CAMDEN
Living Excellence

Third Quarter 2019 Earnings Call

November 1, 2019 - 10:00 AM CT

Kim Callahan – Camden Property Trust

Good morning and thank you for joining Camden's third quarter 2019 earnings conference call. Before we begin our prepared remarks, I would like to advise everyone that we will be making forward-looking statements based on our current expectations and beliefs. These statements are not guarantees of future performance and involve risks and uncertainties that could cause actual results to differ materially from expectations. Further information about these risks can be found in our filings with the SEC, and we encourage you to review them. Any forward-looking statements made on today's call represent management's current opinions, and the Company assumes no obligation to update or supplement these statements because of subsequent events.

As a reminder, Camden's complete third quarter 2019 earnings release is available in the Investors section of our website at camdenliving.com, and it includes reconciliations to non-GAAP financial measures which will be discussed on this call.

Joining me today are: Ric Campo, Camden's Chairman and Chief Executive Officer; Keith Oden, Executive Vice Chairman; and Alex Jessett, Chief Financial Officer. I know that several of the multifamily calls this week have gone over 90 minutes in length, so we will attempt to be brief in our prepared remarks and try to complete our call within one hour. We ask that you limit your questions to two, then re-join the queue if you have additional items to discuss. If we are unable to speak with everyone in the queue today, we'd be happy to respond to additional questions by phone or email after the call concludes.

At this time, I'll turn the call over to Ric Campo.

<u>Ric Campo – Camden Property Trust</u>

Thanks Kim, and good morning. Today's on-hold music was provided by the Talking Heads. In their hit titled "Once in a Lifetime" they say that life is "Same as It Ever Was," which seems to describe the strength in the multifamily space.

Camden's third quarter earnings and same property net operating income growth was better than we expected, leading to another guidance increase making that three for the year.

Apartment demand continues to exceed new supply in our markets driven by higher job growth than the national average. Household formations continue to be strong through the third quarter with a nearly 1.4 million increase in household formations so far this year - the highest in the last 10 years. The apartment capture rate has remained high. Apartments continue to be the home of choice for Millennials and many others. The record high employment has finally started to bring some of the one million Millennials that are still living with their parents since the Great Recession back into the apartment markets. This puts smiles on the faces of the parents, their grown children and the apartment owners.

We continue to improve the quality of our property portfolio through development, acquisitions, repositioning and selective property dispositions while maintaining one of the strongest balance sheets in REITland.

I want to give a big shout out to our Camden teams for their focused vision and hard work, making sure that they are improving our team members, our customers and our stakeholders lives one experience at a time.

Thanks. And I will let Keith take the call from here.

Keith Oden – Camden Property Trust

Thanks Ric. Our third quarter results marked the 3rd straight quarterly beat and same store raise which leaves us well positioned for a strong close out to 2019. We'll be providing 2020 guidance next quarter along with our customary report card and letter grades for each of Camden's markets. Our most recent 3rd party economic forecasts are indicating supply will peak in Camden's markets in the aggregate in 2020, with a slight decline in 2021. Most of our markets will see flat to declining supply next year. However, we do expect to see increases in Houston, Orlando, Atlanta, Dallas and Austin. Some highlights from our same store results include the fact that same store revenue grew 3.6% in the third quarter and 1.4% sequentially. Our top markets for the quarter were Phoenix at 6.9%, Raleigh up 5.3%, San Diego/Inland Empire up 4.5%, Denver and DC Metro both up 4.1% and Atlanta up 4.0%. Our weaker markets remained South Florida and Houston below 2%.

Regarding occupancy, our focus remains on maintaining occupancy above 96%. We averaged 96.3% in the third quarter of 2019 up from 96.1% in the prior quarter and 95.9% in the third quarter of 2018. Year-to-date occupancy was 96.1% vs. 95.7% last year. October occupancy remains slightly above 96% at 96.1%.

Turning to leasing activity, third quarter 2019 new leases were up 2.4% and renewals were up 5.1% for a blend of 3.6%. This compares to a third quarter '18 blended rate of 4.1%. This 50-basis point decrease in rents was mostly offset by our 40-basis point increase in occupancy compared to last year. October prelims for new leases were flat as expected and up 5% on renewals for a 1.9% blend, roughly the same as October of 2018. November/December renewals are being sent out at an average 5% increase.

Our net turnover continues to set new record lows for the third quarter of 2019. It was down to 51% vs. 54% last year. Moveouts to purchase homes for the quarter was 14.3%, which was the same as last quarter and the third quarter of 2018. For this metric, 14-15% is beginning to feel like the new normal for moveouts to purchase homes vs. the 18-20% rate prior to the Great Recession.

Regarding technology initiatives, Camden is evaluating numerous initiatives to increase revenues, reduce expenses and provide an overall better living experience for our residents. We have completed the roll out of mobile maintenance and an enhanced self-service online functionality for our residents. We are currently piloting Chirp, our proprietary mobile access solution and we will update you periodically on our technology and innovation initiatives.

At this point, I'll turn the call over to Alex Jessett, Camden's Chief Financial Officer.

Alex Jessett– Camden Property Trust

Thanks Keith. Before I move on to our financial results and guidance, a brief update on our recent real estate and capital markets activities. During the third quarter of 2019 we began construction on Camden Hillcrest, a 132-unit, $95 million new development in the Hillcrest neighborhood of San Diego, California. Subsequent to quarter-end, we stabilized our Camden McGowen Station development in Houston, Texas generating a yield in the low 5% range. As a result of the elevated supply in the Midtown submarket, this yield is slightly below our original proforma but within the range of our expected returns for similar mid- and high-rise urban developments. As the supply dynamic in Midtown continues to improve there will be further upside for Camden McGowen Station, resulting from its irreplaceable location adjacent to public transportation and a vibrant city park. Later in the fourth quarter we will begin construction on Camden Atlantic, a 269-unit, $100 million new development in Plantation, Florida.

For 2019, we have now completed $218 million of acquisitions and $185 million of new development starts. We are actively working on several additional real estate transactions which, if successful, would close around year-end and are therefore not included in our fourth quarter guidance as the impact to the quarter would be immaterial.

On the financing side, subsequent to quarter-end we completed a $300 million 30-year senior unsecured bond offering with an all-in interest rate of 3.41% after giving effect to underwriters discounts and other expenses of the offering. We used the proceeds for the early redemption of our existing $250 million 4.78% bonds due June of 2021 and the prepayment of our $45 million 4.38% secured mortgage due 2045. These transactions locked in 30-year debt at near all-time low yields and extended the average duration of our debt by approximately three years. After taking into effect these transactions, 100% of our debt is now unsecured and all of our assets are now unencumbered. In conjunction with the redemption and prepayment, we incurred a one-time charge to FFO of approximately $0.12 per share. This charge represents the combined amount of our make-whole payment on the previously outstanding $250 million bond, the prepayment penalty on the $45 mortgage and the write-off of remaining related loan costs. Again, this $0.12 charge was recorded in October and is included in fourth quarter and full-year FFO guidance.

Turning to financial results, last night we reported funds from operations for the third quarter of 2019 of $130.5 million, or $1.29 per share, exceeding the midpoint of our prior guidance range by $0.01. This $0.01 per share outperformance resulted primarily from higher same store NOI resulting from a combination of higher than anticipated levels of occupancy and lower than anticipated real estate taxes.

We have updated and revised our 2019 full-year same store revenue, expense, net operating income and FFO guidance based upon our year-to-date operating performance and our expectations for the fourth quarter. As a result of our better than expected third quarter same store occupancy, which we believe will carry over to the fourth quarter, and our anticipation of continued lower property taxes in the fourth quarter, we increased the midpoint of our full-year revenue growth guidance from 3.4% to 3.5% and we decreased the midpoint of our full-year expense growth guidance from 2.75% to 2.2%. The anticipated property tax savings are primarily being driven by lower Texas property tax rates as a result of the passage of Texas House Bill 3, which reduces school district tax rates by approximately $0.07 in 2019 and an additional $0.06 in 2020. As a result, we are now anticipating full-year property taxes for our same store portfolio to increase at just under 1%, approximately 200 basis points inside our prior guidance. The result of this higher revenue guidance and lower expense guidance is a 50-basis point increase to the midpoint of our 2019 same store NOI guidance, from 3.75% to 4.25%.

Last night we also revised the midpoint of our full-year 2019 FFO guidance from $5.09 to $5.02 per share. This $0.07 per share decrease includes the impact of the fourth quarter $0.12 per share charge related to the early debt repayment. Excluding this charge, our full-year FFO per share guidance midpoint increased by $0.05 per share as the result of:

- Our anticipated 50-basis points, or $0.025 per share increase in 2019 same store operating results. Approximately $0.01 of this increase incurred during the third quarter with the remainder anticipated in the fourth quarter,
- $0.015 of higher interest and other income resulting primarily from higher cash balances and other miscellaneous corporate income; and,
- $0.01 from an anticipated fourth quarter business interruption insurance recovery from a prior period for one of our non-same store communities.

Last night we also provided earnings guidance for the fourth quarter of 2019. We expect FFO per share for the fourth quarter to be within the range of $1.21 to $1.25. The midpoint of $1.23 represents a $0.06 per share decrease from our $1.29 reported in the third quarter of 2019, and includes the impact of the fourth quarter $0.12 per share FFO charge related to the early debt repayment. Excluding this $0.12 charge, our fourth quarter FFO per share guidance midpoint increased by $0.06 per share as compared to the third quarter as the result of:

- A $0.02 per share, or just over 1% expected sequential increase in same store NOI driven primarily by our normal third to fourth quarter seasonal declines in utility, repair and maintenance, unit turnover and personnel expenses;
- A $0.02 per share increase in NOI from our development communities in lease-up, our other non-same store communities and the incremental contributions from our joint venture communities;
- A $0.01 per share increase in FFO associated with the previously mentioned fourth quarter business interruption insurance recovery from one of our non-same store communities, and
- A $0.01 per share decrease in overhead expense due to the timing of various corporate initiatives and expenditures.

Our balance sheet remains strong with net-debt-to-EBITDA at 3.9 times and a total fixed charge coverage ratio at six times. We ended the quarter with no balances outstanding on our $900 million unsecured line of credit and $157 million of cash-on-hand. After closing our $300 million bond offering on October the 7th, redeeming the $250 million bond on October the 23rd, and repaying the $45 million mortgage on October the 31st, we now have approximately $73 million of cash-on-hand. At quarter-end, we had $672 million of on-balance sheet developments under construction, with $337 million remaining to fund over the next two and a half years.

At this time, we will open the call up to questions.

Trent Trujillo – Scotiabank

Hi, good morning. I appreciate the prepared comments about the potential for some acquisitions around year-end. But just for some context, can you give an indication of how many deals you're looking at and the approximate value of that pipeline?

Ric Campo – Camden Property Trust

We are probably evaluating $1 billion of transactions on an ongoing basis. It's likely we'll close one or two of those by the end of the year, and we're talking about hitting our original guidance or being slightly ahead of the original guidance, which would be closing $100 million to $200 million by the end of the year.

Trent Trujillo – Scotiabank

Okay. A quick follow-up on that same topic. Earlier this year, you removed dispositions from your guidance because you had other sources of funding, which included equity issuance. Your stock is now at an all-time high. How are you thinking about your cost of capital and the potential to issue more equity to take advantage of some of these opportunities that you're seeing?

Ric Campo – Camden Property Trust

Clearly our cost of capital has gone down this year when you think about the 30-year bond we did at an all-in rate of 3.41% including fees. Clearly the stock price at this level lowers our costs as well. Ultimately, in order to grow, you have to either issue equity or issue debt, and we have said for a long time that we're going to manage our balance sheet to be one of the best balance sheets in the entire REIT sector. To the extent we can match fund acquisition opportunities or fund our development, ultimately, we do need to be in the capital markets. We want to be opportunistic in that area. This year we've issued over $1 billion of bonds at really good rates, and we did an equity issuance in February. We will continue to try to be prudent in our capital management and make sure that we have a use of funds before we load up the balance sheet. Right now we have cash on our balance sheet, and we need to spend it.

Trent Trujillo – Scotiabank

I appreciate the thoughts. Thanks.

Nick Joseph – Citigroup

You mentioned that you expect supply to peak in 2020. Can you provide some more color on that in terms of expected deliveries in 2020 versus this year, and then maybe specifically for D.C. and Houston?

Keith – Camden Property Trust

Using Ron Witten's numbers, in 2019 across Camden's footprint, we're going to get roughly 137,000 deliveries. That ticks up in 2020 to about 150,000, and then as we mentioned, it will come down slightly in 2021 to about 147,000. The progression is 137,000, 151,000 and then back down to 147,000 with a peak in 2020.

In D.C., the numbers are basically flat, 12,000 this year, 12,000 next year and another 12,000 in 2021. Houston is the big change. We go from roughly 8,000 apartments this year to about 15,000, which percentage-wise is a big jump, but 15,000 is closer to the long-term average for deliveries in Houston. So, it looks like we're trending back to what the long-term average has been, but it's a pretty big jump over 2019.

Nick Joseph – Citigroup

Thanks. When you think about how that plays into Houston, obviously, it's been a little bit of a drag this year in terms of same store revenue growth versus the portfolio overall. How do you think about operating that portfolio going into heightened supply next year?

Ric Campo – Camden Property Trust

The Houston market is an interesting market because we expected Houston to be better this year than it has been. What's going on here is we continue to have strong job growth with 75,000 to 80,000 jobs. The unemployment rate dropped dramatically over the last couple of years. And what we thought would be higher apartment demand didn't materialize the way it usually does. I think this is indicative of migration rates around the country. They've gone down primarily from historical numbers, and that's generally a function of the unemployment rate being low everywhere. There's not as much incentive for somebody to leave their city if they can get a job and can create a situation for the family there to go to another city. That's one of the issues. The other issue in Houston is that when our unemployment rate went down, the new jobs that were created were taken by existing people who lived here, who already had a housing solution. They either lived in a house or an apartment already, and we didn't create new demand as a result of that. When you start looking at the numbers going forward into 2020 and 2021, we think that flips. Usually, apartments are getting 40% to 50% of the demand in household formations driven by jobs. Last year, they got about 15% of the capture rate in Houston. We think that's going to turn next year and has started turning already, and we're going to see it turn in 2020 and 2021, which should be more constructive for being able to lease those apartments that are coming online during that period.

Nick Joseph – Citigroup

Thanks.

Shirley Wu – Bank of America Merrill Lynch

Hi, good morning. Thanks for taking the question. You talked about Houston a little bit. Could you also talk about Southeast Florida, where you're also seeing a little bit of a softer market? And what could potentially happen in the near-term to make that market better or worse than expected?

Keith Oden – Camden Property Trust

Southeast Florida has two primary issues. There's been moderation in job growth for sure. Fort Lauderdale is down to about 15,000 jobs in 2019, and it looks like it's trending to about 13,000 jobs in 2020, both of which are on the low end of their historical rates. About the same thing in Miami, 18,000 jobs this year trending to 15,000 next year. You still have a pretty big overhang of shadow inventory of condominiums. They're soaking up some of the demand at the higher end of the market. So that's a little bit of an issue on the supply side. In 2019 Fort Lauderdale had about 3,000 new apartments. It looks like that's going to be less than 2,000 in 2020, which should help some. And then Miami, you've got total supply this year for completions of about 7,700, and it looks like that drops down to about 7,000 next year. While we think that scenario looks like it's in equilibrium, it certainly doesn't feel like a scenario where you're going to see a great return to pricing power in South Florida in 2020. We'll see. We're in the process right now of putting together our bottom-up budgets, and we hope to provide you a lot more clarity and guidance on our view for South Florida on our next conference call.

Shirley Wu – Bank of America Merrill Lynch

That's helpful. As we're talking about this topic on supply and as you anticipate higher supply into 2020, could you talk about your strategy going forward? And that focus on occupancy versus rate?

Keith Oden – Camden Property Trust

If you look at Camden's total footprint, supply is going up across our markets from 137,000 to about 151,000, so it's 14,000 apartments over Camden's entire footprint, roughly 8,000 of that is in Houston. And again, the 8,000 gets us back in Houston to a normal run rate for absorption. The anomaly of that 14,000 increase is that about 8,000 of it is in Houston. Houston is coming off such a low base that it doesn't seem terribly troublesome to us, and the rest of it is a rounding error across our markets. I think from our perspective, 2020 in the aggregate is going to be a lot like 2019, but you're going to see some movement around the markets. I think I mentioned the markets where we've got supply increases, including Orlando, Dallas, Austin and Houston. Pretty much everywhere else in our portfolio, we should see moderate declines in supply. We are going to maintain our strategy of trying to maximize occupancy. At this part of the cycle, we think that's probably the better trade-off. Again, when we put together our plan for next year, my guess is that we'll be planning for something that's a little higher in average occupancy than what you would have seen in our portfolio over the last five years. Maybe not materially, but maybe 95.5% to 96.0%. We've been fortunate this year to be able to outperform occupancy every quarter so far, and it looks like that will carry over in the fourth quarter this year.

Shirley Wu – Bank of America Merrill Lynch

Great. Thanks for the color.

Alex Goldfarb – Sandler O'Neill

Good morning down there. Just two questions. First, on the transaction market, you guys have been pretty clear the past few years that it's obviously tough to acquire. Just curious, as cap rates and rent growth across the country almost converged to the same levels regardless of market, are you finding that your IRRs are the same as you underwrite? Or are you seeing more competition from some of the coastal markets or rent control markets coming your way, where the IRRs you're underwriting this year may actually be lower than what you would have had last year just given the competition?

Ric Campo – Camden Property Trust

Generally speaking, the reason we haven't been as aggressive from acquiring properties is because of that issue, right? When you get down to the issue, we want to have a decent spread over our long-term cost of capital on our terminal IRRs. The going-in yields are pretty much the same across the country. For the type of property we're looking for, we're now sub 4% in most markets, including Houston. So, the idea of the growth that you have to have from that starting point to get a terminal IRR that is a decent spread over your long-term cost of capital is tough. That's why we haven't bought as many properties. Bottom line, we're looking for a needle in a haystack, where it's under managed, under what we could build it for, and under replacement cost. It’s a challenge getting those units. That said, there is a hope that in the next year or two there will be a convergence of sellers who will have to adjust going in yields or pricing to match what the buyers really want, because there is a big bid-ask spread and there's a massive wall of capital out there that needs to be placed. The sellers need to recharge their own balance sheet so they can continue to develop.

Keith Oden – Camden Property Trust

On the second part of your question, is there a migration of capital flows to Sunbelt markets from other lower cap rate markets? There are some decent indications recently that some of the big players who have historically wanted to play only in the gateway cities and coastal markets are migrating into the Sunbelt for all the reasons that we like our footprint where it is right now. Job growth continues to outperform the rest of the U.S. in our markets. The cost of doing business and the regulatory environments are certainly more friendly in most of our states. I think there is some evidence that that's going on, and it does put additional pressure on cap rates.

On the question of IRRs, the flip side of the cap rates that we're chasing is that as you underwrite an IRR, you have to be realistic about what an exit cap rate is. You're looking at acquisition cap rates at 3% and 3.25%. We would have been hard-pressed to even think about a 4.25% exit cap rate before, but that's the price of poker. When you do the underwriting with what we think are realistic exit cap rates based on the current environment, your IRR is not that far off from where it would have been a year ago. The challenge, as Ric pointed out, is if you're starting from a 3.75% it almost doesn't matter what your math is on the exit cap rate. First, we're going to hold these assets when we buy them for probably 20 years. Second, to get from 3.75% to a run rate that's above our weighted average cost of capital, it just seems like forever. We're reluctant in the same way that lenders at some point in time quit lending over a spread and call a floor. I don't really care what the spread is, I'm not willing to lend money below x%. In our world, we're just not willing to invest money below x%.

Alex Goldfarb – Sandler O'Neill

It's certainly amazing to talk about 3.75% cap rates in Sunbelt markets. The second question is for Alex on property tax. You said that there's an impact to this year's savings, but you also expect another savings next year. From a qualitative standpoint, I know you're not giving guidance, but as we think about next year, how would we gauge the amount of savings that we should anticipate? Is the savings already in the third quarter run rate?

Ales Jessett – Camden Property Trust

Without giving guidance, what we will see is further decreases in tax rates in Texas in 2020. It's $0.07 in 2019, it's an additional $0.06 in 2020. And then, obviously, the offset to that is we were very successful in 2019 with the amount of refunds that we've gotten in. We'll see how our budgets play out for the refunds we anticipate in 2020.

Alex Goldfarb – Sandler O'Neill

Okay. Thank you.

Derek Johnston – Deutsche Bank

Hi everyone. Thank you. Your starts under construction and shadow pipeline continue to remain robust. How are you viewing the development platform, given the compressing development yields in this environment? And has the low end of your yield expectation range comfortably declined to around 5%?

Ric Campo – Camden Property Trust

I think the answer is absolutely. We are continuing to be in the development business, and we like where we sit in that regard. We've generally started between $200 million and $300 million annually, and we have a pipeline to continue that process. Yields have definitely come down. Returns have come down on development as a result of construction costs going up faster than rental rate increases. In the last book of business that we completed, our average return was around 7%. Now our average return is around 6%. Think about the blended rate of the different types of assets that we're building. We're building suburban, wood frame assets that are trending at higher returns than the urban, concrete, higher density projects. Those are going to be in the low 5% range, and the stick-built suburban properties are going to be 6% and some change. So, our blended rates are going to be probably 100 basis points less than we got in our last cycle. On the other hand, when you look at the spread that you're getting for the risk of developing, the spreads actually stayed the same because cap rates have compressed. People are paying sub-4% cap rates for assets of this quality, so the spread in terms of risk reward that we're getting from developing continues to be robust. We need at least a 150 basis points positive spread on a development project versus an acquisition, and we're continuing to get that because of the compression in cap rates and the wall of capital that continues to bid up existing properties.

Derek Johnston – Deutsche Bank

Understood. Switching to D.C., it does contribute an outsized amount of NOI versus other metros in the portfolio, and yet the rest of the portfolio is in the Sunbelt, which of course makes sense. How do you see D.C. fitting into the mix going forward, considering you don't really have any ongoing development or communities planned in the pipeline? I believe at this point there is one redevelopment project going on. So, how do you view the D.C. market going forward?

Keith Oden – Camden Property Trust

We still think long term, we are appropriately allocated to the D.C. Metro market. Keep in mind that we have D.C. proper assets and then we've got Northern Virginia and all the way into Maryland. Yes, there's probably a wave that all those markets are affected by, but they all have their own individual drivers. We just finished two pretty sizable developments in D.C., including NoMa last year in D.C. proper. We continue to be very constructive on D.C. It's certainly outperformed our expectations this year. We're at 4.1%. NOI growth in D.C. and relative to our overall portfolio, that's accretive to the average, and that's the first time that's happened in a number of years. We continue to like that area, we'll continue to invest. And as I said, we just wrapped up about $425 million of new development in the D.C. Metro area in the last two years. It continues to be an important part of our portfolio. I gave D.C. Metro a letter grade of B with a stable outlook that probably was wrong. It probably was more like a B or B+ stable or maybe B with an improving outlook, based on the performance of our portfolio so far.

Derek Johnston – Deutsche Bank

Thank you.

Austin Wurschmidt – KeyBanc Capital Markets

Alex, you referenced in your prepared remarks numerous initiatives that you were working on to improve revenue and expenses. Can you expand on that? And do you expect it to be more of a contributor to revenue growth in the $50 million of revenue-enhancing capex that you guys have completed this year?

Keith Oden – Camden Property Trust

Are you talking about the technology initiatives that we're working on?

Austin Wurschmidt – KeyBanc Capital Markets

The technology initiatives or other items that will contribute to top line growth?

Keith Oden – Camden Property Trust

We're always looking for new areas of enhanced service where we can drive value to our residents. One of the areas that we've spent a lot of time exploring in the last year is creating opportunities for parking options for our residents, where people might be willing to pay for reserved parking for an additional space, etc. That's an area that probably has gotten more focus of our attention in the last 12 months. In terms of technology, there are a number of things that we're looking at. I mentioned that we had already rolled out the mobile maintenance, which has been a real game changer for us. The other thing that we're working on right now is a smart lock solution, and we have a proprietary product that we're piloting right now. There are a number of "smart lock solutions" out there, but the economics of them just don't work for the multifamily industry. The game changer will be when someone comes up with a solution that is cost-effective for the multifamily business as opposed to the high-end condo business. We are pretty well down the trail on a proprietary solution that we're piloting in Houston right now. We're already rolling out the perimeter access piece of it. And in the first quarter next year, we'll be rolling out the smart lock component. Always keep your head up and keep looking and be aware of any opportunities that we have to better serve our residents.

Austin Wurschmidt – KeyBanc Capital Markets

Can you give us a sense of what the spend is on that? And what the returns are you expect from those items?

Keith Oden – Camden Property Trust

We don't have that nailed down yet because since it's a proprietary product. It's something that, at a point in time, we'll make available to anybody else who wants a smart lock solution with economics that work in the multifamily business, but we haven't nailed that down yet.

Austin Wurschmidt – KeyBanc Capital Markets

Okay. Last question for me. To the extent you successfully close on the $100 to $200 million of deals you referenced in the acquisition pipeline, you utilize that available cash on the balance sheet. As future opportunities arise, what's your willingness to utilize the ATM versus an overnight?

Ric Campo – Camden Property Trust

The balance between the ATM and overnights is about the same in terms of cost to the company. It's obviously more efficient and quicker to do an overnight versus an ATM because you can only sell a limited amount of volume each day. But really, the determining factor for our capital allocation is trying to match fund the investments that we're making. We'll use the most efficient platform to do that, and use a combination of debt and equity as we have in the past.

Austin Wurschmidt – KeyBanc Capital Markets

Thanks for the thoughts.

Alex Kubicek – Robert W. Baird

Good morning. Looking at McGowen Station, how aggressive did you have to get on concessions there to get it fully leased? And then also, with that yield coming in a little lower than you initially expected, have you reevaluated your underwriting expectations for the downtown development right down the road?

Ric Campo – Camden Property Trust

On the first question, the McGowen Station market, depending upon what time of year and what was going on, ranged anywhere from a month free to two months free, sometimes 2.5 months free. When you look at the Downtown, Midtown and Greenway markets in Houston, that's probably where the highest percentage of properties are at the very high end. It's definitely been a slugfest there from that perspective. Now that we're stabilized, we're feeling pretty good about McGowen Station, but it's definitely a lower yield than originally projected.

On the Downtown project, we are definitely going to open up into the same concessionary market. The good news is there are not a lot of new properties opening their doors in Downtown, but the Midtown and the Greenway markets do have an effect on that. We expect it to be a concessionary market for at least the next 12 to 18 months, but we're confident that Downtown continues to be a very positive place for people to live. In the last five years, we've gone from 4,000 people living Downtown to 10,000 people living Downtown. There's been about $3 billion worth of investments to improve walkability and parks and transit. We think long term, and even in the near term, Downtown will continue to be a great place for people and an alternative for people to live. You've seen much more densification in Houston. The folks that are living Downtown are surprising because they're tending to be an older demographic rather than a younger demographic, primarily because of the price point that the Downtown buildings are offering. We feel good about it, but we will open into a concessionary market for sure. We are taking some of the units out of the Downtown market by doing a WhyHotel. We'll have 100 units out of the building that will be a hotel, which will be an interesting test. On one hand, we'll have cash flow generating from the hotel, and they tend to get occupied very quickly. That cash flow will offset what we would otherwise have in vacant units. We'll be able then to lease-up a smaller property as opposed to the whole property, and then we'll be able to close down the WhyHotel over a period of time while we continue to lease-up.

Alex Kubicek – Robert W. Baird

That's really helpful color. Lastly, looking at L.A. and Orange County, how is that revenue growth result coming relative to your initial expectations year-to-date? Curious if supply has been the motivating factor why you have been pushing occupancy over rate. Just curious what you've seen in that market.

Keith Oden – Camden Property Trust

At the beginning of the year, I rated L.A. as A- and improving, and Orange County as A- improving. We were very constructive on L.A./Orange County at the beginning of the year, based on the way our portfolio is positioned. We've got a different footprint than a lot of the other public companies do in California. It's all Southern California, and even within Southern California, it's not concentrated in L.A. I think it's performed in-line with our expectations. Obviously, they've had a moderate increase in new apartments in L.A. and Orange County. You got roughly 3,500 new apartments in Orange County and a total of about 13,000 in all of greater L.A. Those numbers look like they're trending down next year in both markets, with decent job growth continuing in L.A. and Orange County. I know that there's been a little bit of disparity between our results, with ours a little bit better than some of our competitors, but it certainly wasn't unanticipated for us that we would have a good constructive year in both of those markets at the beginning of 2019.

Alex Kubicek – Robert W. Baird

Great. Thanks. Thanks for taking my questions.

Wesley Golladay – RBC Capital Markets

Hi, good morning everyone. Going back to that supply forecast for this year versus next year, does that take into account delays in construction time for next year?

Keith Oden – Camden Property Trust

I would say, yes, because our data providers tell us that they are doing a lot of work around trying to get refined in terms of delivery dates and do it monthly as opposed to looking at quarterly or even just looking at aggregate numbers. Having said that, for the last three years, I would say both data providers have underestimated the amount of slippage. Maybe they got ahead of it for 2020, and we're really going to just go from 137,000 to 151,000. Just color me as skeptical based on the last four years of estimates versus what actually materialized. I hope there's a little bit better refinement in that data, but I guess I'll believe it when I see it.

Wesley Golladay – RBC Capital Markets

Got it. And then looking at the balance sheet. Everything looks really good there. The one thing that does stand out is you have some 5% coupon debt maturing in 2023. How soon can you get after that piece of debt?

Ric Campo – Camden Property Trust

The 2023 maturity is definitely one we'd like to take out. The challenge you have is that the prepayment penalties are very expensive. The closer you get to 2023, the lower it goes, obviously. We took the $12 million charge for the early extinguishment of our 2021 bonds that we replaced with the 30-year bond, and we'll look at those opportunities. We looked at the $12 million charge, and the breakeven analysis basically was if the rate went up 18 basis points or spreads gapped 18 basis points between the time that we issued in October versus the maturity of these bonds. It’s like buying insurance on 18 basis points, which is what we did. That cost today would be a bigger spread, and a much more expensive insurance policy. When you get down to 10 or 15 basis points, and when you think about how spreads moved and how the treasury has moved, that's a rational insurance policy to buy. Today it would be much more expensive, and that's why we wouldn't take the 2023s out today. As we get closer and look at what happens to rates and spreads, we could make that decision in the future.

Alex Jessett – Camden Property Trust

We look at this all the time, and we're running math on it weekly. Right now, the prepayment penalty on that would be about $20 million as compared to the $12 million that we just incurred, but we are looking at it on an ongoing basis.

Wesley Golladay – RBC Capital Markets

Okay. Thanks a lot.

Zachary Silverberg – Mizuho Securities

Hi guys. Just a few questions on the cost side. Can you talk about some of the big moves in same store expenses in some of the core markets that you saw in 3Q, specifically in Atlanta or the big jumps in Charlotte and Southeast Florida?

Alex Jessett – Camden Property Trust

Yes, absolutely. When you look at Atlanta, we got some very large property tax refunds in the third quarter. I will tell you those were in our plan. There was really not a surprise there for us. If you look at Charlotte, keep in mind that Charlotte really had very high property taxes. We talked about that in the beginning of the year. Charlotte actually does a revaluation every eight years, and this happened to be the year. As a matter of fact, our total Charlotte property tax growth for 2019 is right around 35%. If you're looking at Southeast Florida, that's also property tax driven. Really, they're all property tax driven, and it depends upon the timing of either when refunds come in or as I said with Charlotte, the overall increase in that market due to the fact that they reval every eight years.

Zachary Silverberg – Mizuho Securities

All right. Thanks. You mentioned the benefit from Texas, but do you anticipate any other major tailwinds or headwinds and reassessment of taxes or anything of that sort in 2020?

Alex Jessett – Camden Property Trust

Yes. The only thing that we're looking at in 2020 is that Raleigh also revalues every several years. Raleigh is going to revalue in 2020, and that's going to be over four years. Obviously, it's a smaller market for us, so it shouldn't be as incremental as what we saw in Charlotte. And then just to clarify on Texas, when we talk about a $0.07 or a $0.06 reduction in property tax rates in Texas, what we're talking about is not FFO per share. We're talking about the mill rate. If you think about a standard mill rate in Texas being $2.22 per $1,000, if you have a $0.07 reduction that works out to be about a 3.5% reduction in Texas due to the rates.

Zachary Silverberg – Mizuho Securities

Thanks for the color.

Neil Malkin – Capital One Securities

First question on Houston in general. Sorry about the World Series.

Ric Campo – Camden Property Trust

Is there a game?

Neil Malkin – Capital One Securities

Yes. Given the fact that the market really is so heavy on energy, I know you've talked about medical being a big presence, but it really seems to ebb and flow with how the energy sector is doing, plus the fact that it's very easy to bring on supply quickly. I wonder, do you ever think about paring down your exposure in that market given the volatility and one main demand driver of it?

Ric Campo – Camden Property Trust

I think that it is a misconception that energy drives Houston fundamentally. Let's talk about the middle of 2014 when the oil price was over $100 a barrel, then went to $20 or so by 2015. The energy industry lost 80,000 jobs in Houston. At that time, Houston produced another 80,000 jobs in the petrochemical business, the medical business and other ancillary businesses. Houston had basically flat job growth for a couple of years as a result of that. Then the market responded by construction starts dropping. The good news about the ability to add supply is that you can cut the supply as fast as you can add the supply. We cut the supply pretty dramatically, and the market didn't have a major dislocation like it had in the '80s. Houston has a much more diversified economy than it had in the past when you think about the price of oil, the drilling and activity from that perspective. But the petrochemical part of the downstream energy business is actually doing really well. 33% of all gasoline is manufactured in the Houston ship channel, and 60% of airline fuel is manufactured there. A lot of primary chemicals are continuing to do really well and those are driven not by energy prices, but by economic activity. If you have a recession on the horizon, that's one of the reasons Houston is less bulletproof from a recession.

If you go back to the '80s when the U.S. had a recession, Houston never felt it because it was so energy dependent mostly on the upstream side.

With that said, we definitely look at our allocations of real estate, and we want to make sure that we're balanced. Houston represents about 11% of our portfolio today. It's been a great long-term market for us, but we definitely look at where we're buying and where we're selling, and you don’t see a new development in Houston other than in our joint venture right now. That doesn't necessarily mean the opportunity isn't here, because I think that is one of the misconceptions of Houston. A lot of people made a lot of money in our stock when we underperformed the market in 2014 by 2,000 basis points and because people threw the stock out the window because of the energy situation, even though we didn't perform from a cash flow perspective that badly here. We're going to make investments here. We're going to stay in Houston. We'll toggle it here and there, but we have never considered leaving this market. Maybe we’ll slow the growth or pare back some of the assets that are needing more capex, but beyond that we're long-term players here.

Keith Oden – Camden Property Trust

Neil, thank you for the condolences to our Houston Astros. Like I told everybody in Camden, D.C. is our largest market, Houston is our second largest market. Before they ever played a game, Camden was a winner, and one of the teams was going to end up with the trophy.

Neil Malkin – Capital One Securities

Good way to look at it. Okay. Last one for me. A lot of companies have been talking about tech and integration and how that feeds into various platforms on both revenue and expense management side. You're obviously not doing the smart home route, but I'm just curious how you're thinking about using technology to proactively help with things like capex. Anything along those lines you're doing that could either be on the revenue or expense side where you're leveraging big data or the Internet of Things to enhance your platform?

Ric Campo – Camden Property Trust

I would first of all dispute that we're not doing smart homes, because we are. We're doing the smart homes that people want. People do not want systems that turn their lights on or not. They definitely want smart thermostats, and things like access. We do a lot of focus groups and spend a lot of time trying to understand what our customers want and what they are willing to pay for. On that side of the equation, we're pushing the edge of the envelope to create value for customers and drive revenue for us. On big data, we just completed and/or are in the process of putting additional modules on an Oracle cloud-based system where our financial reporting and HR is now going to be in the cloud, and that is all about big data. It's all about having access to all of our data via smartphones and then being able to drive expenses lower in capex.

I think the Internet of Things is a real thing, so ultimately when you have all your data in the same place and it's communicating across platforms in the cloud, we'll be able to leverage smart devices for our air conditioning units and in our maintenance facilities. Instead of fixing a broken unit that inconveniences a tenant or a resident, we can actually do preventive maintenance, which would save us money over the long term. I think that was a big investment and a massive amount of time and effort. It was nearly a two-year project, and everyone in our company was involved in it. The teams did a great job. It was definitely a big-ticket project which can be painful since employees are doing their regular jobs plus trying to implement a new system. Our teams did a great job of managing a tough thing. Ultimately, our big data and our ability to analyze and understand how things are working is definitely going to be enhanced dramatically as a result of that project.

Neil Malkin – Capital One Securities

Thank you.

John Pawlowski – Green Street Advisors

Just one quick one for me. Keith, I was hoping you could compare the 2019 operating backdrop versus 2018 as it relates to urban versus suburban properties, and what you're seeing on the rent growth side. Are suburban properties coming down to earth versus urban, or are they still pulling ahead? Any comments there would be great.

<u>Keith Oden – Camden Property Trust</u>

John, pretty consistently this year, our suburban product has outperformed by about 50 basis points. It's primarily the result of where the last cycle of product got built, and it was overwhelmingly built by the merchant-build community who had a bias towards urban assets. That's where the demand was for their product on an exit basis. So yes, we continue to see that hasn't changed. That's one of the things in our Houston portfolio that's actually helped us pretty dramatically, as our suburban assets have held up really nicely. The real supply challenges, as Ric mentioned, have been in the Midtown, Downtown and the Greenway Plaza area. But absolutely, it is a trend, and it's continued. My guess is that because there's so much competition in the urban core areas, you're probably going to see a drift back towards the suburban assets by the merchant community, and we'll deal with that when we have to.

<u>John Pawlowski – Green Street Advisors</u>

Yes. And just to be clear, I was talking portfolio-wide. So that comment holds in the supply-related markets of Dallas, Charlotte, other markets as well?

<u>Keith Oden – Camden Property Trust</u>

Yes. The 50 basis points is across Camden's entire portfolio.

<u>John Pawlowski – Green Street Advisors</u>

Okay. And that was a similar margin this time last year?

<u>Keith Oden – Camden Property Trust</u>

Yes, it was.

<u>John Pawlowski – Green Street Advisors</u>

Okay. Thank you.

Hardik Goel – Zelman & Associates

Thanks for taking my questions. Stepping back from just the company-level stuff, you talked a little bit about the challenge of allocating capital today. Some of your peers are really going out there issuing equity and expanding the size of the company. You have been more prudent. How do you see this play out longer term, 5 to 10 years, with this wall of capital issue? What could change? How could this wall of capital shift elsewhere? And what is it about the narrative that you think will keep it there or move it?

Ric Campo – Camden Property Trust

Well, I think the narrative will change when we have a recession, right? When we have the next cycle. Generally, what happens in a business contraction is that people lose jobs, and demand is reduced as a result of that situation. When that happens you have landlords, especially with new developments that are in lease-up, who have to discount dramatically to buy market share. That generally has an effect on pricing. Cap rates rise and prices go down. On the recession side, last year at this time when the market was going down, everybody was talking about a recession and the Fed was raising rates. Now we're in an accommodative easing cycle. We don't bet on recessions or major upticks. We're trying to be in a position where we plan for the worst and hope for the best. That's why our balance sheet is where it is today because you don't know what's going to happen in the future. Multifamily is one of the top real estate classes, multifamily or industrial have the "hot hands," and that's where investment capital wants to go. In the multifamily space, that's because people need a place to live. When you look at the demographics, where people live and how they operate today, especially the Millennials, they are doing everything later in life. They're buying houses later in life, having kids later in life, and they want the optionality of an apartment. Apartments are really good. If interest rates go up because of inflation, apartment leases roll over an average of 8% every month. We're repricing our assets every day, so you have a good backdrop for inflation. That's why the capital is coming this way. We are expanding our business as well. When you look at the development pipeline plus the acquisitions, that's $400 to $500 million per year of additional capital that gets put out. Ultimately, we're at the beginning of a cycle. If this was 2012 or 2013, we might be more aggressive on all those fronts. But because we're late in the cycle and there's a lot of uncertainty out there, we're going to be more prudent.

Hardik Goel – Zelman & Associates

Got it. Just a quick follow-up on that. You mentioned cap rates of 3.75%. You have an exit of 4.0% to 4.5%. Is it conceivable that in a recessionary scenario, not for you, because you have a strong balance sheet, but for private operators that are underwriting like that, is it possible that they see they significantly underperform the unwritten returns because cap rates gap out more because they're starting from such a historically low base?

Ric Campo – Camden Property Trust

That's definitely the risk, right? If you're wanting a 6% IRR and you start at 3.75%, you then have a growth expectation of the cash flow at an exit cap rate. If cap rates gap 100 basis points, you need a 25% increase in revenue or NOI to be able to offset that increase in cap rates in order to make a return. That's the inherent risk of buying a cap rate at that level today. It's worked out for lots of folks because rents have grown and cap rates have continued to stay very low, but ultimately people might be disappointed in their returns if you have a scenario where cap rates gap and rents don't grow as much. The issue of whether somebody gets in trouble financially? I think that's probably a low risk because there's a lot of equity in the system, even in the development game the merchant builders are all 30% to 40% equity today because of the way the bank system is requiring the equity. I don't think there will be a lot of financial stress in terms of people having to sell. But on the other hand, their expectation of their pricing and their profit margins, which have been amazingly high and sticky for a long time, will probably revert to more normal levels or less than they originally anticipated.

Hardik Goel – Zelman & Associates

Thank you. That’s great color.

John Guinee – Stifel, Nicolaus & Company

Two curiosity questions. It looks like San Diego is about $720,000 per unit for a pretty small project with 130 or so units. Can you talk about what you're building there and why it hits that price? And then second, if I look at your redevelopment summary, is it okay to project out maybe 1,000 units per year to get this major overhaul? People should think about that as ongoing capex?

Keith Oden – Camden Property Trust

On San Diego, the short answer is it's the price of poker for an A+ location that's adjacent to the Hillcrest neighborhood where single-family homes and little bungalows sell for $1.5 to $2 million. You're 1.5 miles from Balboa Park and two miles from Downtown. I'm generally not a believer in using the word “unique” for real estate, but this is a really “unique” site. It's literally up on top of a bluff with a view of Mission Bay, so it almost required that we build that scale and scope of project. Again, you're talking about comparable rents in that neighborhood that are pushing $3.80 to $4.00 per square foot. The returns work because people are willing to pay a premium to be in that neighborhood. They're relatively small unit footprints, but yes it's expensive to build in California for sure.

Ric Campo – Camden Property Trust

On the 1,000 units annually, I think that is a rational thought process. We haven’t moved through our portfolio, but we'll continue to make that investment. The best investment on the board that we can make is redeveloping our existing properties.

John Guinee – Stifel, Nicolaus & Company

So what do you think, you have decided to redevelop one property per year?

Alex Jessett – Camden Property Trust

Yes. I think you have to split it into two categories. For repositions, which are separate from redevelopments, we're doing about 2,300 units per year, and I think that's probably a pretty safe number to continue. When you look at the redevelopments, there are four communities. They're all unique in that they're all high rises and they are communities where extensive exterior renovations were necessary. That particular pool is a little bit shallower than the pool for repositions. We'll keep looking for redevelopments, but I wouldn't expect to see a huge amount of these on an ongoing basis.

But as I said, we'll continue to add repositions of about 2,300 to 2,500 units each year.

John Guinee – Stifel, Nicolaus & Company

And that's more of a $10,000 to $12,000 price tag?

Alex Jessett – Camden Property Trust

It started that way. It's creeping up a little bit closer to the $15,000 to $20,000 price range for obvious reasons, but we're still getting fantastic returns on those repositions.

John Guinee – Stifel, Nicolaus & Company

Great. Thank you.

Ric Campo – Camden Property Trust

Thanks for being on the call today, and we will see a lot of you at NAREIT coming up.

Edited for Readability