

Transcript of  
Elme Communities  
Second Quarter 2024 Earnings Call  
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**Participants**

Paul T. McDermott - Chairman, President and CEO, Elme Communities  
Tiffany Butcher - Executive Vice President and COO, Elme Communities  
Steven Freishtat - Executive Vice President and CFO, Elme Communities  
Amy Hopkins - Vice President, Investor Relations, Elme Communities  
Grant Montgomery - Vice President, Research, Elme Communities

**Analysts**

Cooper Clark - Wells Fargo  
Anthony Paolone - JPMorgan  
Michael Gorman – BTIG

**Presentation**

**Operator**

Greetings and welcome to the Elme Communities Second Quarter 2024 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, Elme Communities**

Good morning and thank you for joining our second quarter earnings call. Today's event is being webcast with a slide presentation that is available on the Investors section of our website and will be available on our webcast replay.

Statements made during this call may constitute 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 in 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'll turn the call over to our President and CEO, Paul McDermott.

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Thanks Amy, and good morning everyone. Presenting on the call with me today are; Tiffany Butcher, our Chief Operating Officer; and Steve Freishtat, our Chief Financial Officer. Tiffany will provide an update on our operating trends and initiatives and Steve will cover our balance

sheet and outlook. Grant Montgomery, our Head of Research, is here to answer market level questions during Q&A. I'll start today's call with a brief market level overview.

The Washington Metro is a top performing apartment market this year and the region remains one of the best positioned apartment markets nationally. Across our submarkets, deliveries have peaked and net inventory ratios have normalized in the low single digits. Our Washington Metro portfolio, which comprises over 75% of our homes, is benefiting from strong, stable demand, allowing us to drive occupancy above our targeted level for the year. We believe we are positioned to capture growth in the second half of the year that will set us up well heading into 2025.

Turning to Atlanta, absorption rates are accelerating and the supply overhang continues to decline. In Elme's submarkets, absorption is now nearly 60% higher than the pre-pandemic period. Our operating fundamentals are showing stability with modest improvement supported by strong retention and renewal rates. Tiffany will provide more details in her remarks.

While supply remained elevated, it is not expected to increase materially above the current levels in any of our submarkets and we expect the overall level of demand relative to supply to continue to improve through 2025. Moreover, units under construction and new starts have declined significantly, pointing to better conditions in 2025 and a highly favorable supply / demand dynamics forecasted for 2026 and 2027.

Our residents' financial health also remains solid. The rent to income ratio for new leases was 23% on average in the second quarter compared to 24% a year ago, reflecting a positive credit trend relative to rental rate growth. Employment trends remain stronger for middle income wage earners relative to high wage earners, and the composition of job growth is shifting in favor of non-cyclical industries, which are two favorable trends for Elme.

As of the second quarter, government was our largest industry exposure in the Washington Metro and healthcare was our largest industry exposure in the Atlanta Metro. Affordability and relative value remain critical to our strategy, and our rent levels are several hundred dollars below both class A rents and the cost to own a home in our markets. Move outs to purchase homes comprised just 8% of second quarter move outs, well below the historical level in the mid-teens.

Additionally, our retention rates remained historically high, averaging 65% year-to-date as our value oriented resident base tends to be stickier with an average tenure of about 2.7 years. As we move forward, our focus on maintaining rent levels that are affordable for the largest and most underserved segments of the rental market, combined with our efforts to enhance the class B living experience, should continue to attract strong and steady demand from value conscious renters.

And with that, I'll turn it to Tiffany to discuss our operating trends and growth initiatives.

**Tiffany Butcher - Executive Vice President and COO, Elme Communities**

Thanks Paul. The positive momentum we began to experience in April has continued and blended lease rate growth and occupancy improved sequentially during the second quarter across both the Washington and Atlanta Metros. Effective blended lease rate growth increased to 3.2% for our

same store portfolio during the second quarter, comprised of renewal lease rate growth of 5.4% and new lease rate growth of 0.2%.

New lease rate growth increased to 0.4% in July, showing continued improvement. Renewal lease rate growth was 4.6% in July and we're signing renewals at an average rate of 4% for August and September lease expirations, reflecting gradual moderation in renewal rates through year end, which is in line with our expectations.

Same-store resident retention remains very strong at 65% during the quarter, highlighting the longer term nature of our resident base and our heightened focus on customer service excellence as part of our 2024 platform initiatives.

Moving on to occupancy, same-store average occupancy increased sequentially to 94.6% and ending occupancy increased to 95.5% in the second quarter, driven by strong demand in the Washington Metro, offset in part by the impact of new supply and the timing of evictions in our Atlanta portfolio. Through July, same-store occupancy has averaged 95.3%, representing a 70 basis point increase relative to second quarter.

The demand patterns that we're seeing in northern Virginia, where the majority of our Washington Metro communities are located, are exceptional and occupancy averaged 96.1% for our Washington Metro communities during the quarter, increasing to an average level of 96.6% in June and 96.7% in July, which is above the upper end of our targeted range, allowing us to continue to push rents during the busiest leasing months.

In Atlanta, while the market is experiencing an unprecedented level of new supply, market demand is improving and Atlanta occupancy averaged 89.5% during the quarter, increasing to 90.6% in July. Additionally, we have 24 homes, or just over 1% of our Atlanta portfolio that are temporarily out of service due to a fire, which detracted from our occupancy improvement. Although the timing of evictions could continue to pressure occupancy, we're seeing stable demand patterns and we're focused on driving higher occupancy over the second half of the year.

Turning to bad debt. Reducing bad debt is the top priority and the proactive steps that we have taken are delivering better credit performance overall. We expect to benefit from lower year-over-year bad debt in the second half of this year and even more so into 2025 as higher credit standards and credit protections at the front end of the leasing process and normalizing eviction delays at the back-end drive credit performance to a more normalized level.

Turning to renovations, during the second quarter, we generated an average ROI of approximately 17% on a 150 home renovations. We now expect to complete approximately 475 full renovations and over 100 home upgrades this year. Looking forward, renovations continue to be a key growth driver for Elme. Our identified renovation pipeline of nearly 3,300 homes represents over 35% of our portfolio, which is more than enough runway to deliver renovation led value creation for the foreseeable future.

Our operational initiatives remain on track as we elevate our platform to new levels of success. We're pleased to report that in June, we successfully launched our shared services department,

known as Elme Resident Services, focused on streamlining community operations and enhancing process efficiencies across resident account management, collections and renewals. We're excited to welcome our shared services team into their new roles within Elme.

This launch was supported by the successful roll-out of several new technologies, including an AI platform that saves team members time by managing electronic communication with current residents, automating payment and collection efforts and entering service requests. We're already beginning to see an increase in resident engagement with this new tool. We're also implementing new software to manage balances after move out, reducing the amount of time our team spends attempting to collect and track payments from former residents. Lastly, we've partnered with a provider flexible payment options to give our residents the ability to choose when they pay during the month, while we received cash from the provider when rent is due. With all of these tools as part of our program and a strong team in place, we are confident in our ability to achieve our multi-year goals related to this effort.

This successful launch of Elme Resident Services is a key milestone to achieving the \$1.7 million to \$1.9 million of additional NOI and FFO from operational initiatives in 2024, which aligns with our 2023 to 2025 upside target of \$4.25 million to \$4.75 million.

Beyond the initiatives that comprise our 2023 to 2025 upside target, we're also rolling out managed WiFi across our portfolio in phases, starting with approximately 2000 homes in phase one which are scheduled for installation during the fourth quarter.

And with that, I'll turn it over to Steve to cover our 2024 outlook and balance sheet.

**Steven Freishtat - Executive Vice President and CFO, Elme Communities**

Thanks Tiffany. Starting with guidance, we are tightening our 2024 core FFO per share guidance range to \$0.91 to \$0.95, maintaining our midpoint of \$0.93. We are tightening the range and raising the midpoint of our same-store multifamily NOI growth assumption, which is now expected to range from 0.75% to 1.75% in 2024, due to stronger than expected performance in our Washington Metro portfolio.

We now expect interest expense for the year to range from \$37.5 million to \$38.25 million. While we expect fewer rate cuts in 2024 than our outlook going into the year, our continued focus on managing our cash and debt balance, as well as successful execution of our new revolving credit facility has helped us stay within our initial range, though at a slightly higher midpoint.

Turning to our balance sheet. Annualized net debt to adjusted EBITDA was 5.6 times at quarter end, in line with our targeted range and we continue to expect our leverage ratio to finish this year in the mid 5 times range. As previously discussed, subsequent to quarter end, we entered into a new 4-year \$500 million revolving credit facility to replace the prior facility, which had been due to mature in August 2025. The new facility has two six month extension options and an accordion feature that allows us to increase the aggregate facility to \$1.0 billion.

Our liquidity position remains strong with over \$320 million available on our new revolving credit facility as of August 1. With no secured debt and the only maturity prior to 2028 being the \$125 million term loan, our balance sheet remains in excellent shape.

To conclude, our second quarter performance reflects continued strength in the Washington Metro and improving trends in our Atlanta portfolio. Our renovations continue to yield very strong returns with plenty of runway ahead. Additionally, our operational initiatives are on track and the successful launch of our shared services department represents our latest platform enhancement. Looking forward, we are still in the early innings with our operational initiatives, and we are setting the stage for further ROI driven initiatives in 2025.

And with that, I will open it up to Q&A.

### **Operator**

Thank you. At this time, we will be conducting our question-and-answer session. [Operator Instructions] Thank you. Our first question is coming from Cooper Clark with Wells Fargo. Your line is live.

**Q:** Great. Thank you for taking the question. Wondering if you could walk through bad debt in the quarter for the whole portfolio in Atlanta specifically. I'm wondering if you still think Atlanta bad debt could get to that 3% to 4% range by the end of the fourth quarter and that full-year '24 average of 5% to 6%.

### **Tiffany Butcher - Executive Vice President and COO, Elme Communities**

Cooper, this is Tiffany Butcher. Sure, happy to answer that question. I would start off by saying, in the second quarter, we saw improvement in our bad debt across both of our markets, both here in the Washington DC area as well as in our Atlanta portfolio. In the Washington Metro portfolio we are now below 1% bad debt, so we are definitely in the normalized range for bad debt here in the Washington Metro area.

In our Atlanta portfolio, we've continued to see improvement over where we were for the full-year of 2023 and an improvement over where we were in the first quarter of '24. So in terms of our bad debt as a percentage of revenue, we are currently in the second quarter about 6.6% in our Atlanta portfolio, which obviously continues to be above historical norms, but we have seen stability in that number.

What I would say about the most recent trend that is impacting our bad debt is that we are now starting to see positive momentum in some of our Atlanta communities and counties for implementing House Bill 1203, which is the bill in Georgia that allows landlords to hire off duty officers to execute evictions. And that's going to drive a significant improvement in Atlanta over the back half of the year, because it has continued to be a challenge to gain possession of homes given the level of backlog that there is in the Sheriff's offices in many of the Atlanta counties.

So we look forward to being able to take possession of those units and then be able to turn them and ultimately release them to rent paying tenants. And that's going to be very helpful in terms of getting us to that reduced level of bad debt by year end. So I think with the implementation of

House Bill 1203, along with additional efforts that we're making internally in terms of streamlining the collections process and improving our credit screening with the implementation of our new ERS team, those are the major factors that are going to help us get to that lower level of bad debt by year end.

**Q:** Okay. Thank you. That's super helpful. And I guess just switching over to the updated NOI guidance, it seems that it's mostly expense driven. Wondering how same-store revenue shaping up relative to expectations assumed in guidance, clearly some DC strength year-to-date on the top line.

**Steven Freishtat - Executive Vice President and CFO, Elme Communities**

Yeah. Cooper. So, I mean, if we look at it so right, the NOI, we tightened – slightly raised at the midpoint. So the midpoint at about one and a quarter. Looking at the expense growth, we do see expense growth in the 5% to 6% range for this year. That is lower than what we initially forecasted coming into the year and that's helped up by a couple of things; one is taxes, where we've just seen assessments not come in as high as we initially thought, and the second one is lower payroll. We're really starting to see the effects of the operational initiatives and the operational upside that we have out there really start to take effect. And so, we're starting to see that savings take place.

On the revenue side, we're expecting revenue to be in the 2.5% to 3% range for '24. And that's really driven, I think, by the bad debt in Atlanta that Tiffany was just talking about, that we're seeing that trend in the right direction. We're just not seeing it move as quickly as we initially had thought when we came into the year.

**Q:** Okay. Thank you very much.

**Operator**

Thank you once again. [Operator Instructions] Our next question is coming from Anthony Paolone with JPMorgan. Your line is live.

**Q:** Thanks. Good morning. In Atlanta, where do you think occupancy finishes off the year in terms of how you're seeing things now?

**Tiffany Butcher - Executive Vice President and COO, Elme Communities**

Hi, Tony. It's Tiffany again. In Atlanta, we are seeing occupancy trend into low 90% and our guidance assumes that occupancy remains at that, you know, kind of low 90s percent range through year end as we continue to see kind of gradual improvement in the supply demand dynamics in the Atlanta market. We've continued to see solid retention, which is also helping that occupancy trend, but it's just going to be a gradual improvement. And we are continuing to adjust our pricing revenue strategy to maintain occupancy in that range through year end.

**Q:** Okay. Thanks. And then just shifting to maybe investments in capital markets. Can you talk about, maybe just update us on how much you're spending and the returns you're getting on full renovations and also just maybe some discussion about where you're seeing sort of Class B cap rates in your markets?



**Tiffany Butcher - Executive Vice President and COO, Elme Communities**

I can start off by talking about the renovations and I can turn it over to Paul to talk about the capital markets. So to say, in terms of renovations, we have increased the number of renovations that we're doing for the year. We're now projecting over 475 full home renovations and over 100 partial renovations or home upgrades through the remainder of the year. We're continuing to see upper teens returns.

So, we averaged a 17% ROI on our renovations for the quarter and year to date. So that continues to remain a very good investment source for us. As well as investing in our managed WiFi, I mentioned in my prepared remarks that we are launching phase one of over 2,000 units of managed WiFi that will be installed in the fourth quarter, which also have very strong returns.

And Paul, I'll turn it over you to talk about capital markets.

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Thanks, Tiffany. Tony, just in terms of what we're seeing out there, looking at the transactions market, I mean, first off, from a macro standpoint, year-over-year, it's been pretty flat. And when we look at potential sellers right now that we've talked to or approached, they're facing a rate cut prospects plus an election and a lot of them are being advised in many cases just to hold and they're probably questioning why go to the market.

The real sellers that we are seeing remain folks with debt maturities, redemptions or operators with some type of profit left in the promote, but that has not really helped to accelerate and expand the volume. We talked to a lot of investment sales folks over the last quarter, they're expecting, they say their pipelines are up for the second half of the year, but it's all, I think it's fraught with a lot of contingencies.

From a buying standpoint. Institutional capital, PE shops, family offices are all in the fray. I think the only people we're really seeing on the sidelines are the odysseys. I think the thesis right now for a lot of the new LP capital coming in is that they're buying below replacement cost and they're underwriting flat to negative residual in the first two years with a recovery in years 3 through 5.

And that's very consistent with what, from an institutional perspective, we're seeing even our own observations on our portfolio, the improvement runway of years '26, '27 and '28. But particularly in the value-add space, we're seeing that work, that renovation work on new acquisitions being pushed to years 2 and 3 and that's really contingent on the supply and demand dynamics in the respective markets.

I'd say what we've seen in terms of cap rates, the core cap rate, folks that are really, really pushing, we're seeing those cap rates in the 4.5 to 5 range, the core plus cap rates in the 5 to 5.5 range and obviously that can vary by submarket to submarket. And then the value-add space, we're seeing those cap rates probably trade between 5.5 and 6, Tony.

And just from a lending standpoint, you know, on who's out there, you know, the really top quality that 40% to 50% LTV, we're still seeing the insurance companies be aggressive there, but Fannie and Freddie, we know, I believe, are behind their goals as of 2Q and they're probably going to get

a little bit more aggressive on some of the rate buy downs. We're seeing spreads at probably 150 over and you can buy that down to, you know, 120s.

And you can end up, you know, on, let's say, a 5-year deal in a 5.25 with a full-term IO. So, if we do see product coming to the market, we do expect the agencies to be a bit more aggressive in the second half, but it's really just about getting deals back to the table given the potential for obviously the September rate cuts and an election coming in November.

**Q:** Great rundown. Thank you both.

**Operator**

Thank you once again. [Operator Instructions] Thank you. We have a question from Michael Gorman with BTIG. Your line is live.

**Q:** Yeah. Thanks. Good morning. Maybe just a bit more of a strategic question as we tie together what you're seeing in the markets fundamentally? And then just Paul, some of your commentary there about the investment market and transaction markets, are you seeing anything in some of your potential target markets as you track them, not only from a deal perspective but from an operating perspective that maybe has caused you to change how you're thinking about potential expansion markets, just due to how they've behaved in the current cycle or how they're managing to go through the current supply cycle that we're seeing now?

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Michael, I would say that it's just from an underwriting standpoint. We obviously are applying just based on our portfolio experience, we're applying a lot more scrutiny on the going in rental rates, how much diminution we would probably see in that year one. I think most of the markets we're looking at that second year is probably flat and then we are looking at positive spreads in that third year.

And what that has done strategically, as I said earlier, Michael, is really probably might have pushed back the timing of some of the renovations in our portfolio. I think as you know, we have over 3300 units to renovate. We're obviously monitoring those and then any new acquisitions that would all be part of our going in strategy in terms of when we feel like we can get in there operationally and create future value.

**Q:** Okay. Great. Thanks for the time.

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Thank you, Michael.

**Operator**

Thank you. Our next question is coming from Ann Chan with Green Street. Your line is live.

**Q:** Hi, good morning. Thanks for your time. Going to your guidance, could you share what kind of changes to supply and demand assumptions are baked into the new guidance, if any?



**Tiffany Butcher - Executive Vice President and COO, Elme Communities**

Yes. So I would say, in terms, what we're seeing that is driving our guidance is stronger than expected performance in the Washington DC market. And Grant can talk a little bit about the supply demand dynamics that are impacting that. But just, kind of from an operating perspective, we have continued to see strength in our new leasing both in the second quarter as new lease rate growth, growth flipped from negative in the first quarter to positive in the second quarter and we have continued to see increasing strength in that in the month of July as we're in our peak leasing season.

We've also continued to see occupancy increase significantly as there is strong and robust demand for our product here in the Washington DC area and Grant can talk a little bit more about the demand drivers for that. But we have continued to see from first quarter to second quarter to the month of July, the occupancy continue to improve in our portfolio. And as we mentioned in our prepared remarks, the DMV had same-store occupancy at 96.1% in the second quarter and 96.7% in July. So incredibly strong occupancy driven by the high demand and lower supply environment here in Washington. Grant, do you want to comment a little bit on that?

**Grant Montgomery – Vice President, Research, Elme Communities**

Sure. And this is Grant. When we look at from a supply standpoint, our submarkets are performing really well and actually are set to move in a better direction even over the next quarters than where they are currently. Over the first quarter – second quarter, the net inventory ratio of deliveries was about 2.5%, which is well below the US level and the Sunbelt.

Over the next four quarters, that's expected to decline even further, to just 2.3% on average. But we are in markets where that is significantly even lower than that. So, for example, in Northern Virginia, where over 60% of our homes are located, net inventory ratio is down to about 1.7% over the next four quarters. So that's really driving the tightness on the supply side.

From a demand side, we continue to see solid job growth across both markets, particularly again, in our Northern Virginia market, where we have 1.6% employment growth, and even further detail there, we're really seeing strong demand in industries that particularly drive demand for our communities. We're seeing job growth, in particular, strength in education and health, construction and local government, all which are up over anywhere from 2% to 6% year-over-year growth.

So we really see it on both sides. A tight supply in our core market, tightening across our entire portfolio, and continued strong job growth, in particular, growth in industries that create demand for the types of homes that we provide to our residents.

**Q:** Great, thank you. And just wondering if you could also give a breakdown of the 1.3% blended rate expected for the rest of this year or for this year?

**Tiffany Butcher - Executive Vice President and COO, Elme Communities**

Sure, we can absolutely walk through that. So, in terms of where we're expecting for the full-year to be in terms of blended lease rate growth, we're expecting kind of new rates to be in the negative 1% to positive 1% range for the full-year. We're expecting renewal rates to be in the 3.5% to 4.5%

range for the full-year. And we're expecting, therefore, the blends to be in the 1.5% to 2.5% for the full-year.

**Q:** Great. Thank you.

**Operator**

Thank you. Our next question is coming from Cooper Clark with Wells Fargo. Your line is live.

**Q:** Hey, thanks for taking the follow-up. I just wanted to circle back on, Paul, some of your comments around pricing. Given your implied cap rate today and some of the pricing commentary, wondering if you thought about picking up capital recycling specifically out of your Maryland portfolio or maybe some of your District assets. Wondering if that's something you're looking at as we kind of move through the rest of the year here?

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Cooper, we always are looking at our portfolio and we're looking at recycling. I think, as you know, we have the Watergate, which is definitely a recycling candidate. And we're watching the DC market slowly but steadily improve. And I think we've – we'll have some positive things to talk about the Watergate going forward. We have at our disposal, I believe, you know, outside of a good balance sheet with optionality and liquidity. We do have the assets that you mentioned to look at as recycling candidates.

And I wouldn't say that that is at the top of our list right now. I think we've got a lot of very proactive initiatives to drive value for the shareholders. But we will – as we progress throughout the balance of the year, we will look at those assets. That's really going to depend on market conditions right now. And we don't have plans to actually do any recycling from now through December. But in terms of just preserving optionality, we would probably move forward with the guidance that we've provided to you, Cooper.

**Q:** Okay, great. And then, I guess this one is for Steve. You've talked about potentially doing something on the unsecured side if pricing gets closer to 6%. Wondering, where you're seeing pricing today in the unsecured market and thoughts around raising any incremental debt for the right acquisition opportunity as opposed to using the capacity on your LOC?

**Steven Freishtat - Executive Vice President and CFO, Elme Communities**

Yeah. So, Cooper, thanks for the question. Very timely given the movements in the 10-year. So I'd say given a lot of the movements in the last week or so, if we were to do new unsecured debt, it would probably be in the high 5s and then secured debt maybe a little bit inside of that. So we're – definitely rates are much more attractive than they were when we were coming into the year.

We certainly have, we just redid our credit facility, of course, that pushed out our maturity till '28, but we do have a balance there that we could certainly love to term out at the right time. And as far as acquisitions go, we feel like we've created the balance sheet that creates a lot of optionality. So there are a lot of different ways we could go with that.

I would say that from a leverage perspective, again, we're right where we want to be, right in line with our leverage governors. So if we do find an opportunity out there, I'd say it's probably on what Paul just spoke about a moment ago, capital recycling and recycling assets is probably our top choice right now of being able to finance an opportunity if we were to find something.

**Q:** Okay. Thank you.

**Operator**

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

**Paul T. McDermott - Chairman, President and CEO, Elme Communities**

Thank you. Again, I'd like to thank everyone for your time and interest today, and I look forward to keeping you updated on our progress and speaking with many of you again in the very near future. Thank you.

**Operator**

Thank you. This does conclude today's call. You may disconnect your lines at this time and have a wonderful day. And we thank you for your participation.