

Transcript of WashREIT Second Quarter 2022 Earnings Conference Call July 29, 2022

Participants

Paul McDermott - Chairman, President & Chief Executive Officer
Stephen Riffie - Executive Vice President & Chief Financial Officer
Amy Hopkins – Vice President, Investor Relations
Grant Montgomery - Vice President, Head of Research

Analysts

Bill Crow – Raymond James
Michael Gorman – BTIG
Blaine Heck – Wells Fargo
Michael Lewis – Truist Securities
Alan Peterson – Green Street

Presentation

Operator

Welcome to the WashREIT Second 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 second quarter earnings call. On the call with me today are Paul McDermott, President and Chief Executive Officer; Steve Riffie, Executive Vice President and Chief Financial Officer; Grant Montgomery, Vice President and Head of Research; Drew Hammond, Vice President, Chief Accounting Officer and Treasurer; and Steven Freishtat, Vice President, Finance.

Before we begin, 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 now, I'd like to turn the call over to our President and Chief Executive Officer, Paul McDermott.

Paul McDermott – Chairman, President & Chief Executive Officer

Thank you, Amy. Good morning, everyone, and thank you for joining our second quarter 2022 earnings call.

These are obviously quite interesting times. The capital markets have been disrupted as a result of the Fed's response to rising inflation as well as other macro events, yet apartment market fundamentals remain historically strong. Interest rate movement has caused debt markets to pull back, and as a result, transactional markets have slowed down substantially. However, as an all-cash buyer, we continue to receive calls about acquisition opportunities as certainty of execution is now paramount.

We have completed the deployment of the commercial asset sale proceeds and are working on additional opportunities to continue our growth and geographic diversification. Steve will cover where our portfolio is one year after launching major transformation steps and the anniversary of turning the corner from the worst of pandemic leasing conditions, as well as our second quarter results and growth outlook. But first I would like to talk about the environment we now face in the near term as we continue our geographic expansion.

As interest rates have risen, deal competition has subsided as leveraged buyers face negative terms and have moved to the sideline. Our underwriting has been conservative, and we planned for the potential of a lower growth economy. We underwrote the expectation for 2023 rent increases to trend down to high single digits versus the unprecedented double-digit trade outs we are continuing to experience thus far, and to approximate historical levels after 2023.

Depending upon the market, submarket and vintage of assets, we believe cap rates have expanded 30 to 50 basis points and we will continue to monitor price movement as the markets are still volatile. That said, we have capital to deploy and are being judicious with our underwriting and continue to insist on full due diligence on each acquisition we pursue. Recently we passed on a transaction as our disciplined due diligence discovered additional capital requirements. While market conditions had changed, we were not able to be compensated adequately by the seller. Although this decision delays our assumed acquisition timing and lowers near-term guidance, we still have a good pipeline of opportunities and are confident we will complete acquisitions meeting our requirements this year.

In May we closed on the acquisitions of Alder Park and Marietta Crossing for \$178 million, bringing the total size of our Atlanta portfolio to approximately 1,800 units, or just over 20% of our total homes.

Our acquired portfolio returns continue to exceed the expectations that we underwrote as we assumed that the current very strong rent growth levels would moderate in the coming years. Maintaining this discipline, along with focusing on growth starting with firm initial yield targets, has proven to be prudent as the environment shifts.

Thus far, we've executed on our geographic expansion by targeting specific assets, but we are also evaluating private portfolios and other opportunities which would allow us to scale our portfolio more rapidly in line with our strategic direction. While there is currently less product in the markets as sellers are assessing conditions, we are working on opportunities to continue to grow, including exploring ways to structure transactions based on net asset values. These kinds of opportunities take time but may provide excellent mutual value creation opportunities ahead.

With that market back drop, I'd like to comment on the operating environment in our markets.

We continue to benefit from good fundamentals driven by strong demand for value-oriented homes in the DC Metro and Atlanta. Nearly 80% of our same-store portfolio is located in Northern Virginia, where effective rents

accelerated into the summer months, rising nearly 3.5% on average during the second quarter and 13% year over year, according to RealPage. New lease trade outs for the Washington region, which continue to have positive momentum, increased 15.4% for the second quarter, up 430 basis points from last quarter. In Atlanta, year-over-year effective rents grew by 16.8% in the second quarter, as reported by RealPage, and remain at near record levels.

Our communities are benefiting from strong demand and high retention in addition to significant growth in market rents. Even as the outsized market rent growth that we are seeing today moderates, we foresee sustained demand for our value-oriented price points.

As interest rates have increased, homeownership has become even less affordable for middle income renters, which comprise the largest share of renter households in our current and target markets. Housing shortages continue to worsen overall, and the lack of affordable housing options is even higher. According to a recent study, the Washington Metro has a shortage of 151,000 housing units and Atlanta has a shortage of 81,000 housing units. Within our Washington Metro markets, the premium to own a starter home compared to our current average asking rent is over \$1,700 per month. In Atlanta, it's approximately \$1,000 and widening, as Atlanta home values have risen nearly 60% compared to three years ago. In fact, the differential cost between renting versus owning nationally is the highest it's been this century.

We're seeing the impact of the rising cost of homeownership in our moveout statistics, as the number of moveouts related to home purchases declined 20% year over year during the second quarter and over 25% on a year-to-date basis for our same store portfolio. Move outs driven by home purchases were even lower in our Atlanta communities, representing less than 9% of our second quarter move outs.

Furthermore, the majority of new supply coming into our markets is concentrated outside of the areas where our communities are located. Only 11% of the new supply in Atlanta and less than a third of the new supply in the Washington Metro is delivering into WashREIT submarkets in 2022 and 2023. Moreover, our price points do not compete with new deliveries. Our average effective monthly rent is \$800 lower than newly delivered Class A communities in the Washington Metro, and \$480 lower for our Atlanta communities. Given the recent rise in construction and debt costs, we expect supply levels to decline past 2023.

So far this year, we've achieved higher rental rates than we had expected, and market rent growth has remained very strong into the summer. Over 30% of our leases expire between July and September, and we expect same store NOI growth to be higher in the second half of the year as the combination of rate increases earned into our rent roll and final pandemic leases rolling off drives higher overall growth in rental income.

Additionally, income growth remains robust, and can support continued rent growth. Median incomes for our Washington Metro communities have risen 12% over the past year, and 14% for our Atlanta communities from the second half of 2021 to the first half of 2022, underscoring the strengthening credit profile of our resident base as market rents grow.

Given the strong demand levels that we are seeing today, combined with rent increases we have experienced since last July, we are well positioned for strong same store NOI growth for the rest of 2022 and 2023. The acquisitions we have made throughout 2022 will provide even greater NOI growth. We expect strong NOI, Core FFO and Core AFFO growth going forward beginning this third quarter of 2022 and further strengthening in 2023.

In fact, with this growth building, I want to be clear that the reason we are lowering the balance of 2022 guidance is because we delayed the timing of the assumed acquisition and are capitalizing less interest because now is not the time to activate development at the Riverside. As Steve will cover, our growth is now getting stronger.

As we continue our transformation, we are rolling out new and improved operational infrastructure that will position us to deliver better service to our residents and operating leverage for our shareholders as we grow. We are making great progress on this part of our transformation, and we continue to uncover new opportunities to improve property-level operations.

We're executing a major overhaul of our operating model, technology platform, human resource infrastructure and brand strategy ahead of internalizing property-level residential operations later this year. This transformation includes three phases in total, and we are now moving into phase 3.

Since our last update, we have designed our near-term and future-state human capital models and have filled several key positions and are continuing to recruit for corporate positions that will support our internalized model. We are redefining our culture to further support and meet resident needs while incorporating Diversity, Equity, Inclusion and Belonging into all people-related aspects of this project. As we look forward to welcoming the onsite property teams to the company, we are building out our training program and developing compensation and incentive packages to align all team members with our resident-centric mission and long-term vision and ultimately support our business strategy and growth.

We are implementing our core technology platform and are testing and planning for cutover of third-party data into our new core operating system. We are also creating a resident-focused brand strategy, with plans to launch our new name, brand and website later this year. A significant component of our marketing will be focused on customer experience and technology enablement.

Along with our infrastructure overhaul, we aim to elevate the value living experience for mid-market renters by rolling out a pilot program that brings the ease of living and operating cost avoidance provided by smart home and smart building automation. It's a well-known fact that Class B properties have lagged Class A when it comes to technology investments. But we believe that by tailoring our technology investments to the needs and priorities of our residents we can improve our residents' day-to-day experience at investment levels that make sense for mid-market price points with technologies that will reduce our operating expenses and advance our environmental goals.

Our initial pilot program includes smart door locks, thermostats, water leak sensors and community-wide Wi-Fi designed to ease the resident move in and living experience. We plan to roll out this pilot initiative as part of our broader plan to improve and streamline the technology used at communities as we start to bring property-level operations in-house starting later this year.

We expect the process of onboarding the property-level operations in each of our communities onto our internal systems to be completed by mid-2023 and for most of the costs related to the broader infrastructure transformation to be absorbed this year, in line with our updated guidance range. By year-end, we expect to have the G&A expense base in place going forward, which will not be substantially different from the ongoing level that it's at today, to support a doubling of our unit count when conditions are appropriate to do so. The future should provide additional opportunities and benefits to scale the business and optimize our expense base. Meanwhile,

we now have significant growth earned into our portfolio as we creatively wait for the best opportunities to further scale. Steve will expand on that further. However, before we cover that, I'd like to provide an update on a couple of our recent ESG initiatives. We've nearly completed the installation of solar panels on two of our apartment communities in DC. When activated, these systems will generate enough clean energy to reduce greenhouse gas emissions equivalent to the impact of 7,800 trees each year. Additionally, this past month we kicked off the installation of electric vehicle charging stations across all of our Maryland communities. We are coordinating with the State of Maryland, as well as the local electric utility to take advantage of rebates that will potentially cover 100% of the installation costs. We are actively coordinating across our Virginia and DC properties to identify and take advantage of other similar rebate opportunities to lower the entry cost of installing EV charging for our residents given the increased demand in the past year.

Now I'd like to turn the call over to Steve to discuss our growth outlook in more detail, capital allocation and planning, and our second quarter results and outlook.

Steve Riffie – Executive Vice President & Chief Financial Officer

Thank you Paul, and good morning, everyone. I'd like to cover where we are at this point, having launched our most significant steps in our transformation one year ago, and talk about our operating results, trends and outlook before covering our second quarter results and guidance.

We are now in the third quarter of 2022, which represents the first quarter of performance that includes the full allocation of the net proceeds from exiting our commercial businesses. It will also be the first quarter where substantially all of our multifamily leases have had at least one post-pandemic-inflection lease-rate increase.

Our transformation was designed to provide tailwinds of growth as opposed to the headwinds facing the commercial office and retail sectors. We have had historically strong rent-trade outs since we reached the pandemic-rental-inflection point beginning, on average, last July. By the end of this quarter, nearly all of our leases will have captured strong year-over-year rent trade outs and substantially all pandemic lease concessions will have now burned off. The growth that we are capturing as we sign new leases remained in the double digits for leases signed to date with July and August commencement dates, reaching yet a new same-store peak for effective-new-lease trade outs of 13.9% for July. Our total loss-to-lease stood at 11% at quarter end, and combined, this gives us true visibility into the growth that is ahead.

Starting with the third quarter of 2022, we expect to average double digit same-store multifamily NOI growth for the next five quarters. All things considered, we have excellent visibility into very strong NOI and Core FFO growth for the second half of 2022 and all of 2023.

On top of our historically strong same-store growth, we have strategically and geographically expanded and invested in southeast communities where the year-over-year growth for the months owned in both 2022 and 2023 will be much higher than our same-store growth.

While we are forecasting inflationary impacts on our cost-base, most notably payroll and utility costs, we have a rent-roll with fully embedded year-over-year rental growth that is further enhanced by the burn off of the pandemic induced lease concessions. As we capture our loss-to-lease, it will build on top of the growth that is already embedded in our rent roll, driving higher NOI growth which will carry into 2023. Given that most of this growth is

either earned in or embedded in our loss-to-lease, it is now visible as we begin the third quarter and again, we expect it to drive strong Core FFO and AFFO growth through 2023 as well.

Another main objective, as we launched this final step of our transformation into a multifamily company, was to geographically diversify our portfolio. As Paul just gave an update on our recent acquisitions, we have made great progress thus far, as annualized NOI for our Atlanta communities is expected to be approximately 20% of our multifamily NOI by the fourth quarter of 2022.

We continue to evaluate southeast acquisitions on an ongoing basis and are exploring additional opportunities to further diversify our geographic concentration. We will monitor capital markets and pursue opportunities to scale and diversify, by recycling some lower growth assets in our DC Metro portfolio into higher growth southeastern communities, that align with our investment strategies.

We will be disciplined about accessing capital markets and we certainly see the current disruptions to them. We are creatively exploring other opportunities to scale, grow profitability and further expand geographically, including through private portfolios via possible NAV-to-NAV structured acquisitions that could make sense for both parties. These pursuits take time to evaluate and execute and may provide excellent opportunities to further accomplish our three objectives of profitable growth, geographic expansion and profitably scaling the company, when it makes sense to do so. Nevertheless, our primary objective of delivering value and profitable growth is now visible and we are experiencing it as we begin the third quarter.

Now turning to our operating highlights. Same store occupancy averaged 95.8% during the quarter and retention was 63% during the quarter, representing a 6% year-over-year increase.

For same store move-ins that took place during the second quarter, effective-new-lease-rate growth was 11.7% and effective-renewal-lease-rate growth was 10.9%, which blends to 11.2%. We are continuing to achieve mid-teen effective new-lease-rate growth for our same-store communities, averaging approximately 13.9% for July move ins.

For Atlanta move-ins that took place during the second quarter, effective-new-lease rate growth was 17.7% and effective-renewal-lease rate growth was 16.3%, which blends to 16.9%. For July move-ins, new-lease-rates increased 18.2% and renewal-lease-rates increased 16.3% resulting in blended-lease-rate growth of 17% in our Atlanta communities.

We expect blended-lease-rate growth to moderate after the seasonal summer months but remain above historical levels through 2023. Beyond what's already reflected in our loss-to lease, average-effective-market-rent growth is expected to be approximately 11% for the Atlanta region and 6% for the Washington Metro area for 2023, according to RealPage data.

Our loss-to-lease stands at 15% for our non-same-store portfolio and just over 10% for our same-store portfolio which blends to a total loss-to-lease of 11%. We expect to capture our loss-to-lease over the next 12 to 16 months, allowing in-place rents to grow as the portfolio turns.

During the second quarter, we renovated 75 units for a return on investment of a little over 12% 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 25%. As we continue to acquire communities with renovation potential, we expect renovation-led value creation to have an increasing impact on our growth trajectory alongside our geographic expansion. In particular we expect renovations to extend the tail of our rental rate and NOI growth going forward. We expect to return to our historical annual renovation run rate of approximately 600 units per year as we look forward, and then grow that as we continue to scale.

Our forecast contemplates inflation pressure on wages, utilities, insurance and repairs and maintenance costs into 2023. Even considering those factors, at this point, we expect strong NOI growth in 2023.

Now turning to our financial performance. Net loss for the second quarter of 2022 was approximately \$8.9 million, or \$0.10 per diluted share compared to a net loss of \$7.0 million or \$0.08 per diluted share in the prior year.

Core FFO was \$0.21 per diluted share, reflecting a year-over-year decline of \$0.14 due to the impact of our commercial asset sales, as well as the timing of reinvestment.

Multifamily same-store NOI grew 5.1% over the prior year driven by higher base rent and occupancy compared to the prior year period, offset in part, by higher bad debt. The increase in bad debt was largely due to some increasing delinquencies as a result of an extended eviction timeline, while the Virginia's government assistance program was winding down prior to ending on July 1. We expect repossessions to increase during the third quarter and for bad debt to show a visible decline in the fourth quarter.

Average effective monthly rent per home for the quarter increased 7% compared to the prior-year period on a same-store basis, which also represents a substantial improvement compared to the 3% year-over-year growth achieved last quarter. As we mentioned last quarter, we expected growth in average-monthly rent to remain strong over the course of the year, as more and more rental growth has been captured in our rent rolls to date. We still have one-third of our leases expiring during the third quarter, replacing leases signed while rents were just beginning to recover, starting July of last year.

Other NOI, which represents Watergate 600, grew 9.6% in the second quarter compared to the prior year driven by higher rental income from new leasing and rent increases, as well as increased parking usage. Watergate 600 is an architectural landmark in an amenity-rich neighborhood, with a high-quality institutional tenant base.

Now turning to our outlook for the balance of the year. We are slightly lowering and tightening our guidance range by \$0.02 at the midpoint due to a delay in timing of further acquisitions and increased interest costs, including lower capitalized interest and higher interest rates. Neither of these adjustments have changed our outlook for 2023. We are raising and tightening our same-store multifamily NOI growth guidance and now expect it to range between 8.5% and 9.5%. At the mid-point this represents 11.5% NOI growth for the last two quarters, and a 25 basis point increase over our prior guidance. NOI growth for same-store and Trove combined also increased and is now expected to be between 12.25% and 13.25%. Trove was fully invested in both years and represents true year-over-year growth on the same capital investment.

Non-same-store multifamily NOI, which consists of Trove, The Oxford, Assembly Eagles Landing, Carlyle of Sandy Springs, Alder Park, Marietta Crossing and the Riverside Development site is expected to be between \$22 and \$23 million, of which Trove represents approximately \$7 million. This is slightly lower than previous guidance as operating expenses and bad debt are expected to be higher and capitalized costs related to development are

lower. We have raised the midpoint of our guidance for other same-store NOI, which consists solely of Watergate 600, to a range from \$13.25 to \$13.75 million.

Our FFO guidance range incorporates approximately \$125 million of additional acquisitions, now expected in the fourth quarter of this year, later than previously guided. This delay in timing, net of carry costs, lowered our 2022 guidance by approximately a \$0.01 per share. The other factor that impacted our prior guidance is that we suspended development activities at Riverside, for now, and are no longer capitalizing interest or taxes. As I said, our guidance includes \$125 million of additional acquisitions later this year, and when completed, we expect our net-debt-to-adjusted EBITDA to be in the mid-5 times range, on an annualized basis.

G&A, net of core adjustments for severance and structuring costs, is expected to range between \$25.5 and \$26.5 million, excluding the impact of transformation investments for our future platform and our full integration. Interest expense is now expected to range between \$25.5 and \$26.25 million, which reflects the net impact of higher interest rates, later acquisitions, and lower capitalized interest 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 finally, we continue to expect transformation costs, which represent costs related to our strategic transformation including core system implementation, branding and human capital initiatives, operating platform design and retention, and termination benefits, to range from \$10.5 to \$11.5 million. By the end of 2022, we expect to have the infrastructure in place to manage all of our communities in house and we expect we will incur our residual transformation costs in 2023.

Operating fundamentals are historically strong, and while we expect the current pace of market-rent growth to moderate, we see a lot of momentum as the year progresses which will carry over into 2023. Much of this near-term growth is embedded in our portfolio today and is being extended further as our in-place leases catch up to increasing market rates. Looking forward, we continue to expect outsized-market-rent growth in our markets over the near term, which will drive the top end of our loss-to-lease higher, as our in-place lease pool turns.

Trove will provide meaningful growth, experiencing a full-year of stabilized occupancy, coupled with initial lease up concessions burning off. Finally, our value-add-renovation and affordability-gap strategy, and our strong renovation pipeline, provide opportunities that we have already captured, to further extend profitable growth beyond market rent-growth levels for the next three to four years.

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

Paul McDermott – Chairman, President & Chief Executive Officer

Thank you, Steve.

Before I conclude, I want to take a moment to welcome our new board member, Jenny Banner, who will serve on our audit and governance committees. Jenny is a highly accomplished senior leader with 14 years of CEO experience and 20 years of public company board experience. Among her many accomplishments, she has been a public speaker and consultant globally on the board's role in digital transformation, which is an area of focus for us as we continue to improve and streamline our corporate and property-level technology infrastructure. Her

technology expertise and leadership will be a great asset for WashREIT. I'd also like to thank the entire board for their ongoing support and commitment.

To conclude, as we enter the third quarter, we have a line of sight on the best growth outlook we've had in recent history. It's been a year since we embarked on the final phase of our multifamily transformation. With same-store NOI growth expected through the third quarter of 2023 expected to average in the double digits and even higher growth from our non-same-store communities, our outlook is certainly much better than it was a year ago.

Our internal transformation continues, and we are actively preparing to begin bringing our community operations in house. Looking forward, we have several exciting announcements on the horizon, including our new resident-focused brand rollout later this year. While our plans to scale our company might take time as the capital markets disruption subsides, we are confident in our ability to execute on opportunities to grow profitability and to further expand geographically and look forward to delivering very strong growth from our existing communities through 2023 and beyond.

And with that, I will open the call up to answer questions.

Operator

Thank you. Ladies and gentlemen, the floor is now open for questions. Our first question today is coming from Blaine Heck with Wells Fargo.

Q: Good morning. So clearly acquisition expectations are delayed a little bit, contributing to your guidance reduction. It sounds like that delay is related to the specific situation you have with that seller. But more generally, Paul, can you give us a sense of whether you expect opportunistic or somewhat distressed situations to emerge, given the disruption in the capital markets or is the overall decline that we're seeing in transaction volume just more attributable to just price discovery on all deals given the meaningful movement we've seen in the cost of capital, that maybe the fundamentals are holding up well enough that there isn't going to be much distress?

Paul McDermott – President & Chief Executive Officer

Let's start with the capital markets and let's start looking at debt first. If we look at the agencies right now, their coverage ratio constraints and their underwriting on trailing 12 has really started taking them out on deals, I'd say over 55% LTV. The debt funds who we talked about, a couple of calls ago who were normally very aggressive. Well, their costs have increased and thus they're stabilized debt yield requirements, they were really as they owned a lot of the higher LTV deals, and they were extremely competitive. Now that those types of requirements on the debt yield have really hindered them from reaching out and doing those higher LTV deals, I still think you're going to see deals and we are seeing deals because we're known to be an all-cash buyer and the deals that are going to get done in this market are going to be all cash or lower leverage, 50% LTV, 55% or lower.

The biggest thing that has changed in the last quarter is the premium that is being given to certainty of execution. We've tied up five deals and we've closed five deals. I think we are known in the target markets that we're in that we do offer certainty of execution. We're not shying away from our underwriting. As I said in my remarks, our observations are the cap rates have expanded 30 basis points to 50 basis points. If I was talking about office product, that number is probably going to be higher. Same with retail, but I do think that is because capital cost has increased, you're seeing some repricing of assets and I think the larger deals are the portfolio deals. If I had

talked to you six months ago, I would have said there probably would have been a premium for portfolios and now we're seeing discounts.

The other big thing, we're seeing now is that loan packages or loan sales are just as important on an investment sales platform as one-off. There's definitely been a bifurcation, when I look at the markets and especially, if you're looking at DC in the office market trophy versus commodity, one of those is getting financed and really one of those have been hit pretty hard, but it really depends on the asset class, the submarket and the vintage in terms of the type of discounts that we would apply, but we've gotten more calls probably in the last 60 to 75 days on deals than we have probably in the 18 months we've been in the capital markets and most of the brokers that we talk to and even some of the owners. I think people are taking a little bit of a pause for the next 30 days, but we expect to see a surge in product coming to the market after the Labor Day.

Q: That's very helpful color. As you mentioned, you are halting development at Riverside at this point and this is related to the first question, but on the other side of the deal. Is there anything to read into that decision with respect to a potential monetization of that asset or even part of that asset or would you say it was driven more by kind of the other factors that you mentioned in prepared remarks?

Paul McDermott – President & Chief Executive Officer

I think it's driven because we are being prudent in our underwriting. When we look at our requirements or our initial going in yields on that, we want to see more data points from that market. That market is certainly moving in a positive direction. But when we combine that with the increase in construction costs from when we first started the pre-development work on that, construction costs have gone up probably 20% over the last two plus years. That's the only reason we're still very committed to that asset. We like what we're seeing in our current same store pool from the Riverside asset itself and we think that project will be a long-term winner for us. But just right now, we're really focused on current income as we make this transition.

Q: Last one for me, Steve, I wanted to ask about same store results in the quarter and particularly on the change in rental and other revenue at 5.3%. In the context of average rent per home up 7% year over year, along with a 0.7% increase in occupancy. I guess I would have expected the total revenue number to be up more. Was there anything in the other property or elsewhere that offset that rent and occupancy growth?

Steve Riffie – Executive Vice President & Chief Financial Officer

Well first, what you're seeing is that we've really been building it. You'll see that kind of growth in the third and the fourth quarter continues. We hit our inflection point a year ago in terms of post pandemic, maybe a little slower than some other markets which started in July. So that's in concessions and all that started to continue to burn off through June that we're amortizing. We did have a little bit of timing noise in the quarter on both an expense item, a couple of expense items that also would have affected revenue.

We had what we think will be our peak bad debt quarter, which affected revenue a little bit in the second quarter. We've got projections going out for the year, but I think second quarter was our peak as we looked at just the aging of receivables that whole clock on getting repossession of units back flips at the beginning of the third quarter. It was just a little bit extended there. So that may have affected the second quarter a little bit. And then on the expense side, which is not what you're asking about, but we had just a comparative year-over-year, we had a real estate tax reassessment credit in the second quarter of last year. It looks like expenses went up more, other than that and a couple of the assets that we bought in Atlanta – we have a little bit of timing differences. We were

forecasting exactly when we would incur a few costs. And we did a couple a month or two earlier than we thought we would, just as we were onboarding those assets. When you really look at what we tried to put out there in our prepared remarks, we are seeing incredible historical levels trade outs, new renewal effective leased blended or loss-to-lease was 11% end of the quarter. And we just see this momentum now coming into the third quarter with pretty good visibility and would also say because we had our inflection last July internally as I look at this every week our team, I was expecting our peak new trades out to be in May or June we actually hit another peak in July which is telling me that we have real strength that is continuing in our August rents that are really strong too, that are really longer than I would have thought. I feel the revenue is really building.

One other thing just to emphasize from the prepared remarks, this is the first quarter, we launched that, a year ago, this transformation. We are now finally fully invested as of July 1 for a whole quarter from the reinvestment from the transformation. And we're also finally reaching the pandemic lease inflection. So, we were setting up for growth, it starts really July 1 for us. And that's we've been positioning ourselves throughout the last year to get there.

Operator

Our second question today is coming from Michael Lewis with Truist Securities.

Q: I wanted to follow up and ask a little more specifically about cap rates on your second quarter acquisitions versus what you expect for the fourth quarter ones, you mentioned cap rates moving 30 basis points to 50 basis points. So, it's unfortunate that you got delayed on an acquisition pace, but are you benefiting here, in other words, it becomes a drag this year. But you think maybe cap rates are a little higher than you thought on the acquisition side. Maybe that becomes a little bit more of a tailwind next year or am I kind of overstating that movement in acquisition cap rates?

Paul McDermott – President & Chief Executive Officer

Well, let me make a couple points on your question. It's never unfortunate to walk away from a deal that doesn't meet your underwriting criteria, because somehow, somehow, we think that that's going to come back and rear its head. And this particular deal that we had tied up would have met and exceeded our acquisition goals this year. But I'm proud of my team for having the discipline when we didn't get the capital improvement adjustments that we needed. Clearly, the market was moving while we tied it up. We also think that there could be some credit challenges potentially moving forward.

This is the time you need to maintain your discipline. But to your point, we're going to see a lot more deals in the second half and just the bid ask, I would expect that a lot of brokers that are taking on listings right now and even some of the owners, they're becoming more realistic on the bid ask. Some of the sellers, particularly in the southeastern markets were a little bit in denial that the market had moved, and we were watching deals get very traded all around us. These are deals that were probably, in the mid to upper three deals that were now going at 4.25 to 4.35 and seeing even in some of the submarkets those deals getting priced in the upper fours. I think our investors and our portfolio will be a beneficiary longer term and coming in at a better basis.

Q: Wanted to ask you about the portfolio now, Atlanta is only about 8% of total NOI in 2Q, how aggressively do you go about getting some belt up as a percentage of the portfolio from here, I know you have, like you said, more acquisitions in the back half of the year. Does this involve a next stage of either DC area dispositions and some

bulk acquisitions or is it more of a gradual shift in the portfolio over time and kind of where do you want to end up on that mix?

Steve Riffie – Executive Vice President & Chief Financial Officer

Some of those acquisitions and all came in late in the quarter, our models show us at 20% in the fourth quarter, in terms of Atlanta NOI is part of it. The other thing I'd say is obviously they're growing really well and we'd have talked – and then I'll get to kind of what we will do transactionally. We talked what we were targeting for when we rolled out the transformation to try to get approximately a four cap rate a little better. We're, as of today for the assets that we've acquired, our 12-month yield forecast looking forward from June 30 to now is a 4.6%. So obviously, we're getting growth and good returns on what we've acquired so far. So that's growing there.

We have three objectives, I may have mentioned this in the prepared remarks; one, we wanted to get out of the headwinds and get the tailwinds behind us and to generate profitable growth. Well, we're at that one-year point where we've repositioned the company and we've got significant growth ahead of us, as I laid out in the remarks and I think if you model it, it falls all the way down to the bottom-line and hopefully we'll be able to give guidance for next year soon in terms of all the way down. Now secondly, the goal was to geographically expand, and I think we want to continue to do that. 20% is not where we're stopping and we want to make it more and more a part of the asset base of the company and it really diversifies our business risk, but it also, we believe, with our research, allows us to participate in even higher growth. The third thing is to continue to scale and to scale profitably that will require external capital, and we'll do that at the time so that it makes sense, but we're not pausing here.

We're looking at some creative solutions with private portfolios that can accomplish geographic expansion and scaling if we could agree on NAV to NAV versus just current capital market pricing, et cetera. Those take a while, but there are people we're talking to along those lines. So, we're going to continue to be creative, but we also can and will and we're getting ready to do some of this. We will recycle out of some low growth assets here and use those proceeds to allocate capital more to the southeast and higher – and generate higher growth. So, we're going to the playbook some of it we're not using right now, but we have a big playbook. We wanted to create optionality. We got a portfolio deal done. I think we can move faster. It's just we're going to execute what makes sense at each point along the way.

Q: That's helpful. And then just one last quick one for me. You have almost no debt maturing in the next several years. So of course, I'm going to ask about the one piece you do have, which is the term – the 2.3% term loan next year. Should we just assume, you'll roll that into another term loan and how much do you think rate has moved on that?

Steve Riffie – Executive Vice President & Chief Financial Officer

That's part of the optionality we have because that is debt that we can repay without penalty. We have the option of rolling that back into the bank market into another term loan. But I also want to keep open the possibility that we could pay it off if we got a hold of the portfolio and had to assume another kind of debt instead. We're going to have both of those options. We could extend it if we needed to. It also might be the way that we can structure a potential portfolio transaction where we need to pay off some of our debt.

Operator

Our next question today is coming from Michael Gorman from BTIG. Michael, your line is live.

Q: Paul, sorry if I missed it, but did you mention the deal that you walked away from because of the discipline on your underwriting did that ultimately trade with another buyer? Did they pull it off the market? Is that something that you think will come back as you talk about the next 30 days as sellers reset expectations? What's the status there?

Paul McDermott – President & Chief Executive Officer

To our knowledge, and as of this call that deal was pulled and we would expect it's not a fund that is monetizing, but we probably would expect to see that deal potentially in the fall. We've done our homework and we've underwritten the asset appropriately and calculated the breadth and we stand behind our number that we would acquire that asset at.

Q: As you talk about your underwriting and what you're seeing in the market and obviously WashREIT is being disciplined here, have you gotten more conservative with your underwriting in terms of rent growth over the past, 30 to 60 days as you've looked at the macro environment? Do you have a sense – obviously, the capital markets have been having an impact on cap rates, but if you got a sense that buyers are shifting their underwriting expectations for rent growth in the apartment market as well?

Paul McDermott – President & Chief Executive Officer

Let me answer that in two pieces, I would say that our team from the get go has always been disciplined in the underwriting and we really never thought that these growth rates we are seeing now were sustainable and last year when we were losing deals, we took the market rent growth the first year, we pared that down to high single digits in year two and then we returned to normal historical rates, which were mid to low single digits in the beginning of the third year.

I think we are still comfortable with those, although we're hedging a little bit and we're also digging deeper now into historical on accounts receivable, bad debt. In addition, we have a great physical team, we're counting on that a more moderate increase other buyers that we've seen come in especially because they right now, the people that are active in the market are getting deals done. Like I said earlier, either all cash buyers or they are in the mid-level LTVs. They've tightened their underwriting approach and there's a particular focus on the credit envelope around that NOI.

Q: One more on the underwriting as you're doing this transition to the in-house property management, you're doing the technology rollout, all those things. How does that factor into how you consider the expense side of your underwriting when you're looking at these assets, your ability to maybe drive better NOI through the efficiency side as you're underwriting assets. Is that something that you're not putting through the models yet just because you're still early in the transition or how does that factor into how you're looking at assets?

Steve Riffie – Executive Vice President & Chief Financial Officer

We factored into our modeling of onboarding all of this. I don't know that we'll get the full benefit of it until we have everything in-house and it's running. But as we look at our property management expenses, about 70% of that is what we pay third parties. And then about 70% of that is what we pay third parties. And then the balance of it is split between our own internal management, overseeing it, doing our overnight pricing and asset management and all of the properties today and then our own technology charges on top of that.

We believe that when you cut out the third-party services, we have a very scalable base of our technology and corporate structure ourselves that there's a net savings in all of that, plus in terms of efficiency and staffing. When you own it yourself, you can operate it consistently across all your properties according to our own model. There are things like centralization of certain functions, etc., that are factored into our long-term cost structure. We're factoring it into it. It's going to take until about mid-year of next year before all the properties we currently own are internally on the same system. But thereafter, we believe we'll start to realize some of those savings, too.

Q: One last one for you. You talked about some of the potentially interesting or innovative transactions on the NAV to NAV side, for private portfolios. For the \$125 million of acquisition guidance targeted for kind of fourth quarter of this year. Are any of those private portfolios kind of targeted in that number or those more traditional one off deals that you're seeing in your pipeline that you're underwriting right now?

Steve Riffie – Executive Vice President & Chief Financial Officer

Those are traditional deals that we have sight on in our pipeline. As Paul said, our pipeline is probably going to expand after Labor Day and on top of that, plus maybe some other deals that we passed on might be visible again at that point in time. We're working on assets that could possibly do more than that. That's what we're guiding to right now. That is not the portfolio NAV to NAV type structure, those are hard to work out, but there may be ways to do that that creates value and scale and gets our geographic expansion kind of accelerated. So, we're doing those things in addition to our normal in the market, working with brokers and owners to acquire assets.

Operator

Our next question today is coming from Bill Crow from Raymond James, Bill your line is live.

Q: A couple of quickies and then a more theoretical or strategic question. First, on the bad debt, I think you're probably talking about it more than anybody else on the multifamily side. I'm just curious whether it is an issue that's kind of a Walmart versus Target sort of issue, a submarket issue or why you seem to be having a little bit more challenge on the bad debt front than your peers?

Steve Riffie – Executive Vice President & Chief Financial Officer

It's timing because we had a light bad debt in the first quarter, and they had a heavier one. When you look at it, it's just literally where we are in terms of the program. In terms of just a couple of the macro things that I think that you're implying, which is a very good question. It's not a question about income or people's ability to pay. And I'll let Grant add a little color in a second to that, too. But right now, we're back to pre-pandemic rent levels and incomes are much higher. And it's more about the ability to get possession of space versus the ability of renters to pay. In fact, in the units where we've had some age delinquency until we hit the opportunity to start repossessing, we're getting 14%, 15%, 17% trade-outs in some cases in the same property. So there's a deep market with the ability to pay behind it. But Grant, maybe you could comment, if you don't mind, just on sort of the macros and incomes and all that, if you would.

Grant Montgomery – Vice President, Research

Sure. Happy to. In our portfolio, our average rents have increased approximately \$350 since March 2020, the onset of the pandemic. Meanwhile, in the Washington Metro, monthly incomes across the region have grown about \$570. And as we mentioned in the call within our portfolio, our actual resident's incomes are up 12% year-over-year in the Washington region and just over the last six months, comparing the end of 2021 with the

beginning of 2022 incomes up over 14% for our residents in our Atlanta property. As Steve said, it's really not a wherewithal issue at all in terms of incomes versus rents.

Q: Second question, I think you said retention was 68%. I think it was somewhere in that range, 60%. Curious how many of those people are leaving to buy houses and whether you think you've seen any benefit over the last month or two from the shoot up in mortgage rates?

Grant Montgomery – Vice President, Research

We certainly have both in our Washington market and in our Atlanta market. In our Washington market, the reason for move out to home purchase has declined about 20% compared to the prior year. Where in Atlanta it's been even more dramatic and it's about a 50% change. It's under 9% move out. And that has been more in the high teens as recently as the beginning of the year.

Q: Just a bigger picture. Paul one of the things that I've admired of you since we first met was your aggressiveness and your focus on driving shareholder value. I'm just curious, as you continue to trade, what, 100 basis points wide of the multifamily REIT group on a cap rate basis and but also as you continue to build out your company and they add a lot of employees. Does it change the way you might think about selling the company? You know, if you were to get a bid, how you might react to that?

Paul McDermott – President & Chief Executive Officer

In our first discussion way back when I said, first and foremost, we're going to do the right thing for the shareholders. We're trading down along 52-week lows in that region. 90 days ago, we were at a much different number and had broader options. What we're doing right now is creating value for our shareholders. Everything we're doing with Project Relmagine, bringing the operations back in-house, diversifying our portfolio, recycling out of lower growth assets into higher growth assets, our thesis and our execution has always lent itself to creating value for our shareholders. I know the cap rates that we're trading at right now. Do I think that we can do better? When you start seeing our next quarter's performance, maybe the next five quarters performance, our stock will improve. We're not a group that picks up our jacks and goes home when we hit a speed bump. I still think there's a lot of value to create here. But of course, we're always going to do what's in the best interest of our shareholders. And we're going to be consistent about that.

Operator

The next question is coming from Alan Peterson from Green Street. Alan, your line is live.

Q: I was just hoping to get some more color around the lower growth DC assets. And, in terms of the initial marketing or when you guys are having those marketing discussions, can you share what pricing is looking like for those types of assets? And amongst the three submarket locations, Maryland, DC and Virginia, where we could potentially see some of those dispositions come out of?

Paul McDermott – President & Chief Executive Officer

I'll start with DC. The trade outs we're seeing are strong in DC. The challenge that you're seeing in DC right now, there's a couple of them. First, we had caps on our ability to increase rents and over the last 24 months, basically, and now that those have come off, a lot of the buyers that we talked to and a lot of the brokers, investors want to see a little bit more seasoning and particularly, flush out the AR numbers, we definitely know the market is there. DC does perform well when other markets don't.

The biggest challenge in DC right now is we still have TOPA. For buyers that want to use leverage they're in a little bit of a jam on let's say a forward rate lock deal where TOPA might take six months. You can't get a spread lock. That's hindered the deal pace. But overall, D.C. like we've said before in our prepared comments, is back to and is better than pre-pandemic. It's a matter of time since more prudent investors are being sensitive to credit standards applied by operators.

If I turn to Virginia, Northern Virginia is the most active in our region. The macro economy is outperforming, and deals are getting more attention. There's probably two or three times as many apartment deals in Northern Virginia right now as there are on the market in D.C. There aren't really any accounts receivable or bad debt issues. Northern Virginia is seeing excellent trade out as we've also said. Maryland is still seeing activity not to the level of Northern Virginia.

Another market, particularly in Montgomery County, when you look up the I-270 corridor, rent caps are coming off and job and wage growth are keeping investors interest, particularly in the life sciences quarter up I-270. So, we feel good about what we have here right now. We think the market's coming back to us. And in terms of what we would sell, we look at opportunities where we can allocate from let's call it a moderate growth to a higher growth. Those will be the assets that we choose and we're not really expecting a lot of dilution in this recycling.

Q: Appreciate those comments. Steve, you mentioned the capital markets discipline and back in 4Q 2021 and 1Q 2022, you guys brought to market some ATM issuances. Is ATM issuances still part of the go forward funding plan for acquisitions today? Can we anticipate any ATM issuances over the course of the next two quarters, at these pricing levels?

Steve Riffie – Executive Vice President & Chief Financial Officer

Well, first, I wouldn't indicate that in advance of issuing equity and create an overhang on the stock, but ATMs are a part of the playbook. But it's not a part we're using today at the stock prices. I don't think it makes sense to us to issue equity at these prices now. Potentially exchanging units on an NAV to NAV basis in a structured transaction, you're getting a different relative value for those. We were at \$26 just three days after this call a quarter ago, and we're not there today. So not at these levels, but we'll be prepared to use that if it makes sense and if the equity markets come back.

Q: Understood. Maybe just one last one for me on the transition. I appreciate the comments on the human capital side. Are you guys running into any difficulty, either at the corporate level or at the onsite level in terms of hiring? And what positions are you running into the most difficulty with?

Paul McDermott – President & Chief Executive Officer

Steve and I will ham and egg this one. First off, yes, it's a very competitive labor market, not just attracting, but retention. We're all eyes on that in terms of our human capital model and our head of HR has been very proactive, especially on the retention side. But in addition, I would say that we're trying to build up our corporate infrastructure to prepare for the onboarding later this year. And as Steve said into mid-next year, it's really been at the property level. We have a good start on that obviously with our third-party managers and we expect a lot of seamless transition there as we onboard those employees that come along with the properties. At the corporate level it would probably be very job specific.

Steve Riffie – Executive Vice President & Chief Financial Officer

I think you hit it. We have weekly status by position meetings of what positions we want to onboard on when and we're building the infrastructure and the leadership in the regional leadership and all out. We've been recruiting our own third-party management staff now for a couple of quarters and are communicating with them. Part of our program of really assimilating multiple cultures into our mission and vision for the renter that we target. We're bringing together three cultures into one. There's been a lot of work done on that to try to make sure that this is a place that our employees are going to want to work and be proud of. We're looking at everything from what the incentive programs are to, how we reward people, how we will make them feel they have access or included in what we're trying to do. We have a lot of people in the communities already targeted specifically to come on board. We're going to have to add to it because it'll be a challenging job market. But I think we've got pretty good visibility and have been working on it for a couple of quarters.

Paul McDermott – President & Chief Executive Officer

The only other thing I would add Alan is just obviously workplace flexibility is high on a number of people's agendas and we're trying to incorporate that into our human capital structure moving forward.

Operator

Thank you. And there are no more questions in queue. I would now like to hand the call back to Paul McDermott for closing remarks.

Paul McDermott – President & Chief Executive Officer

Thank you. Again, I'd like to thank everyone for your time and interest today. We will continue to update you as we progress our multifamily transformation and we look forward to speaking with many of you over the next several weeks. Thank you, everyone.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. You may disconnect your lines at this time and have a wonderful day. Thank you for your participation.

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