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# Armada Hoffler Properties, Inc. (AHH)

Q4 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 fourth 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, Thursday, February 9, 2017.

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 fourth 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 fourth quarter earnings along with our quarterly supplemental package and our 2017 guidance presentation was distributed this morning.

A replay of this call will be available shortly after the conclusion of the call through March 9, 2017.

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, February 9, 2017, 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.

We will start the call today by discussing current events and the year ended 2016. After which, Lou and I will discuss our 2017 guidance. Now, I will turn over 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.

Today we reported full year 2016 results of a dollar one of Normalized FFO per share, reaching the high end of our expected range. Our same store portfolio produced another quarter of growth while our overall portfolio remained leased in the mid-nineties. Our construction business finished the year with profits well over 5 million dollars and is carrying nearly 220 million dollars of third party backlog into 2017.

While it’s gratifying to report another year of solid financial results, I’m even more proud of what we’ve accomplished in the three plus years since our IPO.

Before I turn the call over to Mike, let’s reflect on just how much our Company has achieved since the spring of 2013.

Three years ago we were a newly public company with a market cap of some 350 million dollars.

Three years ago, we were talking about our identified development pipeline of projects concentrated in the southeastern part of Virginia and our expectation of 150 to 175 million dollars of new development every 18 to 24 months.

And finally, three years ago, the management team and I talked about how the successful execution, delivery and stabilization of the projects in our development pipeline would eventually lead to future growth not only in NOI, but more importantly, in NAV.

Today, each of the projects in that original pipeline has been delivered; many have stabilized; and the healthy wholesale to retail spreads that we’ve created have been recognized.

Today, after successfully executing our business plan, our market cap has more than doubled; our earnings, NAV, dividends and share price have all grown meaningfully; and total return to shareholders has outpaced the REIT index by a significant margin.

Today, we have leases out for signature for nearly 40 thousand square feet of new tenants at 4525 Main. These commitments, when combined with the existing Town Center tenants who relocated, upgraded and expanded into the building, will bring occupancy to well over 90 percent. We are very pleased that we were able to hold rents at this, the premier address in the region, and achieve our target returns. And with the relocations from lower price point space creating vacancy that appeals to a wider array of prospective tenants, we are poised to quickly bring office occupancy at Town Center back to its historical levels in the mid to high nineties. As you already know, our expansion of Town Center continues with the construction of Phase 6 currently underway and the acquisition of the Columbus Village shopping center next door.

Today, our predevelopment and development pipeline approaches 440 million dollars and reaches as far north as the Inner Harbor of Baltimore through the Greater Washington D.C. metro area, into downtown Durham to midtown Charlotte and some of the fastest growing markets throughout the Carolinas.

With not only the volume, but the quality of locations and projects in our current pipeline, the potential for value creation has never been greater.

So our message this morning is the same as it was three years ago, when we were promising successful execution of that original pipeline – efficient construction, delivery and stabilization of our development projects is the primary path to future NOI and NAV growth.

Near term per share earnings growth will be largely offset by our continued ATM activity and asset dispositions as we prepare our balance sheet for the delivery of several premier assets. But as we have said before, we've never managed our business on a quarterly or even yearly basis; our goal has been and always will be to build a portfolio of the highest quality real estate in order to create value over the long term and return that value to our shareholders.

Given our track record of success over nearly four decades, we have every reason to believe that the best is yet to come.

At this time, I'll turn the call over to Mike to review our fourth quarter and full year 2016 results, after which I'll comment on our 2017 guidance. Mike…

## Michael P. O'Hara
*Treasurer, Chief Financial Officer*

Thanks Lou

Today I want to cover the highlights of the quarter, the full year, and thoughts on our balance sheet.

This morning, we reported FFO of 27 cents per share and Normalized FFO of 25 cents per share.

For the full year, FFO was 96 cents per share and Normalized FFO was $1.01 per share. This compares to FFO of 87 cents and Normalized FFO of 93 cents in 2015.

FFO excludes 30 million dollars of gains on real estate sales which equates to over 50 cents of earnings per share. Despite this treatment, as we have discussed in the past, asset sales and capital recycling will continue to be an element of future shareholder value creation and we believe this past year's asset recycling improved the quality of our portfolio and underlying cash flow. On a related note, because we structured these transactions as 1031 tax-free exchanges, there are no taxable gains in 2016. Tax efficiency remains one of our corporate goals.

The 4$^{th}$ quarter represents the 10$^{th}$ consecutive quarter of same store NOI growth. Same store NOI was positive 1.3 percent and positive 1.8 percent on a cash basis as compared to the fourth quarter of 2015.

For the full year, same store NOI was positive 1.2 percent and positive 1.7 percent on a cash basis as compared to 2015.

At the end of the quarter, our core operating portfolio occupancy was 94 percent, with office at 90 percent, retail at 96 percent and multifamily at 94 percent. The overall drop in portfolio occupancy was primarily due to a decline in office occupancy. As Lou discussed, two tenants are expanding and relocating into 4525 Main Street from other Town Center office buildings. Keep in mind that 4525 Main Street is not currently included in our core operating properties.

On the construction front, we reported a segment gross profit in the fourth quarter of 1.4 million dollars on revenue of 50 million dollars. For the full year, we reported a segment gross profit of 5.7 million dollars on revenue of 159 million dollars.

At the end of the fourth quarter, the Company had a third party construction backlog of 218 million dollars.

To summarize our 2016 performance metrics, the company excelled in all areas. Normalized FFO increased 8 cents per share or 9 percent and AFFO increased 11 cents per share or 14 percent. The dividend was well covered with a 73 percent payout ratio for 2016.

Additionally, total shareholder return for AHH outperformed the indexes. The 2016 total shareholder return was 47 percent versus 9 percent for the RMS and 21 percent for the Russell 2000. And since our IPO in May 2013, total shareholder return was 59 percent versus 27 percent for the RMS and 48 percent for the Russell 2000. We are obviously pleased with these returns and are grateful for the trust our shareholders have placed in the management team.

Now turning to our balance sheet.

We continued to take actions to enhance flexibility and strengthen our balance sheet including increasing the capacity of the credit facility, hedging our interest rate exposure and continued use of our ATM program.

We used the ATM program last quarter to raise 17.4 million dollars of gross proceeds at an average price of $14.10 per share. For 2016, we raised 68 million dollars of gross proceeds at an average price of $12.89 per share.

In addition, we issued 46 million dollars in stock and OP units as part of acquiring 75 million dollars worth of property acquisitions in 2016.

During the year, our equity market cap increased by 322 million dollars to 805 million dollars. Our total enterprise value increased by 472 million dollars to 1.3 billion dollars.

At the end of the quarter, we had total outstanding debt of 527 million dollars including 107 million dollars outstanding under the 150 million dollar revolving credit facility.

In January of 2017, we added two properties to the credit facility borrowing base to increase the capacity by 25 million dollars to a total of 275 million dollars.

We continue to evaluate our exposure to higher interest rates and look for opportune times to enter into hedges. At year end, 97 percent of our debt was fixed or hedged. Subsequent to year end we purchased a 2 year, 50-million-dollar interest rate cap at 1.5 percent to replace the cap maturing on March 1st.

During 2017, we intend to continue to position the balance sheet for the development pipeline and associated growth through:

- Opportunistic asset sales. In the first quarter of 2017, we sold a single tenant asset at a 5.0 cap for 4.6 million dollars. The proceeds will be used for balance sheet purposes. We continue to evaluate our portfolio for opportunistic sale candidates.

- Continued use of the ATM program which we believe is the most efficient manner for us to fund our growth and development activities.
- And increasing the capacity of our credit facility by 25 million to 275 million dollars.

At this time, I'd like to draw your attention to our 2017 guidance presentation that we published this morning. I'll now turn the call back to Lou to begin the discussion of our 2017 guidance. Lou.

## Louis S. Haddad

*President, Chief Executive Officer & Director*

Thanks Mike.

Looking back over the last three years, you'll see on page 3 of the 2017 guidance presentation that we've successfully produced and delivered over 300 million dollars of new real estate, creating over 50 million dollars of equity in the process, some of which we've monetized, but all of which has manifested itself in healthy NOI and NAV growth.

As I mentioned in my opening remarks, while we're pleased to report another quarter and year of bottom-line per share growth, I'm much more excited about the opportunities in our development pipeline and the associated value creation and growth potential over the next few years.

When we look at each of the development pipeline projects and predevelopment opportunities presented on page 4, you'll see that the quality of assets in our pipeline has never been higher, the locations and markets have never been better and the potential value creation has never been greater.

All told, the total cost of the projects in our current pipeline approaches 440 million dollars. Given our history of delivering healthy wholesale to retail spreads of around 20 percent, we expect that these projects alone will add some 90 million dollars to NAV or well over a dollar per share on a fully diluted basis over the next few years. And as you can see, we are forecasting deliveries to begin in less than 12 months.

Remember, this does not include many other exciting development opportunities that we continue to explore as far west as Nashville, throughout the Southeast and along the east coast. However, I believe it is important to note that we continue to decline the vast majority of opportunities presented to us. The standards we use to evaluate whether to deploy our precious capital on a new project remain, and will continue to be, exceedingly strict.

As Mike and I have reported to you on many occasions, we have various mechanisms at our disposal to fund and appropriately lever the projects in our pipeline in order to meet our corporate goals. We will continue to use a combination of our credit facility, construction loans and our ATM program as our primary capital sources. Alternatively, as we have demonstrated before, we may choose to monetize and recycle the healthy spreads on some of these assets.

However, even if we choose to retain all of these properties, we believe that continued and prudent use of the ATM program will be more than sufficient to fund the necessary equity to maintain our target debt metrics. So while we continue to forecast absolute growth in NOI and FFO over the short term, we expect growth on a per share basis to be muted in favor of long-term value creation, just as it was as we executed on our previous pipeline.

The growth in NOI since our IPO is illustrated on page 6 and as you can see, the successful execution of our prior 260 million dollar pipeline was the primary driver. When we extrapolate this past success to our current 440 million dollar pipeline, you can understand why we're so optimistic about the growth potential of our Company.

At this time, I'll ask Mike to walk through the details and key assumptions underlying our 2017 guidance. Mike…

## Michael P. O'Hara

*Treasurer, Chief Financial Officer*

Thanks Lou.

Today, we introduced 2017 guidance of 99 cents to $1.03 per share. We believe that 2017 will be a year of execution and positioning the balance sheet for the development pipeline and future growth. In addition, with no NOI contribution from new development projects, the mid-point of the 2017 guidance is flat with 2016. This is similar to 2014, prior to the delivery of the IPO pipeline. Once the pipeline deliveries began in late 2014, Normalized FFO per share increased by 23 percent over the subsequent two years.

Now I'd like to go through the details of the 2017 guidance. Please turn to page 7 of the presentation.

First, starting with our assumptions:

- Disposition of a single tenant asset during the first quarter with the proceeds being used for balance sheet purposes.
- Raising 40 million dollars through the ATM program or 10 million dollars per quarter
- Interest expense is calculated based on the Forward LIBOR Curve which forecasts rates rising to 1.25 percent by year end.
- Maintaining core debt to core EBITDA in the mid 6x range.
- No acquisitions in 2017

This 2017 guidance of 99 cents to $1.03 per share is predicated on the following:

- Total NOI in the 73.8 to 74.5 million-dollar range,
- Third party Construction Company gross profit in the 5.0 to 5.5-million-dollar range.
- General and administrative expenses in the 10.2 to 10.5-million-dollar range.
- Interest income from our mezzanine financing program in the 5.7 to 5.9-million-dollar range. As of year-end, the aggregate loan balance of these mezzanine loans was 59.6 million dollars.
- Interest expense in the 17.9 to 18.5-million-dollar range.
- And, 56.8 million weighted average shares outstanding.

Now I'll turn the call back to Lou.

## Louis S. Haddad

*President, Chief Executive Officer & Director*

Thanks Mike.

Before I open the call up for questions, I am excited to reiterate that the Board of Directors has declared a cash dividend of 19 cents per share for the first quarter or 76 cents on an annualized basis. This represents a 5.6 percent increase over the prior quarter's dividend and the third increase in three years, totaling nearly 19 percent dividend growth during that period.

This reflects the Board's confidence in our long-term strategy and our ability to execute as well as the Board's commitment to returning value to our shareholders.

Thank you for your time this morning, and your interest in Armada Hoffler. Operator, let's 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. Hey, Lou, just wanted to—and maybe start with a big picture question. Trump seemingly is a little bit more pro-defense—that may or may not have helped with the Brooks Crossing transaction—but we really haven't seen a lot of Government services job growth as of yet. Maybe you can talk about kind of how the region feels particularly given that historically people would view your region as definitely Government-centric.

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

A

Sure. Thanks, David. Well, as you know, we really don't have any tenants that are directly involved with the DoD. However, obviously several of our tenants benefit by job growth in the area, whether it's related to the port or to tourism or general business or the military.

There's a huge amount of optimism in the region regarding the potential Trump policies. Obviously, strengthened defense leads to more military spending, which helps everything in this local economy. Perhaps more importantly for us is the infrastructure spending that they're talking about. You may know that our greatest concentration office tenant-wise is in architects and engineers, and I can tell you a lot of the leasing upward pressure that we've seen over the last few months is related to those folks expanding, which is great to see.

So everything that's being talked about is positive for this region. We'll see how much actually materializes. But I'll tell you, it really started in the last six months of 2016. There's been a tremendous amount of wins in the region. ADP is locating a huge office here, hiring 1,500 people. Job growth in the area is over 3,000 jobs in the latter part of the year. A new convention center hotel is opening up in Norfolk, a new entertainment district. The Beach is talking about a new arena, and the convention center hotel as well. So there's an awful lot happening that we're excited about and, of course, Town Center sits in the middle of all of it.

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

Q

Good segue into the Town Center. So, obviously, the Columbus Office building saw a dip in occupancy. It looked like maybe some of that was in your renewal leasing schedule, but it didn't seem to maybe explain the entirety of the drop in occupancy there, so can you maybe dive a little bit deeper into kind of the—from some of your legacy assets at Town Center to 4525?

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

A

Sure. I appreciate the question. We're very excited about all these developments. So the drop in occupancy is potentially 30,000 feet of tenants expanding into 40,000 square feet of space in 4525 Main. When you take that 30,000 feet out of the core portfolio, it's a drop in and of itself of around 5% on the office occupancy.

A better place to go—and this is why we're so excited—is soon, when we sign these leases that are out for signature now in 4525 Main, that building's occupancy comes to 94%. When you add that square footage to the Town Center Office portfolio, we now have an Office portfolio of around 840,000 square feet that has about 75,000 feet of vacancy. The good news is that the majority of that vacancy is lower price point space that appeals to a much broader section of tenants.

So, as I said earlier, we're expecting to very quickly get back into the mid-90s overall on a much bigger portfolio.

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

Q

Lastly, just on the same topic you said about 40,000 square leases out for signature at 4525; are those all new entrants into the Town Center market for you guys with the submarket there?

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

A

Correct. They are new.

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

Q

Okay. Great. All right. Thanks for the color, guys.

**Operator:** Thank you. 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. Can you talk a little bit about what the occupancy and same-store NOI growth expectations are embedded in your '17 guidance?

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

A

Sure. Rob, as we've talked before, Mike and I and the Management Team, we're thrilled that we've got 10 consecutive quarters of same-store NOI growth. We've been running this portfolio in these markets for well into our fourth decade and our—we look at things more on a—you know, things can be lumpy on a year-to-year basis. We had some quarters where we were growing at 4% and 5%, but ultimately this thing resolved itself into the 1.5% to 2.5% range on a long-term basis. So what's within the '17 guidance is in that neighborhood 1.5% to 2%. Like I said, it's not going to vary a whole lot from that over any type of a meaningful horizon. We don't have a tremendous amount of space to lease, as you know when your occupancy is the mid-90s, so we're not going to see any significant variance from the Main.

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

Q

Okay. Then while we're on Town Center, with the construction of the new phase, you talked to people about expecting apartment occupancy to dip. It looks like, at least sequentially, that there's still not really been any change in occupancy or any material change in occupancy to either of the two apartment buildings at Town Center. Is that still to come, or are you basically expecting that this is going to be it? How are you guys thinking about that these days?

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

A

That's a great question, Rob, and I want to make sure we don't throw a head fake out there. When we had construction on 4525 Main, we were forecasting a meaningful dip in occupancy at the Cosmo. That ended up not being the case and its part of the reason why that year, 2015—did as well as it did occupancy-wise. This year, we're forecasting that that dip is yet to come. We've been pummeling those people with pile drivers for the last several months. Piledriving is over. Now construction pours start with backup alarms and everything else starting around 3:00 a.m., 4:00 a.m. So, the prudent side of us is forecasting that that dip is going to occur. In fact, to date we've seen a 1%, 1.5% decrease from those year-end numbers at Cosmo occupancy.

So, a long answer to a short question, we are forecasting a 3% or 4% dip in occupancy in those properties.

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

Q

Okay. Mike, what is the thought around the adoption of the now being able to capitalize acquisition costs? You guys adopting that effective January 1? Is that a future adoption for you?

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

A

Good morning, Rob. No. We actually adopted it during the fourth quarter.

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

Q

Okay. Then so when you look forward, that's historically been a big chunk of the gap between NAREIT and normalized FFO. What's really out there in '17 to sort of bridge that gap?

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

A

The other big driver that's really been pushing, and you'll see this, this past quarter and then FFO was higher than normalized, and it's because of the mark-to-market adjustments on our interest rate swap locks. So I think we picked up about $1.3 million in income in the fourth quarter. So that will continue to fluctuate and be the big difference between the two in '17.

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

Q

Okay. Then just lastly, Lou, in terms of adding large-scale projects to the development pipeline, I mean, where are you these days? Is the shadow pipeline, the stuff that you're not yet able to announce, is that packing up and piling up and we're likely to see some stuff over the next couple of quarters? How is that sort of trending versus the last three or four years when you think about stuff that's highly likely to be green-lit but not yet announced?

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

A

Yes. So, what you see in our guidance presentation, we have about $98 million of unannounced projects. Those are getting close, so our expectation is the next—prior to the call for the next quarter that those announcements will come out. The shadow pipeline beyond that, in a sense it's massive. I want to reiterate what I said earlier: the vast majority of what we see, we reject. So out of every dozen or so that come our way that we investigate, there might be one or two that merits going a little further and spending a little seed capital. Some of you might have seen the report that came out on the national project; that's a great example. We really like the project. We really like the local partner. We really like the market and we'll see if it comes together. The proof is in the pudding. If the market is as good as advertised, then we'll not have any trouble getting leasing commitments, and then you'll see that move forward.

But, Rob, in addition to that, we're already looking at the next project with Duke and downtown Durham. We're looking at the next project here at Town Center with the city, and we're looking at the next project at the Inner Harbor. So, we just need to be careful and not get out over our skis. We've been able to keep this ship in the middle of the channel and chugging forward for, like I said, well into our fourth decade. We're not going to vary from our principles.

The pipeline gets bigger. When we first became public, we talked that $150 million to $175 million run rate. That's now eking up into the $200 millions every 18 months or so, so—and that's fine. That's comfortable for us, comfortable for our Construction Company. But we want to be really careful. You know, it's not—development is a science and a lot of people talk about the art. There's no art to it. It's science. It's getting in and doing the hard work and the heavy lifting, and unless you do that and you it for an extended period of time, you're not going to create value. All you're going to do is practice.

So, we want to be really careful about loosening any of those standards going forward.

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

Q

Okay. All right. Thanks, guys.

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

Thank you.

**Operator:** Thank you. Our next question comes from the line of John Guinee with Stifel. Please proceed with your question.

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

Okay. Great. Thank you. Just a few questions. First, flat FFO but continuing to increase the dividend a penny a quarter or $0.04 a year; do you think you need to be raising the dividend as much as you are when you're value creation is via development and external growth versus internal growth?

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

Thanks, John. Appreciate that. Good morning. We've been telling our Shareholders, both, Retail, as well as Unitholders, as well as Institutions that we were going to keep that dividend in the 70% to 80% range. So we're very comfortable with the raise. We think it's conservative and we promise to stay conservative with it and keep that below the 80% mark. So we're trying to serve all of our masters.

One thing you have to remember, we have acquired a tremendous amount of property with stock and we intend on acquiring more property with stock and OP units. What's near and dear to those people is dividend growth, and while we're not going to be slaves to that by any stretch of the imagination, we're going to continue to responsibly increase it when our metrics allow.

Mike, do you want to...

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

Yes. Good morning, John. One other thing to add is, we said earlier, our payout ratio for 2016 was below 75%. The other thing that's happened in 2017 is our AFFO was going up even though at the midpoint our normalized FFO was flat. We're hitting some straight-line rent adjustments and the gap adjustments sort of going the other way in 2017. We'll certainly—you know, we're modeling to keep that payout ratio still well below 80%.

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

Then sort of the second question is that if I'm looking at your same-store NOI page, basically you're about 57% retail, 23% multifamily, 21% office. I remember, Lou, you talking a couple of years ago is you really like food/drug anchored retail centers. You though those had a lot of downside protection, but maybe not a lot of upside potential. How do you feel about that product in today's ever-changing retail environment?

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

Good. Thanks. Another great question, John. The grocery sector is changing. More and more players are coming into it, both at the high-end and at the low-end. We feel just as strongly as we always have, but the moderator to that is being cautious, and cautious relates to location. It's no longer, and it never really was all about just the credit behind the actual store. As I said and have stressed on numerous occasions, we really look at sales, sale (phon) potential and actual sales of these grocery stores because that tells you that that location is strong.

One thing that we've seen, again, over a long period of time, is if you have the strong location, even if it turns out that your grocer may end up not being one of the winners, that location is leasable to the grocer who is a winner. So, we haven't seen anything that would change our opinion on that retail, and I still disagree with your connotation of commodity retail but it certainly had some of those characteristics, because as you exactly pointed out, there's a lot of downside protection there, upside is slower to come, but when you have a lot of development in your pipeline, I go to sleep at night a lot easier knowing that the vast majority of our metrics and dividend coverage and all the rest is related to people selling food and diapers and the like.

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

Great. Thank you.

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

A

Thank you.

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

Have a good day.

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

A

You too.

**Operator:** Thank you. Our next question comes from the line of Laura Engel with Stonegate Capital Partners. Please proceed with your question.

Laura Engle
*Stonegate Capital Partners*

Q

Good morning. Thanks for taking my questions. First I wanted to see if you all could tell us a little bit about this Greentree disposition and, alongside that, give us an update on any of the remaining properties from that initial 11 retail purchase that are out there and your thoughts on timing on it.

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

A

Sure. I'm going to turn that over to Eric Smith, our CIO, for that conversation. Eric?

Eric L. Smith
*Secretary, Chief Investment Officer*

A

Okay. Thank you, Lou. Good morning.

Laura Engle
*Stonegate Capital Partners*

Q

Good morning.

Eric L. Smith
*Secretary, Chief Investment Officer*

A

So first I'll address your Greentree question. As you can see from the materials, we were able to sell that asset at a 5 cap rate, and, obviously, I think it speaks for itself when we have that opportunity to monetize an asset of that cap rate and use those proceeds on the balance sheet as opposed to issuing equity. We believe that to be a prudent disposition, and so that was the driving force behind that decision.

On the Cavalier portfolio, as you know, we've sold a few of those assets. As we've said in previous calls, we were assessing a few other assets that if we down the value in the marketplace, could be potential disposition candidates, not because we were concerned about the quality of those remaining candidates but because they were just somewhat outside our geographical footprint. With that said, not outside our historical footprint of our multi-decade ownership.

So we continue to ping the market. We have not seen the opportunity to monetize those at a level that we think is appropriate, and so we're happy to hold that real estate again. The diligence we did during the acquisition of that portfolio got us comfortable with the real estate, and so we were happy with the optionality that that pattern has led us to decide to hold onto those, at least through this year, and we'll continue to look at those as time goes on.

Laura Engle
*Stonegate Capital Partners*

Q

Okay. Great. One more question; the article in the National Business Journal, is that—the SoBro Skyscraper its tagged—is that strictly a development job or what's—can you clarify your role in that initiative?

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

A

(Inaudible). As I said, that's still way down the road in predevelopment. If the leasing comes together, the entitlements come together, then it's certainly an asset that we would like to own, but there's a lot of wood to chop there. We're excited about it. We're excited about that market and hopefully we can report on it further. But it would be disingenuous of us to describe that as anything other than an opportunity that we're looking at.

Laura Engle
*Stonegate Capital Partners*

Q

Okay. Great. Well, I appreciate it. Congrats on the quarter and I will get back into queue. Thank you.

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

A

Thanks very much.

**Operator:** Thank you. 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.

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

A

Good morning, Craig.

Craig Kucera
*Analyst, Wunderlich Securities*

Q

Mike, I wanted to circle back with you on a comment I wanted to clarify. Did you say that the NOI guidance was exclusive of any development NOI or did I hear you incorrectly?

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

A

No. What we're saying is that there's no—we're not putting in place any development projects during '17 that will generate any meaningful NOI. So, in the past couple of years we've been bringing on development projects that have been meaningful in increasing NOI, but that will not be the case in '17. Certainly, we'll have more ramp-up with Lightfoot and JHV during '17.

Craig Kucera
*Analyst, Wunderlich Securities*

Q

Got it. So I know you've got a chunk that is at 4525 that's expected to stabilize in the second quarter, and so I guess you're saying of the three that are stabilizing sort of midyear there's not going to be any meaningful impact to NOI this year?

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

A

So, first on 4525, that the leasing activity is happening there, certainly some of that will come online during the year. The new leases that Lou is talking about, well, those tenants probably won't occupy until the end of '17 at best case.

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

A

Yes. We've got a lot of design and construction to go, so the impact from that building stabilizing is not going to be material in 2017. We are forecasting and we're really, really pleased with what's going on at Johns Hopkins, that the retail is, if it's not at 100%, it's getting really close, and we feel it will stabilize with the students in August this coming year.

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

A

Just the other thing on the stabilization of 4525, Craig, that's going to go into the same-store NOI pool come the third quarter because of the timing of when that building developed, not because it's going to be 80% plus occupied at that point in time.

Craig Kucera
*Analyst, Wunderlich Securities*
Q

Got it. As we think about when the impact of those projects does become more meaningful in 2018, what kind of yields should we be thinking about relative to what you develop then?

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

I'm trying to think of the best way to answer that. So, 4525 Main has been leased up essentially at our pro forma rent. The pro forma rents would've had us creating well over 20% spreads between our cost and where that ends up. So, I think the way you need to think of it is in terms of value creation. You've got a 240,000 square foot high-rise that's stabilized in the high 20s run rate-wise and in a market where, as we've said before, there's not a whole lot of comps, but I can't imagine what someone would need to pay us to get us off of those buildings.

Craig Kucera
*Analyst, Wunderlich Securities*
Q

Okay. With the acquisition of Columbus Village Two, I know that the cap rate is a little bit low and it's going to be a bit of a drag on earnings for a while. Is that a component of Town Center Basics or is that a separate component? I know you mentioned that that, along with another project that's adjacent to Town Center, you could eventually redevelop.

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

Craig, I'm really glad you brought that up because it brings up another point. When we look at our flat guidance for the year, it's somewhat similar to when we traded a bunch of NOI in riskier assets for much more stable NOI and it cost us a few cents. That property, in and of itself, is a significant drag on earnings. We purchased in the low fives within and of—and for all stocks, two million shares—and so the impact of 2017 earnings is somewhere at $0.03 or $0.04 range, but it is absolutely the right move for us. It gives us all the flexibility in the world.

It is not part of Basics. That's on the other side. The Basics is the last piece of the core of Town Center and it's something we're very excited about. What that represents, along with the Columbus Village One that we purchased earlier in the year, earlier—or I guess that was in 2015—gives us 12 acres of developable property to expand Town Center and we get paid handsomely to wait. Even if we were to do nothing but renew the tenants that are in those two shopping centers, the results in NOI gets us back into the 7% range on a cap rate basis, and, trust me, that is Plan C; that is the worst that we will ever do there.

So, we're positioning Town Center for the next decade and that's going to be a big part of it.

Craig Kucera
*Analyst, Wunderlich Securities*
Q

I got it. All right. That's it for me. Thank you.

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

Bill Crow
*Raymond James Financial*

Q

Hey. Good morning, guys.

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

A

Good morning, Bill.

Bill Crow
*Raymond James Financial*

Q

Lou, could you just discuss the pressures and development and construction costs and whether we're getting to a point where rental rate growth, as you projected going forward, is not sufficient to justify the increase in cost of construction?

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

A

Yes. Thanks, Bill. Unfortunately, it's not a really short answer. We've seen this cycle. This will be the fourth time where we're looking at increasing rent, increasing interest rate environment, along with hopefully some from decently robust growth in the economy. A couple of other things happen when that becomes this scenario. Replacement cost goes up on our assets and that is good for real estate in terms of retail tenant expanse. That obviously is good for commercial real estate. Household formation goes up and that's good for real estate as well.

So when you take the whole basket, the whole question is whether you can mute the downside of higher rates and higher costs and take advantage of the upside of the expansion that's going on in the economy. For us, that manifests itself in a couple of different ways. One, is we get even more selective about where we deploy our capital. You hear it all the time; it's location, location, location. Secondly, when we do these public/private partnerships, any of which we're looking at now, we put more pressure on the entity the public entity, whether it be an institution or a city or a state or a large-scale company.

So, in order for us to keep our metrics where we need them to be, we basically have to selloff the risk side and take advantage of the upside. It's an exciting market for us. I would tell you this is exactly in our wheelhouse, so let's hope it all materializes. There's a lot of talk and a lot of noise now about all kinds of great things that are yet to come, but if it does come, we're in a great position to take advantage of it for the facts that I just mentioned.

The second piece of that is there is a related note. There is a lot of pressure right now on construction costs, both from a commodity standpoint as far as the labor standpoint. The country never really recovered from the 2008 recession in terms of the labor workforce of people entering the trade, so subsequently, subcontractors have much more pricing power than they did, which, again, is healthy for the overall environment but it's going to present challenges for us. The good news there is having a 40-year-old construction company that has seen it's—our President's been here for—this is the 26th year, I believe. He's seen all this before. We just work harder.

I can tell you it's a situation that we're we'll versed in handling and it makes us even more excited about what's going on in our pipeline.

Bill Crow
*Raymond James Financial*

Q

Okay. Then the other question I had—and if I missed your answer to this earlier, I apologize—but the 30,000 square foot move out into your new project, how close are you to backfilling the 30,000 feet and us that new tenants or is that expansion of existing tenants?

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

A

There's a lot of (cross talking). Thanks, Bill. There's a lot of moving parts. As I mentioned on our last call last quarter, we saw a significant uptick in leasing activity. We're seeing more prospects now than we've seen in quite a while, probably since the great recession. So those 30,000 feet of tenants that moved into 40,000 square feet—by the way, not only expanded and relocated, but significantly upgraded rent-wise because, like I said, we held rent at that building—it created vacancy in four of the Town Center buildings, which, again, is great news for us.

So we've got some vacancy in the two high-rises, although not much; we've got some vacancy in the two mid-rises, which is a little bit more, but those price points are in the low 20s. I'd say right now we have a half a dozen prospects looking at those places, all of which are new to Town Center. But we're also—we're not done juggling. We're actually talking to people about expansion, other tenants talking about expanding, and so we have some pieces moving around.

Twenty-seventeen is a transition year for us here at Town Center. We've got construction in the middle of it, we've got new tenants coming in, a lot of stuff going on, and I think it's really going to manifest itself very well in 2018 the effect on '17.

A lot of people talk to us about being too conservative on what we throw out there. That's where we play. We want to set proper expectations and then work like hell to come up with the upside, and that's exactly where we're positioned now.

Bill Crow
*Raymond James Financial*

Q

Great. Thanks, guys.

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

Aaron Adlickson
*Analyst, Stifel, Nicolaus & Co., Inc.*

Good morning, guys. Aaron Adlickson here. I think our questions have been answered.

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

A

Great. Thanks, Aaron.

Aaron Adlickson
*Analyst, Stifel, Nicolaus & Co., Inc.*

Thank you.

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

A

Great to hear you.

**Operator:** Thank you. Mr. Haddad, there are no further questions. I'll turn the floor back to you for final remarks.

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

Great. Guys, thanks again for your support and listening this morning. We look forward to updating you on some great stuff in the not-too-distant future. Take care.

**Operator:** Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.