Bluerock Residential Growth REIT, Inc.

Q1 2021 Earnings Conference Call

Monday, May 10, 2021, 11:00 A.M. Eastern

CORPORATE PARTICIPANTS

Ramin Kamfar – *Chairman and Chief Executive Officer*

Christopher Vohs – *Chief Financial Officer*

Ryan MacDonald – *Chief Investment Officer*

Jordan Ruddy, *President and Chief Operating Officer*

Jim Babb, *Chief Strategy Officer*

Mike DiFranco – *Executive Vice President-Operations*

Steven Siptrott – *Managing Director and Head of Transactions*

PRESENTATION

Operator
Good morning ladies and gentlemen, and welcome to the Bluerock Residential Growth REIT's First Quarter 2021 Earnings Conference Call. All participants will be in a listen-only mode. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on a touchtone phone. To withdraw your question, please press star (*) then two (2). 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 2021 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 Investors tab. In addition, we anticipate filing our 10-Q later today.

Following our remarks, we'll be pleased to answer any questions you may have. Before we begin, please note that this call may contain forward-looking statements as they are defined under the Private Securities Litigation Reform Act of 1995. There are 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 a reconciliation to GAAP, and the reasons management uses these non-GAAP measures and the assumptions used with respect to our earnings guidance.

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

Ramin Kamfar

Thank you, Chris, and good morning everyone.

In addition to Chris, with me today are several key members of our executive team, including Jordan Ruddy, our President and Chief Operating Officer; Ryan MacDonald, our Chief Investment Officer; and Jim Babb, our Chief Strategy Officer.

I'm also pleased to introduce to you two additional Bluerock team members who will be participating on these calls going forward: Mike DiFranco, our EVP of Operations who will discuss our operational performance and Steven Siptrott, our Managing Director and Head of Transactions, who will provide transactional commentary.

We are encouraged by the underlying fundamentals in our portfolio as we see the positive impact of the continued rollout of the vaccine, declining COVID rates and an accelerated economic recovery over the coming quarters.

On the operating front, our core strategy, which is fundamentally about having the right Class A affordable first ring suburban assets in the right markets, allowed us to demonstrate resilience throughout the challenges of the COVID pandemic, and is generating top quartile rent growth outperformance as we progress through the recovery. We grew occupancies throughout the pandemic which set the table for robust acceleration of rent growth since the beginning of the year, and we are optimistic these positive trends will continue throughout the busy leasing season. We're also excited about upside from two operating initiatives to enhance our above trend organic rent growth. One is our new smart home technology platform which is in the early stages of being rolled out, and the other is our existing unit renovation program which we slowed down during the pandemic last year but will be reaccelerating this year and we expect will continue to achieve peer leading results.

Moving on to capital markets, during the quarter we began to execute on our stated strategy of expanding our common equity base through redemptions of our preferred stock into our common equity. Our continuous offering of non-traded preferred stock continued to be very robust, with our highest quarterly capital raise since inception and an accelerating trend throughout the quarter. We continue to believe this access to non-traded preferred equity capital is a competitive advantage for Bluerock, allowing us to fund accretive external growth during periods when our stock prices is low or volatile with the flexibility to convert to common equity over time at our option at a future date, when our common stock price is more favorably valued.

As we look ahead, we're confident in being well positioned to capitalize on what we expect to be an economic reacceleration in the back half of 2021 and beyond. Our platform displayed resilience during the depths of the pandemic and our strategy of focusing on a suburban sunbelt knowledge economy footprint continues to position us well to deliver shareholder value throughout the full cycle environment.

I'd like to again note that management continues to be significantly aligned with shareholders through its substantial ownership of BRG's fully diluted equity.

Finally, before handing the call to Ryan, I want to thank all of our employees and partners for their hard work over the last year resulting in our strong operational and balance sheet position which we expect will allow us to capitalize on continuing positive trends in 2021 and beyond.

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

Ryan MacDonald
Thank you, Ramin. Let me echo your last comments, I want to thank our BRG team and property staff for their tremendous efforts over the last 12 months. We couldn't have delivered our solid operating results without them.

Moving on to our results, during the first quarter of 2021, on a GAAP basis, net income to common stockholders was $1.00 per share, compared to a net loss of 70 cents per share in the first quarter of 2020. We achieved 16 cents of core FFO, which is NAREIT FFO with the addback of certain non-cash non-operating items. On a year over year basis, this was down from 22 cents in the prior year quarter and was negatively impacted by 5 cents from a strategic increase in our cash balance through nine opportunistic and accretive dispositions over the last twelve months and a tactical decision to slower our investment cadence during the pandemic.

Operationally, year-over-year, same-store NOI was 60 basis points for the quarter including revenue growth of 2% which was ahead of internal budgeting and was offset by expense increases of 4.4%. Mike will provide additional detail on the same-store numbers but it's important to note that our strong lease trade outs in the beginning of the year have positioned us well against our 2021 annual same-store guidance. As we mentioned last quarter, we expect same store revenue to build throughout the year as we continue to benefit from sequential rental rate growth and anticipated burn off of modest COVID-related bad debt allowances.

Shifting to our quarterly capital markets activity, we raised $98 million of our Series T Preferred during the quarter, which is our highest quarter ever and provides unique access to attractive cost of capital even during the depths of the pandemic when all multifamily REIT stocks were under significant pressure. Also, at the beginning of the year, we restarted calling redemptions of our Series B redeemable preferred equity into our common equity. In total, during the quarter, we redeemed $71 million of Series B preferred for common equity at a per share price of $11.12. This was offset with buybacks of our common stock totaling $41 million, expanding common equity by 2.8 million shares which represents a more than 10% increase in float since the beginning of the year. Subsequent to quarter end, we've continued to expand our float with $43 million in conversions against $13 million in buybacks.

Turning to the balance sheet, during the quarter, BRG made one new preferred equity investment into an operating asset totaling $7 million in equity and additional $21 million was funded during the quarter into existing preferred equity, mezzanine loans and a ground lease. Subsequent to quarter end, we invested $21 million in BRG equity into two transactions, the first being a preferred equity investment into an operating asset single family residential platform yielding 10.5% annually and the second being an opportunistic off-market acquisition in Olympia, Washington. On the disposition front, we continued to be active in the early part of the year selling five assets with gross sales prices totaling $303 million. Those sales netted BRG $102 million in equity proceeds and following quarter end, we completed one additional sale with a gross sale price of $32 million which netted BRG $3 million in proceeds. The six dispositions are being sold at an average in-place economic cap rate of 4.0%, which compares very favorably to third-party NAV estimates approaching the 5% range.

As of the end of April, BRG had approximately $229 million available for investment through a combination of cash and availability on a revolving credit facility, and we expect to reduce this balance throughout the year as we invest capital into our committed pipeline investments totaling north of $120 million in BRG equity and redeem our Series C and D totaling $127 million over time following the expiration of the non-call periods for both Series this year.

With that, I'd like to turn the call over to Mike. Mike?

Mike DiFranco

Thank you, Ryan, and good morning, everyone.

The operating portfolio continued to build strong momentum as the months progressed throughout the quarter, led by continued strength and renewals and a resurgence in new lease rates. We came into the quarter with a strong occupancy base of 95.4% and maintained that strength while building rate sequentially throughout the quarter. During the quarter, we saw our average rate growth for the consolidated portfolio, improve 300 basis points on a sequential quarter-over-quarter basis to positive 3.5%. Rates accelerated aggressively on a sequential month-over-month basis throughout the quarter finishing March at positive 5.8% and continued throughout April finishing the month at 7.7%. Renewals were consistently strong throughout the first quarter but it was new lease rates turning positive in February that really drove the significant acceleration in average growth on a sequential month-over-month basis. From a market perspective, the out-performance was broad-based with 11 of our 17 MSAs at or above 3.5% rate growth for the quarter and six MSAs posting growth exceeding 6% on average. Additionally, with strong occupancy and availability close to 96% and 7%, respectively at the end of the quarter, we are well positioned going into the summer leasing season.

Moving on to our quarterly results, our 2% year-over-year increase in same store revenue was driven by a 1.2% expansion in occupancy and a 1.0% improvement in rental rates, however, this was partially offset by approximately $300,000 in collection loss due to the impact of COVID-19. For the quarter, 13 of our 15 same-store MSAs posted positive revenue growth with almost 50% of our MSAs exceeding 3%.

Collectively, our Sunbelt knowledge economy market suburban footprint continues to outperform our urban and coastal-focused peers as we continue to benefit from positive migration trends, affordable rent levels and outsized employment growth.

On the expense front, year-over-year same-store expenses increased 4.4% for the quarter with taxes and insurance together accounting for approximately 70% of the increase. Controllable expenses were up 2.3% and included additional expense for the adoption of our Smart Home technology package roll out. We do project a corresponding revenue increase over the next twelve months as we expect to capture additional fee income with each lease rollover. As we've communicated in prior quarters, utilizing technology to drive both topline revenue growth and controllable expense savings is a strategic area of focus, and we expect to see the continuing benefit of that investment in our results.

Finally, on the value-add front, during the quarter, we took a more conservative posture in view of COVID-19 and a seasonally weaker part of the calendar, however we continue to deliver significantly above trend returns with 72 units completed at an average ROI of 24%. We anticipate that the number of renovations will accelerate as we move throughout the year and feel comfortable increasing the range of our previously established guidance range.

And with that, I will now turn it over to Steven Siptrott. Steven?

Steven Siptrott
Thank you, Mike. In terms of capital allocation, we continue to be active on the disposition and reinvestment front as we seek to strategically recycle capital into assets and markets with a higher growth profile on a go-forward basis. While our new investment activity in the quarter was light, we have a robust pipeline of accretive opportunities in due diligence totaling north of $120 million in BRG equity that we expect to close and fund in the back half of the year.

In terms of dispositions, our six accretive dispositions were executed at an economic cap rate of 4% based on $300 per unit replacement reserves and the buyer's year one tax estimates. The recent dispositions allowed for us to exit non-core markets, including Tyler, Texas, and Lake Jackson, Texas, while reinvesting the capital into markets such as Raleigh, Phoenix, and Austin. Post disposition and reinvestment, Atlanta and Phoenix now represent our two largest operating portfolio markets by concentration, with approximately 30% share by unit count. Given the robust bid for our assets and markets, we expect to execute opportunistic dispositions throughout the remainder of the year that will be accretive both on an NAV and earnings basis.

With respect to new investment pipeline, we continue to generate relationship and off market opportunities at cap rates that are more attractive than fully marketed deals. From a portfolio allocation standpoint, we will continue to invest in both operating assets with substantial NOI upside potential and preferred equity investments that offer stable and attractive risk-adjusted returns. To conclude, we continue to focus on core markets such as Raleigh, Phoenix, Austin, Atlanta, to name a few, all of which display tremendous demand side tailwinds that we believe will drive relative rental rate growth outperformance.

With that, I will hand it back to Ramin. Ramin?

Ramin Kamfar
Thank you, Steven - I want to reiterate that we are very encouraged by our early year rental rate growth numbers and we expect them to continue right through the busy part of the leasing season at least, and that with run rate earnings upside potential from the favorable underlying secular market trends, given our positioning and our attractive footprint, along with capital and reinvestment opportunities from the opportunistic dispositions that we're doing, we're quite optimistic about our growth profile in the coming years.

With that, we'll 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 (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). At this time, we will pause momentarily to assemble our roster.

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

Gaurav Mehta
Thanks. Good morning. First question on the investment activities that you are expecting, you talked about $120 million in commitment in BRG equity is providing, I was wondering if you could provide some more color on what kind of pricing and cap rates you're expecting on that capital that you're planning to deploy?

Ryan MacDonald
Sure. Good afternoon, Gaurav. It's Ryan here. So that $120 million is really bifurcated between about $75 million of it is preferred equity and investible capital with a cost or rate around 12.5% on that piece, and then on the operating investments, which represents called another $45 million, the average cap rates actually north of almost 4.5 on those two deals. One is a loan assumption from a seller that we bought from last year off market deal, and then one is actually a buyout of an existing preferred equity investment that we made a couple of years ago. So a good attractive cap rates on the operating deals and then a very healthy interest rates on the preferred equity.

Gaurav Mehta
Okay. Second question on your preferred equity investment that you made in April in single family housing. Can you really talk about why you guys decided to invest in a single family housing platform to preferred equity investment? And we expect more of that going forward?

Ryan MacDonald
Sure. Again, Gaurav, its Ryan here. So a couple of things. One is we certainly believe that scattered home single family residential is a natural extension of the multifamily business, and so we've had success with some of our three-bedroom townhome investments, and we found an opportunity here with an operator and a portfolio that we thought made sense to recap, at least from a preferred equity perspective. So it's no different the underwriting than some of the other preferred equity deals we've done. The assets here are primarily in Texas. We know the markets well and then the cost of capital and the detachment point of around 80% LTV again, good credit underwriting. So, we thought it made sense to dip our toes in the water. Obviously, the single family residential space is having a pretty attractive growth profile, and I wouldn't be surprised to see us do a few more investments like this within our preferred equity platform going forward.

Gaurav Mehta
Okay, and lastly on your Series B redemption and you guys did $70 million of Series B redemption in 1Q. Do you expect that kind of run rate going forward? And then secondly, you issued common shares for redeem that $11.12 and had a common share pricing much lower than that. Are you still using common shares to redeem what you did in April? Or are you guys using cash to redeem for now?

Ramin Kamfar
I think, hi Gaurav. It’s Ramin. As you know, we're – we've got a number of the strategic plan with a preferred has been to – it has been to use it to grow when we have periods like last year where our stock price was significantly below $9 or $11 for most of the year, and then to redeem it as a stock price becomes more attractive, because and the reason for that is over time, we need to get – one of the feedback that we've gotten from our analysts such as yourself and from an institutional investor is what do you plan to do with the outstanding preferred.

Well, you saw us redeem the Series A, you'll see us redeem the Series C and D over time, and those are all cash redemptions. The Series B will be a combination of stock and cash redemptions, depending on where the stock price is. If it's attractive or it's not, and we have the flexibility and we have the plan to use both of those. So we can't time it – we can't price it exactly, because you give a redemption notice out several weeks in advance, especially as you're going through the quiet period and so on and so forth, but we're very fully aware of potential pressure on the stock as we do redemption, but we also have eye on the goal, which is to get into RMZ inclusion we’re short by a very small dollar amount on a percentage basis in terms of our market cap.

I think we're close to the inclusion before COVID hit, and so the goal is to expand our equity base to be able to get on the RMZ that expands our institutional ownership, provides additional demand for the stock. It provides additional support for the stock and allows us to provide and makes the redemptions much more efficient. So it's a balancing act.

We are aware that we're not looking to just – we're not looking to step on the stock by, on the common by just redeeming large amounts of the B, it's a balance between the stock price and reducing and getting on the RMZ through expanding our float, and so we want to be very thoughtful and measured with that. You also know – you also, I'm sure, have seen that we have a buyback in the market that provides support for the stock. So, I wouldn't be surprised if you saw us redeem part of the B in cash. I wouldn't be surprised if we take a break from redeeming the B to allow the stock – the common to absorb and recover. We own north of 30% of the equity -- common equity here as management. So we're very sensitive to the stock price, making sure that we deliver value for the shareholders, but we think over time getting on the RMZ and reducing our leverage, our perceived leverage, including the preferred will be significantly accretive for us in terms of expanding our multiple.

Gaurav Mehta
Okay, thank you. That's all I had.

Operator
As a reminder if you have a question, please press star (*) then one (1) to be joined into the queue.

The next question comes from Craig Kucera with B. Riley Securities. Please go ahead.

Craig Kucera
Hey, good morning guys. I just want to follow up on the single-family preferred investment. Are the returns comparable to you for that relative to multifamily?

Ryan MacDonald
Craig it's Ryan again. Yes, they are. I think it was a 10.5% rate, but in part, because a little bit lower than maybe some of our development deals, which are in the 12% to 14% range, but the detachment point A was an operating portfolio, and then B the detachment point was a little bit lower. So, from a credit underwriting standpoint, yes, the returns are generally similar for that mezzanine and pref book on single-family.

Craig Kucera
Got it, and I may have missed this, but is it structured such that you have an option to buy the portfolio at some point, are you really looking to primarily keep that investment as a source of interest income?

Ryan MacDonald
We don't have an option to buy this portfolio. We really looked at it as a credit investment, but, I think, it does a couple of things for us, it helps get us educated on the space and the more data we have, obviously the better we can be as we look at other opportunities, so.

Craig Kucera
Got it. So that makes sense. More of a housekeeping item. What is the game plan for the mortgage at District at Scottsdale? I think it matures in about a month, and I know you've got cash, and you've got line of credit capacity, but just some color there on what you're thinking of doing there.

Ryan MacDonald
Sure. What I will say without saying it is that Phoenix has an extremely attractive bid. If you recall, we bought that deal as a lease up deal, we thought way below market, and we believe that there will be ultimately an attractive opportunity to potentially recycle that capital at significantly higher returns in the near future. So that's plan A. If for some odd reason that that doesn't go through as planned, we have an ability and actually have an extension from our lender at basically no cost to take us through next year.

Craig Kucera

Got it, and just one more for me. Just with the increase in lease rate growth throughout this quarter, I'd be curious, are you seeing any trends in demand broadly speaking, maybe between your suburban and infill properties in similar markets, or is it pretty much just broad demand across individual markets driving that lease rate growth?

Ryan MacDonald
Sure. Hey, it's Ryan again. What, I would say it's generally broad based. I think in Mike's prepared remarks, he talked about the depth across MSA of growth. What I will say is there are certainly certain markets that are outperforming, and then on the urban versus suburban, I mean, 90%-ish of our portfolio is suburban first-ring suburban, so the majority – there's really not much urban to compare it against, but from a market perspective, I think, if you look at the Phoenix's of the world, the Atlanta's, the Raleigh, Durham's, actually, the Las Vegas' of the world are really, really showing out-performance on a relative basis, but generally speaking, we've got a lot of markets that are trending above, what I would call, average growth at 3% kind of threshold. We've got a lot of markets that are better trending above that, I love. Even Orlando, the interesting thing on Orlando that actually turned positive from a new lease perspective. So, it's been positive on a blended basis because of renewals since February, but in March, you actually had new leases turn positive and then accelerate into April. So, markets that were probably thought of as less growth, certainly with the pandemic are actually coming out and have really good trends.

Craig Kucera
Okay. Thanks.

Ryan MacDonald
Thank you, Craig.

Ramin Kamfar
Thank you, Craig.

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

CONCLUSION

Ramin Kamfar
Thank you, operator, and thank you everyone for joining us today, look forward to continuing to report on our progress to you in coming quarters. Take care.

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