Flash Note

Rating: Buy

Price Target: $15.50

ARMADA HOFFLER PROPERTIES, INC. (AHH: $13.10)

October 14, 2016

Notes From the Road

- **AHH non-deal roadshow.** We recently traveled with Lou Haddad, chief executive officer, and Mike O'Hara, chief financial officer, of Armada Hoffler Properties, Inc. (AHH) on a non-deal roadshow discussing AHH's business model, strategy, development pipeline, capital recycling, opportunities for growth, and market fundamentals within target markets. The most notable takeaway from our meetings with AHH was related to the pullback in construction lending management had experienced and the increased opportunity/deal flow they are seeing as a result.

- **More exacerbated capital advantage.** As a public REIT, AHH now has a sustainable capital advantage given higher equity requirements on development due to High Volatility Commercial Real Estate (HVCRE) rule implementation, which went into effect in early FY15 but has become more prevalent with bank lending limits (LTVs) in many cases dropping from a previous 80% to a current 60%-65% range, while construction loan spreads over LIBOR have also increased ~100-120bps over the last 9-12 months (i.e., from a previous L+185 to L+295). This is limiting new development in their markets from smaller competitors while also driving substantially more deal flow to AHH.

- **Development pipeline pretty full, but we might see another announcement by year end.** AHH currently has a $315mm development pipeline (inclusive of several mezzanine investments expected to convert into equity upon construction completion), but because of the aforementioned debt constraints its competition is facing it is now evaluating a significantly higher number of development opportunities from third parties seeking a capital/ development partner. As such, another development joint venture may be announced by year end. Longer-term debt (i.e., 5-year fixed money) on refinancings has recently come in at 3.25%.

- **Strategy remains focused on retail/mixed-use development and multifamily development (vs. acquisition).** Management continues to believe that well-located grocery-anchored shopping centers offer the best risk-adjusted returns within their markets and will be the portfolio focus, while new developments target a 20% wholesale/retail spread. CBD office remains attractive with the right tenants but suburban office assets remain unattractive as a core holding, while multifamily cap rats remain too low to acquire but well-located, high-barrier-to-entry development projects (such as Point Street in Baltimore) remain attractive.

- **Capital recycling, new development, and right-sizing the balance sheet may be dilutive near term.** Management noted that they are in the process of selling some 7%+ cap rate assets and are developing in the 5%+ area while also utilizing the ATM to keep the balance sheet conservatively levered. While the longer-term impact will be greater NAV accretion, in the near term it may come at the expense of per share earnings growth.

- **Town Center update.** Management noted that they were breaking ground on Phase VI at Town Center, while also currently discussing Phase VII and Phase VIII as well. The $32mm Phase VI development will include 33,000 sq. ft. of ground level retail, 5,000 sq. ft. of restaurant space, a 17,000 sq. ft. theatre and 120 apartment homes. As with the development of the Encore apartments, occupancy in the Cosmopolitan (apartments) may decline as it did during Encore's development period, while future Town Center phases may be inclusive of adjacent redevelopment opportunities.

- **Sticking to their knitting.** AHH will continue to execute its business model (as they had as a private company over four decades) via high barrier-to-entry development, and the company's target remains to become a $1B company in three to five years. While a portfolio purchase could accelerate this, it is highly unlikely given AHH's focus on quality, while we believe the company remains an attractive acquisition candidate for a larger REIT that lacks a development competency and/or ability to redevelop a tired portfolio.

- **Maintaining Buy rating, $15.50 target.** AHH continues to create substantial value via development as the wholesale-to-retail value spread remains significant (150bps-200bps). Our NAV estimate of $14.59 values forward NOI at a 6.5% cap rate and our $15.50 target is 106% of NAV, representing a 2017 FFO multiple of 14x, in line with diversified REIT peers trading at 13.9x. It is difficult to own a small REIT with this level of intellectual capital on the development side. Given AHH's attractive relative valuation, consistent internal value creation via development, and the potential to become a substantially larger company, we maintain our Buy rating.

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Disclosures:

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Our price target is based on historical valuation metrics of comparable companies, and may not prove relevant over time.

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Ratings Distribution (in Percentages) & Investment Banking Disclosure Chart Information

Ratings Distribution & Investment Banking Disclosure

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Hold -rated	**62**	**26.27**	**10**	**16.13**
Sell -rated	**5**	**2.12**	**2**	**40.00**
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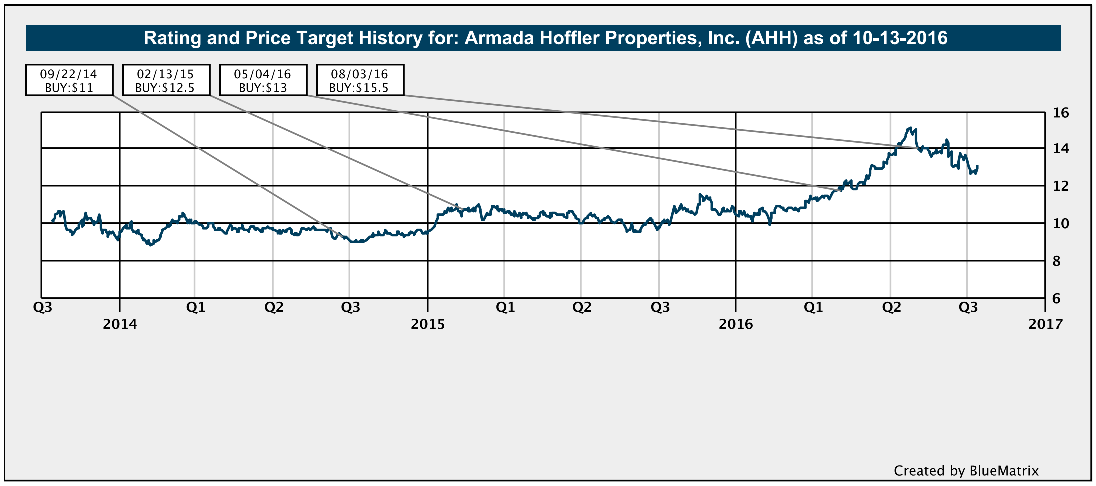

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