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PRESENTATION

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Hey, good afternoon, everybody. My name is Drew Babin from Robert W. Baird. I'm the residential analyst. I'm here with Mike Schall, John Burkart and Angela Kleiman from Essex Property Trust. Thank you all very much for allowing me to host this panel and thank you all for attending.

And with that, I'll hand it over to management for a quick set of prepared remarks, and then we'll open it up for questions at that point.

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Very good. Thanks, Drew. Thank you all for joining us today. Everyone can hear us back there, I assume? Great. By way of background, Essex is an S&P 500 company with more than 60,000 apartment units. We are a dedicated -- we're the only multifamily company that's dedicated to the West Coast, essentially the coastal urban markets in California and Washington, an area that represents, if you take those 2 states just by themselves, represents around the fifth largest economy of the world. So it's a large area, a diverse area. These are unique markets in that job growth generally outperforms the U.S. average, and there's a number of factors that limit the supply of housing and, therefore, there's a pretty significant housing shortage on the West Coast, both in Seattle and the coastal urban markets of California.

I guess the proof of the concept is evident in the track record of the company, where we just announced our 25th consecutive dividend increase to $7.80, which is -- that amount of dividends is a return of around 40% on the original IPO price in 1950. And I think we have one of the top return -- total returns of all the REITs that were in existence at that time.

In terms of guidance, we have a packet, a company presentation that's out on the Internet and available on our website. Generally, we have improved -- we've experienced improved economic conditions in 2019. And part of that is because multifamily supply continues to be less than the demand represented by job growth. And this year, we expected same-store rents to grow about 3% and core FFO to grow about 4%.

We provided an operations update on Page 22 of the investor presentation for April and May, our same property revenue had increased 3.4%, which is ahead of guidance although there's a couple of caveats to that. One is that we had less supply deliveries in the first half of the year, and so we may have some resistance going forward, but we are still trending ahead of the midpoint of the guidance range. We'll provide an update on the second quarter earnings call at the end of July.

And so I'll turn it back to you, Drew, for questions.

QUESTIONS AND ANSWERS

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Sure. So the way we're going to structure this is if you have a question, you're welcome to come up and use the microphone right here. Otherwise, we'll repeat the question so that it can be heard on the audio line. And feel free at any point to raise your hands, and I will go to you for questions. Sure.

Unidentified Analyst

Yes, Mike, on the last call, you talked about the regulatory (inaudible) but it's probably not the end of it. What do you think will happen next with some of the actions within the community groups (inaudible)

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

So quite a lot has happened this year. There have been literally hundreds of bills relating to housing in one form or another that have been introduced into the legislature. And one of them, we believe, is actually probably the most important of them, which is Assembly Bill 1482, has passed the assembly and has gone on to the Senate and probably will make it to the governor's desk sometime in the next couple of months. And that started out as a bill that was a statewide rent control and really anti-gouging bill. And the statewide limit on renewal rents would be CPI plus blank was in the original bill. So everyone said, well, what is the blank going to be? And that was -- there was quite a bit of discussion about that. And it was decided last week to fill that in with 7%, so CPI plus 7%. And I think that, that is a good indicator of how California has evolved as it relates to this rent control topic in that it's a more balanced discussion than it was a year ago.

So we -- a year ago, clearly, we were fighting Prop. 10 and Prop. 10 would have changed the Costa-Hawkins or repealed the Costa-Hawkins Rental Housing Act, would have opened the door for very restrictive forms of rent control. And at this point in time, we see a more balanced discussion because Governor Newsom, who took over for Jerry Brown, recently earlier this year has promised 2 things: He promised on the one hand to produce 3.5 million homes between now and 2025; and on the other hand, to add to the protections for renters. So again, it's a more balanced discussion where the need for more housing is recognized. And so having policies that are not overtly anti-housing is a big part of the change, I think, in California and represents a more balanced discussion as it relates to the whole rent control topic. So try to protect the renters from huge increases in rents, which happen from time to time, typically where you have someone that buys a building from a family that's owned the property for a long time, has rents that are pretty significantly under-market, takes over that building and tries to bump rents up by 20% or that type of scenario. So it protects against that situation while at the same time, preserves the economics, much of the economics to the developers and people that produce housing in California. Makes sense? Go ahead.

Unidentified Analyst

Just a question about (inaudible) tax regulation. We've seen the effect of the 10% cap on (inaudible) taxation specifically but also generally how longer-term (inaudible) with high tax states, like California, in Washington state, (inaudible)

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Yes. The -- in the past year, actually, the growth of the median home price stalled out. It went from being into the low double digits into the low single digits this past year. And I think largely because of the tax law, which limited the state and local income tax deduction and also limited its deductibility which we have a slide in our presentation that makes a point that for-sale housing at the median is 80% more expensive than rental housing. So clearly, that acts as a headwind, not that we needed more headwinds going from a renter transitioning to a homeowner. So it's that dynamic has actually changed. I think, Drew, I think you published some research on this subject, which I think hits the nail on the head. So clearly, the incentives to become a homeowner are less given the tax law.

In terms of what are people doing? We are, as a general rule, we study this migration pattern and what we've seen is, yes, there are many people that are moving out of California. But generally, the lower-incomes people or lower-income paying jobs are moving out of California and actually, the people moving into California are high-paid workers, typically from high-cost East Coast metros. So we see -- yes, we're losing people on the bottom rung of the income scale. We're gaining people at the top rung. And the net, which, of course, is job growth, is a positive. And again, we are generating more jobs than we are producing housing, so this supply/demand balance continues to be in the favor of demand over supply, and -- which is what is -- this has been the reason that we are dedicated to the West Coast, because that condition has been there for most of the last 30 years.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So if there's nothing else from the audience right now, I have my own list here. Most of the apartments meetings I've had, the topic of technology has come up, both in terms of just social responsibility but also some areas where there's really an economic ROI that comes from it. So I just thought I'd ask you what is Essex doing on that front that might be kind of exceed what some peers might be doing. Who else is getting involved? If you could speak to that, I think that would be helpful.

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

And maybe I'll start and then I'll let John finish. About a year ago, Essex and 2 other apartment REITs formed a industry consortium of sorts, in that it's essentially a venture capital fund that is focused on investing in technologies that benefit apartments. And so that fund is $108 million of capital. But more importantly, there's almost 1 million apartment units in the U.S. and Canada that are part of that consortium. So the idea is, we used to get 10 or 20 concepts from entrepreneurs, tech entrepreneurs, say, hey, try my product out at Essex. And of course, it's almost impossible for us to approach it on that basis.

So this industry consortium was a result of having -- now we take those inquiries and we give them to the venture capital fund. They have already mapped out all the industries that can have an impact on apartments. And then, of course, to the tech entrepreneur, hey, we can provide funding and we can provide access to about 1 million apartment units.

And so that program is ongoing. We recently -- John and I were -- and our Chief Technology Officer were at the meeting of the partners in Utah, and so the amount of energy and the ideas of working together, how we as an industry can promote technology usage within the company and ultimately with the objective of better service to our customers but also things that can reduce costs and improve the level of performance of apartment buildings that's out there. And I've got to tell you, there is a tremendous amount happening. Each of the investments that we've made, which I think number around 9 investments, we had each of the CEOs present to the L.P. group and of course, all the Chief Technology Officers of these companies are there. And so we are finding a lot of great ideas, including home automation type of technologies, revenue share opportunities and approaches that would essentially fundamentally change how we market and how we pursue a lease.

So maybe, John, do you want to add to that and talk a little bit about the things that we may be rolling out and have rolled out over the last year or so?

John F. Burkart - *Essex Property Trust, Inc. - Senior EVP of Asset Management*

Sure. So part of the way we look at these things, as we look at them, some of them are just simply ancillary. Like it might be revenue share with dog walking, those type of things. And so we are adding those items over time as they make sense to really improve the customer experience. Another set of items might be term investments. This might be smart units or this type of thing where they're probably going to have a certain lifespan. And those types of items, we are watching carefully, we're piloting and we're starting to roll some of those out. But we are aware of the technology life cycle and how things can move rather rapidly, making sure our returns make sense while we're improving both the customer experience and also lowering costs in that particular case.

Our focus in the biggest sense is really on the disruptive changes, where we really have the opportunity to really change the business and look and say if we can take things that are labor-intensive, let's say, leasing units, and turn that all -- to an online or self-help type process. And in doing so, improve the customer experience as well as lower our labor cost. That's the big endgame. And so we're really -- we have areas in all 3 of these buckets that we're working on. The biggest focus is that. And so from that is going to stem everything from automating each site to ensure that all the payments are online, workers are online, paperless leases, and all those types of things moving all the way through to smart units, which enable us to have smart locks and a lot of customers to do self tours.

We are taking the approach, in many of these cases, to parallel path things so where we don't have necessarily all the technology available. We're still doing self tours. We just do them in a way that might be a little bit old school with a map. And we're doing that because we are watching how the customer behaves, whether they enjoy this process, how we can learn from it. We're certainly finding that the customer, not a surprise, prefers to do things by themselves. They prefer to be able to gather the information when they want 24/7 and understand things. And so as we then move that process to a digital process, we will again both improve the customer experience and reduce labor costs.

So there's quite a bit. It's -- in all the years in operations, it's an incredibly exciting time to be in operations and an awful lot of things happening which will, I believe, ultimately transform the business over the coming years. It's happening quite fast right now. A lot of it is -- the key to it is this technology venture fund because it's able to focus the opportunities and align them so that we can then deploy them across the portfolio.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Go ahead.

Unidentified Analyst

How has that investment helped?

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

The -- how's it helped?

Unidentified Analyst

Yes, the venture fund. I mean...

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Let's see. It's probably a taxable REIT subsidiary. I think that's...

Angela L. Kleiman - *Essex Property Trust, Inc. - Executive VP & CFO*

Yes, this is a TRS.

Unidentified Analyst

And how much of that do you guys both control? What percent?

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

The 3 multifamily companies, 3 public multifamily companies own 51%, 17% each.

Unidentified Analyst

Three public and then what?

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Three public and then the rest are, yes, private companies. Is there any other public company that's in there? But essentially, yes. There's one -- yes, there is another public company in there, and then the rest are private owners, large -- generally large private owners.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Anything else from the audience? In that event, I was hoping to kind of go market by market, talk about some of the employment growth dynamics, beginning with Southern California. I guess talk about who's adding jobs in L.A., Orange County, San Diego. And also, kind of the secondary question, obviously, there's a lot of supply in downtown L.A. Can you talk about who's adding jobs there? And kind of what's attractive or what's transformative about that market? What is kind of the long-term positive story that is being embraced there?

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Yes. Let me start with that and John might want to chime in here. Southern California is more like the United States. It is a slower growing than the tech markets of Seattle and Northern California. And actually, it had a fairly slow start to 2019. It underperformed our forecast -- our job forecast in Southern California of 1.3%. It -- I think the trailing 3-month average through April was about 1%, so it underperformed by 30 basis points.

I think part of that though was due to a couple of things. One is the shutdown of the federal government was a factor. There was a large merger of Disney with Fox, was part of that, there were maybe a couple of layoffs that were announced over that period of time. And so we think it's picking up steam. There were also some benchmark revisions in the prior year 2018 that created a tough comp, which will get easier this -- that get easier as we go through 2019. So those were the, I think, the key dynamics in Southern California.

In terms of the job categories that are doing well, professional and business services continues to be very strong in the marketplace. And I guess second to that and typically, is education and health services. So there still are some decent high-quality jobs in Southern California, and then there's also -- it's a more diversified economy. So other parts of the labor pool are also growing but not as robustly as those 2.

In terms of downtown L.A. and supply, downtown L.A. is a longer-term story. And to go back and tell that story, I'd go back several years, 10 or 15 years ago where all those high-rise buildings were in downtown L.A. but there were virtually no housing in the downtown. And over time, when 2006 California passed the law, the California Global Warming Solutions Act, which sought to put housing next to the jobs or on the transit nodes leading out from the major metro area. So really downtown Los Angeles is the embodiment of California's desire to be more green and to reduce commutes, get people out of their cars, et cetera. And so the downtown -- building apartments in the downtown became a big part of that overall plan. And certainly, there's been a lot of apartments built in the downtown over the last 10 years as that's happened.

Which is both good and bad because I would say it's a transition in process. All the jobs are there so the proposition is a worker that's commuting into the downtown, you don't have to commute anymore because we'll just put housing right there next to the jobs. And you don't need a car, and you can walk to work and life goes on. But along the way, there's all kinds of disruption from the construction activity, and there's some grittiness in the downtown areas and the reasons why the -- I'd say the baby-boom generations don't really want to live in the downtown. The millennials are the ones that are really gravitating to the downtown and changing it.

So our view of the downtown is that in the short term, it will continue to have some supply/demand struggles, which will be represented by large concessions when several properties are in lease-up. But longer term, it will be this -- certainly a winner. Again, all the jobs are there. It is a matter of improving quality of the life in the downtown.

So we're a long-term believer in downtown L.A. In the short term, we think there will be some bumps. And we sold a building -- or actually the highest-quality building in downtown L.A. last November and used the money to buy stock back because in the fourth quarter, there were some softness on stock price. And essentially that's how we look at the world. If the public market's going to undervalue the company, we don't mind selling a building and essentially buying stock back. Or if the public market's going to value our stock in a premium to NAV, then we'll issue stock and we'll buy property. So that's an example of how we try to add value both -- on both sides of the transaction market. Do you have anything else?

John F. Burkart - *Essex Property Trust, Inc. - Senior EVP of Asset Management*

Maybe I should make a comment on rents, because I spoke about it on the call. As we mentioned on the Q1 call, we had a really good first quarter. And as we got into the time for the call, which was late April, the rents had come back a little bit. So I brought that up for the sake of transparency and insight. And the question got asked, do we think this is long term. Is this -- is there a problem. We said no, not at all. We don't see it that way. We think it's just a short-term blip. And so now here a month later, it's clear it really was a short-term blip. And so our rents in May, we posted our average rents here for April/May in our presentation at 3.2%, and that's really made up of April at about 2.7% and then May at about 3.5% averaged out. So just wanted to close that gap and close that loop because it really was a short-term blip, and what we are seeing is a consistent, strong marketplace.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

If we can maybe shift our attention to Northern California, I think you mentioned earlier -- I mean, obviously, job growth and job growth at very high-income levels has been very strong in both San Francisco, San Jose. I think in the Bay Area, East Bay has maybe -- have a relative spot of weakness. Can you talk about -- was that just a supply issue? Is there anybody adding jobs directly in East Bay that might kind of remediate that? Can you just talk about the relative dynamics that are going on there?

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Yes, well, unfortunately the Bay Area is small enough and the transit situation -- the public transit situation is a little bit better because the BART system is a pretty effective system. So -- and why I say that because you can work in Downtown San Francisco and you can get there from the East Bay fairly easily, where you have not as great an ability to do that in Southern California.

But Northern Cal is doing very well. It outperformed our expectation in terms of job growth. We expected 2%. The trailing 3-month average through April was 2.4%, so all good there. As Drew mentioned, there are some spots where the supply is -- has grown to some extent, mainly in the East Bay. And that's caused the East Bay to be a little bit softer than San Francisco to San Jose and along the peninsula, actually the peninsula being the strongest of all the markets in the Bay Area. So we, again, see great strength when you look at pretty much all the indicators from -- the top 10 tech companies have 26,000 job openings in Washington and California, and that's up from about 16,000 a year or so ago. So there's been big improvement in job openings. Lots of activity on the commercial side in terms of office construction. So future space for future residents to be there. And pretty much everything looks very solid in Northern California.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Any questions from the audience? Moving on to Seattle, it seems like job growth in Seattle continues to be very, very strong, as it has been in the last few years. And supply growth is maybe moderating enough to facilitate some absorptions from relative rate growth. Can you talk about just the strength you've seen there? How things are kind of shaping up so far into this peak leasing season and what you might expect for the rest of this year?

John F. Burkart - *Essex Property Trust, Inc. - Senior EVP of Asset Management*

Sure. I'll grab that. Seattle, again, starting back last year, had one of the strongest job growth years it's had for many, many years. And it continues on with that momentum into this year. We were at 2.4% year-over-year job growth. And what we're seeing is that the job growth is sufficient by far to cause all the supply to be absorbed fairly rapidly. In many cases, the concessions are well below 4 weeks. 4 weeks is pretty standard for lease-up. In many cases, there are 2 weeks and in some cases, less than that. There's some supply that has moved out to the East side and so is demand. So what we're also seeing are companies, like Amazon and others, that are moving out to the East side. Most of our portfolio, about 80% of it is in the East side with a little north and south and then a little bit in the downtown area. But what we are seeing is demand across the whole Seattle region. And certainly in the East side, the demand is very good. So supply crept up a little bit on the East side. We are still seeing a strong demand and overall expect that market to perform very well this year.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And now moving on to development, this year is a very big development year for Essex, about $770 million pro rata development deliveries. Can you talk about the positive impact that it's going to have sort of towards the end of this year as those lease up and into next year? Then maybe talk about other value-add opportunities and things that Essex may pursue once those visible pipeline opportunities are maybe kind of worked through.

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Sure. I'll talk about that. Yes. So we have a large development pipeline that is delivering late this year. Actually it is probably one of the main reasons why core FFO isn't higher than our 4% target range because we have -- dilution is you deliver a vacant building until you get through the lease-up. There's a drag on operations. So most of the benefit of that will occur in 2020. And so that process will play itself out. The -- we are focusing, in terms of new development activity, mostly on preferred equity investments where we take someone else's development deal and we provide the -- essentially the bridge financing between the typical nonrecourse construction loan, which is about 55% loan-to-cost, up to about the 85% level. So we'll come in and that piece is a preferred equity participant and charge 10% to 12% for that piece. And so we have been pretty active in that space. We think it's a better risk/reward opportunity given what's happening on the West Coast. And by that, I mean rents are growing at somewhere around 3%, and construction costs are growing at a much higher level. And so if you get any delays in your construction start, you end up being squeezed with respect to construction costs growing faster than rent. So we think that the preferred equity is a better risk/reward proposition, and so we are focused on that. Not that we won't do a few direct development deals, but again, it -- we think the risk/reward trade-off in that space is a difficult one.

Most of the transactions we look at on the development side, both the preferred equity and our own transactions, the cap rate is somewhere in the 4.5% to 4.75% range without trending. So with rents in place today, as we compare -- if we're comparing acquisition to a development, we do it based on current rents. And we think that, that premium, 10% to 15%, is not enough to justify the risks of development, so we'd rather be a preferred equity player given those dynamics.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

We have time for one more question from the audience, if there is one. In that case, I'll ask about acquisitions and portfolio management initiatives. It seems like the spread between B cap rates and A cap rates, secondary and primary markets, is as tight as it's ever been or it has been in some time. Can you talk about whether, all else equal, it's maybe time to double down on class A, more CBD-type properties? Maybe it's just the time to be more aggressive selling more B properties given that the pricing is opportune. Can you just talk about the way Essex is thinking about that right now? And also maybe tie in capital allocation and things you're doing with the capital markets.

Michael J. Schall - *Essex Property Trust, Inc. - President, CEO & Director*

Sure. I think there are interesting things happening. And Drew, in our preparation for this, you made the comment that As and Bs are compressing yield-wise, and I would agree with that. And I think it's for a couple of reasons: Number one, you have all the product that's coming to market is in the luxury segment; whereas the demand, the job growth and the demand represented by job growth is in various price points. They're not all in that luxury segment. So I think there is some saturation or maybe if you look at that top A segment, there's not enough renters that fit that, that have the incomes to afford those units. So I think that, that has constrained the A valuations relative to the Bs. The Bs represent the more affordable part of the housing stock and, therefore, there's a lot of demand for that. They're lower priced, so the lower-income people are going to be focused on the Bs primarily rather than the As.

And so the other dynamic is the sources of capital that we see that are looking for deals. So the luxury is, by definition, a core product. So new building, no value add and -- whereas the amount of capital is really represented by the private equity buyers, which are looking for value-add deals. So you end up with a little bit of a mismatch with respect to capital in that the core fund -- there also are core funds that are looking for deals but they have plenty to choose from. I'd say that the private equity that are looking for value-add deals are the ones that are -- have some challenges in this marketplace.

So how we would react to that? We, again, our main strategy is to try to find arbitrage between the public and the private valuations of real estate. And so again, back to what we did last November was a good example where we sell a very high-quality building at a sub-4 cap rate and buy some stock back. So if we could find that trade again, obviously we're in a much different place today because interest rates have dropped a lot and our stock has done pretty well. And so we're back into trying to go the other direction: buy property, potentially issue some stock; or sell, again, some high-quality buildings at somewhere around a 4 cap rate and reinvest in probably -- if we can find value add, that's great. If we can't, we'll just look for opportunities. If one market has -- one submarket has a significant increase in rents, we'll look to the market next door to see if we can find the next beneficiary of that rent growth.

Andrew T. Babin - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Great. Looks like we're out of time. Please join me in a round of applause for Essex.