

December 7, 2020

Armada Hoffler Properties, Inc. (AHH)

Harbor Point Update Call

Operator

Welcome to Armada Hoffer's Harbor Point Update 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, Wednesday, December 7th, 2020.

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

Please go ahead.

Mike O'Hara

Good afternoon and thank you for joining us for an update on our new joint venture to develop and build the new T Rowe Price global headquarters building. On the call this afternoon, in addition to myself, is Lou Haddad, CEO. Please go to the Investor Relations section of our website armadahoffer.com for the Harbor Point update presentation.

During this call, we will make forward-looking statements. 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 December 3rd press release and the risk factors disclosed in documents we have filed with, or furnished to, the SEC.

Our opening remarks will be short and afterwards, we are available for Q&A. Now I'll turn the call over to Lou.

Lou Haddad

Good afternoon and thank you for joining us today. As you saw from last week's press release, we are embarking on a new joint venture with a long-established partner to bring a major new facility to our Harbor Point development on Baltimore's waterfront. We are hosting this call and offering the short presentation available on our website, to give further details on this exciting project and answer any questions you may have. The importance of T Rowe Prices' commitment to Baltimore in general and our site in particular cannot be overstated. Not only does the new world headquarters building further validate Harbor Point as a top east coast destination but bringing some 1700 employees to the site will further increase demand for our existent, adjacent facilities and accelerate the opportunities for additional development.

Once again, the advantages of a diversified, vertically integrated business model have proven to be key for maximizing the positive financial impact that the new project will have on our company both in the short and long-term.

First, as would be the case for any property owner, the presence of this iconic building abutting currently owned high-quality assets is a major value enhancement to our portfolio in and of itself.

Secondly, and not nearly as commonplace is our 25-year relationship with Beatty Development, a partnership which has produced some of Baltimore's most prestigious landmarks. This familiarity allows us to assume the high return, yet limited risk of the equity in the joint venture. We expect our 30mm investment in this build-to-suit to yield double digit profits. Additionally, we have the option to exit the venture after 4 years for full market value. While those two benefits will have long-lasting positive effects on the value of our company, the unique advantage of having a top-flight general contracting company allows us the ability to help maintain the project schedule and earn substantial income during the development process. We anticipate construction fees for the engagement to fall between 4-5mm over a two-year period.

A second joint venture with Beatty will be developing a mixed-use facility inclusive of an oversized parking garage on an adjoining parcel to accommodate existing parking commitments as well as a significant portion of the T Rowe Price requirement. We are currently programming the site and will offer further details on this project along with our existing pre-development pipeline on our next quarterly earnings call.

Now I'll turn the call over to Mike for further details on this announcement.

Mike O'Hara

Thanks Lou. This project will be very beneficial for our three existing assets on Harbor Point and for our company as a whole. On page 4 of the Harbor Point Update presentation, you will see the proximity of the T Rowe Price's new headquarters (number 4) to our three buildings, which are highlighted in green.

This is our third joint venture with Beatty Development on Harbor Point and the first in which we are the minority partner. Beatty Development is the lead developer with our role of adding development expertise, being the cash equity source and the general contractor. With AHH being the minority partner, this is an unconsolidated joint venture and therefore it will be an off-balance project. As such, the only impacts on our balance sheet will be our cash equity requirements. No debt will be reflected on our balance sheet, as the joint venture will be the borrower under the construction loan. Discussions with a lender are ongoing and we do not expect financing to be an issue. Just to be clear on the structure, we have ownership in the joint venture, this is not a mezzanine loan.

As the minority partner in the joint venture, we view this as a short-term investment with a four-year exit strategy and not a long-term hold. Per our agreement, we have the right to sell the asset or our share of the JV for full market value. Once complete, we are expecting an annual double-digit return on our capital before an exit profit, which we expect to be substantial.

As you can see on page 6 of the presentation, we will also be forming a joint venture with Beatty Development to develop the mixed-use project with large parking facility on an adjoining parcel. The JV will be structured in the same manner. It will be an unconsolidated joint venture with a five-year exit strategy.

As for our equity needs, Beatty development owns the land for both projects, therefore, there are no immediate material cash requirements. As with other development projects, the cash requirements will be spread out over the next two years. Given our current liquidity position, we are well positioned to take advantage of these opportunities.

We are available now for any questions.

Operator

[Operator Instructions] Our first question comes from the line of Rob Stevenson with Janney.

Rob Stevenson

So Mike, just one clarification. So Beatty is a 60% partner on the mixed-use and the garage and you guys are 50-50 on the T. Rowe headquarters?

Mike O'Hara

Yes, it's 50-50 on the T. Rowe and the 60-40 for the other. We are the 60% and he is the 40%.

Rob Stevenson

Okay. You were the 60% on that one. Okay. And then, Lou, so it's a 15-year lease. What are you looking at in rents for T. Rowe? And what level of TIs are you guys expecting to give them on this? And how does that compare to the existing office buildings?

Lou Haddad

Rob, right now, we can't divulge the rent. It's really a question for T. Rowe. We've offered all the information we can at this time.

Rob Stevenson

I guess another way to put it is, where are rents on the other office buildings these days on leases that are being signed?

Lou Haddad

So triple-net rents are in the high 20s and low 30s.

Rob Stevenson

Okay. And are they just the one building or you guys have been working on backfilling some of the WeWork space? Are they taking any building in any space in any -- in the existing building or anything?

Lou Haddad

No. Their headquarters will be as a stand-alone on the adjacent -- on the parcel adjacent to the Wills Wharf building.

Rob Stevenson

Okay. And can you remind us what the current occupancy or current lease rate is in that building or as of 9/30, whatever?

Lou Haddad

It's in the supplemental as of 9/30. It's in -- do you remember, Mike?

Mike O'Hara

Yes. We've got about 100,000 square feet left to lease on the building and the rates are, like Lou was saying, in the high

20s, low 30s as the asking price, depending on TI, triple-net.

Rob Stevenson

Okay. And is there -- I mean, when I look at the picture in 10 of the presentation, it looks like that the site for the T. Rowe building is being used as parking. I would expect that parking isn't really a problem right now with COVID. But as that starts to go back over the next couple of years, during the construction process, where are those people going to park? And are you having to pay or do anything to -- from parking for the other office buildings?

Lou Haddad

No. There's still room on the site to relocate the cars while we're building the oversized parking garage on the adjacent parcel to the T. Rowe building. That structure will go up first, and we'll break ground some time in 2021. Well, we're programming that site now, and we're coming up with details at our next earnings call.

Mike O'Hara

So parcel 7 now is not being used to park, and that we're going to be doing some work on parcel 7 to expand parking there.

Rob Stevenson

Okay. And so the mixed use with the garage -- at least the garage portion of that would open prior to the 1 half '24 delivery of the T. Rowe building working currently.

Lou Haddad

Most probably. And if there's any overlap, as Mike said, that extra lot on number 7 will take care of the overflow.

Operator

[Operator Instructions] Our next question comes from the line of Dave Rodgers with Baird.

Dave Rodgers

I wanted to look at Pages 5 and 6. It looks like it's 2 separate \$30 million kind of cash investments for you guys to make. Do you have an expectation for the timing of kind of how quickly that goes out and then maybe a timing of recognition of the fees? Will that be more back-end weighted or will you see some front-end weighting on the capital outflows on the fees?

Lou Haddad

So Dave, on the two \$30 million, obviously, those are estimated amounts at this point in time until we actually know the final size of these projects as well as what the loan to cost will be. So that's our estimates at this point in time. We're expecting it's going to take a couple of years. The T. Rowe building won't start construction until January of 2022. So that's going to be in design for the next year or so and then be the typical development process at that point in time. On the parking garage on that mixed-use side, again, that's going to be starting construction probably mid this year to fall-- I mean, next year into fall. And again, it's going to take a while for that equity to go fully out. And as a reminder, our partner owns both parts of the land. So there isn't any outlay for land.

Dave Rodgers

Okay. Lou, what can you talk about, I guess, with regard to the return and kind of the thresholds or anything you might need to meet along the way? You talked about a 4-year hold and an anticipated double-digit return. So I guess that would be my first question on the return. And then second of all, how do you -- obviously, this was always part of the plan is to kind of build another campus similar to what you have in Virginia Beach. As more of this when I think of Exelon or T. Rowe maybe gets sold off, how do you think about this as kind of a longer-term hold for you guys, and I realize it's just early days?

Lou Haddad

Yes. It's a little bit early, Dave. I mean we've got the option to exit after the 4 years. We'll see what life looks like at that time. On a return basis, this -- the returns are commensurate with what you would expect with a build-to-suit this kind of credit and this kind of quality. Remember, for us, it's more the cash-on-cash return of our equity investment as opposed to the return on cost.

Operator

Our next question comes from the line of Dane Bowler with 2nd Market Capital.

Dane Bowler

Just a question on -- is there any sort of waterfall structure to the 50-50 and 60-40 joint ventures? Or is it -- if you choose to not exit at the 4- and 5-year periods, would you just get a straight 50% of the profits?

Lou Haddad

Yes, Dane, this is a 50-50 pari passu joint venture and same on the exit.

Dane Bowler

Okay. So no waterfall, whatsoever?

Mike O'Hara

No.

Operator

[Operator Instructions] There seems to be no further questions at this time. I now would like to turn the call back over to Lou Haddad for any closing remarks.

Lou Haddad

Thanks very much for joining us this afternoon for a brief call. We look forward to updating you again at our earnings call in February. Take care.

Operator

With that, this concludes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.