Armada Hoffler Properties, Inc.
Second Quarter of 2014 Conference Call
August 5, 2014

Operator: Greetings. Welcome to Armada Hoffler's Second Quarter 2014 Earnings Conference Call. At this time, all participants are in a listen-only mode. After Management's prepared remarks you'll be invited to participate in a question and answer session. At that time, if you have a question, please press star, one on your telephone. As a reminder, this conference call is being recorded today, Tuesday, August 5th, 2014.

I will now turn the conference over—to the call—to Ms. Julie Loftus Trudell, Vice President of Investor Relations at Armada Hoffler. Please go ahead, ma'am.

Julie Loftus Trudell: Good morning and thank you for joining Armada Hoffler's second 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 second quarter earnings along with our quarterly supplemental package was distributed this morning.

The press release announcing the arrival of five national retailers to Town Center, which completes the co-tenancy requirement for the anchor tenant, Anthropologie, was also distributed this morning.

A replay of this call will be available shortly after the conclusion of the call through September 5, 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 the remarks made herein are as of today, August 5, 2014, will not be updated subsequent to this initial earnings call.

During this call, we will make forward-looking statements, including statements related to the current and future performance of our portfolio, our identified development pipeline and future pipeline, impact of acquisitions, our construction business, our portfolio performance and financing activities as well as comments on our outlook.
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 we have filed with or furnished to the SEC.

We also will discuss certain non-GAAP financial measures, including but not limited to FFO, Core FFO and Core EBITDA. Definitions of these non-GAAP measures, as well as reconciliations to the most comparable GAAP measures, are included in the quarterly supplemental package, which is available on our website at www.armadahoffler.com.

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

Louis S. Haddad: Thanks Julie. Good morning and thank you for joining our call today.

We continue to be very pleased by the performance of our Company and grow even more optimistic about the future.

This morning, we reported another solid quarter with FFO per share of $0.19 and Core FFO per share of $0.21, which was in line with our expectations. We raised our 2014 outlook and are enthusiastic about the second-half of the year.

This is a very exciting time for our company as each of our three divisions is firing on all cylinders.

We are executing on the goals we laid out at the beginning of 2014 and, while only mid-way through the year, have made significant headway.

I’m going to take the next few minutes to run through these goals with an update on our progress.

In 2014, we set out to execute new leases for pipeline projects as well as our stable portfolio. We are doing just that.

We are delighted to announce that we have rounded out the co-tenancy requirement for our anchor retail tenant at 4525 Main Street, Anthropologie, and have completed our retail plan for this fifth phase of the Town Center here in Virginia Beach.

As you may remember from previous earnings calls, we made deliberate choices regarding certain vacancies – in some cases holding space off the market – in order to allow our retail plan to play out.

Now, I'm am pleased to report that this group of exciting new tenants coming to Town Center will create meaningful long-term value for our shareholders across a number of metrics including – occupancy, NOI, retail same-store sales, and tenant credit quality.

As detailed in a press release this morning, West Elm, Free People, lululemon, Francesca's and Tupelo Honey Cafe have signed leases for retail space at Town Center.

West Elm and Tupelo Honey Cafe will complement Anthropologie, at the base of the newly constructed 4525 Main Street tower, bringing the retail space in that new building to 100% leased.

Free People, lululemon and Francesca's will be across the street in the South Retail property of Town Center.

Like Anthropologie, this will be West Elm, Free People, lululemon and Tupelo Honey Cafe's first and only locations in Southeastern, Virginia.

We believe the addition of this first class roster of retailers further demonstrates what we've known for years – that Town Center is the premier address in the region.

Negotiations continue for 20,000 square feet of Town Center retail space that - once signed – will result in virtually 100% retail occupancy in Town Center.

As for the office portion of 4525 Main Street, our two anchor tenants, Clark Nexson and the City of Virginia Beach have both moved in bringing the occupancy to over 50%.

In addition to the success with Town Center retail leasing, we are seeing significant momentum at our multi-family development projects.

The rollout at Liberty Apartments – the first project, which we delivered in the beginning of 2014 - is ahead of schedule with approximately 60% of the units leased and about half of the retail space either leased, under letter of intent or in negotiation.

Lastly, lease negotiations with a handful of retail tenants outside of Town Center are coming to a close, at which time our retail portfolio occupancy will be in the high nineties.

In 2014 we set out to execute on strategic and opportunistic acquisitions. We did just that.

Yesterday we announced that we entered into an agreement to acquire Dimmock Square – a retail power center located in Colonial Heights, Virginia just south of Richmond.

This acquisition is an outstanding addition to our portfolio, representing a best-in-class power center, in a contiguous market.

The acquisition of Dimmock Square will add over 100,000 square feet of 100% occupied retail space to our portfolio.

Current tenants at Dimmock Square include Best Buy, Pier 1, Old Navy, Dress Barn and Shoe Carnival amongst others. The center is strategically situated between the 900,000 square foot Southpark Mall and a Walmart Supercenter.

The definitive agreement provides that we will acquire a 100% interest in Dimmock Square in exchange for approximately 990,000 of operating partnership units and approximately $10 million of cash.

We successfully deployed OP units in this transaction, increasing the capital base and generating earnings for shareholders.

We believe the acquisition will be accretive to annual FFO per diluted share and is expected to close in the current quarter.

This opportunity was born out of a deep and longstanding relationship and we will continue to pursue such strategic and opportunistic acquisitions in the future.

In 2014, we set out to maintain stable portfolio occupancy in the mid-nineties. And we are doing just that.

In the second quarter our portfolio occupancy increased slightly to 94.6% from 94.5% at March 31st. We believe these figures and their trajectory for the latter half of this year represent the significant time and attention our asset management team gives to not only leasing vacant office and retail space but retaining tenants as well.

We have already discussed the leasing success in our retail portfolio. In addition, I should note the trajectory of our multifamily occupancy. With construction complete next door to the Cosmopolitan apartments in Town Center, occupancy has not only rebounded but is peaking at about 95% as of today - its highest level since the project was launched.

When combined with historically strong occupancy at Smith's Landing apartments, we expect multifamily occupancy to be in the mid-to-high nineties in the latter half of this year as well.

In 2014, our goal was to deliver the development projects on time. And we are doing just that.

Our development projects are on budget and progressing as expected.

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

We remain on track to deliver the remaining 2014 development projects in the second half of the year. Mike will detail these in a moment.

In 2014, we set out to execute contracts for third party construction work with consistent segment profit. And we did just that.

In the spring we announced that we entered into a contract to build The Harbor Point project – a 20-story mixed-use tower for Exelon Corporation. Work on this project - located on Baltimore's waterfront adjacent to Harbor East – is underway with completion expected in the spring of 2016.

While the first phase of any construction project always carries the most risk from a timing standpoint we are tracking on schedule.
We believe the size and scope of this project will help to drive our construction division's annual gross profit contribution in the coming years.

As evidenced by the noted accomplishments - our team has a lot to be proud of.

At this point, I would like to transition from our accomplishments and provide you additional color on our longer term strategy.

We are currently in the process of our budget planning for 2015 so it's a bit early to be precise on our expectations for next year. However, I would like to provide you a roadmap of our longer-term strategy over the next three to five years.

Outlook 2014 – Long – Term Strategy
Our long-term strategy is simple – continue to grow NOI.

- Through organic NOI growth in our stable portfolio;
- Through our development pipeline projects;
- Through our third party construction gross profits; and
- Through strategic acquisitions.

When combined with measured decisions about our corporate metrics and balance sheet – we are focused on ensuring that our future NOI growth will translate into healthy FFO per share growth over time.

Let me discuss each of these drivers of growth individually.

While we enjoy organic growth from contractual rent bumps consistent with our competitors, we recognize that our same-store NOI growth is somewhat limited by our high occupancy levels. This is a situation we're happy to be in as it means that our assets are well positioned, sought after by tenants, and should be valued at lower relative cap rates.

Turning to our 3rd party construction division. In addition to sourcing development opportunities, as well as controlling costs and timely delivery of development projects, the gross profits from this business has been a reliable source of income year in and year out.

As we've discussed, the construction division provides a unique opportunity to project our brand and capabilities throughout the marketplace.

Historically the construction business contributed approximately $4 million of gross profit annually. We believe that in 2014 - and for the next couple of years - this 4 million dollar run-rate will be the low-end of our range.

Our development pipeline is a key driver of future growth.

In our supplemental package this quarter you can see that there are approximately 230 million dollars of development pipeline projects marching through our identified and next generation pipeline – which we'll together refer to, going forward, as simply our development pipeline.

This figure will ultimately be closer to $300 million once we include the Johns Hopkins project that we've previously discussed and continue to finalize.

We have historically discussed the value creation from our pipeline projects in terms of equity creation from our wholesale to retail spread.

We strive to maintain this spread with all of the development and construction tools we've previously discussed, including - structuring land acquisitions, managing the design process, acquiring municipal support through public / private partnerships, and managing the construction process.

This same value creation can be quantified through NOI. Assuming the inclusion of Johns Hopkins, we expect in excess of $25 million of NOI from these development projects once they are all stabilized, which is in excess of 60% growth over 2014 NOI.

We expect approximately one-third of the $25 million of NOI to come online in 2015 with the remainder in 2016 and 2017 as the development projects stabilize.

Over time, we are looking forward to continue developing $150 to $175 million of assets every 18 to 24 months.

As a complement to growth from our development pipeline, we are committed to strategic acquisitions.

The recently announced acquisition of Dimmock Square is a great example of an opportunity where we were able to take advantage of a long-standing relationship while utilizing our operating partnership units as currency to ensure both top line revenue growth and accretive FFO per share metrics.

We look forward to augmenting the stable income from our business with accretive acquisitions.

In the context of our long-term strategy, let me now touch on the last annual goal we laid out for 2014 – to manage the balance sheet to ensure appropriate leverage metrics and position the Company for continued FFO growth.

The translation of this NOI to FFO per share will come through prudent balance sheet management.

We believe we continue to have all the levers at our disposal that we've previously discussed - including potential equity raises, dispositions, acquisitions with OP Units, sale of pipeline projects and joint ventures - and subject to market conditions and other factors, we expect to use them appropriately to provide value to our shareholders. This is important to us as we, and our former partners, represent approximately 40% of the ownership of the Company.

As a result, we are continuing our long-standing strategy of selling single tenant assets from time-to-time.

Across our stable portfolio and pipeline, we have a half dozen such assets with a majority of these existing within our development pipeline and not yet delivered.

To this end, we have entered into an agreement to sell the Virginia Natural Gas office building – which we can see from our Town Center offices - for approximately 8.9 million dollars which represents a cap rate of approximately six-and-a-quarter percent. The Company will net approximately $7.7 million after tax protection payments and other disposition costs.

We believe that investors should focus on this transaction as it relates to company valuation given the proximity of this property to Town Center.
With that, I will ask Mike to walk you through some of the key financial and portfolio metrics contained in the second 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. Good morning everyone.

Today I want to cover the highlights of the quarter including a discussion on our balance sheet and insight into the Dimmock Square acquisition. I'll wrap up with an overview of our updated 2014 outlook.

FFO for the second quarter was $.19 per share and core FFO was $.21 per share. The second quarter was in line with our expectations.

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 package. These adjustment includes a reduction to second quarter FFO of $300,000 from non-stabilized development projects.

During the second quarter we executed approximately 49,000 sq. ft. of new and renewal office and retail leases.

This does not include the leasing activity at 4525 Main Street and our other development projects.
Office re-leasing spreads for the quarter were higher by $.79 per square foot on a GAAP basis and lower by $2.18 per square foot on a cash basis. The retail re-leasing spreads were higher by $.81 per square foot on a GAAP basis and lower by $.46 per square foot on a cash basis.

Same store NOI for the quarter was positive 62 thousand dollars or .7% on a GAAP basis and negative 43 thousand dollars or .5% on a cash basis. These numbers do not include the leasing activity Lou discussed earlier.

During the second quarter our portfolio occupancy increased slightly from 94.5% at March 31st to 94.6%.

Along with this increased leasing activity comes TI and leasing commissions, which will impact AFFO over the next couple of quarters. The projected cost of this leasing is approximately $4.0 million - as outlined in the supplemental package – of which approximately $1 million impacted the second quarter.

The cost related to the recent leasing activity are higher than our long-term run rate for tenant leasing outlays and the return on cost associated with these leases are creating value for our stockholders.

On the construction front, we reported a segment gross profit, in the second quarter, of 1.1 million dollars on revenue of 20 million dollars.

During the quarter we executed approximately 6.0 million dollars of new contracts and at the end of the second quarter the Company had total construction backlog of approximately 179 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 little exposure through 2015 as we have one loan maturing in 2014 with a balance of $1.0 million and two loans maturing in 2015 with combined balances of less than $9 million.

At the end of the second quarter, we had total outstanding debt of $350 million, including $88 million outstanding on our credit facility.

Our core debt to annualized core EBITDA multiple at quarter end was 7.0 times. Our weighted average interest rate is 3.5% and average loan term to maturity is 8.9 years.

Approximately 42% of our debt was fixed at June 30th and taking into account interest rates caps approximately 75% of our debt was fixed or hedged. Please see page 14 of the supplemental package for the details of our interest rate caps.

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

As our development projects ramp up and start to come on line we are evaluating our leverage metrics and our ratio of fixed rate debt to overall debt. The first step we are taking to reposition our balance sheet is the disposition of an asset.

We announced that we are selling the VNG building and using the net proceeds of approximately $7.7 million to pay down credit facility. We are also evaluating other dispositions.

Now, turning to the Dimmock acquisition.

We are acquiring 100% interest in the LLC that owns the Dimmock Square shopping center in exchange for 10 million in cash and issuing approximately 990 thousand OP Units.

We expect to close on this transaction during the third quarter. Assuming a mid-third quarter closing, this acquisition will add approximately $470,000 to FFO in 2014 and the time weighted share impact for third quarter will be 500 thousand shares.

Now let me walk you through our updated full-year 2014 outlook:

We raised our full-year 2014 total Core FFO outlook, which excludes the impact from non-stabilized projects and non-cash compensation expense, to approximately $27.5 million from the previous expectation, which was in-line with the full-year 2013 Core FFO - approximately $26.5 million.

This includes the impact from the Dimmock Square acquisition, as I just discussed, which we expect to positively impact Core FFO by approximately $470,000, assuming a mid-third quarter 2014 closing.

We remain on track to deliver five development projects this year which will be excluded from our Core FFO results. These projects include:

- Greentree Shopping Center – During the second quarter we turned over the pad to WAWA
- The Encore Apartments – which is expected to open in the first week of September; and
- The Whetstone Apartments which are expected to open in mid-September;
- This is in addition to the already delivered 4525 Main Street – delivered in June 2014; and
- Liberty Apartments, which were completed and acquired in January 2014.

Based on the leasing activity we are experiencing, we now expect the negative impact from non-stabilized projects on FFO in 2014 to be $1.0 million, down from the previous expectations of $1.5 million,

In addition, we lowered our expected full-year 2014 G&A expenses to approximately $7.6 million compared to $7.8 million previously, which includes $750,000 of non-cash comp which we will add back for core FFO.

And lastly, we increased the third party construction company annual segment gross profit to approximately $4.3 million from the previous expectations of $4.0 million. The increase reflects the impact of the $170 million of new contracts, signed in 2014, which begin in earnest later this year.

And finally our dividend.

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

The dividend will be payable in cash on October 9th to stockholders of record on October 1st.

I'll now turn the call back to Lou.

Louis S. Haddad: Thank you, Mike. As I hope we communicated on this call, we're doing exactly what we said we were going to do and are ahead of schedule and feel great about where we are going.

Thank you 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. Ladies and gentlemen, if you have a question at this time, please press star, one on your telephone keypad. If your question has been answered and you wish to withdraw it, you may do so by pressing star, two. If you're using a speakerphone today, please pick up your handset before entering your request. Once again, that's star, one at this time. One moment while we poll for our first question.

Our first question comes from John Guinee with Stifel. Please proceed with your question.

John Guinee: So, John Guinee here. Thank you. A couple of questions; first, looks to me, Lou, as if you've got basically the third-party GC work is largely Inner Harbor East and then Johns Hopkins, and the rest of it is just sort of cleanup. Is this what we should expect, sort of a couple—maybe one big deal announced every year for the third-party GC business?

Louis S. Haddad: Thanks, John. I'd like to clarify that. The Johns Hopkins engagement is a development engagement. We will own that facility and therefore there won't be any construction profit involved in it. The Exelon project is a little bit of an outlier, but not a whole lot. You're very intuitive. Our—we're a Company that specializes in large complex deals and so we seem to be able to attract these couple hundred million dollar projects on a regular basis. I don't know about once every year, but it seems much more like once every couple of years, but you'll see those augmented by deals that are more in our sweet spot of 20 to $50 million along the way.

John Guinee: Okay. So Johns Hopkins, the one up there on Charles Street is actually a in-house development deal versus the third-party GC deal?

Louis S. Haddad: Correct.

John Guinee: Okay. Then, Exelon you think you can get something of that magnitude every couple of years?

Louis S. Haddad: It seems that way, John, whether it's the Swedish Embassy about four years ago, the Four Seasons Hotel a couple of years ago, Legg Mason's world headquarters. It—I don't want to—we certainly don't want to promise it, but it certainly has been the history.

John Guinee: Got you. Okay. Then, if I'm looking up, I guess, Mike, at Page 34, what's the—what portion of your Liberty—what portion of the ultimate, I guess, 2 million of stabilized NOI, how much of it was in place in 2Q and how much more should we expect before it stabilizes?

Michael P. O'Hara: Good morning, John. Liberty actually had negative NOI during the second quarter. We expect that to turn positive on NOI basis for—during the third quarter, but for the entire year it's still going to be negative from an FFO standpoint.

John Guinee: Okay. How about from an NOI standpoint, just, you know, unlevered cash NOI on the project?

Louis S. Haddad: John, I…

John Guinee: Let me rephrase it. When does Liberty stabilize on a cash NOI basis?

Louis S. Haddad: We're looking for stabilization midway through next year. As we reported earlier, we always project about 18 months for our multifamily projects to lease up. That's been our history. This one is tracking a little bit ahead of that, and as we reported this morning, obviously with 60% leased and we're only seven months into it; however, we've learned not to take the victory lap on that too soon so we're sticking with midyear '15 for stabilization and recognition of the NOI that you referred to.

John Guinee: Okay. Then, how does the map work? Is it—if this is a $2 million stabilized NOI and you said you were negative for the second quarter, I would've expected Page 11 from Core FFO to—from NAREIT to Core FFO to have more than a $300,000 adjustment.

Michael P. O'Hara: John, Liberty Apartments on its own was approximately negative drag of around $380,000 during the quarter, but we had some income offset that from our first couple of tenants. We had the City of Virginia Beach move into 4525 Main Street, for instance.

John Guinee: Okay. So it offset slightly by initial occupancy of 4525?

Michael P. O'Hara: Correct.

John Guinee: Okay. Then just what's the pricing on Dimmock Square? What's the sort of a cap rate price per pound? How do you underwrite that?

Louis S. Haddad: Great question, John. I'm going to turn that over to Eric Smith who headed up our Acquisition Team on that, but before I do, I want to talk a little bit about Dimmock Square and why we're so excited about it. We mentioned in our release that this is a best-in-class power center in that submarket. That submarket's contiguous to our home market—it's about an hour from my house, actually—and has traditionally been very strong retail wise. This Center is equidistant from a very strong mall and a Walmart Supercenter, and it's been 100% leased essentially forever.

A good indicator of its strength is Best Buy. Many of you may be familiar with what's going on at Best Buy, and while it's a $10 billion retailer with $3 billion in cash, over the last couple of years it's been downsizing, shedding unprofitable stores and renewing for less square footage in a number of locations. This year they re-upped for five additional years at the full 30,000 square foot size at Dimmock Square. That gives you a good idea of the strength of that market. Eric?

Eric L. Smith: Thanks, Lou. Good morning, John. The—a little bit of detail on the transaction. We obviously are thinking, as Lou mentioned in his prepared remarks—we're excited about it in the fact that it came out of a long-standing relationship, we have the use of OP units as currency in the transaction and the fact that it's attractively levered right upon confirmation of the transaction.

As we think about this acquisition and future acquisitions as well, we're obviously looking to create value and be judged (ph) primarily on an FFO per share and NAV per share basis, and this acquisition does just that. When we were negotiating with the sellers, they obviously took a look at the stock price and were seeing a stock price in the mid-$9 range or so during negotiations. We actually—in the context of that dialogue, they looked at our OP units and valued them slightly higher, just shy of $10, around the 9.75 range; and in doing so, if you look at the number of OP units, that price level combined with a $10 million cash outlay—it was mentioned earlier—that would imply a cap rate on this asset first (ph) cap rate in the low 8% range.

Obviously, if you put a higher valuation on those OP units, that would of course lower that implied cap rate since the two move inversely, but at the end of the day we're very pleased with it. We were able to raise capital at the cost that allowed us to execute on the accretive transaction and grow FFO and NAV per share with this deal, and we think that that's great for our stockholders.

John Guinee: Got you. So it's next to SouthPark Mall, which is a CBL-owned mall that does about 330 a square, I think.

Eric L. Smith: Yes. Yes. According to the data I have at 97% occupied, we're real pleased with our retail corridor there in Colonial Heights. You know, the one, three, and five statistics are all solid on both households, as well as net income. I think all three radiuses are north of 55,000 and a one-mile north of 65,000 of average household income, and then the vacancy rates in that Colonial Heights corridor as well as the in-line retail rental rates compared extremely favorably as compared to the larger Richmond market overall.

John Guinee: Okay. Okay. Let me just go back to Michael real quick. I'm just getting the map wrong on this, I think. Is—if I'm looking at Liberty, what's this stabilized NOI, because I'm sort of surprised to hear a 380 negative in the second quarter with a $2 million stabilized NOI. Is 2 million the wrong number for Liberty?

Michael P. O'Hara: I think it's around 2 million once fully stabilized in the retail, and, John, what I was saying on the negative 380, that wasn't NOI; that was FFO for the quarter.

John Guinee: Okay. Got you. Oh, I see. I see. All right. Then lastly, Lou, can you kind of walkthrough—I guess you've got half of the six leases you signed—Anthropologie and then the five others—three of them are going into the new building that's under construction. Now, which block is that again?

Louis S. Haddad: That's Block 11. That's 4525 Main Street and those three tenants end up being 100% of the ground floor space. As a matter of fact, they ended up being 105% of the ground-floor space. We had to reclaim back some from the parking garage from the city.

John Guinee: Okay. So how many square feet are those three tenants taking on Block 11?

Louis S. Haddad: It's about 26,000 feet, John.

John Guinee: Okay. Then the other three tenants are going into which block?

Louis S. Haddad: That's going into Block 4 here at the Armada Hoffler Tower, and you guys will remember that space, that's the old Red Star space that we held off the market.

John Guinee: Okay. How many square feet are they going into in Block 4?

Louis S. Haddad: Those three are about 8- or 9,000 square feet.

John Guinee: Okay. So if we were to just look at a before and after on Block 4, just looking at that in a vacuum, what would be the craziest cash NOI when you came public, sort of second quarter of pro forma NOI when you came public, and what's the pro forma NOI after 8- or 9,000 square feet of tenants moved out and 8- or 9000 square feet of tenants moved back in?

Louis S. Haddad: Okay. The—let's make sure we don't cross up our timing here.

John Guinee: Yes.

Louis S. Haddad: When we came public, the Red Star Tavern was in place, and so in our NOI there would have been—and I'm speaking off-the-cuff here—somewhere in the neighborhood of a couple of hundred thousand dollars on those square feet. Shortly after we came public, Red Star closed as a chain, causing a hole in our—I guess it was our second quarter results last year, as well—as you guys remember—another restaurant in Town Center, we had to close on different circumstances. So that happened in July of last year.

We then said that we wanted to hold that space off the market because we had already had preliminary discussions with Anthropologie and we thought we had a good shot at getting them, but only if we could surround them with their desired co-tenancy. That played out over the last year or so, and so now that square footage is going to yield somewhere in the $300,000 range as the rents for these retailers are significantly higher than the restaurant range.

Now, as Mike mentioned, and going along with that, is the pretty extensive TI build-out, which impacted us by $1 million or so this quarter.

John Guinee: So it—and so the million dollars just has to do with the Red Star space, and the 8- or 9,000 square feet of Red Star's square footage?

Louis S. Haddad: Well, no. It's—I mean, it's not exclusively there and we still have a lot more to spend.

John Guinee: Well, I know that, yes. But then the $4 million; is that $4 million include the space on Block 4, as well as the space on Block 11?

Louis S. Haddad: Yes. Well, no, not 11. All of that is first-generation space that's being capitalized and we can harken back—I want to make sure—I want to continue this conversation. These are great questions, John, but also want to give somebody else a shot. But if you harken back at least one, if not two conference calls ago, we talked about our long-term strategy with the large tenant here at Town Center where they expanded by 10,000 feet. We turned a 30,000 square foot tenant into a 40,000 foot tenant and renewed them for 15 years, but that transaction was nearly $2 million worth of outlay. So that's a big part of that $4 million.

The timing wise is what Mike's talking about. While those deals have been set, the cash washes through between this quarter and the next.

John Guinee: Okay. Great. All right. Well, look, yes, take some other questions. Thank you.

Louis S. Haddad: Thank you, John.

Operator: Our next question comes from Craig Kucera with Wunderlich Securities. Please proceed with your question.

Craig Kucera: Yes. Hi. Good morning, John (ph).

Louis S. Haddad: Morning.

Craig Kucera: I was—I had a question about your leverage and kind of your thoughts there. Looking at a quarter year, you're maybe pushing 64% net to asset or real estate assets; and kind of philosophically, how far are you comfortable pushing leverage going forward?

Louis S. Haddad: I'm going to let Mike answer that question, but I'll also caution you as a developer, leverage on development projects is a big part of how we create value, and so at any given time there's going to be a significant amount of construction debt out there that skews these results which is why we try and focus on Core leverage metrics. But, Mike, why don't you take that?

Michael P. O'Hara: Yes. Just to continue on, so what happened is we're in the process right now where you've got to take some of these assets just coming online, especially with the multifamily, you know, we've spent most of the money in getting these projects up and ready to be occupied, and borrowed all the money. So obviously, it's—you know, we're a little bit behind the curve at that standpoint until the NOI comes online. All right. That—if you take that out of the equation, our debt-to-EBITDA right now is in seven times range. I think on an ongoing basis we want to be at seven or below debt-to-EBITDA, and that's what we're shooting for and we'll continue to structure our balance sheet accordingly.

Craig Kucera: Got it. So it sounds like you're kind of about where you want to top things out. As far as kind of the way you've been managing the balance sheet, you know, you've got a lot of debt coming due in a few years. A lot of it is floating; you're capping it which makes sense, but is that just a function of kind of your size relative to your development pipeline? Are you—do you see over time kind of maintaining that strategy versus maybe locking in some low long-term rates?

Michael P. O'Hara: Yes. So on the maturities between, you know, up to '15 we only—we've got like 10,000 worth of maturity—I mean, 10 million worth of maturity, so not a lot of maturities in the next couple of years. In 2016 as we hit the first big slot of the maturities, a big piece of that is the credit facility which matures in 2016 and we'll certainly make sure that we get that extended before 2016 on that.

You know, we're certainly taking a look and starting to evaluate what assets we want to build and put permanent financing on and put that out to 10 years. That's something we'll continue to do here over the couple of months and make sure we pick the right assets for doing that. We haven't done it at this point in time because we want the flexibility with our assets to either do dispositions if need be in order to keep our leverage and metrics in line, and also have the flexibility of adding to our borrowing base for our credit facility. So you know, we're continuing to fine-tune it and we'll continue to work on it over the next six months.

Craig Kucera: Got it. Finally, you know, from 50,000 feet it looks like things have improved a bit on the job front for Virginia Beach as we're moving further away from the sequester. I know you only signed 10 or so commercial leases during the quarter, but did you see any improvement there or any sort of pickup in traffic at the Cosmopolitan or pricing power as kind of you went through the quarter?

Louis S. Haddad: Yes. We've seen significant increases, which as we reported, the Cosmo occupancy now is trending. It's 95% occupied, and actually 98% leased and that's where we're headed. The traffic has picked up considerably. I don't know if that's a statement about the broader market as opposed to what's happening here at Town Center. But I think, you know, when you have the kind of retailers that we just announced making the decision to come here on a long-term basis, it's indicative of what people are thinking is going to happen here.

Craig Kucera: Okay. Thanks a lot.

Operator: Our next question is from Dave Rodgers with Robert W. Baird. Please proceed with your question.

David Rodgers: I'm sorry. I just wanted to start with a couple of clarifications. Mike, maybe for you, I think you mentioned that the new retail center you acquired was 470,000. Was that NOI or FFO?

Michael P. O'Hara: That's FFO and that's for 2014. (Cross talking).

David Rodgers: Remainder of the year assuming a mid-quarter close, right?

Louis S. Haddad: Right.

Michael P. O'Hara: Correct.

David Rodgers: Okay. Just wanted to verify that. Then maybe the difference in your non-stabilized FFO guidance—and I think maybe we've been around it a little bit, but my guess is it's Liberty and/or Retail. Can you talk about that $0.5 million kind of increase, I guess if you will, in the guidance with related—with respect to that non-Core number? How much is Liberty? How much is Retail? Was Retail anticipated in that number or did it come in better than anticipated? Any color on that would be helpful.

Michael P. O'Hara: Yes. So the major pieces on that, you know, the initial 1.5 million number are the multifamily, because, you know, it's—they open up with zero occupancy for the most part and try and ramp them up. So you know, we took a look at three multifamily owned coming online during the year and add, you know, what we add as—what we saw as occupancy schedules based upon some preliminary reports we saw from—you know, we got from our property managers.

A couple of these: one, is Liberty's leasing quicker than we had in our projections; and we're seeing a tremendous amount of activities associate at Encore, more so than we were expecting as well. So it's a combination of those two things and we're seeing, you know, the leasing activity on the Retail over at the 4525 Main Street.

David Rodgers: Okay. Okay. Thanks for that. Again, maybe talk a little bit more about 4525 Main. I don't think you put a lot in your comments about the office component of that building, but, you know, what are you seeing in terms of traffic for that space and, you know, talk about your confidence, I guess, with respect to being able to get that building leased up in fairly short order, and at least continue to make progress on the occupancy side.

Louis S. Haddad: Sure. David, I appreciate you bringing that up because I would like to elaborate on that a little bit. We want to make sure, everybody, to bear in mind how that project is designed. That building is positioned as the most expensive address in the region, and I'm not talking about just up Hampton Road; I mean, the peninsula as well. It's completely state-of-the-art. It's the best address that you can get if you're going to be in this market, and consequently it's got the highest rent and it is designed to give us a couple years worth of absorption.

We go—we came out with it because we didn't want to get stuck where we've been for the last several years here at Town Center with essentially no space to lease. The office space at Town Center is somewhere in the 99%—percentile; has been forever. We've had one, maybe two office tenants leave in our history, so we're hopeful. I mean, it's counterintuitive, but we're hopeful that this inventory will last us a while.

That being said, that all sounds great, but remember when you are at the top of the market there's a smaller subset of firms that are in position to take advantage of that. The anchor tenant—I'll give you a good example—the anchor tenant Clark Nexsen, which is the largest architectural firm based in Virginia—they do business in 47 countries—they've effectively nearly doubled their rent in coming here, but they've done that because they feel that they can compete much better on a world stage from an address like that versus where they were.

Those are the kind of companies that we need to get and they're not here on an everyday basis. All that said, traffic is really good. We're over 50% leased as we sit today and we'll be cash positive from day one. But we've just started scheduling the broker events and the grand opening and the ribbon-cutting will be later on in September, so we're very excited about the projects.

But I don't have an expectation that all this space is going to be gone in the next 12 months. That would be good on one hand. On the other hand, it puts us right back in the box and we're certainly not ready to launch yet another high-rise.

David Rodgers: Okay. Fair point. I guess maybe on your equity-owned next generation development pipeline, maybe a little bit more color in characterizing the demand for the discussions that you're having today, the scale of those discussions and your kind of confidence in the ability to kind of maintain or even grow that development pipeline on the equity-owned side.

Louis S. Haddad: Dave, again, another great question. I mean, I hope this call lasts forever. The opportunities out there are at a fever pitch. Actually Dan Hoffler and I had the conversation about a month ago that, wow, if all this was happening while we were private, we probably wouldn't have gone public. But the funnel has really opened up and we're having a tremendous amount of discussions.

I tell you that the toughest problem right now—not the toughest, but the biggest challenge is maintaining our discipline. You know, we see a lot of really good projects. We're trying to narrow the funnel to only do great projects, and of course, the difficulty is in identifying those from the outset, because the development process is a fairly lengthy one. But from everything we're seeing, there isn't going to be any issue for the foreseeable future in maintaining our pipeline where we want it to be.

We want to be careful about expanding it and we really don't want to get out over our skis (ph). We have a plan. As I've mentioned, our five-year plan has us being right where we want to be in the next five years if we don't do anything other than execute what's within our control, and I'd like to think that that's a baseline, and then we're going to do some additional great things from there. But we've got to be careful not to—to stick to our netting, knock it out over our skis and just keep that growth trending upwards.

David Rodgers: Last question for me, with regard to the asset sales, I guess, you talked about with the VNG building making up some tax protection payments modestly lowering, I guess, the net to the Company. Talk about how you think about that concept going forward with respect to additional asset sales versus 1031 proceeds and kind of redeploying those. You had the opportunity to put maybe those proceeds into the retail center that you bought this quarter, but I guess, I think about 1031 versus the tax protection payment and how should we expect you to think about that going forward?

Louis S. Haddad: So it's another great question, Dave. I'm going to turn it over to Mike to give you our thought process on that, but before I do, I just want to make sure it's—we're sitting in a wonderful position here. As people on the call know, there's a lot of froth out there in terms of what people are paying for assets. It gives us a tremendous amount of flexibility in terms of what we do with our balance sheet. We do plan on employing 1031s in order to maximize those proceeds in some places, as Mike will tell you, and sometimes it'll be better for us to pay down debt, particularly where the equity markets are right now relative to our stock price; and other times when really good acquisitions are lining up it'll do what (inaudible) do 1031s. Mike?

Michael P. O'Hara: Yes, Dave. I guess the first is on the VNG and Dimmock transaction. That is not a candidate for 1031. With Dimmock we're acquiring LLC interest and not the building, so therefore not eligible for 1031; and evaluating dispositions of assets, obviously the net of the Company after tax protection, it's got to be involved in our thinking whether or not we sell an asset or not. You know, like most REITs, when the IPO happens, the former owner's got tax protection, and we're not different than anybody else.

Amongst our assets we have assets that don't have full protection, VNG is one of those. It had 75% tax protection and not 100% tax protection. Then we have tax that's going to come back to former owners that are over and above the agreed-upon value for the tax protection.

David Rodgers: All right. Thanks, guys.

Operator: Our next question is a follow-up from John Guinee with Stifel. Please proceed with your question.

Louis S. Haddad: John?

John Guinee: I'm sorry, guys. The best way to look at this Virginia Natural Gas deal, basically a 6.25 cap on 8.9 is really about a 7.25 cap on the 7.7 million net?

Louis S. Haddad: John, that math is correct, John.

John Guinee: Okay. Great. Then on your guidance, if I look at 27.5 for the year and do the complicated math of subtracting out first and second quarter Core FFO, I get to about 13.6 million for the rest of the year. Is that a correct number Mike?

Michael P. O'Hara: Yes. Mm-hmm.

John Guinee: Then if I subtract out Dimmock Square I get down to you know, 13.1 and change which would—seems like a slope in the wrong direction from an average Core FFO but shade under 7 million a quarter for the first two quarters and then some—then a run rate excluding Dimmock of 6.5 to 6.6 for Q3 and Q4. Am I missing something there, and what's causing that slippery slide?

Louis S. Haddad: A couple of things, John; key word there is we're saying approximately 27.5 and we're saying that for good reason; and secondly, got the VNG disposition in there that it's removed from obviously from FFO, NOI.

John Guinee: Got you. Okay. Thank you very much.

Operator: There are no further questions in queue at this time. I would like to turn the call back over to Mr. Haddad for closing comments.

Louis S. Haddad: I really appreciate everybody taking the time to talk with us this morning. We appreciate your interest in the Company and I look forward to updating you on our activities and results in the coming quarters. Take care.

Operator: Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and have a great day.