Bluerock Residential Growth REIT, Inc.

First Quarter 2019 Earnings

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CORPORATE PARTICIPANTS

Christopher Vohs – *Chief Financial Officer*

Ramin Kamfar – *Chairman and CEO*

Ryan MacDonald – *Chief Acquisitions Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and welcome to the Bluerock Residential Growth REIT's First Quarter 2019 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 Financial Officer of Bluerock Residential. Mr. Vohs, please go ahead.

Christopher Vohs
Thank you, and welcome to Bluerock Residential Growth REIT's first quarter 2019 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 later this week.

Following the conclusion of our prepared 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 Reform 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, please refer to our earnings supplement for reconciliation to GAAP, the reason the management uses these non-GAAP measures and the assumptions used with respect to our earnings guidance.

And with that, I will 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 key members of our executive team, including 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 strategic accomplishments and financial highlights from the quarter and close with some capital markets commentary. Afterwards Ryan will provide you operational, transactional and balance sheet details.

We delivered a strong first quarter, demonstrating accomplishments across each of our strategic initiatives, including achieving operational outperformance, value-add renovations and accretive external growth. Building on the momentum from last year where we reported industry-leading NOI growth, we began this year in a similarly strong way. With industry-leading same-store revenue growth of 5.8% and same-store NOI growth of 9% over the prior year quarter, we are continuing to prove out our investment thesis of investing in highly amenitized multi-family assets in knowledge economy growth markets. We continue to source attractive growth opportunities through a combination of operating and development investments, and also continue to unlock the embedded value in our portfolio, as we executed on our renovation program.

We have to start with our GAAP net loss to common, which was $0.53 a share for the quarter as compared to a net loss of $0.40 a share for the prior year quarter, but I will note that the figures include non-cash items, including depreciation and amortization expense, of $0.74 and $0.59 per share for the current and prior year quarter periods respectively.

On the revenue front, we produced a healthy 23% growth in the first quarter to $51.5 million from $41.9 million in the prior year period, which reflects our significant investment activity throughout the year along with strong same-store performance.

Moving on to property level results, we grew property NOI 29% to $27.1 million in the quarter from $21 million in the prior year period. Same-store revenue and NOI grew a very strong 5.8% and 9%, respectively, for the quarter versus the prior year period, while we kept a tight control on cost resulting in 180 basis points of margin expansion. Ryan is going to provide you with additional detail in his remarks.

On the funds from operations front, during the first quarter we achieved core FFO of $0.20 per share, which was flat compared to $0.20 per share in the prior year quarter, due to an unfavorable interest expense comp, which we have in the first half of 2018. Core FFO is simply NAREIT FFO with the add back of non-cash non-operating items and we believe it is the most representative measure of our operating performance. We also delivered strong dividend coverage with a payout ratio of 81% of core FFO in the quarter.

Shifting to capital allocation during the quarter, we repurchased common stock totaling $5.1 million at an average price of $10.01, which represents a significant discount to our estimates of NAV. We view buybacks as an important piece of the capital allocation decision-making process and will look to utilize it on a measured basis over time.

We continue to grow our asset base. Gross assets were up 14% for the quarter from the prior year period to over $2 billion. During the quarter, we also invested approximately $16 million in BRG equity across two investments, which Ryan will provide additional detail on.

Moving to capital markets. During the first quarter, we raised $44 million through sales of our Series B preferred stock. The Series B has a unique advantage for BRG because it allows us to grow accretively decoupled from the cyclicality of REIT equity pricing. So, in a market like 2018, where we had accelerating interest rates and many REITs, including BRG, traded at significant discounts, we were able to raise Series B capital on growth with conversion into common at a more favorable part of the REIT equity pricing cycle at a future date at the future price. We expect that first quarter Series B raise will be reflective of a baseline quarterly run rate for the year.

Finally, as we look ahead, we believe we are uniquely positioned with multiple growth levers to continue delivering shareholder value.

- First, we believe our market selection in terms of picking the right knowledge economy growth markets and our asset selection in terms of assembling the right well-located highly amenitized live/work/play communities will allow us to deliver strong organic growth as seen in our industry-leading same-store revenue and NOI growth this quarter.

- Second, we continue to anticipate being able to enhance the solid organic growth through our value-add upgrade program, which is delivering very attractive returns. From inception to date, we have renovated over 1,900 units at an average ROI of 26%. Our future identified renovation pipeline exceeds 4,500 units and that alone could grow our NAV by multiple dollars.

- Third, we continue to find accretive external growth through our issuance of unique Series B preferred and through sourcing attractive acquisitions with upside potential through our Bluerock network. We currently have a robust pipeline of accretive value creating opportunities and look forward to reporting on them in future quarters.

- And fourth, we will continue to review stock buybacks as an additional method of capital allocation in periods where we believe the stock is attractive relative to the underlying NAV of the company.

Last but not the least, we are excited about the year ahead and look forward to delivering against our guidance and growing NAV for our shareholders of which management is the largest at approximately 27% ownership in the underlying equity of BRG on a fully-diluted basis. With that, I'd like to turn the call over to Ryan. Ryan?

Ryan MacDonald
Thank you, Ramin. Good morning everyone.

The operating portfolio began the year posting top quartile growth with strong gains across the majority of our assets. The growth continues to be broad-based across the majority of our markets and includes sustained outperformance in our Florida market and reaccelerating top line growth in our Texas and Carolina assets.

Portfolio-wide, across BRG's assets, average occupancy held strong in the first quarter of 2019 at 93.9%, which compared favourably to the first quarter of last year at 93.5%.

Overall, same-store revenue increased a robust 5.8% over the prior year period driven by a 5.3% increase in average rental rates and a 40-basis point increase in occupancy. 27 of the 28 properties in the pool recognized increases in average rental rates in the quarter versus the prior year period and the rent outperformance for the quarter was evenly distributed with 10 of our 15 MSAs achieving year-over-year rent growth exceeding 4%. During a typically slower part of this leasing calendar, we were able to continue to aggressively push rental rates. Lease rate growth averaged 4.6% in the quarter, with renewals and new leases achieving 5.1% and 4.1% respectively and we continued with the strong momentum into the second quarter. April preliminary lease rates are running 5.2% for renewals and 3.9% for new leases for blended rate of 4.5%.

On the expense front, same-store expenses increased 1.4% with taxes accounting for the largest increase offset by a variety of savings, including payroll and utilities. Same-store NOI for the quarter increased 9% on a year-over-year basis, and while we expect to be above trend in the coming quarters, we are projecting it to moderate from the 9% level as expense growth normalizes.

On a sequential quarter-over-quarter basis, same-store revenue was up 0.4% over the prior year period of which average rental rates contributed a positive 1.1% and occupancy declined 60 basis points off a strong fourth quarter number. Driving rate growth continues to be a significant focus for us and we continued to execute that strategy in a more seasonally weaker part of the year.

On the operational margin front, we expanded our year-over-year margins by approximately 200 basis points to 59.3%, due primarily to increases in same-store revenue and new acquisition mix and that was slightly offset by tax increases projected for 2019.

We continue to be pleased with our value-add renovation program, which has delivered healthy results – to date through the first quarter of 2019, across the existing portfolio, we have completed north of 1,900 interior unit renovations at an average cost of approximately $4,900 per unit and have yielded monthly increases of $108 per month, resulting in a weighted average ROI of 26%. Excluding new acquisitions, we estimate there are over 4,500 units remaining to be renovated in the portfolio with comparable economics, which would be accretive to our FFO and NAV.

In terms of some brief market commentary, our top three markets by operating property concentration, Orlando, Atlanta and Houston, all performed well throughout the quarter. During the first quarter, our Florida Space Coast assets in Port St. Lucie and Daytona led the way for the second straight quarter, achieving average lease rate growth of 8%. These assets continue to field strong demand with limited supply. Atlanta and Austin followed with total lease growth in the 6% range. Austin in particular and more specifically on the south side of town where our operating portfolio is concentrated, continues to show signs of strengthening as supply in the area continues to moderate. The Carolinas showed broad-based improvement in the quarter, posting 4% average rate growth, and Houston and Orlando posted 4% and 3% rate growth, respectively.

Moving briefly to our development commitments - as of the end of the year, the total BRG investment in development and preferred equity and mezzanine loans stood at $268 million across 15 projects. Of the 15 projects, 10 are currently in lease-up or stabilized and we look forward to reporting on their progress in future quarters.

Moving to the investment side of the business, during the quarter we invested $16 million across two investments. The first was an $8 million purchase of our partner's minority interest in the Arium Pine Lakes which allows us to further increase our wholly owned asset base. The second was a $9 million senior and mezzanine loan investment for a highly attractive development investment opportunity in the core of Chapel Hill, North Carolina. The loan is earning 10% annually and we anticipate it will increase in the latter part of the year as additional capital is required to execute the development business plan.

Turning to the balance sheet, as of the end of April, BRG had approximately $64 million available for investment through a combination of cash and availability on our revolving credit facilities. Plus, we continue to grow our capacity through our Series B preferred offering which reaccelerated to our target run rate during the first quarter. And as of today, 98% of our total secured debt balance is fixed or hedged at 2.5% LIBOR for the next two to three years.

Before handing the call back to Ramin, I want to reiterate that our portfolio continues to perform very well, producing top quartile operational results on a consistent basis. Additionally, utilizing our network approach, the pipeline of investment opportunities continues to be extremely robust and we look forward to reporting on significant activity in the next few quarters. Finally, we are reaffirming our guidance that we provided on our year-end call.

And with that let me hand the call back to Ramin before we open it up to Q&A. Ramin?

Ramin Kamfar
Thank you, Ryan.

That is the end of our prepared remarks, so we are happy to open it up for 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 (1) 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 (2). Once again that is star (*) then one (1) to ask a question. At this time, we will pause momentarily to assemble our roster.

The first question comes from Gaurav Mehta with National Securities. Please go ahead.

Gaurav Mehta
Thanks. Good morning. Couple of quick questions. First on the transaction market. I was hoping, if you could comment on which markets you are seeing opportunities to acquire assets and when should we expect you may sell assets in 2019?

Ryan MacDonald
Sure. Good morning. So, I think the markets are consistent with what we have talked about in the past. Florida continues to be a target MSA state for us, Orlando, Jacksonville, Tampa, Denver. We have also targeted reentry into Nashville if the right opportunity presents itself. We have also targeted Las Vegas. We think the job growth in Las Vegas is extremely robust and the cap rates are attractive relative to some of the other West Coast markets.

Gaurav Mehta
Okay. As a follow-up. Could you also comment on how you are underwriting acquisitions in 2019 versus how you approached acquisitions last year? Has there been any changes as to your underwriting metrics for this year?

Ryan MacDonald
No. I think the acquisition market for us has been pretty consistent year-over-year. As you recall, we source our deals differently than I think traditionally other REITs do. We have a network of partners that brings us a robust amount of opportunities that we are able to sift through, and so I think from a pricing metric standpoint, it is consistent with what we have delivered in the past, and I think the opportunity set will continue to be focused on that value-add renovation opportunity where we can drive NAV and NOI growth.

Gaurav Mehta
Okay. And lastly, I think in your prepared remarks, you talked about supply moderating in Austin. Are there any other markets where you expect supply to moderate in 2019 and any markets where you expect supply may increase in 2019?

Ryan MacDonald
Sure. I think, Dallas continues to be a market that certainly has experienced a lot of job growth but continues to be fairly supplied. Charlotte is a market that we see supply moderating throughout 2019. We have been pleasantly surprised with the employment growth there and the demand side of the equation. Again, Orlando continues to be in balance. Nashville is a market that I think downtown has experienced significant supply over the last couple of years and one of the reasons we have not necessarily focused on that market, but we have been able to see some supply

weighing certainly in the suburbs and I think there are potentially some opportunities in the suburbs of Nashville.

Gaurav Mehta
Okay. Thank you for taking my questions.

Operator
The next question comes from Jim Lykins with D.A. Davidson. Please go ahead.

Jim Lykins
Hey, good morning guys. First a couple things on your upgrades. You are getting some great returns, but I am wondering, costs were up about 14% sequentially, so is that more of a one-time thing this quarter? Or how should we be thinking about costs for the remainder of 2019? How do you see that trending?

Ryan MacDonald
Good morning Jim. I think we had anticipated costs going up for 2019, which really was a function of the level of upgrade we were doing, or we were anticipating doing throughout the year. I think we had anticipated a budget for the year of about $6,500 per unit. This quarter came in at about $5,500 per unit on average for the renovations. So, obviously that cadence will change quarter-to-quarter depending on which units and which properties get upgraded, but I think the uptick in year-over-year cost was consistent with what we projected. Now the commensurate rent premium we were able to get on that higher renovation cost is consistent with the higher cost per renovation as well.

Ramin Kamfar
Jim – this is Ramin – just so you know we don't have a standard upgrade package that we will have across the portfolio. Each property is effectively a custom program that is bespoke to that property, and when we buy a property, we basically benchmark it against, if it is a 10-year-old property that has to have the right bones, you cannot change the bones of the building, but maybe the amenities need to be upgraded, expanded. The bones have to be there, but you may need to update and expand the club house, you need to upgrade the pool area, and do upgrades on the unit. So, what we will do is we will map out three levels of upgrades. There is the middle of the road, then there is a lighter one, then there is a heavier one, each of them at a different price point depending on how much headroom we have. If we have got $400 box to the brand-new top-of-the-line luxury property, we will have three upgrades, one for $100 improvement in rent, one for $175, one for $250, and that costs more as the rent premium goes up, and then we will test it out and we will see where we are getting resistance. Obviously, we would like to get the $250 because this is a great return on investment. So, if we can do that, then that will push our cost up, but the return is commensurate with those costs and if we cannot get that, then we will do the moderate one or the light one. So, the numbers will move around. The thing to look out is our metric and whether we are getting our metric return and I think we are above that year-to-date.

Jim Lykins
Okay. That is all very helpful and switching gears a little bit. In your guidance, you have got $200 million to $400 million dispositions. Is there anything you can tell us about timing? How should we be baking that into our models?

Ramin Kamfar
Sure. I think during our last quarter's call we talked about the cadence of those dispositions

probably being backloaded in the latter part of the year. So, I think that is still consistent with our projections at the beginning of the year.

Jim Lykins
Okay, and one last one for me. One line item in FFO that was not in my model, what was that shareholder activism $338,000. Is that something that could bleed into 2Q as well?

Ramin Kamfar
That was related. As you know we had an activist that approached us Q4 of last year and they filed a 13D in Q4 and then another one in Q1 with a letter that I am sure everyone saw, and obviously when stuff like that happens, you need to have – the Board gets very active with our Board. They are fully engaged, and you need to have advisers and all of that unfortunately costs money. So, that is what you see in terms of the shareholder activism. We have broken it out, so people can see it, so that they do not think it is part of our operating expense or regular G&A. Could it bleed into Q2? I think there will be some costs in Q2 but it all depends on how things develop.

Jim Lykins
Okay. Thanks, Ramin.

Ramin Kamfar
Thank you.

Operator
The next question comes from Drew Babin with Baird. Please go ahead.

Drew Babin
Hey good morning. Quick question on the value-add. In the press release, all the math on the historical ROI CapEx makes sense, the 26.3% ROI. Was the 26.3% rent premium achieved in the first quarter? Is that an ROI or a rent premium? I am just curious what the actual rent premium was?

Ryan MacDonald
It is an ROI Drew. We can get to the actual rent premium offline.

Drew Babin
Okay. Thanks for clarifying that and I guess a broader based question. You know, obviously, last quarter, when guidance was provided with the dispositions, I think I asked the question does that imply leverage might substantially come down and I think the answer was no probably not, there will be more acquisitions, and with those acquisitions, activity was later in the first quarter. Was that sort of as expected? Do you expect that the acquisitions you talked about last quarter will be significantly backloaded similarly to the dispositions? Is that still the assumption?

Ryan MacDonald
I think the cadence is still in line with our projections. I think typically the first quarter is a typically slower part of the calendar for transaction volume historically for most people but based on our pipeline and available opportunities that we have or see, I think that you will see that ramp up quite significantly in the coming quarters.

Drew Babin
Okay, thanks for that and one last one for me. Just on the topic of cost of equity. It looks like

during the quarter the price that you bought back stock was about 6.5 dividend yield, which is about where you issued the Series B, and obviously cost of common equity has other things bolted to it rather than a straight 6.5. So, I guess I am curious on the other hand. What sort of equity yield or however else you might think about it, where might it make sense to maybe substitute common for the Series B and/or convert some of the Series B as we go forward?

Ramin Kamfar
Drew, I think that is a very good question, and I think it is something that we evaluate continuously. Obviously, we would love to issue common as opposed to issuing Series B because I think when you look at where we are today at about $340 million in common market cap, and you look at where RMZ starts to include companies, I think our last three peers got included in the multifamily space and got included at about $400 million. So, we would love to hit that target and get on the RMZ, because again if you look at the last three, they were up somewhere between 25% and 50% on that alone given what is going on with passives and index funds driving valuations these days. So, I do not have a number to give you today because that is really a board level decision. Obviously, the stock has performed very well over the last 12 months where total TSR has been 35% to 45% depending on what the start date is, and we have nice upward momentum. I think we have closed a significant part of our thesis that we did the internalization on the dividend reset. We have had a big retail base, they basically threw out the stock based on the dividend reset primarily and our stock went from $13 down to $7-ish this time last year, maybe 14 months ago or something, but that there is not a lot of this excess – and unfortunately we are not big enough to have Fidelity and Cohen & Steers sitting there with a catcher's mitt saying, hey these guys are a bargain. So, it has been work to eat up into that excess stock. We have done non-deal road shows, tried to build up our institutional base. We have delivered on the numbers and exceeded them last year, and we have also had the buyback slowly. It is not a significant amount, but it is slowly eating up the excess supply and our thesis was that we just need to wait out 2018 where you are in a period where you have got rising rates and all REITs, all equity REITs, are under pressure, including ours, us more than others. And then, as we get to 2019, and the Fed stops raising rates, the equity REITs will trade better and we should trade much better because we will eat through this excess supply out in the market and we will have delivered –clean results, post internalization and at some point, particularly as we get into later 2019 and we are going into our house views that we are going into a slowdown sometime late 2019-2020, and the Fed is going to start cutting rates, that is going to be even more attractive for the REIT market.

So, it has played out in terms of the front part of our thesis. Our stock has done well. We are happy with that. We are still not happy with the level of the discount, but as we get closer to some intrinsic value, I think you will see both of those. We are going to look to expand – there are three ways for us to get from $340 million to $400 million and get on RMZ, it is $2 a share in stock price, that is one way. It is issuing additional common equity, that has got to be at the right price, and its conversion of the Series B preferred and that is like issuing common equity and that has to be at the right price. But what the B did for us last year, we raised $120-ish millions of it, when we were trading part of the year at $7 and $8 a share and continued to grow and you will see the results of it as we put out numbers this year and now we have an opportunity, if we converted it today, it is at $11.50. Hopefully, we will get to convert as we continue to grow NAV where that conversion price goes up. So, the answer to all of that is yes. We want to build our equity base and that is one of the ways where going back to your prior comment you mentioned in terms of delevering, it comes from the conversion of that equity and the potential issuance of additional equity. But again, it all has to be at the right price, because we are still a significant – there is a published NAV out there. Our internal estimate of NAV is significantly higher than that. I think you will see a print from us some time later this year that will kind of bring that into more clarity and we want to be kind of protective in terms of the value for shareholders.

Drew Babin
All right. That's great color. Thanks, Ramin.

Ramin Kamfar
Thank you, Drew.

Operator
Again, if you have a question, please press star (*) then one (1). This concludes our question-and-answer session. I would like to turn the conference back over to Ramin Kamar for any closing remarks.

CONCLUSION

Ramin Kamfar
Thank you, operator. It is Kamfar by the way not Kamar, but – just so there is no confusion on the line. I want to thank everyone for giving us their time today. Thank you for your support, and we look forward to continuing to report to you on our progress in the coming quarters. Goodbye.

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