Transcript of
Sovran Self Storage
First Quarter 2015 Earnings Release Conference Call - Edited
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Participants

Diane Piegza – V.P. Investor Relations
Dave Rogers – Chief Executive Officer
Andy Gregoire – Chief Financial Officer
Ed Killeen – Chief Operating Officer
Paul Powell – Chief Investment Officer

Analysts

Todd Thomas – KeyBanc Capital Markets
Jana Galan – Bank of America Merrill Lynch
George Hoglund – Jefferies
Ross Nussbaum – UBS
Todd Stender – Wells Fargo
John Pawlowski – Green Street Advisors
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Presentation

Operator
Greetings, and welcome to the Sovran Self Storage First Quarter 2015 Earnings-Release Conference call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Diane Piegza, Vice President of Investor Relations for Sovran Self Storage. Thank you, you may begin.

Diane Piegza – Investor Relations Officer
Thank you, Melissa, and good morning, everyone. Welcome to our First Quarter 2015 Conference call. Participating in today's call will be Dave Rogers, Chief Executive Officer; Andy Gregoire, Chief Financial Officer; Paul Powell, Chief Investment Officer; and Ed Killeen, our Chief Operating Officer. Our earnings release was issued yesterday after market. If you did not receive a copy, please visit our website at unclebobs.com.

As a reminder, the following discussion and answers to your questions contain forward-looking statements. Our actual results may differ substantially from those projected due to risks and uncertainties with the Company's business. Additional information concerning these factors is included in the Company's latest SEC filings.

At this time, I will turn the call over to Dave Rogers.

Dave Rogers – Chief Executive Officer
Thanks, Diane, and good morning, everyone. Well, once the snow finally melted and our people and properties thawed out, things pretty much went the way we expected this quarter. February was the slowest month we've had in quite a few years in terms of call volume and traffic, but March and now April have rebounded nicely. Our

same-store occupancy level of 90.5% at March 31st is the best we've ever achieved in a first, and we hope to set a few more record high before the year is over. But the real driver this year is going to be increased rental rates for both existing and new tenants. We think there is room to grow them and the busy season starts now and our folks are on it. Andy will give the details concerning Q1, but the takeaway is that it set us up for a good year to come.

We got off to a bit of a slow start on the acquisition front, acquiring only two stores in Q1, but we closed a few more in April and the deal closing increased considerably in recent weeks. Still, like the Randy Newman song says, "It's a jungle out there." High quality stores in primary markets are trading at historically low cap rates; good stores in secondary markets are price rich; stabilized yields projected for C of O deals are getting squeezed tighter and tighter; and there's a lot of bidders for all of these properties. So we are aware of what's going on in all the domestic markets and we continue to seek and structure value-add acquisitions for our portfolio, but we are being pretty prudent about it.

Overall, the self-storage landscape is much the same as it's been for the past many quarters. Growth of new supply is ticking up, but for the most part the new stores are needed and well placed. Demand continues to increase, customer awareness continues to grow. We large operators continue to press our advantage of scale, technology and brand. So we remain very bullish on the sector and on our company. Self-storage is definitely a fun space to be in and we're looking forward to a good 2015.

Andy, I'll let you talk about the quarter.

Andy Gregoire – Chief Financial Officer
Thanks, Dave. Last night we reported same-store revenues increased 5.7% over those of the first quarter of 2014. The growth was a result of the 100 basis points increase in average occupancy, a 3.4% increase in rental rates. Same-store occupancy increased over the prior year as expected and was 90.5% at March 31, 2015. Tenant insurance income for the same-store pool continued to show solid growth, increasing $332,000 in the first quarter of 2015 as compared to the same period of 2014.

Total operating expenses on a same-store basis increased by 2.5%, primarily as a result of increased repairs and maintenance expenses which includes higher snow removal costs. As noted in our release we have reclassified internet marketing expense from general and administrative expense to property operating expense for all periods presented to be consistent with industry trends.

Same-store net operating income increased 7.5% for the quarter. We have included summary information for our same-store pool by both market and by state to provide our investors additional color on not only our largest market, Houston, but all of our major markets.

In regard to Houston, we have stated over the past few quarters, as we stated over the past few quarters, we believe our scale and platform will reduce any adverse impact of lower oil prices on our properties there. So far results have borne that out with same-store sales increasing 6.5% and NOI up 10.2% for the quarter compared to the same period 2014.

G&A costs were $870,000 higher this quarter over that of the previous year. The main reason for the increase was the fact that we operated 35 more stores at the end of this quarter as compared to January 1, 2014. Increased income taxes on our taxable re-subsidiary and additional legal fees offsetting the impact of the increased overhead was a $266,000 increase in third-party management fees earned this quarter.

Regarding properties, Dave mentioned the two stores we purchased during the quarter for $15 million, in addition to the purchase of the four stores in New York and Connecticut that have been leased since November 2013. Of the two properties acquired, one was purchased a C of O and the other was a mature property. Both are located in the Chicago market.

This month we purchased three mature properties for approximately $23.9 million, which were funded by draws on our line of credit.

Our balance sheet remains strong and during the quarter we issued 1,380,000 common shares through an overnight offering at a price of $90.40 per share, resulting in net proceeds of a $119.5 million, which were used to fund the purchase of the four stores in New York and Connecticut. We did not issue any shares through our ATM plan during the quarter.

At March 31st, we had approximately $10.3 million in cash on hand, $237 million available on our line of credit, and approximately $151 million available under the ATM program.

With regard to guidance, same store revenue growth for Q2 should be in the 5% to 6% range, and NOI around 6.5% to 7.5% for the quarter.

Expenses outside of property taxes should increase 3% to 4%. Property taxes for the quarter are expected to be between 2% and 3%. We expect full-year revenues to grow between 5% and 6% over 2014 and NOI to increase 6% to 7%.

Our guidance assumes an additional $100 million of accretive acquisitions in 2015 of which approximately $31 million has been completed as of today. We have not included in guidance the related acquisition costs incurred to date or that could occur in the future. As a result of the above assumptions, we are increasing our forecasted funds from operations for the full-year 2015 to be between $4.79 and $4.85 per share and between $1.21 and a $1.23 per share for the second quarter of 2015.

With that, Melissa, we will open the call up for questions.

Operator
(Operator Instructions) Our first question comes from the line of Todd Thomas with KeyBanc Capital Markets.

<Q>: So first question on occupancy, I was just wondering if you could share with us where occupancy is today? How that compares year-over-year? And then also, I guess the year maybe got off to a little bit of a slow start, though things rebounded in March and April. Where are you projecting occupancy might peak out in sort of late July, early August? Are you still expecting to be able to get to the same levels that you were previously projecting?

Ed Killeen – Chief Operating Officer
Right now we are at 91.3, 160 basis points over last year same time, and as far as what that spread can look like come toward the end of the peak leasing season it is hard to say. We might see a gap of 200 basis points over last year, but right now we are 91.3.

<Q>: Then last quarter it sounded like part of this year's plan was to be more aggressive on rent increases to existing customers. Did the weather prevent you from starting to send out those rent increases on time at all, so just maybe a little bit of a late start there? And how has pricing power been relative to your expectations as point in the year here?

Ed Killeen – Chief Operating Officer

Well that's exactly it. In regards to in place rates, we did plan to get to a good place by second quarter, which we will. You will see a lot of in-place rents go in for second quarter, but we were pretty gentle in the first quarter and that was weather related. We had very low move out rate versus last year. Obviously that's weather related. But what you will see in the next quarter and through third quarter, you will see us get very aggressive with in-place rates.

In regards to asking rates, right now we're at 4.8% over last year. That gap has actually increased a bit. So you're going to see a lot of our strength come out of current rates going into the peak season.

<Q>: Then just last question, I appreciate the MSA breakout and some of that detail. On Houston, do you have a sense for what's happening in Houston more broadly within the self-storage industry outside of your portfolios performance in the market?

<u>Ed Killeen – Chief Operating Officer</u>
Well as Andy said, things are rolling along quite smoothly in Houston right now. We have very high occupancies. We're not seeing any negative impact from the energy sector right now. Our eyes and ears are certainly on the market; we're watching how things progress and we're cautiously optimistic, but we're not seeing anything yet.

<Q>: What about outside of your property specifically though, are you hearing that there is a little bit of a slowdown or anything being felt by some of your competitors in the market outside of the REITs even, perhaps?

<u>Ed Killeen – Chief Operating Officer</u>
I think everybody will probably share the same feeling that nobody is really seeing that yet. We're not hearing that from anybody.

<u>Operator</u>
Our next question comes from the line of Smedes Rose with Citi.

<Q>: This is John here with Smedes. On guidance, it looks like 2015 FFO guidance increase $0.03 at the midpoint, but you kept the same-store guidance the same. So just trying to get an idea of the driver of that increase. Is it related to the timing of acquisitions or what exactly is driving that increase?

<u>Andy Gregoire – Chief Financial Officer</u>
It really is probably moving towards the higher end in those guidance ranges. So we're still in the range, but probably pushing a little bit towards the higher end. It was the Q1 beat and probably a push a little bit towards the higher end of those ranges is what caused the change in the FFO guidance.

<Q>: Then on the acquisitions, I know you just mentioned here the two in the quarter aside from the $120 million and then you had three subsequent to quarter end. Can you talk about the cap rates you were seeing and what type of seller those were?

<u>Paul Powell – Chief Investment Officer</u>
Yes. The three that we bought subsequent to the end of the first quarter, on a weighted average it was about 5.8 cap and that was brought down somewhat by the Jacksonville property we bought. It was a little over a year and a half and it was at 77% occupancy, so that's why the cap rate was about 5.8.

<Q>: Then sorry, did I miss this one, the two facilities in Chicago?

<u>Paul Powell – Chief Investment Officer</u>
The two we closed were, one was a CO opportunity— I'm sorry?

<Q>: Yeah, right one was a CO, the other one is matured, right?

Paul Powell – Chief Investment Officer
Right, the other one is mature. That mature one was about a 6.8 cap.

<Q>: Then my last question on supply, I know there are talks across the markets, but are there any particular markets where you are seeing any new supply or any supply competing with your product?

Paul Powell – Chief Investment Officer
Yeah, we do a quarterly review, our area managers check with municipalities and based on the first quarter review we found about 86 projects that were either in construction and or the planning stage that we're within our immediate markets. Of significance, 56 of those were in 4 states; 25 of them being in Texas, 12 in North Carolina, 13 in Phoenix and 6 in Denver.

Operator
Our next question comes from the line of Jana Galan with Bank of America Merrill Lynch.

<Q>: Going back to the acquisition market, you had a good pace, but do you still feel good about the additional $70 million you expect to complete inside your guidance?

Paul Powell – Chief Investment Officer
Yes, Jana. We do think we'll certainly hit that guidance. Currently we have under contract 4 properties at $32.5 million and another 3 CO opportunities at $26 million, and then we're in contract negotiations for another 11 operating properties for about $67 million and another 4 or so CO deals valued at about $43 million. So we'll hit that $100 million and hopefully do better.

<Q>: Then just quickly, [indiscernible] I was curious just on Pensacola, it seemed like that had a large occupancy dip year-over-year?

Andy Gregoire – Chief Financial Officer
Yes, we had a flood. Remember, the significant rains last year in Pensacola drove down the occupancy in that area. We had one store that was heavily affected, but it's coming back strongly now so we should be fine. It was really just a loss of customers from the water damage and I think they had something crazy like 20 inches of rain in a day.

Ed Killeen – Chief Operating Officer
Yes, nearly shut down a whole property for a quite a bit of time.

Dave Rogers – Chief Executive Officer
And rather than take it out of the pool, that's the price of doing business, right, so we vacated 400 plus units. Those customers don't have anything to store anymore, so we're almost starting like a lease-up property all over again, except that we sort of take the pain of losing all those customers in one quick flood.

Operator
Our next question comes from the line of George Hoglund with Jefferies.

<Q>: Can you comment on how the reclassifying internet expenses, what impact that had on overall same store NOI growth?

Andy Gregoire – Chief Financial Officer
Yes, George. It actually increased the NOI growth by 20 basis points. You can actually pull that number out, the internet marketing shown on a same store basis for the three month ended 2015 was $1.425 million, for 2014 it was $1.394 million. If you had pulled that out, net operating income would have been $7.3.

<Q>: And going back historically, can you give us on average how much of an impact you think it had historically?

Andy Gregoire – Chief Financial Officer
When it ramped up significantly three years ago, it had an impact, it would have had an impact on the pool, but now the growth on the same store basis is not that significant. Obviously, if you had stores you spent more money, but the actual per store spend over the last few years has not grown significantly.

<Q>: Then also just on the CO deals, I mean the one you did in the first quarter and the ones you are looking at now, in terms of underwriting, how long are you guys assuming until stabilization and what types of stabilized yields are you guys underwriting?

Paul Powell – Chief Investment Officer
Yes, the CO deal that we closed in the first quarter in Chicago, we targeted about an eight cap. We figured it would lease up within 3-3.5 years. The ones that we have under contract currently, again, we are targeting about an eight cap overall and a 2.5-3/3.5 year, depending on which market, as a stabilization.

<Q>: Then just one last question. On the third party managed assets, how much a difference do you think it makes for rebranding assets to Uncle Bob's versus if you had to left an asset with its original branding?

Dave Rogers – Chief Executive Officer
I think it's critical. You can't get the power of scale, you can't get your folks to answer the phone with the sales work that we do, you're not exposed on the web the right way. We don't do it, unless we can brand it Uncle Bob's, we don't it; it doesn't make any sense at all not to bring it into the pool.

Operator
Our next question comes from the line of Ross Nussbaum with UBS.

<Q>: Couple of different questions here, you've talked about February being I think you used to work "bad," how much of that was sort of Boston, Buffalo, Connecticut snow or was it more widespread across the portfolio than that?

Ed Killeen – Chief Operating Officer
That was indeed the badness, if you will. Our ins were down 5.9% in February, yet for the quarter they were flat and that almost all is attributed to the Northeast and the snow. The weather related issues in the Northeast, they are very trade areas specific, as you can imagine. On one side of town it might be clear as day, on the other side of town we, in particular, got hammered. So not only did you have a more static customer base, you had a lot of costs associated with extra snow removal and a lot of damage, so that really drove up the R&M costs. So yes, that bad February was due, by and large, to the Northeast.

<Q>: You realized or I guess your rent property by per square foot for the quarter, it looks like it was up 3.4% year-over-year for the same-store pool. For the fourth quarter that number was like 5.2%, a couple quarters before that 4.4%. So I guess I'm trying to figure out, did you guys back off on the rent growth because of what was going on in February? Why was the rent growth in this quarter weaker than it was in the prior three?

Andy Gregoire – Chief Financial Officer
There was a couple of things going on here. First of all, with the in-place we were hesitant. Really, when you see that weakness that we saw in February, we did pull back a little bit. But the other thing was we increased free rent this quarter, which you haven't seen us do much. We think we are the best in where we are at free rent-wise. I mean, we gave away $1.8 million during the quarter, $1.67 million last year, so the increase was like a $142,000 of free rent. That's unusual for us, but we think we're the best at reducing that. It's probably where we have the least room to improve. So we do a great job in revenue management giving away to lease. We just wish the whole industry would follow that process. So sometimes it's tough when there's others out there giving it away to compete against that, so you saw a little bit of that and that hurts the rent growth.

<Q>: So I'm just try to reconcile sort of what I'll call a little bit of a slowdown in the realized rent growth in Q1 against your comments. You're going to be aggressive on rate growth as we get here into the peak season. Do you guys think that you will be able to achieve better than call it the 4.5% to low 5% rate growth that you were able to see last, sort of what I'll call summer'ish?

Andy Gregoire – Chief Financial Officer
Yeah, I really do think that, I mean, March and April were very strong. The increase letters that went out for the second quarter have been significantly more than we've done in a long time. So we're feeling comfortable, the phones are ringing; it's coming into the busy season. Occupancy up 160 basis points at this time in April is a surprise for us. We didn't think we could have that gap and that's looking at 200 basis points at the peak of the busy season. That's stronger than we had expected. We really thought 100 was where we were going to run occupancy-wise this year. I think the spread in rates will be similar to last year, so I think we're comfortable with it.

Ed Killeen – Chief Operating Officer
If regards to the asking rates, the in-place rates that we're speaking of getting a little bit of more aggressive of at or with over the next quarter into the peak selling season, the value of those increases are by far the greatest that they've been in any quarter that we really have been recording them. So while we are a little bit gentle in the in-place for the first quarter, the value of those that we put in were the greatest ever and we think that we'll continue to be able to do that through the peak selling season, so that will make a difference.

<Q>: Final question from me. Where are asking rates today versus in-place? Going to roll-up or roll down?

Paul Powell – Chief Investment Officer
We have more people below the current rate than we do above.

<Q>: Okay, so you've gotten an embedded roll-up?

Andy Gregoire – Chief Financial Officer
We have 34% of our customers above the current rate and 57% below the current rate.

Operator
Our next question comes from the line of Todd Stender with Wells Fargo.

<Q>: Dave, you mentioned that you're going to push rates on new and existing customers this year. I imagine it is the fact that you are at a very high occupancy in the Q1 going into peak season. Is it the lack of new supply, is it that occupancy level? I want to know what gives you that confidence right now, that's part one? And then two, what markets do you think you're going to be focusing on primarily? And then counter to that, what markets maybe you can't push as much?

Dave Rogers – Chief Executive Officer
Yes, certainly it's all of those, Todd, and the metrics of the sector are just great. There is some new supply coming on that we have been talking about, but not enough to really make a difference. Because as we have talked about, our occupancy jumps pretty good, going back 10 or 11 quarters ago, and we have been on a nice upward trend hitting historic highs over the last few quarters.

What's happened also, though, is that a lot of these independent operators and smaller operators have enjoyed this overflow. We've talked about how we've turned away thousands of customers a quarter away; they've got to go somewhere, they are going to the smaller operators, their occupancies are coming up and it enables us then to have a lot more pricing power in the industry and as a company. So the lack of new supply helps, uptick in demand helps and just the overall strength of being able to know where you can push or where you have to pullback a little bit helps. And in terms of the overall, I think you've heard it from us then the others over the last at least 2.5 years, it's a right time to push rates and get some pricing power. As far as individual markets, I'll let Ed just talk about a few of those.

Ed Killeen – Chief Operating Officer
Todd, looking at it from a market specific standpoint, it looks like we are going to be able to push pretty hard, oddly enough, in the Northeast. If, for no other reason, pent up demand we're ready to start pushing in the Northeast. You will see us push pretty hard in Florida and still Texas; San Antonio is a market that really is undersupplied and we'll be pushing pretty hard there. Phoenix we'll be doing the same there. So there are quite a few markets we'll be pushing. I would say, again, Texas, Florida, New England and we'll be able to push hard in quite a few different markets.

<Q>: Then on the property, on the stabilized property in Chicago, what was the occupancy, what are the in-place rents, and what are the market rents around that specific submarket?

Paul Powell – Chief Investment Officer
On the stabilized asset we bought in the first quarter, in-place rents were around $10. This was a true mom and pop run property; it was a full property. We expect to be pushing rates 15% to 20% in the first year. The occupancy was 94%. An acquisition, again, it was a full store, zero rate management, so as of today I think we've already pushed rates to some degree. I don't have that number in front of me right now.

Operator
Our next question comes from the line of John Pawlowski with Green Street Advisors.

<Q>: You've mentioned Houston and Texas operations largely impact. Any sense to the transaction market is shifting pricing or property is coming available for sale at all?

Paul Powell – Chief Investment Officer
In Texas, we are not seeing the deals that we are looking at the pricing is certainly not coming down. We're also seeing a big increase in development opportunities, at least coming through my office. So we're not seeing any opportunities really in Texas that we're going to take advantage of just because of our current, what we own in Texas. So we're looking at those opportunities but we're not seeing any price relief.

<Q>: So the sense is, for example, the Four Season's portfolio train on a similar cap rate range or little bit higher?

Paul Powell – Chief Investment Officer
Yeah, I think if another portfolio of the quality of the Four Seasons came on the market, you would pay certainly a sub 6, maybe unified cap for a portfolio of that size and quality.

Operator
Our next question comes from the line of Anthony Ha with SunTrust.

<Q>: David, could you talk a little bit about where you think your property's street rates are versus maybe some very nearby surrounding private operator street rates, and how that differential looks like today maybe compared to a couple of years ago? And maybe as a follow-up, how far can that rubber band stretch before things change?

Dave Rogers – Chief Executive Officer
I think we are having the gap closed on us a little bit now that the independent guys are not seeing a 70's handle their occupancy, and they are more in the 80s, higher 80s. I think that we still suffer in most markets more discounting than we would like to see, but on a rate picture I think the gap is closing. It depends on lot of places, certainly. And the same goes with the other REITs that we compete against. So I think the rate gap we have—now this is before. We are ready to go again. We have held back a little bit on rate increase. So I think you are asking me now right as we're getting started. If we have the same question in September, I think our gap will be up considerably higher because we will be using our pricing power a little bit more.

I think the gap can go pretty [indiscernible]. I think the idea that we've been espousing for the last couple of years on the fact that get seen, and not just us, but the other big guys who have the power to get on the web and be that first page and have some real presence with that CO. I think that makes a big difference. You got a guy across the street that's not seen and it may not be until the customer drives up to our store that he even knows that that guy is there and he's already been preapproved with us, has his rate set, has his contact information and is locked and leased ready for him to go. So, I expect that gap to grow considerably through the busy season. They may catch up a little bit in the fall, but right now I think the gap is not too great. I think it is going to get greater and I think we can sustain that for as long as the web is getting us the power that it gives us.

<Q>: I'm not sure if someone asked this or not, but did you comment on your willingness to look for or to pursue some certificate of occupancy deals as some of your peers have been doing?

Dave Rogers – Chief Executive Officer
We've been doing it. And as Paul mentioned, we closed a couple last year, we closed a couple last quarter; we've got quite a few in the pipeline. I will tell you, a lot of the fun has been taken out the game just in the last year or so. The spreads have gotten quite tight. The whole idea is we are not taking on the idea of entitlement risk and spending that year or two years or three years preparing the garden to get approval and zoning for it, and we're willing to pay for that and we are not taking the construction risk. We want to have people who know what they are doing, who've done it before, preferably who have built properties that we've bought, so we lay off the construction risk. And the only risk we are taking on here is the lease-up risk, which we think we are very capable of doing with the platforms we have. But man, they're not leaving much room for us to get paid for that part of it. As Paul has talked about over the last couple of quarters, it's getting down quite a bit from, you know, we've had a couple deals that were looking north of ten on a stabilized basis and haven't for a deal or two, and then it came down to eight and seven. Some guys want, they want to get paid a 6 cap rate on the projected NOI four years out. It's really gotten to be, as I said, a lot of the fun has been taken out of it just in the last nine or ten months.

Operator
Ladies and gentlemen, thank you. At this time we have come to the end of our time for questions. I will now turn the floor back to Mr. Rogers for any final concluding remarks.

Dave Rogers – Chief Executive Officer
Thanks, everyone, for your interest and attention to us. We are looking forward to a good rest of the year and we look forward to seeing a lot of you at NAREIT. Have good weekend.