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Armada Hoffler Properties, Inc. (AHH)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

Louis S. Haddad
President, Chief Executive Officer& Director

Michael P. O'Hara
Treasurer, Chief Financial Officer

Eric L. Smith
Secretary, Chief Investment Officer

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Armada Hoffler's second quarter 2016 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, Tuesday, August 2nd, 2016.

I will now turn the conference call over to Michael O'Hara, Chief Financial Officer at Armada Hoffler.

Please go ahead.

Michael P. O'Hara
Treasurer, Chief Financial Officer

Good morning and thank you for joining Armada Hoffler's second quarter 2016 earnings conference call and webcast.

On the call this morning, in addition to myself, are:

- Lou Haddad, CEO

And Eric Smith, our Chief Investment Officer, who will be available for questions.
The press release announcing our second 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 September 2, 2016. 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 2, 2016, and 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 will also 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 Mike.

Good morning and thank you for joining us today.

This morning we reported quarterly results with Normalized FFO per share of 26 cents driven primarily by better-than-expected NOI growth.

We are pleased with our results for the second quarter and continue to successfully execute on our strategy. Based on our year-to-date results and the outlook for the rest of the year, we've raised our 2016 Normalized FFO guidance range.

Growing earnings and outpacing expectations are important, however, they are ancillary to our primary goal – creating value for our shareholders by adding quality real estate to our portfolio through our development efforts and complementary strategic acquisitions. The result of this type of growth is not only size, but high quality stable NOI that demands lower cap rates.

Since our IPO in May of 2013, we've certainly grown in size:

- Our portfolio has grown by over 80%
- NOI has grown by over 50%
- Normalized FFO has grown at a double digit pace
- And our market cap has more than doubled.

Just as important, we've increased the overall quality of our portfolio through:

- Developing high quality, well located projects at our target wholesale to retail profit of 20 percent or more
- Prudent asset recycling
- Opportunistic acquisitions
- And making the right real estate decisions for the long-term benefit of the Company and our shareholders.

As a result, we've created and delivered significant value and substantially increased our NAV over the last three years.

By most any measure, we are making good on our promise to investors… and there is still a lot more to come.

With:

- 2 large projects delivering this quarter
- 200 million dollars of new development underway in the Baltimore Washington corridor
- A new flagship project under construction in downtown Durham
- Another new groundbreaking in Town Center later this year
- And several interesting opportunities taking shape in our pre-development pipeline,

We are poised to add significant value to our asset base and continue increasing NAV.

During the quarter we surpassed a billion dollars of enterprise value, and as long as high quality opportunities continue to present themselves, we have every reason to believe we will maintain our current growth trajectory toward a billion-dollar equity market cap.

Mike will discuss our quarterly results in more detail after I briefly touch on a few of the highlights.

I'll start with the primary growth engine of the Company, our development pipeline.

This quarter we announced the planned expansion of the crown jewel of our portfolio, the Town Center of Virginia Beach. Phase six of this public-private partnership is a new 35-million-dollar mixed-use project that will include approximately 39 thousand square feet of retail space as well as 120 luxury apartments. In addition, Zeiders American Dream Theater has committed to invest 8 million dollars in a new 17 thousand square foot performing arts theater and the City of Virginia Beach will contribute 3 million dollars in public infrastructure, including an open-air public plaza and pedestrian bridge connecting to the adjacent parking garage at the Cosmopolitan apartments.

18 thousand square feet of retail space has already been pre-leased to national name-brand tenants that will complement and enhance an already impressive Town Center roster that includes amongst others, Anthropologie, Lululemon, West Elm, Brooks Brothers, and Free People, further solidifying Town Center as an upscale retail destination in the region. We expect to break ground on Phase 6 of Town Center later this year.

This represents just the latest chapter in our successful, ongoing, multi-decade public-private partnership with the City of Virginia Beach, one that has created a vibrant downtown central business district in the largest city in Virginia.

For those who have recently begun to follow our company, Town Center spans 25 acres across 17 blocks and is home to 110 commercial tenants, 412 hotel rooms and 804 residential units – including five high-rise buildings, one of which is the tallest building in the Commonwealth of Virginia. In addition to 800 thousand square feet of office space, Town Center boasts 23 restaurants, a 1,300 seat performing arts theater and 30 thousand square feet of conference space.

With over half of the tenants in Town Center new to Virginia Beach and almost a third of them new to the Coastal Virginia MSA, this signature project continues to serve as an economic catalyst for both the city and the broader region.

In addition to drawing new businesses to the area, Town Center provides already established tenants the ability to either relocate to or expand within the most exclusive address in the market. For example, just last month we agreed to lease 14 thousand square feet of office space at 4525 Main to an existing Town Center tenant at One Columbus looking to expand their footprint by almost 40%. With the additional capacity we designed and built at 4525 Main, we were able to accommodate this particular tenant's needs and are in discussions with a second long term tenant looking at a similar relocation and expansion. As a result, not only will we increase occupancy at 4525 Main but also create capacity and opportunity for tenants looking to relocate to Town Center at a lower entry point.

Moving beyond Town Center to the remaining projects we have slated for delivery this year.

Last month, the anchor Harris Teeter store at Lightfoot Marketplace in Williamsburg, Virginia opened for business. As of today, the project stands at over 70% leased and we expect the initial small shop tenants to take occupancy later this quarter.

We remain on track to deliver Johns Hopkins Village later this month and open with approximately three fourths of the residential units leased and approximately two thirds of the retail space leased or under LOI. We look forward to building upon this solid opening and expect to reach full stabilization next year.

With respect to our 2017 and 18 deliveries, our progress on Point Street Apartments in Baltimore's Inner Harbor, One City Center in downtown Durham and The Residences at Annapolis Junction Town Center continues as expected with construction well underway at each site.

We expect to announce at least one more new development project by the end of the current quarter.

Moving from our development pipeline to acquisitions and dispositions.

This quarter we closed on our acquisition of Southgate Square, a retail center located in Colonial Heights, Virginia just south of Richmond. This 220 thousand square foot center is anchored by a brand-new Burlington store as well as Michaels and PetSmart. We acquired the asset for a combination of 21 million dollars of debt and 1.6 million Operating Partnership units.

The opportunity to acquire Southgate Square arose from the same longstanding relationship that led to our acquisition of Dimmock Square two years ago and our pending acquisition of Southshore Shops, which we expect to close later this week. Southshore is a 40 thousand square foot retail center also located in the greater Richmond market. While this is a relatively small asset for us – approximately 9 million dollars – it's significant in that it will be our third OP unit transaction with this particular partner and our 5th deal involving either stock or OP units. For those of you who follow our Company, it should come as no surprise that each of these new partners have been very pleased with the significant returns they've realized on their investment in us, leading to repeat business and further interest in our OP Unit program.

Turning to dispositions.

You'll remember that as part of the capital stack for our 11-asset portfolio acquisition that we completed in January, we had originally identified 5 non-core retail assets as disposition candidates. And as of today, we've completed the sale of 2 of those assets.

We had been under contract to sell another 2 assets to a single off-market buyer, however, both fell out of contract on the last day of due diligence when the purchaser attempted to significantly re-trade the transaction. As these assets had not been fully marketed, we felt no pressure to negotiate the price. We are comfortable holding all 3 Kroger-anchored centers for an extended period of time. Our intent is to fully market some combination of these assets later this year.

Shifting to the foundation of our Company – our Core Portfolio.

At the end of the quarter, our occupancy stood at just over 95%. Occupancy across all product types at the end of the quarter remained in the mid-90s. Even with these consistently high occupancy levels, our core portfolio continues to deliver organic upside as demonstrated by our 8th consecutive quarter of same store NOI growth.

Turning to our third party construction business.

Year to date, we've added over 240 million dollars to backlog and since the end of the quarter have been verbally awarded additional contracts of approximately 30 million dollars. With over a quarter of a billion dollars of work in the pipeline, we expect our construction business to continue to generate profits toward the higher end of our historical range for the rest of the year and through 2017.

Before I turn the call over to Mike, I should mention our new 75-million-dollar ATM equity offering program that we entered into this quarter. As you might expect, we took advantage of favorable market conditions and accelerated our use of the additional capacity created by this program in order to strengthen our balance sheet in anticipation of the future growth I discussed earlier.

With that, I'll turn the call over to Mike for more details.

Michael P. O'Hara
Treasurer, Chief Financial Officer

Thanks Lou

Today I want to cover the highlights of the quarter, thoughts on our balance sheet, and additional details on our 2016 guidance.

This morning, we reported FFO of 24 cents per share and Normalized FFO of 26 cents per share, which was at the high end of our expectations. Our core portfolio continues to deliver excellent results. Both occupancy and Same Store NOI increased this quarter. Same store NOI growth was positive 1.7 percent and 1.2 percent on a cash basis, which represents the 8th consecutive quarterly increase.

At the end of the quarter, our core operating portfolio occupancy was 95.3 percent with office at 94.6 percent, retail at 96 percent and multifamily at 94.3 percent.

On the construction front, we reported a segment gross profit, in the second quarter, of 1.2 million dollars on revenue of 33 million dollars. At the end of the second quarter, the Company had a third party construction backlog of 252 million dollars, which will sustain this part of our business for the foreseeable future and should translate into profits at the higher end of our historical range.

Now turning to our balance sheet.

We continued to take actions to enhance flexibility and strengthen our balance sheet including refinancing upcoming loan maturities, hedging our interest rate exposure and continued use of the ATM program.

We used the ATM program last quarter to raise 21 million dollars of gross proceeds at an average price of $12.32 per share. The amount raised was substantially higher than last quarter's guidance. The stock hit record highs on 16 occasions and was up 22 percent during the quarter, so we took advantage of this opportunity to strengthen the balance sheet. If the stock continues to trade at these levels, we will continue to be opportunistic with the program. Even with the increased use of the ATM program we are raising the 2016 earnings guidance.

During the quarter, we sold one of the five non-core properties from the January portfolio acquisition and a second of these recently closed. Combined these assets sold for 12.9 million dollars. As previously discussed, these proceeds will be used for balance sheet purposes.

At the end of the quarter, we had total outstanding debt of 513 million dollars including 107 million dollars outstanding under the 150-million-dollar revolving credit facility.

We continue to evaluate our exposure to higher interest rates and look for opportune times to enter into hedges. During the quarter, we purchased a 70 million dollar LIBOR interest rate cap at one percent for two years. As we have said before, we believe using interest rate caps is the most efficient way to hedge against the potential for increasing interest rates. With this new cap, 95 percent of our debt was fixed or hedged.

We are also working on refinancing the 2016 and 2017 debt maturities. We have a commitment to refinance the Town Center 2016 maturities. The loan is for five years, 35 million dollars and floating at LIBOR plus 195. The new loan amount is six million dollars more than the maturing loans. We also have a commitment to refinance 4525 Main Street and the Encore apartments. The new loan is a five year loan for 57 million dollars and the rate was locked at 3.25%. Both loans are scheduled to close this month.

Now turning to development.

During the quarter, we closed on the Annapolis Junction project. This is structured similar to the Point Street Apartments project with our investment funded through a mezzanine loan. The project is non-consolidated, and therefore does not stress our balance sheet during construction and lease up. Projects of this size and duration require debt and equity for over two years with no return on that capital. With the mezzanine debt structure, we are paid a return on our investment, earn a construction fee during development and have the option to purchase a controlling interest in the property upon completion. Our current investment in Annapolis Junction is in the form of a 42-million-dollar mezzanine loan which bears interest at 10 percent.

Now, let me walk you through the full-year 2016 guidance that we updated this morning.

We expect 2016 Normalized FFO in the range of 96 cents to 1 dollar per share.

This updated 2016 guidance is predicated on the following assumptions:

- Total NOI in the 65.8 to 66.5-million-dollar range.
- Third party Construction Company gross profit in the 4.7 to 5.2-million-dollar range.
- General and administrative expenses in the 9.1 to 9.4-million-dollar range.
- Interest income from our mezzanine financing program in the 3.0 to 3.3-million-dollar range. As of June 30, the aggregate loan balance was 39 million dollars.
- Interest expense in the 16.0 to 16.5-million-dollar range.
- The sale of two of the five non-core retail properties, totaling 12.9 million dollars and the sale of the others at year end.
- And, 49.8 million weighted average shares and OP units outstanding, including the OP units expected to be issued as part of the Southshore acquisition.

This guidance excludes any impact from future acquisitions, other than Southshore, asset sales and other capital markets activity with the exception of continuing the ATM program.

Now I would like to make a few comments about this updated guidance. The increase is guidance is due to a number of factors. The Southshore acquisition is accretive, increases in occupancy, and third party construction gross profit. Another factor is the delay in selling three of the non-core retail assets that were purchased in January. As Lou discussed, the buyer attempted to renegotiate the sales amount and we decided not to sell these properties. The proceeds from these sales were to be used for balance sheet purposes but due to the increased proceeds from the ATM program we can hold these assets and stay within our target debt metrics.

The updated average shares outstanding takes into account the OP units to be issued in the Southshore transaction as well as increased use of the ATM program during the year as I mentioned earlier.

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 from Robert W. Baird. Please proceed with your question.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Q

Hey, good morning guys. Nice quarter, obviously. Just wanted to, I guess quickly touch on a couple of different things. I guess the first would be on the office side particularly around Town Center, I guess for the remaining portion of your offices. Yeah, not a lot of leasing activity in the quarter, but it seems like your commentary in the prepared comments was a little bit more positive in terms of maybe moving people over to the Main Street Tower in kind of seeing some backfill activity at One and Two Columbus. So can you extrapolate on that a little bit?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Sure, Dave. You recall that for the main reason to build 4525 Main and the size that we built it, was to allow just this type of activity. And so it really does us -- it's really pleasant to see that we're starting to get that organic growth that traditionally has been a big driver for us here at Town Center, in the last couple of years it's kind of flattened out. So, it's good to see that moving out again. It confirms that we're talking about long-term tenants, one being a brokerage firm, the other being an engineering firm.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Q

Okay, yes good that's helpful and then interest in the Town Center from kind of outside of the Town Center and kind of the timing around that. I know there some bigger expirations coming, how do you feel about those still in the current market?

Louis S. Haddad
President, Chief Executive Officer & Director

A

I'm very positive about it, Dave. We're seeing an increase in activity lot more tours coming through and people looking for offers. So, feel really good about that for the first time in a while. So hopefully as a trend that's going to continue.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Q

Great, on the new development. You said you announced the new development this quarter. Can you kind of just talk about what kind of those conversations look like, and whether that might be office or family and kind of how you're looking at, kind of a major positive development opportunities for you guys going forward.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Sure. As we alluded to, on the last call, at the last couple of calls we're really focusing our development efforts in that Baltimore -- corridor, as well as in the Raleigh, Durham area as well as Charlotte, I think most probably these new announcements will come from there. And really hits, it kind of the horse race within the pipeline right now, we have office opportunities multi-family opportunities as well as retail opportunities. I wouldn't handicap with wins, but I can tell you that really exciting opportunities I think our Group's will be very happy to perform.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Q

I guess we expect that these would be more traditional equity owned developments or will we expect to see continued kind of the mezz program expand a little further as you think about multi-family maybe.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Yes, I don't believe you will see that uptick in the form of the mezz program. I want to hence appreciate bringing that up, want to make sure we reiterate. We are a traditional developer, we like doing joint ventures and we also obviously do it alone, the mezz program was created specifically for large volume multi-year commitments of multi-family, it typically because these things take a couple of years to build and then some amount of time after that the lease-up. And that's a kind of size that we are talking with the two that are underway, basically being a $100 million projects, stress on our balance sheet just isn't tenable and hence the mezz program, but that's not a natural way of doing business for us.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Q

Okay, that's fair. Last question from me and I can jump back in. But you did the ATM in the quarter about $20 million, I think at $12.30 or so per share with the stock up closer to 15, it doesn't seem like you have a large amount of equity issuance built under your guidance in terms of the underlying share count. But I guess, talk about these large projects in relation to the ability to go to equity at a much more attractive price now and how you think about that?

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Good morning, Dave. So obviously with the stock trading at 15, our cost of capital has gotten low, which is, terrific. So it's just helps our returns on our development spreads versus the retail and return on cost versus our cost of equity. And I think or may be like to spend a couple minutes on the development pipeline and just kind of go through the requirements and just kind of tell you how our balance sheet is set up on page 17, in supplemental kind of lays out our development pipeline. And what's been what under development right now and not delivered. We've got about $55 million to fund out the remaining part of that pipeline, of which $33 million and that is the Town Center phase 6, will to not begin until this fall. So, majority of that funding is going to be in 2017 and 2018. Now it would remaining $14 million of finishing out JHU and Lightfoot which we have construction loans to fund those out. 4525 Main Street, we have approximately estimating $6 million to complete that which is TI in leasing commissions and that will get spent out as we lease the space. On the Durham City Center at joint venture with funded 100% of our equity requirements. Our equity requirement $10 million has been funded and remaining of that will be funded through the construction loan that the joint venture has and then upon completion in the second quarter and 2018 will bring it on to our balance sheet at that point in time. And the last piece of the mezz loans, we've got 26 million to fund under our mezzanine program and now go out in the next six months, you can see that what's happening with the ATM program, what's in our development pipeline right now, we're situated real well to fund these out.

Dave Rodgers
Analyst, Robert W. Baird & Co. Equity Capital Markets

Okay, Great. Thanks for the color.

Operator: Our next question comes from the line of Rob Stevenson with Janney Montgomery Scott. Please proceed with your question.

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC

Q

Good morning, guys. Lou, can you talk a little bit about like when you take a look at the portfolio today other than the Kroger assets what and obviously what's your point, I mean, what else you know from your standpoint or how sizable if you don't want identify projects, specifically how sizable you know is the pool of properties that beyond it's a, if you think about likely it gets recycled over the next 12 to 18 months in the portfolio.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Thanks Rob, Good question. As we mentioned, we've got the three Kroger's that way, we intend to market later on this fall and the SunTrust building is already on the -- I cannot believe that closes beginning in the fourth quarter. With regard to the rest of the portfolio, we don't have the obvious candidates that we did couple of years ago, we told you that we don't like to hold on to [suburban] office space and we, don't like single-tenant buildings. We pretty much got rid of those in the portfolio, that being said, we're constantly evaluating what's going on within the portfolio and really looking hard at with the tenant make-up is, as well as the sales of those tenants in, the case of the retail. So it's hard to put a number on it, we're going to continue to be opportunistic with recycling capital, but there aren't any obvious candidates at this minute.

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Well we have the two commonwealth of Virginia building. Which we were waiting to hold until we get to the that the two year holding point on those, which will be coming up next spring.

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC

Q

And then within the retail portfolio mean, what's the opportunity set for you guys in near term to get, occupancy up in a couple of the Kroger assets and at the Harper Hill Harris Teeter location, boost occupancy in a couple of assets that are sort of sub optimally occupied in the retail portfolio.

Eric L. Smith
Secretary, Chief Investment Officer

A

Steven this is Eric. Appreciate the question. As you may recall from our conversation last quarter, there's been some the meaningful lease-up activity across that the core portion of that 11 assets portfolio we purchased, we talked about kind of going in cap rates may recall that the due to the efforts of our asset management team, we increased that check going in cap rate from the high sixes to the low sevens with some near-term lease-up activity, post acquisition and so we are pleased that the near term wins there. There still are some challenges, you mentioned, particularly has a little bit of challenging space, given the layout of the center of the changes in elevations and some other challenges that we're working through, we continue to have a positive outlook, being able to lease up that particular centre beyond. I think it's in the high 60s right now, was the prospects we're talking to but that is a centre particularly focused on either in finding the lease-up opportunity or looking at , some other creative ways to think about that centre, in the [way]to create some value-add opportunities, so we are, mindful of that particular centre and we – but overall on that core portfolio throughout the Carolinas is we're pleased with some of the leasing activity we've had to date.

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC

Okay. Thanks guys.

Operator: Our next question comes from the line of Bill Crow with Raymond James. Please proceed with your question.

Bill Crow
Analyst, Raymond James & Associates.

Q

Good morning guys. Question, just if you could give us a 30,000 foot picture of the local economy in Virginia Beach, any progress towards light rail that might be helpful for you guys. And in particular, kind of what is the, what are the fundamentals like on the multi-family side since you've decided to go ahead with another development project in that sector.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Okay. I take the first question, the first part of your question. Things are progressing well here in Virginia Beach on a number of fronts. The city has several initiatives that they are well underway, they look to crystallize deal for new 17,000 seat arena here at the ocean front, here and I think this quarter. They're also making all of the necessary pre-development expenditures towards the light-rail expansion to Town Center; I don't think will be crystallized till after the November election. There will be, there is a referendum a non-binding referendum but a referendum nonetheless on the issue that's going to be on the ballot. As far as both the local economy you are continuing to see some fairly robust growth, there has been a number of announcements here recently, particularly in downtown Norfolk that's backfill, some of those older office buildings, that's going to help the entire region. The port continues to grow by leaps and bounds, its status as the only [Panamax] ready port on the East Coast bearing dividends. So we're very optimistic about what's going on here, and hence launching another phase of Town Center, as well as the acquisition next door that we had last year, multi-family specifically is doing extremely well here at Town Center. As of today the Encore Apartments are approaching 97% leased, Cosmo, it continues to be strong. We are forecasting once we start construction much like happened a couple years ago when we were building 4525 main we are forecasting a little bit of a swoon head Cosmo when that construction starts on that base of the building, but again it's a temporary.

Bill Crow
Analyst, Raymond James & Associates.

Q

Okay, that's helpful. A follow-up, you did mention the [Panamax and the ports] are they actually, is the port actually experiencing heavier traffic now, that the canal is open?

Louis S. Haddad
President, Chief Executive Officer & Director

A

We have actually welcomed the first [Two 12,000] unit -- you are testing my knowledge. Our ships should have come through and they were greeted with much fanfare here a couple weeks ago.

Bill Crow
Analyst, Raymond James & Associates..

Q

Okay. And then finally from me total construction cost Index, which we, we look at, is showing that the construction costs are up almost 5% year-over-year. Is that consistent with what you guys are [seeing].

Louis S. Haddad
President, Chief Executive Officer & Director

A

Yes, we are seeing some fairly healthy increases, mainly on the labor side, as you know commodities remain pretty cheap and of course the oil swoon has helped out as well, but Labor wise prices are going up, particularly in large complex and really when you get into high rises. It's harder and harder to find subcontractors.

Bill Crow
Analyst, Raymond James & Associates..

Great, that’s it for me. Thank you.

Operator: Our next question comes from the line of John Guinee with Stifel Nicolaus & Co. Please proceed with your question.

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

Q

Great. Okay. Just a few easy ones. You guys love developing all types of product, particularly the complicated deals I was in Durham by the way that's ginormous hole, you have in the ground there.

And by the way it looks like you guys have a lot of work to get to Hopkins open in the third quarter. They really going to make it for the students coming back in a few weeks.

Louis S. Haddad
President, Chief Executive Officer & Director

A

They will make it. Yes.

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

Q

Seems like you but you like to own retail and candidly you're buying a lot of commodity retail Kroger's – Burlington Coat factory, PetSmarts, Michaels is that this sweet spot right now, when you're looking at all types of products in the Mid-Atlantic that you like this commodity retail the best and why?

Louis S. Haddad
President, Chief Executive Officer & Director

A

John got out of a turn that over to Eric to answer more specifically, but I can answer it from a 33-year perspective, over those decades, we've been through four recessions, we've been through booms, we've been through busts in the Mid-Atlantic and I can tell you it consistently what always survives and thrives is commodity retail, particularly, well located grocery anchored high-volume retail. Those are lessons that were hard-won over a long period of time. And so we are sticking with that actually

Eric L. Smith
Secretary, Chief Investment Officer

A

John, just a little more color, because I think your comment is a fair one, some color into our process and the number of opportunities that we're looking at relative to the transaction volume, the folks on the investment team here would be just seeing almost very close to all of the opportunities, certainly the on-market opportunities in the Mid-Atlantic within our geographical footprint and in prior history, a number off market opportunities as well. And most of those that we're looking at on the retail side after we utilized all relationships and contacts and sources to check on the activity at the center have a conversation behind the scene with the tenants themselves on how the stores are doing and how those particular stores at the various centers were looking at, fit into the long-term strategy of that particular retailer. We're turning down many, many of those retail opportunities. So the ones that actually make it through the filter and on to this call and our disclosure and into our portfolio are the ones that made it through a fairly thorough robust analysis of that tenant quality at that particular center in that particular submarkets. So I think that's an important point that while on the surface these centers may look a little bit more commoditized, a great deal of diligence has gone into the strength of those particular tenants, those particular centers within the overall plan of the retailers question.

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

Q

And then let me just ask. I think Dave Rodgers have asked that question but let me just rephrase the same question. You've been opting complete at I guess 4265 at Virginia Beach Town Center for two years now sort of sitting in the mid '60s, is it because the economy is just a very defensive oriented economy really a far suburb of Washington DC, two, Virginia Beach Town Center is just too pricey relative to alternatives or is it because whether it's Virginia Beach proper or downtown Norfolk or some office park. There are now more competitive, more attractive Office alternatives in your part of the world.

Louis S. Haddad
President, Chief Executive Officer & Director

A

No, yes and no. So, John we start reiterating

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

Thanks a lot.

Louis S. Haddad
President, Chief Executive Officer & Director

A

I appreciate the question. John, I will make sure that we reiterate this properly. For the first 11 years of the existence of Town Center, we effectively had-- did not have any space to lease, we have been at 99% occupancy on the office side for building on a decade and basically had to say no to every 5000 foot tenant or expansion opportunity that came along. When we built 4525 Main, the idea was to oversize it and have some flexibility for some time to come. We frankly had expected that some time to come would have come a little faster than it has, but we're very comfortable having that space to lease. The second part of John's question, is it too pricey for the market that the [nuance] question, it is intended to be the most expensive address in the region, already there are 1.8 million people. And so therefore naturally some 80%, 85% of the tenants in the market are not coming to Town Center, it takes those tenants that are willing to pay that premium in order to have that address – recruitment our clients are or what have you. So it's by design, not going to be filled with natural growth in the market. And thirdly, the other no for that piece of the puzzle is that there is not a competing product in the region. There are products that are offer 20%, 30% cheaper rent. We can't compete with that nor are we interested in. But that's about it.

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

Right. Thank you.

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

Craig Kucera
Analyst, Wunderlich Securities

Q

Hey, good morning guys. Appreciate the guidance update that I noted that the NOI guidance was up about $1.3 million on both the bottom and the top. Is that purely a function of hanging onto the three extra Kroger's or is there some other moving parts?

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Yes, good morning Craig, it's a combination of a couple items. One is, yes, hold on to those three properties, through year-end. The other is the addition of the Southshore acquisition. And on top of that with you know, our NOI as performed, our properties have performed form really well in the first six months, it's added to that as well.

Louis S. Haddad
President, Chief Executive Officer & Director

A

We also upped guidance on the construction company as well.

Craig Kucera
Analyst, Wunderlich Securities

Q

Right, right. Getting to the same store, You know, I think last year, the cash same-store was running at maybe 5.5%, first quarter was just inside for this quarter things slow down a bit do you think that you're going to see a pickup backs maybe the 4% to 5% range in the back half of this year, or do you feel like to a large extent, the portfolio of settling down to 2%, which I think it's maybe closer to your longer-term average.

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Yes, we had some nice cash pickups last year. Part of that [had] to do with the re-tenanting here it Town Center we had the [big loss for remember] took to 15 year space and all we had some free rent and moving periods and all had a straight-line rent adjustment. So really start picking up some cash there and there the retail return we did here, we know we're not giving guidance on same-store NOI, but we certainly hopes to get back at that level.

Louis S. Haddad
President, Chief Executive Officer & Director

A

It didn't make that again for those you on the phone. Mike and I've been telling people for a very long time, again, having that 33-year window of what goes on in our portfolio. Our long-term, same-store growth is in the 2% range, we've enjoyed significantly higher gains in net over the last couple of years. We would expect that would return to the center line over the long haul, Now again, what's been added to that is there are lease-up opportunities now within the portfolio that would augment that but that's traditionally what happens in our markets.

Craig Kucera
Analyst, Wunderlich Securities

Q

Got it. You know in the past you've had some success pricing OP unit deal is actually above the stock price, but maybe the discounts to NAV [hearing] the here we stand today with you guys creating the $15 range. Can you comment on where this next tranche of Southshore is pricing.

Eric L. Smith
Secretary, Chief Investment Officer

A

This is, Eric, I appreciate the question, that trend is intact and going strong. If it didn't work for the robust movement of the stock in a very short time period. So how little bit of history with [may be] they grew that we're buying Southshore from is appropriate for a second, you'll recall we, can have engaged acquiring giving Square from this group. And that OP unit deal like if my memory serves me correctly was priced at a high nine handled the stock quickly traded down thereafter to the low [nine's] and those folks obviously questioned it which would they longer question me more obviously only to returning [due] the next deal with us Southgate and I believe we did that one in a low 11 handle. When we actually came to closing that deal at a low 11 [handle]the stock is traded up into the high 11s approaching 12. And so when we negotiated the Southshore's deal we not only went out with an offer cap rate that we were going to budge off, but we did definitively said that those shares needed to be, those need to be priced at $12.50 a good $0.60 at the time, $0.60 or $0.65 above the current trading share price only to negotiate the deal and see the stock price take off to the $15 range. Given the relationship with this seller and the success that they had experienced over the first two deals, we actually came out and we're able to negotiate a pricing of those OP units at $13 at the end of the day, which was I think a fair negotiation on both sides given the success of that relationship in the previous deals for both parties. But certainly any deal we are now discussing are certainly that the $15 handle is where the conversation is beginning.

Craig Kucera
Analyst, Wunderlich Securities

Q

One last one for me. Do you with the cost of equity capital so much lower today than it's been in the past, are you more inclined to maybe push harder on looking at acquisitions, maybe more so in the retail space today than you were maybe six months to nine months ago where [orders] development still in the near term probably the way to go.

Louis S. Haddad
President, Chief Executive Officer & Director

A

It's an interesting questions. It does open up more opportunities to acquire higher quality products. But we are really reticent to change our strategy for a short-term, which could be short-term; the developments pipeline is going to continue to be our main engine. I think where you would see and what you're speaking our manifest itself more as of Mike alluded to with using the ATM even more robustly to allow for further development opportunities.

Operator: Our next question comes from the line of Laura Engle with Stonegate Capital Partners. Please proceed with your question.

Laura Engle
Stonegate Capital Partners

Q

Good morning and thanks for all the information as always and a good quarter. Lot of my questions have already been answered but I wondered that if you could just give us, you talked a lot about the sale of the non-core centers, especially the Kroger centers, what's kind of the best or worst case scenario going forward for those properties and what point we all in a reconsider pricing given performance.

Eric L. Smith
Secretary, Chief Investment Officer

A

This is Eric. I appreciate the question. So just for a refresher of couple of stacks on the three centers in question. The center in South Bend has a Kroger lease going out to 2020 and is in the mid 90% occupancy. The center in the Memphis MSA either Kroger took [20-28] with 96% occupancy. And then the one in Waynesboro Virginia has a shorter term on Kroger till 2018. But again, there is only about 15,000 square feet of small shops that Kroger dominates that whole portion of the Memphis MSA is a 100% occupied. And so we feel good about the Centers, we feel good about the Kroger anchors and we feel good about the term left and the likelihood for renewal. So, I guess the worst [reasonable] case is for reasons that we are unaware as we sit here on this call that pricing doesn't come in where we need to -- during our marketing effort later this year. And we opt to hold these, I guess that's what reasonable case that's certainly not our plan and best case, I really don't want to get into the pricing here on the call of the individual centers and are asking prices that to negotiate against ourselves publicly, but obviously best case is we hit pricing that puts the all-in sale of all these are at a Seven Handle collectively across these non-core assets that we would have sold and we would dispose of the remaining -- some subset of those remaining three by the end of the year as we have mentioned.

Laura Engle
Stonegate Capital Partners

Q

Right, Okay. And then, we talked a lot about the development pipeline but just with three significant projects seen initial occupancy coming out. These estimates for stabilization and have it ever attracted historically estimated versus in the final, why would you say these are conservative as we factor these in the estimates within the next in 12 to 24 months, how would you characterize these estimates as far stabilization for several of them coming online mid-2017.

Eric L. Smith
Secretary, Chief Investment Officer

A

I'd say they're reasonably conservative. It is certainly not worst case. So we trying here on of being a little bit more conservative than our goals.

Laura Engle
Stonegate Capital Partners

Well, I appreciate it and I'll let you get back to the queue. Thank you.

Operator: The next question is from the line of Paul Pruyear from Raymond James Financial. Please go ahead with your questions.

Paul Pruyear
Raymond James Financial

Q

Hey, good morning. Thanks, Lou. Just one more question from us on the apartment side. We're seeing a lot of new supply at the A level in the apartment space. Are you not seeing in that region, are you still getting rent increases there at Town Center.

Louis S. Haddad
President, Chief Executive Officer & Director

A

We're still getting rent increases. But we are seeing a lot more supply come on and that's not just a Town Center as you suggested -- we're seeing it in our markets in Carolinas, as well as at Baltimore Washington Corridor, so obviously location becomes more and more important. So we're still leasing up here again just to reiterate the locations are going to stand in the test of time and whether any storms that might be coming. The rate of increase might slow but I feel that they will -- for here, for the Inner Harbor, for Fort Meade and Washington where we are I think we are going to continue to grow -- at a slower pace until that new supply gets absorbed, but at Town center again just this morning coming in to work on the radio, heard that advertisement for yet another apartment projects that is one mile east of Town Center. And my guess is that's a couple hundred bucks a month cheaper than being in Town Center, that's going to continue to happen and probably accelerate, but we don't really feel a lot of that pressure.

Paul Pruyear
Raymond James Financial

Q

So are you expecting different yields in your apartments versus share, retail and office and the expansion?

Louis S. Haddad
President, Chief Executive Officer & Director

A

yes, on the retail side, again, we look for that that 20% spread between wholesale and retail and obviously that's different for retail than it is for apartments and that's continuing, it's going to continue to hold through here.

Paul Pruyear
Raymond James Financial

All right, thank you.

Operator: Thank you. At this time, there are no further questions and I'll turn the call back to Management for closing remarks.

Louis S. Haddad
President, Chief Executive Officer & Director

Thank you for your time this morning. And thank you for your interest in Armada Hoffler. We look forward to updating you again soon. Have a good day.

Operator: Thank you, this concludes today's teleconference. Thank you for your participation and you may disconnect your lines at this time.