

Transcript of
Sovran Self Storage
Third Quarter 2014 Earnings Release Conference Call
October 30, 2014 - Edited

Participants

David Rogers – Chief Executive Officer
Andrew Gregoire – Chief Financial Officer
Paul Powell – Executive Vice President, Real Estate Investment
Edward Killeen – Executive Vice President, Real Estate Management
Diane Piegza – Vice President, Corporate Communications

Analysts

Todd Thomas – KeyBanc Capital Markets
John – Citigroup
Jana Galan – Bank of America
Ross Nussbaum – UBS
David Toti – Cantor Fitzgerald
George Hoglund – Jefferies

Presentation

Operator

Greetings and welcome to the Sovran Self Storage Third Quarter 2014 Earnings Release conference call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to our host, Ms. Diane Piegza, Vice President, Corporate Communications for Sovran Self Storage. Thank you, you may begin.

Diane Piegza – Vice President, Corporate Communications

Thank you, Melissa, and good morning everyone. Welcome to our Third Quarter 2014 conference call. Leading today's call will be David Rogers, Sovran's Chief Executive Officer. Also participating are Andy Gregoire, Chief Financial Officer; Paul Powell, Executive Vice President of Real Estate Investment; and Ed Killeen, Executive Vice President of Real Estate Management. Our earnings release was issued yesterday after market. If you did not receive a copy, please visit our website at unclebobs.com.

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

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

David Rogers – Chief Executive Officer

Thank you, Diane. Good morning, everyone. Our third quarter was a good one as occupancy remains high, rental rates grew, and operating costs were pretty well contained. Andy will provide the details, but 3Q on an absolute and on a per-share basis was our most profitable ever.

We acquired some high quality stores in markets where we already have a presence, five were purchased during the quarter at a cost of \$46 million. We bought three more in October for \$41 million, so during the first ten months of 2014 we bought a total of 31 stores for \$278 million. These are in addition to the three we acquired early in the year on behalf of one of our joint ventures at a cost of \$34 million, so we've been fortunate to add this group of really good stores to our portfolio this year, but it's a competitive arena and we've got to stay nimble and keep our pencils sharp to make it work.

This is the 75th quarterly earnings call that we've held over the 19 years we've operated as a public company. I've got to say, the last dozen or so have been the most enjoyable as we've been able to report some pretty great news in all of them. We have every expectation that this will continue in the upcoming quarters. Overall, the self-storage sector is strong as the major themes remain in place, which are growth of new supply is minimal, demand continues to tick up, and customer awareness is strong, so it's good.

With that, I'll let Andy give the specifics.

Andrew Gregoire – Chief Financial Officer

Thanks, Dave. Last night we reported same store revenues increased 7% over those of the third quarter of 2013. The growth was the result of 140 basis point increase in average occupancy and a 4.4% increase in rental rates. Same store occupancy increased over the prior year as expected and was 90.5% at September 30th. Tenant insurance income for the same store pool continued to show strong, increasing \$442,000 in the third quarter of 2014 as compared to the same period in '13.

Total property operating expenses on a same store basis increased by 2.4% primarily as a result of increased repairs and maintenance expenses, a portion of which related to the Arizona floods. The property tax expense percentage increased lower than in 3Q than it was in the first half of 2014 because in the third quarter of 2013, we had experienced an increase in property taxes, making for an easier comparable. Same store net operating income increased 9.2% for the quarter. We again have included in our release some additional data on previous same store pools to give our investors more color as to the performance of our maturing stores.

G&A costs were \$1.1 million higher this quarter over that of the previous year. Aside from an increase in internet advertising, the main reasons for the increase were the fact that we operated 42 more stores at the end of this quarter as compared to January 1, 2013, our continued investment in revenue management, and incentive compensation. Offsetting a portion of the overhead costs was an increase in third party management fees earned.

From a balance sheet perspective, we finished the quarter in a solid position. During the quarter, we issued 424,000 common shares through our ATM program at an average price of \$78.46, resulting in net proceeds of \$32.9 million. The proceeds were used to fund the majority of the five stores acquired during the quarter. At September 30th, we had approximately \$7 million of cash on hand, \$249 million available on our line of credit, including its accordion feature, and approximately \$172 million available under our ATM program.

With regard to guidance, we have included in our release the expected ranges of revenues and expenses for the fourth quarter and the entire year. Same store revenue growth for Q4 should be in the 6% to 7% range and NOI around 7.5% to 8.5% for the quarter. Expenses outside of property taxes should increase between 2% to 3%, and property taxes for the quarter are expected to increase 5% to 6%.

We expect full-year revenues to come in at a very strong 7% to 8% over 2013 and NOI to increase 8% to 9%. Our guidance assumes an additional \$10 million of acquisitions on top of the \$41 million we completed in October. We have not included in guidance the related acquisition costs incurred to date or that could occur in

the future. As a result of the above assumptions, we are increasing guidance and are forecasting funds from operations for the full year 2014 at between \$4.33 and \$4.37 per share, and between \$1.10 and \$1.14 per share for the fourth quarter of 2014.

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

Operator

(Operator instructions.) Our first question comes from the line of Todd Thomas with KeyBanc Capital Markets. Please proceed with your question.

<Q>: I was just wondering if you could elaborate a bit on the comment in the press release that pricing adjustments were made in anticipation of the off-peak leasing season. I was just wondering, what does that entail? Did you increase discounting to maintain higher occupancy levels, or did you reduce your rent increases to existing customers? What adjustments were made during the quarter exactly?

Andrew Gregoire – Chief Financial Officer

You hit on it. By design, we made a strategic decision to increase our free rents during the quarter. Now, we are probably the lowest free rent out there of the bigger providers. We really have reduced free rent. We thought while the activity was high, our model was showing that it made sense to increase free rent earlier in the quarter than we had done in the past, so we increased our free rent during the quarter. Sacrificed a little in the quarter, but we think it's going to set us up very nicely Q4 and Q1. So it was mostly a decision on the free rent side while the activity was high. If you look back to what we've been doing with free rent, 2Q we were very aggressive at reducing free rent. When the activity is there, our system tells us to push hard, reduce free rent and increase rent, so the 8.6% we saw in Q2 is just part of our model. How it works, it's very aggressive when the activity is there. When the activity falls off, like it traditionally does in the fourth quarter, the model this year says it makes more sense to give free rent earlier on. So we're a little ahead of the industry, and we like that decision.

<Q>: Then what's the plan over the next several months until the peak leasing season picks up. Is it pretty much the same where you'll keep discounting slightly higher, and what is the plan with rent increases to existing customers?

Edward Killeen – Executive Vice President, Real Estate Management

As far as in-place rent increase goes, we were very selective this quarter in how we segmented in-place customers, and I think we'll take that same approach in the fourth quarter and into the first quarter of next year. We'll choose a smaller population of customers, but those that do receive a rate increase, it'll be in the double-digits where we've been the last few quarters. As far as discounting goes, we have to see what happens with our activity over the next couple months, but we think that there will be at this point, it's difficult to say, but we think we'll be able to narrow the gap a little bit when it comes to discounting.

<Q>: Then just a question on new supply. It seems like developers are pretty eager to get back in the game in a meaningful way, and I was just wondering is there enough capital and operating expertise available out there to facilitate a meaningful ramp in development? I was wondering, maybe you could give us an update on what you're seeing today as you look out over the next one to two years from an overall industry perspective in terms of what you're seeing in new supply today.

Paul Powell – Executive Vice President, Real Estate Investment

We're still seeing a lot of potential development in the pipeline, a lot of talk. In our markets, we've seen an uptick in projects, either in the development stage or in the entitlement process. In our recent review of our area managers, we saw about 100 within our market, and about 70 of those would be in our immediate trade area, which is an uptick from this time last year, and we expect to continue to see that. But we're still not that

concerned. We still think it's a year and a half, two years out before we'll see a significant supply that we'd have some concern about but right now, I think there's a lot of talk and we are working with some preferred developers and possibly doing some CO deals. Time will tell, but we're not too concerned at this point.

Operator

Our next question comes from the line of Christy McElroy with Citigroup. Please proceed with your question.

<Q>: This is actually John here with Christy. My first question is with regard to guidance. So in Q3, you beat the midpoint of your guidance range by \$0.02 but you only raised 2014 guidance by a penny, so from what I understand your guidance excludes the impact of acquisition costs so just trying to understand why guidance wasn't up more.

Andrew Gregoire – Chief Financial Officer

There's a couple of things at play there. Number one, we're in the guidance range, so we're talking tight numbers here. The other thing was we issued a little more equity in 3Q than we had expected. We were trading at a reasonable level compared to cap rates we were paying. We thought it made sense to take advantage of that. We're also preparing for that Westy transaction next year—there's a \$120 million deal, potential deal that would happen early next year, so we're just getting ahead of that game and we were comfortable with it during the quarter, but really the guidance is it's such a tight range that it didn't make sense to move it any more than that.

<Q>: I guess going along those same lines with equity, so given another \$10 million of assumed acquisitions in 2014, is there anything additional assumed in your guidance for further ATM throughout the year?

Andrew Gregoire – Chief Financial Officer

Yes, we look to match fund and look at the 70% equity issuance.

Operator

Our next question comes from the line of Jana Galan with Bank of America. Please proceed with your question.

<Q>: I was wondering if you could speak to some of the October trends that you're seeing, maybe give us an idea of where Street rates are now compared to last year.

Andrew Gregoire – Chief Financial Officer

Sure, a couple things. Ed can talk to Street rates, I'll talk to occupancy. Today, it's 110 basis points above last October. We've got two normal move-in days left in the month, so somewhere between 110 and 120 is where we figure we'll end October. Rates, I don't know if you have the rates?

Edward Killeen – Executive Vice President, Real Estate Management

Our Street rate ending September were 8.8% year-over-year, and we're trending right about there.

<Q>: Then I was just wondering if maybe you could talk to any geographic differences that you're seeing, any potential weakness in markets potentially due to supply increases.

David Rogers – Chief Executive Officer

I think we're pretty early on to be worried about supply in any of our markets. All of our states on a same store revenue and same store NOI basis were improved, didn't have any real weak spots. We had some particular store weak spots where we had a flood at one and a couple stores we took a lot of units out of service to rebuild, but those were by site—I think we're really happy with all the regions and all the markets. Yeah, I think it's very widespread.

Operator

Our next question comes from the line of Jeremy Metz with UBS. Please proceed with your question.

<Q>: It's Ross Nussbaum here with Jeremy. So I want to go back to the increased free rent/discounting you guys have put in place here. I guess what I'm wondering is if I recall, you didn't do that into 4Q of last year, did you?

Andrew Gregoire – Chief Financial Officer

We did, late in 4Q we were heavy discounts last year.

<Q>: So you've just done it—

David Rogers – Chief Executive Officer

Earlier, correct.

<Q>: Right, so that's where I'm going. Something, I guess, has changed seasonally for you to do it earlier, despite the fact that you're more occupied, you've got better realized rent growth. Is it the move-in activities kind of being down on a year-over-year basis that you think you need to start driving more traffic?

Edward Killeen – Executive Vice President, Real Estate Management

Well you know, Ross, I don't know if it's anything different in what we saw, but as we build our predictive modeling, what we did last year, what we learned last year is that this year, we needed to do it earlier. It wasn't so much that we were incorrect in what we were doing last year; it's just that we had more data to forecast better for what we're doing this year, and that all suggested that we go into it a little earlier, as Andy said, when activity is high, when the phones are ringing, when you have strong rates. You want to lock in more of those customers at those more favorable rates going into the low season, and given last year's activity, we learned that we should do it a little bit earlier this year.

<Q>: Then on the realized rent growth, you guys were at, I think, 4.4% this quarter, which was the same as the second quarter, so I'm trying to think about that, what I'll call sequential flat line, but you had the same trend a year ago. In 2Q and 3Q of last year, you had 3.6% realized rent growth, and then that trailed off a little bit into the weaker seasonal period, so are you expecting the 4.4% realized rent growth to also trail off for the next two quarters? Let me start with that.

Andrew Gregoire – Chief Financial Officer

No. We would not expect it to trend off. I think that free rent really, because it's in that number, drove that number down a little bit this quarter. We would expect that to hold pretty strong. We think we still have 100 basis points in occupancy, and we think 4-plus, 4.5-plus in rates that we should carry right through the slower season.

<Q>: Then that was going to be my next question, which is have you seen any correlation, or maybe it's elasticity when you're thinking about when you try to push realized rate 5%, 6%, 7%, did you see occupancy come in when you were more aggressive on the rate pushes? What did the data kind of tell you this summer?

Andrew Gregoire – Chief Financial Officer

The data tells us we're still turning customers away, even at these occupancy levels. We have more room to run in occupancy, but we're turning customers away and we can be very aggressive at certain times of the year, and we're going to continue to do that. The data tells us to be aggressive when the phone is ringing hard, because we are still turning customers away because there's many product types that we're full at, so we're aggressive when that phone is ringing for those product types.

David Rogers – Chief Executive Officer

To be clear, when we say we're turning customers away, it's because we don't have room for them, not because they're turned off by the price.

Operator

Our next question comes from the line of David Toti with Cantor Fitzgerald. Please proceed with your question.

<Q>: A couple questions on acquisitions. Have you guys been looking at the Four Seasons portfolio?

Paul Powell – Executive Vice President, Real Estate Investment

Yes, we did look at it. We may do a deal with one of our institutional partners on that, but at this point I really can't say a whole lot more about it.

<Q>: Cap rates on the latest acquisition pool, have you disclosed those?

Paul Powell – Executive Vice President, Real Estate Investment

Yeah, the cap rates on the five that we purchased in the third quarter, one of them was a—actually two of the properties were Uncle Bob-managed properties. One of them was still in lease-up. It had opened in May; we bought it in the end of the third quarter, so we're projecting a low 3 cap in the first year of operations should stabilize at 8.5% in about 3.5 years. The other four were around 6% or low 6% range.

<Q>: Then just to follow-up on one of the earlier questions about development, some of your peers are involved in sort of increasing volumes of CO deals. Have you guys considered that all, or seen those opportunities come across the desk?

Paul Powell – Executive Vice President, Real Estate Investment

Yes, we're looking at a few now. We are negotiating contracts on three as we speak. Whether they turn in to deals, we'll see. We're also working with about three or four other developers in specific markets where we would hopefully do some CO deals. So yeah, we're seeing that spread, though, the cap rate spread decrease some from the beginning of the year. Beginning of the year, I was looking at a 3% spread; now I'm looking at 1.5% to 2.5% spread, depending on which market, so even those cap rates have started to compress even more so than we anticipated, so we're going to be very selective and do them in markets where we know there will be home runs. But yeah, we hopefully will have some under contract going into 2015 that would either open up in that year or maybe go into 2016.

David Rogers – Chief Executive Officer

I'm not sure if it came across, Dave, by spread. What Paul is talking about is we're willing to pay, say, a 6 cap in Chicago for a mature deal that has the normal upside, let's say. If we're doing a CO deal, we would like to see a 9 cap 3 - 3.5 years out at maturity. That's our risk for lease-up, I guess. The CO deals I think are pretty commonly structured across the people who are doing them, but we basically marry ourselves or are looking to connect with people who have the entitlement process done, have the expertise and the fact that we can rely on them to do a good job for the construction, deliver us the key to that CO, and then we take the lease-up risk. That's what Paul was talking about when we're looking for formerly maybe 300 basis points seems to be squeezing in considerably over the past few months into something in the 180, 200, 220 basis point range.

Operator

(Operator instructions.) Our next question comes from the line of George Hoglund with Jefferies. Please proceed with your question.

<Q>: I don't know if this was asked already, but can you address the insurance participation rate and sort of what's the trend there, and then also what's the overall sort of increase in rate charged on tenant reinsurance?

Edward Killeen – Executive Vice President, Real Estate Management

As far as penetration rate and the capture rate, which is new enrollments, they're both trending upwards. Our penetration rate end September was 58.9% versus 56.9%, and capture rate is up as well to 82.8%, nearly 83%.

Andrew Gregoire – Chief Financial Officer

The rate we charge a customer hasn't changed, George. We have the ability to change that at any time, but we haven't changed it yet this year.

Operator

Mr. Rogers, there are no further questions at this time. I'd like to turn the floor back over to you for any closing comments.

David Rogers – Chief Executive Officer

Thank you, Melissa. We appreciate everyone's interest in our company and we'll probably see most of you next week at [indiscernible]. So in the meantime, have a good weekend. Thanks.