Bluerock Residential Growth REIT

Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Ramin Kamfar, *Chairman and CEO*

Christopher Vohs, *Chief Accounting Officer*

Ryan MacDonald, *Chief Acquisitions Officer*

Jordan Ruddy, *President and Chief Operating Officer*

Jim Babb, *Chief Investment Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and welcome to Bluerock Residential Growth REIT's Third 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 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, please go ahead.

Christopher Vohs
Thank you and welcome to Bluerock Residential Growth REIT's Third 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'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 or 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 statement 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 proforma measures, please refer to our earnings supplement for a reconciliation to GAAP. The reasons management uses these non-GAAP measures is the assumptions used with respect to any proforma 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. Good morning, everyone. In addition to Chris, with me today I have several additional team members of our executive team — Jordan Ruddy, our President and Chief Operating Officer, Jim Babb, our Chief Investment Officer, and Ryan MacDonald, our Chief Acquisitions Officer.

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

Let me start with the financial highlights. On the revenue front, we're continuing to achieve significant growth. Our topline revenue for the third quarter was $30.1 million, which is a 46 percent increase from $20.6 million in the prior year quarter, largely as a result of our significant investment activity since then. I will note that our revenue growth was impacted by our asset sales in the second quarter of this year and expect the reinvestment of those proceeds to occur through the end of the year and reflect on our revenue numbers. Net loss attributable to common stockholders for the quarter was 45 cents per share as compared to our net loss of 12 cents per share for the prior year quarter.

For the quarter, our adjusted funds from operations attributable to common stockholders, or AFFO for short, was $3.4 million compared to $4.3 million in the prior year quarter. On a per-share basis, AFFO came in at 13 cents, which significantly exceeded our guidance of negative 2 to negative 3 cents. Our AFFO was impacted temporarily by the asset sales that I noted above and also by a one-time 2 cent charge resulting from about $600,000 in costs across eight properties in Florida and Georgia, which were slightly impacted by Hurricane Irma. Our proforma AFFO, which assumes that our investible cash was fully invested as of the beginning of the third quarter, was 37 cents per share versus our guidance range of 25 to 27 cents. The detail for the proforma, which we include to show our earnings power on a fully invested basis, is available in our earnings supplement for your review.

For the tenth consecutive quarter, BRG's Board determined to pay the full amount of our management fee and 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. The payment of the fees and LTIPs favorably impacted our actual and our proforma AFFO per share numbers by 11 cents and by 10 cents, respectively.

Moving on to property operations, property NOI dollars grew to $16 million in the quarter, which is a 26 percent increase from $12.7 million in the prior year quarter. Same-store NOI was down 60 basis points for the quarter versus the prior year. This was impacted by operational volatility at two of our assets in the Dallas-Fort Worth MSA, and Ryan's going to provide additional detail for you.

Our asset base continues to grow. Our gross assets are over $1½ billion as of the end of the quarter, which is up 7 percent on a quarter-to-quarter basis and up 59 percent on a year-over-year basis. On the acquisition front, during the quarter, we closed on two operating properties totaling 720 units for approximately $96 million.

Shifting to the capital market side, our Series B 6 percent preferred offering continues to offer us access to cost effective capital. Third quarter sales totaled $42.4 million, and we expect the quarterly run rate through 2018 to maintain around the $45 to $50 million level.

Additionally, post-quarter end, we closed a $150 million revolving credit facility which will enable us to deploy our capital more efficiently and provide capital structure flexibility as we grow the business. Initially, two assets were added to the borrowing base, giving us revolver capacity of about $72 million to start, and our goal is to increase the borrowing base to max capacity through the first half of 2018.

Moving on to the internalization, on October 31st, following the approval of stockholders at our annual meeting, we closed the internalization of the external management function previously performed by our manager. The consideration was $41.2 million, calculated pursuant to a formula that was established in the management agreement at the time of our IPO. To further align the interests of our management team with those of our stockholders, 99.9 percent of the consideration was paid in equity. We estimate the internalization will be accretive to the AFFO by approximately $3.8 million on a run rate basis, based on our current numbers, with the benefit significantly growing over time. For example, at $1½ billion in equity size, we estimate the savings would be about $10 million per year.

During the third quarter, we also announced the Board was undertaking a review of the common stock dividend policy and also announced that we estimated that the 2018 dividend would be between 65 to 75 cents. We're currently refining our 2018 budgets and expect to be in a position to announce the dividend sometime in the December timeframe.

Finally, before handing the call over to Ryan, I'd like to note that our AFFO per share guidance for the fourth quarter is 3 to 6 cents per share. We expect this number to grow significantly as we move through 2018 and complete investing the substantial cash that was on our balance sheet at the end of the third quarter.

Ryan?

Ryan MacDonald
Thank you, Ramin, and good morning, everyone. I'd like to start off by noting that from a same-store perspective, like the previous quarter, this quarter continued to be a transitionary period for us as we finished our targeted disposition efforts and began the process of reinvesting the capital into growth oriented assets whose performance will not be captured in the same-store pool for some time.

Portfoliowide, across BRG's assets, average occupancy for the third quarter of '17 was 94 percent. Occupancy held firm in October as well, finishing the month at 94 percent. Same-store NOI in the quarter decreased by 60 basis points from the prior year period in the prior year, with a 90 basis point increase in same-store property revenues driven by a 1.6 percent increase in average rental rates versus the prior year period and a 70 basis point decrease in occupancy.

Same-store expenses increased by 3.3 percent, primarily attributable to an increase in R&M turnover costs and increased real estate tax assessments. I want to note that our same-store performance was disproportionately impacted this quarter by a negative performance from two assets in the DFW MSA, particularly our Frisco asset, which remains challenged with new supply and where we expect the operational volatility to persist through 2018. Excluding the two DFW assets, year-over-year, same-store revenue and NOI increased 3.4 percent and 4 percent, respectively.

On the margin front, our margin decline is primarily attributable to our recent disposition and reinvestment activity. We exited mature cash-flowing assets and recycled the capital into higher growth opportunities that typically take a couple of quarters to stabilize into a steady operational state. Takeover volatility and one-time upfront expenses can further disproportionately distort margins during a period of high investment activity.

Shifting to the investment front, in the third quarter, we closed on two investments totaling 720 units and $96 million in gross asset value and $29 million in BRG equity for an 89 percent ownership interest. The business plans focus on executing our Core-Plus renovation strategy, which includes targeted capital improvements of the amenity areas and select interior unit floor plans so that we can migrate both assets to our standard highly amenitized, live-work-play lifestyle product. The assets are projected to yield a proforma year one cap rate of 5.7 percent and are projected to grow to a stabilized cap rate of approximately 7 percent versus market cap rates ranging from 5 to 5½ percent.

Subsequent to the quarter end, we closed three investments totaling 1,342 units and $220 million in gross asset value and purchased the minority interest in our Arium Grandewood property for approximately $3 million. BRG invested $103 million for 100 percent ownership across the four properties. The average initial going-in cap rate for the assets is approximately 5.3 percent, with opportunity to drive the blended stabilized cap rate to approximately 6½ percent through our

Core-Plus renovation strategy. Two of the investments were partially funded with draws from our new line of credit, totaling $54 million. Our Hunters Creek purchase was funded with a $72 million fixed rate loan from Freddie Mac at 3.65 percent.

In terms of pending transactions, we are under contract to purchase one additional 304 units asset in Greenville, South Carolina, for a total purchase price of approximately $40 million. BRG is projected to invest approximately $15 million in equity for 100 percent ownership in the asset. The investment is subject to customary closing conditions and risks typically associated with multifamily real estate investments.

In terms of remaining commitments by yearend, we are projecting to convert three existing common equity development investments to mezzanine loans earning 15 percent annualized AFFO. To date, we have spent $24 million in common equity for investments in Crescent Perimeter and Vickers Village in Atlanta, Georgia. As part of the conversion to the mezzanine investment, we are estimating $7 million of additional investment across the two developments, for a total combined projected mezzanine investment approximating $31million. The remaining mezzanine investment is a to-be-built development in Flagler Village in Fort Lauderdale, Florida. To date, $25 million of common equity has been invested, and we expect to convert this amount — invest additional capital for a total mezzanine investment of $50 million.

Following the conversion of existing development common equity and the additional investment in the three projects outlined, the total BRG investment in development preferred equity and mezzanine loans is projected to be approximately $208 million. And following the remaining acquisition, an additional investment in the three mezzanine development opportunities, we are projecting to finish the year with approximately $20 million of cash on hand, inclusive of our estimated fourth quarter Series B preferred raise.

Finally, our pipeline continues to be very robust, and we look forward to reporting additional feedback on our continued investment activity in the coming quarters. 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 I'm happy to open it up to Q&A, Operator.

QUESTIONS AND ANSWERS

Operator
Thank you, Mr. Kamfar. We will now begin the question-and-answer session, To ask a question, you may press star, then 1 on your telephone keypad, If you are using a speakerphone, please pick up your handset before pressing the keys. If your question has been addressed, you may withdraw from the queue by pressing star, then 2.

And our first question this morning will come from Rob Stevenson of Janney. Please go ahead.

Rob Stevenson
Good morning, guys. Ryan, you indicated what the change in the same-store occupancy was. What was the same-store occupancy in the third quarter?

Ryan MacDonald

It was 94 percent.

Rob Stevenson
Okay. And then do you guys have a sequential same-store revenue growth for the quarter?

Ryan MacDonald
We do. I think it was .9 percent, and excluding the two Dallas assets, it was 3.4 percent.

Rob Stevenson
Okay. That was year over year, though, wasn't it?

Ramin Kamfar
That would be year over year.

Ryan MacDonald
Excuse me, it was .6 percent, and excluding the two Dallas assets, it was 1.2 percent.

Rob Stevenson
Okay, perfect. And then can you guys talk about how leasing is currently going at the four development assets that had initial occupancy over the last few months — City Center, Helios, Southside Place, and Lake Boone Trail?

Ryan MacDonald
Sure. City Center, we're currently — as of 9/30, we're about 60 percent leased, and I think today we're about 65 percent leased. We were doing about 10 to 15 units pre-Harvey. I think we did about 100 units post-Harvey, so we're on track. I think, if you average out over the course of that timeframe, it's north of 30, but we're back to the normal, I think, 10 to 15 units, albeit there's no concessions on the post-Harvey units.

On Helios, we're about 28 percent leased as of 9/30, which is averaging 16 to 20 units a month on proforma. Leigh House, we've actually had a pretty good start there as well. We're about almost 25 percent leased at quarter end, averaging about 20 units a month with rents on proforma. And then, finally, our other deals, Alexan-Southside by the Medical Center in Houston, again, we actually just opened units there, Rob, in October, and we're about 12 percent leased there, and we expect that to accelerate in the coming months.

Rob Stevenson
Are you seeing — in the Houston asset, are you seeing people disaffected by the hurricane running in, and is it a staggered completion there, or are most of your units going to wind up being delivered already?

Ryan MacDonald
With respect to Southside, it's a staggered completion. City Center, we've actually delivered the substantial majority of the units.

Rob Stevenson
Okay. And then how significant has the preferred B raise been thus far in the fourth quarter? You guys did, you know, a pretty decent amount, $40-some million in the third quarter. Are you anticipating that the fourth quarter's going to be equal to that or greater at this point?

Ramin Kamfar

That would be a good estimate, which is, you know, we'll be at the same level or maybe a tad higher. It's hard to tell, to project to the last million, because you've got Thanksgiving and the holidays coming up, but outside of that, our run rate remains to be robust — and as far as we can look out.

Rob Stevenson
Okay. And then, just lastly, Ramin, on the — as the Board contemplates any changes to the dividend policy, what's the key two or three things that you guys are still contemplating that's not known now that you guys are trying to ratchet down before you finalize that decision?

Ramin Kamfar
Well, we announced that the number is going to be —we estimated back in August, when we announced that, that the number's going to be in the 65 to 75 cents range, I repeated that in my remarks, so we're comfortable with that range. I think what we're trying to do is just finalizing the budgets, because we want to make sure that we cover the number. We're comfortable today where we sit, but obviously we have significant cash that we're continuing to invest. We've invested a significant part of it since quarter end. We've got some additional investment to do, and given our size, the numbers are sensitive to timing, but where we sit today, we're comfortable with it. Obviously, people don't really announce — and so it's really a call on what our 2018 number is going to be, which, as you know, our peers don't do until they announce Q4 in February, so we need to make an earlier call on that and we're comfortable that we're going to be able to do that in December as we promised.

Rob Stevenson
Okay. Thanks, guys.

Ramin Kamfar
Thank you.

Operator
The next question will come from Craig Kucera of B. Riley FBR. Please go ahead.

Craig Kucera
Hey, good morning, guys. I would like to circle to the Whetstone asset which looks like it's still on accrual. I know that you guys had anticipated operations would improve there. How are things going at that asset, and how are you feeling about the market right now?

Christopher Vohs
Sure. Hi, Craig. The market obviously still continues to be impacted. That little micro market of Durham continues to be impacted by immediate supply in the submarket. I will tell you operationally at the asset, we are starting to see the right trend versus the last couple quarters, but it's going to take some work to kind of work through the supply — the immediate supply in that submarket over the coming quarters. But obviously —

Craig Kucera
But obviously —

Ramin Kamfar
Hi, Craig, it's Ramin. But, obviously, that's the benefit of the preferred, which you're not dependent on — if you're off proforma because of market issues or anything unexpected, you know, the preferred provides some protection there.

Craig Kucera
You don't anticipate selling the asset, then, to recoup your investment, or do you think it will eventually improve operations to begin cash flowing?

Ramin Kamfar
I think we absolutely think that the market will improve, certainly throughout '18 into '19, and we're not looking to sell the asset in '18.

Craig Kucera
Okay. You reclassed a couple things out of NOI, I think tenant reimbursements — or, I'm sorry, utility reimbursements and property management fees. What was the thought process there, and should we expect that going forward?

Ramin Kamfar
The answer is that, yes, you should expect it going forward. In terms of utility reimbursements, the accountants came to us and said that they need to be classified as revenues as opposed to the expenses, based on a series of tests that you have to go through that tells you whether you're a principal as a REIT or an agent, and Chris can go through it in detail with you if you'd like to walk through those tests, but that's a direction from the accountants, and that's what you'll see in our numbers going forward. It does have an impact, obviously, of reducing our margins a bit, just because of the way the numerator and the denominator work.

We broke out property management fees, because when we looked at what our peers were doing, we felt that that was a more comparable way to represent the numbers and provided a better sense to people of what our true operating margins are, and, yeah, so you should expect that going forward also. It's all done — so the first one was done because of accounting guidance, and the second one was done to provide additional clarity and visibility and transparency to the investors.

Craig Kucera
Okay. You had some weather related losses you expensed during the quarter. Can you give us some color on what — on why that was expensed?

Ramin Kanfar
Chris, do you want to take that?

Christopher Vohs
Sure, yes. So we incurred approximately $925,000 in damages across eight properties, and one of the properties reached our insurance claim limitation, which was about $250,000, and that was our Gulfshore property in Naples, which took a direct hit from Irma. And so those are our expected losses on those specific properties, less our expected amount from the insurance proceeds.

Craig Kucera
Okay. Thanks. I'll jump back in the queue.

Operator
And the next question will come from Paul Penney of Northland Securities. Please go ahead.

Greg - Northland Securities
Hi, guys, this is Greg on for Paul. Thanks for taking my questions. First, how many employees will be in the REIT post-internalization, and are there any areas that you expect will need additional personnel?

Ramin Kamfar
I think the number is around 40. I think that there is — you know, so you've got — I think the team is pretty fully staffed there. There is an administrative support agreement with Bluerock that provides some non-core functions, such as investor relations and marketing and human resources and so on and so forth that is more cost efficient for us at our size to source from Bluerock than it is to have inhouse. We're just not big enough to have an HR team, for example. But the contract is cancellable at our option. It's renewable at our option, and the idea is that as we get bigger and it becomes cost efficient to bring it in house, we'll do that, which should happen as we continue on our normal growth path and/or if we find a cheaper vendor — we're getting these services at cost and we're not tied into the contract. If we get the services from another third party at a cheaper price, we have the flexibility to switch over.

Greg - Northland Securities
Makes sense. Thanks. And then, secondly, I know you've talked a little bit about the damages from hurricanes, but I was wondering, are there any intermediate term supply and demand dynamics that you expect to benefit from in the Houston and Florida markets following the hurricanes?

Ramin Kamfar
Well, I think Houston, you probably heard it from Camden and others, what's happened in Houston is that a lot of stock got taken out, and the overhang that we had in that market that we expected is going to take a year or two to eat through, got basically eaten through by the hurricane, so, as Ryan mentioned in response to an earlier question, the leases that — we took 100 leases immediately after the hurricane, which ramped up our average for a month number. That rate has obviously slowed down, but now post-hurricane leasing, the concessions have gone away, and we had up to a couple of months of concessions beforehand.

And I think our property is more valuable today in Houston. Our properties are more valuable in Houston than they are pre-hurricane, and we saw the same thing across our markets in Florida, where supplies tightened up, and you're going to see it in higher occupancy numbers and in — over time in high rental numbers and in higher property values. Anecdotally, I can tell you that people who were — we know of cases where sellers had their property out to market, had accepted or were close to accepting an offer, and they pulled their property off with a view that they're going to remarket it, take it back to market at a higher price post-Irma. So on that front, it's been a — notwithstanding, obviously, all of the horrible suffering that the hurricanes caused from a property value and performance point of view, the impact for us has been positive.

Greg - Northland Securities
Got it. Thank you.

Operator
And once again, if you would like to ask a question, please press star, then 1. And we'll pause just a moment for any additional questions.

And we do have a follow-up question from Paul Penney of Northland Securities. Please go ahead.

Greg - Northland Securities
Yeah, just one more thing that came to mind. I noticed Consensus had Q4 AFFO of 14 cents, a little bit higher than the guide, and I was wondering, what do you think is the main cause for the difference that the Street's maybe not modeling in?

Ramin Kamfar
I think the Street may not be — we've had a delta between our guidance and what we actually report, because the Board has been giving us our management fee and LTIPs, and that difference has been about 10 to 11 cents per share. Now, that LTIP, the ability to pay us in LTIPs goes away after the internalization, so you're going to see that for about a month. I would think that's probably about 3 cents a share in Q4, but you're not going to see the rest of that impact, so that may be one of the things that is changing the delta, because if historically you look at our guidance and what we've reported, we've been not only at the top end or exceeding the guidance organically, but we've had a 10 to 11 cent delta on top of it.

So I'm guessing that that's the issue, but it also has to do with the fact, Greg, that we've had a couple of noisy quarters. In Q2 we had a number of asset sales. We've had costs related to the internalization, we've had costs related this quarter to the hurricane, and next quarter you're going to see again internalization costs and we're continuing to deploy the cash that we have, so our goal is — this has been — the internalization has been a big milestone for us. We're happy to have that behind us. The line of credit is another — although we didn't emphasize it or talk about it on this call, is another big milestone for us that's going to help us be a lot more efficient in terms of cash management.

So our goal going into 2018 is to have a lot less noise and be a lot more fully invested, so people can really get a good sense of the tremendous portfolio that we've built and we're continuing to build and the value that we're creating at the property level and let that come through and put all this noise behind us.

Greg - Northland Securities
Understood. Thanks again.

Ramin Kamfar
Thank you, good question.

Operator
Thank you. And in showing no additional questions at this time, we will conclude the question-and-answer session. I would like to hand the conference back over to Ramin Kamfar for his closing remarks.

CONCLUSION

Ramin Kamfar
Thank you, Operator. As I said, it's been a couple of noisy quarters. We've had some big milestones, we've been working on the internalization for a year as of today, actually. We're

happy to put that behind us and bring the team in house and look forward to continuing to build a first-class portfolio delivering shareholder value, build a first-class team, increase our equity sponsorship, and deliver great shareholder — great returns to our shareholders. Thank you, everyone, for your support. Look forward to reporting on our continuing progress to you in the coming quarters.

Operator
Thank you, sir. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. At this time, you may disconnect your lines.