Transcript of
Elme Communities
Third Quarter 2022 Earnings Conference Call
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Participants

Paul McDermott - Chairman, President & Chief Executive Officer
Stephen Riffee - Executive Vice President & Chief Financial Officer
Susan Gerock – Senior Vice President & Chief Information Officer
Amy Hopkins – Vice President, Investor Relations
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Analysts

Michael Lewis – Truist Securities
Anthony Paolone – JP Morgan
John Powlowski – Green Street
Young Ku – Wells Fargo

Presentation

Operator
Welcome to the Elme Communities Third Quarter Earnings Conference Call. As a reminder, today's call is being recorded. At this time, I would like to turn the call over to Amy Hopkins, Vice President, Investor Relations. Amy, please go ahead.

Amy Hopkins, Vice President, Investor Relations
Good morning, everyone and thank you for joining us for our third quarter earnings call. On the call with me today are Paul McDermott, President and Chief Executive Officer, Steve Riffee, Executive Vice President and Chief Financial Officer, Susan Gerock, Senior Vice President and Chief Investment Officer, Grant Montgomery, Vice President and Head of Research, Drew Hammond, Vice President, Chief Accounting Officer and Treasurer, and Steven Freishtat, Vice President, Finance.

Today's event is being webcast through the Investors section of our website at elmecommunities.com, and a replay will be available this afternoon. We will have a slide presentation in conjunction with our prepared remarks, and those slides will also be available on our webcast replay.

Before we begin our prepared remarks, I would like to remind everyone that this conference call contains forward-looking statements that involve known and unknown risks and uncertainties, which may cause actual results to differ materially, and we undertake no duty to update them as actual events unfold. We refer to certain of these risks in our SEC filings.

Reconciliations of the GAAP and non-GAAP financial measures discussed on this call are available in our most recent earnings press release and financial supplement, which was distributed yesterday and can be found on the Investor Relations page of our website.

And with that, I'd like to turn the call over to Paul.

Paul McDermott – Chairman, President & Chief Executive Officer
Thank you, Amy. Good morning, everyone, and thank you for joining our third quarter 2022 earnings call.

Much has changed in just a few months - both in the broader financial markets as the Fed continues to try to control rising inflation, and for our company as we break from our past and move on from being WashREIT.

Becoming Elme Communities represents the start of a new trajectory, positioning us to capitalize on the opportunity to be a differentiated provider of multifamily homes. It marks the culmination of our multifamily portfolio transformation, geographic expansion, and technology-forward infrastructure transformation.

I am pleased to report a very strong third quarter, which Steve will discuss in more detail, but first I'd like to cover the progress that we have made in our transformation and how the launch of our resident-focused brand fits into the execution of our growth and operational strategy.

We have made the break from a business-to-business commercial company and become a business to consumer provider of apartment homes. We focus on the largest, and most underserved renter cohorts. In fact, 97% of our apartment homes are affordable to households that earn the area median income.

20% of our apartment homes are now located in the Sunbelt. We're targeting economies with diverse, innovative industries that drive outsized job creation, wage growth and in-migration.

Our portfolio's allocation in the Atlanta and Washington markets enables our participation in growth while also providing relative insulation during economic downturns. Atlanta's regional economy is projected to fare well in the face of increased macroeconomic headwinds in 2023, maintaining job growth of approximately 1% and positive economic traction, according to Oxford Economics. Longer-term, job and GDP growth of 1.8% and 2.4% from 2022-2026 are projected to continue Atlanta's track record of national outperformance.

Washington's job growth in 2023 is also projected to continue apace, growing 1.4%, according to Oxford Economics, continuing its long history of countercyclical outperformance during periods of national economic stress. Both markets are projected to grow more than the national average in 2023.

We've targeted a deep, underserved, and undervalued base of mid-market demand.

Mid-market renters comprise the largest share of apartment demand in each of our markets yet only a limited share of new supply is affordable for these renters. Thus, the demand is deep and competition from new supply is limited.

Mid-market renters are underserved on multiple levels as the quality and maintenance level of physical assets, service, and overall resident experience in this apartment market segment is often of a lower caliber. Additionally, we see that they are undervalued, as residents at these price points see a lower standard of care for their space and receive a lower level of respect. In turn, residents place a lower level of trust in service providers.

We see the opportunity to elevate what home can be for our residents, and our new name represents a combination of the words, "elevate" and "home." Our new mission is to elevate the value living experience and

create a place our residents are proud to call home by continuously focusing on service, efficiency, and innovation.

Our vision is to be the most trusted owner and operator of residential communities by elevating the standard for value living.

Our clarified vision and mission statements support our strategy to deliver what the deepest cohorts in the apartment market need, and in turn, to create value for our stakeholders.

Delivering a superior value living experience starts with making the most of every dollar spent at our communities. It means providing customer service that goes beyond responding to resident enquiries. It means anticipating the needs of our residents and empowering our teams to add value with every interaction. It means knowing what our residents value and providing amenities that meet their needs. It means investing in smart home and building automation that is impactful and makes sense at mid-market price points. It means ensuring that on time rent payments are reported to the credit bureaus to help build resident credit scores. It means delivering industry-leading environmental performance for value-oriented communities. All of this means we are committed to producing strong recurring results for our investors.

While redefining our mission and launching our new resident-focused brand are important to executing our growth and operational strategy, the work that was done to get us to where we are today goes much deeper than our brand ethos. Becoming Elme Communities marks the culmination of a multi-year effort to transform nearly every aspect of our business.

I would now like to turn it over to Susan Gerock, our Chief Information Officer and a key leader in our infrastructure transformation to talk about our progress and how the changes that we've made position us to deliver greater value for our stakeholders.

Susan Gerock – Senior Vice President & Chief Information Officer
Thanks Paul and good morning, everyone.

We have spent the past year designing a technology-forward, streamlined, efficient, cost effective, and highly scalable operating model and technology platform that will deliver a better experience for our residents as well as efficiencies and capabilities that will drive better value for our stakeholders.

Efficiency is critical to making the most of every dollar we and our residents spend. We prioritized efficiency when making operational decisions during our infrastructure transformation – from maximizing our operating margins to making sure we are doing everything we can with the resources we have to provide ease of living for our residents.

We are focused on improving what makes a difference and what we can provide most competitively.

So, what have we achieved thus far?

First, our ongoing focus on revenue maximization through daily pricing strategies are achieving better rents than we underwrote in our acquisition portfolio. Second, given that we already control all our leasing and portfolio

management in house, onboarding the first set of communities has only strengthened our ability to manage leasing decisions by removing the middleman and providing a closer connection with our community teams.

Third, we've recruited outstanding new talent, including key portfolio-level operational positions. Our team has already begun to successfully onboard our communities.

Fourth, we have harnessed the power of data as we implemented our new and improved technology platform. By providing access to more data through our reorganized, streamlined infrastructure and technology platform, we have reduced friction, improved our analytical capabilities, and better positioned our company to execute on our mission of raising the bar for mid-market price points while growing profitably.

The significant changes that we have implemented have set us up to deliver growth, and while we are already seeing benefits of our transformation, we believe that the real payoff is still ahead of us.

I would now like to turn the call back to Paul.

Paul McDermott – Chairman, President & Chief Executive Officer

Thank you Susan.

As Susan highlighted, our infrastructure transformation positions us to capitalize on the opportunity to be a differentiated provider of multifamily homes. We are targeting a deep, solid, and underserved base of mid-market demand. This strategy is already delivering remarkable results, and we expect to generate strong returns for investors as we continue our geographic expansion into new markets over time.

With that said, investment discipline is foundational for this company, and as the Fed's most recent shift to more restrictive policies added another layer of uncertainty, we pivoted and ceased negotiations to acquire two assets. We do not believe that many sellers have realistically adjusted their price expectations to the shifting macro-outlook and while we have the capacity to acquire $125 million of additional multifamily communities, we will remain prudent about growing further in this environment until capital markets conditions improve.

I would now like to turn the call over to Steve to discuss our operating trends, third quarter performance, and growth outlook.

Steve Riffee – Executive Vice President & Chief Financial Officer

Thank you, Paul, and good morning, everyone. Today I would like to cover the operating trends that we are experiencing and how those trends and the growth that we have captured to date provide us with confidence in our 2023 outlook. I will also cover our third quarter results, guidance for the remainder of 2022 and updates to our guidance for 2023.

I will start with touching on the highlights of our growth outlook. As Paul and Susan discussed, changing our company name, unveiling our mid-market resident-focused brand, and beginning to bring our communities in house, culminates in the start of a new trajectory for our company. All of this coincides with a record growth outlook. We expect to deliver historic NOI and Core FFO growth in 2023, with same-store NOI growth of 10% at the midpoint of our guidance range, and Core FFO growth of 14% at the midpoint, the strongest in over 20 years.

We have several reasons to feel confident in our ability to deliver this growth and to continue to deliver solid results beyond 2023.

First, our focus on value-oriented price points provides stability across business cycles. History shows us that when you get into a recession, people don't tend to trade up they tend to trade down to more affordable rents. Over the past one-, five- and ten-year periods, Class B rent growth has outperformed Class A in both of our operating markets.

Second, as Paul highlighted, our portfolio's allocation to the Washington Metro provides stability during downturns and the Atlanta region is projected to fare well in the event of increased macroeconomic headwinds in 2023.

Third, we have a well-positioned balance sheet with low leverage and strong liquidity. We've prioritized the strength of our balance sheet throughout the transformative capital recycling we completed, as well as through the pandemic, and maintained our investment grade debt rating. It will continue to serve us well as we knew we had to remain prudent through all we executed.

Fourth, we anticipate operating cost efficiencies in 2024, after our community onboarding process is complete. These efficiencies should provide us with another gear for increasing profitability beyond the near horizon and have not been factored into our record growth expectations for 2023 as we complete the internalization process.
All in all, we believe that we are well positioned to grow even further should the capital markets backdrop improve.

In keeping with historical trends, the third quarter was our highest volume leasing quarter, and lease rate growth remained in the double digits throughout the quarter following the early August peak. Effective-new-lease-rate growth was 10.5% and effective-renewal-lease-rate growth was 10.1%, which blends to 10.3%, for same store move-ins that took place during the third quarter.

For non-same store move-ins that took place during the third quarter, effective-new-lease rate growth was 13.8% and effective-renewal-lease rate growth was 18.4%, which blends to 16.3%. Overall, we captured very strong lease rate performance which will carry over into 2023.

Lease rate growth in October has moderated but remains historically high, with effective blended lease rate growth of 7.1% for our same store portfolio and 9.7% for our non-same store portfolio.

October traffic and application volumes reflect solid demand for our value-oriented communities. We are currently sending out renewal rates of 10% to 12%, on average, with high renewal acceptance rates indicating that our pricing power remains strong, overall, given the significant growth in market rents in our regions.

Same store occupancy averaged a strong 95.6% during the quarter and increased to 95.7% post quarter end. Retention was 60% during the quarter which is in line with the year ago period and above our historical average. Our revenue maximization strategy prioritizes lease rate capture during the busiest leasing months, and we are now focused on maintaining occupancy as we head into the winter months. Strong demand and retention support a healthy forward occupancy trend as we head into the winter months.

Due to the rising cost of homeownership, our renewal and retention rates improved, while move-outs related to home purchases represented the most notable drop compared to the prior year and sequential period. The percentage of same-store move-outs related to home purchases declined by over 5% year-over-year and nearly 4% on a sequential basis.

Looking forward, we are positioned with historically high embedded growth, which we expect will drive outsized revenue and NOI growth in 2023.

Our mid-single digit earn in and our loss to lease of over 8% as of September 30 provide confidence in our outlook for rent and NOI growth as the market environment shifts from the very strong demand trends that we are experiencing today. We are on track to deliver same-store multifamily NOI growth of 10% at the midpoint of our guidance range and stronger annualized growth from the three Atlanta communities acquired this year with the vast majority of that growth already embedded in our portfolio.

On the expense side, we believe we have conservatively incorporated additional inflation pressure in our 2023 expectations on top of the levels we are incurring in 2022. Our expectations for greatest cost pressure are assumed to be in non-controllable expenses driven by higher real estate taxes and utilities costs. Additionally, we assume that payroll and repairs and maintenance expenses, which represent the largest components of our controllable expenses, will increase further due to ongoing inflationary expectations. We anticipate that our ability to implement expense controls will improve over the course of the year after our properties are fully onboarded, thus operational and other expense controls should have a larger impact on 2024.

This provides us with confidence in our growth outlook.

Now moving onto renovations. During the third quarter, we renovated approximately 100 units for a return on investment of a little over 13% excluding the rent growth that we achieved on comparable unrenovated units. And if you included total rental increases in your ROI it would look more like 22%.

While we expect to be closer to our historical renovation run rate of approximately 600 units per year in 2023, our renovation programs offer flexibility to change the pace as the environment shifts. Over the past year, while market rent growth has been at record-setting levels, we have eased off our pace of renovations, benefiting from double digit rent growth and preserving renovation opportunities for when market rent growth reverts towards historical levels.

I will now briefly cover our third quarter results, which were in line with our expectations for stronger rent growth momentum in the second half of this year.

Core FFO was $0.23 per diluted share, reflecting a year-over-year increase of 15% driven by strong growth in rental income.

Multifamily same-store NOI grew 10.4% over the prior year due to higher base rent and lower concessions, partially offset by higher repair and maintenance and payroll expenses. Third quarter repairs and maintenance expenses were higher, in part, due to increased turnover compared to the prior year period. We expect full year same-store multifamily operating expenses to increase by approximately 5% overall. We expect multifamily

same-store NOI growth to accelerate in the fourth quarter because of the very strong lease rate growth we captured during the summer leasing season.

Average effective monthly rent per home for the quarter increased 10.6% compared to the prior-year period on a same-store basis, and over 3.5% sequentially. Again, the acceleration in growth reflects the impact of the very strong lease rate growth we captured during our busiest summer leasing months.

Other NOI, which represents Watergate 600, grew 6.2% in the third quarter compared to the prior year driven by higher rental and parking income. Watergate 600 has a high-quality institutional tenant base and a 7-year weighted average lease term.

Now turning to guidance. First, I will point out that we are confident that our growth is underway and therefore we pre-released 2023 guidance on September 27.

I will not reiterate all those points and they can be found in our press release, but I will point out the following key highlights of our 2023 outlook.

Core FFO for 2023 is expected to range from $0.96 to $1.04 per fully diluted share, which implies approximately 14% growth, year-over-year, based on the midpoint of the 2022 and 2023 Core FFO guidance ranges, the highest since 2000. We expect most of this growth to be driven by rent growth, much of which has already been captured in our existing leases, which supports our ability to grow our dividend if we make that capital allocation decision to do so in the future.

Same-store multifamily NOI growth is expected to range from 9% to 11%, which reflects year-over-year growth of 10% at the midpoint, further building on the double-digit NOI growth expected in the second half of 2022.

Non-same-store multifamily NOI is expected to range from $12.75 million to $13.75 million in 2023 which now excludes the impact of the prior 2022 assumed acquisition guidance. While this guidance range does not reflect the impact of potential acquisitions, we have more than $650 million of availability on our line of credit as of quarter end, and we are running at lower than our targeted leverage levels. We will continue to evaluate acquisition opportunities in our target markets and will pursue further acquisitions when they create additional value for shareholders.

G&A, net of core adjustments, is expected to range from $26.25 to $27.25 million which reflects a small year-over-year increase of less than 2% at the respective midpoints, due to temporary costs associated with transitioning our community-level operations in house. We expect G&A to decline in 2024 and then to remain stable as we scale our portfolio when the time is right to do so.

With that said I will also update our outlook for the balance of the year. We are reiterating the midpoint and tightening our 2022 Core FFO guidance range to $0.87 to $0.89 per share.

We are reiterating the midpoint and tightening our full-year same-store multifamily NOI growth guidance to 8.75% and 9.25%. At the mid-point this represents 11.5% NOI growth for the fourth quarter. NOI growth for same-store and Trove combined is expected to be between 12.5% and 13%.

We are reiterating the midpoint and tightening our guidance range for non-same-store multifamily NOI to be between $22.25 and $22.75 million. Other same-store NOI, which consists solely of Watergate 600, is expected to range from $13.25 to $13.75 million.

Our FFO guidance range assumes that no further acquisitions are completed this year, compared to prior guidance which assumed $125 million of acquisitions. This adjustment did not impact our 2022 or 2023 Core FFO guidance. Incorporating our updated acquisitions assumptions, we expect our net-debt-to-adjusted EBITDA to be below 5x at year end.

G&A, net of core adjustments for severance and structuring costs, is now expected to range between $26.0 and $26.5 million which reflects a slight increase in the midpoint. Our G&A guidance excludes the impact of transformation investments for our future platform and our full integration, which we now expect to be approximately $10 million, a decline of $1 million, compared to our prior guidance.

Interest expense is now expected to range between $24.5 and $25.0 million, which is lower than our prior guidance range due to the removal of our previous $125 million acquisition assumption during the second half of the year.

We expect our Core AFFO payout ratio for the year to be in the mid-70s and are establishing an AFFO growth profile that should provide us with additional flexibility to grow the dividend.

And with that, I will now turn the call back to Paul.

Paul McDermott – Chairman, President & Chief Executive Officer
Thank you, Steve.

Becoming Elme Communities represents much more than just a name change - it's the start of a new growth and value creation trajectory. We are now in the final phase of our infrastructure transformation and have successfully begun transitioning property-level operations in house. We are delivering historical growth, have a strong balance sheet, a revamped operating platform, and a clear strategy and mission meeting the needs of the deepest renter cohorts, yet we are trading at one of the highest implied cap rates.

The tailwinds we pursued in our transformation support strong growth over the coming years. While the value we created is currently being masked by the challenging macro environment, we are well positioned given our geographic mix and mid-market renter focus and we are confident in our ability to continue to deliver profitable growth.

Now Operator, I would like to open up the call to questions.

Operator
At this time, we'll be conducting a question-and-answer session. Please hold while we poll for questions. Your first question for today is coming from Anthony Paolone with JPMorgan.

Q: You mentioned in the press release about evaluating opportunities that will create additional value, you also talked about not doing acquisitions. Can you elaborate a bit on what some of the other things you're considering or what those might be?

Paul T. McDermott – President & Chief Executive Officer
When we talked about the acquisitions or the lack thereof going into the fourth quarter, we've talked to a number of different investors. What we're seeing out there and even our levered competitors, there's really a lot of pricing and yield discovery taking place. As for our team, you know, we're repricing risk. We are moderating some of our growth assumptions. We talked to the levered folks, they're experiencing obviously higher interest rates. They're seeing their leverage decrease by 5% to 10%. And we're also seeing folks increasing their residual cap rate on the back end by plus or minus 50 basis points.

Interesting also, we're seeing a lot of folks shy away from large deals. I think that we feel like now is the time for patience and discipline. We think the cap rates are coming to us and we will move when we see the right opportunity. The opportunity that we passed on had more to do with the renovations and the yields. When we look at those, a big part of our renovation story is maintaining that affordability gap. I'd like Grant to comment on the affordability and kind of its importance to our portfolio.

Grant Montgomery – Vice President, Head of Research
It is really central, and we are maintaining that, it's been expanding within the Washington region. There's a 26% premium for new products over our in-place effective rents. In Atlanta, it's even a higher 33%. That's in the $650 to $700 range, which really provides quite a bit of price insulation and differentiation of our product versus the new product that's coming online.

Paul T. McDermott – President & Chief Executive Officer

I want to reiterate like Steve said in his remarks, we still do have a pipeline. We are still underwriting opportunities. We've increased our metrics for what we need going in in this environment. We think it's the right thing to do. But I want to assure you that when we do see the right opportunity, we will do our best to execute on it.

Q: Along similar lines but on the other side of this with Watergate, it actually seems like the assets performing pretty well and pretty steadily. So, is the idea to keep that for now or lack of liquidity in the office market or how should we think about that?

Paul T. McDermott – President & Chief Executive Officer
The Watergate, it has almost seven years of WALT on it. And when we look at our portfolio in its totality, by year-end, it's expected to be less than 10% of our total NOI. We are seeing traffic on it. We did increase occupancy during the course of this year. I'd like to see a few more data points on D.C. office right now. It's as you said, it's not a very liquid dynamic in the investment sales market right now, especially in D.C. office.

It is a non-Core holding and it is something that we would like to monetize, but we want to wait and make sure we can create the most value for our shareholders.

Operator
Your next question is coming from John Powlowski at Green Street.

Q: Good morning and thanks for the time. I just had a few quick questions on the transformation. Paul, is the senior management team that will oversee the internal operating platform fully built out now and fully hired both at the corporate and regional level or is there more hiring to do?

Paul T. McDermott – President & Chief Executive Officer
There is some additional hiring to do over the next six-plus months. We've incorporated that hiring into our 2023 guidance. We just started onboarding the properties last weekend and I'm happy to say that the first few coming on, the execution was successful. We plan on onboarding properties from now through mid-next year, and I'm sure we'll be adding additional personnel as that goes, but like I said, all of that is baked into our G&A numbers and our guidance for 2023.

Steve, anything you want to add there?

Steve Riffee – Executive Vice President & Chief Financial Officer
At the community levels, they'll be coming on more and more as we bring on more properties. We have obviously had to get ahead of this as we're onboarding properties. So, we have beefed up our regional teams, add additional director of operations, regional managers, regional maintenance managers. We've positioned our accounting team to take over what third-party accounting folks have done before, and our IT is replacing their IT. So, those things are done. But as Paul said, as we incrementally have more people coming on board and relieve the middleman, we'll be replacing them with a few more of our people.

Q: Does any of this work trickle in the 2024, or will it be fully done by the end of next year?

Steve Riffee – Executive Vice President & Chief Financial Officer
We will not be into 2024. We should have everything that we currently own today on board by the summer of 2023.

Q: Steve, what are your expectations for revenue and expense growth within the 10% midpoint of NOI growth next year?

Steve Riffee – Executive Vice President & Chief Financial Officer
Overall, some facts that go into it, I can talk about how we might think that will blend over the course of the year too. It starts out a little stronger in the year and we would expect it to blend down a little bit later.

We reported a loss to lease of 8.3 at quarter end. We're now getting into November which is seasonably a little bit lower pricing and we're only seeing seasonal patterns no weakness other than that. And we're still in the sevens as we begin November on that. We have a strong earn-in and we feel really good about two-thirds of our leases expired in our second and third quarter. And we've got tremendous trade-outs during those quarters which provide revenue growth.

On top of all of that and I'm going to throw it to Grant for just to add a little color here. We're seeing say on blended across the Atlanta and D.C. markets, a real page expectation of 3% revenue growth but how we play it is even a little stronger than that and Grant could add a little color to that.

Grant Montgomery - Vice President, Head of Research
I think it's sort of two prongs on those. One would be submarket selection. There is quite a lot of variability. There's as much variability within a market as between markets and many of our submarkets that we have seen and played in Washington historically or that have moved into recently, Atlanta are expected to significantly outperform the average for the region.

And then additionally if you look at how the vintages of apartments performed and those that were really central to our strategy, those that outperformed historically as we said in the script over the last year for example, the vintages that we really focus on in Atlanta have outperformed the market a new product by over 200 basis points and in Washington, D.C. over 340 basis points. So, we think there may be some additional upside based on our strategy and our submarket selections beyond what you may see in a whole regional level.

Steve Riffee – Executive Vice President & Chief Financial Officer
Then I would take it from there and say we've really focused going into the winter months on occupancy and we've actually been talking a little bit since quarter end and it's very strong. And when you think about the real strong rental growth we've captured in this market up to now, we're putting our renewals our right now at 10% to 12% and we're expecting even the winter months high-single digit rent growth, etcetera. We do believe it will trail off towards December of 2023 and start out higher in the year and kind of average down.

In terms of just our leasing patterns and our volumes and activity, they're very strong. They're historically higher than we've seen in October and early November before. That carries really well in terms of strength. So we look at all of this and we're expecting with the earn-in and a healthy occupancy going into the winter months, we stress test it and we certainly don't have the kind of rental growth in 2023 that we've modeled in 2022 but we feel really good about it.

Q: But for 2023 NOI growth guidance, are we talking like 8.5% revenue and 6% in expense growth gets you to 10%? Are those the types of ranges you guys are thinking through?

Steve Riffee – Executive Vice President & Chief Financial Officer
We projected our expense growth to be around 7% on top of what we've experienced this year which was 5%. The categories that we think will be the highest for next year are going to be your payroll because we're offering incentives to get people to change jerseys and come over to our team, and then real estate taxes and utilities. So, we've left room for those kinds of increases in there.

Operator
Your next question for today is coming from Young Ku at Wells Fargo.

Q: I wanted to go back to your comments regarding acquisitions. You talked about adjusting return requirements on your end. So, maybe talk about how big the gap is between what you're willing to pay for and versus what those sellers' expectations are today.

Paul T. McDermott – President & Chief Executive Officer
Looking at acquisitions, maybe we can talk about cap rates just to start out. They are clearly varying by submarket to submarket and vintage to vintage. When I look at the effects of that, the Core and the Core plus cap rates, we haven't seen as much movement.

But on the value-add, because a lot of the buyers are very dependent on leverage, we've definitely seen some movement on the cap rates. And for the B value-add cap, that is the space that we play in, we've seen those move up to 100 basis points. And that's on limited quarterly data. Everybody's pipelines are down and transaction acquisition volume is down.

But it's not for us at least. It's not just about cap rates. It's about our going in basis as we've talked about the opportunity to create value, based on geographic demographics. Also, what the residual looks like at the back end for us. But we really see, as I said earlier, the market coming to us. I do acknowledge that there are some bid-asks gaps out there still.

We believe that most of the sellers and a lot of these value-add sellers that are either on floaters or are on shorter-term paper. We think there's going to be ample volume next year. But we do see higher cap rates than we've experienced over the last 24 to 36 months.

Q: Thanks for that color. You guys still have $125 million in capacity earmarked for acquisitions. And also mentioned that the implied cap rate is high versus peers. Is stock buyback something that you may consider instead of an acquisition?

Steve Riffee – Executive Vice President & Chief Financial Officer
This is how we're thinking about it. The big picture is the capital markets are unsettled right now and they just haven't adjusted yet to the post-Fed actions, thinking long-term here. Debt prices, equity prices assets. The macros have disrupted the equity markets and the macros with regarding us have masked the value that we've created with historic growth, a new trajectory, a strong balance sheet. So, we think we should let that settle.

Further, I'd say, asset prices, as Paul commented, have not adjusted fully yet. But we think cap rates are coming to us and we're positioned to create even further value when they do. The way we think about it is having historical growth, a strong balance sheet, liquidity, it's right where we should be if we're heading into more economic uncertainty or even a recession. It'll service really well as the equity prices and the asset values adjust and are fully discovered.

Regarding share repurchases, we only would look at them and we do model them all the time, but we'd only do them on a leverage-neutral basis. And right now, it actually doesn't pencil out as our best, most likely option in the near term.

Finally, if you think about our transformation scales our friend and making us more profitable. So getting smaller really doesn't make us stronger right now.

Q: Okay. Thank you for that color, Steve. Regarding Watergates. Like you said, there's seven years of term left. It's a good property. I just want to get a sense on what the physical utilization of that property has been, just to get a sense on how sticky the in-places leases are.

Paul T. McDermott – President & Chief Executive Officer
We are in the low 90% occupied, 92%. We've got good traffic coming through there. Our largest tenant has been there for quite some time. It's actually who we acquired the building off of. So we feel confident about future utilization. We would like to take advantage of some of the traffic we've seen as well as building at some time for the D.C. office market recovery.

Operator
Your next question is coming from Michael Lewis at Truist Securities.

Q: My first one for Steve is kind of a guidance question, what are you thinking about for the term loan next year and what do you anticipate the interest rate would be to refinance that?

Steve Riffee – Executive Vice President & Chief Financial Officer
We have a really good debt maturity ladder, but the $100 million is due in July of next year. We were working on some potential portfolio deals that don't pencil out now that might come back to us later so we were keeping that option open. Right now, what we've assumed in our guidance is that we'll refinance the term loan if it is swapped to fixed. I think you noted in your notes the 2.3% through July.

We'll plan on refinancing it in a short enough term that we can prepay it without penalty, but I anticipate that we will have opportunities to acquire, and we'll probably have to assume some debt so we're going to want some debt that we can repay. Looking at what that pricing might be, what we're assuming is low-5s after the fixed period.

Q: Just coming back to the question about the acquisitions? The company obviously has come a long way. I like the rebranding but when I look at this third quarter composition of the portfolio, you're still 80% D.C., Virginia, and Maryland apartment. You're about 10% office. There are no acquisitions in the 2023 guidance although it sounds like there may be some.

I'm just kind of curious, how much acquisition volume do you think you ultimately need to do to put this portfolio where it needs to be? And eventually you have some proceeds from the office, you've got, you have some dry powder right now. So I think you could do it, you know if the transaction market a little bit comes up. But, what's the total volume of deals that you think you need to do to get this portfolio where you ultimately want it to be?

Steve Riffee – Executive Vice President & Chief Financial Officer
I'll start it and let Paul talk about it strategically. There's more than one way to get there and clearly there's disruption. So, we're waiting for prices to settle, etcetera. When we rolled out in our webcast June a year ago, we

targeted to be like 40% in the Sunbelt, we're 20% there today and we've done a pretty good job of allocating. So, how do you do that? Well, one thing is you scale and you grow, and you continue to use new capital and go there. Another way is once you have asset prices, settle down and rediscover, you also do some recycling, etcetera.

A third way and we actually were in pretty good discussions, and they might come back to us when the capital markets make sense. But we were looking at NAV to NAV unit deals, and we had some opportunities that could have moved us there really quickly. So, we just need to let things play out and the options will present themselves and we'll do the right capital for the right opportunities at the right time.

But today, all we're saying is, we need to make sure that we only create shareholder value, we're solving for three things from the very beginning in addition to keeping the balance sheet strong. Number one is, we wanted profitable growth and we're delivering historic growth for the next year. The second thing was we wanted to geographically diversify. We got the 20% and we just talked about some of the options in the playbook that you just asked.

The third thing is scale. And scale can help us. We saw some ways to scale faster before the capital markets got worse because of the Fed. And I'm not sure the Fed is going to do this forever. So, I think those opportunities may represent themselves.

Paul T. McDermott – President & Chief Executive Officer
I do expect some type of settling in the second half of 2023. To Steve's point, the Fed is not going to do this forever. We are keeping in touch with the folks that we had those conversations with. And as well, I don't want anyone thinking for a moment that we're not still actively touring properties, visiting the submarkets that are on our target list, and maintaining our dialogue with both the brokers and the owners in those respective submarkets.

The only thing I'd add to what Steve said in terms of scale is that everything that we've gone through right now, we've always said, look, we'd like to double the size of the company. Now we've built out the infrastructure to do that. And I think now it's just a matter of executing on the right opportunities at the right time. I said it earlier, patience and discipline is the order of the day.

I think the ground is still moving under our feet and a lot of sellers want to see where the Fed shakes out as well as buyers. And so, I'm confident that we're going to see either from a one-off basis or from a portfolio basis opportunity in 2023 to scale. We're just not predicating everything on that at this moment just given the dynamics that are taking place in the marketplace.

Operator
The next question is a follow-up question coming from John Powlowski, your line is live.

Q: Can you just remind us if there are any known move outs of Watergate 600 for next year?

Paul T. McDermott – President & Chief Executive Officer
I don't believe there are, I'll double check on that, but I don't believe there are.

Operator
And if there are no further questions, I'd like to turn the floor back over to management for any closing comments.

Thank you. Again, I'd like to thank everyone for your time and interest today, and we look forward to speaking with many of you over the next several weeks. Thank you.

Operator
Thank you, ladies and gentlemen. This does conclude today's event. You may disconnect your phone lines at this time and have a wonderful da