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AVB - AvalonBay Communities Inc at Citi Global Property CEO Conference

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CORPORATE PARTICIPANTS

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Kevin O'Shea *AvalonBay Communities, Inc. - CFO*

PRESENTATION

Unidentified Participant

Welcome to the 9:30 a.m. session at Citi's Global Property CEO Conference. The session is for investing clients only. If media or other individuals are on the line please disconnect now. The disclosures are up here and on the webcast. For those in the room or on the webcast you can use Slido to ask any questions anonymously or you can put your name in. Just enter the code CITI17 and we'll clear them up here.

We're very pleased to have with us AvalonBay. Tim Naughton, Kevin O'Shea. Tim, I'll turn it over to you for some introductory remarks and then we'll kick it off with Q&A.

Tim Naughton *- AvalonBay Communities, Inc. - Chairman, CEO*

Thanks, Michael. Thanks, Nick. Glad to be here this morning. As Michael mentioned, I'm here with Kevin O'Shea, our CFO, and sitting over here in the grandstands is Jason Reilley, who runs Investor Relations for us.

I wanted to just touch on three things briefly, just quick give a quick intro to AvalonBay. I know many of you are familiar with the Company but nevertheless wanted to give a quick intro, talk briefly about apartment market fundamentals and then lastly provide a mid-quarter update consistent with the press release we issued earlier this morning that maybe you didn't see but I'll go over that in case you didn't get a chance.

Just to start, AvalonBay is a $32 billion apartment REIT, have just under 85,000 apartment homes, currently have an equity market cap of about $25 billion, which puts in the top 10, maybe eighth or ninth largest REIT by equity market cap. Our market focus is the coast, DC to Boston on the East Coast, major metropolitan areas on the West Coast, Seattle down to San Diego, and about 55% of our NOI is on the east and about 45% on the west.

We've been public for almost 24 years now. If you look at the financial performance of the Company, we have delivered about a 14% compound total shareholder return during that 24 year period. During that period we've seen dividend growth on a compound basis of about 5.5% and an FFO growth on the order of 7%. So a long track record of success within our markets.

From a capital allocation standpoint, I think we're probably principally known as a developer. We have developed a good part of our portfolio. It's a mix of urban and largely suburban infill and some suburban bedroom as well, mix of high-rise, midrise and garden product.

We've been active developers this cycle. We've actually started $8.5 billion so far this cycle. We've completed about $4.5 billion so we have about $4 billion currently under construction. Of the $4.5 billion that's completed, we think that's generated about $2 billion of NAV upon initial stabilization so highly accretive, on the order of $17 a share, and that's just so far this cycle, not including the $4 billion that's currently under construction.

We continue to capitalize this in a very conservative way, have traditionally had one of the lowest levered balance sheets in the sector. We're running at about 5x today or 23% debt to total enterprise value and have current liquidity between $1.5 million and $2 billion, either between the line of credit, which has been on tap pretty much the entire cycle and some cash that's on the balance sheet.

In terms of fundamentals, it's been a great cycle for apartments really since 2010. That's really evidenced by the kind of FFO growth you've seen in the sector. The sector has grown at about 9% on a compounded basis, FFO. During that same time period we've grown at about 13%, which is around 350 basis points of outperformance relative to the sector but when you think of it from a cumulative standpoint it's close to 3,500 basis points of outperformance in terms of cash flow growth just during that six-year period.

Demand has been extremely strong. It's really been a function of strong demographics, moderate job growth and importantly, delay in family formation, which has in effect really increased the level of primary demand for rental housing. Going forward, 2017 and beyond, we actually think demand is going to be more balanced than we've seen over the last few years. We expect homeownership rates actually to level off and expect to see single-family and multifamily or for sale and rental demand to be more in line with what we've seen historically, roughly 2/3 for sale or single-family and 1/3 multifamily or rental housing.

Currently supply, which has been elevated recently and we expect to be around 2% of total inventory this cycle, we still think that's roughly in line with overall structural demand. However, we are seeing some regional and submarket imbalances. Just in our market footprint, we expect about 2x the level of supply to be delivered in urban submarkets than relative to suburban submarkets and we don't see that relationship on the demand side. We think maybe demand, while stronger in suburban markets, is only on the order of 25% to 30% stronger. So right now, at this point in the cycle, we're actually seeing, at least in our markets, both in terms of our portfolio and if you looked at third-party estimates of runaway growth, it's about 200 basis points of outperformance in the suburbs than the urban submarkets currently.

In terms of our outlook for the year, we gave guidance of 2% to 3% for total same-store revenue growth, which is down about 180 basis points from last year? Then I think we'll probably talk about 2018 later, Nick, but our sense is with supply peaking in 2017, 2018 could potentially be a little bit better than what we're seeing in 2017 and then to the extent anything happens on the fiscal stimulus or tax or trade reform side, that's more likely to have a 2018 impact than 2017.

Then lastly, before turning it back over to our moderators, we issued a release this morning in terms of an update of as to what we're seeing in Q1 from an operating performance perspective. We're estimating Q1 same-store revenue growth of between 3.1% and 3.2%, which is up about 25 basis points above what our projections were. Most of that is really on the backs of improved occupancy, as we're currently seeing occupancy in the high 95% range and we had estimated it would be closer to mid 95% and in terms of from a regional standpoint, Seattle and New York -- more Seattle or falling a little short of expectations, whereas the other regions, Northern and Southern California, mid-Atlantic and Boston are running about 50 basis points above internal expectations. Light-term rent change so far this year, January and February, was around 1.25%, which was about 300 basis points below the same period last year, about what we had expected so far and as I mentioned earlier, occupancy has been stronger. Then lastly, March and April renewals have been going out in the high 5% range, which after some negotiation with residents, we would expect to come in around the mid-4% range, which is about 50% basis points above what we've seen so far this year.

So with that, Michael and Nick, I'm happy to turn it over to you all.

Unidentified Participant

Great. So we've kicked off each one of these sessions by asking what differentiates AvalonBay from your multifamily sector peers that you expect will result in outperformance of AVB stock over the next year relative to your peers?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Well, performance of stock is hard to project. Maybe it's easier to talk about just from a cash flow standpoint why we think we are likely to outperform over this year and the next couple of years. Really the difference we think has really been on the capital allocation side, Michael.

From a market standpoint, as has been well understood, we are seeing pressure in New York and San Francisco, which has had a bit of an impact on total portfolio performance where we've only been performing in line and in some cases, call it 25 basis points below some of our peers on a storm same-store basis. But when you look through to FFO growth being driven by some of the portfolio management and capital allocation decisions we've been making, we've been outperforming, as I mentioned earlier, on a compound basis 350 basis points so far this cycle and we expect that to continue over the next couple of years, maybe not on the order of 350 basis points but a couple of hundred basis points, largely driven by the accretion that we're seeing from the development platform. So I think that has been the biggest differentiator and we think is likely to continue, particularly in light of most of that $4 billion is already funded today and so it's really just our ability to kind of pull through the economics of those developments at this point, in terms of sort of locking in the accretion that we've enjoyed so far this cycle.

Unidentified Participant

You've talked about from an operating perspective being ahead and you broke out the markets that we're running ahead of expectations, Northern and Southern California, the mid-Atlantic, Boston, whereas Seattle and New York are a little bit short. I guess how much of that is rate-driven versus occupancy-driven for those shortfalls or being ahead and maybe we can drill down a little bit into Seattle and New York and how much of it is occupancy versus rate.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Yes, in the Seattle and New York, I think it's a combination. First of all, two very different markets. Seattle has been a great performer the last few years. We had very high expectations again this year for Seattle. In Q1 our estimated same-store revenue growth for Seattle was 6% plus so the fact that it has fallen short a little bit is still at a pretty high level of performance. Conversely, New York, our expectations for New York and New Jersey were in the 1% to 2% range. Manhattan then was closer to 0% to 1% and so far we are seeing rate growth that is -- actually seeing rents trend down in the city. Conversely, in some of the suburban markets in the New York metro area, New Jersey, Long Island and Westchester we continue to see reasonable rate growth kind of on the order of inflation.

Unidentified Participant

When you think about 2018, you mentioned you could see a potential re-acceleration. I guess maybe we can get into some markets and start with New York. You mentioned the deterioration there. Do you expect that deterioration to continue into 2018? Is that the outlier for that kind of re-acceleration comment?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Yes, I think so, Nick. But I think it depends where you're at. Where we're seeing most pressure today is in Midtown West and we think it's coming in Brooklyn, where we have some exposure to both those markets but we have exposure to other neighborhoods as well. We're not seeing the same kind of pressure but New York -- it's going to continue to be challenged, just given the amount of supply coming through. Job growth has been decent, I think probably better than most people realize but yes, I think New York is going to be a challenge here through 2018.

Unidentified Participant

You mentioned your kind of unique exposure relative to peers in terms of owning in Westchester, Central Jersey, Long Island -0 not Long Island City but Long Island. Will those markets hold up better this year and into next year? Is this a New York City specific issue?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

I think it's a New York City specific issue. It's going to affect northern New Jersey a bit, just because of the spillover effect from Manhattan, particularly along the waterfront. But central New Jersey is probably the healthiest and it just comes down to really supply at the end of the day. Long Island continues to be very supply constrained and it's performing fine as well. So we expect those markets to continue to perform and we're talking about inflation, inflation plus 50 to 100 basis points, in terms of rent growth.

Unidentified Participant

What are you seeing in the market today in terms of concessions across the different markets and maybe relative to where you expected them to be?

Unidentified Participant

You know, first of all, we don't have many concessions in our portfolio. We tend to price on (multiple speakers).

Unidentified Participant

I guess in terms of competition, in terms of the market overall.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Yes, it depends. You know, in New York they're fairly [rampant] but there's some artificial reasons for that, just given rent stabilization. Oftentimes you're incented to try to set the face rent as high as you can and give two or three months and free rent so as the markets recover you don't have an artificial ceiling on where the rents might be able to go. So you're fighting that issue but I think if you looked at our development portfolio we're less than -- we're probably two to three weeks in terms of what we're giving on the development portfolio. That's where you tend to see the highest level of concessions and the stabilized portfolio, it's a matter of days. It's probably a couple of days' worth of concessions. So the REITs are still, for the most part, pricing on stabilized assets; it's real effective. I think most of the revenue management models that people have adopted are sort of pushing in that direction but you do get some outliers, particularly merchant builders who are trying to position their assets for sale that oftentimes will artificially sort of push, in my view, push concessions.

Unidentified Participant

What are you seeing in Northern California? It sounds like that's outperforming a little relative to expectations. It's another market that is maybe concerning, along with New York, for this year. Do you expect more of a bounceback there?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

We expect it to stabilize as we move throughout the year. I know others have said they see the supply being more of a frontload issue in Northern California. We think that's true with respect to San Jose not as much as it relates to East Bay in San Francisco. So to the extent we see some bounceback we think it may be stronger in San Jose. East Bay is obviously continuing to be the strongest of those three submarkets or subregions, again largely based upon two things -- one, affordability and secondly just hasn't seen the same level of supply that we've seen in the San Francisco and San Jose markets.

Unidentified Participant

Then you mentioned the outperformance of suburban assets. Are you seeing the difference in terms of your different brands in terms of operating performance?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

We are but it maps to two things. We have three brands, for those of you who aren't aware. Avalon is sort of the power brand, roughly 3/4 of the portfolio. Eaves is more of the value brand, if you will. It tends to be more suburban. Avalon is a mix of urban and suburban and then there's AVA, which is largely urban and kind of focused on a younger demographic. Given the supply that we've seen in urban areas, you might guess maybe AVA has been a little bit more challenge and given the suburbs and the product has outperformed that's kind of the sweet spot for eaves, so you've seen the strongest performance has definitely been in the eaves brand and then it's a bit of a mix on AVA and Avalon but they've underperformed eaves for sure.

Unidentified Participant

When would you expect or what would you need to see for urban to start outperforming suburban again?

Tim Naughton *- AvalonBay Communities, Inc. - Chairman, CEO*

We don't see it happening in 2017 or 2018. The supply situation I mentioned for 2017 is true in 2018 as well, where we expect about 2x of deliveries in urban submarkets. So I think it's time, Nick. I think it's maybe a 2019 event. As you started to see some new supply -- I think deliveries will start to fall as we get into early 2019 and some of these urban markets, as some folks are sort of [retacked] to the suburbs.

Unidentified Participant

How are you managing from a development standpoint? You obviously have some much larger projects going on. I guess if you think about mitigating some of that risk through joint ventures, both from an equity perspective but also just size of transaction relative to your enterprise value.

Tim Naughton *- AvalonBay Communities, Inc. - Chairman, CEO*

Well, the largest we -- I mentioned there's two large -- I'm not sure if I mentioned here or the last meeting I was in. But we started two large deals in Q4 that totaled about $1 billion, one at about $600 million in New York called The Circle and the other about $350 million in Hollywood. We are developing those on the balance sheet. We had considered bringing in a capital or retail partner in the case of the Columbus Circle and have chosen not to for a couple of reasons. One, controlling it through construction and just honestly just market sentiment wasn't great and it's one of the benefits of having a great balance sheet that has very little leverage. You're not kind of forced to sell into that even if from a risk management standpoint you might want to. It just may not be a good time to do it from a market standpoint.

So there's a few ways we can do it, Michael. You can do it through the balance sheet, which we've done with Kevin's stewardship. But you can also do it through the sale or the joint venture of stabilized assets, which is another option we have available to us. But when you look at both of those deals, the Hollywood deal is basically 1% of total enterprise value and Columbus Circle is 2% and when you think of other sectors there's much more extreme cases than that of developments as being in terms of their size relative to the enterprise value.

Unidentified Participant

But I guess you also have the Upper East Side project that's not in those numbers yet and that's a pretty large transaction and there's others in your shadow pipeline. I guess at what point do you -- rather than just a suburban stick building that's pretty low risk and just from a capital perspective and execution, these larger urban projects carry just a lot more capital as well as execution risk.

Tim Naughton *- AvalonBay Communities, Inc. - Chairman, CEO*

I'm not sure about the execution risk side of it. The capital risk for sure because you just have more exposure to a single location and a single property but from a -- if you met from execution development and construction I'm not sure that's the case. From a market standpoint I think that's fair but there's many ways to mitigate risk. You mentioned one of them, which is joint venture, but you can do that with how you think about managing the balance sheet and your exposure to any one submarket, so another way to manage it would be to sell down in a particular submarket if you're just concerned of your exposure into a particular neighborhood or part of Manhattan, for example. So we'll consider all of the above.

Unidentified Participant

As you think about raising capital, Avalon has been, I think, ahead of the game at raising common equity capital early to fund future needs, especially on the development side, and you've tried it. a variety of different ways, doing a forward, doing a spot transaction. I guess as you think about your capital needs going forward, how should the investors think about common equity relative to asset sales or leveraging up the balance sheet?

Kevin O'Shea - *AvalonBay Communities, Inc. - CFO*

Sure. So Michael, as you're aware, there are basically three principle markets that we seek to tap when we're funding the business.

Unidentified Participant

Kevin, just bring the microphone a little bit closer, please. Thank you.

Kevin O'Shea - *AvalonBay Communities, Inc. - CFO*

Sure. So there's three principle markets that we look at when we're contemplating funding the business -- the asset sale market, the debt market and the common equity market. So as you would expect, we do spend a fair bit of time internally tracking pricing and trends in each of those markets. We look at our balance sheet through a variety of metrics, one of which Tim alluded to, which is taking a look at our investment book, the development underway and seeing how well match funded we are against that and then also looking at forward uses and forward liquidity and excess liquidity as we step through the quarters that are ahead of us.

So I'd say today, in terms of relative attractiveness, the unsecured debt market and the asset sale market continue to screen as very attractive, both on current pricing relative to investment yields on new developments and relative to historical precedents. Common equity market is less attractive, still accretive relative to our investment yields and as Tim alluded to, we do have developments that are expected to have initial stabilize yields of call it 6.5% depending on the project. When you look at capital costs, funding assets, funding activity through asset sales, last year the cap rate on the $0.5 billion or so dollars that we sold was around 5.3% so that maps relatively favorably compared to investing in new development projects with yields that are in the mid-sixes, which was the case last year. Unsecured debt for us, if we were to secure 10-year unsecured debt, spreads have come in, they're probably at around 100 basis points, 105 basis points relative to 10-year treasury. So that equates to something around the order of a mid-3% yield. As you may be aware, we are the only apartment REIT with an A3 rating from Moody's and an A- rating from S&P. So we do have the ability and an advantage to tap into lower-cost forms of debt capital when we issue unsecured debt in the bond market.

So this year, our unsecured debt -- total capital needs on a net basis of free cash flow is about $1.7 billion. That's about an average year, maybe a little bit above average year for us. The budget contemplates that we'll meet that with unsecured debt and asset sales. We will, of course, monitor all three markets and when it makes sense we are prepared to advertise the balance sheet with new common equity when it makes sense to do so, when it's accretive. There is a desire, however, as Tim alluded to, to sell assets primarily in our northeastern suburban markets, just to replenish the portfolio. If you look at our development underway in our rights pipeline, it is a little bit over-indexed toward the northeast suburban assets. So as we roll forward here, it does put a little bit more of a premium on us to try to sell older northeastern suburban assets that we developed in earlier cycles where we've already harvested most of the value.

So as we look at trying to equitize development activity, there is a natural bias in favor of selling assets when it makes sense or at a point of indifference mathematically relative to common equity. But there is a benefit to tapping equity when it does make sense. As you alluded to, Michael, we did have a little bit more of a bias toward rating common equity, call it earlier in the middle point of the cycle, mostly in the middle point of the cycle it made mathematical sense relative to where we were trading. We tended to be trading at a premium to going concern NAV at that point in time. We very much wanted to make sure that by the time we got to the midpoint in the cycle, we had the balance sheet we wanted and would be happy to end the cycle with, because you never really know when the cycle will end.

So we have a target leverage ratio for net debt to EBITDA to run in the 5 to 6 turns level. We're tracking in toward the low end of that today at about 5 turns. We think that it makes sense to track toward the lower end of that range as we are in the later stage of the cycle, just because EBITDA will change at some point when we go into correction and we want to be in a position to have a strong balance sheet, both to pull forward the development that's underway as well as potentially pursue opportunities that might emerge in terms of attractive land buys during the correction.

So that's kind of how we roughly think about it. We do look at all three markets. I have a little bit of a bias at this point toward asset sales than secured debt and if you think about us going forward in any given year, our activity is use-driven but in most years we have about $2 billion in uses give or take, usually about $600 million or so of debt that's maturing and about $1.25 billion to $1.4 billion of investment activity uses in terms of development and redevelopment.

QUESTIONS AND ANSWERS

Unidentified Participant

Is there questions from the audience?

There was one that came through on Slido. Why are there so many fire incidents in New Jersey, not just for AvalonBay? There was another one that you guys had. Is there any comments you can make about that?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

I don't think so, Michael. You're referring to we had a fire recently at a construction site in Maplewood, New Jersey. Unknown source at this point. But yes, no comment. I don't know how to answer that, to be honest.

Unidentified Participant

As you think about corporate governance, Tim, you're now on three boards including your own. I guess how do you think about your time and how does the board think about your commitment to being on three public company REIT boards?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Yes, thanks, Michael. As Michael mentioned, I'm obviously chairman of AvalonBay. I've been on the Welltower board for a little over three years and just recently joined Park Hotels, which was the spin of Hilton's real estate assets.

A couple of things. One, first and foremost, I'd only join a board if I think it can make me a better CEO of Avalon. I'm not doing it for the money. In both cases, those are industries where both are companies that I think are leaders or can be leaders within their sectors in industries where I think there's something to learn in the multifamily industry and yet it's not conflictual. So it was important in the case of Park that it was DC-based, too, honestly. So as I talk to my board about it, you look at all the outside activities beyond just running the Company that you're involved in, been involved historically in ULI and NMHC and Real Estate Round Table, NAREIT and --

Unidentified Participant

Little league soccer.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Well, it does matter. My kids are grown and they're launched, so to speak, so you do have a little bit more time. But you know, as I add Park Hotel I've cut back in other areas in the case of NMHC and ULI, which I'm no longer active in. So it's really about trying to find the right combination of outside activities that's going to again make me a better CEO and give me the breadth and perspective that's helpful in this job.

Unidentified Participant

Sticking on major lodging and Park Hotels, one of your competitors, AIMCO, came out pretty scathing against AirBNB and the impact that's having at their assets. So I'm curious how Avalon is approaching AirBNB and how it's impacting your assets and what you're doing about it.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Yes, in terms of our strategy with respect to AirBNB, it's -- we're piloting it in a couple of places where there's a regulatory structure in place but I'd say it's pretty de minimis in terms of its impact so far on our -- it's a handful of assets where we're seeing an impact that I would say is negative, that we hear from residents that they're just concerned about AirBNB traffic in the building. So it's something we're watching closely, taking more of a wait-and-see approach and still agnostic about.

Unidentified Participant

Yes, just one question in terms of the length of the cycle. You've said that you're going to remain a little lighter on land. You're bringing the development pipeline down to the lowest it's been by the end of the year, at least for this cycle. But it sounds like from comments you've made today as well as comments you've made on the earnings call that maybe you think this cycle will be longer and resemble kind of previous longer cycles. So how do you merge those two thoughts?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Well, this cycle is around seven years. The 90's cycle we saw 40 quarters or 10 years of positive rent growth so that's the longest that we've seen. When we look at our current development pipeline, we have $4 billion under construction. It's going to take a couple of years to bring to fruition. We've got $3 billion in the shadow pipeline that we would expect to start probably ratably roughly $1 billion a year, maybe a little less, over the next three years. As you mentioned, we did say that we do intend to stay light on land. The risks are frankly asymmetric that holding land can lead to a bad outcome at this point in the cycle. So therefore we're willing to option land, you know, if we think there's opportunity there, but recognize that as the apartment cycle, the economic cycle and the capital cycle play out, things could be less attractive from an economic standpoint. It's really about optionality more than anything else, Nick, I would say this point.

Unidentified Participant

Okay, so we're going to go to our rapid fire. Same-store NOI growth for the multifamily property sector overall, not Avalon, in 2018.

Unidentified Participant

And the average this year is 2.9% across the spectrum.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

3.25%.

Unidentified Participant

How much higher or lower do you expect private market cap rates to be for the multifamily sector in 12 months?

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Higher by 25 basis points.

Unidentified Participant

Rank the best real estate decisions to make today -- buy, build, sell.

Tim Naughton - *AvalonBay Communities, Inc. - Chairman, CEO*

Build, sell, buy.

Unidentified Participant

Build, sell, buy. Great. Thank you very much.