Bluerock Residential Growth REIT

First Quarter 2018 Earnings

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CORPORATE PARTICIPANTS

Christopher Vohs - *Chief Financial Officer*

Ramin Kamfar - *Chairman and CEO*

Ryan MacDonald - *Chief Acquisitions Officer*

Jim Babb - *Chief Investment Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and welcome to Bluerock Residential Growth REIT's First Quarter 2018 Earnings Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to introduce your host for today's call, Christopher Vohs, Chief Financial Officer of Bluerock Residential. Mr. Vohs, please go ahead.

Christopher Vohs
Thank you, and welcome to Bluerock Residential Growth REIT's first quarter 2018 earnings conference call.

This morning, prior to market open, we issued our earnings press release and supplement. The press release can be found on our website at bluerockresidential.com under the Investor Relations tab. In addition, we anticipate filing our 10-Q this week.

Following the conclusion of our remarks, we'll be pleased to answer any questions you may have. Before we begin, please note that this call may contain forward-looking statements as they are defined under the Private Securities Litigation Reform Act of 1995. There are a variety of risk and uncertainties associated with forward-looking statements, and actual results may differ from those set forth in such statements. For a discussion of these risks and uncertainties, you should review the forward-looking statements disclosure in the earnings press release as well as our SEC filings. With respect to non-GAAP measures we use on this call, including pro forma measures, please refer to our earnings supplement for a reconciliation to GAAP, the reasons management uses these non-GAAP measures and the assumptions used with respect to any pro forma measures in their inherent limitations.

And with that, I'll turn the call over to Ramin Kamfar, Chairman and CEO of Bluerock Residential Growth REIT, for his remarks.

Ramin Kamfar
Thank you, Chris, and good morning, everyone. In addition to Chris, with me today are several additional key members of our executive team. We have Jordan Ruddy, our President and Chief Operating Officer, Jim Babb, our Chief Investment Officer, and Ryan MacDonald, our Chief Acquisitions Officer.

I'll focus my remarks on key strategic accomplishments, some financial highlights from the quarter, and close with some capital markets commentary. After, I will ask Ryan to provide you with additional operational, transactional and balance sheet detail.

We began 2018 by delivering a solid quarter from an operational perspective while continuing to advance each of our strategic objectives in terms of portfolio growth, ongoing balance sheet enhancements and disciplined capital allocation.

To start with our GAAP numbers, net loss attributable to common stockholders for the quarter was $0.40 a share as compared to our net loss of $0.20 a share for the prior year quarter. This net loss was caused primarily by non-cash items, which were $0.59 a share in the 2018 quarter.

To switch to operating numbers, on a per share basis, we delivered AFFO of $0.18, which allowed us to achieve a key milestone of fully covering our $0.16 quarterly dividend on a current basis. This reflects a 21% growth in our AFFO year-over-year to $5.6 million.

The quarter also had significant growth on the revenue front. Our top line revenue for the first quarter was $41.9 million, which is a 49% increase from $28.2 million in the prior year quarter, largely as a result of our significant investment activity in the second half of 2017.

Moving on to property level numbers, property NOI grew to $21 million in the quarter, which is a 31% increase from $16 million in the prior year quarter. Same store revenue and NOI grew 5.4% and 3.5% respectively for this quarter versus the prior year quarter. Ryan is going to provide you with additional detail.

Our asset base continues to grow. Our gross assets are over $1.8 billion, which is up 31% on a year-over-year basis and 4% on a quarter-to-quarter basis.

On the acquisition front, during the first quarter, we closed on one 264 unit operating property for $22 million in equity and one follow on investment in an existing development mezzanine loan for $21 million in equity. Following the quarter end, we increased our ownership in two assets to 100% by buying out our partners' minority interests with a $9 million investment and made one additional 264 unit acquisition for $18 million in equity. Again, Ryan's going to provide additional detail for you.

Shifting to capital markets, during the first quarter, we raised $18.5 million with sales of our Series B 6% Preferred Shares. This preferred offering is an important part of our growth strategy as it continues to offer us access to cost effective capital, while at the same time minimizing potential dilution because it is--unlike a standard preferred, it is convertible into common stock not based on our current stock price on the issue date, but based on a future stock price at the time of conversion. We expect that the quarterly run rate will reaccelerate back to a steady state level in the $45 million to $50 million range over the next several quarters.

As I mentioned, one of our key strategic objectives is to enhance our balance sheet to ensure we have the necessary liquidity and flexibility to support our ongoing growth. During the quarter, we closed on a $50 million junior revolving credit facility, which along with our senior revolver, will enable us to deploy our capital more efficiently and provide capital structure flexibility as we grow the business.

Lastly, in the first quarter, the company repurchased approximately $4.2 million worth of shares at an average price of $7.92. The share repurchases are an important component of our capital allocation plan and are accretive both from an NAV and AFFO point of view and underscore our conviction in the value of the equity and our commitment to creating shareholder value. We intend to continue utilizing the program opportunistically and with consideration of several factors, including our stock price, prudently managing our leverage and other available investment opportunities.

With that, I'm going to turn the call over to Ryan. Ryan?

Ryan MacDonald
Thank you, Ramin, and good morning, everyone.

I'd like to start off by noting that the operating portfolio performance began to reaccelerate in the first quarter across all assets, but with particular outperformance in our Florida markets, fueled by continued robust job growth.

Portfolio-wide across BRG's assets, average occupancy for the first quarter of 2018 was 93.5% and 94.2% as of the end of April.

Same store revenue increased 5.4% over the prior year period, driven by a 4.8% increase in average rental rates versus the prior year period and a 20 basis point decrease in occupancy. All 16 properties in the pool recognized increases in average rental rates in the quarter versus the prior year period.

On the expense front, same store expenses increased by 8.2%, primarily resulting from an approximate $400,000 increase in real estate taxes due to higher valuations by municipalities and a negative Q1 2017 tax true up. Excluding the Q1 '17 negative tax true up, same store expenses increased 5.7%.

Same store NOI for the quarter increased 3.5% on a year-over-year basis - excluding the Q1 '17 negative tax true-up, NOI increased 5.1%.

On the operational margin front, we experienced a 290 basis point decline in our margin to 57.3%. This decline is primarily attributable to our 2017 disposition and reinvestment activity as well as the negative Q1 '17 tax true up. On the disposition front, we exited mature, cash flowing assets and recycled the capital into higher growth opportunities that typically can take several quarters to stabilize into a steady operational state. And as we bring these assets onto our operational platform, we usually incur one time upfront expenses that can disproportionately distort margin in the near term.

Shifting to the investment front, we continue to remain active but disciplined in terms of acquisitions and investments.

In the quarter, we closed on one operating property acquisition in suburban Denver totaling 264 units and approximately $61 million in gross asset value. The business plan is consistent with our focus on executing core plus renovation strategies, whereby targeted capital improvements to the interior units and amenity areas will migrate the asset to our standard, highly amenitized live/work/play lifestyle product. BRG funded the purchase with approximately $22 million in equity for 88% ownership, and the venture capitalized the deal with a $40 million fixed rate loan from Freddie Mac at 4.31%. The asset is projected to yield a year one cap rate of approximately 5% and grow to a stabilized cap rate of approximately 6.4%, versus market cap rates ranging from 4.75% to 5.25%.

Following the end of the quarter, we closed on one additional off market purchase of an operating property in Daytona Beach, Florida for approximately $46 million. The opportunity was sourced from a seller we've previously transacted with, and contracting for the deal during lease-up provided assurance to the developer so they could repatriate the proceeds into a new project with a tight closing timeframe. As a result, we believe our year one cap rate and projected stabilized yield of 5.4% and 6% is 20 basis points and 80 basis points above prevailing market cap rates. To fund the purchase, we utilized approximately $18 million in equity and $29 million from our senior line of credit.

In addition to the acquisitions, post quarter end, we closed on the buyout of minority ownership interest in Arium Gulfshore and Arium Palmer Ranch, totaling $9 million in BRG equity. The buyout, which took our ownership to 100%, was funded through refinancing both existing loans. Arium Gulfshore was added to the senior line of credit with an amount totaling $41 million, and Arium Palmer Ranch was funded with a fixed rate agency loan in the amount of $41 million, as well. Following the buyout and refinance of the existing loans, $12 million in equity was returned to the company.

In terms of the development commitments, in the first quarter, BRG funded an additional $21 million of equity into the existing Flagler mezzanine loan. The total BRG investment in development preferred equity and mezzanine loans at the end of the first quarter was $234 million.

Moving on to the balance sheet, following the quarter end, we refinanced Arium Metrowest and Outlook at Greystone off the senior line of credit and into fixed rate agency loans with combined proceeds of $87 million at an average interest rate of 4.4%. In total, these transactions repaid $79 million in senior line of credit borrowing base, yielding the company $5 million in incremental equity proceeds.

Following the post quarter transactions and reconfiguration of the senior line of credit borrowing base, the senior and junior line of credit balances as of the close of business on May 4th stood at $69 million and $16 million respectively.

And today, BRG has approximately $42 million available for investment through a combination of cash and availability on our junior line of credit, plus we continue to have capacity through our Series B offering.

Lastly on the balance sheet, we have worked to reduce the floating rate exposure at the company, and as a result of the recent transactions, since the end of the fourth quarter, our floating rate exposure on permanent financing has been reduced to 33% from 43%. We will continue to manage that exposure down throughout 2018 and expect the percentage to normalize around 25%. The modest remaining projected floating exposure will continue to give the company prepayment flexibility as we manage our capital allocation.

In closing, I will note that our first quarter performance exceeded our expectations, but we are not budgeting that outperformance going forward. Additionally, our guidance includes an incremental impact from rising rates of about $0.01 going forward. Having said that, we are comfortable with and are reiterating our full year AFFO guidance of $0.65 to $0.70 per share.

And with that, I will now return the call to Ramin to conclude.

Ramin Kamfar
Thank you, Ryan.

That's the end of our prepared remarks, and with that, I'm happy to open it up to Q&A.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

And our first question comes from Drew Babin of Robert W. Baird. Please go ahead.

Drew Babin
Hey, good morning.

Ramin Kamfar
Good morning, Drew.

Drew Babin
Quick question on the buildup to the 5.4% same store revenue growth. I noticed that was a 4.8% rate growth with 20 basis points lower occupancy, and I guess it appears to me there's some kind of other property income tailwind in that overall revenue growth number. I was wondering if you could talk about other property revenues and if there's any specific initiative, is there any items that are sort of driving that tailwind?

Ryan MacDonald
Sure, Drew. This is Ryan. We did implement a valet trash program across our properties throughout '17, so we are starting to see the benefits of that. And that was the largest tailwind in the other income piece this quarter. It should moderate over the course of the year, but we are seeing some benefits this year.

Drew Babin
Okay. And then a question on property tax expenses - obviously, with properties in your portfolio may not be fully assessed yet--you had sort of a lumpy payment in the first quarter--might we expect any lumpy expense growth for the remainder of the year or anything we should be aware of as far as timing's concerned?

Ryan MacDonald
Drew, I don't think so. This was a change of the methodology going back to '16 taxes versus '17. We changed it in '17. So, it shouldn't be as lumpy going forward, the comps going forward in '18.

Drew Babin
Okay. And then just one more question on your Links at Plum Creek acquisition - looking at the current rents, looking at occupancy, it looks like the initial yield on the deal is maybe around 4% or so on a trailing basis, and I was just curious whether that's kind of a value add opportunity type project or if there's something I'm missing in terms of the growth opportunity near term?

Ryan MacDonald
Sure. I think I said in the prepared remarks, it's about a 5% yield on the first year. There is some occupancy buildup as we stabilize the property. Currently, the existing owner was running at about 500 basis points. So, that 5% does not include the occupancy gains that we think we'll gain over the next, call it, 12 to 18 months. And then there are some core plus

renovation strategy to build up to that 6.4% stabilized yield over time, as well. But, the initial going in yield on in place income with the reduced occupancy is about 5.

Drew Babin
Okay, all right, that's very helpful. Thank you.

Operator
Our next question comes from Jim Lykins of DA Davidson. Please go ahead.

Jim Lykins
Hey, good morning, guys. First of all, could you talk a little bit what is in the acquisition pipeline right now and how we should be--just any color on how we should be thinking about that throughout the rest of 2018?

Ryan MacDonald
Sure, Jim, it's Ryan again. Our pipeline continues to remain robust. Certainly, our pipeline exceeds our access to available capital at this point. We are somewhat limited with capital availability. I think we raised about $18.5 million on the B this quarter, so we have a few more acquisitions in the pipeline. I think we've got $40 million of availability today. We have a couple of deals in the hopper. But, beyond that, it's subject to capital availability.

Ramin Kamfar
Yes, Jim, I think it depends on the Series B raise, assuming, obviously, given where the stock price is and the market is, we're not going out for common equity. And we--so, the Series B raise was $18.5 million. As you know, we got it up to about $45 to $50 million a quarter in 2017, and then that offering ran out, and we're in the process of bringing online a new offering. So, the first quarter was $18.5 million. I think this quarter's probably going to be closer to $30 million. And over the next couple of quarters after that, I think we'll--we're hoping to get to $50 million and even beyond. And that's what's going to be driving our acquisitions. We see plenty of opportunities to go out and buy the core plus value add stuff that we like to buy. That gives us an opportunity to increase our cap rates by 100 basis points and drive value. So, the commitment of that capital, the investment of that capital is not an issue for us. It's going to be very efficient.

Jim Lykins
Okay. So, you mentioned a couple of deals in the hopper. I'm also wondering if your guidance assumes any acquisitions or no?

Ryan MacDonald
Our guidance throughout the year does assume some additional acquisitions and some buildup of the Series B capital raise throughout the year.

Jim Lykins
Can you tell us how much you assume for acquisitions?

Ryan MacDonald
Sure. The total invested capital that we assumed in our 2018 guidance on a gross basis is about $350 million, so it assumes a Series B capital raise of about $124 million of equity.

Jim Lykins
Okay, that's very helpful. And then lastly, the share buybacks, is that--great to see you guys out buying some shares. So that continued into Q2. How should we be thinking about that for the rest of the year, as well?

Ramin Kamfar
Well, listen, we would have loved to--we wanted to buy more in Q1 because it's obviously very accretive, but we ran into our blackout period before we could put a 10b5 in place that would have allowed us to continue to buy it back. So, I think you'll see us back in the market. It all depends on the Series B raise rate, depends on acquisition opportunities and depends on our stock price. I really don't want to give away the stock price that we're going to be buying it. Let's just say that our guidance doesn't assume any buybacks. So, if we're doing a buyback, it's going to be flat to accretive to that.

Jim Lykins
Okay. Thanks, guys.

Operator
Our next question comes from Paul Penney of Northland Securities. Please go ahead.

Greg
Morning, guys. This is Greg on for Paul. Thanks for taking my questions. Congrats on the dividend coverage, by the way. I was just wondering, how are you thinking about your full year guidance after this strength in Q1, and particularly, other than the rising rates that you mentioned earlier, are there any other reasons why you're not forecasting similar performance over the following quarters?

Ramin Kamfar
Well, Paul, thank you for the congratulations. We're happy to have gotten to dividend coverage, and we expect dividend coverage should continue, but we tend to be conservative in terms of our budgeting. I'm sorry. It's--sorry, Greg. I just looked online and it said Paul, so thank you, Greg.

Greg
No worries.

Ramin Kamfar
We tend to be conservative in terms of our budgeting. We were--for the internal budgeting for the guidance. So, we beat our internal budget for the guidance in the first quarter, and--but, our budget doesn't assume that we'll continue to beat it. Orlando, in particular, for example, is a very strong market and above our projections. But, I don't want to assume that going--that's going to continue in perpetuity going forward. I'd rather have our assumptions revert back to our baseline budget and be sitting here three months from now meeting that number or beating it than basically taking this above market performance and projecting it and then have a penny miss on the downside.

So, no other issues - I mean, the penny increase in rates is already in our guidance number, so that's not a surprise. And we don't see any other reasons other than we want to be good in terms of the guidance we put out.

Greg
Got it, appreciate the detail. And then second, given the current strength in the Orlando market, was just wondering if you're planning to expand your property base there or do you think you're comfortable with your positioning in that market. And then I guess also maybe you could provide an update on the supply demand characteristics in that market.

Ramin Kamfar
So, I think Orlando is a tremendous market. I just spent--we just spent two days touring the market, and it's tremendously impressive. If you think about what is happening in terms of the US economy as we move from an industrial to a knowledge and experiential economy, Orlando is an irreplaceable next generation market. What is happening there with Disney World and Universal Studios and Sea World and all of those--and now Margaritaville, etc., etc., all of the stuff that's going on is irreplaceable in the United States. There's tremendous healthcare on top of that, etc., etc.

So, it's a huge growth market, it's got big blue horizons, again, as we continue to migrate into this knowledge/experience economy. And we like Orlando, and over time, we'd like to--we will buy additional assets. Obviously, you need to balance that with diversification across other markets that we like.

So, that's the answer. You'll see us--as we grow, you'll see us increase our exposure to Orlando, and I think the market's going to remain strong for a significant period of time. I mean, all of Florida is obviously quite attractive with in migration on top of the jobs growth on top of what recently happened with taxes that makes our core southern, particularly Florida and Texas markets more attractive over time.

Ryan MacDonald
And on the supply/demand side, I mean, we're forecasting in '18, going into '18 about 40,000 jobs and 7,000 new units, so that's above the kind of five to one ratio that we think about from an equilibrium standpoint. So, I think job growth is the number two in the nation throughout the last couple quarters, and we don't see it declining.

Greg
Good to hear. Thank you.

Operator
Again, if you have a question, please press "*" then "1".

Our next question comes from John Benda of National Securities Corp. Please go ahead.

John Benda
Hey, good morning, everybody. How are you today?

Ryan MacDonald
Morning.

Ramin Kamfar
Good. How are you, John?

John Benda
Good. So, just quickly, just on your comments that you just mentioned about Florida, could you elaborate a little more on why the decision was made to go into Colorado as an entirely new market versus building up an existing footprint and maybe what some of the demographics are out there?

Ryan MacDonald
Sure, John. This is Ryan, and I'll take a first stab and then I'll let Ramin fill in. We've been looking at Denver for quite a while now, and we've pursued some opportunities. As you recall, with our network of operators, we're able to cycle in and out of markets more efficiently than our competitor peer set who have to establish large infrastructures in a market. So, we saw a specific opportunity on the south side of Denver in a place called Castle Rock that we think has incredibly attractive schooling, incredibly attractive barriers to entry and feeds not only from the Denver MSA but also pulls from Colorado Springs. So, you have certainly a burgeoning tech sector and significant in migration from the west coast to Denver that we're seeing currently.

So, I think it fits within our knowledge economy growth market footprint, but again, we were waiting for the right opportunity to execute on versus establishing a beachhead and then trying to buy multiple assets. The right opportunity fit the right strategy in the right part of town for us with the right economics.

Ramin Kamfar
I think Denver--we're--obviously, as we grow, we're going to continue to increase, continue to open in selective new markets that have the long term knowledge economy demographics in terms of job growth and population and creation of intellectual capital, etc., etc., that we want. We've had our eyes on Denver for a significant period of time, and this was the right opportunity for us to enter that market.

I think you see that Denver obviously--and it's validated by the fact that you've got some of the larger REITs that don't focus on--that don't have our strategy are now entering or have recently entered Denver. Jim, do you want to add anything to the Denver--?

Jim Babb
--No, I think what you and Ryan hit on, I mean, John, the idea is to continue to grow our footprint in markets that fit the long term fundamentals that we believe in. Florida's been very good to us, but the knowledge base economies are--we find very attractive in that part of the world, and I think you'll probably see us try to migrate into some new markets over the course of the next 12 to 24 months.

John Benda
Okay, great. And then quickly, what is the analysis performed when you decide to increase an ownership position in an existing property versus investing in a new one?

Ramin Kamfar
Well, I think you're looking at it from a number of factors. One is obviously a financial analysis, what's the return on the additional capital investment. You're underwriting kind of the future performance of the asset, how much value creation is there left as part of that analysis. Part of it is is it an asset that we want to have wholly owned because we're migrating. Now we have 31% of our asset base is--one of the knocks against has been, well, you don't own any assets that are 100% and are now 31% of our assets are wholly owned, which gives us financial

flexibility with the respect to our line of credit because to have a line of credit and do all these financings, you need to have wholly owned assets.

And then a combination of what our operator or partners' investment horizon is because they may be--they have different investments. They may and do have different investment horizons. So, when an opportunity comes up, if it's an attractive investment financially, if it's an asset that we want to hold long term, and in this case, these two assets have continue--we believe continued to have tremendous upside both at the market level and at the asset level, so we decided to increase it.

John Benda
Okay. And then just real quick for a last question, on the development portfolio, are you seeing any problem there or is everything going to schedule in terms of completion, on stabilized operations, etc.?

Ryan MacDonald
John, this is Ryan. I think we've generally been on schedule across the board with our projects.

Ramin Kamfar
There are no major issues on the development side. Obviously, the Houston lease-up has been slower or had been slower before the hurricane. The hurricane gave us a nice boost in terms of that market, and--but, after the hurricane's gone, some of those rentals are temporary, are going to revert back to housing, so you're going to have to backfill those. So, outside of the slowdown in Houston, I look down at our list of average kind of leasing per month for our--we've got four deals that are in lease-up, and it's 23 a month, 17 a month, 15 a month and 21 a month. And you want to be in the 20ish--in the high teens or 20 number. So, they're all on--they're pretty much all on track, and we expect a strong leasing season coming up. Obviously, we're going into the leasing season now.

John Benda
Great, thank you very much.

Ramin Kamfar
Thank you, John.

Ryan MacDonald
Thanks, John.

Operator
This concludes our question and answer session. I would like to turn the conference back over to Ramin Kamfar for any closing remarks.

CONCLUSION

Ramin Kamfar
I want to thank everyone for giving us the time today and look forward to continuing to report to you on our progress. Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.