benefits associated with having both portfolios on the same operating platform, as well as accelerate the unit interior redevelopment effort, the value accretion that we've previously outlined for the Post merger is something we continue to feel confident about.

As noted in our earnings release, during April we closed on a property acquisition located in Denver. This off-market acquisition of this newly developed property was negotiated late last year with the closing subject to the completion of the construction of phase I of the project. The property is located adjacent to a recently approved new light rail station that will connect to downtown Denver and located adjacent to high end restaurant and retail shopping venues. This is a high-quality property in a terrific location that is a great addition to our Denver portfolio. We expect to get underway with a phase II expansion of the property later this year.

We continue to see heavy deal flow with our underwriting and transaction volume reaching a 5-year high for the typically slower first quarter of the year. I continue to believe that as we work further into the cycle of new property deliveries, the capacity and optionality surrounding our balance sheet, along with our proven execution capabilities will yield increasing opportunity for earnings accretive external growth.

In summary, we like the start to the year and continue to believe 2018 will play out along the lines we expected. Demand remains high. Resident retention is strong and rent trends look to have stabilized. We're excited to be nearing completion of the final steps in fully integrating all operating and reporting activities of the legacy MAA and Post portfolios and we remain very enthused about the long-term value proposition surrounding the merger.

I appreciate all the hard work that our team has done over the past year in stabilizing our platform and we look forward to the opportunities in front of us with the important summer leasing season.

That is 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 operating performance came in as expected. Revenues for the first quarter were 1.8% over prior year with 96.3% average daily occupancy and 1.4% effective rent growth. Expenses increased just 1.6% over the prior year and NOI increased by 1.9%.

Looking at revenue drivers by portfolio in the first quarter as compared to the prior year, the legacy MAA portfolio generated revenue growth of 2.3% with 96.4% average daily occupancy and effective rent growth of 1.8%. The legacy Post portfolio had 0.4% revenue growth with 95.8% average daily occupancy and 0.2% effective rent growth.

Supply has been elevated in our markets for several quarters. Despite the supply headwinds, we saw the blended lease over lease performance of the combined company grow by 1.6% in the first quarter which is 40bps points higher than the same time last year. This is primarily the result of new lease pricing on the Post portfolio which improved by a significant 260 basis points in the first quarter from the same time last year.

This is further supported by improving monthly trends during the quarter. Blended pricing growth for the overall same store portfolio in January was 0.7%, February was 1.8%, and March was 2.2%.

Expense performance continues to be a bright spot for both portfolios. While improvements in revenue management practices are just now showing up in pricing, our programs to more aggressively manage operating expenses have shown more immediate results. Overall expenses within the same store portfolio were up just 1.6% - this includes $900,000 of winter storm related costs incurred during the quarter. Adjusting for storm costs, our expenses increased less than 1%.

Total expenses on the Post portfolio during the quarter were down 2.2%. That was driven by reductions in personnel costs, repair and maintenance expenses as well as property and casualty insurance. As a result, the first quarter operating margin on the Post portfolio improved another 90bps. This is on top of the 130bps improvement we made in the first quarter of last year. We still have room to run with our expense management programs on the legacy Post portfolio and expect continued progress in 2018. Our operating disciplines are now fully in place and at current run rates the savings will continue.

April results show the benefit of our consolidated platform and momentum. Overall same store average daily occupancy in April was 96.2% which is 10 bps higher than prior year. This is driven by a 50 bps year over year improvement in the legacy Post portfolio. Overall same store April blended lease over lease rates are up 2.9% which is 90 bps better than the blended rents in April of last year. Our 60 day exposure, which represents all vacant units and notices for a 60 day period, is a low 8.3% and in line with prior year.

The supply picture is well documented. Dallas and Austin are facing the most pressure. In 2018, we expect 22,000 deliveries for Dallas and in Austin we expect 8,400 deliveries. We are encouraged that job growth has remained strong in both markets. Dallas job growth was at 2.5% in 2017 and expected to increase to 2.6%. Austin Job growth was 3.3% in 2017 this year and expected to remain robust at 3.3% in 2018. These growth trends are strong and well ahead of nation-wide trends.

While elevated supply levels have pressured rent growth in several of our markets, we are still seeing good growth in a number of our markets. Phoenix , Richmond, Orlando and Jacksonville stood out from the group.

Our focus on customer service and retention is paying dividends. Move-outs by our current residents continue to remain low. Move outs for the overall same store portfolio were down 2.3% for the quarter. Move outs to home buying were down 3% and move outs to home renting were essentially flat to last year. Home renting remain an insignificant cause for turnover and accounts for less than 6% of our move-outs. On a rolling 12 month basis, turnover dropped to a historic low of 49.6%. This steady decrease in turnover was achieved while increasing renewal rents by 5.5%.

Momentum is building on the redevelopment program across the legacy Post portfolio. In 2017 we completed renovation on 1,700 units. We have completed an additional 560 in the first quarter and expect to complete 3,000 this year. On average we are spending $9,400 and getting a rent increase that is 11% more than a comparable non redeveloped unit. As a reminder, we have identified a total of 13,000 Post units that have compelling redevelopment opportunity.

For the total portfolio, in 2018 we expect to complete over 8,000 interior unit upgrades. On the legacy MAA portfolio, we continue to have a robust redevelopment pipeline of 10,000 - 12,000 units. On a combined basis with the legacy Post portfolio, our total redevelopment pipeline now stands in the neighborhood of 25,000 units.

As you can tell from the release, our active lease-up communities are performing well. In Houston, Post Afton Oaks stabilized in the first quarter as expected.

Our remaining pipeline of lease-up properties, The Denton II, Post South Lamar II, Post Midtown, Post River North and Acklen West End are all on track to stabilize on schedule. We have begun leasing at Post Centennial Park in Atlanta.

2017 was a year of significant change for our organization. We started 2017 with two completely different operating platforms and teams. We are pleased that the bulk of the integration work of the Post portfolio is now behind us. We have started 2018 with a much more aligned and cohesive operating platform and team. Results are progressing as expected. We are looking forward to continuing to capture value creation opportunities on both the revenue and expense sides of the equation as we finalize full integration activities in 2018.

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 2018.

Net income available for common shareholders was $0.42 per diluted common share for the quarter. FFO for the quarter was $1.44 per share, which was $0.01 per share above the mid-point of our guidance. First quarter performance included $0.02 per share of non-cash expense from the valuation of the embedded derivative related to the preferred shares issued in the Post merger. This was not included in our original guidance. Same store performance, G&A expense and interest expense were all slightly better than expected and combined to produce the outperformance for the first quarter.

During the first quarter, we did not acquire any communities. We did, however, close on the disposition of two land parcels acquired in the Colonial merger for $5.9 million in total proceeds. The sales produced net gains of $200 thousand recorded during the quarter. As Eric mentioned, in April we closed on the acquisition of Sync36, a 374-unit high-end community located in Denver. The acquisition included a land parcel to develop an additional 79 units as part of a phase II expansion, which we expect to begin later in 2018. Including the Phase II expansion, the total investment is expected to be approximately $128 million. Following quarter end, we also closed on the disposition of an additional land parcel, located in Las Vegas, for total proceeds of $9.5 million, which will produce a $2.8 million gain that will be recognized during the second quarter.

Also during the first quarter, we completed construction of one of our development communities, Post River North, located in Denver. The community was completed on plan with a total investment of $88.2 million, and is expected to be stabilized in early 2019 at a 6.4% NOI yield. We currently have two communities remaining under construction with a total projected cost of $125.8 million, of which all but $24.4 million was funded as of quarter-end.

Including Post River North, our lease-up portfolio now contains five communities totaling 1,509 units. Average occupancy for the group was 56.1% at quarter end. We expect four of the communities to stabilize in the 2nd half of this year, and the remaining community to stabilize in the 1st half of 2019 at an overall average stabilized NOI yield of 6.4%, which will ultimately produce over $21 million of NOI.

Our balance sheet remains in great shape. During the first quarter, we paid off an additional $38 million of secured debt, pushing our unencumbered NOI to over 85%. We also executed $300 million of forward interest rate hedges to secure future bond financings, projected for later this year. At quarter-end, our leverage, as defined by our bond covenants, was only 33.1%, while our Net Debt to Recurring EBITDA was just over 5.0 times. We also had almost $600 million of combined cash and borrowing capacity under our unsecured credit facility at quarter-end.

Finally, we are maintaining and confirming our outstanding guidance for all major components of our forecast, including Net Income, FFO, AFFO, same store performance, and transaction volumes.

In summary, net income per diluted common share is projected to be $1.78 to $2.08 for the full year 2018. FFO is projected to be $5.85 to $6.15 per share, or $6.00 per share at the mid-point, which includes $0.08 per share of projected final merger and integration costs related to the Post merger. AFFO is projected be $5.24 to $5.54 per share, or $5.39 at the mid-point. For the second quarter, FFO is projected to be $1.43 to $1.53 per share, or $1.48 per share at the mid-point.

Though we expect continued volatility related to the valuation of the preferred shares acquired with the Post merger, our projections do not include any further valuation adjustments over the remainder of the year, as these adjustments are both non-cash and impossible to predict.

We remain on track to capture the full $20 million of overhead synergies related to the Post merger, as well as other NOI and earnings opportunities outlined with the merger, which are reflected in our current guidance.

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