August 8, 2024

# Armada Hoffler Properties, Inc. (AHH)

Q2 2024 Earnings Call

**Operator**

Good morning, ladies and gentlemen. And welcome to the Armada Hoffler Second Quarter 2024 Earnings Conference Call.

(Operator Instructions)

This call is being recorded on Thursday, August 8, 2024.

I would now like to turn the call over to Chelsea Forrest, Vice President of Investor Relations.

Please go ahead.

**Chelsea Forrest**

Good morning. And thank you for joining Armada Hoffler's second quarter 2024 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, President and COO.

The press release announcing our second quarter earnings along with our supplemental package were distributed yesterday afternoon.

A replay of this call will be available shortly after the conclusion of the call through September 8, 2024. 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 here and are as of today, August 8, 2024, and will not be updated subsequent to the 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 program, our construction business, our liquidity position, our portfolio 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 taken 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 yesterday afternoon and the risk factors disclosed in documents, we have filed with or furnished to the SEC.

We'll 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 armadahoffler.com.

I'll now turn the call over to Lou.

**Lou Haddad**

Thanks, Chelsea. Good morning. And thank you for joining us today.

As you can see from our earnings release, it was another strong quarter here at Armada Hoffler.

We continue to see our portfolio produce robust operating metrics. Tenant demand for our space is at an all-time high, and rents have never been better. These results, combined with a couple of one-time items, produce significant outperformance for the period.

We now anticipate the year ending with earnings at the high end of our prior guidance.

Before Shawn and Matt delve into the specifics of this quarter's performance, I'll take a minute to update you on our succession plan.

As expected, our Founder and Chairman, Dan Hoffler, retired last quarter. He remains active on our Board.

I have now assumed the role of Chairman and will perform the dual role until early next year, when the Board expects to appoint Shawn as CEO.

At that time, I will remain active as Executive Chair.

Shawn continues to exceed my highest expectations, just as he has for the last five years. He has already assumed many of my duties and built a core team with several members from within the organization to lead the execution of our strategic vision for the company in the coming years.

I could not be more enthusiastic for the future of Armada Hoffler.

I'll now turn the call over to Matt to highlight some of our quarterly metrics before Shawn delivers the business update.

**Matthew Barnes-Smith**

Good morning. And thank you, Lou.

Once again, the team has produced another strong quarter of financial results in line with prior guidance.

For the second quarter of 2024, we reported FFO of $0.25 per diluted share and normalized FFO of $0.34 per diluted share in line with our expectations. The variance between FFO and normalized FFO can be attributed to the change in fair market value of our derivatives and the write-off of accumulated developments and other pursuit costs. This non-cash write-off and subsequent accounting treatment resulted in a one-time reduction of the taxable liability for our TRS and associated increase in earnings for this quarter by $1.5 million.

We expect this one-time event, coupled with a tenant termination fee that will be recorded next quarter to guide us to the top end of our earnings range.

Each of our operating segments produced a robust performance this quarter, maintaining 95% occupancy across the portfolio. The construction division posted $4.3 million of gross profit, the highest quarter in Armada Hoffler's construction management history. This feature is unique to our business model, as we believe that Armada Hoffler is the only publicly traded U.S. REIT to benefit from a meaningful third-party fee-based construction business, as well as to internally build to our own portfolio.

Looking specifically at the portfolio performance, all three segments posted positive re-leasing spreads. The retail segment achieved a 5.8% GAAP spread with the office segment achieving a 24.3% GAAP spread. These results were 2.9% and 4.4% on a cash basis, respectively.

Our multifamily portfolio reported a combined trade-out spread of 2.0% for the quarter, accelerating to 3.4% for the month of July.

We have seen significant improvement in new lease trade-outs increasing from negative 4.8% in the fourth quarter of 2023 to essentially flat in the second quarter of 2024, turning positive in July at 2.3%. Renewal spreads on apartment leases remain strong at 4.3% for the second quarter, improving to 4.4% for the month of July.

All these metrics demonstrate our performance of our peer set, the value of high-quality assets, and the strength of our sub-markets.

Our portfolio same-store NOI growth was positive at 0.6% on a GAAP basis and 1.8% on a cash basis. The office segment was the standout performer this quarter, posting 9% GAAP and 7.7% cash same-store growth.

We believe this performance is unmatched in the REIT sector and once again indicating that even in a challenging market, high-quality assets in great locations remain full and in high demand.

Shawn will cover the leasing components of these metrics later on the call.

On the balance sheet side, we executed on $85 million worth of term loans this quarter, paying down more expensive debt and continuing our balance sheet transition. This will not affect total leverage as we exchange debt one for one.

We intend to maintain our investment grade credit rating and we'll continue to monitor the market for opportunities to execute on accretive balance sheet transactions.

We also opportunistically issued approximately $9 million on the ATM through early July as we took advantage of the wider market rotation into rate-sensitive sectors and the especially strong bid for REITs.

I will now pass the call over to Shawn.

**Shawn Tibbetts**

Thank you, Matt. And thank you, Lou, for your confidence in my ability to lead our company into the future.

Additionally, we appreciate all of you for joining us to review the impressive results that our team was able to produce during the Q2.

I will walk through the high-level components and add color to the material Matt has just reviewed.

We presented the components underpinning our 2024 guidance during the first quarter call suggesting a range of $1.21 to $1.27. Given the earnings outperformance this quarter, I will reiterate my comments made last call regarding the front-loaded nature of our earnings this year.

If you recall my remarks, the combination of higher construction profit in the first half of the year, the reduction of interest income as a result of our partners selling Solis City Park and the carry cost of Southern Post and Allied Harbor Point through stabilization materially contribute to the lumpiness of earnings over the four quarters.

However, we do expect to hit the high end of the range due to strong performance and a couple of one-time items.

In terms of operating performance, occupancy across the portfolio is 95%, slightly ahead of the Q1. The combination of high occupancy and NOI consistent with the previous quarter demonstrates our strong leasing and operating execution across the portfolio.

Our assets are strategically positioned in attractive markets and the properties are typically the newest and best located in the respective submarket.

Our properties and communities feature top-tier amenities that attract investment-grade tenants who consistently choose them over competitors in the market.

Let's spend some time walking through our fundamentals across the sectors.

In our retail and office properties, value creation is realized through consistent leasing activity, re-leasing space, and increasing rents.

In addition to the daily management of over 700 tenants, we executed 32 commercial leases for a total of approximately 250,000 square feet.

Our commercial renewal spreads were 10.8% on a GAAP basis while maintaining an overall commercial occupancy of 95% through the second quarter.

Our Trophy Office product continues to demonstrate strength as evidenced by our market-leading statistics.

The office portfolio achieved an occupancy of 94.3%, a slight increase from the 93.6% last quarter and well above the high end of the peer set.

In addition, the aforementioned properties achieved a 9% same-store NOI and 24.3% positive renewal spread on a GAAP basis. These are primarily driven by our best-in-class Town Center assets.

Additionally, our office expirations are minimal for the next few years. Coupled with our high-credit tenants, we expect to outperform the peer set for the foreseeable future by a very wide margin and the results speak for themselves. This level of success is attributable to the combination of location, amenities, design, and recent vintage.

As a result of these attributes, our office product remains in high demand and highly occupied with rents at the high end of the respective sub markets.

Our office properties are in a class of themselves in each market.

In addition to the location, quality and amenities, 95% of our office, ABR is located in mixed use ecosystems like Town Center of Virginia Beach and Harbor Point.

At Harbor Point, we executed a new 35,000 square foot lease with Stifel and delivered another 46,000 square feet of expansion space to Morgan Stanley. Harbor Point is now firmly entrenched as the destination of choice for financial services. The area is becoming more activated every day and we will see this continue to accelerate when thousands of (inaudible) price employees are on site.

We are witnessing a pronounced flight to quality within the market and Harbor Point is the beneficiary.

We recognize the challenges present in major office markets and what other landlords are experiencing, but it is simply not the case at our Armada Hoffler. And in fact, the opposite is true. The first office tenant has already taken occupancy at Southern Post and our anchor tenant, Vestas, will move in and open for business in the fall. These assets remain positioned to attract top tier tenants who prioritize the premium real estate spaces that we are able to create in mixed use communities.

In the retail segment, we have executed new leases including additions to our mixed-use communities like strong regional concepts, South Moon under and Josefina.

Our proactive leasing strategy has resulted in a positive lease renewal rate of 6% on a GAAP basis, ensuring a stable revenue stream.

We believe that proactive tenant relationship management is key to maximizing NOIs and property values.

In the multi-family sector, robust performance was driven by strong sub-market demand.

Our multifamily properties achieved an average occupancy of 94.9% this quarter and demonstrated a strong 4.3% lease renewal spread.

I will now spend a few moments highlighting the portfolio expansion in our mixed-use ecosystems, Southern Post and Harbor Point.

Our development and construction teams remain on target to deliver the three projects in the pipeline throughout the remainder of the year.

We look forward to 2025 and beyond as they lease and begin to positively contribute to the NOI growth.

Southern Post located in Roswell, Georgia integrates retail, multifamily, and office while underscoring our commitment to enhancing community driven high-quality developments.

We are now 71% leased in the commercial space at rents running ahead of pro forma levels. Tenants will continue opening their doors through the fall and we are excited to unveil several prominent brands and local businesses adding a diverse mix of shopping and dining options that will enhance the projects appeal.

The multifamily component Chandler Residences is also progressing well with 43% of the units currently leased.

We expect this momentum to continue given the limited supply of high-quality product in the sub-market.

Southern Post reinforces our reputation as a leader in creating high-quality integrated communities.

It strengthens our presence in the Southeast region and showcases our ability to deliver complex mixed-use projects that meet evolving market demands. The T. Rowe Price Global Headquarters at Harbor Point is wrapping up and we anticipate a move in later this year. This trophy built-to-suit project is well situated among our assets on the peninsula and will bring thousands of additional professional workers to the site.

Our Allied Harbor Point project is also progressing well with pre-leasing kicked off in July. This 312-unit high-rise apartment building sits at the top of the market and its approximately 1,200-space parking garage component complements the T. Rowe Price project.

Its waterfront views and amenities are virtually Baltimore's best and we look forward to this property complementing our other trophy assets at Harbor Point.

As mentioned in the previous quarter, our partner was contemplating a sale of one of the deals in our real estate financing portfolio at a mid-5 cap rate.

In early July, they successfully executed on the sale of a pre stabilized apartment project, Solis City Park in the expected mid-5% cap range. This market data point confirms our business thesis in several ways. They have since returned the principal and accrued interest to us at an annual return on invested capital of over 8%.

We will deploy some of the capital into a very attractive multifamily deal located in a high growth Southeast market with the same partner.

Our construction business continues to produce record profits.

While working through the $300 million current backlog, the second quarter yielded results consistent with the targeted projections included in our original 2024 guidance. The partner firms using our construction expertise continue to identify and execute on opportunities that allow us to demonstrate our capabilities and collect market data for our internal underwriting of future opportunities.

Our diversified portfolio continues to perform well with each asset class contributing positively to the company's financial results.

We remain committed to leveraging expertise to optimize the portfolio, drive growth and deliver long term value to shareholders.

Operator, we are ready for the question-and-answer session.

## QUESTION & ANSWER

**Operator**

Thank you so much presenters. Ladies and gentlemen, we will now begin the question-and-answer session.

(Operator Instructions)

Our first question comes from the line of Rob Stevenson of Strand. Your line is now open.

**Rob Stevenson**

Shawn or Lou, development pipeline is essentially complete here.

I can't remember you guys not having something under construction in almost 10 years I've covered you. Are there any projects that are penciling right now given demand and your cost of capital?

**Lou Haddad**

Good morning, Rob. Thanks for the question.

We are not finding what we believe pencils.

Obviously cap rates have moved, interest rates have moved, the economic backdrop is frankly moving all over the place and we're not seeing anything that attracts us to pull the trigger or even begin intense underwriting given the environment.

So we're always on the lookout obviously but no sir, we are not seeing something that is causing us to be tempted to move at this time.

**Rob Stevenson**

What about on the redevelopment side beyond Columbus Village II and Virginia Beach?

**Lou Haddad**

Yes. I think things like that make sense, especially when we're looking at the basis we have in the land.

We are working on as you know a redevelopment opportunity there, but it's rather small at the end of the day.

We're talking 10 million, 15 million, not wholesale massive development.

So we think that works, that type of thing, especially given the kind of attractive tenants that we're looking at, but we're not looking at any major redevelopments as we sit here today for the same reasons.

**Rob Stevenson**

Okay. And then Matt, so $0.62 here to date, the guidance is $1.23 to $1.27 and loose and you're trending towards the high end.

So, $0.61 to $0.65 in the back half. You've got the WeWork drag and I think you've also got some drag here from capitalized interest as the Baltimore and Southern Post deliver here. How should we be thinking about the cadence in the back half? Is the second quarter likely to be the sort of high point for the year? Did I understand correctly, the $1.5 million TRS benefit, that's a third-quarter impact, not a second quarter?

**Matthew Barnes-Smith**

Hi. Good morning. Good morning, Rob. Yes. The $1.5, $1.6 million positive tax impact is a Q2, second-quarter impact.

We believe or we know there's going to be a termination fee that will be a third-quarter impact to the positive Y-o-Y, but you are correct. The second quarter will, we believe, be the kind of highest quarter that we're looking at this year. The two areas, and you rightly pointed out that the first one, interest expense will increase into the back half of the year as these developments come online and we no longer capitalize the interest through the lease-up period of these developments.

And the second part of that is the construction gross profit.

As we said on previous calls, was heavy in the first half of the year.

We still anticipate guiding to the midpoint of our construction gross profit range, $13.7 million-ish, which would show that it's coming down in the second or the third quarter and fourth quarter this year.

**Rob Stevenson**

Okay. And then last one for me, some other REITs have reopened their previously issued preferred stock series and raising some capital that way.

Is that something that you guys have been thinking about given that the preferred is still under 10% of the capitalization or is 7% or wherever it is today about where you want it and that cost of capital isn't attractive for you these days?

**Matthew Barnes-Smith**

Rob, I think that's a great question. And obviously the economic backdrop has changed dramatically since our last update. Volatility is certainly unsettling and the subsequent movement to like the slower growth, lower interest environment enables us to contemplate additional avenues, strengthen our balance sheet.

But as we sit here today, we are not ready to make any of those type of calls on this Thursday morning.

But at the end of the day, we're looking at it all.

I think it's a great question. Frankly a great idea, but I can tell you that it's not top a mind as we sit here in the room this morning.

**Rob Stevenson**

All right. Thanks, guys.

Have a great day. Appreciate the time.

**Operator**

(Operator Instructions)

And our next question comes from the line of Peter Abramowitz of Jefferies. Your line is now open.

**Peter Abramowitz**

Yes. Thank you very much.

So, you touched on at a high level on some of the items impacting the bridge from FFO this quarter to kind of get, like you said, to sort of the top end of the range, for the rest of the year.

I guess if we just step back and think about it, you kind of have some unexpected items that are tailwinds through the termination fee in the third quarter and the tax benefit in the second quarter.

I know you kind of kept all the ranges the same as they were last quarter and that's how you sort of get to the high end.

But if we just think about kind of swing factors within the portfolio or elsewhere in the business, like what would make you comfortable because I think I was maybe a little bit surprised that if you have some of these unexpected tailwinds and not see a little bit of a raise.

**Shawn Tibbetts**

Yes.

I think, Peter, thank you for the question. Good morning.

I think as we look at our opportunities in the future, we are constantly trying to accelerate lease up of these developments. And as Matt mentioned, the kind of interest or carry cost of those less than stabilized developments, obviously we're still constructing part of them.

We think conservative approach is to show that drag and to represent that drag and kind of holding the range as it is.

I think if we saw tailwinds, they would be in faster lease-up of some or part of those developments and I don't think as we sit here today again given the economic backdrop that we can come out with certainty and move that range within good faith. Certainly, we're working to that end.

But as we sit here today, we think that's the prudent kind of message to send to the street.

**Peter Abramowitz**

That's helpful. Thanks, Shawn. And then on the leasing spreads, they were particularly strong in office.

I think you called out Town Center as driving a lot of that. Any specific deals that kind of stood out in there? And I guess is that sort of indicative of where the market is in Virginia Beach or overall, in your portfolio?

**Shawn Tibbetts**

I would say Virginia Beach was strong.

We had some fairly good-sized leases here at Virginia Beach.

I'll just share with you on the retail side that was a nice lease.

We're able to get a good deal on that. The comment was really specific to the Town Center office which showed some good kind of growth in that rent.

Some renewals here at Town Center in the building that we're sitting in, some long-time tenants and we're able to negotiate some nice deals with them.

But yes, I think this goes back to our story which is this mixed-use ecosystem is driving demand and that demand allows us to kind of command a little higher price than the competition because frankly the competition is in a different league when compared to either Town Center or Harbor Point and soon to be Southern Post.

So again, this is our thesis and we're proud of it.

We want to leverage it where we can, and it seems that people are willing to pay for that kind of highest-quality trophy asset setting and that's what gets into those spreads.

**Peter Abramowitz**

Got it. And then you mentioned I think a mid-five cap rate on the multifamily asset that's getting sold that you have a structured finance investment in. Just curious, do you think that's indicative of the market overall and where cap rates are? I think we've seen there was a large private equity deal that was closer to like a 4% going in, which was surprisingly low to us, but just trying to square your comments against that large transaction, sort of where you think the market's at today.

**Lou Haddad**

Yes. In fairness, I think we need to distill down what point in time we, so as we always try to do, we put out the stabilized kind of cap rate at 5.5. The going in was less than five. And this is a strong Charlotte market. You hear a lot of commentary about the markets overbuilt, so on and so forth.

We are after all in the real estate game long and Charlotte has great growth fundamentals.

So, I think, my comment to that would be, yes, I think the market is probably healthier than people give it credit for, number one. Number two, to trade at a stabilized yield in the mid fives, probably sub-five in terms of going in yield, as we said here today, when the transaction happened a few weeks back.

I think that demonstrates strength in these growth markets.

Again, I'm not saying that there's not supply coming online, but I think if we think about it long, that supply in our mind is pretty quickly absorbed in these high growth markets throughout the kind of Southeast and South Atlantic.

**Peter Abramowitz**

Got it. So that 5.5 is more like a year two, year three number rather than going into year one?

**Lou Haddad**

Yes. I would say out in stabilization, you know 24, 36 months, whenever they kind of hit that stabilization period, but yes, that's in the future.

**Peter Abramowitz**

Got it. That's helpful. That's all for me. Thanks.

**Lou Haddad**

Yes. Sir.

**Operator**

Thank you so much. And we don't have any further questions at this time.

I would now like to turn the call to Shawn Tibbetts for closing remarks.

**Shawn Tibbetts**

Thank you very much.

I want to start by saying thank you to our talented team, our dedicated team, got strong DNA in this company, we continue to leverage that alongside the culture to create shareholder values.

So just want to say again, thank you for you all joining us here today.

We appreciate you working alongside us to understand our story.

I do know there's a lot going on in the market, so I know your time is valuable as you sit here and listen to our story. There's a lot of work to be done as the markets move out there, but we appreciate you.

Just know we are here to continue to provide that value back to the shareholder.

We come in with a mission to do that every morning, and we're looking forward to continuing to drive this company onward and upward. And again, thank you for your time.

**Operator**

Thank you, presenters. And thank you, ladies and gentlemen. This concludes today's conference call. Thank you for your participation. And you may now disconnect. You have a great day.