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BRT.N - Q1 2019 BRT Apartments Corp Earnings Call

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## CORPORATE PARTICIPANTS

**Jeffrey Alan Gould** *BRT Apartments Corp. - President, CEO & Director*

**Ryan Baltimore** *BRT Apartments Corp. - VP*

## CONFERENCE CALL PARTICIPANTS

**Craig Gerald Kucera** *B. Riley FBR, Inc., Research Division - Analyst*

**James O. Lykins** *D.A. Davidson & Co., Research Division - VP & Research Analyst*

**Robert Chapman Stevenson** *Janney Montgomery Scott LLC, Research Division - MD, Head of Real Estate Research & Senior Research Analyst*

**Evelyn Infurna** *ICR, LLC - MD*

## PRESENTATION

### Operator

Thank you for standing by. This is the conference operator. Welcome to BRT Apartments Corp. Inaugural First Quarter 2019 Conference Call. (Operator Instructions) And the conference is being recorded. (Operator Instructions) I would now like to turn the conference over to Evelyn Infurna, Investor Relations. Please go ahead.

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**Evelyn Infurna** - *ICR, LLC - MD*

Thank you. Good day, everyone, and welcome to the BRT Apartments conference call. On the call today is Jeffrey A. Gould, President and Chief Executive Officer. Available for questions, we will also have George Zweier, Chief Financial Officer; David Kalish, Senior Vice President; and Ryan Baltimore, Senior Vice President.

As a reminder, this call is being webcast through the company's website at [www.brtapartments.com](http://www.brtapartments.com). Additionally, the company's supplemental information and earnings release are available for your review, and the company's 10-Q will be available later today on the Investor Relations section of the BRT's website.

Before we begin, I'd like to remind everyone that this conference call contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on management's current expectations, assumptions and beliefs. Forward-looking statements can often be identified by words such as believe, expect, estimate, anticipate, intend and similar expressions and variations or negatives of these words. These forward-looking statements include, but are not limited to, statements regarding BRT's strategy and expectations for the future. These are not guarantees of future results and are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those expressed in any forward-looking statements.

Listeners should not place undue reliance on any forward-looking statements and are encouraged to review the company's most recent annual report on Form 10-K and the company's other filings with the SEC for a more complete discussion of risks and other factors that could affect these forward-looking statements. Except as required by law, BRT does not undertake any obligation to publicly update or revise any forward-looking statements.

This conference call also includes a discussion of funds from operations, or FFO, adjusted funds from operations, or AFFO, and net operating income, or NOI, all of which are non-GAAP financial measures of performance. These non-GAAP measures should be used as a supplement to, and not a substitute for, net income computed in accordance with GAAP. For a more complete discussion of FFO, AFFO and NOI, see the company's earnings release and supplemental that were filed yesterday and the 10-Q that will be filed later today.

As a reminder, the company recently changed its fiscal year so that it ends on December 31.



I would like to now turn the call over to Jeff Gould, President and CEO of BRT Apartments Corp. Please go ahead, Jeff.

**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

Thanks, everyone. I would like to welcome everyone to BRT's inaugural quarterly conference call. Before we walk through our financial results, we thought it would be helpful to give you an overview of our business model. BRT is a small-cap equity REIT primarily focused on the ownership, operation and development of multifamily properties. These properties are owned by consolidated joint ventures in which we generally contributed 65% to 80% of the equity. We own 37 multifamily properties located in 12 states with an aggregate of 10,336 units and have ownership interest through unconsolidated entities in 3 multifamily properties located in 2 states with an aggregate of 1,026 units. Most of our properties are in the Southeast United States and Texas. We believe that acquiring properties through joint ventures is currently the most efficient strategy for us. We select operators with local expertise that we can leverage their experience in property management platforms to find the best risk-adjusted multifamily investments for our stockholders. We have been able to achieve significant efficiencies by using this model as we do not have to waste valuable resources bidding on deals that we may or may not win. Prior to the multifamily equity business, we were bridge lenders and frequently lent money on multifamily assets. This background allowed us to become highly skilled in investing in this asset class.

Our approach in acquiring multifamily asset is unlike other models in our space, but given our size, we believe this approach helps us leverage our platform and provide the right combination of opportunity while mitigating risk.

Moving on to our results. Today, we are going to walk through the results of the first quarter 2019, discuss the portfolio and some of our markets. During today's discussion, we are going to refer to the quarter ended March 31, 2019 as the current quarter; and the quarter ended March 31, 2018 as the 2018 quarter.

Net loss was \$4.2 million or a loss of \$0.27 per diluted share in the current quarter versus net income of \$25.2 million or \$1.75 per diluted share in the 2018 quarter. The 2018 quarter includes \$52 million or \$3.60 per diluted share from gain on property sales before giving effect to \$25.1 million or \$1.74 per diluted share of noncontrolling interest.

NOI for the current quarter was \$15.9 million, an increase of 4% versus \$15.3 million for the 2018 quarter. FFO was \$3.1 million for the current quarter or \$0.19 per diluted share compared to \$5.3 million in the 2018 quarter or \$0.37 per diluted share. FFO for the 2018 quarter includes \$3.2 million or \$0.22 per diluted share without giving effect to the noncontrolling interest of \$800,000 or \$0.05 per diluted share from the gain on insurance recovery related to our Retreat at Cinco Ranch property in Katy, Texas.

AFFO was \$3.7 million for the current quarter or \$0.23 per diluted share compared to \$3.8 million in the 2018 quarter or \$0.26 per diluted share.

Rental revenues increased by 4.1% to \$30.7 million from \$29.5 million in the 2018 quarter, and operating expenses increased by 4.2% to \$14.8 million from \$14.2 million in the 2018 quarter, driving an NOI increase of 4%.

On the value-add front for the current quarter, we repositioned 294 units at 17 properties, spending on average approximately \$4,245 per unit and achieving a return on investment of roughly 27%. As reflected in our supplemental financial information, a portion of the cost may have been incurred in the prior period, where we report the return on investment when a unit is re-leased. Overall, we are very pleased with the performance of our value-add program. We expect this strategy to continue to be a factor in our ability to drive same-store rent and NOI growth over the long term.

During the current quarter, we acquired a 312-unit property located in Kannapolis, North Carolina, a suburb of Charlotte, for \$48.6 million, including \$33.3 million of mortgage debt assumed in connection with the purchase. The mortgage debt matures in 2052 and carries an interest rate of 3.52%. The property is well located, approximately 24 miles from Charlotte, North Carolina, near I-85. The community is near several major employers, including Carolina Health Systems, an under-construction Amazon fulfillment center and the North Carolina Research Campus.

On May 7, we acquired a 328-unit multifamily property located in the suburb of Birmingham, Alabama. The purchase price was \$43 million, including \$32.3 million of mortgage debt obtained in connection with the acquisition. The mortgage debt bears interest at a rate of 4.19% per year. It's interest-only until 2025 and matures in 2029.

Our same-store pool comprise 27 properties totaling 6,989 units. Same-store NOI for the current quarter increased by 3.2% from the 2018 quarter. Same-store revenue increased 4.6% in the current quarter to \$22.1 million. Same-store expenses were up 6.2% from the 2018 quarter, with 55% of the increase from real estate taxes. When a property is reassessed at a higher value for real estate tax purposes, we generally appeal if we believe that a reduction is obtainable. Same-store rental rate increased 3.3% to \$996 a unit from \$965 a unit a year earlier. The growth in our same-store rental rate was driven by growth in key markets led by Mississippi, which grew by 7.4%; and South Carolina, which grew by 6.3%. In addition, we were able to increase rental rates in Indiana by 5.6%, Ohio by 5.5%, Alabama by 4.7% and Florida by 4.6%. Our most challenging region is St. Louis. We are managing down our exposure in this market as we have not seen the growth that we anticipated and, in some cases, have had to drop rents to stimulate occupancy.

Turning to the balance sheet. We finished the quarter with \$21.1 million of cash and cash equivalents and net debt of \$845.8 million, including \$37 million of corporate subordinated debt that matures in 2036 and carried an interest rate of 4.75% as of March 31, 2019. In April, we entered into a credit facility with an affiliate of Valley National

Bank. The facility allows us to borrow up to \$10 million and carries an annual interest rate of 50 basis points over the prime rate with a 4% or 5%. We intend to use the facility as a bridge to fund acquisitions of multifamily properties.

On May 2, the company borrowed \$9 million on the line in connection with the acquisition of the Birmingham, Alabama property that I described earlier. Borrowing under the facility will generally be repaid from property sales or refinancing transactions.

Finally, on March 11, the Board approved a quarterly dividend of \$0.20 per share, which is equivalent to an annualized yield of 5.6% based on our stock price of \$14.19 as of the close of business on May 6.

Thank you for joining us today on our inaugural conference call. With that, I will turn the call over to the operator for your questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Rob Stephenson with Janney.

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**Robert Chapman Stevenson** - *Janney Montgomery Scott LLC, Research Division - MD, Head of Real Estate Research & Senior Research Analyst*

Jeff, can you just talk a little bit about how we should be thinking about the year pipeline on the acquisition and disposition side over the remainder of '19? And have you seen any changes in valuation, cap rates, et cetera, out there over the last quarter or so?

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes, sure. Good to talk to you, Rob. Yes. So we continue to see the transactional business and reselling of 2 assets as well as buying, as you know. When we dispose of assets, we have the capability in looking at other new assets to acquire. The pipeline has been very strong. As you know, we don't look at deals unless they're under contracts so we readily can put the money out for new acquisitions. And it's been solid. Competition is definitely tighter, but at the same time, we're seeing very good deal flow. So we're pleased with the response of our partners as to new deals. And if and when we get money back, we very comfortably we can put out the money in an accretive fashion.

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**Robert Chapman Stevenson** - *Janney Montgomery Scott LLC, Research Division - MD, Head of Real Estate Research & Senior Research Analyst*

Okay. And then you guys did just under 300 rehabs in the first quarter. Is that a good run rate for the year? Or do you accelerate that during the summer months as turn increases? How should we be thinking about number of rehabs for the year? And does that sort of \$4,250 a unit likely hold steady for the remainder of the year?

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes. So I'm going to turn that over to Ryan to give you a more detailed answer on that.

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**Ryan Baltimore** - *BRT Apartments Corp. - VP*

Rob, yes, so we don't project and give guidance on how many units we plan to turn. A lot of it is dependent on turnover at the individual property level. Given our past couple of quarters, we've been in the 300 range, but again, we don't project forward as we don't know how many units we're going to necessarily get back to renovate, as we've been getting renewal increases that have been pretty strong in the 4% range. So we haven't had as much turnover as we sometimes anticipate.

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

And some of these new transactions that we've recently purchased, there's definitely a value-add component to it, and we're excited about those opportunities. And we think that will drive definitely some renovations of units.

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**Robert Chapman Stevenson** - *Janney Montgomery Scott LLC, Research Division - MD, Head of Real Estate Research & Senior Research Analyst*

Okay. And then just last one for me. On the same-store growth expectations for '19, is there anything abnormal with year-over-year comps or anything else that would materially alter the sort of 3%, 3.5% same-store NOI run rate that you ran for the first quarter throughout the remainder of the year, either elevating it or reducing it?

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes. I mean in the current quarter, taxes accounted for 55% or so of the same-store expense increase. So that's something that we're watching carefully. And as I said earlier, we're monitoring tax increases. We do our best to appeal taxes. And in some states and cities, it's obviously more prevalent in having to fight these taxes on an annual basis. So that's part of it. I mean that's a little bit of an open question. We saw a little bit of an increase in repairs and maintenance, which is really the result of renovating units and turning over -- and the turns allowed us to increase rental rates, which was good. So that has some impact on it. But generally speaking, same stores we don't give actual guidance on, but I would tell you that it's, I guess, more or less dependent on taxes. And there is some seasonal fluctuation, yes.

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**Operator**

The next question is from Jim Lykins with D.A. Davidson.

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**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

First, a couple questions about the renovations. First -- and apologies if I missed this, but how much for the 294 did you say you spent per unit?

**Ryan Baltimore** - *BRT Apartments Corp. - VP*

Jim, this is Ryan. We spent approximately \$4,245 per unit and received an annual ROI estimated of about 27%.

**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

Okay. And I know you guys don't give guidance, but there's some pretty solid returns. Is there any reason to think that, that may be slowing as we go through 2019 or can you stay at those levels? Is there any color you can give us at all on how to think about those returns?

**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes. So we have seen a pretty consistent return on equity on the renovation program over the last number of years, and we don't see any reason that should not continue. We've done well with it.

**Ryan Baltimore** - *BRT Apartments Corp. - VP*

Yes. Just to add on that, what we do with our renovation program is if we see the returns start to drop and the returns are not there anymore, we'll just stop the program. We typically fund most of our renovation money upfront. So if that's the case, they'll return that money as a distribution or hold it for other amenity upgrades that might make sense where we could see the returns in the 20-plus range.

**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

We've consistently seen return on equity being minimum like 15% or so and, obviously, these numbers reflect far more solid returns than that. But it's been -- we've been pleased with those results for quite a while now.

**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

Okay. That's helpful. And also, for the acquisition in Birmingham, first, are you able to provide a cap rate for that?

**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes. So generally speaking, the new acquisitions in Birmingham and the other one we mentioned, as I said earlier, we were pleased with the opportunities. The Alabama deal, the value-add -- it was a net value-add program. We reserved about \$4,750 per unit to do the renovations. We're hoping to achieve north of a 16% return on the renovation. As far as cap rate goes, we're buying this typically at about 6% stabilized cap rate along with the value-add program. The North Carolina property that we recently purchased as well, on a value -- on a stabilized basis, that's somewhere north of 6% as well. We had to buy it at a lower cap rate going in, but again, with the value-add component, which we plan to do there, which is pretty significant, what happened there is the value-add was basically completed already, but they weren't getting the bonus as they get on the value-add. So the work for the most part is already complete. So we should see that fairly readily improving cash flow.

**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

And have you identified the number of renovations at this property?



**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Well, the one in North Carolina was basically completed. This is the one we bought with HUD debt. And the renovation almost entirely is complete. Again, none of the rent bump is really -- or minimal amount of the rent has been effectuated from the work, and that's all going to happen. On the Alabama deal, our plan is to do most, if not all, those units over time. So we think it's a good long-term...

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**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

How many is most? What -- is there a number?

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

There's 308 units in the property.

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**James O. Lykins** - *D.A. Davidson & Co., Research Division - VP & Research Analyst*

Okay. And you'll be renovating most of those?

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Yes, over time. And obviously, we have other units in the portfolio that we're going to be hitting as well. Some of the -- as Ryan alluded to, there's some older -- some properties that are sort of legacy assets that still remain work to be done. But here our plan is to do a majority of these units, yes.

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**Ryan Baltimore** - *BRT Apartments Corp. - VP*

Yes. Jim, just a point on that. At the Alabama deal, there's 328 units. 20 have already been rented prior to acquisition, so there's 308 remaining to be renovated.

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**Jeffrey Alan Gould** - *BRT Apartments Corp. - President, CEO & Director*

Right. The nice thing there is we know from the 20 units that we've done that we can achieve those rent increases, and it's worked in the market. So that's always a good indicator for us, and we'd like to have some guidance as to the ability to -- once we do the work to be able to charge these increases, and here we've seen it directly, and we're very confident we can get the bumps.

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**Operator**

(Operator Instructions) And our next question is from Craig Kucera from B. Riley FBR.

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**Craig Gerald Kucera** - *B. Riley FBR, Inc., Research Division - Analyst*

Just based on your commentary on St. Louis, are those assets that you're considering bringing to market and possibly recycling out of?



**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

Yes. So to St. Louis specific, we were -- the reality is that our concern with that particular market was we just -- we were continuing to have at [concessed] rents. We had lower occupancy than we originally anticipated we were going to be able to achieve. It's a transient downtown market with minimal rental growth, and it was something that we were surprised with. But the fact is that with the occupancy and with the trends we see down there, as much as we've been able to increase or decrease operating expenses, we just don't see it as a long-term viable property, the downtown St. Louis property. We do have another property that's running very well, which is not the downtown property in St. Louis, and that we plan on refinancing and keeping for a period of time. We're pleased with the performance of that property, which is outside the downtown market. Other properties, what we do as we basically look at our entire portfolio on a consistent basis. And any property that we start to see where the renovations have more or less been complete and we've really milked and used most of the value-add, those are potential deals for sale. Also, where we see markets trending in a way that we're not pleased, obviously, and we can recycle the capital to use elsewhere in a growing market, we choose to do that. So we're confident that we can get the portfolio. In some of our properties, frankly, where they're getting older, those are areas that we think, obviously, properties don't get any younger, and over time, those are somewhat concerning. So there's issues and examples of we have to put in property and work in renovations where you don't see the rental growth. And those are properties that we focus on as well. So yes, we're constantly focusing on these current properties in our portfolio, and there likely will be other sales to come.

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**Craig Gerald Kucera - B. Riley FBR, Inc., Research Division - Analyst**

Okay. And I know you said you don't give out guidance quarterly or annual on the value-add program, but have you sort of tallied up the total amount of units that you think remain in the portfolio, whether that's inclusive or exclusive of the recent acquisitions that you think you can renovate and achieve pretty decent returns through behest?

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**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

Yes. So as you said, we don't give the guidance on that, so we don't have -- I don't want to give a specific number as to the amount of additional or further renovations that we plan to do. But I can -- we can say comfortably that there's going to be a large number of those. And the whole focus now is we've really minimized the new development pipeline almost completely. We have income coming in from some of the development properties that are now complete and being leased up. But as far as renovation program, we would rather just give you the facts as the quarters come and as to what we've actually been able to complete and get the bonus of rent.

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**Craig Gerald Kucera - B. Riley FBR, Inc., Research Division - Analyst**

Okay. And just on the new development, I know you're winding it down, but is that sort of post what's currently under development? Do you anticipate doing new developments? Or is this likely sort of you're winding that aspect of the business down?

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**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

I mean there's a chance we might do a deal, a development deal, but it's not the real plan right now, the reason being the development deals have just gotten to be so difficult by way of returns and -- versus risk. So the bottom line is, originally, when we were going into some of these development deals, we were building to an 8.5% unleveraged-type return, those going back a few years. Now we're probably seeing unleveraged returns down to roughly 6%. So you have to always balance risk/reward and budget and issues without building new. It's nice to have brand-new products, but when the returns become down to those levels and at those numbers, it's just not as appealing as buying an existing property where you know the value-add component exists and where you can do light renovations as opposed to taking the risk of new development. So I think it's going to be minimal. I don't want to say it's 100% that we absolutely won't do a deal, but it's not in our current plans.



**Craig Gerald Kucera - B. Riley FBR, Inc., Research Division - Analyst**

Got it. One more for me. Just wanted to get your thoughts on leverage today. I think you guys are a little bit more levered than a lot of your peers. And just your thoughts sort of maybe on a feeling on leverage, and do you plan to reduce leverage over time or kind of keep the balance sheet relatively constant where it is today.

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**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

Good question. We understand that there's been focus on the debt. So I can answer it a few ways. One is our new acquisitions, we're typically borrowing or LTV at about 60% or so, 60% to 65%. So we think based on the risk/reward of a fairly stable asset class, we think that's a good number to be at, and we're not concerned about leverage at those numbers. We don't want to leverage any higher than that on new acquisitions. As it relates to market cap, as it relates to book value, it does show that our debt appears to be high, but I think based on your analysis and other research that we've seen, if you look at the debt to real value, we don't think it's anything of great concern at all. As a matter of fact, we think we're stable and leveraged appropriately. But I think over time, we amortize our debt quite a bit on an annual basis. So that obviously helps. But we are looking and focusing on trying to reduce leverage to some extent. We're not going to be the type of REIT that's leveraged at 30%, 40% as some of the big boys, but I could say it is just not efficient for us nor do we think it makes any sense as far as returns and what's best for the shareholders. But our belief is that 60% level is something that we think is a good target for us, long term.

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**Operator**

This concludes the time allocated for questions. If there were any questions that remain unanswered, please email [investors@brtaptments.com](mailto:investors@brtaptments.com). I'd now like to turn the conference back over to Mr. Gould for any closing remarks.

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**Jeffrey Alan Gould - BRT Apartments Corp. - President, CEO & Director**

Yes. So I just want to thank all of you for joining us on our inaugural call. We're trying to be out there and be transparent so that all of you can ask your questions and we could be really responsive to you. We are happy to meet with any of you in person, so please reach out to us at the number or the e-mail address, [investors@brtaptments.com](mailto:investors@brtaptments.com), if you have any further questions. And again, we're happy to meet you wherever it might be, and we look forward to talking with you on our next call in a few months. So thank you very much.

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**Operator**

Thank you for participating. This concludes today's conference call. You may disconnect your lines.

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