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NexPoint Residential Trust, Inc.
Form 10-Q
July 31, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-36663

NexPoint Residential Trust, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland 47-1881359
(State or other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

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300 Crescent Court, Suite 700, Dallas, Texas 75201
(Address of Principal Executive Offices) (Zip Code)

(972) 628-4100

(Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	(Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 30, 2018, the registrant had 20,747,367 shares of common stock, \$0.01 par value, outstanding.

NEXPOINT RESIDENTIAL TRUST, INC.

Form 10-Q

Quarter Ended June 30, 2018

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Cautionary Statement Regarding Forward-Looking Statements

This quarterly report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. In particular, statements relating to our liquidity and capital resources, the performance of our properties and results of operations contain forward-looking statements. Furthermore, all of the statements regarding future financial performance (including market conditions and demographics) are forward-looking statements. We caution investors that any forward-looking statements presented in this quarterly report are based on management's current beliefs and assumptions made by, and information currently available to, management. When used, the words "anticipate," "believe," "expect," "intend," "may," "might," "plan," "estimate," "project," "should," "will," "would," "result" and similar expressions that do not relate solely to historical matters are intended to identify forward-looking statements. You can also identify forward-looking statements by discussions of strategy, plans or intentions.

Forward-looking statements are subject to risks, uncertainties and assumptions and may be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. We caution you therefore against relying on any of these forward-looking statements.

Some of the risks and uncertainties that may cause our actual results, performance, liquidity or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

- unfavorable changes in market and economic conditions in the United States and globally and in the specific markets where our properties are located;
- risks associated with ownership of real estate;
- limited ability to dispose of assets because of the relative illiquidity of real estate investments;
- our multifamily properties are concentrated in certain geographic markets in the Southeastern and Southwestern United States, which makes us more susceptible to adverse developments in those markets;
- risks associated with our strategy of acquiring value-enhancement multifamily properties, which involves greater risks than more conservative investment strategies;
- potential reforms to the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae");
- competition could limit our ability to acquire attractive investment opportunities, which could adversely affect our profitability and impede our growth;
- competition and any increased affordability of residential homes could limit our ability to lease our apartments or increase or maintain rents;
- the relatively low residential mortgage rates may result in potential renters purchasing residences rather than leasing them, and as a result, cause a decline in occupancy rates;
- the risk that we may fail to consummate our pending property acquisitions;
- failure of acquisitions to yield anticipated results;
- risks associated with increases in interest rates and our ability to issue additional debt or equity securities in the future;
- we are subject to certain risks associated with selling apartment communities, which could limit our operational and financial flexibility;
 - contingent or unknown liabilities related to properties or businesses that we have acquired or may acquire;
 - lack of or insufficient amounts of insurance;
 -

the risk that our environmental assessments may not identify all potential environmental liabilities and our remediation actions may be insufficient;

• high costs associated with the investigation or remediation of environmental contamination, including asbestos, lead-based paint, chemical vapor, subsurface contamination and mold growth;

• high costs associated with the compliance with various accessibility, environmental, building and health and safety laws and regulations, such as the ADA and FHA;

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- risks associated with limited warranties we may obtain when purchasing properties;
- exposure to decreases in market rents due to our short-term leases;
- risks associated with operating through joint ventures and funds;
- our dependence on information systems;
- risks associated with breaches of our data security;
- risks associated with our reduced public company reporting requirements as an “emerging growth company”;
- costs associated with being a public company, including compliance with securities laws;
- the risk that our business could be adversely impacted if there are deficiencies in our disclosure controls and procedures or internal control over financial reporting;
- risks associated with our substantial current indebtedness and indebtedness we may incur in the future;
- risks associated with derivatives or hedging activity;
- the lack of experience of NexPoint Real Estate Advisors, L.P. (our “Adviser”) and property manager in operating under the constraints imposed on us as a real estate investment trust (“REIT”) may hinder the achievement of our investment objectives;
- loss of key personnel of Highland Capital Management, L.P. (our “Sponsor” or “Highland”), our Adviser and our property manager;
- the risk that we may not replicate the historical results achieved by other entities managed or sponsored by affiliates of our Adviser, members of our Adviser’s management team or by our Sponsor or its affiliates;
- risks associated with our Adviser’s ability to terminate the Advisory Agreement (as defined below);
- our ability to change our major policies, operations and targeted investments without stockholder consent;
- the substantial fees and expenses we will pay to our Adviser and its affiliates;
- risks associated with the potential internalization of our management functions;
- conflicts of interest and competing demands for time faced by our Adviser, our Sponsor and their officers and employees;
- the risk that we may compete with other entities affiliated with our Sponsor or property manager for tenants;
- failure to maintain our status as a REIT;
- failure of our operating partnership to be taxable as a partnership for federal income tax purposes, possibly causing us to fail to qualify for or to maintain REIT status;
- compliance with REIT requirements, which may limit our ability to hedge our liabilities effectively and cause us to forgo otherwise attractive opportunities, liquidate certain of our investments or incur tax liabilities;
- risks associated with our ownership of interests in taxable REIT subsidiaries;
- the recognition of taxable gains from the sale of properties as a result of the inability to complete certain like-kind exchanges (“1031 Exchanges”) in accordance with Section 1031 of the Internal Revenue Code of 1986, as amended (the “Code”);
- the risk that the Internal Revenue Service (the “IRS”) may consider certain sales of properties to be prohibited transactions, resulting in a 100% penalty tax on any taxable gain;
- the ineligibility of dividends payable by REITs for the reduced tax rates available for some dividends;
- risks associated with the stock ownership restrictions of the Code for REITs and the stock ownership limit imposed by our charter;
- the ability of our board of directors (the “Board”) to revoke our REIT qualification without stockholder approval;
- recent and potential legislative or regulatory tax changes or other actions affecting REITs;
- risks associated with the market for our common stock and the general volatility of the capital and credit markets;

• failure to generate sufficient cash flows to service our outstanding indebtedness or pay distributions at expected levels;

• risks associated with limitations of liability for and our indemnification of our directors and officers; and

• any other risks included under Part I, Item 1A, “Risk Factors” of our annual report on Form 10-K, filed with the U.S. Securities and Exchange Commission (“SEC”) on February 15, 2018 (our “Annual Report”).

While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. They are based on estimates and assumptions only as of the date of this quarterly report. We undertake no obligation to update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, new information, data or methods, future events or other changes, except as required by law.

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Operating Real Estate Investments		
Land	\$ 189,615	\$ 189,615
Buildings and improvements	811,696	806,981
Intangible lease assets	—	1,340
Construction in progress	5,113	3,786
Furniture, fixtures, and equipment	51,644	44,725
Total Gross Operating Real Estate Investments	1,058,068	1,046,447
Accumulated depreciation and amortization	(109,189)	(88,252)
Total Net Operating Real Estate Investments	948,879	958,195
Real estate held for sale, net of accumulated depreciation of \$897 and \$3,397, respectively	17,295	32,961
Total Net Real Estate Investments	966,174	991,156
Cash and cash equivalents	18,312	16,036
Restricted cash	20,907	27,212
Accounts receivable	3,819	2,932
Prepaid and other assets	3,516	1,559
Fair market value of interest rate swaps	26,827	16,480
TOTAL ASSETS	\$ 1,039,555	\$ 1,055,375
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgages payable, net	\$ 729,897	\$ 724,057
Mortgages payable held for sale, net	13,418	30,348
Credit facility, net	34,995	29,843
Bridge facility, net	—	8,576
Accounts payable and other accrued liabilities	4,905	6,226
Accrued real estate taxes payable	8,382	9,684
Accrued interest payable	2,273	2,074
Security deposit liability	1,607	1,518
Prepaid rents	2,051	1,470
Total Liabilities	797,528	813,796
Redeemable noncontrolling interests in the Operating Partnership	2,083	2,135
Stockholders' Equity:		
Preferred stock, \$0.01 par value: 100,000,000 shares authorized; 0 shares issued	—	—
Common stock, \$0.01 par value: 500,000,000 shares authorized; 20,747,367 and 21,049,565 shares issued and outstanding, respectively	207	210

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Additional paid-in capital	198,567	206,227
Accumulated earnings less dividends	15,570	17,885
Accumulated other comprehensive income	25,600	15,122
Total Stockholders' Equity	239,944	239,444
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,039,555	\$ 1,055,375
See Notes to Consolidated Financial Statements		

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NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Rental income	\$31,069	\$30,508	\$61,642	\$62,416
Other income	4,586	4,726	9,070	9,809
Total revenues	35,655	35,234	70,712	72,225
Expenses				
Property operating expenses	8,231	9,665	17,108	19,536
Real estate taxes and insurance	4,588	5,093	9,444	10,058
Property management fees (1)	1,066	1,057	2,120	2,170
Advisory and administrative fees (2)	1,863	1,849	3,701	3,674
Corporate general and administrative expenses	1,986	1,886	3,799	3,219
Property general and administrative expenses	1,648	1,576	3,195	3,162
Depreciation and amortization	11,038	12,208	22,410	24,651
Total expenses	30,420	33,334	61,777	66,470
Operating income	5,235	1,900	8,935	5,755
Interest expense	(6,823)	(7,063)	(13,620)	(14,222)
Loss on extinguishment of debt and modification costs	(78)	(4,803)	(629)	(4,803)
Gain on sales of real estate	—	19,896	13,742	19,896
Net income (loss)	(1,666)	9,930	8,428	6,626
Net income attributable to noncontrolling interests	—	2,524	—	2,836
Net income (loss) attributable to redeemable noncontrolling interests in the Operating Partnership	(5)	—	25	—
Net income (loss) attributable to common stockholders	\$(1,661)	\$7,406	\$8,403	\$3,790
Other comprehensive income (loss)				
Unrealized gains (losses) on interest rate derivatives	2,749	(2,095)	10,510	(1,049)
Total comprehensive income	1,083	7,835	18,938	5,577
Comprehensive income attributable to noncontrolling interests	—	2,936	—	2,720
Comprehensive income attributable to redeemable noncontrolling interests in the Operating Partnership	4	—	57	—
Comprehensive income attributable to common stockholders	\$1,079	\$4,899	\$18,881	\$2,857
Weighted average common shares outstanding - basic	20,780	21,044	20,883	21,044
Weighted average common shares outstanding - diluted	21,295	21,473	21,362	21,383

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Earnings (loss) per share - basic	\$(0.08)	\$0.35	\$0.40	\$0.18
Earnings (loss) per share - diluted	\$(0.08)	\$0.34	\$0.39	\$0.18
Dividends declared per common share	\$0.25	\$0.22	\$0.50	\$0.44

(1) Fees incurred to an unaffiliated third party that is an affiliate of the noncontrolling limited partner of the Company's operating partnership (see Notes 10 and 11).

(2) Fees incurred to the Adviser (see Note 11).

See Notes to Consolidated Financial Statements

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(dollars in thousands)

(Unaudited)

	Preferred Stock Number of Shares	Common Stock Number of Shares	Additional Paid-in Capital	Accumulated Earnings Less Dividends	Accumulated Other Comprehensive Income	Common Stock Held in Treasury at Cost	Total	
Balances, December 31, 2017	—	21,049,565	\$ 210	\$ 206,227	\$ 17,885	\$ 15,122	\$—	\$239,444
Net income attributable to common stockholders			—	8,403	—	—	8,403	
Repurchase of common stock			—	—	—	(9,672)	(9,672)	
Retirement of common stock held in treasury		(382,941)	(4)	(9,668)	—	9,672	—	
Vesting of stock-based compensation		80,743	1	2,008	—	—	2,009	
Common stock dividends declared			—	(10,696)	—	—	(10,696)	
Other comprehensive income			—	—	10,478	—	10,478	
Adjustment to reflect redemption value of redeemable noncontrolling interests in the Operating Partnership			—	(22)	—	—	(22)	
Balances, June 30, 2018	—	20,747,367	\$ 207	\$ 198,567	\$ 15,570	\$ 25,600	\$—	\$239,944

See Notes to Consolidated Financial Statements

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$8,428	\$6,626
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of real estate	(13,742)	(19,896)
Depreciation and amortization	22,410	24,651
Amortization/write-off of deferred financing costs	1,225	1,357
Change in fair value on derivative instruments included in interest expense	(1,241)	812
Net cash received (paid) on derivative settlements	1,177	(542)
Amortization/write-off of fair market value adjustment of assumed debt	(121)	(103)
Vesting of stock-based compensation	2,009	1,592
Changes in operating assets and liabilities, net of effects of acquisitions:		
Operating assets	(1,399)	(467)
Operating liabilities	(1,413)	197
Net cash provided by operating activities	17,333	14,227
Cash flows from investing activities		
Net proceeds from sales of real estate	29,553	82,736
Additions to real estate investments	(15,104)	(12,087)
Acquisitions of real estate investments	—	(138,106)
Net cash provided by (used in) investing activities	14,449	(67,457)
Cash flows from financing activities		
Mortgage proceeds received	17,760	583,713
Mortgage payments	(29,471)	(211,441)
Credit facility proceeds received	5,000	