31-Mar-2015

Armada Hoffler Properties, Inc. (AHH)

Q1 2015 Earnings Call

CORPORATE PARTICIPANTS

Louis S. Haddad
President, Chief Executive Officer& Director

Michael P. O'Hara
Chief Financial Officer

Julie Loftus Trudell
Vice President of Investor Relations

Eric L. Smith
Secretary & Vice President-Operations

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Armada Hoffler's first quarter 2015 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 1" on your telephone.

As a reminder, this conference call is being recorded today, Thursday, April 30, 2015.

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

Please go ahead.

Julie Loftus Trudell
Vice President of Investor Relations

Good morning and thank you for joining Armada Hoffler's first quarter 2015 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 May 29, 2015.
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, April 30, 2015, will not be updated subsequent to this initial earnings call.

During this call, we will make forward-looking statements, including statements related to the future performance of our portfolio, our development pipeline, impact of acquisitions and dispositions, 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 and Normalized FFO. 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

President, Chief Executive Officer & Director

Thanks Julie.

Good morning and thank you for joining us.

Given that it was only two short months ago that I was discussing our fourth quarter results and 2015 guidance, I'm going to keep my comments brief today.

I'll discuss some highlights of the quarter and how we are executing on our strategy. Then I'm going to focus my attention on the quality of our real estate before I turn the call over to Mike O'Hara to discuss the quarterly results in detail.

We continue to execute on our strategic plan and successfully delivered on a number of fronts during the quarter. As you can see – with the number of high-quality portfolio transactions that we have announced – we continue to aggressively manage our assets as we take the Company to the next level.

We are pleased to report another solid quarter with FFO per share of $0.17 and Normalized FFO of $0.19 per share, which was at the higher-end of our expectations, and we have raised the bottom-end of our 2015 Normalized FFO per share range by $0.01.

At quarter end, occupancy across the core portfolio was 95.6%. Our success in leasing is evidenced by an increase in quarterly GAAP and Cash Same Store NOI - 4.3% and 6.3% - respectively, compared to the first quarter of 2014.
While we are pleased with this organic increase, remember, it is primarily the NOI from our development pipeline that we expect to drive our growth.

As for our pipeline projects, during the quarter we delivered over 200,000 square feet of fully-leased office space in Hampton Roads, Virginia including two build-to-suit office buildings for the Commonwealth of Virginia which are under 15-year leases for both locations.

We also delivered a new office and manufacturing building for Oceaneering International, which was also pre-leased for 15 years.

Lastly, we delivered Sandbridge Commons, a new 70,000 square foot shopping center in Virginia Beach anchored by a Harris Teeter. Currently, this property is close to 90% leased.

Work began on the Johns Hopkins project this quarter. As a reminder, this $66 million development project is adjacent to John Hopkins' main campus. It will be a multi-use facility with residential and retail space along with structured parking. We anticipate completion by the third quarter of 2016.

Turning to dispositions, we continue our long-standing strategy of selling non-core assets in order to redeploy the capital on our balance sheet as well as selectively monetizing the wholesale-to-retail spread on our development projects.

During the quarter we closed on the previously announced sale of the Sentara Williamsburg office building for $15.4 million dollars - representing a cap rate of 6.3% - and used the proceeds from this sale in a 1031 tax free exchange.

During the quarter, we also announced that we entered into a definitive agreement to sell Whetstone Apartments in Durham, North Carolina for approximately $35.6 million, representing an implied cap rate of 5.7%.

This was an opportunistic sale for us. We received an unsolicited offer that yields a profit well in excess of 20% despite the fact that the asset was delivered in the third quarter of 2014 and was in the early stages of lease up.

Whetstone is our fourth disposition announced in six months and we will redeploy that capital in a way that best creates value for our shareholders.

We continue to pursue strategic acquisitions that complement our growth from the development pipeline.

During the quarter we closed on the previously announced acquisitions of Perry Hall Marketplace and Stone House Square, two grocery anchored retail centers located in Maryland, for an aggregate of approximately $20 million of cash – net of $15 million of proceeds from the sale of the Sentara Williamsburg office building – and 415,500 shares of common stock.

Together, these acquisitions add over 185,000 square feet to the Company's portfolio and further expand the Company's geographic footprint in Maryland. The properties have a combined occupancy of approximately 90%.

We have already begun to monetize the upside of this acquisition in the form of a signed LOI with a new tenant.

Before I turn the call over to Mike to discuss the quarter in more detail, let me spend a moment talking about how quality real-estate is fundamental to our long-term strategy.

What we, the management team, have learned in our 30 plus years together is that high quality real estate stands the test of time, appreciates over the long-term and is very difficult to duplicate.

For example, the recent disposition of a non-core asset that is close to Town Center sold for a cap rate in the low 6% range. We believe, this establishes cap rates for quality assets in the Virginia Beach central business district.

That said, I'd like to refresh you on the details of Town Center. This is a $700 million central business district mixed-use project that we developed in partnership with the City of Virginia Beach, Virginia.

Town Center is a 17-block, on-going, multi-phase development. To date, the City of Virginia Beach has invested approximately $200 million in Town Center in the form of infrastructure, public facilities and over 4,000 structured parking spaces.

This investment has helped us create a vibrant downtown central business district for Virginia Beach – the largest city in Virginia.

Town Center is home to over 115 commercial tenants, 410 hotel rooms and 640 multi-family units – including three high-rise buildings one of which is the tallest building in Virginia. In addition to 750,000 square feet of office space, there are 15 restaurants, a performing arts theater and 30,000 feet of conference space.

This project has attracted new tenants both to the city –with over 50% of tenants being new to Virginia Beach –and over 30% of tenants being new to the Hampton Roads Market.

We believe that Town Center is unique to the region and it has no local or regional comps. In our minds, this premier asset - in a vibrant 1.7 million person MSA - deserves a value on par with similar facilities in the Charlotte, Raleigh Durham and Northern Virginia markets.

If you triangulate our recent sale of an office asset, a stone's throw from Town Center, for a 6.3% cap rate – and the recent multi-family disposition with an implied cap rate of 5.7% – it is not hard to conclude that the Town Center assets would command a very attractive cap rate if they were ever marketed.

Going forward, our focus and strategy remains unchanged -- we will continue to develop high-quality institutional grade office, retail and multifamily properties in attractive markets throughout the Mid-Atlantic.

We remain comfortable with our targeted pace of commencing $150 to $175 million of development projects every 18 to 24 months with a 150-200 basis point spread between development cost and retail value.

When combined with our attention to the balance sheet – we have every intent, to ensure, that these quality assets and the wholesale to retail spreads that accompany them – will result in both NAV and FFO accretion for our shareholders over the long-term.

The funnel for development pipeline opportunities is full and we look forward to announcing new projects in the coming quarters.

With that, I turn the call over to Mike and then we will take your questions. Mike…

Michael P. O'Hara
Chief Financial Officer

Thanks Lou and good morning.

Today I want to cover the highlights of the quarter, including thoughts on our balance sheet and I'll wrap up with our 2015 guidance.

We have made some changes to our supplemental package this quarter which I hope you find more helpful.
This morning we reported FFO of $.17 and Normalized FFO of $.19 per share, which was at the higher end of our expectations.

Please see page 10 of the supplemental for the Normalized FFO calculation which excludes certain items including, but not limited to, debt extinguishment losses, property acquisition costs, and mark-to-market adjustments for interest rate derivatives and other non-comparable items.

Our current quarter FFO also excludes the gain from the Sentara sale. Asset sales will continue to be an element of our future value creation.

We had another strong quarter of same store NOI growth. Same store NOI was positive 4.3% on GAAP basis and positive 6.3% on a cash basis compared to the first quarter of 2014.

Next quarter we will be adding five development projects to our core portfolio. These properties are now stabilized and will be removed from the development pipeline. They are:

- Greentree Shopping Center
- Oceaneering
- The two Commonwealth of Virginia buildings, and
- Sandbridge Commons shopping center

At the end of the quarter our core portfolio occupancy was 95.6% compared to 94.5% in the first quarter of 2014. Office came in at 93.5%, retail at 97.4% and multifamily at 96.6%.

In our Portfolio Summary, on page 14 of the supplemental, you will see that we have summarized all properties – our core assets as well as those from the development pipeline that are delivered but not yet stabilized – in one place.

We've also noted those properties that are in the Virginia Beach Town Center.

On the construction front, we reported a segment gross profit, in the first quarter, of .9 million dollars on revenue of 29 million dollars. Historically, we experience the lowest 3rd party construction gross profit in the first quarter and this year was no different. We expect this to ramp up throughout the year.

At the end of the first quarter, the Company had a total 3rd party construction backlog of $138 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.

We continue to be methodical in our approach to ensuring a strong balance sheet.

During the quarter, we closed on our new 200 million dollar unsecured credit facility with an accordion feature to $350 million, which includes a 5 year - 50 million dollar term loan.

Simultaneous with closing, we paid off approximately 39 million of secured debt, which was 100% of our pre-payable debt on stabilized properties, except for Smith's Landing, which we are in the process of refinancing with a 20 year fixed rate loan.

After closing on the credit facility and the Smith's Landing refinancing, the maturity of over 120 million dollars of our debt is extended until 2019 or later.
As I mentioned during last quarter's call, we are evaluating additional fixed rate debt vs interest rate caps. In addition to Smith Landing's fixed rate loan, we entered into swap lock to fix the rate on the 50 million

dollar term loan. The swap lock is for five years with the first year floating. LIBOR is fixed at 200 basis points starting March 1, 2016.

As of March 31, our fixed rate debt, including swap locks, was 50% of our total debt and including interest rate caps, 81% of our debt was fixed or hedged.

As you can see from our outstanding debt summary on page 11 of our supplemental, with a new layout I may add, at the end of the first quarter, we had total outstanding debt of 381 million dollars. This includes 17 million dollars of debt on the Whetstone project which has been reclassified to Debt related to assets held-for-sale and 60 million dollars outstanding on our revolving credit facility.

We announced this morning that our Board has authorized an ATM offering program. We intend to file this program with the SEC next week. The ATM program will be one of multiple options at our disposal to raise capital to fund our development activities.

Now, let me walk you through our full-year 2015 guidance.

This morning we raised the bottom-end of our 2015 Normalized FFO. Our current 2015 Normalized FFO guidance is $.86 to $0.90 cents per share from our previous guidance of $0.85 to $0.90 per share.

We are changing this due to better visibility on future third party construction business as well as the expectation that G&A expenses will come in towards the lower end of the range.

Our 2015 estimates are predicated on the following:

- Total GAAP NOI in the 52.3 million to 53.3 million dollar range, which includes approximately 8.0 million dollars from development pipeline projects. The development pipeline NOI has been lowered from last quarter due to the sale of Whetstone. We are not changing the overall NOI guidance because we expect to close on a Whetstone replacement property this year.

- 3rd party construction company segment gross profit in the 4.5 million to 5.0 million dollar range.

- General and administrative expenses in the 8.3 million to 8.6 million dollar range.

- Interest expense in the 14.0 million to 15.0 million dollar range. The mid-point of the range reflects the assumption factors in the LIBOR forward yield curve which anticipates increasing LIBOR during the year.

- And, 40.2 million weighted average shares and OP units outstanding which includes the shares that were issued for the acquisition of the two Maryland shopping centers.

This guidance excludes any impact from future acquisitions–with the exception of the Whetstone replacement–dispositions, or other capital market activity.

Before we turn to Q&A, I would like to make a few comments about the second quarter.

The second quarter's Normalized FFO is expected to be higher than the first quarter but not reach the average run rate for the year. The reason is the development pipeline NOI and FFO growth is back-end weighted reflecting tenant occupancy and leasing. This is also consistent with the gradual increase in the development pipeline NOI during the year.

I'll now turn the call back to Lou.

Louis S. Haddad
President, Chief Executive Officer & Director

Thank you Mike.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, if you have a question at this time, please press "star 1" on your telephone. If your question has been answered and you wish to withdraw it, you may do so by pressing "star 2". If you're using a speakerphone today please pick up your hand set before entering your request.

Thank you. Our first question this morning is coming from the line of Dave Rodgers with Robert W. Baird. Please proceed with your question.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Well, Lou, congratulations. You've finally arrived. You sound like a real REIT CEO pushing his stock price. Well done, very well done.

Hey, Mike, should we just look at the rest of the year as maybe $0.21, $0.24, $0.24?

Michael P. O'Hara
Chief Financial Officer

A

Hi, John. You know, the (inaudible) the pairing (phon) are going to climb as we start getting the NOI coming in place. I don't want to be specific on each quarter, but we feel good about our overall guidance for the year and the way it's going to ramp up during the year.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Then I noticed Oyster Point, I think. Is that a 2017 sale? Is that a forward sale?

Louis S. Haddad
President, Chief Executive Officer & Director

A

It sure is, John, and I'll take a minute to talk about that. As I said earlier, we're aggressively managing this balance sheet and our assets. The Oyster Point project is the oldest building in our portfolio. It's 30 years old or so. We think it's really well-positioned in that it's right next to a town center and—or Newport new city center over in that city.

We learned over the last several months that we have two big tenants there, one is the GSA with the Air Force, which has been in the project for about 20 years, and of course, SunTrust which anchors the building. SunTrust recently renewed and is downsizing, and more concerning to us is that our folks at the Air Force are giving us a pretty good indication that in 2017 they'll be going back to base. That's not definite, but the cards seem to be pointing that way. So, we did a quick evaluation and we came up with needing to invest about $5 million to re-tenant the building. That combined with the fact that there's a lot of new product in that city center that is being offered at a discount in order to attract tenants tells us that's not a great use of $5 million in the future.

We didn't think there was a great market for it because anybody that we offered it for sale on the open market, anybody doing a reasonable amount of due diligence would come up with those same facts. So, what we were really looking for was, was there a user in that area that could use the building and therefore would be a bargain to them because they could get it for below replacement cost. As it turns out, we found just that person in the form of Hampton University, which has been very good to us. They've been a construction client for going on a quarter of a century.

The great part about—the great news for them is that they don't really need all the space right away, so we've worked out a deal where we effectively, and reap the FFO for the next two years while Hampton slowly comes into the building and ultimately will close in 2017. Most probably we'll do a 1031 with that asset, it's debt, and with the $5 million that we would've invested in that old building into what we would consider to be a much better long-term asset.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Great. Thank you. Then two other quick questions; one's a quick one and one's a longer one. What's your ATM size and expectations of drawing it down, if that's the correct term? Then second, you said something very interesting that we hear all the time in the Washington D.C. area, which is the Air Force is moving employees back to the base. Can you sort of elaborate on the whole government contracting, government and employee? You have a lot of bases down there. It's almost a far suburb of the D.C. area. Can you talk about what's happening in that whole Defense contracting environment in your part of the world?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Sure. Well, first on the ATM, first I want to make sure I give you the rough fact of it. Bank of America will be maybe the left tier (phon) on the ATM. As most of you recall, they're heading up our $200 million credit facility and they've been—they're our lead bank for a quarter of a century. So, we feel very good with them in the first seat on the ATM.

The size of the program is not going to be very large. As anybody can see looking at our volume, we're not talking about a significant amount of throughput. At the same time, we wanted to have a better option, and hopefully we'll be able to increase our flow through. However, as I remind people for the 80th time, as the largest shareholder, we're going to be real careful about selling stock, particularly where the stock is trading right now.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Great.

Louis S. Haddad
President, Chief Executive Officer & Director

A

With regard to the Defense contracting, John, my first comment would be that this is the reason why we stay out of that business. I believe—don't hold me to this, but I believe that that GSA lease in the SunTrust building is our only GSA lease across the 270 tenants we have portfolio-wide, and frankly, we don't want to be in that business. We're hearing on the periphery—like I said, because it doesn't affect us directly—we're hearing on the periphery that there is a significant movement—and you're probably hearing the same thing—there's a significant movement to move people back to the base.

With the new rules that have come out from Homeland Security, it's very difficult for these folks to occupy private facilities. In fact, if the GSA were to renew the Air Force at the SunTrust building, we'd have to make a significant investment on the Homeland changes before we even talk about improving the building. So, I think it's a trend you're going to continue to see. We're very fortunate in this area, I think fortunate. I guess the silver lining of living in a dangerous world is that folks are really ramping up on shipbuilding. As you see, we're now going to be home port to six carriers and they're fully funded, the next carrier in Newport News shipbuilding. We both have got two coming in for a three-year refueling and a significant amount of money has been spent now on Special Forces, which is also located here at Oceana.

So, we're going to continue to see influx of people. Like I said, I kind of wish there was a better reason than what we're all facing, but it's good for business.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Great. Thank you very much and keep up the good work.

Louis S. Haddad
President, Chief Executive Officer & Director

Thank you, John.

Operator: Thank you. Our next question is coming from David Rodgers of Robert W. Baird. Please proceed with your question.

Stephen Guy
Robert W. Baird & Co. Equity Capital Markets

Q

Yes. Thanks. This is actually Stephen Guy filling in for Dave today. I wanted to ask about the replacement property for Whetstone Apartments and maybe you can discuss the timing; and I assume that's going to be another multifamily. I'm just trying to reconcile kind of keeping NOI in the same place. Then a second question would just be kind of with the new ATM, the line of credit, any other acquisitions in the pipeline or dispositions for that matter? Thanks.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Thanks, Steve. We're trying to maintain flexibility. I wouldn't conclude that the replacement property is going to be multifamily. We are comfortable in putting it into our base model because we're negotiating on a number of different fronts so we feel comfortable that that 1031 will be completed. I'll tell you it's more—we're more—if you take my comments at face value about quality, we're more about finding high-quality assets. The NOI is going to match up probably favorably because I doubt very seriously that we'll buy a 5.7 cap property, but it's still going to be a very high-quality asset, and most probably outside of our home market and more targeted to the markets that we're trying to get more of a presence in.

With regard to the ATM, as I said, it's another tool in the chest. We will continue to evaluate dispositions. We continue to evaluate acquisitions. We're aggressively managing this thing to where it's going to produce the maximum amount of value. I can tell you, as I mentioned earlier, the opportunities—the pipeline's full of opportunities. It's a matter of finding the right one to cherry pick. We feel pretty comfortable there'll be some announcements this summer. It's going to be an extremely busy summer for us that we're very excited about.

Stephen Guy
Robert W. Baird & Co. Equity Capital Markets

Q

Great. Thanks. Are you leaning towards one, I guess, property type or another, or is it really just, you know, the entire pipeline is full of the diversity that you see in your current portfolio?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Let's see. I'll tell you, it's—you're going to continue to see the same kind of diversity that you see from us now. We have been, as you see by the recent history or at least the last several months, we've been more active in acquiring retail property. We feel very comfortable playing in that arena. We've got a number of clients that are in the existing portfolio that are translating well into opportunities outside of the market. But, I wouldn't say that we are targeting any one product size. It's really being opportunistic.

But as you might expect, we're very comfortable in the mixed-use world and there's a lot of people that are not comfortable in that world. It's where we live, so that's going to be another focus for us as well.

Stephen Guy
Robert W. Baird & Co. Equity Capital Markets

Great. Thanks. Good quarter.

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

Stephen Guy
Robert W. Baird & Co. Equity Capital Markets

Q

Yes. I forgot to ask, can you, just idle curiosity, more fully describe what you're doing up at the Hopkins Campus?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Sure, and great question, John. So, it's another one we're really proud of. The John Hopkins project represents our 23rd public-private partnership with the public side, this time being the institution, obviously, of John Hopkins. Their goal is to revamp the Charles Village right outside their main gate to their main campus. They own a number of properties there. They're in partnership with us and we're launching the first project. It's actually broken ground, and that—while it went through several iterations , because as I think I've mentioned to all of you before, when we answered their RFP, we did not answer with the specifics here's what we think you should do. We answered it by saying we're the best partner for you and we'll work with you to figure out what's best to do.

The good news is that that usually gets you the win. The bad news is it takes these institutions a while to figure out what they want to do. So hence, we're two years into it and we've just broken ground.

So, it had several iterations in the gestation period, but what has ended up being market grade housing that is geared toward students, as well as graduates and staff; retail on the ground, the area desperately needed a whole service drugstore, pharmacy obviously, and so our retail is anchored by CVS; and the President and his staff is working with our staff and our leasing reps to fill up the rest of that retail with the kind of things that you would hope to see right outside of a campus of a major institution. There's also—same with between the retail in the housing structured partner.

We hope that that's the first of many engagements that we'll have with Hopkins that we hope, you know, over the next decade or so that we're a big part of remaking that neighborhood.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.
Q

But is your 20% partner John Hopkins?

Louis S. Haddad
President, Chief Executive Officer & Director
A

No. That's on the private side. As a matter of fact, our—this is all—John, as you know, this can all get pretty incestuous. Our 20% partner is our client for our construction company at Exelon Building.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.
Q

What's his name?

Louis S. Haddad
President, Chief Executive Officer & Director
A

Beatty Development, Michael Beatty.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

Yes. Got you. Hey, thanks a lot.

Louis S. Haddad
President, Chief Executive Officer & Director

Okay.

John W. Guinee
Analyst, Stifel, Nicolaus & Co., Inc.

All right.

Operator: Thank you. At this time, I would like to turn the floor back over to Management for any additional or closing comments.

Louis S. Haddad
President, Chief Executive Officer & Director

Thanks very much, folks. We appreciate your interest in the Company and we look forward to updating you on our activities and results in the coming quarters, so take care.

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