Camden Property Trust
Citi Global Property CEO Conference Roundtable
March 4, 2019 - 10:15 AM ET

Nick Joseph: Welcome to Citi's 2019 Global Property CEO Conference. I'm Nick Joseph with Citi Research. We're pleased to have with us Camden and CEO Ric Campo. This session is for investing clients only. If media or other individuals are on the line, please disconnect now. Disclosures are available up here and on the webcast on the disclosures tab. For those in the room or the webcast, you can sign on to liveqa.com and enter code Citi2019 to submit any questions if you do not wish to raise your hand.

Ric, I'll turn it over to you to introduce the company and the team, and provide the audience three reasons why somebody should buy your stock today, and then we'll get into Q&A.

Ric Campo: Okay, great. Thank you.

Camden is a multifamily company with 55,000 apartments located in 14 major markets across the U.S. We've been a publicly traded company since 1993 and have a total market cap of $12 billion. Our strategy is to focus on high-growth markets measured by projected employment, population, and migration growth. We operate a diverse portfolio of assets, geographically and A/B, urban and suburban, providing lower volatility of our cash flow. We recycle capital through acquisitions and dispositions; create value through development, redevelopment, and repositions; and maintain a strong balance sheet with low leverage.

We've been hosting this roundtable discussion for a long time. I thought about it when we were coming in that this week would mark the 10-year anniversary of the bottom of the stock market. I believe we were at a different hotel 10 years ago, but it's interesting to look and see where we are today. During this week 10 years ago, our stock bottomed at $16.38 per share. Thankfully, the recession ended after that and we've picked up from there.

In the last 10 years, I think it's interesting to think about what companies have done over that timeframe. What we've done is dramatically improved the quality of our portfolio, growing our earnings and dividends, strengthening our balance sheet, and delivering an almost 16% annual total shareholder return.

When you look at our portfolio now versus 10 years ago, we have completed $3 billion of asset dispositions, selling at an average age of 23 years and investing the capital into acquisitions and development. We completed $1.7 billion of acquisitions with an average age of four years. We've completed $1.6 billion of developments, which would be worth $2.4 billion today, creating $800 million of value for our shareholders. We've raised our monthly revenue per occupied unit by 65% to approximately $1,750 and maintained an average age of 13 years, despite those 10 years passing. I wish I could have done that personally. We've increased and nearly tripled our FFO per share from $1.68 to $4.77, increased dividends per share from $2.05 to $3.08 for a 50% increase, and had a10-year annualized return of roughly 16%, exceeding both the average and being in the top tier of the multifamily group.

One of the other big things we did was change our balance sheet pretty dramatically. We lowered our net debt to EBITDA from approximately 8 times to 4.2 times, currently the best in the multifamily sector. We retired virtually all of our secured debt and have only one encumbered asset today and $12 billion of unsecured assets with no mortgages on them. We reduced the number of joint venture partners from nine to one, and the one we have today is with Texas Teachers, which is a blind pool fund. We had upgrades from all major credit rating agencies. Camden is now one of only four companies that has an A- or better rating from S&P, Moody's, and Fitch. I think there are only eight REITs that actually have an A rating.

2018 was another solid year for Camden. We raised our FFO guidance twice last year and beat by $0.05 per share. We achieved the highest FFO in the company's history, paid the highest level of regular dividends in our history, reported same-store revenue and NOI growth of 3.2% and 3.4%, which was the second best in the sector. We're off to a good start in 2019. We posted a new investor presentation on our website this morning, which includes preliminary data for first quarter 2019 regarding new lease and renewal rate growth. Quarter-to-date new lease and renewal growth is 0.6% and 5.6%, for a blend of 3.1%. Quarter-to-date occupancy is 95.8%, unchanged from the fourth quarter and 40 basis points above our first quarter 2018 level. We issued $328 million of common equity in February, retired $439 million of secured debt between February 1st and March 1st, and we acquired a 316-unit apartment community in Scottsdale, Arizona, for $97 million.

The three reasons to buy Camden stock are: (1) we have an experienced management team with a proven history of performance; (2) we operate a geographically diverse portfolio of assets located in high-growth markets with strong demand for rental housing; and (3) we have the strongest balance sheet in the sector, positioning us very well for future growth opportunities. Thank you.

Nick Joseph: Great, so we're starting each session with the same question, which is, what is the biggest potential disruption to your business, and what are you doing to take advantage of it or mitigate the risk of it?

Ric Campo: The multifamily sector doesn't have a big disruptor compared to other sectors. I've thought about this for a long time. It's really hard to disintermediate needing a bed and a bathroom. You don't need a kitchen, but you do need both of those other things, so we don't think that the multifamily business can be disrupted. I think what could disrupt our business plan could be something that we don't know about now--a recession, job growth changes, something pretty dramatic like what happened 10 years ago or something like that. I don't think there's any one major thing that can disrupt the multifamily business.

Nick Joseph: You recently did the equity raise you mentioned in your prepared remarks. The balance sheet was already in a very good position. You had raised equity towards the end of 2017, and the deployment of that capital was a little slower than what you initially anticipated. What was the thought on raising equity last month?

Ric Campo: The thought was that our capital requirements for 2019 are roughly $1 billion. We have a $300 million acquisition pipeline. We have $330 million of development spend that we need to complete. We have a budget for $100 million of dispositions, and then we have $439 million of debt to pay off. When you add all that up, it's roughly $1 billion. Our debt to EBITDA is in the low 4s now. If we used debt to fund all of that, we would take our debt to EBITDA up to 4.9x, plus or minus, right at the high end of our range. Our range is 4 to 5 times debt to EBITDA. That was one consideration, which is that we need the capital.

Number two is if you take our stock price and look at it over a five-year period and you plot the stock price versus the Street's average NAV, there have been five points in that period of time when it's been within shouting distance or above the Street's NAV. For public real estate companies, the only way to grow is to issue equity or borrow money. You can do joint ventures around the edges and things like that, but we fundamentally don't like joint ventures. We think you might make a better return on your investment, but you're taking a lot more risk for that extra return. We don't think it's worth it, so we don't do many joint ventures.

When you think about equity, equity is just part of the capital stack. We have a capital stack that we believe is 75% equity and 25% debt. Our weighted average cost of capital is 6.18% when you weight in long-term costs of capital. We're doing acquisitions at 7.0% to 7.5% unlevered IRRs, and we're doing developments at 7.5% to 8.5% unlevered IRRs. If we can always make a spread on our long-term cost of capital, we will do well long term. That's why we did the equity.

Nick Joseph: Can you elaborate on the acquisition portion of that capital spend, $300 million for this year? Last year I forgot what you bought, but it was below what your expectations were. Do you have greater expectations of hitting what you have in your acquisition capital spend for this year?

Ric Campo: We do. Last year we had a budget for $500 million in acquisitions and we did $300 million. We could have hit the target, had we just hit the bid, but we were disciplined in our approach to allocating capital and we just didn't find the right acquisitions. We thought last year that there would be more pressure on sellers, and there just wasn't. Rates stayed lower for longer. The pressure actually came in the fourth quarter, and that will lead me into 2019.

In 2019, we have a $300 million budget. We already closed $97 million, so I think that we'll be able to find $200 million of additional acquisitions. Let me describe the acquisition that we just closed in Old Town Scottsdale. It's in a very good prime location, and it's very hard to find development sites there. We worked on this project in October of last year and had a bid of $98.5 million on the project. It was awarded to a competitor at $102 million. By the end of November, the seller called us back and asked if we were still in at $98.5 million. We said no. We ended up closing the transaction last week at $97 million. I think what happened to the buyer was they put the deal under contract in October, when rates were much lower. You had dislocation in the markets that happened in the fourth quarter. The 10-year went to 3.25% and the buyer went away. The seller was worried that they were going to bring a tainted deal back to the marketplace, so they called us, knowing that we had the cash and the ability to close, so we did.

We think we'll be able to get our acquisition targets done this year. I think the market's a little bit different because of the scare in the fourth quarter with rates, and there are still plenty of sellers who need to sell. This particular project is a good example of what we want to buy, which is a very undermanaged project. It's in the low to mid-4% cap rate zone, 10% or 12% below replacement cost, and we think we can get the cap rate above 5% during the second year, primarily because of our management and some other things that we put in place.

Nick Joseph: Is that a good example of what you're looking to acquire this year? Is it all going to be pre-stabilization, below replacement-cost deals, or are there any stabilized assets that you're interested in as well?

Ric Campo: We're only interested in those kind of assets, and that's why we didn't buy assets last year. We could only find $300 million of those. They are not as easy to find as well-managed, well-developed, stabilized properties. It's like a value-add in the core space. We have certain property management companies and merchant builders that manage their own properties. We love to buy from them, because they don't really know how to operate the properties.

Nick Joseph: If there actually is GSE reform, how does that impact these pre-stabilization deals if GSE financing isn't as readily available to take out the construction debt?

Ric Campo: I've been talking about GSE reform for 15 years. I was chairman of National Multi Housing Council during 2008 and 2009, when the GSEs were bankrupt. It was interesting talking about the reform then, when there was a lot of energy around it. Given the fact that they print money right now for the government and give massive amounts of capital, plus they're used as a political tool for whoever is in charge, I don't see anything happening. But even if it does, from a public company perspective, I would always like my competitors to have less capital than me.

Nick Joseph: When you think about acquiring these pre-stabilized deals, other than burning off the concessions, what else are you doing to get that excess yield?

Ric Campo: We're doing some really simple things like cleaning the property, fixing things that are broken, basic things like taking care of customers and making sure they really know that you appreciate them as a customer. That's really what we do. Then what happens when you get around to renewals is you keep more people, because they don't move out because they're mad at you. Second, you're able to then raise rents or burn off the concessions.

The merchant builders are really good at building. They do a great job. They're a great service to the industry and to creating housing for America, but they're not the greatest managers. Oftentimes people will put in a revenue management system, for example. We love revenue management systems, and when they're operated by people who don't know how to run revenue management systems, there's always an embedded 2% or even 5% from just fixing the revenue management mistakes.

Nick Joseph: Would you ever want to do third-party management?

Ric Campo: Never.

Nick Joseph: For that exact reason?

Ric Campo: Think about it - you compete for the lowest possible cost, and then it is a business that has 30-day cancellable contracts, and you're only as good as you were 30 days ago. It's a low-margin business and people focus on the owner who's screaming the loudest at the moment. I would rather focus my people's talent on properties where they can create value for shareholders.

Nick Joseph: When you think about where your assets are today, your market mix and exposure, where would you like to lighten up or add to? I think in the past, you've talked about maybe potentially expanding in Seattle or Northern California. How do you think about that?

Ric Campo: We like our markets. Otherwise, we wouldn't be there, and I'd sell out of those markets like I did in Las Vegas in 2016. We like them for all the reasons that I talked about. In terms of other markets, it's always interesting to look at other markets, but the challenge we've had is the entry point and how to get scale in a market and how to get an entry point that isn't really dilutive to our business, and that’s been difficult to do. I've been waiting for a cycle and we haven't had a cycle yet. Perhaps there will be a cycle in the next few years and we'll be able to enter a market like that.

Beyond that, I don't really have plans to lessen one market or grow another market. When you look at our concentration of NOI to various markets, you can see some that are underweighted relative to the average, and Phoenix would be a good example. We've been adding to Phoenix. In Tampa and Orlando, we sold a lot of older assets there, so we've been adding to those markets. Ultimately, I think Camden needs to be bigger to be more efficient from a G&A perspective. With that said, I wouldn't see us trimming any markets. I would just see us growing in markets we're underweight in now.

Nick Joseph: How much larger do you think you need to be to reach peak efficiency?

Ric Campo: When you look at G&A to total assets and G&A to total revenues, we're definitely in the bottom of the pack there. If we were a high-cost G&A company that didn't deliver top-tier shareholder returns or top-tier NOI or revenue growth, I'd be really worried. But over time, we're going to grow. The challenge with growing is that means we have to sell more equity or take our debt levels up. I guess some people don't worry about too much debt, but we do. I think fundamentally that lower-leveraged companies should trade at premiums, and they generally do over time.

Unidentified Participant: Regarding your operations in Dallas - Dallas has lots of supply, but on your call you mentioned that your assets are performing much better for the lack of a concessionary environment. The supply that's coming online, would you say that it's targeting a certain segment of the market that you're able to outcompete in your asset base? And if so, is there a type of asset that people are developing that you would be willing to buy in Dallas?

Ric Campo: Our portfolio is holding up better in Dallas because of the mix in our portfolio. Our mix in Dallas is more on the B side than the A side, or in suburban versus urban properties in Dallas. In a market like this, we have a lot of concessions in the As and in new developments. You're going to have more pressure at the top end of the market. That pressure isn't felt as much in the B part of the market, and that's why we have A and B in our portfolios, to try to dampen that cash flow dislocation when you have competitive markets. In terms of buying in Dallas, we're happy to buy the same kind of property we just bought in Phoenix. If we can find an undermanaged asset below replacement cost in a great location that's a great long-term asset, we'll buy it.

Nick Joseph: Maybe just more broadly on operations, I recognize we're only two months into the year, but in the operating update you have a positive spread year-over-year on blended rate versus what you did in the first quarter of last year. You have occupancy that's probably higher than expected. But where are you, relative to where you would have expected to be after two months, and maybe factor in the renewals 30 and 60 days out.

Ric Campo: Our occupancy may be higher than last year, but it's exactly where we want it to be, because we make it by adjusting our rents. At the end of the day, occupancy is a function of where you want it to be, not where the market's going to let you have it, because you can toggle those numbers to get it there. In terms of where we are today, we feel pretty good about where we are. 2018 is going to be a lot like 2019, and we feel good about the fact that we do have a little more occupancy now. Like I said, that was a choice. That should give us some decent running room into the strong leasing season coming up in the spring and summer. I do like the fact that when you look at our blended rate of revenue from new leases and renewals, in 2017 it was 2% in the first quarter. In 2018 it was 2.8% in the first quarter, and in 2019 it's 3.1%. Whenever you see an “up and to the right” move in those numbers, you feel pretty good. That's where you want to see them.

Nick Joseph: Are there any markets thus far this year that are either trending ahead of or below expectations? Anything we should be keeping an eye on?

Ric Campo: So far this year, the markets are trending pretty much where we think they should be.

Nick Joseph: Maybe Denver-specific, I think you rated it your top market as A stable, but the jobs-to-completion ratio is 3:1, below the 5:1 you typically talk about. What's going on in that market where you're positive despite that ratio?

Ric Campo: On the 5:1 ratio, five jobs for one unit of demand is an interesting ratio. I'm not sure who came up with it, maybe Ron Witten or somebody like that, and maybe over a long period of time that's what it was. But what's been interesting, at least in the last 10 years, is that it hasn't really worked, and I'll give you a good example. In Houston in 2014, oil prices peaked at $110 per barrel, and by 2015 they were down to $20-something, and it was awful. 80,000 jobs were lost in the energy sector, all high-paying jobs. Houston basically had zero job growth in 2015, yet they absorbed 15,000 apartments. What happened to the 5:1?

I think part of the issue is that we have a different dynamic today because you don't have the same homebuyer mentality that consumers had 15 years ago. The thought was when you got to be 30 years old, you'd be married, have kids, and then the normal thing is you'd move out to the suburbs and buy a house. That's just not happening today. The millennials are taking longer to get married and to have kids, and they have too much student debt and are just not homebuyers. That's why we see home buying and single-family home sales dropping.

I think there's more demand being created without the jobs than we used to think. The other thing I think is happening, especially in markets like Denver, is we still have about one million pent-up millennials who are living at home, compared to the levels that they were living at home in 2007. When you think about that, even though we have very low unemployment rates and decent job growth, you still have all these 30-year-olds that are living at home. I think that you still have the release of that demand, so that means you need less jobs. What's happening is people don't have enough capital, so they're saving their money longer, and then they're wanting to get out. I know plenty of my friends that have millennials living with them, and they want them out as soon as possible, but they don't want to pay for it. They want them to fund it. I think that also leads to the ability to absorb more supply without having the jobs.

Nick Joseph: Maybe on the expense side, you had the Attack the Run Rate initiative. Going forward, did you get the low hanging fruit? Putting aside property taxes, is it just inflationary growth going forward, or is there still more opportunity for efficiency there?

Ric Campo: For those of you who don't know what he was talking about, last year we had what we called Attack the Run Rate. When you have a large organization that's far-flung with 161 different locations not including regional offices, you have to have mantras that people can get behind. Attack the Run Rate was an idea where we wanted people to think about all of their expenses and why they actually spend them. Not just zero-based budgeting, but what are you doing every single day? Why are you spending that money, and is it something you really need to spend? We created "Attack the Run Rate" and did a great job. Employees saved a couple million dollars out of our run rate. When you think about a couple million dollars, it's $0.02 per share with 100 million shares outstanding, so $0.02 is nothing to sneeze about.

I think our Attack the Run Rate continues. I think from time to time you have to shake the tree, because we all get complacent as we have great earnings. We doubled our dividends, we increased our FFO dramatically and everybody's doing well. People are getting good bonuses and the stock price is doing great. But you have to shake the tree and get a reality check. Let's make sure we understand that this is a nickel-and-dime business and you need to deal with those issues and think about that. I think we definitely got whatever was low hanging, but we're still working on it, and we should still be able to drive expenses down.

Unidentified Participant: What do you see as the potential changes from Fannie and Freddie and your view on the potential ramifications for the industry and your company, a REIT itself?

Ric Campo: Like I said earlier, I don't think there are going to be a lot of changes, but maybe there will be at some point. I think that Freddie and Fannie are a large part of the market. I'll tell you one of the reasons I don't think that it will change dramatically for our type of property, which is investment-grade quality. When you look at Freddie and Fannie, in the secondary and tertiary markets they're the only lender. The reason I think that it doesn’t change is that ultimately when they start talking about change, they’ll say multifamily doesn't need to be financed by Freddie and Fannie. Then what you'll see is all the folks that are getting loans from Freddie and Fannie in the small towns across America - rural towns and tertiary markets where big insurance markets don't go - they're going to go crazy. Their congressmen are going to come and say that a change will bankrupt multifamily in their small town.

That's why it won't get done, not because people like me want it or need it. It's such a political thing for whoever's in charge to use to their advantage. If it did get changed, and if it does get changed, I think they will stay in the small towns and they’ll stay in the secondary and tertiary markets, which we don't play in anyway. And then what happens is, in the investment-grade area, you have plenty of other capacity. The life companies today are more aggressive than Freddie and Fannie, and you can get a better spread from life companies.

It's not like there aren't other capital sources that want multifamily. It's a stable asset class. Its cash flow is very stable, even through downturns. It's going to be an investible asset that lenders will want to come and deal with. I think that the best case for us, thinking about our business, is that if people have less capital than we do, maybe prices adjust and then we’ll have more opportunity to grow and to create value for our shareholders because there will less competition on the capital side. I think fundamentally it could be better for us if the GSEs just went away into the night than if they didn't, but I don't think that they will because of all those political issues.

Unidentified Participant: You guys had some success with the cable and internet packages. Are there other opportunities for ancillary income that have yet to be tapped at Camden?

Ric Campo: We definitely have a very robust tech package, and we're earning $20 million per year, plus or minus, in EBITDA from that package. I do believe there are other sources in the future. One of the things that we do a lot of is survey our residents to find out what they will and won't pay for. What we don't want to do is constantly nickel and dime them. If you start out with a base rent and then add this and this and this and this and this, now you're 15% or 20% above the base rent. All of a sudden, they think that it's a bait-and-switch, and you don't want your customer to feel like you bait-and-switched them as you got them into this long-term lease that is probably one of the biggest financial decisions they've made.

We want to make sure that we create value for those customers. Some of the things that we think people will pay for are being developed now and include easier access into their apartments, managing packages, etc. They're willing to pay for things like that. The industry is working on that right now, and we are definitely in the middle of it. For example, being able to open your apartment with your cell phone or let someone in to walk your dog or put a package into your apartment or groceries into your fridge without you being there. You send a text code to the provider. They'll pay for that, so we're working on things like that for probably the third or fourth quarter of this year. I think there will be more ancillary income, but you have to be careful that you're not nickel-and-diming your customer, and that they see value in the proposition.

Nick Joseph: Just want to quickly turn to development. You continue to start projects. What development spread are you seeing today on the projects you're starting, relative to the stabilized cap rates in those markets?

Ric Campo: Our development yields continue to be 150 to 200 basis points above what we can buy things for today. Unfortunately, cap rates have compressed and development yields have compressed to follow that as well. Because of construction costs and rental fatigue in markets with development, we've seen spreads narrow. They're still positive, and we're still able to hit a reasonable positive spread, but it's more difficult.

Nick Joseph: How do you think about the size of that pipeline as we go later into the cycle?

Ric Campo: Our pipeline has shrunk over the last few years. There's no question about that, and it was by design. In the latter part of a cycle, I always want to be at the lower part of my development cycle. If we have a recession in 2020, 2021 or 2022, I don't want to have $1 billion of capital that I need to lease up in development, because generally what happens in a recession scenario is that rents go down and you don't really make the returns on your development until you have a recovery. So, we're comfortable with $300 million in annual development starts, and that way we can have a rolling $300 million of capital outstanding. That to me is a rational number in this environment.

Nick Joseph: We have four rapid fire questions this year. Will there be more or fewer public apartment companies one year from now?

Ric Campo: The same.

Nick Joseph: What will same-store NOI growth be for the apartment sector overall, not Camden specifically, in 2020? This year it's 2.9%.

Ric Campo: I would say around 3%.

Nick Joseph: What will the 10-year treasury yield be one year from today? Today it's 2.75%.

Ric Campo: I would say 2.9%.

Nick Joseph: Then, finally, in what year will the U.S. enter a recession?

Ric Campo: Maybe 2023.

Nick Joseph: Great. Thank you very much.

Ric Campo: Thank you.

Edited for Readability