

EQUITY RESIDENTIAL

Form 10-Q

November 05, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended SEPTEMBER 30, 2015

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: 1-12252 (Equity Residential)

Commission File Number: 0-24920 (ERP Operating Limited Partnership)

EQUITY RESIDENTIAL

ERP OPERATING LIMITED PARTNERSHIP

(Exact name of registrant as specified in its charter)

Maryland (Equity Residential)

Illinois (ERP Operating Limited Partnership)

(State or other jurisdiction of incorporation or
organization)

13-3675988 (Equity Residential)

36-3894853 (ERP Operating Limited Partnership)

(I.R.S. Employer Identification No.)

Two North Riverside Plaza, Chicago, Illinois 60606

(Address of principal executive offices) (Zip Code)

(312) 474-1300

(Registrant's 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.

Equity Residential Yes No

ERP Operating Limited Partnership 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).

Equity Residential Yes No

ERP Operating Limited Partnership Yes No

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Equity Residential:

Large accelerated filer

Accelerated filer

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

Smaller reporting
company

ERP Operating Limited Partnership:

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 Exchange Act).

Equity Residential Yes No

ERP Operating Limited Partnership Yes No

The number of EQR Common Shares of Beneficial Interest, \$0.01 par value, outstanding on October 30, 2015 was 364,261,854.

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EXPLANATORY NOTE

This report combines the reports on Form 10-Q for the quarterly period ended September 30, 2015 of Equity Residential and ERP Operating Limited Partnership. Unless stated otherwise or the context otherwise requires, references to “EQR” mean Equity Residential, a Maryland real estate investment trust (“REIT”), and references to “ERPOP” mean ERP Operating Limited Partnership, an Illinois limited partnership. References to the “Company,” “we,” “us” or “our” mean collectively EQR, ERPOP and those entities/subsidiaries owned or controlled by EQR and/or ERPOP. References to the “Operating Partnership” mean collectively ERPOP and those entities/subsidiaries owned or controlled by ERPOP. The following chart illustrates the Company's and the Operating Partnership's corporate structure:

EQR is the general partner of, and as of September 30, 2015 owned an approximate 96.2% ownership interest in, ERPOP. The remaining 3.8% interest is owned by limited partners. As the sole general partner of ERPOP, EQR has exclusive control of ERPOP's day-to-day management.

The Company is structured as an umbrella partnership REIT (“UPREIT”) and EQR contributes all net proceeds from its various equity offerings to ERPOP. In return for those contributions, EQR receives a number of OP Units (see definition below) in ERPOP equal to the number of Common Shares it has issued in the equity offering. Contributions of properties to the Company can be structured as tax-deferred transactions through the issuance of OP Units in ERPOP, which is one of the reasons why the Company is structured in the manner shown above. Based on the terms of ERPOP's partnership agreement, OP Units can be exchanged with Common Shares on a one-for-one basis. The Company maintains a one-for-one relationship between the OP Units of ERPOP issued to EQR and the Common Shares.

The Company believes that combining the reports on Form 10-Q of EQR and ERPOP into this single report provides the following benefits:

- enhances investors' understanding of the Company and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;

- eliminates duplicative disclosure and provides a more streamlined and readable presentation since a substantial portion of the disclosure applies to both the Company and the Operating Partnership; and

- creates time and cost efficiencies through the preparation of one combined report instead of two separate reports.

Management operates the Company and the Operating Partnership as one business. The management of EQR consists of the same members as the management of ERPOP.

The Company believes it is important to understand the few differences between EQR and ERPOP in the context of how EQR and ERPOP operate as a consolidated company. All of the Company's property ownership, development and related business operations are conducted through the Operating Partnership and EQR has no material assets or liabilities other than its investment in ERPOP. EQR's primary function is acting as the general partner of ERPOP. EQR also issues equity from time to time and guarantees certain debt of ERPOP, as disclosed in this report. EQR does not have any indebtedness as all debt is incurred by the Operating Partnership. The Operating Partnership holds substantially all of the assets of the Company, including the Company's ownership interests in its joint ventures. The Operating Partnership conducts the operations of the business and is structured as a partnership with no publicly traded equity. Except for the net proceeds from equity offerings by EQR, which are contributed to

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the capital of ERPOP in exchange for additional limited partnership interests in ERPOP (“OP Units”) (on a one-for-one Common Share per OP Unit basis), the Operating Partnership generates all remaining capital required by the Company's business. These sources include the Operating Partnership's working capital, net cash provided by operating activities, borrowings under its revolving credit facility and/or commercial paper program, the issuance of secured and unsecured debt and equity securities and proceeds received from disposition of certain properties and joint ventures.

Shareholders' equity, partners' capital and noncontrolling interests are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The limited partners of the Operating Partnership are accounted for as partners' capital in the Operating Partnership's financial statements and as noncontrolling interests in the Company's financial statements. The noncontrolling interests in the Operating Partnership's financial statements include the interests of unaffiliated partners in various consolidated partnerships and development joint venture partners. The noncontrolling interests in the Company's financial statements include the same noncontrolling interests at the Operating Partnership level and limited partner OP Unit holders of the Operating Partnership. The differences between shareholders' equity and partners' capital result from differences in the equity issued at the Company and Operating Partnership levels.

To help investors understand the differences between the Company and the Operating Partnership, this report provides separate consolidated financial statements for the Company and the Operating Partnership; a single set of consolidated notes to such financial statements that includes separate discussions of each entity's debt, noncontrolling interests and shareholders' equity or partners' capital, as applicable; and a combined Management's Discussion and Analysis of Financial Condition and Results of Operations section that includes discrete information related to each entity.

This report also includes separate Part I, Item 4. Controls and Procedures sections and separate Exhibits 31 and 32 certifications for each of the Company and the Operating Partnership in order to establish that the requisite certifications have been made and that the Company and the Operating Partnership are compliant with Rule 13a-15 or Rule 15d-15 of the Securities Exchange Act of 1934 and 18 U.S.C. §1350.

In order to highlight the differences between the Company and the Operating Partnership, the separate sections in this report for the Company and the Operating Partnership specifically refer to the Company and the Operating Partnership. In the sections that combine disclosure of the Company and the Operating Partnership, this report refers to actions or holdings as being actions or holdings of the Company. Although the Operating Partnership is generally the entity that directly or indirectly enters into contracts and joint ventures and holds assets and debt, reference to the Company is appropriate because the Company is one business and the Company operates that business through the Operating Partnership.

As general partner with control of ERPOP, EQR consolidates ERPOP for financial reporting purposes, and EQR essentially has no assets or liabilities other than its investment in ERPOP. Therefore, the assets and liabilities of the Company and the Operating Partnership are the same on their respective financial statements. The separate discussions of the Company and the Operating Partnership in this report should be read in conjunction with each other to understand the results of the Company on a consolidated basis and how management operates the Company.

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CONSOLIDATED BALANCE SHEETS

(Amounts in thousands except for share amounts)

(Unaudited)

	September 30, 2015	December 31, 2014
ASSETS		
Investment in real estate		
Land	\$6,424,887	\$6,295,404
Depreciable property	20,540,247	19,851,504
Projects under development	1,039,657	1,343,919
Land held for development	154,690	184,556
Investment in real estate	28,159,481	27,675,383
Accumulated depreciation	(5,914,695)	(5,432,805)
Investment in real estate, net	22,244,786	22,242,578
Cash and cash equivalents	37,366	40,080
Investments in unconsolidated entities	74,108	105,434
Deposits – restricted	135,674	72,303
Escrow deposits – mortgage	54,071	48,085
Deferred financing costs, net	57,001	58,380
Other assets	405,798	383,754
Total assets	\$23,008,804	\$22,950,614
LIABILITIES AND EQUITY		
Liabilities:		
Mortgage notes payable	\$4,891,529	\$5,086,515
Notes, net	5,881,794	5,425,346
Line of credit and commercial paper	29,996	333,000
Accounts payable and accrued expenses	253,027	153,590
Accrued interest payable	86,083	89,540
Other liabilities	353,106	389,915
Security deposits	76,934	75,633
Distributions payable	209,086	188,566
Total liabilities	11,781,555	11,742,105
Commitments and contingencies		
Redeemable Noncontrolling Interests – Operating Partnership	522,585	500,733
Equity:		
Shareholders' equity:		
Preferred Shares of beneficial interest, \$0.01 par value; 100,000,000 shares authorized; 803,600 shares issued and outstanding as of September 30, 2015 and 1,000,000 shares issued and outstanding as of December 31, 2014	40,180	50,000
Common Shares of beneficial interest, \$0.01 par value; 1,000,000,000 shares authorized; 364,140,040 shares issued and outstanding as of September 30, 2015 and 362,855,454 shares issued and outstanding as of December 31, 2014	3,641	3,629
Paid in capital	8,584,143	8,536,340

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Retained earnings	2,007,590	1,950,639
Accumulated other comprehensive (loss)	(157,020) (172,152)
Total shareholders' equity	10,478,534	10,368,456
Noncontrolling Interests:		
Operating Partnership	221,487	214,411
Partially Owned Properties	4,643	124,909
Total Noncontrolling Interests	226,130	339,320
Total equity	10,704,664	10,707,776
Total liabilities and equity	\$23,008,804	\$22,950,614

See accompanying notes

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EQUITY RESIDENTIAL

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Amounts in thousands except per share data)

(Unaudited)

	Nine Months Ended September		Quarter Ended September	
	30,	2014	30,	2014
	2015		2015	
REVENUES				
Rental income	\$2,035,359	\$1,942,492	\$694,245	\$662,001
Fee and asset management	6,413	7,596	2,044	2,077
Total revenues	2,041,772	1,950,088	696,289	664,078
EXPENSES				
Property and maintenance	364,948	361,087	122,383	120,139
Real estate taxes and insurance	254,513	245,717	84,962	80,568
Property management	60,887	61,080	18,925	18,407
Fee and asset management	3,764	4,293	1,169	1,253
Depreciation	584,862	565,772	196,059	190,469
General and administrative	50,942	41,296	15,290	9,968
Total expenses	1,319,916	1,279,245	438,788	420,804
Operating income	721,856	670,843	257,501	243,274
Interest and other income	6,906	3,213	256	576
Other expenses	(2,839)	) (7,179)	) (1,139)	) (4,976)
Interest:				
Expense incurred, net	(333,622)	) (347,224)	) (114,205)	) (118,251)
Amortization of deferred financing costs	(7,734)	) (8,554)	) (2,607)	) (2,628)
Income before income and other taxes, income (loss) from investments				
in unconsolidated entities, net gain (loss) on sales of real estate properties and land parcels and discontinued operations	384,567	311,099	139,806	117,995
Income and other tax (expense) benefit	(698)	) (1,146)	) (329)	) (260)
Income (loss) from investments in unconsolidated entities	14,388	(10,201)	) (1,041)	) (1,176)
Net gain on sales of real estate properties	295,692	128,544	66,939	113,641
Net (loss) gain on sales of land parcels	(1)	) 1,846	—	1,052
Income from continuing operations	693,948	430,142	205,375	231,252
Discontinued operations, net	350	1,500	81	(62)
Net income	694,298	431,642	205,456	231,190
Net (income) attributable to Noncontrolling Interests:				
Operating Partnership	(26,191)	) (16,273)	) (7,778)	) (8,738)
Partially Owned Properties	(2,473)	) (1,800)	) (986)	) (708)
Net income attributable to controlling interests	665,634	413,569	196,692	221,744
Preferred distributions	(2,557)	) (3,109)	) (833)	) (1,037)
Premium on redemption of Preferred Shares	(2,789)) —	—	—
Net income available to Common Shares	\$660,288	\$410,460	\$195,859	\$220,707

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Earnings per share – basic:

Income from continuing operations available to Common Shares	\$1.82	\$1.13	\$0.54	\$0.61
Net income available to Common Shares	\$1.82	\$1.14	\$0.54	\$0.61
Weighted average Common Shares outstanding	363,386	360,900	363,579	361,409

Earnings per share – diluted:

Income from continuing operations available to Common Shares	\$1.80	\$1.13	\$0.53	\$0.61
Net income available to Common Shares	\$1.80	\$1.13	\$0.53	\$0.61
Weighted average Common Shares outstanding	380,423	377,228	380,663	377,954

Distributions declared per Common Share outstanding	\$1.6575	\$1.50	\$0.5525	\$0.50
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See accompanying notes

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EQUITY RESIDENTIAL

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (Continued)

(Amounts in thousands except per share data)

(Unaudited)

	Nine Months Ended September		Quarter Ended September	
	30,	2014	30,	2014
	2015		2015	
Comprehensive income:				
Net income	\$694,298	\$431,642	\$205,456	\$231,190
Other comprehensive income (loss):				
Other comprehensive income (loss) – derivative instruments:				
Unrealized holding gains (losses) arising during the period	1,796	(21,784)	1,908	97
Losses reclassified into earnings from other comprehensive income	13,647	12,606	4,736	4,271
Other comprehensive (loss) income – foreign currency:				
Currency translation adjustments arising during the period	(311)	(466)	191	(2,184)
Other comprehensive income (loss)	15,132	(9,644)	6,835	2,184
Comprehensive income	709,430	421,998	212,291	233,374
Comprehensive (income) attributable to Noncontrolling Interests	(29,244)	(17,705)	(9,025)	(9,530)
Comprehensive income attributable to controlling interests	\$680,186	\$404,293	\$203,266	\$223,844

See accompanying notes

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$694,298	\$431,642
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	584,862	565,772
Amortization of deferred financing costs	7,734	8,554
Amortization of above/below market leases	2,534	2,376
Amortization of discounts and premiums on debt	(7,718)	(8,750)
Amortization of deferred settlements on derivative instruments	13,483	12,205
Write-off of pursuit costs	2,322	2,067
(Income) loss from investments in unconsolidated entities	(14,388)	10,201
Distributions from unconsolidated entities – return on capital	3,564	4,557
Net (gain) on sale of investment securities	(387)	(57)
Net (gain) on sales of real estate properties	(295,692)	(128,544)
Net loss (gain) on sales of land parcels	1	(1,846)
Net (gain) on sales of discontinued operations	—	(223)
Realized/unrealized loss (gain) on derivative instruments	3,055	(66)
Compensation paid with Company Common Shares	29,269	24,647
Changes in assets and liabilities:		
(Increase) in deposits – restricted	(1,268)	(2,223)
Decrease in mortgage deposits	756	1,638
(Increase) decrease in other assets	(25,428)	3,854
Increase in accounts payable and accrued expenses	63,385	76,331
(Decrease) increase in accrued interest payable	(3,457)	8,163
Increase (decrease) in other liabilities	5,120	(173)
Increase in security deposits	1,301	4,146
Net cash provided by operating activities	1,063,346	1,014,271
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in real estate – acquisitions	(159,575)	(404,658)
Investment in real estate – development/other	(485,758)	(380,691)
Capital expenditures to real estate	(134,438)	(133,181)
Non-real estate capital additions	(2,384)	(2,446)
Interest capitalized for real estate and unconsolidated entities under development	(45,850)	(38,140)
Proceeds from disposition of real estate, net	457,499	224,538
Investments in unconsolidated entities	(22,998)	(14,568)
Distributions from unconsolidated entities – return of capital	45,245	77,042
Proceeds from sale of investment securities	387	57
(Increase) decrease in deposits on real estate acquisitions and investments, net	(62,433)	20,845
(Increase) decrease in mortgage deposits	(407)	560
Net cash (used for) investing activities		