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Armada Hoffler Properties, Inc. (AHH)

Q3 2017 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 2017 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, October 31, 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 third quarter 2017 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 were distributed this morning.

A replay of this call will be available shortly after the conclusion of the call through November 30, 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, October 31, 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.

I am now turning the call over to our Chief Executive Officer, Lou Haddad… Lou…

Louis S. Haddad

President, Chief Executive Officer & Director

Thanks Mike.

Good morning everyone and thank you for joining us today.

This morning we reported third quarter results of 25 cents of Normalized FFO per share, which was slightly higher than our expectations. We have also raised our guidance for the full year as Mike will detail later in the call. Amongst others, a meaningful factor behind the increase in guidance is the performance of our construction company.

And that is a great place to start my commentary.

We have raised the top end of the guidance in this sector of the business to another all-time high of 7.5 million dollars. We challenged that group at the beginning of the year with the reality that 2017 would be a year of prudent deleveraging of the balance sheet without any concurrent rental income from new development deliveries. Therefore, additional third-party construction profit would be an important driver for earnings growth, with the caveat that the efficient execution of portfolio projects remained paramount. It was a tall order to eclipse the stellar year they had in 2016. To say they answered the challenge would be an understatement.

It is important to note that while these results are largely due to the hard work of many committed professionals, the numbers for both 2016 and 2017 were aided significantly by outsized contract volume and a significant one-time savings from a 100+ million-dollar contract. Our expectation is that the construction company will return to its historic third-party gross profit norms of 4.5 to 5.5 million in the next year. Remember, the primary mission of this division is execution on our development projects, which do not contribute to construction profits, as well as helping to secure further portfolio business with public entities and joint venture partners.

A great example of the complimentary nature of our various divisions is currently taking place within our footprint. Our construction group has a long history of third-party work in the industrial and distribution sector. This experience began back in the early 1990s and continues today as we are currently working on a few significant engagements with brand-name companies. In these negotiations, we have offered a menu of fee construction and development, build-to-suit purchases or long-term lease arrangements, thereby giving clients optionality not typically seen in the industrial sector. We anticipate having an announcement soon from this cross-selling platform.

Before Mike takes us through the quarterly results and updated 2017 guidance in detail, I'll comment on our retail portfolio and the many exciting office, multifamily, and student housing projects in our development pipeline.

As a diversified REIT, we invest in, develop, and build several different product types: office, multifamily, student housing, retail, and mixed-use, and we also generate additional revenue through our operating divisions. Due to our opportunistic rather than formulaic approach to development, over the course of our Company's history the segment mix in our portfolio has fluctuated and will continue to do so. For example, just three years ago, office assets generated nearly half of our portfolio NOI and retail assets made up less than 40 percent. Through constant, proactive and strategic portfolio management, the retail portion of our portfolio today stands at over 60 percent of NOI yet still significantly less when combined with other income from our operating divisions.

While we expect this percentage to drop significantly upon stabilization of the multifamily, student housing, and office projects in our development pipeline, we remain confident and bullish about the retail assets in our portfolio. These properties continue to perform with year-to-date same store NOI up over last year.

Given the current trepidation over all things retail, I will reiterate our philosophy on this sector of our business. As most of you know, we don't own malls, we don't own department stores and we shy away from big box centers. We own three types of retail properties: mixed-use destination assets, grocery anchored centers and power centers anchored by best in class retailers.

For nearly 40 years, we have adhered to the basic tenets of real estate: prime locations, proven operators, and diligent monitoring of sales traffic and demographics. The current retail environment has yielded a host of opportunities to acquire such properties, particularly in the grocery sector, and we are currently combing through these for centers that may meet our standards. We invest in superior locations in our geographical footprint, including high quality addresses in secondary and tertiary markets that most public REITs dismiss, featuring high quality anchors that we believe will continue to perform well in an increasingly competitive landscape. We are looking to add to this portfolio in the near future. Off-market opportunities that involve the issuance of OP units are especially attractive.

I'll now spend a few minutes on our projects currently under development.

Construction is underway on our two student housing projects on the historic Charleston peninsula. These developments are located within one mile of the College of Charleston and in close proximity to five other schools in the area. We also continue to evaluate and explore further opportunities to grow our footprint in this market.

Design progress on our new build-to-suit office building for Huntington Ingalls at Brooks Crossing is on track for an early 2018 construction start and 2019 delivery. This state-of-the-art facility is expected to house nearly 600 employees and serve as a catalyst for further development in this public private partnership with the City of Newport News.

Construction on our Harding Place project in downtown Charlotte is nearing its mid-point and we remain pleased with the strong rental rates and absorption that this sub-market continues to display.

The construction of Phase VI of the Town Center of Virginia Beach has topped out and is tracking for a delivery next summer. This infill block will have a variety of entertainment options as well as exciting new retailers and loft-style apartments. We're pleased to announce that Williams Sonoma and Pottery Barn will be the anchor tenants of this development. These sought-after names in home furnishings will join their sister brand West Elm, further solidifying Town Center as a prime destination for shopping, dining, and entertainment in Coastal Virginia.

The initial units at Annapolis Junction have been delivered on schedule and two months into the leasing effort we have signed over 80 leases at proforma rents. Needless to say, we are very pleased with the progress to date but there is a long way to go until stabilization.

The Point Street apartments at Harbor Point in Baltimore are on track to begin deliveries early next year. Given the prime locations and compelling market dynamics of both of these off-balance sheet projects, we fully expect to exercise our at-cost purchase options.

Last quarter, we entered into an LOI for a significant block of the remaining office space at One City Center in downtown Durham. Lease negotiations continue in earnest and assuming lease execution, the office component will be 90 percent preleased in advance of our expected summer 2018 delivery. We have begun preliminary discussions with our joint venture partner and Duke University about the next development project in Durham.

With almost 440 million dollars of development in our current pipeline and our target wholesale-to-retail spreads of around 20 percent, we expect that these projects alone will add well over a dollar per share of NAV once all projects are delivered and stabilized.

We continue to explore a number of exciting development opportunities in our target markets. As an example, you may recall that last quarter we entered into an agreement with S.J. Collins, a seasoned developer of high-quality, grocery-anchored retail centers, to deliver a Whole Foods center in Decatur, Georgia. We have now closed on a second Whole Foods engagement through this relationship. This one in Delray Beach, Florida. We are actively working on more opportunities with both this developer and exclusive retailer.

Assembly of our next development pipeline is well under way and we look forward to discussing those projects with you early next year.

At this time, I'll turn the call over to Mike to discuss our third quarter results and updated 2017 guidance in detail. Mike…

Michael P. O'Hara

Treasurer, Chief Financial Officer

Thanks Lou.

Before I discuss the quarter, I want to point out that we updated the company logo and branding, which you can see on the cover of our supplemental package. We also enhanced our website. If you get a chance, please visit the updated website and look at the new information we've added regarding our development pipeline and portfolio.

This morning, we reported FFO of 25 cents per share and Normalized FFO of 25 cents per share which was slightly above expectations.

On the construction front, we reported a segment gross profit in the third quarter of 1.8 million dollars on revenue of 41 million dollars. We increased the guidance on this segment of our business again this quarter. The construction company is having perhaps its best year ever. As Lou said, we do not expect this level of profit in 2018.

At the end of the third quarter, the Company had a third-party construction backlog of 77 million dollars.

Now turning to our balance sheet.

We continued to take actions to enhance flexibility of our balance sheet and work on loan maturities.

As discussed last quarter, maintaining a strong balance sheet as a private company was instrumental in being successful for 34 years prior to going public in 2013. With the management team being the largest shareholder at 17 percent, this approach has not changed. In May, we completed an equity offering to raise 85 million dollars to help fund our 440-million-dollar development pipeline. With this equity raise, we now have the capacity to complete and bring the current development projects on balance sheet. With our current leverage metrics well positioned, we did not issue any shares this quarter and do not intend on issuing any during the fourth quarter. We do not currently have an ATM program in place but we expect to implement a new program early next year. As Lou discussed, we are seeing a lot of activity in predevelopment and acquisitions. With these opportunities, we want the availability of additional capital for accretive transactions.

We continued to work on loan maturities. Our 2015 credit facility was scheduled to mature in early 2019 and last week we closed on a new credit facility to stay ahead of the maturity. The new facility is 300 million with an accordion to 450 million. This facility includes a 150 million revolver and 150 million term loan. The revolver matures in 4 years and the term loan matures in 5 years.

During the quarter, we also closed on a new 5-year, fixed rate loan on the Hanbury Harris Teeter center and lowered the interest rate on the Cosmo.

At the end of the quarter, we had total outstanding debt of 494 million dollars including 58 million dollars outstanding under the 150-million-dollar revolving credit facility.

We continue to evaluate our exposure to higher interest rates and look for opportune times to hedge our interest rate exposure. At quarter end, 100 percent of our debt was either fixed or hedged. Again this quarter, we purchased a 2-year, 50-million-dollar interest rate cap at 1.5 percent.

During the quarter, we continued with asset recycling. We sold the two Commonwealth of Virginia single tenant office buildings at a 6.8 cap rate with a gain of 38 percent over our development cost. The proceeds from this sale were used in a 1031 tax free exchange to purchase the outparcels at our Wendover Center.

This past quarter, we signed a term sheet with S.J. Collins solidifying the relationship on their grocery anchored development business. We expect to be their capital source on development projects that have signed anchor leases and strong small shop pre-leasing. In addition, we have the option to purchase these centers upon completion. As Lou mentioned, we closed on a second mezz loan with S.J. Collins for a Whole Foods anchored center in Delray Beach, Florida. The loan is for 6 million at 15 percent. This center is 85 percent leased or under LOI in a strong market.

Now I want to address our Same Store NOI results. Last quarter, we discussed that this metric, which had been positive for 11 consecutive quarters, decreased as expected. It is being impacted from the drop in occupancy at the Cosmo as a result of the construction of Town Center Phase Six across the street and by the relocation and expansion of two significant office tenants to 4525 Main Street, which is not in our Same Store NOI calculation. We believe this activity is positive for the company, not negative, and adds true value, despite the interim financial optics. We expect this anomaly to reverse around mid-2018 once 4525 Main Street is in the same store NOI calculation and the Cosmo occupancy rebounds concurrently with Phase VI opening for business, as expected.

To illustrate what is truly happening with our portfolio, look at our occupancy and releasing spreads. Our core operating portfolio occupancy this quarter is 95 percent, with office at 89 percent, retail at 97 percent and multifamily at 94 percent. And our releasing spreads have been strong for 2017, with GAAP positive 5.7 percent and cash positive 3.9 percent.

Now for an update on our full-year 2017 guidance that we issued this morning. We expect 2017 Normalized FFO in the range of 98 cents to one dollar per share which is an increase from last quarter.

The updated 2017 guidance is predicated on the following:

- Total NOI in the 72.6 to 73.0 million-dollar range.
- Third-party Construction Company gross profit in the 7.2 to 7.5-million-dollar range.
- General and administrative expenses in the 10.4 to 10.6-million-dollar range.
- Interest income from our mezzanine financing program in the 6.9 to 7.1-million-dollar range. At the end of the quarter, the aggregate balance of these mezzanine loans was 75 million dollars. This updated guidance includes the Delray Beach loan.
- Interest expense in the 17.2 to 17.5 million-dollar range.
- And, 60.2 million weighted average shares outstanding.

Now I'll turn the call back to Lou.

Louis S. Haddad
President, Chief Executive Officer & Director

Thank you, Mike.

As you may have surmised by now, we remain extremely bullish on the performance of our company. With an accretive pipeline nearing delivery, positive releasing spreads and a solid balance sheet, we believe we are poised for significant growth over the next few years. When combining these factors with a well-covered dividend that has increased annually, now yielding in excess of five percent, we feel that we are delivering exceptional value to our shareholders.

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 "#". 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 Dave Rodgers of Robert W. Baird. Please go ahead.

David Rodgers:

Hey, good morning, guys. Lou, I wanted to start with retail discussions that you're having with Phase VI of Town Center, obviously two great signings since the last time we out spoke, but maybe just more about the discussion. Did West Elm help that commitment or you just really think there was slowdown in the demand for that kind of retail and the portfolio?

Louis Haddad:

Well, certainly - thanks, Dave. Good question. Certainly, West Elm being here for the last couple of years - obviously they are all members of the same parent company at Williams-Sonoma. And so, obviously they like their experience here with West Elm and decided to bring the other two brands into the development as well.

The environment for the mixed-use retail remains strong, but I would tell you that it's shifting. There is a lot more and again we all term it as retail and it's at the bottom of these high-rise buildings. But it's not pure retail, where it used to be a lot of soft goods it's now more services, fast casual eateries, professional office space and the like. But you still need to have a number of these top shelf tenants to add to that mix, and that's why we're really pleased with the two new signings.

David Rodgers:

And maybe sticking with the Town Center, I noticed you have some office leases that have not yet commenced. But you've actually on, but curious as you do have some holes to fill I think in some of the older assets?

Louis Haddad:

Yeah. We're feeling really good about what's going on right now in office. We've got some -- what we've almost rolled through all of the initial Town Center leases. We've got a few more to go and we're already well into renewing those as well. So as far as our retention rates it remains at pretty darn close to 100%. And as Mike mentioned, releasing spreads are pretty strong.

That leaves us -- if you look at Town Center on the whole, forgetting within the same store pool and what's not, we've got about 800,000 square feet of office space and about 10% of that is vacant across the entire portfolio. A lot of that is in the older assets and it's all in -- a lot of its in small pieces. So, releasing although somewhat tedious, it is pretty robust. And we expect as I mentioned on the last couple of calls that the town center office will get back into its 95% range in fairly short order.

David Rodgers:

And then maybe last one from me on S.J. Collins and the recent loan that you put out this quarter $6 million. Can you remind us on how big that you'd be willing to kind of go with that program in terms of maybe the impact that it will have on earnings et cetera?

Louis Haddad:

It's going to be interesting, I mean the relationships although we've known those guys for quite a while, the relationship is fairly new. And obviously the relationship between Amazon and Whole Foods is fairly new as well. So, we're not sure how fast how that run rate is going to be, but our companies continues to get tighter and tighter. Our construction company's been introduced into the mix. And I think with very few exceptions you'll see that whatever those engagements are they'll involve our construction company as well as Mike said, our option to purchase. We're obviously very excited about the whole prospect of what could be coming down the pike in that arena.

Operator:

Thank you. Our next question is coming from John Guinee of Stifel. Please go ahead.

John Guinee:

Great, thank you very much. Lou, not to put you on the spot a little bit, but could you expand on a conversation we had previously which I think will be very helpful to everyone on the call. Talk about how your major grocery anchors are thinking right now about the threat from the top end in terms of e-commerce and the bottom end in terms of Lidl and all the deep discount grocers.

Louis Haddad:

Sure. Thanks, John it's a good question. I'll try and be concise. As we've said before we have nearly a 40-year history in the grocery space. We believe that groceries are going to continue to be a stalwart in the retail game, but it's going to be changing just like it's changed several times over the past four years with category killers coming and going and shifting demographics and the like.

The basic tenants are still there, both for the proven operators as well as the real estate professional in that good locations with proven operators, with the right demographics are going to continue to perform. We play primarily in what would be termed probably the high, middle of the road grocer. The Harris Teeter and the Krogers, the Publix, Lowe's Foods, Food City, really good national and retail -- national and regional names.

We stick with those names and we stick into the right locations, we feel very good about what's going to continue to happen in that space. I think, if you were to interview professionals in that space, they tell you that, yes, there is going to be some bleed from the internet top-end, and yes, there is going to be some bleed from the Europeans at the bottom-end. But the middle while affected, is still going to be a great place to play, you just got to really be careful about locations, as well as your whole distribution strategy.

So, we continue to believe in those names, we're going to continue to invest in those names, again in the right locations, and we're going to continue to trim around the edges where we don't see that value. We think that the bottom end is going to be challenged greatly, particularly from the Europeans. And so, if we look at the names that play in that space on the grocery business, there is going to be some winners and losers, but certainly going to be some consolidation long-term. But we face consolidation in every sector of our business be it office, retail or multi-family and again that's why they pay us to be real estate professionals and come up with the right locations.

John Guinee:

Thanks. And then second question on, Williams-Sonoma and Pottery Barn. Can you talk a little bit about two things? One what kind of deal you have to cut in terms of base rent, net and gross, as well as tenant concessions, the TI dollars to get them in this space? And also, are they new to the trade area and are they moving from a different location and if so, from where are they moving?

Louis Haddad:

Okay. Great question, John. You're exposing all of our secrets here. As I alluded to you on earlier -- with this mixed-use retail, it's really a mixed bag of operators. And what I said about professional space and fast casual restaurant space and even education space for for-profit colleges, those are predominantly the high payers. I would tell you that in these mixed-use open-air centers, particularly a secondary market like Virginia Beach, you are not doing those deals to get rich. You want to have a good roster with those kinds of names so you can drive traffic to your restaurants, to your office space and to your multi-family. But for us, that takes a good amount of incentive and very often a percentage-rent deal that as a microcosm is not a great deal for us.

When we put it into the mix, it adds where you might have to give some concessions to get a William-Sonoma, you would then a get a high-volume restaurant next door, paying $50-$60 a square foot. And that's where we have to continue to play. The mix is incredibly important in these mixed-use centers. You've got to stick with the one-of-a-kind retailers, as well as restaurants, because you got to bring the highest volume -- I'm sorry, the highest income traffic to the center.

With regards to William-Sonoma and Pottery Barn, they have had presence in the market, they were both I believe in a major mall regionally. I do not know if they have decided whether or not to consolidate or simply to open these new locations, that's really more for them to say.

Operator:

And your next question comes from Scott Freitag from Bank of America. Please go ahead.

Scott Freitag:

I noticed you sold two office assets in the quarter. I was wondering if you can just update us on the non-core that you make look to sell, and also maybe just an update on your Food Lion assets.

Louis Haddad:

Non-core assets, we've cycled through what we typically sell as a matter of course as we've said in the past we don't like to hold on to single tenant office space particularly suburban office space. And that's pretty much as it as far as the portfolio.

I've mentioned last quarter if not two quarters ago, that we have three Food Lions still in the portfolio, they're fairly old, we developed them in the late 1990s, they've served us well. We don't believe that there is really further growth to be had there.

One has since renewed, they are coming to the end of their 20-year leases, one is since renewed, we expect to renew the other two. And I would say over the next 12 to 18 months that they won't be in our portfolio. But we are also not in any hurry to dump any real estate. These are really fine locations with really good performance on the small shop side. But again, as a matter of course, we don't believe that they belong long-term in the portfolio.

Scott Freitag:

Okay, and then on your expiration schedule for next year I noticed you have about 8.5% of your office rent expiring and a similar number for retail. Does your expectation to renew and then also if there any known move outs in those numbers?

Louis Haddad:

Yeah and again thanks for the question Scott. We don't expect anybody to move out. And again, only get back to the strength here at Town Center. We're home to about 115 commercial tenants, in the office in the mixed-use side. We've been operating this development for going on 15, 16 years. I believe, I don't think -- correct me on this, but I believe this been count on one hand the number of tenants that have actually left. I don't expect anybody in that 8.5% to leave, I shouldn't say anybody because I don't know how many small guys there are, but I'm thinking of the top 4 or 5 that make up that percentage and re-leasing negotiations are well underway.

Scott Freitag:

And is it the same thing on the retail side?

Louis Haddad:

On the retail side, most significant thing, there's a large Kroger North Point that is going to the very high-volume Kroger and it's going to renew just buying either before the end of the year or shortly thereafter. There also is an exploration in late 2018 of the small Kroger that we talked about last quarter or two in Waynesboro, Virginia. It is a 30,000 foot Kroger, it was a throw in to the portfolio that we bought and our expectation is that they will not renew there and we're working on a redevelopment plan on that space.

Operator:

Next question is coming from Rob Stevenson. Please go ahead.

Rob Stevenson:

Hi, good morning guys. Mike, just wanted to dive more into the guidance here. Was there anything in third quarter FFO that's not recurring moving forward? I mean you guys have done $0.76 of FFO year-to-date, mid-point of the guidance is $0.99, so which would be a $0.23 fourth quarter which is a $0.02 quarter-over-quarter decline. Is that just construction companies or something else that's potentially pushing earnings down sequentially?

Michael O'Hara:

Yes, a couple of things in the third quarter that effected NOI. One was the occupancy at JHU dropped during the summer time, and that occupancy dropped lower than we were expecting, that dropped down into the 25% range and certainly that's going to bounce back to now we're 100% leased for the full fourth quarter. We also have some miscellaneous items and some bad debts and some small tenants that hit in the third quarter, we don't expect to repeat in the fourth quarter. So, certainly, we are looking for the NOI to rebound. We had a one-time item during the third quarter, we had sold an outparcel – Sandbridge outparcel. I think we talked about it in the first or second quarter that closed during the quarter and that gain was around $500,000.

Rob Stevenson:

Okay. So, the $500,000 is the only sort of negative to earnings going forward, which shouldn't rest given the shares outstanding, I mean, shouldn't be more than sort of a penny because just trying to figure out, at the mid-point if you're looking at a $0.02 quarter-over-quarter decline in earnings and what else would sort of make up for that or whether or not you guys are more likely to come in at the higher end of that guidance range?

Michael O'Hara:

Yeah, The other area is the construction company. If you take a look at the gross profit year-to-date in our guidance on there, you'll see that the fourth quarter is not going to be like the previous quarter.

Rob Stevenson:

Okay. All right. Perfect. And then also, did I hear you correctly say that all the development pipeline, plus the JV and mezz projects takeouts are now funded at this point?

Michael O'Hara:

Yes, we did that $85 million equity raise in May in determining the size of the equity raise and was able to complete these projects to bring them online and keep our debt to EBITDA in the mid 6 times range.

Rob Stevenson:

Okay. So, the next time you really need capital is when you kick off anything substantial from a development standpoint and/or decide to make a standalone acquisition without a corresponding disposition?

Michael O'Hara:

Correct, and as I just said year earlier, that we do not have an ATM in place right now. So, we are not planning on issuing any equity in the fourth quarter, and we look to file that early next year. And as hopefully we'll see some more development acquisition activity pick up.

Rob Stevenson:

Okay. And then Lou, I mean in terms of the construction company. I mean is there any -- did somebody come out of the blue, and give you a one-off project that makes you think that the current level or somewhere in that neighborhood is not sustainable going forward? Did the other hotel in Virginia Beach with one of the related parties kick off or something like that that wound up driving the sort of outsized year in construction?

Louis Haddad:

No, let's see if I can get this a little bit little more clear for everybody. The predominant drive over there it was a $140 million high rise construction projects in Baltimore at the Inner Harbor there, In that $140 million That was done over a very short period of time relatively to the size of that contract. So, contract volume during that 18 months or so was certainly outsized.

And the second feature of that was a significant savings split that we had with the owner that yielded a 7 figured check back to us. And as much as I'd like to think that there is another one of those around the corner, I'm not seeing it right now.

So that's really that it. Remember, the construction company is a balancing act. The most -- it's really nice to make these third-party fees and it's always augmented our business and it really keeps the name out there and helps to track tenants to the portfolio -- but we really need those guys focusing, when we talk about these 20% and 30% spreads. For instance the two office buildings that we sold last quarter or is nearly a 40% spread between what we've built it at and what we sold them at. The key component to that is our construction company, and so that's got to be job one.

So, we've got a full slate of development projects that they're working on that need to stay, we need to stay focused on. And therefore, our expectation is that that's going to go back to norm. Remember we've been in this business for going on 40 years. So, it typically reverts back to the norm. And again, stress -- don't want to go on and on here -- but we are not looking to expand this company or its backlog or its personnel beyond just a little bit. The kind of work that we do is negotiated third party work with well-heeled clients that see the value of hiring a construction company upfront and working with their architect to bring about the best results.

We are not going to go out and bid for contracts and slug it out for nickels and that sort of thing, and that's why it has consistent earnings. Those types of engagements take a long time to develop, those relationships take a long time to develop, and it's a fairly finite handful of people. And so, it's going to stay consistently in that $200 million to $300 million range with a solid mix of our work versus third party work.

Operator:

Thank you. Our next question is coming from Craig Kucera of Wunderlich Securities. Please go ahead.

Craig Kucera:

Hey, good morning guys, want to circle back on the operating expense. Mike, you give a little bit of color, but there was a pretty big increase sequentially and was that all bad debt and sort of miscellaneous, or was there anything else in the rise in operating expenses quarter?

Michael O'Hara:

It's a lot of miscellaneous expenses across all the different properties and then the other piece was the bad debt write-off this quarter.

Craig Kucera:

Got it. So, should we assume -- obviously the bad debt is not necessarily recurring -- but the other pieces, are any of those recurring or enough more likely non-recurring?

Michael O'Hara:

We hopefully don't expect that bad debt to keep recurring. I think some of it was ramping up some expenses in a couple of properties and doing some maintenance and et cetera, but we expect it to pretty much stay in line going forward.

Craig Kucera:

Okay. And it looks like you had some pretty good success in Annapolis Junction here in October, on the leasing front. Is there any chance that -- if that continues, you would close on that asset in 2018 or is that still likely a 2019 event?

Louis Haddad:

Our hope is to close on it in 2018. It’s 400 units so we're trying not to get overly excited, but we are really happy with the start, where of course we're heading into what would be a slow lease up time here heading into the holidays, but we want to close on that thing as close to stabilization as possible. We have got a great partner up there, who is active daily in the leasing efforts and I can't stress enough we do a lot of these JV joint-venture arrangements, picking the right partners is so critical, because that's your boots on the ground in all those various markets. We're sitting here in Virginia Beach, we've got an office in Baltimore and we’re talking about Annapolis Junction or Charleston or Raleigh or wherever, our partner with boots on the ground is extremely important to our success and Annapolis Junction is proving to be exactly what we had hoped.

Operator:

Thank you. Our next question is coming from Laura Engel of Stonegate Capital Partners. Please go ahead.

Laura Engel:

Good morning and thanks for taking my questions, and I did notice the website, new logo everything looks great. Wanted to know the investment in Florida, is this principally a result with Whole Foods connection or is this a state that we might see more activity in going forward?

Louis Haddad:

It's predominantly through the Whole Foods connection to S.J. Collins, but Florida is a market we're comfortable with. We did our first project in Florida in 1992, we have been back several times since, very comfortable in that marketplace and I hope that it will be a focus for S.J. Collins Whole Foods and Amazon. We’re certainly going to be looking for more opportunities there.

Laura Engel:

Okay. And then as far as the development pipeline, I know you spoke about the bullish stocks from the retail sector, but as far as seeing more and more multi-family developments in the pipeline, I guess can you just give us your general outlook on that sector in the upcoming two years as far as that versus retail or mixed use or office space?

Louis Haddad:

Sure. Great question. Multifamily for us and is going to continue to be a focus. We are concerned about, and let me back up, we're seeing a tremendous amount of multifamily opportunities and they're showing up on a weekly basis. We’re weeding through those for the best. What's starting to concern us even in the best markets like the Charlottes and Baltimore's Inner Harbor and the like, is that it's becoming less and less space at the top end. People are pushing rents higher and higher and there is more and more supply coming online. So, we're going to be really cautious on that end and then unless it's in an A-plus location, we're just not going to pull the trigger, because we think that there is got to be feeling out there somewhere, particularly with all the new supply coming online.

One thing that really intrigues us that we're investigating now and where there is plenty of room currently, is down in the workforce housing market. There is a shortage of good quality apartment projects that are available to teachers, policemen, firemen and the like. And that part of the market has been left to aging facilities. And so, we're seeing some good opportunities there. And I'd like to thank you'll see an announcement here in the not too distant future about doing more of that kind of space.

Operator:

Your next question comes is coming from Paul Pruyear of Raymond James. Please go ahead.

Paul Pruyear:

Hey good morning and thanks for taking my questions also. Yeah, I was going to ask about the multifamily as well. And I guess since you've brought up workforce housing, just curious when you say “you're going to see an announcement”, are you just talking about a lower price point? Could you be more -- could you give us more color there?

Louis Haddad:

Sure, you are definitely talking about our lower price points. You're also talking about -- probably think about more in terms of the three story walkups, garden styles, breezeways, that sort of thing. Still high quality within the units, just not high-rise configuration and elevators and the like. You also have less design features on the exterior of the building, which your architecture is really important because it still has to remain attractive, but you don't have a lot of the relief that you see in these products that we're building now that you're leasing for $2 plus or in the case of some of ours the $3 plus range. So, it's not really departure from the basic model, it's just somewhat more value engineered and more of a type of construction that it is.

Paul Pruyear:

Okay. And then as far as your apartments there at Virginia Beach and of course you've already said it and we're all seeing it more supply towards the higher end. Are you at all concerned about that in that market, and what levels of construction do you think you see at sort of the higher-end for the apartment sector?

Louis Haddad:

Fortunately, in Virginia Beach, that's a great question, Paul. Fortunately, in Virginia Beach, we really can’t be challenged on the location. I think you guys have heard me mention before -- as I am sitting here in our conference room, I’m looking out at probably three apartment projects that are often a distance of a mile or two away -- I think there is total a of seven of them, in circumference around us, and the advertisements that we hear on the radio is that you can walk to Town Center or you can bike to Town Center, its minutes from Town Center or blah, blah, blah, and we continue to say and if you pay a little bit more, you can actually live in Town Center.

So, we really don't have competition at the top end here in this market. Now that said, I’m glad you brought it up, for years the Cosmopolitan has been the leading rent per square foot getter in Virginia Beach. It is now over 10 years old and the two products, the one that’s up at the Encore next door on one side and the Premier that's going up on the new block on the other side, are going to eclipse it if we're not careful. So, next year we are going to go on a major refresh of the facility and make sure it stays at the top. That's kind of a long answer to a short question, but in Virginia Beach, we believe that we are going to continue to be able to command the highest rents, irrespective of what's going on in the market.

Now in other places where we think we have an A location, but not a singular location, for instance our Harding Place project in Charlotte, Charlotte remains robust but our project where it's really well located amongst several that are really well located in Charlotte, and those are kind of places where we really need to see some caution, hopefully amongst our brethren in the development business, because at some point, you are not going to be able to drive rents. We’re going to be really cautious about anything other than A+ location at the high-end.

Paul Pruyear:

Yeah that helps. Yeah, thanks that helps. And then I guess a couple of more questions for us. With Amazon buying Whole Foods, are you seeing any changes in sort of how you are working with Whole Foods maybe the store design, anything at all as a result of what's happened there?

Louis Haddad:

Not at this time, and again we're working with Whole Foods through our relationship with S.J. Collins who their relationships are right at the top, they keep being told that there is a major rollout that's going to happen. They are braced for it, we are braced for it, we're not sure what it looks like. But right now, it's all talk. And what we're building in the two that we are working on, you really don't see significant changes.

Paul Pruyear:

But they have been pretty clear, the changes are coming?

Louis Haddad:

I don't know the changes are coming. They are pretty clear that -- I think it's as I read the same stuff that you read -- they didn't buy to sit on it, they want to expand it, but I couldn't tell you. I don't have any insight as to what's going to happen, configuration wise.

Operator:

Thank you. Our next question is follow up from Mr. John Guinee of Stifel. Please go ahead.

John Guinee:

Great, thank you. Just to clarify Mike, when you are talk about bringing assets on balance sheet, are you talking about the two mezz deals and the Durham JV or just the two multifamily mezzanine deals?

Michael O'Hara:

No, John. All three of those projects. Yeah.

John Guinee:

The City Center and the two-mezzanine multifamily can all come on balance sheet at full cost and still stay at the mid-6 net debt-to-EBITDA?

Michael O'Hara:

Correct. So, I'll just break these down. So, City Center which will be completed next summer, we have funded 100% of the equity on that project. So that we've already got -- we've all funded the equity. So, at that point in time we'll be bringing on the construction that which is going to be somewhere in the $23 million range or so. So that's not -- two multifamily projects again we have funded all the equities through our mezz loan and we bring those on balance sheet where we're going to have properties that are producing EBITDA and we're only bringing on the construction debt onto the balance sheet.

John Guinee:

Okay, but the construction debt can come on balance sheet and still stay under 6.5 net debt-to-EBITDA?

Michael O'Hara:

Yeah right around 6.5.

John Guinee:

I have to do the math?

Louis Haddad:

No, no I was going to saying that, if you do the math you can see what Mike and I have been out there saying, once it stabilizes, we're looking at a double digit increase in earnings. If you did that math, you'd see that's pretty much baked in the numbers given that these projects lease up.

John Guinee:

Got you. Okay and then just out of curiosity, I was actually driving through Waynesboro a few weeks ago. When you have a vacant 30,000 square foot box in a place like that, is it worth zero or $50 a foot? And then when you sell a Food Lion, which I'm assuming is a five-year renewal, is that a 10 or 20 cap deal, just out curiosity?

Louis Haddad:

If it’s a 10 or a 25 deal -- I don't know, it may be staying in our portfolio -- actually John it's interesting, because I was driving through Waynesboro about three weeks ago as well. We actually have some good activity for re-leasing in that center. So, you'll probably see that project stay in the portfolio.

Eric Smith:

And John, this is Eric. In that leasing activity you probably do end up breaking up that space to some extent. There are not that many 30,000 feet users looking at Waynesboro, so you could expect that to be a multi-tenant re-leasing effort.

John Guinee:

Okay, thanks a lot.

Eric Smith:

And then as you had asked on the Food Lion, to Lou's point, a 20 Cap we're going to be the proud owners of those Food Lions. What we're seeing in the market, and again, it looks like some of the anxiety and angst around retail has dissipated slightly. And so, based on the cap rate we're seeing on Food Lions the ones that really nobody wants to own, seem to be up in that 10, 12 cap rate range with the better ones than we would put the ones we're talking about in our portfolio in that range, given the location of the real estate and despite the short-term even after renewal of 5 years. We’re seeing those trade in at the mid-8s, right now. So, if that, if those cap rates held, I think that you could take Lou's statements at face value that those are probably not long-term holds. If those cap rates obviously move materially higher, we would reconsider that at some point. They’re much more valuable on the balance sheet.

Operator:

Thank you. At this time, I would like to turn the call back over to Mr. Haddad.

Louis Haddad:

Thanks, everybody. We appreciate your interest in our company and look forward to updating you on our activities and results in the coming quarters. Have a great day.

Operator:

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