INDEPENDENCE REALTY TRUST, INC
Form 10-K
March 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

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 001-36041

INDEPENDENCE REALTY TRUST, INC.

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	26-4567130 (I.R.S. Employer Identification No.)
Two Logan Square, 100 N. 18th Street, 23rd Floor,	
Philadelphia, PA (Address of principal executive offices)	19103 (Zip Code)

(215) 207-2100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Name of each exchange on which registered
Common Stock	NYSE MKT

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

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

The aggregate market value of the shares of common stock of the registrant held by non-affiliates of the registrant, based upon the closing price of such shares on June 30, 2016 of $8.18, was approximately $326,001,833.17.

As of February 28, 2017 there were 69,035,969 outstanding shares of the registrant’s common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for registrant’s 2017 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

INDEPENDENCE REALTY TRUST, INC.

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FORWARD LOOKING STATEMENTS

The Securities and Exchange Commission, or SEC, encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This report contains or incorporates by reference such "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act.

Words such as "anticipates," "estimates," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements. As used herein, the terms "we," "our" "us" and "IRT" refer to Independence Realty Trust, Inc. and, as required by context, Independence Realty Operating Partnership, LP, which we refer to as IROP, and their subsidiaries.

We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995. These statements may be made directly in this report and they may also be incorporated by reference in this report to other documents filed with the SEC, and include, but are not limited to, statements about future financial and operating results and performance, statements about our plans, objectives, expectations and intentions with respect to future operations, products and services, and other statements that are not historical facts. These forward-looking statements are based upon the current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are difficult to predict and generally beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. Actual results may differ materially from the anticipated results discussed in these forward-looking statements.

The risk factors discussed and identified in item 1A of this report and in other of our public filings with the SEC, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable law or regulation, we undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this filing or to reflect the occurrence of unanticipated events.

PART I

ITEM 1. Business

Our Company

We are a Maryland corporation that owns apartment properties in geographic non-gateway markets that we believe support strong occupancy and have the potential for growth in rental rates. We seek to provide stockholders with attractive risk-adjusted returns, with an emphasis on distributions and capital appreciation. We became an internally-managed real estate investment trust, or REIT, in December 2016 as a result of completing the management internalization transactions, or the management internalization, described below under "Management Internalization." Prior to completing the management internalization, we were externally advised by a wholly-owned subsidiary of RAIT Financial Trust, or RAIT (NYSE: RAS). We elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, or the Code, commencing with our taxable year ended December 31, 2011.

We seek to acquire and operate apartment properties that:

- have stable occupancy;
- are located in non-gateway markets that we do not expect will experience substantial new apartment construction in the foreseeable future;
- in appropriate circumstances, present opportunities for repositioning or updating through capital expenditures; and
- present opportunities to apply tailored marketing and management strategies to attract and retain residents and enable rent increases.

Our Business Objective and Investment Strategies

Our primary business objective is to maximize stockholder value by increasing cash flows at our existing apartment properties and acquiring additional properties that have strong and stable occupancies with the ability to raise rental rates or that have the potential for repositioning through capital expenditures or tailored management strategies. We intend to achieve this objective by executing the following strategies:

- Focus on properties in markets that have strong apartment demand, reduced competition from national apartment buyers and no substantial new apartment construction. In evaluating potential acquisitions, we analyze apartment occupancy and trends in rental rates, employment and new construction, among many other factors, and seek to identify properties located primarily in non-gateway markets where there is strong demand for apartment units, little to no apartment development, stable resident bases and occupancy rates, positive net migration trends and strong employment drivers. We generally seek to avoid markets where we believe potential yields have decreased as a result of the acquisition and development efforts of large institutional buyers.

- Acquire properties that have operating upside through targeted management strategies. We have expertise in acquiring and/or managing properties and maximizing the net operating income, or NOI, of such properties through more effective marketing and leasing, better management of rental rates and more efficient expense management. We will seek to acquire properties that we believe possess significant prospects for increased occupancy and rental revenue growth. Our target profile for acquisitions currently is midrise/garden-style apartments containing 150-500 units with good amenities that we can acquire at less than replacement cost in the $15 million to $50 million price range with a five to fifteen year operating track record. We do not intend to limit ourselves to properties in this target profile, however, and may make acquisitions outside of this profile or change our target profile whenever market conditions warrant.

- Selectively use our capital to improve apartment properties where we believe the return on such investments is accretive to our stockholders. We have significant experience allocating capital to value-added improvements of apartment properties to produce better occupancy and rental rates. We will selectively deploy our capital into revenue-enhancing capital projects that we believe will improve the physical plant or market positioning of particular apartment properties and generate increased income over time.

- Use our extensive experience owning and/or managing apartment properties, and our networks of contacts in the apartment industry, to acquire additional apartment properties. We manage approximately 15,000 apartment units in 17 states (including those owned by us). We believe these factors and our management’s real estate relationships and access to off-market transactions, including relationships with the brokerage community, will continue to provide us with a strong pipeline of acquisition opportunities.

2016 Developments

Management Internalization Transaction

On September 27, 2016, we entered into an agreement, or the internalization agreement, with RAIT to complete the management internalization and separation from RAIT and its affiliates and to repurchase 7,269,719 shares of our common stock, or our common stock, from RAIT subsidiaries, representing all of the shares of our common stock owned by RAIT.

On October 5, 2016, we paid approximately $62.2 million to RAIT to repurchase, or the IRT stock repurchase, and retire RAIT's shares of our common stock at a purchase price of $8.55 per share. This price was equal to the price to the public in our common stock offering described below less underwriting discounts or commissions.

On December 20, 2016, we completed the management internalization. The management internalization consisted of two parts: (i) the acquisition of our external advisor, which was a subsidiary of RAIT, and (ii) the acquisition of substantially all of its assets and the assumption of certain liabilities relating to the multifamily property management business of RAIT, including property management contracts relating to apartment properties owned by us, RAIT and third parties. The purchase price we paid RAIT for the Internalization was $43.0 million, subject to certain prorations at closing. After the management internalization, we terminated our advisory agreement with the external advisor we had acquired.

Upon closing of the management internalization, each of Scott F. Schaeffer, our chairman of the board and chief executive officer, Farrell Ender, our president, and James J. Sebra, our chief financial officer and treasurer, entered into employment agreements with us. Messrs. Schaeffer and Ender became our employees upon closing. Mr. Schaeffer resigned as RAIT's chairman of the board and chief executive officer and Mr. Ender ceased to be employed by RAIT effective upon the closing of the management internalization. Mr. Sebra remains the chief financial officer and treasurer of RAIT until the later to occur of March 31, 2017 or the filing of RAIT's Form 10-K for the fiscal year ending December 31, 2016 with the U.S. Securities and Exchange Commission. Upon closing of the management internalization, we hired substantially all of the employees of the multifamily property management business from RAIT we had acquired and other RAIT personnel who had focused primarily on our business. We expect to continue to provide property management services to RAIT properties that were managed by RAIT's multifamily property management business. We do not expect to otherwise expand our multifamily property management business to third parties.

At the closing of the management internalization, we and RAIT entered into a shared services agreement, or the shared services agreement, pursuant to which we and RAIT will provide each other certain transitional services such as information technology, human resources, insurance, investor relations, legal, tax and accounting for a six-month transition period after the closing ending June 20, 2017.

We believe the management internalization and IRT stock repurchase is and will be transformative for IRT.

By acquiring our external advisor:

- We eliminated all asset management fees payable to the external advisor;
- We eliminated the advisory agreement termination fee, which equaled 4 times the average annual base management and incentive fees earned by the external advisor during the eight full calendar quarters preceding the termination date;
- We removed the possibility of increased asset management fees payable to the external advisor that might result if we raised additional equity;
- We established a newly independent IRT management team; and
- We believe the management internalization will assist us in attracting new institutional investors, diversifying our stockholder base and improving our ability to raise capital.

By acquiring RAIT's multifamily property management business:

- We eliminated the related property management fees;
- We plan to realize the potential for cost savings through the capture of economies of scale; and

- We retained employees with knowledge of and experience with managing our properties

As a result of the IRT stock repurchase:

- We believe we enhanced the float and liquidity of our common stock; and
- We removed the potential adverse market effect on the trading of our common stock of possible sales by RAIT of its some or all of its substantial holdings of our common stock.

As a result of the management internalization we expect to save approximately $2.5 million per year on general and administrative expenses after the shared services period ends while eliminating the increased management cost related to growth under the external management contract structure.

2016 Common Stock Offering

On October 5, 2016, we closed an underwritten public offering, or the 2016 common stock offering, of 25,000,000 shares of our common stock at a public offering price of $9.00 per share for total net proceeds of approximately $213.4 million. On October 21, 2016, we closed on the underwriters' option to purchase 3,750,000 additional shares of our common stock at the public offering price, less underwriting discounts and commissions netting us an additional $32.1 million of proceeds. In the aggregate, we received approximately $245.5 million of net proceeds from the 2016 common stock offering. We used the net proceeds from the 2016 common stock offering plus available cash as follows: $40.0 million was used to repay our $40.0 million senior secured term loan facility; $43.0 million was reserved for, and ultimately paid to, RAIT at the closing of the management internalization; $62.2 million was used for the IRT stock repurchase; and $107.3 million was used to repay outstanding borrowings under our $325.0 million senior secured credit facility.

Financing Strategy

We intend to use prudent amounts of leverage in making our investments. As previously disclosed, we determined that the strategic long term benefits of our acquisition of Trade Street Residential, Inc., or TSRE, in September 2015 justified exceeding our historical leverage limits, defined as having total indebtedness of no more than approximately 65% of the combined initial purchase price of all of the properties in our portfolio. Also, as previously disclosed, following the completion of our acquisition of TSRE, or the TSRE acquisition, we instituted a strategy, which we refer to as our capital recycling strategy, seeking to reduce IRT's leverage ratio over time by using the proceeds from sales of properties which are outside our core geographic footprint in the Southeastern United States or which we believe we have limited potential for further improvements to their operating results to repay a portion of our indebtedness. We have successfully continued to implement our capital recycling strategy to reduce our leverage and reduce our exposure to short term indebtedness. During 2016, our leverage as measured by the ratio of our debt to gross assets decreased from 64% to 54.3%. We continue to review and reposition our financing structures seeking to enhance our flexibility and liquidity while continuing to reduce our leverage. For 2017, we expect one focus of our capital recycling strategy to be to match sales of our properties we classify as "C" properties with acquisitions we classify as "B" properties using the proceeds of sales of the "C" properties. We classify our properties based on industry standards. Our goal in having this focus for our capital recycling strategy in 2017 is to increase the amount of "B" properties in, and remove the "C" properties from, our portfolio without increasing our leverage or requiring additional issuances of our equity.

For further description of our indebtedness at December 31, 2016, see "Part II-Item 8. Financial Statements and Supplementary Data-Note 5: Indebtedness" below, or the financial statements indebtedness note.

In general, however, by operating on a leveraged basis, we expect to have more funds available for property acquisitions and other purposes, which we believe will allow us to acquire more properties than would otherwise be possible, resulting in a larger and more diversified portfolio. See "Part I-Item 1A. Risk Factors—Risks Associated with Debt Financing" below for more information about the risks related to operating on a leveraged basis.

If our board of directors changes our policies regarding our use of leverage, we expect that it will consider many factors, including, among others, the lending standards of government-sponsored enterprises, such as the Federal National Mortgage Association, or Fannie Mae, and the Federal Home Loan Mortgage Corporation, or Freddie Mac, for loans in connection with the financing of apartment properties, the leverage ratios of publicly traded REITs with similar investment strategies, the cost of leverage as compared to expected operating net revenues and general market conditions.

Development and Structure of Our Company

We were formed as a Maryland corporation on March 26, 2009. RAIT acquired beneficial ownership of 100% of our outstanding common stock on January 20, 2011 for approximately $2.5 million and we commenced operations on April 29, 2011 upon our acquisition of six properties from RAIT. Since our formation, we have sold 55,198,300 shares of our common stock in six underwritten public offerings raising $497.2 million of gross proceeds. While RAIT has bought shares in several of these offerings, RAIT's ownership percentage was reduced after each offering. On October 5, 2016, we repurchased and retired all 7,269,719 shares of our common stock owned by RAIT.

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, structure in which our properties are owned by our operating partnership, IROP, directly or through subsidiaries. We are the sole general partner of IROP. IROP was formed as a Delaware limited partnership on March 27, 2009. Substantially all of our assets are held by, and substantially all of our operations are conducted through, our operating partnership. As the sole general partner of our operating partnership, we have the exclusive power under the partnership agreement to manage and conduct its business. Since IROP's formation, IROP has issued 3,207,868 IROP units to unaffiliated third parties as part of the consideration to acquire 23 properties in five transactions, including 1,925,419 IROP units issued in connection with the TSRE acquisition. These IROP units are exchangeable for the equivalent number of shares of common stock or the equivalent value in cash, at our option, in defined circumstances. From IROP's formation through December 31, 2016, 298,919 IROP units held by unaffiliated third parties have been exchanged for 298,913 shares of our common stock with fractional units being settled in cash. From January 1, 2017 through March 1, 2017, 39,899 of IROP units held by unaffiliated third parties were exchanged for 39,899 shares of our common stock. As of December 31, 2016, 2,908,949 IROP units held by unaffiliated third parties were outstanding. As of March 1, 2017, 2,869,050 IROP units held by unaffiliated third parties were outstanding. We refer to these transactions as UPREIT transactions. Limited partners have certain limited approval and voting rights.

As described above under "Management Internalization," we became internally managed as of December 20, 2016. Prior to that, we were externally advised by our advisor, a RAIT subsidiary, pursuant to an advisory agreement and subject to the oversight of our board of directors. As described above, we acquired our advisor from RAIT as a result of the management internalization and terminated the advisory agreement. Our advisor was formed on March 26, 2009 and, prior to the management internalization, was responsible for managing our day-to-day business operations and identifying properties for us to acquire. We did not have any employees until the management internalization closed. See "Employees" below. Items of compensation and expense reimbursement we paid to our advisor prior to the management internalization are outlined below in Item 8-"Financial Statements and Supplementary Data—Note 9. Related Party Transactions and Arrangements."

As described above under "Management Internalization," we acquired the multifamily property management business of RAIT on December 20, 2016 in connection with the management internalization. We now operate that business in our wholly owned subsidiary, IRT Management, LLC, or IRT property manager, formed October 26, 2016. Prior to that, RAIT Residential, a RAIT subsidiary, was our property manager. In the management internalization, RAIT Residential transferred substantially all of its assets and certain of its liabilities to us and we hired substantially all of its employees. IRT property manager is a full-service apartment property management company that, as of

December 31, 2016, employs approximately 400 staff and professionals and manages approximately 15,000 apartment units, including 12,982 units owned by us. IRT property manager provides services to us in connection with the rental, leasing, operation and management of our properties.

Competition

In attracting and retaining residents to occupy our properties, we compete with numerous other housing alternatives. Our properties compete directly with other rental apartments as well as condominiums and single-family homes that are available for rent or purchase in the sub-markets in which our properties are located. Principal factors of competition include rent or price charged, attractiveness of the location and property and quality and breadth of services and amenities. If our competitors offer leases at rental rates below current market rates, or below the rental rates we currently charge our tenants, we may lose potential tenants.

The number of competitive properties relative to demand in a particular area has a material effect on our ability to lease apartment units at our properties and on the rents we charge. In certain sub-markets there exists an oversupply of single family homes and condominiums and a reduction of households, both of which affect the pricing and occupancy of our rental apartments. Additionally, we compete with other real estate investors, including other apartment REITs, pension and investment funds, partnerships and investment companies in acquiring, redeveloping and managing apartment properties. This competition affects our ability to acquire properties and the price that we pay for such acquisitions.

Employees

As of March 1, 2017, we had 395 employees and believe our relationships with our employees to be good. None of our employees are covered by a collective bargaining agreement.

Regulation

Our investments are subject to various federal, state, and local laws, ordinances, and regulations, including, among other things, zoning regulations, land use controls, environmental controls relating to air and water quality, noise pollution, and indirect environmental impacts such as increased motor vehicle activity. We believe that we have all permits and approvals necessary under current law to operate our investments.

Income Taxes

We have elected to be taxed as a REIT beginning with the taxable year ended December 31, 2011. Accordingly, we recorded no income tax expense for the years ended December 31, 2016, 2015, 2014 and 2013.

To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our ordinary taxable income to stockholders. As a REIT, we generally are not subject to federal income tax on taxable income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income taxes on our taxable income at regular corporate rates and will not be permitted to qualify for treatment as a REIT for federal income tax purposes for four years following the year during which qualification is lost unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and core funds from operations, or core FFO; however, we believe that we are organized and operate in such a manner as to qualify and maintain treatment as a REIT and intend to operate in such a manner so that we will remain qualified as a REIT for federal income tax purposes. For a discussion of the tax implications of our REIT status to us and our stockholders, see “Material U.S. Federal Income Tax Considerations” contained in Exhibit 99.1 to this Annual Report on Form 10-K.

The table below reconciles the differences between reported net income (loss), total taxable income and estimated REIT taxable income for the three years ended December 31, 2016 (dollars in thousands):

	For the Years Ended December 31		
	2016	2015	2014
Net Income	$(9,555)	$30,156	$2,944
Add (deduct):			