Management Discussion Section

Operator

Welcome to the Armada Hoffler's First Quarter 2014 Earnings Conference Call. At this time, all participants are in a listen-only mode. After managements' prepared remarks, you'll be invited to participate in a question-and-answer session. [Operator Instructions] As a reminder, this conference call is being recorded today, Tuesday, May 13th, 2014.

I will now turn the conference over to Julie Loftus Trudell, Vice President of Investor Relations at Armada Hoffler.

Julie Loftus Trudell

Good morning, and thank you for joining Armada Hoffler's first quarter 2014 earnings conference call and webcast. With me this morning are Lou Haddad, CEO; and Mike O'Hara, CFO. In addition, Eric Smith, our Vice President of Operations will be available for questions.

The press release announcing our first quarter earnings along with our quarterly supplemental package was distributed this morning. A replay of this call will be available shortly after the conclusion of the call through June13th, 2014. The numbers to access the replay are provided in the earnings press release.

For those who listen to the rebroadcast of this presentation, we remind you that remarks made herein are as of today, May 13, 2014, and have not been updated subsequent to this initial earnings call.

During this call, we will make forward-looking including statements relating to the current and future performance of our portfolio. Our identified development pipeline and future pipeline, our construction business, our portfolio performance, and financing activities as well as comments on our outlook. We will also discuss certain non-GAAP financial measures, including but not limited to FFO, Core FFO and Core EBITDA.

Definition of these non-GAAP measures as well as reconciliation to most comparable GAAP measures, are included in the quarterly supplemental package, which is available on our website at www.armadahoffler.com.

Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict, and generally beyond our control. These risks and uncertainties can cause actual results to differ materially from our current expectations and we advise listeners to review the risk factors discussed in our press release this morning, and in documents that we have filed with or furnished to the SEC.

I would now like to turn the call over to our Chief Executive Officer, Lou Haddad.

Louis S. Haddad

Thanks Julie.

Good morning and welcome to our first quarter call. We are pleased with our solid start to the year.

This morning, we reported FFO per share of $0.20 and Core FFO per share of $0.22, which was better than our expectations.

The winter weather had less of an impact on our construction business than we had anticipated and our general and administrative costs were positively impacted largely due to timing.

We are encouraged by the attractive array of opportunities in our development pipeline and are excited by the volume of leasing activity that we are experiencing not only at Town Center but broadly across our portfolio.

Mike O'Hara will comment in detail about our financial results in a few minutes. Before I hand it off to him, I want to offer some additional color on recent development pipeline announcements, leasing activity at Town Center, and our third party construction business.

Let me start with our next generation pipeline.

We're seeing a high number of opportunities that are 100% occupied build-to-suits with high credit-quality tenants that are fully stabilized upon completion and grocery-anchored shopping centers that have historically been the foundation of our stable cash flow.

Such projects increase our spreads, as we are developing these at attractive return on cost metrics and these types of assets command lower market cap rates once completed.

In fact, this morning we announced two new projects in our next generation development pipeline.

We will develop two administrative office buildings for the Commonwealth of Virginia in Chesapeake and in Virginia Beach for a total of 47,000 square feet. The properties are 100% leased with 12-year leases for both locations. We expect both projects to be completed in early 2015.

In April we announced that we will develop Lightfoot Marketplace, a grocery-anchored shopping center in Williamsburg, Virginia as part of a joint venture partnership in which we are the majority partner.

We expect completion of phase one − consisting of approximately 88,000 square feet − in early 2016.We have signed a 20-year lease with Harris Teeter to anchor the center. We expect to begin construction in the third quarter of 2014. Phase two represents an opportunity to develop another 42,000 square feet in the future.

Such projects exemplify the development opportunities that result from deep and longstanding relationships in both the public and private sectors.

The Next Generation Pipeline is filling in nicely with the addition of these three projects combined with the Oceaneering project that we discussed on our last call.

Now, I would like to spend some time on our 175 million dollar Identified Development Pipeline.

The projects are on budget and progressing as expected. We kicked off the year with our January-close of the Liberty Apartments acquisition and we remain on track to deliver the remaining four development projects this year. The rollout at Liberty Apartments continues on track and currently we have about 35% of the units rented and about half of the retail space either leased, under letter of intent or in negotiation.

The delivery of 4525 Main Street here in Town Center will occur in early-June which is faster than our original timeline of late-July. This accelerated delivery date is evidence of the benefits of having our own captive general contractor.

We are pleased with this progress and believe these projects will ultimately generate NOI of 13-14 million dollars on an annual basis. This would represent NOI growth in excess of 30%.

We continue to employ all of the tools at our disposal to maintain the wholesale to retail spread on development projects.

These tools include structuring land acquisitions, managing the design process, acquiring municipal support through public / private partnerships, managing the construction process, and overseeing the timing and terms of the leasing process.

Turning now to Town Center.

As many of you recall, we have been working to bring a block of retailers to Town Center who will be unique to the region.

Along those lines, we have been holding vacant space off the market with the vision that - when coupled with 20,000 square feet of retail space at the new 4525 Main Street office tower – we could accommodate a host of strong national retailers, with co-tenancy requirements, who will further elevate Town Center as the premier address in the region.

To this end, I'm pleased to announce that we have signed a lease with Anthropologie for approximately 9,000 square feet at 4525 Main Street with an expected grand opening in the fourth quarter of 2014.

For those not familiar with this retail concept, Anthropologie is Urban Outfitters' strongest specialty brand. This will be their first and only store in South Eastern Virginia.

In addition, negotiations continue with the other tenants that comprise our retailing plan in Town Center. However, since we are working with national chains with multiple co-tenancy requirements, we reiterate our expectation that some of these leases will not be finalized until later in 2014.

It is important to note that if we had been quick to fill the vacancies at Town Center we would not have been able to secure Anthropologie and the complementary not-yet announced co-tenants. We look forward to upcoming announcements of other new and exciting retailers.

Turning to Construction.

We've had an exciting development in the third-party construction business this quarter.

We executed approximately 166 million dollars of new construction contracts.

In April, we announced that we entered into a contract to build Harbor Point, a 900,000 square foot tower in Baltimore, Maryland.

This contract was the culmination of a two-year pre-development effort. The reputation and experience that we've earned in Baltimore's Inner Harbor over the last two decades led to this important win.

The Harbor Point project will be a 20-story mixed-use development for Exelon Corporation located on Baltimore's waterfront adjacent to Harbor East. Construction is underway with completion expected in the spring of 2016.

The size and scope of this project helps to assure our construction division's annual gross profit contribution for the foreseeable future. However, the first phase of any construction project, prior to going vertical, always carries the most risk from a timing standpoint so we will not be changing our 2014 parameters for this segment of the business today.

While we are pleased to be off to a solid start this year, we know that we have a lot of work ahead. Execution will remain our focus this year and we know that our success in 2014 will be based on our ability to execute on the goals that we set for ourselves at the beginning of the year.

To reiterate, these goals include:

- Maintain stable portfolio occupancy in the mid-nineties.
- Deliver our development projects on time.
- Execute new leases for our pipeline projects.
- Execute on strategic and opportunistic acquisitions.
- Manage our balance sheet to ensure appropriate leverage metrics and position the Company for continued FFO growth.
- Execute contracts for third-party construction work with consistent segment profit.

We have made meaningful progress on some of these fronts as you've heard in my comments today and we look forward to sharing future updates on all of these execution metrics as the year progresses.

With that, I will ask Mike to walk you through some of the key financial and portfolio metrics contained in the first quarter supplemental package and then we will take questions you may have about this discussion during Q&A.

Mike…

Michael P. O'Hara

Thank you Lou. And good morning.

FFO for the first quarter was $.20 per share and our core FFO was $.22 per share.

The first quarter came in better than anticipated primarily due to the timing of G&A expenses and the fact that the winter weather had less of an impact on our construction business than we had anticipated.

We report Core FFO as we believe that core FFO is a more meaningful statistic in analyzing our business. Core FFO excludes certain items including, but not limited to, non-cash stock compensation expense and the effects from non-stabilized development projects. We add back non-cash stock compensation expense for those shares that were initially allocated from our public offering.

Our adjustments from FFO to Core FFO are illustrated on page 11 of the supplemental. And, as you can see, first quarter includes an FFO lease-up drag of 260,000 dollars from the Liberty Apartments.

During the first quarter we executed 8,000 sq. ft. of new leases and lease renewals of 50,000 sq. ft. Office re-leasing spreads were higher by $5.63 per square foot on a GAAP basis and higher by $.70 per square foot on a cash basis. These office re-leasing spreads reflect the latest renewal at Town Center. The retail re-leasing spreads were higher by $0.43 per square foot on a GAAP basis and lower by $0.64 per square foot on a cash basis.

Same store NOI for the quarter was flat on a GAAP basis and negative 200,000 dollars on cash basis.

The largest effect on cash same store NOI was in office. The primary reason was three months free rent included in the 15-year lease for the renewal and expansion of the 40,000 sq. ft. tenant at Town Center. This is the tenant we have discussed for the past couple of quarters. The free rent was included for the construction period of their space. During the first quarter our portfolio occupancy increased slightly to 94.5% from 94.4% at December 31, 2013.

On the construction front, we reported a segment gross profit, in the first quarter, of 1.25 million dollars on revenue of 19 million dollars. We executed approximately 166 million dollars of new contracts. The largest of the new contracts is the Harbor Point Tower, in Baltimore, as Lou discussed earlier. At the end of the first quarter, the Company had total construction backlog of approximately 193 million dollars.

Now turning to our balance sheet.

We continue to execute on our balance sheet strategy to provide the flexibility to fund our growth objectives in the most efficient and cost-effective manner, while managing upcoming loan maturities.

As for loan maturities, we have one loan maturing in 2014 with a balance of 1.0 million dollars and two in 2015 with combined balances of less than 10.0 million dollars. So over the next two years we have very little exposure.

Now turning to our development projects.

During the quarter we closed the construction loan to fund the Oceaneering project. The loan is for 4 years at LIBOR + 175. Interest only for two years.

On March 31st, we bought out the minority partner in Sandbridge Commons by issuing 30,000 OP Units valued at approximately 300,000 dollars in exchange for their 15%.

As discussed earlier, we purchased Liberty Apartments on January 17th for 30.7 million dollars. The purchase price consisted of issuing approximately 700,000 OP units, the repayment of a 3.0 million dollar mezzanine loan and the assumption of approximately 20.9 million dollars of debt that bears interest at 5.66% with 30-year amortization and maturity in 2043. The total consideration for this acquisition was 1.2 million dollars less than originally anticipated in our prospectus due to the value of the OP units issued as part of the consideration.

In April we closed on the Lightfoot Marketplace project. We plan on funding this project with a combination of a construction loan and our credit facility. This is a joint-venture project with preferred return on our equity.

At the end of the first quarter, we had total outstanding debt of approximately 317 million dollars, including 80 million dollars outstanding on the credit facility. Our core debt to annualized core EBITDA multiple at quarter end was 6.9 times. Our weighted average interest rate is 3.6% and average loan term to maturity is 9.7 years. Approximately 46% of our debt was fixed at March 31st but taking into account interest rates caps approximately 83% of our debt was fixed or hedged.

As discussed in the past we have been evaluating swap locks and purchasing additional caps for our variable rate loans.

In March we purchased a three year 50 million dollar LIBOR cap at 1.25%. With this new cap we now have in place 118 million dollars of LIBOR caps at or less than 1.50%.

We believe that using interest rate caps limits our exposure to raising rates while giving us flexibility at a reasonable cost.

Our goal is to maintain a balance sheet with an appropriate degree of flexibility to fund our growth strategies. Maintaining a balance sheet with adequate capacity and flexibility will allow us over time to facilitate access to a variety of capital sources at the most advantageous terms.

That said, we remind you that the relative size of our portfolio and development pipeline, as well as our financing model, may result in short term fluctuations in leverage metrics which do not incorporate the upside equity creation in our business.

Now let me give you an update on our thoughts for the remainder of 2014.

We continue to expect that our full-year 2014 Core FFO to be in-line with full-year 2013 FFO.

Once again, when analyzing our business we focus on Core FFO which excludes, among other items, the impact of non-stabilized development projects. Our core business is comprised of our stable properties and our construction business. This core business is a solid foundation for sustained growth.

We remain on track to deliver four development pipeline projects this year which will be excluded from our core FFO results.

These projects include:

1) 4525 Main Street
2) Greentree Shopping Center
3) Encore Apartments; and
4) Whetstone Apartments

Using history as our guide, we anticipate an 18 month stabilization period for multi-family. And therefore, the two multi-family projects − along with the Liberty Apartments − will have a negative impact on 2014 FFO results. Conversely, our shopping centers, office and retail properties are immediately accretive on an FFO basis due to the amount of preleasing we require as part of our underwriting criteria.

Non-stabilized projects in 2014 are expected to negatively impact FFO by approximately 1.5 million dollars, which we will exclude from Core FFO.

We expect the Liberty Apartments impact, on the second quarter, to be approximately 300,000 dollars, which will be excluded from Core FFO.

Another thing I want to point out, as it relates to the second quarter.

As you can see on page 23 of the supplemental, we expect substantial office TI and leasing commissions for leases affective in the second quarter 2014, which will impact AFFO.

We continue to expect G&A for the full-year 2014 to be approximately 7.8 million dollars. The first quarter G&A came in lower than expected because of timing of expenses and does not change our expectations for the full-year.

And now, construction.

With the new Harbor Point project and our current backlog we expect the third party construction business to generate segment profit of approximately 4.0 million dollars for full-year 2014.

As Lou mentioned the first phase on any construction project, prior to going vertical, always carries the most risk from a timing standpoint. This may influence the construction schedule and therefore the pace of profit recognition.

And finally our dividend.

Yesterday, we announced that the Board of Directors declared a cash dividend of $0.16 per share for the second quarter of 2014.

The dividend will be payable in cash on July 10th to stockholders of record on July 1st.

I'll now turn the call back to Lou.

Louis Haddad

Thank you, Mike. And thank you all for your time this morning and your interest in Armada Hoffler. Operator, we would like to begin the question-and-answer session.

Operator

Thank you. [Operator Instructions] Our first question comes from the line of Dave Rodgers with Robert W. Baird. Please proceed with your question.

David Rodgers

Yeah. Good morning, everybody. Lou, may be one for you just to start bigger picture question. Can you kind of give us a sense of kind of how the economic environment feels to you particularly in Southern Virginia, given the budget that got approved obviously late last year? You do have an economic impact of the region obviously, not necessarily directly to your portfolio.

But talk about with regard to Main Street office and the tenancy that's looking at that building and give us a sense, I guess if you can in terms of the overall economic environment that you're seeing today?

Louis S. Haddad

Thanks, Dave. Good morning. I thought it's hard for us not to be really optimistic at this point in time and then actually we're happy to be optimistic. The region is doing really well. We are seeing a tremendous amount of leasing activity really across all the sectors, multifamily, retail and office. Tours of all kinds have gone up dramatically in the last couple of months.

We're seeing robust activity to say the least. The key is to turn that into actual leases as quickly as possible. But right now we're really optimistic about what's happening here in our home market, as well as the opportunities that we're seeing with the development pipeline in the Raleigh-Durham area, as well as Baltimore. So, at this point in time, it's really encouraging to see all the activity.

David Rodgers

That's great. Really quickly, let me shift into the multi-family side. Can you give us an update on Liberty Apartments and kind of where that is in the lease process – any additional leases signed there? It doesn't sound like you expect much of traction in the second quarter. And then, maybe, shifting to the Cosmo, the occupancy slipped a little bit sequentially. Can you give us sense of kind of where you expect that to go?

Sure. Let's start with Liberty. The lease-up – as we mentioned upon the acquisition, we forecasted an 18-month lease-up. We're somewhat ahead of that. I'm not ready to spike the football yet. But right now, it is about 80 units leased, which is high-30s percent. It's really steady.

The shipyard – the Apprentice School admits – it's a rolling admission. And they admit about 25 people per month, fairly continuously throughout the year. So we expect that pace of two to four units per week to continue. And it's possible that we can keep this pace that we're at now, in which case it's going to be somewhat quicker than we thought. But I'm not ready to say that. It's just too early in the process. But it certainly is a good start.

With Cosmopolitan, really pleased with the activity that's going on there. Since the quarter ended, we picked up another few points of occupancy. It's in 93% leased range, now – I'm sorry – 93% occupied and nearly 96% leased. Again, I'm not ready to declare victory. We really need to see what happens when Encore comes online later on this summer. Certainly, its good trend to see. There's a lot of interest in the new facility and we'll see how many people actually decide to switch over and move next door.

David Rodgers

Great. And maybe lastly for Mike, I think you've got about $120 million to complete all the developments that are kind of in the pipeline today and I know those don't all fall to this year, but it will be multiyear spend in some cases. But can you kind of talk about the plan to make up the difference in the cash needed for the development?

David, let me start with adding and then I'll Mike answer more specifically. The question -- I'm really glad that you asked because it seems to be hanging out there. Listen, we're going to manage our balance sheet in a very thoughtful manner. As we've said over and over again, we are by far the largest investor in this endeavor.

We're creating significant value through the development process. If you look at our supplemental, I think its page 35, it shows you that our development pipeline and the fact that we're creating in our mind and on paper and in reality in not too distant future, some $50 million to $60 million worth of value.

Now, our goal is to have the current shareholders, ourselves included, enjoy as much of that value as humanly possible and that's where we're going to manage this thing. So when we decide to pull whichever, whoever is -- that's available to us, it's going to dictate how much of that value goes to the current shareholders and how much goes elsewhere? Elsewhere being in the form of assets sales or sale of our development pipeline projects, obviously a capital raise or bringing in joint venture. But the goal again is to toe that line and straddle that line that rewards the current shareholders are hanging there with us and still positions the company for future growth. So we'll be looking at that very quickly, very closely over the next few quarters. Mike, do you have anything to add to that?

Michael O'Hara

Yeah. I'll just reiterate Dave that we will continue down what we've done in the past in new things going after construction loans and that you've seen by the spreads and the terms we get the blend is very aggressive, using our credit facility. And then implement whatever tools are necessary in order to keep the leverage in check going forward.

David Rodgers

Okay. Thanks for the color this morning.

Thank you, Dave.

Operator

Thank you. [Operator Instructions] Our next question comes from the line of Craig Kucera with Wunderlich Securities. Please proceed with your questions.

Craig Kucera

Yeah. Good morning, guys.

Good morning, Craig.

Craig Kucera

You had a big pick up in development this quarter and I wonder if you could give a little bit more color on sort of where you see capacity or internally what's the amount of projects that you think you could have, you got a pretty sizable amount at close to 200 million of backlog. I think you put about 166 million up near this quarter. How much could you do and can you also give us some color on maybe some of the projects that you look at, that you didn't win?

Okay. Let's talk about – I want to make sure it's clear on the phone because you had mentioned two different things, there are two different sectors in our business. The $166 million contract is in our construction division. That division is set up and obviously has been running for the last three decades to perform somewhere between 200 and $300 million worth of projects on an annual basis, and all of the people are in place to do that.

Now again, construction backlog isn't a one year thing, that $166 million will go well into 2015 and back into the spring of 2016. So if there really isn't a capacity problem there, we'll be finishing several projects both on the construction side and development side in the next couple of quarters. We look forward to announcing more construction projects beyond that.

In terms of the development side, the developments, it's somewhat interesting and that you can pretty much time in your process. We don't try and go at break neck speed to get these things started, that's when we talk about those leverage that we pull. We're very careful to ensure the spread.

So what you see is us announcing new development deals. It maybe a year, year and half before some of those actually starts; some of them very quick to build-to-suit projects which obviously are much easier in terms of planning.

So long answer to a short question Craig, but we have capacity in-house to handle everything that we're talking about now, as well as few things that we're looking at in the future. And these things have a way of working out on the timeline to be pretty much seamless, that's been our experience for a last couple of decades. In terms of projects we've lost, I have to tell you, we don't play nicely in the sand box. We typically do not compete for projects, the projects that we get are pretty much the result of longstanding relationships for steady state institutions or what have you.

It's really difficult to compete on a development project on a monetary basis. It's just not a game we want to be in, I mean, basically you have to sacrifice your spread. We see a lot of people do that sort of thing in order to keep their people busy. We are much more jealous of what's going on with our balance sheet than to just do it for practice. So, again a long answer to a short question. I don't recall any project in recent memory at least last four quarters that we were unsuccessful at getting.

There's been a few that we threw back, because it just didn't meet our spreads. As a matter of fact, a couple of projects that we have high hopes for in the next generation pipeline may not happen, because we feel that our spreads are getting squeezed and it just doesn't work to us, to react on.

Craig Kucera

Got it. I guess, maybe I'll rephrase it in a different way and I appreciate the color. Are you seeing more demand for your services, are you seeing more sort of as a reflection of sort of new supply in markets that you guys are currently active, are you – and it doesn't sound like that's necessarily the case, it sounds like you just went after the ones that you wanted?

We're seeing a lot more opportunities than we have probably coming out of the recession we were starting at the bottom, right in 2008. It's been a pretty slow ramp that seems to be gathering momentum for us, and again, as micro-economy in our market sample of one, what's happening here is that activity gone to fewer pitch which is really good on one hand, because you can kind of cherry-pick the things that you want to actually perform. On the other hand, you have to be really careful about wasting time on things that aren't going to head [indiscernible].

Craig Kucera

Are you seeing any change in cap rates as you see that driving any sort of activity?

We're seeing lot of people change, what we term as stupid money for assets out there and we may well take advantage of that as time goes on. So, I think real estates has comeback with a vengeance in those terms, obviously that's good news for us.

Craig Kucera

Okay. Thanks.

Operator

Thank you. Our next question comes from the line of Daniel MacInnis with Raymond James. Please proceed with your question.

Daniel MacInnis

Hey, good morning, guys. I wanted to touch on the retail segment here, so -- flat occupancy sequential yet same-store NOI was up 6% year-over-year. Just wanted to get more color on what that was comprised of? How much of that is due to the inclusion of the Tyre Neck Harris Teeter?

Michael P. O'Hara

Good morning. This is Michael O'Hara. Couple of things equate into our retail. One is in 2014 for the year for the first time we get some percent rent. Cheesecake Factory here at Town Center priced is point any percent rent accumulated went towards TIs [ph] that they put in place something that. The other thing [ph] is 2013, we had a onetime expense, the year expense for 2013 we didn't replicate in 2014.

Daniel MacInnis

Okay, great. Thanks. Also just wanted to quickly touch on the G&A, so you guys quickly said that the timing was part of the G&A being lower than I guess expected, but even if I did the 2 million as a run rate on that 8 million, which is above the guidance that you guys provided. So how am I gained to the 7.8, what timing are we talking about exactly on the G&A and how that effects the quarters going forward?

We still feel good about the 7.8 million and I think its part of the run rate. First quarter is higher, we know it would be higher, so I think you could see – I think the run rate if you take, you know, the remaining between the 7.8 what was spent that will be pretty close around or across the quarters. You know, we've talked about its timing, you know, a lot of it had to do with mostly from professional fees standpoint on internal audit, tax returns, lawyers etcetera that we budgeted in the first quarter that take a push back.

Daniel MacInnis

Okay, great. Thanks guys.

Operator

Thank you. Our next question is a follow-up from the line of Dave Rodgers with Robert W. Baird. Please proceed with your question.

Dave Rodgers

Yeah, Mike, maybe one more for you, on the development dilution 1.5 million add back to your Core FFO that you talked about for the year, I think you did 260 in the first quarter, you said 300,000 for the second. It sounds like -- out of the second half of the year breakout in terms of that drag?

Yeah. The bulk of its going to start hitting on Encore and Whetstone come online, its somewhere in the August-September range. So, the biggest impact is going to be fourth quarter.

Dave Rodgers

Okay. That's helpful. Thank you.

Operator

There are no further questions at this time. Mr. Haddad, I'd like to turn the call back to you for closing comments.

Louis S. Haddad

Thank you, all of you. We appreciate your interest in our company and we look forward to updating you on our activities and results in the coming quarters.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time, and have a wonderful day. We thank you for your participation.