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# Armada Hoffler Properties, Inc. (AHH)

Q2 2018 Earnings Call

# CORPORATE PARTICIPANTS

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*President, Chief Executive Officer & Director*

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

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*Secretary, Chief Operating Officer*

# MANAGEMENT DISCUSSION SECTION

**Operator:**

Welcome to Armada Hoffler's second quarter 2018 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, July 31, 2018.

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

Please go ahead.

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

Good morning and thank you for joining Armada Hoffler's second quarter 2018 earnings conference call and webcast.

On the call this morning, in addition to myself, are Lou Haddad, CEO and Eric Smith, Chief Operating Officer, who will be available for questions.

The press release announcing our second 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 August 31st, 2018.

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, July 31st, 2018, 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 guidance and 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 forward-looking statement disclosure in our press release this morning and the risk factors disclosed 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.

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 everyone and thank you for joining us today. As you can see from the press releases that we issued yesterday and this morning, it's a very exciting time here at Armada Hoffler. As I mentioned during our last conference call, our company is built to thrive in a variety of macro-economic scenarios and the current backdrop is no exception. The growing economy has yielded increased opportunities in development, public-private partnerships, build to suit engagements, third party construction and tenant expansions. We believe these factors more than offset the impact of gradually rising interest rates. This morning, I will offer several updates that will continue to validate this thesis.

First, a few comments on the results of the past quarter. We reported 24 cents of Normalized FFO per share for the second quarter, which was in line with our expectations. Also, same store NOI was positive across all product types on both a cash and GAAP basis. Although increases occurred across the portfolio, a significant portion resulted from office activity within the Town Center of Virginia Beach. As we expected, with the winding down of disruptive construction of phase 6, multi-family occupancy has returned to form. On the retail front, the opening of Williams Sonoma and Pottery Barn has brought additional excitement and leasing activity to Town Center. In fact, post quarter end, two additional leases have been executed, including the regions first Shake Shack. Also, several new retailers are now actively engaged in negotiations for space at Town Center.

Finally, and most notably, we have significantly raised our full year Normalized FFO guidance with the new range rising to a dollar five to a dollar eight per share. This change is primarily due to the anticipated sale of our at-cost, purchase option for Annapolis Junction. Most of you are well aware of the optionality afforded us by our mezzanine lending program in conjunction with our construction and development expertise. While Annapolis Junction would make a fine addition to our portfolio upon stabilization, we believe that the capital currently invested, as well as the profit from the sale of our option, are better deployed in the two new pipeline projects announced yesterday. We believe that this decision, despite representing a meaningful discount to a fully stabilized valuation, is the proper path to maintaining a strong balance sheet, creation of long term value for our investors, and ultimately a higher NAV per share.

This transaction returns 50 million dollars to our balance sheet inclusive of some 5 and a half million dollars of profit on our option. All told, between interest income, construction fees and the option sale, we will have recognized over 16 million dollars of profit from this project. This marks the second time in the last few years that we will have monetized a significant profit on a multi-family project during lease up, once again proving our development spreads and the advantages and optionality that our integrated model brings to our shareholders.

The increase in our guidance range occurs despite the fact that our original guidance included an acquisition that we ultimately passed on, a disposition that was not forecasted, and Annapolis Junction mezzanine interest income originally projected through the end of the year. Additionally, our ATM activity was larger and earlier than we originally anticipated. Collectively, these strategic decisions served to further strengthen our balance sheet in preparation for the robust future growth that we are anticipating through our development pipeline.

While we are thrilled to have meaningfully raised our Normalized FFO guidance range for 2018, we still expect healthy year-over-year earnings growth in 2019 based on the current delivery schedule for the projects in our development pipeline, projected lease up in our portfolio, and the potential for new and accretive transactions.

Starting with Town Center for the pipeline updates, Phase 6 street level retail was delivered and the tenants I mentioned opened to large crowds. Adding to the excitement, the Lego Americana Roadshow has made a two week stop in Town Center and has exposed the center to an even broader clientele. The multifamily portion of this block is on track for August delivery with nearly 30 percent of the units leased.

Point Street apartments at Harbor Point continues to exceed all expectations with leasing in excess of 60% despite being open for only 4 months.

City Center in Downtown Durham is nearly complete, the office portion stands at nearly 90% leased with the first tenants opening in the month of September. The bulk of the remaining space has been proposed to a few small tenants, and we expect occupancy to approach 95% over the next few quarters.

The Harding Place apartments in Downtown Charlotte will deliver in late August, and the leasing office is now open for business.
All other pipeline projects are on track for their scheduled 2019 completions.

Our construction company continues to perform at a very high level. While revenue generated from third party construction projects is lower than previous years, total volume including internal projects will top 225 million dollars for the year which is near the high end of our historic range. Now that the sales contract for the disposition of the build to suit distribution center has been signed, we've narrowed the guidance range on this business segment to reflect the anticipated gain on sale. The profit is roughly double what we would have earned had we simply built the project for a market fee, which serves as further evidence of the advantages of our unique cross-selling platform. As I mentioned last quarter, we expect backlog of third party contracts to surge by summers end with 2019 shaping up to be another stellar year for this division.

Finally, I'd like to highlight the two projects we announced yesterday.

The Wills Wharf office project, adjacent to our Point Street apartment building, will be the latest iteration in our 25-year run at Baltimore's Inner Harbor. This 117-million-dollar building is the fourth property we will have built at Harbor Point. As you can see in the press release, in addition to the hotel lease, we expect 100 thousand square feet of office space to be preleased, bringing the total committed space to over 60 percent prior to construction commencement. We are also seeing considerable interest in the remaining square footage despite the early stage of development. As we have said on many occasions and as evidenced by the amount of construction and leasing activity we've seen in just a few short years, we believe that Harbor Point is one of the top destinations for office, retail and multi-family space in the entire Mid-Atlantic.

Just as exciting is the Interlock project in west mid-town Atlanta. This public-private partnership with Georgia Tech was brought to us by our partners at SJ Collins, and its location at the intersection of 14th street and Howell Mill Road is in the middle of this highly sought-after submarket. As a part of a larger mixed-use complex, the office and retail portion that we will participate in will total some 300 thousand square feet with an estimated cost in excess of 110 million dollars. With Georgia Tech anchoring the project with a 50,000 square foot office lease we anticipate that the project will be nearly 60% leased by groundbreaking, which we expect to occur by year end. SJ Collins will serve as the project's master developer and will be responsible for performing several functions including site development and land sales related to the Hotel, Multi-family and Townhouse portions of the project. These transactions are not well suited to our REIT structure. For this reason, we will utilize a participating mezzanine structure for our investment in the office and retail components of Interlock. Separately we anticipate that our construction company will not only construct Interlock commercial for SJ Collins but will also be the general contractor for the hotel and multi-family developers as well.

Wills Wharf and Interlock commercial represent over two hundred and twenty-five million dollars' worth of development and will be the cornerstones of our next development pipeline. Our expectation is to have more new project announcements over the next few months and that this new development pipeline will equal, if not exceed, the current one. With the mix skewing more towards high credit tenancy in CBD office along with some multi-family and retail, our initial return on investment should be meaningfully higher than the current pipeline being delivered which is more heavily multifamily weighted.

Despite this increase in development activity, be assured that we continue to be extremely selective with regard to the projects we pursue. The vast majority of the opportunities that present themselves do not meet our rigid criteria and are quickly removed from consideration.

The unannounced projects in pre-development include more signature assets in some of the hottest markets in the Southeast. As these engagements come together we will be evaluating further dispositions and use of the ATM as a part of a continuing strategy to maintain a strong balance sheet and grow NAV over the long term.

Remember, Armada Hoffler is first and foremost an opportunistic real estate company that employs multiple strategies to enhance profitability and create value. These have been our central tenets for nearly forty years, and investors can count on this to remain our primary focus. As the company's largest equity holder, management will continue to operate a business model that includes a variety of deal structures as well as disposition of development projects, at cost options, and stable assets. We are extremely optimistic about the company's prospects for the rest of 2018 and our ability to deliver on our promises over a multi-year timeframe.

At this time, I'll turn the call over to Mike to discuss our second quarter results.

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

Thanks Lou.

Today I want to cover the highlights of the quarter, thoughts on our balance sheet, and our updated 2018 guidance.

This morning, we reported FFO of 24 cents per share and Normalized FFO of 24 cents per share for the second quarter, which was in line with our expectations.

As we anticipated, Same store NOI continues to improve, with this quarter being positive in all three property types. The negative impact on this metric from the Town Center relocations and construction activity has finally ended.

The portfolio continues to perform well. Our core operating portfolio occupancy for the second quarter was 95 percent, with office at 94 percent, retail at 97 percent, and multifamily at 89 percent. The multifamily occupancy was lower than last quarter due to the summer occupancy at the JHU student housing project. We do not expect this impact next year as we've changed to one-year leases rather than the current academic year leases. Without the effect of this property, multifamily occupancy would have been similar to the 96 percent of last quarter. Additionally, our releasing spreads in the retail and office portfolio were positive on a GAAP basis.

On the construction front, we reported a segment gross profit in the second quarter of 600 thousand dollars on revenue of 21 million dollars.

At the end of the second quarter, the Company had a third-party construction backlog of 38 million dollars. As Lou said, we expect construction backlog to increase over the next few months.

Now turning to our balance sheet.

Over the past quarter, we continued to take actions to enhance the flexibility of our balance sheet and work on loan maturities.

As Lou discussed, we have two new large development projects with several more in predevelopment. We are making several moves to position the balance sheet for these projects and future growth.

First, during the quarter we sold the Wawa outparcel from the newly acquired Indian Lakes Harris Teeter center for a 5.35 cap rate. We acquired the Indian Lakes center for a 7.1 cap rate and, net of this outparcel sale, we now have a Harris Teeter center that is yielding nearly 8 percent.

Second, we raised 50 million dollars through our ATM program last quarter at an average price of $14.07 per share. We raised more than anticipated due to a couple of large reverse inquiries.

And third, we anticipate selling our at-cost purchase option on Annapolis Junction to our partner. We are selling this option instead of acquiring the property at cost and bringing it on balance sheet in order to use the capital for the development projects we announced yesterday. We expect over 50 million dollars in cash from this transaction through the payoff of our loan and the proceeds from this sale. As we have discussed, this mezzanine structure gives us optionality, including bring the property on balance sheet, using the property as a 1031 candidate or selling our option. By selling the option and not the real estate, we avoid the two-year holding period required under the REIT tax laws. Since this transaction is a sale of an option and not real estate, it will therefore be included in FFO. We also are including this in Normalized FFO because we view this as an integral part of our business model. We will continue joint venture development projects with this structure and in the future expect to periodically monetize the equity creation in this manner. We like the flexibility this structure provides us, especially with multifamily projects which we can sell below our cost of capital and keep the proceeds for balance sheet purposes.

The capital raised from these three transactions is expected to be about 105 million dollars which have and will be used to paydown the credit facility.

We continue to work on the 2018 loan maturities. As of June 30, two loans remained to be refinanced. First is the JHU Village loan which closed last week. The loan is for a 7 year term at a rate of LIBOR plus 125 basis points. We entered into a swap lock to fix the rate at 4.19 percent for the seven-year term. The second maturity is the Lightfoot Marketplace loan which we expect to close in the next couple of weeks.

As discussed last quarter, the lending environment has changed this year with spreads substantially lower. We took advantage of this environment and refinanced our loans that have floating interest rates. We have closed on loans of over 100 million dollars lowering the spreads by 35 to 65 basis points which equates to an annual savings of over 500,000 dollars.

At the end of the quarter, we had total outstanding debt of 587 million dollars including 83 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, 89 percent of our debt was either fixed or hedged. This past quarter, we entered into a 5-year swap lock for 50 million dollars. Subsequent to quarter end, we entered into a 53 million dollar swap lock on the JHU Village loan and purchased a 2-year, 50-million-dollar interest rate cap at 2.50 percent. Inclusive of these two transactions, we are now 100% fixed or hedged.

Today we raised our 2018 full-year Normalized FFO guidance to a dollar five to a dollar eight per share, up from a dollar to a dollar five per share. The guidance includes the expected sale of the Annapolis Junction purchase option and the sale of the distribution center by the TRS. The distribution center is a construction project that evolved from our cross-selling platform. We intend to sell this asset before it is placed in service and include the profit in Normalized FFO. We included this expected gain from this sale in both the Construction Company gross profit and Normalized FFO guidance. This transaction will have an impact on Debt to EBITDA in 2018 as our balance sheet will carry the debt with no corresponding EBITDA. Because of the short-term nature of this project and associated debt, we do not intend to issue any equity for this project.

Now I'd like to go through the details of the updated 2018 guidance.

First, starting with our assumptions:

- The acquisition of the Lowes Food shopping center in the second half of the year
- A gain of 5 to 6 million dollars from the sale of the Annapolis Junction purchase option during the third quarter.
- A gain of 2.4 to 3.2 million dollars from the sale of the distribution center in the fourth quarter.
- No additional activity in the ATM program
- Interest expense is calculated based on the Forward LIBOR Curve which forecasts rates rising to 2.38 percent by year end.

This 2018 guidance of a dollar five to a dollar eight per share is predicated on the following updated components:

- Total NOI in the 78.8 to 79.5 million-dollar range,
- Third party Construction Company gross profit in the 5.6 to 6.4 million-dollar range, which includes the expected profit from the sale of the distribution center.
- General and administrative expenses in the 10.8 to 11 million-dollar range.
- Interest income from our mezzanine financing program in the 7.9 to 8.1 million-dollar range. As of quarter-end, the aggregate loan balance of these mezzanine loans was 93 million dollars.
- Interest expense in the 18.3 to 18.8 million-dollar range.
- And, 64.5 million weighted average shares outstanding.

Now I'll turn the call back to Lou.

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

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

# QUESTION AND ANSWER SECTION

**Operator:**

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

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

**David Rodgers:**

Good morning, guys. Really wanted to start with the new development announcements, a lot of excitement there. Can you talk a little bit more about the project with SJ Collins in midtown Atlanta? Maybe with respect to the sizing of the mezzanine loan and any purchase option that you're considering there as well.

**Louis Haddad:**

Sure, thanks, Dave, and good morning. I don't know if Mike discussed the size of the mez loan. It's still not tied down, because we're waiting on Collins to finalize how they want to handle their construction loan. But Mike you want to comment.

**Michael O'Hara:**

Yes, good morning, Dave. So certainly the loan package is out for the financing on that. And once we know the amount of the senior loan, which will probably be in the 60% to 75%, then we'll know the actual amount of mezzanine financing.

**Louis Haddad:**

It's an interesting deal structure here. We are --we're going to earn a significant coupon on our mez interest like we have - like we are in the other projects with SJ Collins. We also have a cash flow participation that is significant as well, as opposed to the add cost option. So therefore, there will be some meaningful income coming throughout the construction period with this particular structure.

**David Rodgers:**

Okay, that's great, sounds like more to come as well there. I want to look --I want to dive into your new leasing activity. I think you did 13 leases this quarter over 50,000 square feet. You mentioned 150,000 square feet in total leasing for the quarter including renewals, obviously, both big numbers for you guys. But in your comments earlier you kind of mentioned that would lead to the redevelopment of Columbus Village, but it's obviously not in the development or redevelopment pipeline. So maybe what does that look like - how quickly is that coming just given your comments in the press release today.

**Louis Haddad:**

Sure. There's a lot of moving pieces surrounding Town Center and the redevelopment of the two shopping centers we purchased, which our Columbus Village. The first piece that has landed is the Shake Shack that we've mentioned, and according to the Millennials in our office that really means Town Center has arrived. So we'll see if that ends up being the case, but that section of Columbus Village will probably be the only section that remains more of a traditional shopping center, which is great for the project, because we do have some tenants that want to be a part of Town Center but need a parking field out front.

So those three or four acres involved there, with an outparcel building with Shake Shack, will end up staying in the traditional sense. The other pieces of Columbus Village are, like I say, there are a lot of wheels in motion; all the tenants that are there want to stay in new facilities. The city would like us to see go vertical, all those things are moving around, and I'm not quite sure the time frame. It could come together very quickly, or it also could be another year. But in any case, it's been a great purchase for us. And cash flow is going to continue to increase irrespective of development activity.

**David Rodgers:**

Great and maybe finally for me, if you look ahead in 2019, fairly large lease expiration both in retail and in office when combined; any concerns or opportunities that you guys see today as you begin to now look out to 2019?

**Louis Haddad:**

It's a great question, Dave. We're focusing on a couple of the large retail renewals or expirations if you will. Our expectation is that everybody's going to remain in place. I think everybody knows about our small Kroger in Waynesboro, that Kroger will not renew going forward. We got some re-leasing efforts going there, but aside from that, our expectation is that things are going to roll over. But for, the Home Depot, which is the largest expiration that comes due in 2019. Unfortunately Home Depot, we believe, is going to use their option that they have to buy the project out from under us.

So the good news is it's a very strong store in a very strong center. The bad news is we're going to lose that income stream we believe as things move forward.

**Operator:**

Thank you. The next question is coming from the line of Bill Crow with Raymond James. Please proceed with your question.

**Bill Crow:**

Good morning, guys. Two or three questions for me today. Mike maybe we can start with you and just help us think about sources and uses over the next 18 months. If we just look at what's been announced, what’s pending et cetera, what are we looking at? We've got - as far as income sources coming in we've got the mez repayment, we've got the sale of the distribution center. What else do we have as far as inflow?

**Michael O'Hara:**

Good morning, Bill. Yes, so as I discussed early, we've got a $100 million between the ATM and the sale of Annapolis Junction. On top of that, we've got the proceeds from the distribution center. And that will certainly get us well on our way to get these couple of big projects underway. These projects of this size take a while to get out of the ground. And it'll be a while before they're really it gets to be heavy capital requirements on those. So some will be looking to get back into the ATM in 2019 and start to bring in the capital required for that. And we will additionally continue to look at sales of assets like we have in the past. We'll continue to manage the balance sheet and keep the leverage in appropriate places like we always have.

**Bill Crow:**

I know you're not sure how much the mez piece will be on the Interlock yet, but do you have a general range about what comes there?

**Michael O'Hara:**

Yes, it's going to be in the mid $30 million range, and certainly we'll be receiving the coupon on that, that will provide the EBITDA in order to keep the leverage right on that piece of it.

**Bill Crow:**

Okay. And then Wills Wharf expected outflows over the next year and a half?

**Louis Haddad:**

Yes. I see we've got a 20 month or so construction schedule. So, we've got a long runway in order to meet those capital needs, and that building is entirely on balance sheet, and Mike will be shopping for a construction loan appropriately.

**Bill Crow:**

Yes, okay. Mike, on Wills Wharf or more generally on Harbor Point, what's left there? What are the opportunities that you see over the next few years or are we getting to the point where it's getting built out?

**Louis Haddad:**

I know actually, I need to direct you to their website, the Harbor Point website. You can see that there are still an additional four development parcels there. Now people have asked us for years, where's the next town center? This is our fourth building in that little development. It's going to include a great waterfront park and three additional vertical buildings. So we're --our intent is to continue working with Beatty Development and build out the entire center.

**Bill Crow:**

Okay. And then I guess one more for you Mike, and this is a bigger picture question, but it's an interesting time. We're 10 years into the cycle, we've got a fairly significant cost inflation and construction, and we've got rising interest rates. So the question we get from clients is what you are doing with all this commitment to development late in the cycle. Obviously, it's something that you're comfortable with but why are you comfortable and kind of give us your perspective on that?

**Louis Haddad:**

This is Lou again, thanks, that's a great question. You are right, we've gotten that question from investors several times as well, trying to address it as best I can. First, let me say that the next recession that we're subjected to will be my fifth at Armada Hoffler. And we've learned several lessons through the first four and a couple of them come to mind very quickly, including our central tenant. But first and foremost, let me say time to time the business cycle is a fool's errand, nobody knows whether we're in the ninth inning or in the top of the first of a doubleheader or what have you.

And so it's just not worth a lot of consideration. The second point, and if you accept that first point, then the second point becomes even more important, and that is underwriting. We are meticulous in our underwriting of projects, and when I say underwriting I don't just mean the financial models. I mean underwriting your tenants, underwriting your locations, underwriting your design, your construction, every facet that goes into building has to be parsed and reparsed, if that's word, in order to make yourself as bulletproof as possible or at least bullet resistant.

If you've done your underwriting properly and the cycle turns against you, then all that means is that it's going to take you longer to be right. I gave you a great case in point. We launched our Richmond Tower in 2007 at the crest of the biggest boom in history, absolute worst possible time to launch a high-rise. But we did our underwriting properly, we've had a fantastic location, an iconic building, really strong tenants and despite all that, when they brought it online in 2009, I don't believe we could have sold it for what we -- would have cost to build.

So what happened, well, we enjoyed some great cash flow for about five years and in 2014 we sold the building for a $24 million profit? Now they don't always turn out that well, but the bottom line, I guess, our view is whether it's late cycle, early cycle, mid cycle whatever, if you do your underwriting properly then you're generally going to be okay. And that's a tenant that Mr. Hoffler started some 40 years ago and is going to remain our tenant going forward, but thanks for your question, Bill.

**Operator:**

Thank you. Our next question is coming from the line of Jim Lykins with D. A. Davidson. Please proceed with your question.

**Jim Lykins:**

Good morning, guys. Just a couple things. First of all, I want to make sure I heard something correctly. Did you say at Wills Wharf, that it could go from $117 million possibly up to $225 million. Is that correct?

**Louis Haddad:**

No, no, it's $117 million building. My $225 million reference was just the volume that the construction company expects to do this year in total.

**Jim Lykins:**

Okay and also regarding the shadow pipeline. I know you've got a pretty significant shadow pipeline. Just any color at all right now about when we can expect some additional announcements for more projects. And also what you're looking at if it's more public-private partnerships or mortgage --more mixed-use just and anything more you can tell us about that shadow pipeline.

**Louis Haddad:**

Sure and Jim let me correct myself. The $225 million is a combination of both Wills Wharf and the Interlock project that we announced. So with regard to the rest of the pipeline, it's coming together pretty quickly. My expectation is that we'll have further announcements prior to the next conference call. I think everybody can kind of guess where we're going. We're very active in Charleston, we are very active in Charlotte, we are very active in Raleigh-Durham. People know that we've been nosing around in Nashville.

All these places are having projects that are coming together. Again back to my earlier response on the late cycle, at this point, we have the ability to just cherry-pick the best deals that we can underwrite. And so all those locations are very positive for us. I suspect that one or two of these projects won't make the cut, but ultimately I believe that this whole pipeline will be announced by the end of the year, with a couple possibly coming prior to the next conference call.

**Jim Lykins:**

So, Lou from where you're sitting right now I know previously you talked about that shadow pipeline could be potentially in excess of the current development pipeline. How do you think about that? Right now you said you cut some things back or do you think that at this point that could still grow larger than the current development pipeline?

**Louis Haddad:**

Hey, Jim, it's tough to call. If you use a $0.5 billion as a benchmark and to throw around big numbers, they could be a $100 million on either side of that, depending on how things go. And to answer your other question is that, yes, there are more public/private opportunities within what I just said.

**Jim Lykins:**

Okay and one last one for me. I'm just wondering if you can give us any more color on the potential asset sales. I am wondering you are still seeing a lot of private equity chasing high-quality multifamily?

**Louis Haddad:**

Yes. Actually, I am going to let Eric Smith take that, as we are seeing a quite a bit of activity there.

**Eric Smith:**

Yes, thanks, Lou. The narrative that we outlined on our last conference call appears to be still strongly in place. And that narrative, as you may recall, that we're hearing from multiple sources is that the buyers of multifamily are shying away from the interest rate risk, and the construction cost inflation risk that was mentioned earlier on the call. And in lieu of that, they are willing to take specific submarket lease up risk. And so we're seeing still a huge amount of interest in well-located projects, that may be in a non-traditional range of lease up, and certainly even sub 50%. Combine that with the amount of money that has been raised for bridge loans.

Those folks have the financing capacity to bridge those purchases until stabilization, when they can put on permanent debt. So, it seems like avoiding the risk as well as the availability of money, we are still seeing an immense amount of money chasing well-located high-quality multifamily.

**Operator:**

Thank you. The next question is coming from the line of Venkat Kommineni with Janney Montgomery Scott. Please proceed with your question.

**Venkat Kommineni:**

Good morning. Beyond the Wawa land parcel sale, how active on the disposition front do you guys expect to be in the second half of the year?

**Louis Haddad:**

Hey, we're more opportunistic, Venkat, than we are formulaic in terms of our approach to dispositions. As Eric said, there's a lot of money chasing deals out there, and I guess I'm talking a lot about our basic tenet. Another basic tenet we have here is we don't fall in love with real estate, particularly when they're not core assets. So it's very easily could see more dispositions coming in over the 12 next months.

**Eric Smith:**

This is Eric, to provide a little more color commentary that you would imagine based on what Lou just said it being a central tenet of ours. Our asset management group and our individual asset managers are in constant communication with our investment team as they review the stabilized properties in the portfolio; and while they may be performing just fine, constantly asking the question of is that capital better to used elsewhere be it in 1031 or working with Mike and questioning the balance sheet, and whether the capitals is better used on the balance sheet. And so that is an ongoing active conversation at all times internally.

**Venkat Kommineni:**

Okay, great. And then, can you provide a little color on the sales process at Annapolis Junction? What did you guys expect the stabilized pro forma to be if you had tapped it and maybe discussing that cap rate and press per unit this represents?

**Louis Haddad:**

I want to be careful because that transaction that - the ultimate transaction is between our partner and a buyer. And we are not a party to it, obviously, we have knowledge of it, but it's not a hard contract yet. But as I said earlier, it's a meaningful discount to as to what we believe it would bring stabilized. I believe you're talking about a cap rate in the low fives with a stabilized asset. So we've got a decent discount to that, but it's still very good price for us.

**Operator:**

Thank you. The next question is coming from the line of Craig Kucera with Wunderlich Securities. Please proceed with your question.

**Craig Kucera:**

Hey, good morning. Lou, I feel like in prior cycles you've spoken about how when rates are rising you've often seen business improving, particularly is measured by request to-- for expansions. Are you starting to see any of this pick up as we move through 2018, and is that expectation driving you guys toward an increased development weighting towards CBD office?

**Louis Haddad:**

Yes, and yes. We're seeing an awful lot of optimism out there, both on a municipal side with the various cities, as well as very large tenants. So it's - it really isn't different than any other cycle that we've seen. In that people are optimistic, unemployment were - we're essentially a full employment rates are low no matter what anybody says, they're low relative to historical averages. So it's a great time for the development business, so it is a great time for the real estate business. Like we said before, if you can't take advantage of all these various factors and focus simply on that you've got a mildly rising cost of capital, then you really shouldn't be in this business, because this is what we all hope for it.

**Craig Kucera:**

Got it, and one more for me. I think you mentioned that you expected higher development returns on these types of projects and can you give us a rough idea of what we might be looking at versus where some of the multifamily projects have been penciling out recently?

**Louis Haddad:**

Sure. As you guys know, we talked about --we look for a 20% spread between our wholesale and retail construction projects. And so if you follow the cap rate curves down, with multifamily, obviously, we're building to mid 6s to high 6s even low 7s. For office and retail, it starts with a 7 and goes up to 8.5. So the math simply says if we have more CBD office, our initial return on cost is going to be better than the multifamily side.

**Operator:**

Thank you. Our next question is coming from a line of Rob Stevenson with Janney Montgomery Scott. Please proceed with your question.

**Rob Stevenson:**

Good morning, guys. Just on the development pipeline and the shadow pipeline and what you guys are looking at, can you just talk a little bit about what the rough mix is between office, retail and apartments and I guess other? How does that, if you wind up going through with these projects, how does that sort of mesh out in terms of what the future of the company starts to look like from an asset class perspective?

**Louis Haddad:**

Okay. Let's see. So, obviously, the two projects that we just announced are almost singularly weighted towards office. Within the remaining projects, it's still - I would say is an order of half office and with the other --the other quarters is being split between multifamily and retail. And of course, it's subject to change in case something dies. I can easily see there being very little retail in what's left, but it's all going to come together in the next few months, and we'll be able to be a little bit more certain on it.

**Rob Stevenson:**

Okay and then on the redevelopment, it's - the new redevelopment that you're going to do with Town Center with Shake Shack et cetera. What's the aggregate dollar amount that you guys are going to wind up investing in that?

**Louis Haddad:**

Yes. In that particular phase it's going to be pretty small. Like I said we're --what we're going to be affecting first is that four acres or so that is horizontal shops. I believe we're looking at $6 million or $7 million in terms of the total rehab of that Center. As things progress and go more vertical, that number will ramp up pretty significantly, but those future phases involves tear downs rather than rehabs. And we also would expect significant city participation in those phases as well.

**Operator:**

Thank you. The next question is coming from the line of Dave Rodgers with Robert W Baird. Please proceed with your question.

**Dave Rogers:**

Sorry guys, just one more follow-up for me. The Home Depot sale and then the Lowe's Food acquisition in the second half of 2018, can you provide dollar amounts for each of those or a rough estimate?

**Michael O'Hara:**

Yes. The Lowe's acquisition is in the mid $25 million, mid 20s, $25 million or so range. On the Home Depot, it's somewhat complicated in that the building sits on a ground lease. So, the acquisition will just be for the building itself, which is not a lot of money, but we still have to work out what their participation is on paying us for the underlying ground lease that it sits on.

**Louis Haddad:**

Sale wise it's 20 year old bricks and sticks, it's a few million dollars Dave.

**Operator:**

Thank you. It appears we have no further questions at this time. So I'd like to pass the floor back over to Mr. Lou Haddad for additional concluding comments.

**Louis Haddad:**

Thanks very much for your interest in our company. Look forward to updating you on our activities and results in the coming quarters. Have a great day.

**Operator:**

Ladies and gentlemen, this concludes today's teleconference. We thank you for your participation. And you may disconnect your lines at this time.