February 14, 2023

Armada Hoffler Properties, Inc. (AHH)

Q4 2022 Earnings Call

Operator

Good morning, ladies and gentlemen, and welcome to the Armada Hoffler Fourth Quarter 2022 Earnings Conference Call.

(Operator Instructions)

This call is being recorded today, Tuesday, February 14, 2023. I would now like to turn the conference over to Chelsea Forrest, Director of Corporate Communications and Investor Relations. Please go ahead.

Chelsea Forrest

Good morning and thank you for joining Armada Hoffler's Fourth Quarter and Full Year 2022 Earnings Conference Call and Webcast. On the call this morning, in addition to myself, is Lou Haddad, CEO; Matthew Barnes-Smith, CFO; and Shawn Tibbetts, COO.

The press release announcing our fourth quarter earnings, along with our earnings, guidance and supplemental package were distributed this morning. A replay of this call will be available shortly after the conclusion of the call through March 14, 2023. 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 14, 2023, and will not be updated subsequent to this initial earnings call.

During this call, we may make forward-looking statements, including statements related to the future performance of our portfolio, our development pipeline, the impact of acquisitions and dispositions, our mezzanine performance and financing activities as well as comments on our guidance and outlook. Listeners are cautioned that any forward-looking statements are based upon management's beliefs, assumptions and expectations taking into account information that is currently available.

These beliefs, assumptions and expectations may change as a result of possible events or factors, not all of which are known and 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 that we distributed this morning and the risk factors disclosed in the documents we have filed with or furnished to the SEC.

We will also discuss 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 armadahoffler.com. We will start the call today by discussing our 2023 guidance. At this time, I'd like to draw your attention to our 2023 guidance presentation made available on our website.

I'll now turn the call over to Lou.

Lou Haddad

Thanks, Chelsea. Good morning, everyone, and thank you for joining us today. In addition to analysts and investors, there are many of the Armada Hoffler family and joint venture partners on the call. On behalf of our Founder and Chairman, Dan Hoffler, the Board of Directors and executive management, we sincerely thank you for being a part of our team. Through your hard work, dedication and expertise, we have brought about an accomplishment that I previously thought would only be attained a few more years in the future.

The investment-grade credit rating assigned to us by DBRS Morningstar represents an achievement many years in the making. We believe this rating to be a validation of our diversified business model, Class A portfolio, multi-decade track record and responsible fiscal management. This solid BBB designation gives us access to additional capital sources and investors that only transact with investment-grade companies. I encourage all who follow our company to read the rating report, which can be found on the DBRS Morningstar website. It gives a thorough and unbiased assessment of Armada Hoffler.

As you have probably already seen, this morning, we released record earnings for the fourth quarter. The $0.35 of normalized FFO per share far exceeds previous guidance. The primary drivers of this quarter's outperformance were increased NOI from office properties, robust same-store NOI, and the early payoff of a preferred equity asset, which triggered a minimum interest payment. This completes a full year that saw us grow earnings per share by 13% over 2021. The company is obviously firing on all cylinders.

Today, I will focus my comments on our 2023 guidance presentation, which was released this morning and can be found on our Investor Relations website. Later in the call, Matt will give further details on the quarter in our financial metrics. Shawn will wrap up our prepared remarks with comments on the current status of ongoing operations and the development pipeline as well as portfolio highlights.

Turning to Page three of our guidance package. You'll see that we are forecasting a substantial increase in property NOI resulting from organic growth in our same-store portfolio, the lease-up and stabilization of recently delivered development projects and anticipated acquisitions. We also anticipate another record year in construction as we continue to work through over $600 million in third-party contracts over the next couple of years.

This year, we'll realize the impact of the good work Matt and our finance team have done to further move the balance sheet towards more unsecured, longer-term fixed rate debt and our planned reduction of the mezzanine program. All these factors combined to result in a healthy 2.5% increase in bottom line per share earnings.

Regarding our target of $100 million to $200 million of acquisitions, we have identified a few potential off-market accretive opportunities with a possible component of OP unit equity. All told, we are pleased to continue the upward trajectory of our earnings in anticipation of further growth as our development projects deliver and stabilize.

Turning to Page four, you'll see an illustration of this trajectory. This chart shows that the company has been a model of consistency coming out of the pandemic and that we expect that steady growth to continue for the foreseeable future. As the portfolio income continues to climb, you see that mezzanine income decreases as we eventually stabilize the program at the $80 million level that we established as a target some time ago.

Construction fee income is expected to eventually return to the historical range of $4 million to $7 million after a few years of elevated profits. Please note the continuous rise in portfolio NOI despite the disposition of over $300 million of noncore assets over the last year or so.

Turning to Page five, the table at the top reiterates the expected dramatic increase in NOI and the pie charts illustrate the various sectors in our property portfolio. While all sectors will continue to grow on an absolute basis, we expect to continue rebalancing the portfolio. We project that retail will continue to be our largest sector, but less of the total on a percentage basis. Multifamily will grow the fastest simply by virtue of developments in the pipeline and a full year of the newly stabilized apartment communities. We expect the office percentage to remain relatively stable with the addition of the office portion of Southern Post as well as new tenants coming online in our existing portfolio. Our current forecast contemplates exiting the T. Rowe Price joint venture upon completion.

Page six summarizes the consistent and sustained growth our team has already achieved and the future growth that we expect to deliver this year. Whether it's NOI, EBITDA or normalized FFO, each of these important financial measures has incrementally increased and is projected to grow over the three-year period measured here. Perhaps as important, we have every reason to believe that this chart, inclusive of the dividend rate will continue the trend after we add 2024 to the data.

The underlying fundamentals of our portfolio, occupancy, renewal spreads, weighted average lease terms, tenant diversification and credit quality are stronger than ever, producing healthy NOI growth in each of our asset classes and record bottom line per share earnings.

We understand this runs against the drumbeat of news in some real estate sectors, especially office, particularly if your focus is on gateway markets. On the contrary, we are seeing record demand and consequently have the ability to drive rental rates across our properties and submarkets. Given the economic history of resilience this portfolio has demonstrated, we see no reason for this to change. The biggest challenge we are facing is accommodating tenant demand and expansion in a portfolio at capacity. In short, to group us together with the office REITs facing major structural issues is to ignore the strength, quality and performance of our office properties, and even more importantly, this inaccurate characterization would overlook the other 70% of our portfolio and fee income sources, all of which are operating at record levels of profitability.

Now over to Matt.

Matthew Barnes-Smith

Good morning, and thank you, Lou. What a year. I'm extremely proud to be part of the Armada Hoffler team that continues to outperform all expectations.

As Lou indicated, for the final quarter of 2022, we reported FFO of $0.33 per diluted share and normalized FFO of $0.35 per diluted share. For the fourth consecutive quarter, we produced a robust set of operating metrics across our portfolio, achieving exactly what we committed to our shareholders.

For the full 2022 fiscal year, we achieved FFO of $1.21 per diluted share and normalized FFO of $1.22 per diluted share, outperforming our original guidance by 8% and outperforming our pre-pandemic earnings high with materially less reliance on fee income. Shawn will discuss our preferred equity and fee income strategy later on the call reporting on our operational performance and providing additional insights.

Last quarter, I spoke at length regarding our balance sheet transformation towards long-term fixed rate unsecured debt, and I'm pleased to report that we've made strong progress over the last few months, continuing to execute our fiscal strategy. As you have seen in the press release from early December, partnering with one of our preferred lenders, we closed on a $100 million unsecured term loan mirroring the terms and conditions of our primary credit facility. This SOFR plus 130 basis point loan was immediately swapped at an all-in rate of 4.8% and we utilize the funds to pay off secured debt. The term loan facility has another $100 million accordion feature that we will look to utilize this year to convert our remaining secured construction debt once the applicable projects from our development pipeline have reached stabilization.

Taking advantage that the favorable derivatives market in early December, we also executed another swap for the notional amount of $100 million at the all-in rate of 4.73%. This swap was placed on the term loan funds that we recast back in August, replacing the $100 million cap that expired earlier this month. As we transition the balance sheet, we'll endeavor to maintain our variable rate debt is 100% hedged.

For the fourth quarter of 2022, the ratio of our stabilized portfolio debt to stabilized portfolio adjusted EBITDA remained consistent at 5.3x. Our stabilized leverage range between 5 to 5.5x is a result of the continued implementation of our overarching financing plan, deploying our capital in the most optimized way. As Lou noted earlier, that financing approach as part of our overarching diversified business strategy was rewarded this month with a BBB credit rating, providing broader access to capital markets at a lower cost of funds and the opportunity to further our balance sheet transformation.
The team worked exceptionally hard over the last year to ensure that we were well positioned for this rating I would like to take this opportunity to thank everybody at Armada Hoffler who was involved.

DBRS Morningstar identified a number of strengths supporting our investment-grade rating, including our market-leading positions in the Mid-Atlantic and trophy assets in Baltimore a high degree of diversification across asset classes within our commercial tenant base that mitigates exposure to cash flow volatility and our historical EBITDA interest coverage that has been strong for several years. Whilst we're in no hurry to enter the private placement market, we will monitor market conditions and look to transact when the environment is favorable.

In the fourth quarter, our weighted average cost of debt remained low at 3.6%, illustrating the success in maintaining that our debt is 100% fixed or hedged and reducing the risk of uncertainty in this rising interest rate economic cycle. Assuming the forward yield curve stays reasonably consistent with the current projection, our expectation is that our weighted average cost of debt will be below 4% for 2023 and 2024. As mentioned last quarter, we refinanced the Gainesville apartments with a $30 million loan, priced significantly below the construction note. This means that we do not have any debt maturities in 2023 and a small amount of secured debt maturing in 2024 will be paid off at maturity.

As you can tell, the execution of the balance sheet transformation is going exceptionally well. We have strong leverage metrics, competitive with our peers, a low cost of debt and no maturities in the next 2 years. That, coupled with maintaining our strong liquid position means we are intentionally structured for our investment team's opportunity acquisitions, as we mentioned in our guidance slide, ready to support our projected business growth well into the next 24 months.

I will now pass it over to Shawn for some operational highlights.

Shawn Tibbetts

Thank you, Matt. As Lou indicated, the company's 2022 performance was the strongest across the board from a KPI standpoint in its 43-year history. That said, we are now focused on 2023 targets and the teams at Armada Hoffler remains hyper-focused on execution and operational excellence to ensure that the positive trend continues, and that value creation remains top of mind. We believe that best-in-class execution throughout the portfolio, safe and reliable construction services combined with seamless execution of high-quality development projects will continue to create sustained shareholder value for years to come.

Please refer to the supplemental package to review our operating portfolio highlights. I would like to call out a few of the noteworthy operational metrics. 2022 full year same-store NOI for the portfolio was 5.6% on a GAAP basis and 6.7% on a cash basis, with multifamily coming in at 10.2% on a cash basis. Full year 2022 re-leasing spreads on the commercial portfolio or positive 8.4% on a GAAP basis and 2.9% on a cash basis.

As you can see from the performance, our asset management team is extremely diligent in the execution of our operations. Our team remains intimate with the overall performance of these assets as well as the property management teams that act as an extension of our management. This focused approach enables our team to not only react to trends and issues at the asset level, but also to forecast and prevent issues that would otherwise affect NOI at the properties.

One example of this diligence is the continued refinement of our post-COVID era commercial tenant watch list. This process is a useful indicator focused on our tenants who are or who may be potentially at risk due to various economic factors in the market.

Two of the higher profile tenants inhabiting the watch list are Bed Bath & Beyond and Regal Cinemas. Bed Bath & Beyond has been focal point given recent financial challenges. However, neither of the two stores in our portfolio are targeted for closure. As a result of the strength of the stores in our portfolio, we have elected not to reserve against them at this time. Following recent news on Bed Bath & Beyond, the Patterson location in Durham, North Carolina has received an unsolicited inquiry from a popular credit tenant who would like to fill the space should it be vacated.

In our Virginia Beach location, the store is a strong performer amongst its peers. That said, we hope the space becomes available in order to take advantage of our long-contemplated redevelopment plans by adding apartment units at Town Center.

We also have 2 Regal Cinema locations within the portfolio. The [Harrisonburg] location is a strong performer. However, sits on approximately 10 acres that represents a prime redevelopment opportunity. In Virginia Beach, the Regal Cinemas is adjacent to the aforementioned Bed Bath & Beyond site and is ideal for redevelopment into a multifamily community at Town Center. We are not concerned about any other properties on the watch list given the strength of their locations. In terms of office, we remain highly leased at 96.7% with a high-quality roster of tenants.

As DBRS Morningstar recently stated, “the office occupancy rate continues to remain stable in the high 90% range, and the Company is facing issues with tenant expansion requests given the lack of available space”. We are working with one high credit tenant that we expect to take space at some point in 2023. This will result in yet another high-quality global firm located at Town Center in Virginia Beach.

Our residential portfolio continues to thrive. We are now seeing rent growth moderate to a single-digit pace as we had previously forecasted and underwritten. As a result of our conservative approach, we are well positioned in terms of portfolio rent growth and yields for multifamily units currently in the development pipeline.

Our portfolio is resilient, and this diverse makeup continues to provide stability and predictability in the Company's overall performance. The diversity can be characterized in a couple of ways. First, we have robust diversity in property type, which is certainly beneficial over time. Secondly, as DBRS Morningstar states, “the asset quality of [our] multifamily portfolio,” and “the quality and diversification of [our] commercial tenant base,” support a high degree of credit rating.

Additionally, and more likely the case during times where market conditions, increased competition, our mixed-use assets outperformed the competitive set. These competitive advantages give us the ability to remain the beneficiary of the flight to quality and maintain steady earnings growth over time.

Our construction and development projects are progressing according to schedule as we approach the spring months.

We have significant value creation underway, and most importantly, the projects are being executed in a manner that is consistent with the underwriting. As we reported last quarter, our Gainesville project leased up in record time and is now operating in a stabilized state. We couldn't be happier with the performance of the asset developed in conjunction with our partners at Terwilliger Pappas.

Our Chronicle Mill asset in Belmont, North Carolina continues to outperform expectations, both in the form of rents and lease-up schedule. This unique rehabilitation project has been a resounding success and was over 93% leased at the end of quarter four, 2022, with construction being materially complete on the site.

The highly anticipated Southern Post asset in Roswell, Georgia is proceeding as planned. The mixed-use project will become the trophy asset in the submarket with high barriers to entry.

Construction on T. Rowe Price's global headquarters is well underway, on schedule and proceeding as planned. This project is unique is it situated next to our Wills Wharf asset and adjacent to our Constellation asset. We are best positioned to construct and develop this project, given our understanding and familiarity with the Harbor Point market and deep experience constructing a significant portion of the Waterfront in Baltimore. We are excited as this building has come into fruition. This build-to-suit project is expected to achieve initial occupancy in simultaneous stabilization in the third quarter of 2024.

Next door, construction of the allied apartments at Harbor Point is also well underway. We are bullish on this project given our knowledge of the apartment submarket in its location adjacent to our Trophy 1405 Point Street multifamily asset. This project is on schedule and like T. Rowe Price, is also expected to be ready for initial occupancy in the third quarter of 2024.

Our partners at Terwilliger Pappas repaid the entire Solis Nexton loan balance on the last day of 2022, resulting in a 30% return on investment in less than two years. This is a great example of the types of preferred equity investments we look for: multifamily apartment projects in growing markets in the Southeast at a manageable investment size with priority in the equity stack, significant spread over basis, all of which virtually assures our return and creates a true lower risk, higher return opportunity.

Solis City Park in Charlotte and Gainesville II in Gainesville, Georgia, are also preferred equity arrangements with Terwilliger Pappas. Both projects are well underway with initial occupancy expected in the third quarter of 2023 and the second quarter of 2024, respectively.

As with the rest of our preferred equity portfolio, we would love to own one of these assets if the opportunity arises.

The Interlock, developed by our partners at SJ Collins, continues to perform well at 90% occupancy. The mixed-use asset located at Main and Main in West Midtown Atlanta is expected to trade for a healthy profit.

As Lou mentioned earlier in the call, we intend to strategically acquire accretive assets in 2023. The Interlock is certainly a potential candidate.

We are closely managing the fee income portion of our business, both in construction and preferred equity. From a construction perspective, our income has increased temporarily given the incredible opportunity to construct, in partnership with T. Rowe Price, their global headquarters.

The experience of our management team, combined with the focus on shareholder value creation is a key element driving the success at Armada Hoffler. These congruent objectives are embedded as a result of the significant ownership stake held by our management team. This alignment ultimately results in mutual interest with our shareholder base and are therefore appropriately guided in every one of our business decisions. The Armada Hoffler team continues to exceed expectations, especially as Lou mentioned, outperforming the guidance during each quarter of this past year. I would like to say thank you to our incredible team members throughout the organization for performing at the highest levels. We look forward to an increasingly successful year in 2023.

I will now turn the call back over to the operator for questions.

Operator

(Operator Instructions)

Your first question comes from Dave Rodgers of Baird. Please go ahead.

Dave Rodgers

Yeah good morning everybody and congratulations on the debt rating. I know you've been working on that for a while. Maybe start with Lou and Shawn with respect to the acquisition pipeline and the OP units you'd want to use. A couple of thoughts there or questions.

First, can you give us a little bit more detail, maybe on what you're seeing? Is this more distressed out of the private side, more traditional relationships that you had, would that number that you gave include Interlock? And maybe the third question on that would just be, as you think about kind of deploying the equity there, is there another source of capital, either assumed debt or some other point that would kind of fill in the blank for us?

Lou Haddad

Thanks Dave and good morning.

So as I mentioned and previously in the call, we've identified a few opportunities that basically are from -- come from long-term relationships with folks that own properties that we'd be very interested in acquiring, again, off-market and at the right number with the opportunity to increase NOI.

As Shawn mentioned, the Interlock is a possibility, as I've said for several quarters, if there is an opportunity to transact on that at a discount, that would be one. There are a few others. Obviously, we don't want to go too far into particular names there. But it's the sort of thing that you've seen us do time and time again over the years, using OP unit prices at premium levels for properties that would be immediately accretive.

We put that wide range in there because we're not sure who's actually going to meet our criteria. As far as methods of financing as Matt mentioned, we're at or near an all-time high on liquidity. We're also looking to deploy OP units. And obviously, there could be some construction debt, as well as the private placement market when the time is right.

Operator

My apologies, our last caller has been removed from the queue. Your next question will come from Peter Abramowitz of Jefferies.

Peter Abramowitz

Yes, thank you. I just wanted to ask, in terms of the growth trajectory for '23, that's implied in the guidance, could you give a little bit more detail on what's kind of assumed in terms of same-store growth, I would imagine, it's probably flat or negative on office given the move out but the positive elsewhere. But just any more color you could give around that.

Lou Haddad

Yes good morning, Peter, and I'm not sure where you're picking up the negative. Our projection is that office will continue to be positive on a same-store basis. I'm not sure there's a move out, but there's already a move in beyond that as well as significant growth across the sector.

So bottom line is, all sectors are forecasted to be positive in same-store growth. We think that, as Shawn mentioned, multifamily is going to moderate into the low single digits. So, it's historical range. Retail is going to continue to outperform as well office.

And then the biggest part of that NOI growth is a full year of the two newly stabilized apartment properties that we brought online last year. And lastly, the stabilization of Wills Wharf, which again, will have a full year good time around.

Peter Abramowitz

Okay. Got it. And what's the timing of the leases that you have in place to backfill the JHU Medicine move out?

Lou Haddad

Yes. That's being backfilled by Morgan Stanley. And I think it doesn't come online until the first of the year. We can get that answer for you. Do you have that, Shawn?

Shawn Tibbetts

Yes, rent commencement as the beginning of '25, so January '25. And we'll get you a little more detail on that. But yes, the rent commencement dates 1/1/25, that coincides well with the JHU expiration.

Lou Haddad

Yes, I think that where you're headed, Pete, if there's a gap there, but it's totally washed over by the increase in NOI from the other tenants moving in as well as the rest of the office portfolio.

Peter Abramowitz

Okay. Makes sense. And then just in general, can you talk about private real estate markets any signs of things kind of thawing out there and convergence and more activity between buyer and seller expectations as well as the financing side?

Lou Haddad

Yes. I think in terms of acquisitions, dispositions and the like, I think people are still searching for what true cap rates are. We don't think that's really going to settle out until later in the year, hopefully, so price discovery is an issue. That's why, frankly, we're not interested in looking at anything that's out on the market, but are hoping to transact privately with some close relationships that we already have.

In terms of financing, I think everybody is of the same mine, banks are a bit more cautious about deploying capital across all property types. Our long-time partners in the multifamily side are seeing that construction loans are now angling towards only 50%, whereas everybody knows, a few short years ago, we were talking 75% and 80%. So obviously, the need for equity is more than ever. And we're getting more -- many more opportunities than we possibly can transact on. And so, we're basically in a position to cherry pick the right assets that with potential ownership either on mezzanine, preferred equity or ground-up basis.

Operator

Your next question comes from Rob Stevenson of Janney.

Rob Stevenson

Lou, I think in your comments, you indicated that you expect to exit the T.Rowe Price JV upon completion. Is that a 2025 transaction for you guys?

Lou Haddad

Well, the property -- they'll be occupying in the third quarter of 2024. So, we have to look at market conditions, whether that's going to be a day one disposition or hold until early '25. And of course, you've got a significant marketing effort as well. And Rob, I just want to make sure it's clear. That's our current thinking. And we love the venture. We love the building. Obviously, we're going to own everything around it. We're just a little concerned about concentration as well as we'd love to get that capital back and redeploy it. Again, assuming that cap rates settle out where trophy building can transact, at a reasonable level.

Rob Stevenson

Okay. And then I think you and Shawn both talked a little bit about redevelopment. Can you talk about what the sort of near-term redevelopment plans are, especially in the portfolio, especially if you don't get the Bed Bath or the Regal stuff back in the near term? Where else is there opportunities for you guys? And when are those type of -- when is the time frame for start and/or completion of the opportunities that you have in the portfolio today?

Lou Haddad

I'll let Shawn answer it more specifically. But as far as redevelopment, those are the only properties that we have that we'd be looking to take down and change uses. And we're, frankly, anxious to kind of sitting in the cater seat. We're selecting a ton of rent right now. But at the same time, long-term, we'd love to see multifamily in those locations. With regard to ground-up development. Shawn, do you want to -- you're looking at an awful lot of stuff.

Shawn Tibbetts

Sure. Yes, I think there's no shortage of opportunities out there, as you would imagine. And so we're seeing a lot of deal flow. To Lou's point back on the redevelopment, we are happy to collect rent and watch construction prices kind of stabilize or come down. That helps, obviously, the yield and helps our business case. In terms of ground-up development, here in Town Center, we have, as you know, Rob, an opportunity for a site here should the opportunity arise to develop a mixed-use building. We've been calling that parcel or block in Baltimore as well, we have the opportunity to -- if we want to elect to build more multifamily units subsequent to the Allied units that are there today are being built today.

Our partners across the spectrum continue to bring deals. I mean we looked at three deals last week in the multifamily space. So we're seeing strong deal flow there. We just -- we're setting -- we've been very diligent and discerning about which opportunities to pull the trigger on. So I think from our perspective, yes, there are redevelopment opportunities, but probably in the shorter term, there are actual ground-up development opportunities that make more sense for us, assuming that the rent continues to come in.

Rob Stevenson

Okay. And then, Matt, anything of note to the cadence of '23 earnings. I think the guidance averages out to a little over $0.31 a quarter. Are there anything that's going to disrupt that, neither push the quarterly progression up or down meaningfully in specific quarters at this point?

Matthew Barnes-Smith

Today, today in our guidance where the standards you were spread it roughly even, is there potential opportunity for one of our preferred equity deals like Solis Nexton came early in 2022, potentially Solis City Park could be sold and come early in 2023, but we have not put that in the base case of guidance, that would be potentially upside. But yes, we feel that, yes, it will be fairly evenly spread throughout the quarters, and we will see kind of as Lou and Shawn talked about, the potential acquisitions that we've placed in guidance, we'll see what they kind of materializing the timing on that as we work through the year.

Rob Stevenson

Okay. And the $13 million of mezz preferred in the guidance, is that just the three existing investments? Or does that contemplate an additional investment or two throughout the year?

Lou Haddad

That's just the three that are active right now.

Rob Stevenson

Okay. So anything in addition to that, on a net basis, would push guidance up at that point?

Matthew Barnes-Smith

Yes. Rob, there is one additional mezzanine preferred equity deal with our preferred partners, TP, Solis Kennesaw that is in the model. Hopefully, that will close in the first quarter of this year to replace the Solis Nexton that transacted early.

Operator

Your next question comes from Dave Rodgers at Baird.

Dave Rodgers

Sorry about earlier, but thanks for the answer to that first question. Follow-up for me, Lou, on the construction side of the business, added quite a bit of the backlog in the fourth quarter. Curious about just what you're seeing kind of in construction overall, including maybe some cost increases that you're still seeing. But I guess with regard to the backlog, are you just seeing an acceleration of development with this just unique to Armada Hoffler, really trying to get a sense for the competitive landscape maybe that you're facing as well?

Lou Haddad

Dave, I think to answer your last question first, I think it's fairly unique to us. We've got these long-term relationships. They're very active right now, and we're the beneficiary of that and will continue to be so for the next couple of years.

In terms of pricing, things have moderated. We're still putting escalations in contracts, but not nearly to the extent that we were at this time last year through the spring. We're not really seeing and I don't think anybody is expecting that there's going to be any significant decrease. The commodity prices have come down significantly, but that's been offset largely by labor costs as well as a shortage of high-quality subcontractors.

Operator

Your next question comes from Camille Bonnel of Bank of America.

Camille Bonnel

Hi good morning and nice job on the investment-grade credit rating. It sounds like from this call, you have a number of potential investment opportunities this year. Can you just elaborate a little bit more about the plan versus and uses of capital and just in the context of your medium-term leverage targets?

Lou Haddad

Sure, Camille, right now, we've got a number of sources of equity, and we're staring at a lot of opportunities to pick up some really good properties on an off-market basis. And like I mentioned before, using the company's stock at a premium price. So we're excited to get that done. Matt's got a lot of arrows in the quiver.

And of course, we've now added private placement market plus we have the ability to expand our credit line through an accordion feature as well as the liquidity we have on balance sheet. And so we're feeling that with acquisitions we'll stay in that range that Matt has mentioned. He's going to kick me under the table if I say anything other than that. But we also -- lastly, I want to make sure everybody understands, we sold over $300 million of noncore assets last -- in the last 12 or 14 months we still have noncore assets that we can use, if necessary, for a ready source of capital. Plus, I mentioned the T. Rowe price exit is a potentiality. So, there's a number of different ways we can go, but our expectation is that we're not going to get out of that range that Matt had mentioned.

Also, important to note is that it is in our guidance that the Interlock will transact irrespective of who buys it. That $80-some million will not be outstanding come the end of the year is our forecast.

Camille Bonnel

Appreciate the color there. And many of my questions have been answered already. So just one follow-up as I wanted to make sure I caught your earlier comments on the same-store outlook as you're expecting NOI to increase next year. So are you saying your expectations for occupancy will remain positive or improve in 2023 even factoring for any have known move-outs in your office and retail portfolio.

Lou Haddad

Sure. Well, I understand improvement is relative. We're starting from a base of 98% occupied. So, there's not a lot of extra space to lease. As Shawn mentioned, we're essentially trying to shoehorn one more tenant into a Town Center here in our office space, a global organization as well. Our expectation is that we're going to stay at or near or slightly above that 98% level in office and retail. We are projecting that multifamily will moderate, again, back to historical norms of being in the mid-90s with single-digit increases as opposed to what we've all seen in the last couple of years.

Operator

Your next question comes from Chris Sakai of Singular Research.

Chris Sakai

Hi good morning, can you talk about your -- the main drivers for the normalized funds some operations growth and guidance?

Lou Haddad

Yes. I think if you look at the guidance package, the main drivers are really twofold. On Page three of the guidance, the guidance deck. Portfolio NOI is the biggest increase and that, again, is basically two factors: one being same-store sales being up across the board in each of our sectors as well as a full year of stabilized -- newly stabilized properties which obviously, on a year-over-year basis, gives a pretty significant boost.

We're also forecasting a pretty substantial increase in construction income based on that $600 million backlog that we mentioned. Our guys -- I'll take a second to say our guys are doing a phenomenal job. You can imagine, we basically doubled our historical backlog at a lot of large complex projects, and they're running full out and doing a great job for us.

And lastly, the moderating effect of both of those on the negative, if you will, side is that we're projecting interest income to go down from 2022 levels. As I mentioned, as part of our free program to decrease our reliance on net fee income and use more of our capital for our own portfolio. And put it all together, it's a pretty healthy increase.

Chris Sakai

Okay. All right. I suppose this question is for Matt. For 2023, how should we be looking at rental expenses? Should it be roughly the same or increasing from current levels?

Matthew Barnes-Smith

Yes, Chris, we believe that our margins on the NOI will be fairly consistent with what we've seen in 2022. So, we will see an uptick in rental expenses. But as NOI is growing, that will be kind of contra by the increase in rental revenue. Yes. Chris, it's also worth noting that in the commercial side of the business, a portion of those expenses are also reimbursable or pass through paid for by our tenants.

Operator

Ladies and gentlemen, at this time, there are no further questions. So I will turn the conference back to Lou Haddad for any closing remarks.

Lou Haddad

Thanks for all your time and attention this morning, and we're proud of our results, and I appreciate your interest in the company and look forward to further announcements coming soon. Thank you.

Operator

Ladies and gentlemen, this does conclude your conference call for this morning. We would like to thank you all for participating and ask you to
please disconnect your lines.