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Armada Hoffler Properties, Inc. (AHH)

Q3 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 third 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, November 1, 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 third 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 third 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 December 1, 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, November 1, 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, potential redevelopment opportunities, the impact of acquisitions and dispositions, our construction business, our portfolio performance and financing activities as well as comments on our outlook and dividend.

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 once again reported quarterly results at the higher end of our expected range with Normalized FFO of 26 cents per share. And once again, we've raised our guidance range for 2016 and expect to close the year between 99 cents and a dollar one.

Later in the call, Mike will discuss our quarterly results and 2016 guidance in greater detail. But first, I'll provide some comments on our overall corporate strategy as well as an update on our development pipeline.

Since our founding nearly four decades ago, our goal has been consistent – to build a portfolio of the highest quality real estate – through conservative, selective development complemented by strategic acquisitions and dispositions.

As market dynamics change over time, our strategy to achieve this goal will continue to evolve. But our key advantage of being a diversified and vertically integrated organization is our ability to quickly assess, react and adapt to changing market conditions in order to capitalize on opportunities as they present themselves.

A good example of this is what we are seeing on the development front. Over the past several months, we've observed a notable tightening in commercial construction lending with loan dollars decreasing and equity requirements on the rise, thus leading private developers in need of greater equity sources to our doorstep.

For potential partners, we as the lead developer and controlling interest holder provide substantial advantages in addition to providing equity:

- the strength of our balance sheet and the ability to obtain construction financing,
- over 30 years of real estate development, construction and asset management expertise, and
- our in-house general contracting company to provide tight control over both cost and schedule.

In partnering with high-quality private developers that have local market knowledge, who have already invested the time, energy and resources in teeing up a project – whether it be through site selection and acquisition, zoning, permitting, or architectural – we can significantly shorten the overall development process and therefore, expand our development pipeline without significantly increasing our expenditure of internal resources.

As a result, we continue to see a robust level of deal flow for projects that meet all of our development criteria:

- Class A assets
- High barrier to entry locations
- Secondary and tertiary markets in the Mid-Atlantic and Southeastern United States
- Wholesale to retail profit margins of 20 percent or more

In addition to sourcing new development projects, we continue to evaluate several promising new joint venture opportunities across all product types – office, retail and multifamily – in our target markets.

A perfect example of such is Harding Place, our 80/20 joint venture with Southern Apartment Group that we announced this past quarter. Harding Place is a Class A multifamily project in Midtown Charlotte. The site provides residents with convenient access to the Greenway, as well as downtown Charlotte and is strategically located in close proximity to the Carolinas Medical Center, one of the largest employers in the city.

The Charlotte MSA is a target market for our company and we are pleased to have teamed with local partners that have more than 45 years of combined experience developing real estate in this market. With our construction company fully engaged, we expect to deliver Harding Place in 2018.

Turning to the remaining projects in our development pipeline…

This past quarter, we delivered both Lightfoot Marketplace and Johns Hopkins Village. The initial performance from both assets has been solid and we expect to ride this momentum to eventual full stabilization.

Last week, we officially broke ground on the next phase of the Town Center of Virginia Beach, representing the latest chapter in our successful, multi-decade, public-private partnership with the city. We expect to deliver this next phase of Town Center in 2018.

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

If you check page 17 of our supplemental, you'll see that our current development pipeline includes well over 300 million dollars' worth of projects. Given our historical profit spreads, we believe these projects, when delivered and stabilized, will yield significant value to our shareholders. This value creation may manifest itself in a combination of ways including total and per share FFO growth, monetization through dispositions, NAV growth or multiple expansion. We believe the result is organic, profitable growth that could lead to a lower cost of equity for future opportunities.

Our expectation is that 2017 will be a year of significant value creation as we continue to build toward deliveries in 2018 and beyond. And we would expect the significant bottom line growth that I just discussed to naturally follow that timeline.

While we have been able to grow per share earnings by nearly 10 percent annually over the last couple of years, the absence of near-term deliveries suggests a somewhat slower growth trajectory over the short-term.

Moving from our development pipeline to acquisitions and dispositions…

This quarter we completed our planned disposition of the Oyster Point office building in Newport News, Virginia. The Oyster Point building was one of the oldest assets in our portfolio and one that faced stiff competition in the submarket. We are currently under contract to redeploy our proceeds from this building into a stabilized grocery-anchored retail center in the Charlotte market. We expect to close on that acquisition in the next few weeks and look forward to providing further details after closing.

You may have also seen last month that we issued 2 million shares of common stock in an off market acquisition of a stabilized retail asset – our 6th transaction involving either stock or OP Units. We acquired the property in an all-stock transaction from a seller who now holds a significant equity position in our Company. We believe the acquired property is a logical and strategic addition to our portfolio with tremendous potential upside related to redevelopment opportunities, and I look forward to sharing more details with you at the appropriate time.

Whether it's through selective development, redevelopment, or strategic acquisitions and dispositions, the management team at Armada Hoffler remains committed to making the right real estate decisions in order to grow our portfolio, create value and return that value to our shareholders. To that end, our current payout ratio suggests that we have more than enough room to make thoughtful recommendations to our Board regarding our dividend.

With that, I'll turn the call over to Mike for further 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 25 cents per share and Normalized FFO of 26 cents per share, which was at the high end of our expectations. Our core portfolio, construction company and the two new development projects recently placed in service delivered excellent results. I also want to point out that our AFFO is exhibiting solid growth this year as well. The dividend payout ratio is 74 percent year to date even as the share count has grown significantly this year. This payout ratio is well within our corporate goal of 80 percent or less. We believe a well-covered dividend gives us flexibility going forward.

Occupancy increased this quarter, as did Same Store NOI, which increased for the 9th consecutive quarter. Same store NOI growth was positive 1.4 percent and 2.3 percent on a cash basis. However, we do not believe this to be a meaningful metric at this time. Due to the volume of asset recycling and newly delivered development projects, only 54 percent of the year to date and 59 percent of the current quarter total NOI are included in the same store calculation.

At the end of the quarter, our core operating portfolio occupancy rose to 96.2 percent with office at 96.4 percent, retail at 96.4 percent and multifamily at 95.8 percent.

On the construction front, we reported a segment gross profit, in the third quarter, of 1.3 million dollars on revenue of 39 million dollars. At the end of the quarter, the Company had a third party construction backlog of 246 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 the balance sheet.

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

We used the ATM program last quarter to raise 20 million dollars of gross proceeds at an average price of $13.93 per share. We believe the ATM program is the most efficient manner for us to fund our growth and development activities. If the stock continues to trade at recent levels, we will continue to be opportunistic with the ATM program.

During the quarter, we sold Kroger Junction, the second of the five non-core properties from the January portfolio acquisition. Combined with the previous Willowbrook Commons sale, these two assets sold for 12.9 million dollars. As previously discussed, these proceeds will be used for balance sheet purposes. We are evaluating the remaining assets for upside redevelopment potential and possible retention.

At the end of the quarter, we had total outstanding debt of 519 million dollars including 102 million dollars outstanding under the 150-million-dollar revolving credit facility.

We continued work on refinancing the 2016 and 2017 debt maturities. During the quarter, we closed on the refinance of the Town Center 2016 maturities. This new 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 prior loans. We also closed on the refinance of 4525 Main Street and Encore apartments. The new loan is a five-year loan in the amount of 57 million dollars and with a fixed rate of 3.25 percent. After these refinancing's, there are four remaining 2017 debt maturities totaling 30 million dollars. The largest of these is a 21 million dollar CMBS loan secured by the Hanbury Village center that matures in October 2017. This center has high occupancy and is anchored by a Harris Teeter with strong sales. Thus, we expect strong competition among lenders.

As we continue to evaluate our exposure to potentially higher interest rates, we have put in place a strategy that includes a mix of fixed rate debt and interest rate caps. With the combination of the refinancing's this quarter and the interest rate cap we bought last quarter, 99 percent of our debt was fixed or hedged.

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 99 cents to a dollar one per share.

This updated 2016 guidance is predicated on the following assumptions:

- Total NOI in the 67.3 to 68 million-dollar range.
- Third party Construction Company gross profit in the 5.1 to 5.3-million-dollar range.
- General and administrative expenses in the 9.2 to 9.4-million-dollar range.
- Interest income from our mezzanine financing program in the 3.1 to 3.3-million-dollar range. As of September 30th, the aggregate loan balance of these mezzanine loans was 50 million dollars.
- Interest expense in the 16.2 to 16.6-million-dollar range.
- And, 50.2 million weighted average shares and OP units outstanding, which includes the stock issued as part of the October retail acquisition.

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

The increase in guidance is attributable to several positive factors. Construction is having another strong year, portfolio occupancy is increasing, and the two recently delivered development projects are exceeding expectations.

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. Wanted to ask, I guess quickly about the acquisition that you referred to, for October and you issued the S-3 for, but it doesn't sound like you ready to fully talk about it, but it sounds like given that you've already issued the shares and talked about to the acquisition having closed in October that maybe we can get a little bit more detail on that before you are fully ready to announce it.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Dave. Thanks for the question there is not much detail that we want to talk about this time, it's a stable center, and then I believe that NOI is in our projections for 2016. We've got some very sensitive negotiations going on right now, with regard to re-develop opportunities there. I look forward to share in more detail as soon as possible but can't do quite yet.

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

Q

Okay. Well, thanks for that detail. I would say maybe Lou another question on the development side. It sounds like you have some more joint venture opportunities, how is the 100% equity owned pipeline work it sounds like you're maybe leaning more to joint ventures. But I guess, correct me if I'm wrong. How are you thinking about putting capital to work here or through new development?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Well as have I said on the call, activity is extremely robust right now both from our own sourcing as well as JVs. We are basically blind to the source at this point in time, we're basically cherry picking the opportunities, whether they come from outside with developers that we know or we source them internally.

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

Okay in terms of maybe the financing plan, Mike you referenced paying off some of the secured debt that you have, it didn't sound like you have a plan of financing those assets and into those and maybe just go into an unencumbered pool, is that correct? Is that how you're thinking about it?

Michael P. O'Hara
Treasurer, Chief Financial Officer
A

Yeah, good morning, [Dave]. Yeah, we still at times (inaudible). Right now, we are thinking of just keeping the credit facility in its current place right now with $250M with $150 on the revolver. And kind of been doing what we've been doing here in the past, and maybe we will look at that one at a floating rate debt on that one. So at some point in time, we want to monetize it and sell it. [We were] paid off and added to the borrowing base of the credit facility, we could do that.

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

And maybe last question, I think the only area that you really have any meaningful amount of speculative development underway with the town center. And then a couple of different Maryland apartment buildings, but all kind of on the residential side, can you talk about kind of the demand in each of those markets and kind of how you're feeling today about each one of those projects; even though, they are just getting underway. But how you kind of see the underlying fundamentals for those assets

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

Great question Dave. I don't want to take all of our time. I can tell you how excited we are about the bare land properties. Every scrap of news that comes in of what's going on in those markets is more and more positive. At the Inner Harbor with apartments in lesser locations than our Point Street apartments, are we leasing at unbelievable rates in unbelievable speed, so we just can't wait to get that up and the same is happening Fort Meade. We feel really good about the choices that we've made and look forward to getting those completed and leased up as soon as possible.

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

A couple of comments. I can't remember at the IPO, what the status was of your Virginia Beach Town Center high-rise. But it is sitting at about 64% leased. Is there just no demand for that location anymore or is there a favored submarket that is more en-vouge in your part of the world. That's one question. And then the second question is you're buying a bunch of commodity grocery anchored retail, remind us again what you like about those assets.

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

[For the] first question, I was hoping that someone would ask that question with regard to Town Center. First let me say, as I said before on previous conference calls that new high-rise that we put up was designed to give us some flexibility and some vacant space, due to the fact that where nearly a decade, we have essentially had zero space at Town Center, so we programed in an extra 100,000 square feet in order to soak of that demand. Secondly, as I said before, press the Town Center or a solid 20% above the surrounding markets perhaps 20% above the entire MSA and as such a vast majority of companies are not going to pay the freight to come here. So it takes a special user to want to pay for that address. Thirdly, what I'm happiest about and glad that you asked the question, or is that we've seen a noticeable uptick in activity over the last quarter. In fact, it's, that's probably more activity on the office side than we've seen in the last couple of years. I hope that's indicative of what might be coming, what might be brewing in the economy, but I know it's indicative of what's happening here. We look forward, the word weak negotiations on four different tenants are that we've substantially taken out of the remaining space in Town Center of course it’s not done until it's done. Look forward to updating you on that in.

With regard to your second question, I'm not sure that I would refer you to our acquisitions that commodity-based retail and course it depends on your definition of that, if all that we were looking at was the credit of the anchors and the term of the leases then I might agree with you that those are, those could be characterized as well in those centers. What we look for is well located stores with high volume sales and again as I said in the past over nearly 40 years now, we've seen that while there isn't any real estate that completely bullet proof -- grocery anchored centers with high sales stay full -- period. That’s been our strategy for a long, long time, that continues to be our strategy that will resolve itself even further in the coming years. As you know, John, we are not a fan of holding on to suburban office. We aren’t a fan of the garden variety multi-family, those things have their ups and downs and that's why you see us weed them out of the portfolio at opportune times, but grocery anchored high sales volume stores stand that test of time.

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

Great. Thank you.

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

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC

Q

Good morning, guys. Well, when you look at the development page I get at 17 of the supplemental, on the stuff that's either deliver not stabilized or still under development are in the mezz and the JVs and everything. What's the sort of blended stabilized yield that you're expecting on that capital deployment today.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Thanks, Rob that's a good question as you know there is a couple of different product types in there. So I'm not quite sure of the mix. But we're as the quality of the products increases obviously the returns decrease. What we are focusing on is the significant spread we told you that we aim for 20% between wholesale and retail. Right now that pipeline is weighed towards multifamily, which obviously drag you into the lower end of the scale. For instance, on Harbor Point, we are seeing cap rates there in Baltimore transactions believe it or not in the low fives even saw one couple of months ago in high fours and we're well north of 20% over that. But as a blended average the more multi-family that we're going to have in the pipeline, the more you are going to skew down into the sevens as opposed to when we have more office and retail in that pipeline it just skew into the eight, so where there is a fairly tight range and again what we have to be mindful of is our cost of capital and so what you may see as we've alluded to a number of times in that some of those might be monetized rather than brought on board in order to reap that benefit that we may not get paid for in the stock price, as everybody on a phone know, as the largest shareholder we have to look through that lens before we could add things to our portfolio [because we like them].

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC
Q

Okay and then where are you guys in terms of current occupancy at Hopkins Village that kind was basically 78% or so at September 30. Has that moved up since then and how should we be thinking about this as going forward, is this more like a student housing asset where if you miss the semester you know you're stuck with a lower occupancy for a period of time or is this just typical market rate, you know apartments where you know you can continue to build, even once the semester starts.

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

Yeah, again great question appreciate that gives us an opportunity thanks to everybody has a good understanding on the phone that project is a venture with Johns Hopkins University and its purpose is for junior and senior housing. The occupancy is hanging right around -- it hasn't grown appreciably after the start of the semester. We wouldn't expect that is going to grow appreciably other than the retail rents all coming online until we have a pickup in January, but I wouldn't expect as we said on our last call, we wouldn't expect full stabilization until late next summer.

Rob Stevenson
Analyst, Janney, Montgomery, & Scott LLC
Q

And then just lastly, how should we be thinking about dispositions over the next 6 months to a year, call it, there's not much left in the office portfolio to harvest. I know that some of this stuff was recently delivered, so you got REIT rules around that. Is there's stuff in the portfolio at this point where you're looking at it and saying, the time to monetize its next 6 to 9 months or a year or we basically looking at equity funding for 17 largely coming through the ATM.

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

Another great question, there are a few things in our portfolio we're looking at strongly as we've alluded to before that, which we have two state office buildings in the portfolio that frankly will be monetized at the appropriate time. We also -- some of our centers going back that the John's question, some of our older centers are performing well. But what we're seeing out in the marketplace still is a compression on cap rates in what we consider to be maybe commodity retail, but not the all-stars in our portfolio. So you could see us recycle some of the older centers in the coming year

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

Bill Crow
Analyst, Raymond James & Associates.
Q

First of all, maybe the opposite end of Guinee's question earlier, you're selling office to buy the retail, just bullet point it, why is it that you want to get out of suburban office? we're reading a lot more reports about suburban office starting to outperform, just kind of your thesis on that?

Louis S. Haddad
President, Chief Executive Officer & Director

A

I appreciate that. Again it's really kind of comes from the school of Hard Knocks. Remember our markets, we're dealing in secondary markets in our secondary markets land is not at a premium, when you have suburban office you really essentially have because I'm speaking in broad generalities here, what we've seen over 3.5 decades and is that we don't have much of a barrier to entry. And while we're really pleased with the 10 year and 15 year leases that we get at the outset, we've seen that once those things roll over. It's very difficult to maintain the rents and even if you can maintain the rents. You've got a huge outlay of TI in order to -- that new tenant. And you are at risk because this it's fairly easy again in secondary markets for someone threw up a building that next store and enjoy all of your tenants. So it's been our, it's been our experience over a long, long period time that those things have they are greatest value essentially the day that you deliver. That's, worked for us for a very long time. I would not want to get caught up in believing that there is significant upside and B-Assets suburban markets.

Bill Crow
Analyst, Raymond James & Associates.

Q

Appreciate the answers. One final question from me, you talked about the construction lending environment tightening that quick may be touched on that last quarter as well. Tell me difference between your three asset classes or regionally as far as the availability and cost of money.

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Good morning --. So recently, we've gone out on the multi-family. So we haven't gone anything here recently on the retail and office but the feedback I'm getting is that it's tightening up across all of the product types. This new HVCRE's coming through a really change in the capital requirements of the banks. So there the change in our pricing and loan/cost for development.

Bill Crow
Analyst, Raymond James & Associates.

Thank you guys

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

Hi, good morning guys. Just a follow-up on the last question yeah, I know you mentioned that you see is tightening up across the board, but are you, are you seeing any difference in the type of projects that are coming to market. You know maybe, maybe a little bit more pure play multi-family or retail. But maybe less mixed use because there are more moving parts. A little tougher for bank to maybe under right.

Louis S. Haddad
President, Chief Executive Officer & Director

A

I wouldn't say that Craig, we've seen lenders are significantly wary of multi-family across the board. As you all know, there has been a huge boom in multi-family construction and so a lot of these guys regardless of how good the project is simply have full portfolio of construction loans on other projects in the particular market. I think that combined with the higher-risk loans that the regulators are basically foisting on the banks. With regards to real estate lending has led them to bring loan dollars into the 60% range where, couple of years ago, we said multi-family, then you're looking at the 75% loan. Overall, I think that's really good for the market and the economy further, I get the right thing for the wrong reasons, if you will, and because of cause the slowdown in some of these projects that really shouldn't get built perhaps won't, but in the meantime we are the beneficiary of a lot of people bringing their projects our way.

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Let me also add that we are talking about construction loans and not the stabilized assets. It's different lending environment versus construction.

Eric L. Smith
Secretary, Chief Investment Officer

A

I would add one more comment to dove tail into a topic from another question that and other benefit that were enjoying from having these -local- site-specific developers bring us development opportunities on the JV development platform side is that it. As Lou mentioned, we can cherry pick the best of those opportunities throughout the Mid-Atlantic and Southeast and to the extent that construction lenders only have room for a one or a few remaining projects that particular submarket we're able to take advantage of that in some cases two plus years of work with our development partner has done locally. And see that opportunity in that market place, which allows us -- what is an increasingly competitive construction loan environment to be able to secure those construction loans. All be it at a lower [LTC] than we have been seeing in the past, we still finding access to those construction dollars, because as those attractive opportunities.

Craig Kucera
Analyst, Wunderlich Securities

Q

And following up on that. Are you finding that if someone has put in two to three years into a project. Are you seeing any opportunities where there may be some distress maybe developers have been caught midstream and a little bit surprised, and maybe over extended themselves and maybe you can get a better deal than you might normally be able to get.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Definitely happening out there. When you think about it you started working in 2014 project the various 2016, then you definitely have a different expectation when started so yeah. And then again, we want to be opportunistic without being piggish if you will, this Company was built on relationships we get first shot and a lot of these projects, because of our longevity and the fairness of which we treat people, so you're not going to see us rake a partner over the coals, but at the same time, obviously that puts us in a very good position to make a very good deal.

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 [wondered] is on the Town Center next phase is under development, if you could tell us I know it is anchor tenants, not yet announced if you could tell us a little bit about how that [Knicks] at tenants compares to what is already there how the preleasing compares to what you've seen historically and then maybe I guess any kind of lessons learned, having been there for [a long] and really done the majority of the development what's going bring them the success in getting that property online and what you think as far as, anything of the stabilization rates compared to historical rates. Thanks.

Louis S. Haddad
President, Chief Executive Officer & Director

A

Sure. And thanks for thanks for the question. When you guys want start talk about Town Center it's sees guys keep nudging me that when will you shut up because I get really excited about what we're doing there, the anchors that have been reticent to make announcement yet, basically want to be much closer to their store opening before they unveil. But I can tell you is it's the same type of lifestyle center tenant that we've endeavored to attract the Anthropologies West Elms, and Brooks Brothers of the world. So you'll see that it's in that same [ilk], well known international name. I tell you it's brought this --- this little project has brought a tremendous amount of excitement to Town Center from the standpoint of how quickly it is going to stabilize it right in its (inaudible) you are somewhat familiar with Town Center it's right in the center of Town Center. As opposed to on the periphery, it's right next to the public plaza that's become the gathering place for the Town's people and so it's going to be highly visible, highly desirable and we've had some great absorption rates on our retail and our apartments today, the Encore apartments are already the high-90s and I expect that there is a waiting list for the type of apartment that we're building on this Block. So I expect that's going be stabilized very quickly. We are also, we've got, we're while we have a couple of leases with the people I just mentioned, we are in LOI negotiations essential for the rest of the space, there is going to be some rework involved. I guess, something else you want to get out there, we're going to have to move some tenants around and the retail under the – Cosmopolitan apartments to make room for some other co-tenants, that we really want, we're going to be moving a couple of the local shops and if you know when we put together our 2017 guidance. Our expectation is much like when we built 4525, then we are going to see some loss of occupancy in the Cosmopolitan while the construction is going on. -- part in -- swing, but again a temporary blip for a much greater good.

Laura Engle
Stonegate Capital Partners

My other questions have been answered so I will hop back in the queue that appreciate all that get information and congrats on the successful quarter.

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

Good morning. It would really like to give some more color on your construction company. The profitability there and I would assume you're getting cost pressure, if you could comment on the and are you able just to pass that through?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Great question Paul, I appreciate it. May I'd tell you guys are making us talk forever here, some of you know I came up through that company and it's still near and dear to my heart. Paul we're not seeing any pressure on the profitability on their company, essentially because of the way we do business. This is much different than traditional construction, our guys are not out there trying to be the low bit on the projects. Our people get hired to help an owner, develop a projects very hired an architect and we hired a contractor and works those two together to ultimately come up with the best products we can at the most reasonable price and a very short time frame. Therefore, it is not incumbent upon us to put a hard number on the project and until we essentially have the entire project sub-contracted. So long answer to a short question, essentially everything is pass through. It's still the construction business and there is still some risk obviously, you can have subcontractors go out on unit in the middle of projects that we have extremely well oiled vetting machine to keep that to a minimum. As Mike mentioned that backlog is well over a couple $100 million for the third year of fourth year in a row we are our expectations at 2017 it is going to be once again be at the higher end of the range and it also -- it begs the question why not expanded. Well, it's not really expandable we have really liked the idea that company bring in $4 million, $5 million every year that kind of work that it gets it gets from a couple of handful of those client that understand the value of hiring a contractor upfront, because that's where the money is saved during the design process, but it doesn't scale up well, and frankly we have as much benefits in having those guys work for us in controlling our cost and schedules, as well as involved in these joint ventures as we have said before, these mezzanine lending program that we have, we wouldn't have it if we didn't have our construction company on site basically monitoring the process in prosecuting the construction, so it's a multi-headed monster for us that happens to be very lucrative on the stock.

Paul Pruyear
Raymond James Financial

Q

Thanks for that and then the cost pressure.

Louis S. Haddad
President, Chief Executive Officer & Director

A

We're seeing a lot of cost pressure across the board in a number of different markets I say it it's kind of interesting to look as you wonder why in a flat economy and where commodity prices have essentially gone down for the last several years, why would you begin a cost pressure and the biggest reason that we see is that there is a third of sub-contractors out there to do complex high rise-type work, a lot of them went away in the Great Recession and they largely have not come back you have seen a few articles about it in the Wall Street Journal about how difficult it is to get a glass on a high rising stage. That's really a manpower thing and so, not sure when that resolves itself, so for our third-party clients they know what's going on and can react accordingly. For our development business. It's kind of interesting again, as you guys know we don't throw up buildings in hope to lease them, we do projects with Cities and with well-heeled anchor tenants and basically it becomes back to a pass through and what we do a public-private partnership we do our forecasting on what costs are going to be, that basically just means there needs to be more participation from the—City, university, or whoever our public partner is. Same thing when we get an engagement from one of our grocery anchors, they asked us to go somewhere and built a building for them. They understand what their freight is going to be. So while we'd rather not see rising prices, but we're well equipped to take care of it.

Eric L. Smith
Secretary, Chief Investment Officer

A

The other thing that we obviously don't know the answer to what we're discussing in keeping an eye on, is this how that cost pressure out there on the construction cost side might manifest itself in the context of the construction lender [pullback] we're seeing and that impact on the number of the deals that get done. So we're keeping an eye on that and obviously very interested party.

Paul Pruyear
Raymond James Financial

Q

Sounds like somebody needs to raise the rents. Going back to the discussion on leasing at Virginia Beach office, last quarter, I think you commented that the B Rents and B space in Norfolk was [filling], could you just give us some more color on that, the rate, that it is filling, how much lease rates are going up, and how that affects the leasing at Virginia Beach? and I guess as part of that, are you holding rate at Virginia Beach.

Louis S. Haddad
President, Chief Executive Officer & Director

A

We've seen some great success in downtown Norfolk as of late and recently reported that, but the companies that have chosen to relocate and some of those older buildings that we talked about, they brought in over 2000 jobs over the last 18 months. As a matter of fact, they are setting up training station. So that lot of these people while the locals will be able to get those jobs as opposed to people coming in from outside the area. So it's a great benefit for the region they have those building [full]. There has also been one of the major high rises in downtown that is (inaudible) 40 years old, it's now being converted into multi-family, so it's another few hundred thousand square feet that taken off the market. So again, we [applause] there success. We are hopeful that we're going to be one end of the light-rail line, that's going to come to Town center. [but] in any respect, it's good for the region. In terms of what it does for our rents, it's not much one way or another. We are holding rates. The lease that we did, we talked about last quarter at 4525 main was in the 27.50 range. The Board tenants that we're talking with now that I've mentioned are all going to be in high twenties. So we're not budging. If we think about it, we can't -- it would not be wise for us to try and dive and fill these buildings. Not when you have another 700,000 square feet that ultimately is going to roll over. And to be honest with you the 110 tenants here enjoy the exclusivity that we've been able to maintain. So we are going to stay there with that like I said activity has been robust and I look forward to having significant increases in occupancy over the next couple of quarters. Long answer to a short question. I hope I -- get you.

Paul Pruyear
Raymond James Financial

Q

Yes, you did, except for the rate of increase in B rents, if you have a number that would be helpful?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Yes. I don't have the number. I would tell you that those B rents are still B low. One of the prizes that they got was a big commitment from ADP, which I think is around 800 jobs, [150,000] square feet. The city had to kick in significant money to help. That was a huge economic development department lift where they competed with a number of competing cities in order to get that. So I wouldn't think -- speculating and I shouldn't -- I wouldn't think that there was any material increase and what happened. Now, you would imagine with the successes that they've had, I mean the law of supply and demand, the remaining space that's in Downtown Norfolk, you would imagine, you'd be able to start getting a bit of a premium in those rents would start to creep up.

Paul Pruyear
Raymond James Financial

Yes. I'm sure we can drag it down. Thank you. Good color.

Operator: Our final 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. A quick follow up. Refresh our memory as to when you raised the dividend last and by how much? And then the second question is, if you look at your guidance, it implies a $0.22 to $0.24 fourth quarter FFO I think, and that seems like a little thin if you raise your dividend [$0.01] about the same time your FFO is only $0.22 or $0.24. Can you walk us through those two issues?

Louis S. Haddad
President, Chief Executive Officer & Director

A

Yes. I'll start now and then turn over to the Mike. So for the last two years we raise the dividend by coincidentally $0.04 at the end of first quarter of the subsequent year, so that was in February 2015 as well as February 2014.

Michael P. O'Hara
Treasurer, Chief Financial Officer

A

Yeah, John, -- so on the guidance. So, year-to-date, we're at -- $0.77 normalized and I've our range is up to $1.01. So certainly not showing the same run rate is this past quarter, but part of that is the effect of a use in the ATM this past year, as we have talked about we have ramped that up quite a bit and raised $50 million on the ATM. All things been equal the share count going up, it's going to bring down fourth quarter earnings little bit.

Louis S. Haddad
President, Chief Executive Officer & Director

A

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Remember that in that in the past quarter, we have $20 million dollars on the ATM and 2 million shares, go out the door as well for those properties that we're looking forward to talk with you about that obviously adds a bit of dilution but as Mike said, we've had strong AFFO growth this year, we expect that continue and so we feel real good about that dividend coverage.

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

Thank you very much.

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

Guys. Thanks for all your attention and great questions. We look forward to updating you soon on some of the things we talked about and have a great day.

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