

**Transcript of  
Elme Communities  
First Quarter 2023 Earnings Conference Call  
April 28, 2023**

**Participants**

Amy Hopkins - Vice President of Investor Relations, Elme Communities  
Paul McDermott - President and Chief Executive Officer, Elme Communities  
Steven Freishtat - Chief Financial Officer, Elme Communities

**Presentation**

Blaine Heck - Wells Fargo Securities  
Alan Peterson - Green Street

**Operator**

Greetings, and welcome to the Elme Communities First Quarter 2023 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 of Investor Relations, Elme Communities**

Good morning everyone and thank you for joining us for our first quarter earnings call. On the call with me today are Paul McDermott, President and Chief Executive Officer, Steven Freishtat, Executive Vice President and Chief Financial Officer, Grant Montgomery, Vice President and Head of Research, and Drew Hammond, Senior Vice President, Chief Accounting Officer and Treasurer.

Today's event is being webcast through the Investors section of our website at [elmecommunities.com](http://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 Investors page of our website.

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

## **Paul McDermott - President and Chief Executive Officer, Elme Communities**

Thank you, Amy. Good morning everyone, and thanks for joining us today. We delivered strong first quarter results and are on track to generate double-digit core FFO growth this year. Beyond 2023, we expect to deliver additional upside through operational initiatives enabled by our infrastructure transformation, which we look forward to discussing in detail later on this call. I will start with an update on our operating performance, investment market conditions and our progress on internalizing community level management.

Steve will discuss the multiyear financial impact of our operating model and technology initiatives, our first quarter financial results, and balance sheet and guidance updates.

Turning to our operating performance, effective blended lease rate growth was 4.5% during the quarter for our same-store portfolio comprised of effective renewal lease rate growth of 8% and effective new lease rate growth of 0.7%. Blended lease rates were in line with our expectations during this quarter supported by strong renewal rate growth.

We have signed renewal offers for April and May lease expirations with effective rate increases of between 6% and 7% on average. We expect renewal rates to average in the mid-single-digits through the summer months, followed by the low single-digits by the end of the year. We've seen a healthy upswing in new lease rates from March to April, and new lease rates are on an upward trend into May.

Same-store occupancy averaged 95.5% during the first quarter, which is up 50 basis points compared to the fourth quarter, driven by our focus on building occupancy during the winter months to allow us to push rents during our busiest leasing months. We've captured a small increase in same-store occupancy since quarter-end averaging 95.6% during the first three weeks of April. We continue to see very high retention above our historical average in the mid-50% range, averaging 64% during the first quarter for our same-store portfolio, which supported our year-to-date occupancy gains.

Over the longer-term, we expect our focus on elevating the living experience, the value oriented renters to support retention rates that are above the market average, contributing to higher revenue and lower expenses. Our current rent levels translate to rental rate growth of approximately 5.2%, which is over three quarters of the rental rate growth that we expect for the full-year. We expect rental rate growth to be the primary driver of revenue growth for the year, supported by year-over-year reductions in bad debt concessions, vacancy loss and growth in ancillary income.

Same-store delinquency has been improving since the Virginia Rent Assistant Program ended last July, and court timing in the jurisdictions where we are experiencing delays, such as Montgomery County, Maryland, and Cobb County and Sandy Springs, Georgia are beginning to return to their pre-COVID scheduling timetables.

Concessions are tracking to pre-COVID levels and as I mentioned, occupancy trended slightly below our forecast in March but is showing better momentum in April. Our outlook assumes additional occupancy gains during the summer months.

In terms of market rent levels overall, we are seeing an improvement along with an upward trending new lease rates. Combined with stable occupancy that has trended up in April and strong renewal rates through May and early June, we expect to deliver strong NOI growth from our multifamily portfolio this year. As the apartment market absorbs the impact of elevated supply through 2024, we expect to be less impacted than higher ended price points. Our midmarket price points provide relative insulation from new supply. The gap between our rents and new delivery in our Submarkets, even after factoring in the impact of concessions during lease-up is so wide that our homes do not compete with new deliveries.

In the Washington Metro, our monthly rents are over \$600, or 24% below the cost of new deliveries across our Submarkets. In Atlanta, our monthly rents are over \$430, or 22% below new supply across our Submarkets. The gap compared to the cost of owning a home in our markets is even wider, as our rents are \$1,200 or 38% and \$600 or 28% below the monthly cost to own in our Washington Metro and Atlanta Submarkets respectively.

Home ownership has become even less affordable in our markets over the past year, and it's resulted in a significant decline in the percentage of moveouts related to home ownership. Historically, the percentage of moveouts related to home ownership has typically ranged from 15% to 20%.

It hit a new low during the fourth quarter and trended up only slightly to 8.6% in the first quarter, which is down 46% compared to the prior-year. In addition to a large rent gap between our rent levels compared to new deliveries and the cost of owning a starter home, our communities are not located in Submarkets that are receiving high supply.

In the Washington Metro area, development is highly concentrated in the region's core versus our suburban focus, with 81% of units under construction inside the Capital Beltway. In Atlanta, almost 90% of the new supply in the Atlanta Metro is delivering outside of Elme's Submarkets through 2024.

Executing value-add renovations at low teen cash on cash returns remains part of our growth strategy. If the economy softens, we would expect to see an increase in renters prioritizing value. Our renovation programs position us to capture trade downs by offering light new materials at several hundred dollars below the monthly cost of Class A apartments. We have completed over 80 renovations year-to-date at an average ROI of 13.5%.

We expect to complete between 450 and 500 units in 2023 and for renovation led value creation to drive higher rent and NOI growth over time.

Turning to the apartment investment market, we continue to prioritize expanding our geographic footprint, but recognize that opportunities to scale our portfolio may not pencil out given the current market volatility. Our geographic expansion strategy has been successful thus far, and our performance is matching up with our underwriting. As owners come to terms with the reality of a higher interest rate environment, we will be ready to act upon opportunities that we expect will create value for our shareholders.

We are targeting markets that have industries with the best long-term growth prospects and a growing need for affordable rental options for median incomes. We are now just three months away from completing the final phase of our internalization process. We began onboarding our communities last October and we already have transitioned nearly 70% of our homes to Elme Management. Transforming our operating model and technology platform has enabled our teams to drive operational improvements and technology enhancements that will increase our profitability and offer a better living experience for our residents.

By integrating our corporate and community level teams, we're establishing policies, strategies, and incentive structures to achieve our goals. Our internal transformation is a game changer for both revenue and expense management, providing the operational oversight and accessibility needed to take our platform to the next level.

I would now like to turn it over to Steve to discuss the anticipated impact of our operating platform initiatives and technology investments on our margin and Core FFO and AFFO.

### **Steven Freishtat - Chief Financial Officer, Elme Communities**

Thanks, Paul. The full spectrum of operational benefits that we can access as we onboard community operations is extensive, and we are beginning to tap into those benefits with the majority of the internal infrastructure investment now behind us. We estimate the total NOI opportunity to be between \$4 million to \$4.5 million, which represents the additional NOI that we expect to generate above what we would have otherwise generated from 2023 through 2025, had we not internalized community operations. Including the impact of internalizing community level cash management, resulting in interest expense savings on our line of credit. The total expected FFO impact is expected to be between \$4.25 million and \$4.75 million.

Now, I'd like to take a few minutes to discuss each area of operational upside. Starting with the initiative that offers the most NOI upside, which is our investment in Smart Home Technology. Our Smart Home Packages include smart locks, smart thermostats, smart lights, and water leak sensors, which are the technologies that offer the best returns for our price points, while broadening the appeal of our homes to a wider range of residents.

We view this investment as a competitive advantage and believe it will better position us to capture prospective renters who may be looking to trade down for better value. Less than a quarter of apartment homes at Elme's midmarket rent level offer smart locks, according to a survey completed by NMHC.

Our smart home rollout will be completed by the fall, and we expect these technologies to generate a solid return on investment by driving higher rents, reducing operating expenses, advancing our environmental goals, and enabling future technology initiatives, including self-guided tours.

Moving on to our Occupancy Initiatives. We are implementing revised scheduling, policy and process adjustments to manage our occupancy levels more effectively and to minimize the number

of vacant days between apartment turns. We are targeting a five day reduction in our average vacant days by 2025.

Next, managing our communities in house will allow us to effectively capitalize on fee income opportunities, which include WiFi, parking and storage strategies, and preferred renters insurance to name a few. We are also revising our vendor payment process to better utilize virtual cards, which offer credit card rebates, and simplifying our purchasing process through a mobile enabled procurement system integrated with our payables platform.

In terms of Cash Management and Expense Initiatives. We now have access to rent payments earlier following our transition to in-house management and can run a lower average balance on a revolver, resulting in interest expense savings. Additionally, we are taking advantage of tech hardware and software efficiencies at our communities, including reducing telecommunications costs and standardizing maintenance, hardware and software, to name a few.

The fifth category of operational upside is Phase 1 of our multi-year Centralization Initiative, which consists of centralized Resident Accounts Management. By centralizing resident billings, payment applications, collections, resident inquiries, and ledger adjustments using a combination of technology and human interaction, we will automate payment messaging and follow-ups with the goal of accelerating payments, reducing delinquencies, and removing time consuming and non-value added tasks from our community teams. This initiative will create a more seamless payables and receivables experience for residents.

While still in the planning phase and not incorporated into the \$4.25 million to \$4.75 million of operational upside. We intend to centralize renewal negotiations in Phase 2 of our centralization initiative. Centralizing renewal negotiations through early targeted communication utilizing our state-of-the-art CRM system and other technology tools is expected to reduce vacancy, increase efficiency at the community level, and provide a consistent customer experience. Future phases will include leasing and maintenance, and we are continually enhancing property technology infrastructure to enable strategic implementation throughout the portfolio. We look forward to providing more detail as we proceed with implementation.

As we've outlined, we have a wide range of opportunities for operational upside, providing the opportunity to deliver above market, NOI growth over the next several years. Approximately 20% of the total Core FFO benefit of the \$4.25 million to \$4.75 million is expected to be captured this year, with the remaining 80% contributing to NOI and Core FFO growth in 2024 and 2025.

Combined with a strategy that outperforms across cycles and provides relative insulation during periods of economic weakness, we believe we are positioned to create additional value by delivering the operational upside we built into our platform.

Now, turning to our first quarter financial results. Core FFO for the first quarter was \$0.24 per diluted share, representing year-over-year growth of 20%. Multifamily same-store revenue grew by 9% for the quarter due to growth in rental rates, lower concessions and higher occupancy. Operating expenses grew 6% for the first quarter, driven by non-controllable expenses such as real estate taxes and utilities, resulting in multifamily same-store NOI growth of 10.7%.

Average effective monthly rent per home grew 9.7% in the first quarter compared to the prior year for our same-store portfolio, reflecting the impact of the very strong lease rate growth we captured during 2022 and during the first quarter. For our portfolio, average monthly rent grew significantly more in the second half of 2022 to provide historically high embedded growth at the end of the year.

Moving on to our balance sheet. With an annualized first quarter net debt to EBITDA of 4.8x over \$670 million of availability on our line of credit, no secured debt, no debt maturities until 2025 with options to extend out even further and limited exposure to floating rate debt, our balance sheet is in excellent shape.

In March, we took advantage of an opportunity to reduce our interest rate risks and eliminate a major driver of variability in our 2023 interest expense forecast by executing interest rate swaps that convert our \$125 million term loan from a floating rate to a fixed rate of 4.73% from this July through January 2025.

The swaps allowed us to lower and tighten our interest expense guidance point, despite fed actions, which drove interest rate expectations above our forecast from last September, when we initially issued our 2023 guidance. The only floating rate debt we currently have is the balance on our line of credit and \$25 million of our term loan.

Starting in July, our line of credit balance will be our only floating rate debt. The term loan closing in January this year and the associated swaps we executed in March demonstrate our proactive approach to balance sheet management. We will continue to take an opportunistic yet balanced approach to managing our debt maturity ladder and interest rate risk in order to support our strong growth profile over the coming years, while maintaining our financial flexibility and optionality so we can be ready to act upon opportunities to scale our portfolio.

Now, turning to our outlook for the balance of the year. We are tightening our 2023 core FFO guidance range to \$0.96, \$1.02 per fully diluted share, which implies double-digit year-over-year core FFO growth. Same-store multifamily NOI growth is now expected to range between 9% and 10.5%, and non-same-store multifamily NOI is now expected to range from \$12.75 million to \$13.5 million in 2023. Although we are lowering the top end of our same-store and non-same-store NOI guidance ranges, given increased visibility into the Spring leasing season, we see good momentum in April as new lease rates are trending up and renewal rates remain very strong into May.

With over 5.2% of rental rate growth already captured, we feel good about our ability to deliver strong growth this year. While our non-same-store NOI guidance range does not reflect the impact of potential acquisitions, we had more than \$670 million of availability on our line of credit as of quarter end, and we are running below our targeted leverage levels.

We will continue to evaluate acquisition opportunities in our target markets and will further pursue acquisitions when they create additional value for shareholders. Other same-store NOI, which consists solely of Watergate 600 is now expected to range from \$12.5 million to \$13.25 million,

due primarily to higher than expected operating expenses in a few categories, the largest of these categories being utility expenses that are trending higher than we previously forecasted.

We also revised our forecast for event related and tenant daily parking income as the increase in usage has not materialized as originally expected. We are reducing our guidance for G&A net of core adjustments to a range of \$25.25 million to \$26.25 million due to our focus on cost savings initiatives and higher allocation of internal time to transaction activities, including community level training, expansion of our resident experience, technology offerings, and community recruiting efforts.

Our G&A guidance excludes the impact of transformation investments for our platform and our full integration, which we now expect to be between \$5 million and \$6 million due to higher allocation of internal time to transformation activities, higher transition expenses, and higher consulting and marketing expenses related to our rebranding.

Interest expense is now expected to range between \$28.5 and \$29.25 million, which incorporates the impact of our new term loan swaps. We continue to expect our core AFFO payout ratio for this year to be at or below our mid-70s target, and we are managing to an AFFO growth profile that should provide us with additional flexibility to grow the dividend over time.

Before I turn it over to Paul, I'll quickly touch on our ESG updates. Our commitment to ESG has grown during our transformation into a multifamily owner and operator, and it will continue to be a core focus of our entire organization going forward.

Recently, we took strides to enhance our multifamily ESG program across all three pillars. We focused on reducing emissions, providing greater ESG disclosure, and developing policies that align with our ESG goals and values as a multifamily operator. In 2023, we have already increased our MSCI ESG rating from BBB to A and were labeled low risk following our first comprehensive ESG review from Sustainalytics.

Additionally, we achieved 2023 Green Lease Leaders Gold for both our office and residential portfolios from Institute for Market Transformation and the U.S. Department of Energy's Better Buildings Alliance. We have set a strong foundation of sustainability and ESG within our organization, and this year we look forward to redefining new short-term and long-term impact goals as a multifamily focused company.

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

### **Paul McDermott - President and Chief Executive Officer, Elme Communities**

Thank you, Steve. To conclude, we delivered a solid first quarter and we are on a path to a very strong year. We expect to complete the transition of our portfolio to Elme Management this summer, and we see the opportunity to deliver above market growth beyond 2023, driven by operational upside from our internal infrastructure and technology investments.

We have a strong balance sheet with limited exposure to interest rate changes and no maturities until 2025. While the potential for an economic slowdown continues to weigh on sentiment, our outlook is strong and we are well positioned with a geographic mix that provides relative insulation from job losses and midmarket price points that provide meaningful differentiation from new supply.

Looking forward, we believe that increasing demand for quality homes at midmarket price points and focus on elevating the living experience for our residents will produce outsized growth over the long-term.

And now operator, I'd like to open it up for questions.

### **Operator**

Thank you. At this time, we will be conducting a question-and-answer session. Our first question is coming from Blaine Heck with Wells Fargo. You may proceed.

**Q:** Great, thanks. Good morning. Paul, can you give us a sense of whether you expect opportunistic or somewhat distressed situations to emerge given the disruption that we've seen in the capital markets, and then given your liquidity and low leverage, would you guys be interested in partnering with groups that may need some capital to complete development projects or renovations or would you focus more on core kind of fully consolidated transactions?

### **Paul McDermott - President and Chief Executive Officer, Elme Communities**

Thanks, Blaine. First off, just looking at the landscape in the markets right now, we're really only seeing on a macro level, two types of sellers, the largest owners that really have liquidity needs in other parts of their business. So they're obviously selling product that can clear the market, and some of those owners have queues. And then we're also seeing merchant builders that are exiting product that are really at or approaching stabilization.

I think a lot of the folks that we've directly called are more in an asset management mode. They're trying to hold on to what they have. Now, with that said, we still have \$318 billion in maturities coming in '23 and '24 and, during that same time frame, we have a lot of interest rate caps expiring that I don't think are going to qualify for extensions. So we anticipate definitely seeing more product, but it has been thin on the front end.

The people that are out there buying right now, it's really -- we're really seeing the private equity people dominate the landscape. So we really haven't seen as much distress. And a lot of that private equity is attracted to assumable debt or a discount to replacement cost. And this is all with normal underwriting, normalized underwriting in terms of rent growth, taxes, et cetera, reserves. But we have not seen the institutionals going either on the buy or the sell side. So, again, just not that much distress right now.

Tremendous amount of BOV activity, but we have not seen that translate into deals yet. Blaine, I think another rate hike by the Fed may trigger some of that. The deals that we are seeing that are



clearing the market are kind of the smaller deals, less than \$100 million, and they're kind of in the newer side, the higher growth gateway markets. And we've also simultaneously seen that cap rate expansion starting to slow down a little bit, but the quality product has multiple bids on it. Cash buyers not really relying on the debt markets, obviously, to bail them out.

In terms of capital allocation, and would we look at partnering with groups? We've spent a significant amount of time as you know, really trying to simplify our story, so we don't want to complicate it by putting into place a complex structure. But with that said, I think you nailed it. There are going to be shortfall out there either on large portfolio recaps, on large one off recaps. Right now, the rescue capital is probably pricing that preferred equity slice is probably pricing between 11% and 13%. So it's expensive.

And so we definitely would acknowledge there's probably going to be some opportunities, and we have been approached by some people, but I think we've also want to see a little bit more market recovery on pricing before we can put a stake in the ground and say we're going to go in that direction, Blaine.

**Q:** Thanks, Paul. Really helpful there. Second question for me. Can you guys just provide a little bit more color on the plan to reduce G&A and where those savings are coming from? I know it's a small reduction, but I guess my impression was that you guys were looking to grow into the G&A load that you have through the acquisitions and investment through development. So is this just signaling kind of a lack of upcoming external growth opportunities, or is it more about scaling back to make the company a little more efficient and achieve your earnings targets despite a little slower spring leasing season? Just any color you can give on that G&A reduction would be helpful?

**Steven Freishtat - Chief Financial Officer, Elme Communities**

Yes, Blaine, this is Steve. We're seeing an impact on our G&A this year, a couple of things, as we outlined in the call. One is that we're looking at cost savings and efficiencies as we're bringing in onboarding. Our communities are now in house. Also, as we're doing that, we've got our transformation costs that we've seen more internal time go to training as we onboard, and because we're really building out a robust technology platform. So making sure that all folks are trained appropriately on that, that's really driven the G&A to the level that we're guiding to.

And then as we on board, we had said before that we thought G&A, this is kind of going to be the level that we're going to be at. And I think that's going to be the case as we look forward. And then as we look to scale of the company, we've talked about being able to nearly double the unit count of the company and keep G&A really materially the same. So I think that the levels that we're looking at are probably where we're going to be looking for the next couple of years.

**Q:** All right. Great. Thank you, guys.

**Operator**

Thank you. Our next question is coming from Alan Peterson with Green Street. You may proceed.

**Q:** Thank you. And thanks for the time. I was just hoping you guys could shed some light on the deceleration in March. You guys had shared that new lease growth in the first half of February was at roughly mid 3%. I was just hoping to understand what drove some of that deceleration in the March month timeframe there.

**Steven Freishtat - Chief Financial Officer, Elme Communities**

Yes, Alan. Thanks. This is Steve. So we saw coming into the year, coming out of the winter, new lease growth increasing in January and February. Kind of saw that halt there in March a bit, didn't quite align with what we were initially expecting. But have seen that come back in April, that we've seen that trend in April return to going in the upward direction, seeing April about 150 basis points and 200 basis points on a new lease growth level above March and are seeing May continue above that.

So as we look out through the year on our new lease rate expectations, we're expecting and forecasting that to get to the mid single-digit level through the summer, really in the busier spring and summer leasing season. And then return back to a low single-digit number towards the end of the year, really following more of a typical seasonal pattern.

And then on the renewal side, Paul touched on a little bit in the prepared remarks. We've seen a slow moderation of that, as expected, that we were in the high single-digits at the beginning of the year, really trending down to a mid single-digits here towards the middle of the year, and then going into low single-digits towards the end of the year. So that's really tracking in line with our expectations.

**Q:** I appreciate that. And the change in NOI guidance this quarter, was that solely driven off of new top-line expectations or have there been any changes to the 7% expense growth that you were expecting as of last quarter?

**Steven Freishtat - Chief Financial Officer, Elme Communities**

Yes, Alan, obviously we came out with our guidance in the fall, and here now in April, we have the benefit of now four months of seeing how the year is turning out. And so our expectations on the revenue side reflect that, and being transparent, we're expecting revenue growth of about 8% to 8.5% percent for the year.

On the expense side, you're right. We were at 7%, probably coming in a little bit lower than that, kind of 6% to 6.5% for the year driven by a couple of things. One is real estate taxes. We have anticipated a real estate tax increase this year. We've seen some assessments come in a little bit lower than expected. And so that's an update as well. On the payroll side, we came in with expectations. Now that we have onboarded properties, we're seeing opportunities for some efficiencies. So you're really seeing that flow through there.

We mentioned on the call the \$4.25 million to \$4.75 million of operational enhancements and upside that we have and being able to take about 20% of that this year. So we're starting to -- we're

seeing that in the numbers and really have that build throughout the year and being able to take advantage of the enhancements of onboarding our communities.

**Q:** Understood. I appreciate that. And just one more from me. Paul, the pause in the transaction market today, has it made you reconsider or reassess the development opportunity at Riverside as a potential external growth opportunity? And if so, what type of moderation and cost are you seeing or potential development yields would you see at a Riverside development today?

**Paul McDermott - President and Chief Executive Officer, Elme Communities**

Well, Alan, I think if we are going in under the premise that acquisitions are and we've seen the cap rate expansion that probably year-over-year we've looked at it probably a 15% to 20% discount. And then development costs right now, I think for anybody, not just Elme Communities to go into the ground, I think you'd probably be looking at 6% to a 6.5% return on cost.

I think we still like the current income facet of acquisitions without the construction risk. I'd also say just the capital markets right now, given the size of the Riverside development, it's 747 units. I think that that would have to -- that's going to get a lot of scrutiny from construction lenders right now and I think it would be pricey. We continue to monitor it. I think that market has tightened up dramatically, but it's also our largest asset and we're being sensitive to concentration risk by layering that construction loan on top of an existing 1,200 plus units.

So I'm not saying we would take that off to the table, but I think we'd like to see a little bit more improvement in the capital markets before we move forward with that.

**Q:** Definitely, understood and appreciate all the thoughts there.

**Paul McDermott - President and Chief Executive Officer, Elme Communities**

Thank you, Alan.

**Operator**

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

**Paul McDermott - President and Chief Executive Officer, Elme Communities**

Thank you. Again, I would 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 everyone.

**Operator**

This does conclude today's conference. You may disconnect your lines at this time and we thank you for your participation.