Bluerock Residential Growth REIT

First Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Christopher Vohs- *Chief Accounting Officer*

Ramin Kamfar- *Chairman & CEO*

Ryan MacDonald – *Managing Director of Investments*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and welcome to Bluerock Residential Growth REIT's First Quarter 2017 Earnings Conference Call. All participants will be in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note that this event is being recorded.

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

Christopher Vohs
Thank you, and welcome to Bluerock Residential Growth REIT's first quarter 2017 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 will be pleased to answer any questions you may have. 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 variety of risks and uncertainties associated with forward-looking statements and actual results may differ materially 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 we issued this morning as well as our SEC filings. With respect to non-GAAP measures we use in 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 and their inherent limitations.

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, thank you for joining us today.

With me today are several key members of our Executive team, I have Jordan Ruddy, our President; Jim Babb, our Chief Investment Officer; and Ryan MacDonald, our Managing Director of Investments.

I will focus my remarks on key financial highlights from the quarter and close with some capital markets commentary. Afterwards, I will ask Ryan MacDonald to provide you with additional operational and transactional detail.

So let's start with the financial highlights.

On the revenue front, we achieved significant growth as a result of our investment activity. Our top-line revenue for the first quarter was $26.7 million, which is a 61% increase from the $16.6 million in the prior year quarter, largely as a result of our significant transactions since Q1 of 2016.

The net loss attributable to common shareholders for the quarter ending March 31 was $0.20 per share, which is the same as our net loss of $0.20 a share, for the prior year quarter. This net loss was caused primarily by non-cash items which totaled up to $0.55 a share in 2017 first quarter versus $0.41 a share in the prior year quarter.

For the quarter, our adjusted funds from operations attributable to common stockholders, or AFFO, was $4.6 million compared to $5.3 million in the prior year quarter. On a per share basis, AFFO came in at $0.18 a share, which significantly exceeded our guidance which was $0.03 to $0.04 a share.

Our pro forma AFFO, which assumes that our investible cash was fully invested as of the beginning of the first quarter and is done to provide to investors a sense of our fully invested earnings potential was $0.38 a share versus our guidance range of $0.27 to $0.29 a share. The detail for the pro forma calculation is available in our earnings supplement for your review.

For the eighth consecutive quarter, BRG's Board determined to pay the full amount of the management fee in LTIPs in lieu of cash, with the goal of continuing to signal the confidence of management in executing our business plan and the underlying value of our shares. This impacted our AFFO and our pro forma AFFO favorably by about $0.09 a share.

Property NOI dollars grew to $15.3 million in the quarter, which is a 53% increase from $10 million in the prior year quarter and NOI margins improved to 60.9% in the first quarter of 2017 from 60.4% in the prior year quarter.

Same-store NOI grew at a strong 10.9% for the quarter versus the prior year quarter. Ryan is going to provide additional detail on this.

Our asset base continues to grow on a quarterly basis, our gross assets are up 8% to over $1.3 billion at the end of the quarter, up from year end of 2016.

On the acquisition front, during the quarter we closed on two operating properties totaling 683 units for about $117 million and three mezzanine loan investments totaling $22 million of BRG investment. Additionally we are working on closing a portfolio deal with another 1,408 units on a total cost of approximately $189 million.

In March 2017, we elected to abandon pursuit of a development we had in the East San Marco market, this was due to significant cost escalations, which arose from a number of things; from scope changes imposed on the project after we started and from both general and market specific labor and material inflation. As a result of which the project no longer met our return parameters based on the conservative underwriting criteria that we have for our development deals. We took a $2.9 million write-down as a result of this exit, this is a one-time event and we don't believe we have this type of risk in any of our other development transactions.

Shifting to capital markets, in January we completed a follow-on offering of 4.6 million shares of Class A common stock, at an offering price of $13.15 per share for gross proceeds of $60.5 million. The primary goal for this offering focused on building a larger underlying common equity base at pricing levels that exceeded prior underwritten transactions, as well as executing on the pipeline of accretive transactions that we're continuing to see.

In addition our Series B 6% preferred offering continues to ramp up. First quarter sales increased to $23.6 million, which is a sequential increase of 86% from the fourth quarter of 2016. This sales ramp up is continuing into the second quarter with over $15 million raised in April alone, which again is a substantial sequential increase. These increases are the results of our significant effort and commensurate progress we have made in expanding our selling group recently. Our expectation is that we will see the benefits from this expansion, with further increases in the quarterly capital raise run rate through the rest of 2017.

Additionally, we have started the process of putting in place a bank line of credit to enable us to deploy our capital more efficiently and this will provide us additional access to capital and give us capital structure flexibility as we grow the business. No definitive agreements have been entered into, but we hope to report further on this progress in the coming quarter.

On the internalization front we're continuing to make progress working with the special committee of the Board and their Counsel, their financial advisor, their compensation consultant with respect to the internalization of management. At this point we're targeting a third quarter internalization, with the exact timing in the quarter depending on, among other factors, finalizing the internalization related agreements and the subsequent proxy process with the SEC and shareholder vote, though we can provide no assurances as to actual timing or completion of the internalization or signing of the definitive agreements.

Finally, before handing the call to Ryan, I'd like to note our pro forma AFFO guidance for the second quarter is $0.26 to $0.28 per share. Some of you will note that this range is $0.01 lower than prior quarter guidance and that's for two reasons primarily. One is that we are recycling capital, we're selling mature fully cash flowing assets for significant gains obviously, and those dollars are being reinvested into assets that have value creation coming and with upcoming cash flow growth potential. So, they're not cash flowing at the same level currently when we buy them as the assets that we're selling. The second reason is that we're being conservative and budgeting a significant R&M increase for Q2 going into our main rental season.

Ryan?

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

I'd like to start off by noting that our operating portfolio continues to perform exceptionally well, yielding industry leading same-store sales growth.

Portfolio wide, across BRG's assets, average occupancy for the first quarter of 2017 was 94%. Occupancy held firm in April as well, finishing the month at 95%.

Same-store NOI in the quarter increased by 10.9% from the same period in the prior year and the improvement was primarily driven by a 6.2% increase in same-store property revenues of which the majority came from a 4.7% increase in average rental rates versus the prior year period. The remainder of the revenue growth was attributable to an 80 basis point increase in average occupancy across the portfolio, as well as the purchase of 12 additional units at Lansbrook. Same-store expenses decreased by 80 basis points and was primarily attributable to favorable tax true-ups in two Texas properties and a reduction in utilities and maintenance cost.

On the dispositions front, in February, we sold our Village Green Ann Arbor property in Ann Arbor, Michigan for $71 million, generating an internal rate of return of 38% and a return of 2.3 times invested equity.

Following the quarter end in April, we sold our Lansbrook fractured condo community located in Palm Harbor, Florida for $82 million, generating an internal rate of return of 23% and a return of 1.5 times invested equity.

We yielded approximately $33 million in net proceeds from the sales, and expect to reinvest them accretively within two quarters.

In addition to the above we are in various stages of the sales process on two additional assets, which we anticipate will close in the coming quarters.

Turning to the investment front, in the first quarter, we closed on two operational assets in Charlotte and Raleigh totaling 683 units and $117 million in gross asset value and $36 million in BRG equity. The business plans focused on a more localized management approach as well as targeted capital improvements to the amenity areas and select interior unit floor plans. The assets are projected to yield a pro forma stabilized cap rate of approximately 6.5% versus market cap rates ranging from 5% to 5.25%.

During the quarter, at construction commencement, we converted our existing Boca Raton, Florida and Garland, Texas common equity investments to mezzanine loans. We invested $19 million of incremental capital in the two deals, bringing their total mezzanine loan balances to $11 million and $21 million, respectively. Additionally, we've funded the remaining $3 million mezzanine commitment in our West Morehead development within the quarter.

In terms of pending transactions, we are under contract to purchase an off-market portfolio of five assets, totaling approximately 1,400 units across multiple MSAs in Texas, for a purchase price of $189 million. BRG is projected to invest approximately $48 million in equity for a 90% ownership in the venture, and our business plan includes improving onsite management, curb appeal and targeted capital spend for the amenities and select interior unit upgrades. We expect the properties to be immediately accretive to earnings, with projected first year AFFO north of 11% and growing from there. As part of the transaction we are assuming agency financing totaling approximately $147 million.

Following the portfolio purchase and recycling of capital, we are projected to have approximately $75 million of available cash for investment. We anticipate the investable cash being deployed through the middle part of the year, with a fully invested run rate toward the back half of 2017.

With respect to asset level financings, our access to senior financing on the acquisition side remains robust from a variety of lenders, including the Agencies, Banks and Life Companies. Following the spike in rates toward the end of the last year, spreads have compressed to a range generally between 160 to 220 basis points for all-in rates of 3.5% to 4.2%, with terms ranging from five to ten years.

Finally, our pipeline remains very robust. We are currently evaluating north of $1 billion worth of opportunities through a combination of portfolios and one-off assets. Our throughput capability continues to expand with the addition of quality operating partners that helped us penetrate deeper into our existing markets and expanding to new MSAs.

With that, I'll now return the call to Ramin to conclude.

Ramin Kamfar
Thank you, Ryan. That's the end up our prepared remarks and with that I'm happy to open it up to Q&A. Operator?

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Rob Stevenson of Janney. Please go ahead.

Rob Stevenson
Good morning, guys. Ramin, what are you guys estimating at this point to be the all-in cost for the internalization if it goes through?

Ramin Kamfar
By all-in cost you mean the internalization payment that's made to the manager or are you including legal and everything else associated with that?

Rob Stevenson
Yes, all-in, I think it was $400,000 or $500,000 this quarter plus whatever you've done in previous quarters plus whatever is on the road. Then what it eventually winds up from the agreements et cetera that you guys have in place? What does that look like all-in including all the legal cost, et cetera?

Ramin Kamfar
I think the all-in number is going to be somewhere between $35 and $40 million.

Rob Stevenson
Okay.

Ramin Kamfar
But obviously a substantial majority of that, which is the internalization payment being paid in equity. So, we're not using the Company's cash.

Rob Stevenson
Right. Another question here, when you look at the almost $200 million portfolio, you have made some asset sales, you have issued equity and you are continuing to ramp the Series B. How are you guys thinking about leverage and what's the sort of max that you guys are thinking about given where you are in the life cycle of this Company that make sense from a management standpoint?

Ramin Kamfar
I think over the life cycle of the Company the max leverage is going to come down as we get larger and our cost of capital on the equity side comes in. As you know Rob, we've been very focused on our cost of capital on the equity side, that's why we did the institutional preferred and that's why we're doing the retail preferred and that's why we've used as much debt as we have. I think on a debt basis today we are in the mid-50s in terms of leverage.

We are putting in the line of credit that's going to make us more efficient in terms of the utilization of the capital. The Series B is also more efficient in terms of capital utilization because it comes in on a relatively predictable basis as opposed to the follow-on offerings, which are one-off. So, it'll take longer to invest, because you can't necessarily plan for them 100% because they are dependent on market factors. So, as we get larger that number is going to come down to the point that we will get to a point where we will want to get an investment grade credit and be able to issue unsecured debt.

Today what we are using, is we are using 65% leverage going into deals generally and with the value creation as we increase the equity value that number comes down to the 50 or sub-50% range and that's on purpose in terms of what our target is. So, if you look and see where we're selling the assets, where we're buying the assets they are in the 65% range, when we are selling the assets they are in the 40% to 50% range.

Rob Stevenson
Okay. Then a couple of housekeeping items here. The expensed acquisition pursuit cost, that was almost all of that was the abandoned pursuit at East San Marco, you guys are now capitalizing run of the mill acquisition cost of stuff that you acquire, is that true?

Ramin Kamfar
That's correct. As you know the AICPA came out with new guidance that said that instead of expensing acquisition costs you have to capitalize them. So the number that you saw is mostly—I think it was a total of $3 million or maybe three and change and $2.9 million of it was the ESM write-off.

Rob Stevenson
Okay. Then you guys said that same-store occupancy was up 80 basis points. What was the actual occupancy number, I didn't see that in the supplemental.

Ramin Kamfar
Chris, do you want to take that?

Christopher Vohs
Yes let me pull that up real quick.

Rob Stevenson
Okay, if you want, email me later. That's fine on that one, and then just lastly, the $0.01 to $0.02 AFFO guidance does not assume that you pay the management fees in LTIPs again. Is that correct? So if I assume that it's more like $0.10 or so of AFFO?

Ramin Kamfar
That's correct, we never assume that.

Rob Stevenson
Okay, perfect. Chris if you want to email me with the occupancy number, that'd be great. Thanks.

Ramin Kamfar
Thank you Rob.

Christopher Vohs
Sure, for Q1 our average occupancy for same-store was 95.1%.

Rob Stevenson
95.1%. Okay. Thank you, guys.

Ramin Kamfar
Thank you.

Operator
Our next question comes from Craig Kucera of Wunderlich. Please go ahead.

Craig Kucera
Hey, good morning guys. I may have missed this, but what were the cap rates on the disposition you completed in the first quarter and then Lansbrook?

Ramin Kamfar
Hi Craig. I'm going to let Ryan answer that question.

Ryan MacDonald
Good morning, Craig. We're talking mid fives on an economic basis, Ann Arbor is a little bit higher, was a little north of six and Lansbrook was low fives.

Craig Kucera
Got it, okay. With the lift in the Series B issuance, first of all congratulations. Are you thinking about capping that at a certain amount? Or are you looking at possibly ramping that up to the level that one of your peers is doing that activity, maybe upwards of $50 - $60 million a month?

Ramin Kamfar
I think, Craig, that it all has to do with cost to capital. So I think what we don't want to do that, I think you mentioned one of our peers is doing is, get out of balance with respect to preferred versus common. Okay, so what you're not going to see from us is having a $1 billion of preferred outstanding on $300 million of common base.

So you're going to see our view point on it is that, its cost efficient and it has a place in the capital structure, but the capital structure needs to be balanced. So, we are hoping as we grow to continue to grow our common equity base also whatever that's by new issuances or by converting the preferred into common. As you may know we have a two-year non-call, which is a big difference in terms of our preferred and after that we can call it, and the way we look at it is it's effectively forward issuance of common equity at a cheaper cost of capital for us because it's a 6% dividend, we get that money, we reinvest it at a 10% to 11% return on equity that helps grow our AFFO. Hopefully we'll get the increase in stock price.

Starting two years after we can convert those into underlying common to make sure that—preferably if the price is right obviously to make sure that our common base continues to grow because one of the big goals that we have is to get on the RMZ, the Morgan Stanley REIT index because we think that that the result and subsequent increase in distribution of our common equity is going to shrink that along with the internalization and the line of credit, et cetera, et cetera, we're hoping should shrink the discount to NAV that we're trading out.

So, we're looking at it as a strategic element of managing our cost of capital and raising capital efficiently.

Craig Kucera
Okay. I don't want to go too far down this path, but are you comfortable saying that you're going to remain exclusively in multi-family or are there other core competencies that the other Bluerock funds have that you might expand into down the line whether that's office or something other asset class?

Ramin Kamfar
At this point we're a multi-family focused business and there have been no decisions to expand beyond multi-family. I think, again, if you're comparing us to one of our peers, I think our ability to put out capital because of our partner network in the multi-family space is substantially greater because we're

not just looking at one or two or three acquisition guys that are going out and putting out dollars, we have a force multiplier of 10 of the biggest and best firms as our operating partners that do billions and billions of transactions on an annual basis. More than some of the respective public peers and we can tap into that, in fact we're working on our strategic map for the next three years in terms of markets and partners and how we grow the business from here to there. So, we're not looking at this point to go buy large office buildings or go do retail.

Craig Kucera
Got it. You've had more than a $100 million of cash on your balance sheet for over a year, at least at quarter end and that's averaged about 40% of your market cap. When you internalize, you get a bank line of credit, and have a steady source of preferred, do you anticipate operating the balance sheet with substantially less of a cash drag or how should we think about how you'd manage the balance sheet post internalization and having a little bit more wiggle room from the line of credit?

Ramin Kamfar
Absolutely. The line of credit is going to be a primary tool to use. The issue as you know with going out and issuing common is that it's lumpy and you can't really line up acquisitions in advance betting on the fact that you're going to go out and raise these dollars because if the market moves, Janet Yellen says something one day et cetera, et cetera market moves that capital may or may not be there, and we can't risk our reputation, which is one of our strongest assets when we are going out and buying deals and teaming up with partners by showing up one day and saying we don't have the cash.

So, it forces you to have to raise the cash first and then go deploy it. A line of credit is going to help with that because we'll be able to use it as a buffer to eat up the excess cash. So, three things, one is line of credit is going to help with that. Second is the Series B is going to help with that, because as I said the raise is predictable, we did $15 million last month, I have a sense of what we're going to do this month and next month, it's some relation to the $15 million. As we get larger the equity raises become more predictable – it's just the nature of the beast. The number four as we get larger the amount of turnover in our portfolio in terms of monetizing assets is going to be less on a percentage basis. We're still going to be harvest our gains when it's accretive for investors, but it's not going to be 25% of our portfolio, which is contributed to the cash that's come on our balance sheet. Because as you sell the asset that cash comes on the balance sheet and you have to deploy it. So it's really four thing, actually I misspoke, versus three.

Craig Kucera
Got it. One more for me and I'll jump back in the queue. When I look in the supplement on, I think it's on page 12 and maybe page 15 as well, when you're outlining a use of the cash on balance sheets with various investments, mezzanine and identified assets, unidentified assets. Is that not inclusive of the activity that's been subsequent to the quarter, correct? That's not taking into account the sale of Lansbrook or the new portfolio of five assets you have identified. Is that correct?

Ramin Kamfar
That's correct. When we look at the Q1 pro forma AFFO, which is the table that you're referring to, we wanted to keep it comparable to the way we projected Q1 AFFO in Q4. So, it does not reflect new activity. Otherwise you couldn't compare this table with the prior table. So, but Q2 pro forma AFFO, which is the projected, includes the new activity that happened in Q1. Does that make sense?

Craig Kucera
Yes, it does. Thank you very much.

Ramin Kamfar
Thank you, Craig.

Operator
Again if you have a question, please press star, then one. There appear to be no further questions at this time.

I would like to turn the conference back over to Mr. Ramin Kamfar for any closing remarks.

CONCLUSION

Ramin Kamfar
Thank you, Operator. I want to thank everyone for joining us today and look forward to reporting to you on our continuing progress in upcoming quarters. Good bye.

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