Bluerock Residential

Bluerock Residential Third Quarter 2015 Earnings Call

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CORPORATE PARTICIPANTS

Christopher Vohs – *Chief Accounting Officer*

Ramin Kamfar - *Chairman and CEO*

Larry Kaufman – *Vice President of Asset Management*

Ryan MacDonald – *Senior Vice President of Acquisitions*

James Babb – *Chief Investment Officer*

PRESENTATION

Operator
Good day, ladies and gentlemen, and welcome to Bluerock Residential Growth REIT's Third Quarter 2015 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 Accounting Officer of Bluerock Residential. Mr. Vohs, the floor is yours sir.

Christopher Vohs
Thank you and welcome to Bluerock Residential Growth REIT's third quarter 2015 earnings conference call. This morning, prior to market open, we issued our earnings press release and supplement, which can be found on our website at bluerockresidential.com. 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. Before we begin, please note that this call may contain forward-looking statements as they are defined under the Private Securities Litigation Act of 1995. There are a variety of risks 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 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. 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 thank you all for joining us for BRG's third quarter earnings call today. With me are several members of our manager, Jordan Ruddy, our President; Jim Babb, our Chief Investment Officer; Ryan MacDonald, our Senior Vice President of Acquisitions; and Larry Kaufman, our Vice President of Asset Management.

I will open my remarks with some key financial highlights from the quarter and close with some capital markets commentary. Following my remarks, I will ask Larry and Ryan to give you additional operational and transactional detail.

Let me start with financial highlights. For the quarter, our adjusted funds from operations, or AFFO, grew 238% to $4.4 million from $1.3 million in the prior year quarter. On a per share basis, AFFO came in at $0.22, which exceeds our guidance of $0.14 to $0.16 for the quarter. On a pro forma basis, which assumes we completed the investment of the May follow-on proceeds into identified deals as of the start of the third quarter, our AFFO per share was $0.32, which exceeds the high end of our guidance range of $0.26 to $0.28. I would point out that we have a dividend of $0.29 per share quarterly, so we're continuing to achieve our goal of covering our dividend on a pro forma or run rate AFFO basis.

Moving on to the revenue front, we achieved significant growth as a result of our investment activity. Our top line revenue for the third quarter was $11.6 million, which is a 21% increase from $9.6 million in the prior-year quarter. In terms of NOI margin, we showed significant improvement, with NOI margins growing 200 basis points to 59.4% from 57.4% in the prior-year quarter. As a result, property NOI dollars grew faster, at a faster rate than revenues to $6.9 million in the quarter, which is a 25% increase from $5.5 million in the prior-year quarter. Same-store NOI grew substantially by 8.7% for the quarter versus the prior-year quarter.

For the second consecutive quarter, BRG's Board determined to pay the full amount of our management fee in LTIPs in lieu of cash. And from the manager's point of view, we're pleased to accept the LTIPs given our strong belief in the value of BRG stock at current levels and to demonstrate our continued alignment with our investors.

Net loss attributable to common stockholders for the quarter ended September 30th improved significantly to $0.6 million, versus a net loss of $2.1 million for the prior-year quarter. The net loss was caused primarily by non-cash items, which were $4.8 million for the third quarter, versus $3.3 million in the prior-year quarter. Our asset base continues to grow significantly on a quarterly basis. Consolidated real estate assets, at cost, are up 50% to $449 million at the end of the quarter from the year-end 2014. We will look for this to continue to grow through the remainder of the year.

On the transaction front, we closed two investments during the quarter and two in October for a total combined cost of $182 million and we have an additional four properties under contract or LOI for a total cost of $162 million, representing 979 additional units, which we're working on closing. Ryan will touch base on these transactions in more detail in a few minutes.

As we've previously indicated, we will continue to review our portfolio and be active recyclers of capital when it's beneficial for our shareholders. During the quarter and subsequent to it, we exited two non-core assets; one in Southfield, Michigan and one in Chattanooga, Tennessee at very attractive returns that substantially exceeded our underwriting. North Park Towers, which was our Michigan deal, yielded with a 40% IRR and a 170% return on capital over an 18 month hold, while our Villas at Oak Crest, which was our Chattanooga, Tennessee deal, generated to 21% IRR and a 130% return on a preferred equity deal over a 17 month hold period.

Shifting to the capital market side, we completed 2.875 million share Series A redeemable preferred stock offering in October with an 8.25% coupon for gross proceeds of $71.9 million. Part of our goal of this offering was to raise accretive capital inside our common dividend to execute on the robust pipeline of accretive transactions that we're continuing to see. Another important goal we had for the offering was to continue to build our institutional shareholder base, which we executed successfully as we had significant orders from two of the largest REIT dedicated institutional investors for the offering.

Finally, we're looking forward to a solid fourth quarter. We'll continue to report AFFO on a pro forma basis, in addition to actual, so that investors can evaluate our earnings potential on a fully invested basis without the temporary cash drag that's associated with raising and investing capital. Our pro forma AFFO guidance for the fourth quarter is $0.26 to $0.28 per share, which assumes that we have fully invested our remaining cash in pending and pipeline transactions, the details of which are outlined in our supplement which we filed this morning. And now, I'd like to hand over the commentary to Larry Kaufman, Vice President of Asset Management. Larry?

Larry Kaufman

Thank you, Ramin, and good afternoon everyone. Our operating portfolio continues to perform exceptionally well. I would like to highlight just a few key metrics for the third quarter. Portfolio-wide, across all of BRG's assets, average occupancy for the third quarter of 2015 was 95.3%, in line with the prior-year quarter average of 95.3%. Sequentially quarter-over-quarter, occupancy was up a 140 basis points. Occupancy remained strong in October, averaging 95% and continues to hold at that level through November. Same-store NOI increased 8.7% compared to the third quarter of last year 2014. The improvement in NOI was primarily driven by a 6.1% increase in property revenues of which the majority came from a 4.9% increase in average effective rent per occupied unit over the same period last year. Same-store expenses were increased by 2.7% versus the prior-year quarter. And now, I'd like to turn over to Ryan to give you some additional details about the quarter's investment activities.

Ryan MacDonald
Thank you, Larry. We had another very productive quarter on the investment side of the business. First, I'm going to touch on some recent acquisitions, pending transactions, and dispositions, followed by some brief remarks on capital markets.

On the acquisition front, we made two investments in the quarter, and closed a two-asset portfolio in October for a total of a $182 million and representing 1,248 units in three markets. We also have four additional investments pending for a total cost of $162 million and representing 979 units in four markets, in addition to a robust pipeline.

Our first acquisition was a $13.5 million investment in the first phase of a two-phase, off-market purchase of 100% interest in a 2012 and 2015 built Class A, 473-unit property in suburban Charlotte called the Ashton Apartments. This was an off-market purchase directly from the seller, which was complex for a variety of reasons, including the fact that the phase I is operating and has existing financing, while phase II is still under development. As a result of these complications, BRG's cap rates on phase I and II are 6% and 5.8% respectively which, in our estimation, is approximately 50 to 75 basis points better than market, which we estimate to be in the 5% to 5.25% range. We expect to close on phase II with our approximate investment of $8 million in the fourth quarter following stabilization of the property at 90% occupancy.

The second investment was the purchase of a 95% interest in a Class A 2008 built, 252-unit apartment community in Orlando, Florida called the Century Palms at World Gateway Apartments. The asset was purchased off-market for $37 million and is projected to yield a pro forma stabilized cap rate of approximately 6.8%, which is 40 basis points higher than our original underwriting as a result of operational improvement at the property throughout our contract period. This compares favorably to cap rates in the market for similar quality assets in the 5% to 5.25% range. The business plan calls for minor enhancements to the clubhouse and amenities as well as modest in-unit upgrades and installment of washer/dryers in select units. BRG invested 95% of the required equity totaling approximately $13 million with the remaining equity balance coming from BRG's partner. Additionally, the joint venture capitalized the property with an acquisition loan of approximately $25 million from Fannie Mae.

During October, we executed an off-market purchase of a 95% interest in two new built Class A apartment communities totaling 674 units in the Dallas-Fort Worth metro area for a total purchase price of approximately $100 million. Because of our close relationship with the seller and ability to execute quickly, we were able to negotiate favorable pricing that is projected to yield a pro forma year one stabilized cap rate of 5.7% versus market cap rates for similar quality product in the 5% to 5.25% range. BRG invested approximately $33 million with the remaining balance funded by our partner and two individual property loans totaling $67.6 million. This portfolio acquisition was a prime example of the significant demand by senior lenders for high-quality assets, as evidenced by the multiple offers we received from a variety of lending sources, including the agencies, life cos, and banks.

In terms of pending acquisitions, we have four additional investments pending for a total cost of

$162 million, and representing 979 units in four markets. To give you some additional details on the deals, the first pending investment I'll mention today is a healthcare oriented Class A multifamily development project in Raleigh, North Carolina. The project is 245 units and located directly adjacent to REX Hospital, a highly acclaimed medical center within the UNC Healthcare System that employs more than 5,400 staff, including 2,800 medical personnel. Our partner has been working on a rezoning for many years and, as a result, has created significant underlying land value. BRG is coming in at our partner's basis through a convertible preferred equity investment and our underwriting projects a return-on-cost for the project ranging from 7% to 7.5% at stabilization for value creation of 200 to 250 basis points versus sales of high-quality institutional multifamily communities in the Greater Raleigh metro at 4.75% to 5.25% cap rate. We estimate that BRG will fund approximately $17 million in a convertible preferred equity investment in the transaction, and the investment is projected to close this coming quarter.

The last two pending investments I will mentioned today are the result of a new development partnership with the former Chief Development Officer of a large publicly traded multifamily REIT, whose team collectively brings over $8 billion and north of 37,000 units worth of development experience to the table. We are excited about the opportunity for the relationship, and believe these two investments are the first of what we believe to be a potentially long pipeline of unique opportunities.

The first investment is a to-be-built 300-unit Class A luxury garden-style apartment community in Garland, Texas with direct access to the major Dallas employment centers, Legacy Business Park, and Plano. The transaction was sourced off-market and our partner undertook a comprehensive rezoning to allow for residential use at the site, which creates an attractive basis. BRG's underwriting projects the return-on-cost of 7% to 7.5% at stabilization for value creation of 200 to 250 basis points versus sales of comparable communities in the Greater Dallas MSA at 5% to 5.25%. BRG is projected to initially fund approximately $9 million through a convertible preferred equity investment by the end of fourth quarter.

The second investment is a to-be-built 283-unit Class A luxury midrise apartment community in an emerging downtown Charlotte neighborhood called Wesley Heights. We believe the neighborhood has had similar path of growth characteristics to the Berry Hill neighborhood, at the same time, at the time of our successful investment in the 2,300 at Berry Hill development in Nashville. The site is being purchased off-market and required a comprehensive rezoning by our development partner to allow for residential use, which again allows for an attractive basis. BRG's underwriting projects a return-on-cost of 7% to 7.5% at stabilization for value creation of 200 to 250 basis points versus sales of comparable communities in the Charlotte urban core at 4.75% to 5%. BRG is projected to initially fund approximately $10 million through a convertible preferred equity investment by the end of fourth quarter.

Shifting to the dispositions front, we exited two older non-core assets that no longer fit within BRG's current strategy because of age and location. I'm happy to report both assets were sold at attractive gains yielding approximately $10 million in net proceeds to BRG. Returns on our preferred equity investment at the Villas at Oak Crest in Chattanooga exceeded our base case underwriting yielding at 21% IRR and a 130% return on capital. The North Park Towers disposition in Southfield, Michigan also yielded returns that surpassed our original underwriting with a 40% IRR and a 170% return on capital. The disposition cap rate for North Park was approximately 7.6%; however I'd like to point out that we had in-place senior financing with a rate of 5.7%, so post reinvestment we believe this will be accretive to BRG earnings.

Moving to the capital markets front. I'd like to point out that our access to senior financing remains robust, despite the perceived volatility in the market with the agencies over the past few quarters. As I alluded to earlier in my remarks, there continues to be a robust appetite amongst a variety of lenders. Fixed rate spreads generally range between 165 basis points to 220 basis points for all-in rates of 3.6% to 4.25% with term ranging from 5 years to 10 years.

Finally, our pipeline remains very robust. Currently, we are evaluating north of $500 million worth of investments, totaling in excess of 5,000 units and 17 properties. The majority of these pipeline transactions are off-market and in many cases, we've been working on them for extended periods of time.

Before I hand the call back off to Ramin, I'd like to note that our 296-unit development project in Orlando, Florida, called EOS, is 47% leased and received final certificates of occupancy this week. Rents are in line with projections, which means we would be looking at a 7.5% return-on-cost for the project versus market cap rates of 5% to 5.25%, and we've been trending approximately 22 leases per month. We look forward to the continued strong lease-up at the property and reporting on the progress next quarter. And with that, I will now return the call to Ramin to conclude.

Ramin Kamfar
Thank you, Ryan. Just in closing, I want to say that we continue to see significant upside to our strategy, which is building a high-quality Class A portfolio in high-growth primary markets throughout the United States, targeting the high disposable income renter by choice. We to date have assembled one of the youngest portfolios in the market, and we are generating one of the highest average rents for a portfolio in our markets and generating significant value creation in our portfolio. And I want to thank you all for your support, and I look forward to sharing news of our continued progress as we execute our business plan. And with that note, Mark, I'm happy to open up and answer any questions that are out there. Ah, Mike, I'm sorry.

QUESTIONS AND ANSWERS

Operator
That's okay, sir. At this time, we'll go ahead and begin the question-and-answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star (*) then two (2). Again, it is star (*) then one (1) to ask a question. At this time, we will just pause momentarily to assemble our roster. The first question we have comes from Craig Kucera of Wunderlich. Please go ahead.

Craig Kucera
Hi, good afternoon guys. I appreciate the color on the pipeline and the thoughts there, but just want to talk about how we should think about the remaining equity sort of after you close these four investments that are expected to close year end. Do you think sort of a, any sort of a split between invest-to-own, or how should we think about how you'll deploy maybe that $50 million plus of equity that's probably still out there?

Ramin Kamfar
Thank you, Craig, good afternoon. And so we're working on, we're actively working on the pipeline. We've got deals that are in the works and hopefully getting to a point where we can announce them soon as we've said that we, and generally have two quarters to put the money to work and we've done it ahead of time, I would expect the same here. Generally, what with

the way we budget is we've said that we're on the invest-to-own, that's going to be, we have an internal kind of limit of no more than 35%, a third of our portfolio. And it will depend on, but then it is not a large amount, so it'll depend on how the pipeline shakes out. I mean, we have one large deal that we're working on that is actually, could take all of it and that's mostly, that's mostly operating assets. So, from a budgeting point of view, I think it would be, I think we would look at it as again 65% operating assets and 35% invest-to-own, but it may move around. Just because, when you're not talking about hundreds of millions of dollars, every one deal can move that needle around a bit. Does that answer your question, Craig?

Craig Kucera
Yes. No, that's exactly what I was just trying to get a lead on. You have a couple of preferred equity investments, notably the EOS property that is, you have a fairly low ownership but it sounds like it's trending, certainly pretty much going to be a double, triple even homerun. Any thoughts to maybe taking up that ownership in that property, or do you have an opportunity to do that, to take yourself up from kind of a lower ownership?

Ramin Kamfar
Well, EOS is turning out to be a tremendous asset. Unfortunately, that was the deal that we entered into before the lease was public and we were capital-constrained, hence the lower ownership. We'd love to own more of it, but I'm not sure, given our cost of capital, that makes sense. We have, as you know, we will look at it as that's coming online, we will look at, we have looked at our portfolio going into 2016 and one of our key strategies for 2016 is going to be continue to actively recycle capital where it's accretive. And I think EOS is going to fall into that bucket, because it's going to be a double or more. And it's a, I would assume it's a five cap rate in terms of, on the sale and then we can invest it at a substantial spread to that to continue to create value. We'd love to own it but I don't think we can afford it right now, is the short version of the answer, I guess.

Craig Kucera
Got it. And I'll ask one more and then jump in the queue. The bogey in the last couple of quarters in AFFO was the non-cash top, I know last quarter you took the base management fee as stock this quarter. Can you just give us some color on your thought? Like is there a stock price, or how do you think about when you're going to start kind of taking a split between cash and non-cash going forward or should we make any assumption about what you'll be taking as non-cash going forward?

Ramin Kamfar
We think that the stock is hugely undervalued at current pricing. We, I'm not sure I can tell you what, ah, we haven't shared what our internal NAV, numbers are. I will tell you that they're higher than yours. So, our view point is that we will take, we will continue, to the sense that we can afford it I guess at some point, we may not be able to afford to do that, but we've taken it last couple of quarters and assuming the stock price this year are in this vicinity, we'll continue to take it to the extent that we can. And we're hoping that as we grow into a larger size category, as you know, the small cap REITs tend to get revalued with multiple expansion as they get, the next step would be the MSCI as we get larger, MSCI inclusion at some point, and based on our discussions with larger REIT dedicated investors, we're being watched and hopefully as we get bigger, we hit the hurdles and they think they can invest in us. So the goal is to get larger in an accretive way, get revalued, and until then we're happy to have the board to give us shares as opposed to cash count.

Craig Kucera

Got it. Okay, thanks.

Operator
Next we have Steven Manaker of Oppenheimer.

Amit Nihalani
Hi, this is Amit for Steve. Just a few quick questions. Are you able to comment on the competition that you're seeing and if there been any movements in cap rates?

Ryan MacDonald
Amit, how are you? It's Ryan MacDonald. The competition has always been fierce, but I think the way we source our deals off-market into relationships and utilizing our joint venture partners creates a, and has continued to create a robust pipeline, but sure, the competition is fierce for the fully marketed deals, which we tend to stay away from. On the cap rate basis, it's very market and submarket specific. So I think generally cap rates have probably held in line with where they were 6 to 12 months ago, but again, it's very, very submarket specific and even MSA specific, if you want to kind of move it up to 10,000 feet from 5,000 feet, so.

Jim Babb
All right. Hey Amit, it's Jim, and I would probably add to that. Again the nature of how we tend to go about buying deals, we don’t see as much competition, but I do, I would think if we see some strong capital flows into a lot of the markets that we find attractive. We think that sort of underscores what the institutional, or what the rest of the market is seeing in terms of strong job growth and population growth creation. And so we think that underscores our strategy. I think that, and we think that’s probably more of a secular trend, that we’re going to continue to see strong capital flows into the demographics and geographies that we're concentrating on now. We think that bodes well for asset values.

Ryan MacDonald
Yeah, and we've been a prolific seller to those institutions once we fix the asset and bring it to a core stabilization.

Ramin Kamfar
So it's a competitive, it's Ramin. So it's a competitive market, but our focus is to find deals that are, that we can source off-market through relationships, to find the non-competitive deals.

Amit Nihalani
Great. Thank you.

Operator
As a reminder, if you would like to participate on today’s Q&A, please press star (*) then one (1) on a touchtone phone. Again, that is star (*) then one (1). Next we have Wilkes Graham of Compass Point.

Wilkes Graham
Hi, good afternoon. Ryan, this may be for you I'm not sure but I appreciate all the detailed color on the guidance on page 26 of the supplemental. As I'm working my way through it, can you just maybe highlight just for the listeners what the main points are of why you just reported $0.22 in the third quarter versus the guidance of $0.12 to $0.13 in AFFO for the next quarter?

Ryan MacDonald

Sure. Well, the primary difference is…

Ramin Kamfar
We had - well, I'll take it big picture and maybe Chris can jump in. We performed at the top of our, above the top, the operating portfolio, performed above the top of our budgeted numbers. So on a $0.14 to $0.16 basis, we're actually ended up at $0.17 to $0.18. And then the piece of it is the management fee, that’s $0.04. And Chris, do you want to, I know we've drilled, we drilled down into the numbers.

Wilkes Graham
Yeah, that’s the third quarter. I'm talking about the guidance for the fourth quarter.

Ramin Kamfar
Oh, guidance for the fourth quarter?

Wilkes Graham
Yeah. So…

Christopher Vohs
Well, it has to do with the preferred offering grade and investing that capital. And as we’ve pointed out, we've got an accretive, robust pipeline that we think will get invested over the next couple of quarters. So, it's primarily due to…

Wilkes Graham
Great. In other words, do you, as Ramin said, the third quarter AFFO number, before the effect of taking management fee and stock was $0.17 or $0.18, call it $0.18 versus $0.22. And just that very initial dilution from the preferred before you invested capital is what gets you down to $0.12, $0.13?

Ramin Kamfar
That’s correct. My apologies, I misheard the question.

Wilkes Graham
Yeah, I think it fits into the answer overall. So, thank you.

Operator
Next we have Rob Stevenson of Janney.

Kenneth Haupt
Hi guys, it's Ken for Rob. Ryan, I just wanted to see if you can give us a little more detail on the current pipeline beyond the properties that you guys have identified thus far, just curious as to sort of what you're seeing out there in terms of opportunities? Thank you.

Ryan MacDonald
Sure, good afternoon, Ken. We've got a pipeline that’s 17 assets today, about $750 million in gross AUM. I think it ranges primarily from core plus to development, although I think there is an opportunity potentially for us to execute on a value-added transaction, an opportunistic value-added transaction potentially in South Florida, Southwest Florida that is a very, very unique and well-located opportunity. So, it's consistent with buying something that’s potentially broken and fixing it and at accretive cap rates, and utilizing our joint venture partners to execute on the business plan. So it’s, we've got a robust pipeline that fits within our current territory, but

primarily focused on Southeast and Florida.

Kenneth Haupt
Thanks a lot.

Operator
Again, as a reminder, if you would like to ask a question, press star (*) then one (1) on a touchtone phone. Again, that is star (*) then one (1). Again, we will just pause momentarily to assemble our roster. Well, at this time, we're showing no further questions. We'll go ahead and conclude the question-and-answer session. I will now turn the conference back over to Management for any closing remarks.

CONCLUSION

Ramin Kamfar
Thank you, Mike, and again thank you everyone for your support. And we look forward to continuing to share news of our progress as we execute our business plan. Bye-bye.

Operator
And we thank you sir, and to the rest of the Management team for your time also today. The conference call is now concluded. At this time you may disconnect your lines. Thank you, take care, and have a great day everyone.