August 4, 2020

Armada Hoffler Properties, Inc. (AHH)

Q2 2020 Earnings Call

Operator

Welcome to Armada Hoffler’s second quarter 2020 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, Thursday, August 4th, 2020.I will now turn the conference call over to Michael O’Hara, Chief Financial Officer at Armada Hoffler.Please go ahead.

Mike O’Hara

Good morning and thank you for joining Armada Hoffler’s second quarter 2020 earnings conference call and webcast.On the call this morning, in addition to myself, is Lou Haddad, CEO. 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 September 4th, 2020. 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, August 4th, 2020, 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 mezzanine program, our construction business, liquidity position, 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, particularly in light of the adverse impacts of the COVID-19 pandemic on the U.S. and global economies. 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. I’ll now turn the call over to Lou.

Lou Haddad

Thanks Mike.

Good morning everyone and thank you for joining us today. As we all continue to fight the pandemic in our own ways, we express our gratitude to those who are battling for us on the front lines and pray for all who have been affected by COVID-19. We are grateful that the health and well-being of our employees and their families remain largely unaffected by the virus and that our company remains strong and optimistic about our future. Obviously, we must all remain diligent in our activities and stay prepared for potential setbacks.

As you saw from our earnings release this morning, and the various press releases we've issued over the last few weeks, we have been extremely busy at the company over the last few months. Our activities have been consistent with the formula we've employed during the last 4 recessions that the company has endured. Strengthen the balance sheet, work with your tenants, cut expenses and, most importantly, be ready to outperform your peers in the subsequent recovery. After my remarks, Mike will relay to you how we've bolstered our liquidity position to pre-pandemic levels, maximized rent collections to nearly normalized levels, and reduced expenses. Prior to that, I will focus on the last and most important facet of our strategy, positioning the company for growth in the subsequent recovery. Although the improvement in the economy has been uneven to date and most probably will still incur some setbacks, we believe the most likely case to be a slow, bumpy climb back to normalcy over the next 18-24 months. We believe that with our multiple property types and operating divisions, we will thrive in such an environment; much as we have done in the past. Today we reported earnings of 29 cents of normalized FFO for the quarter. This result combined with 32 cents from the first quarter gives us the highest earnings during any 6-month period in our history. Although the second half will not be quite as strong, primarily due to over a hundred million dollars of asset sales and, to a lesser extent, bad debt assumptions, we are confident in our guidance for the year in the range of $1.09-$1.13 per share. Although there remains a material amount of uncertainty surrounding the effects of the virus on the economy, as a company that has a hard won reputation for transparency, we think that it is important to offer guidance based on the information we have available to us and our best projection of our company performance for the remainder of the year. Our guidance reflects the proactive measures we've taken to strengthen the balance sheet as well as taking into account the various effects the pandemic may have on our company, tenants, and clients. As Mike walks you through the components of our guidance later in the call, please know that this level of performance is only made possible through the efforts of a seasoned, dedicated, and motivated group of professionals who have risen to the occasion under extremely adverse conditions to stabilize our operations. On behalf of our board of directors, our heartfelt thanks to our team for the passion, determination and excellence they continue to display. While we are extremely proud of the accomplishments to date, we are most excited about the moves being made to position the company for a return to growth with the eventual upswing in the economy. Long before the pandemic, we embarked on a long-term disciplined rotation out of much of our older, non-core retail centers into higher quality multi-family and mixed-use assets both through development and acquisition. The 7-asset sale completed in the second quarter was a major step in the continuation of this process. As a part of this strategy, we intend to continue the disposition process with a few smaller retail assets. These dispositions, a strong cash position, the anticipated payoff of 3 mezzanine loans, and measured use of the preferred stock ATM, give us the capital to potentially restart the development process and pursue additional acquisitions later this year. To that end, we are proceeding with the acquisition of the Edison apartment complex in Richmond, Virginia as previously disclosed in our original 2020 guidance. This 174-unit asset was developed by our predecessor company in partnership with an experienced Richmond-based multi-family developer. As such, current ownership includes several members from our management team and board of directors. The building could not be acquired until this year due to the historic tax credit structure of the entity. The complex is within sight of the state capital and has achieved high occupancy and increasing rents for several years. We will be acquiring the asset at a 6.75% cap rate which equates to a 25 million dollar purchase price with the 7 and a half million dollars of equity paid in the form of OP units priced at 12 dollars in keeping with our track record of selling units at a premium to the current stock price. We appreciate our 40% joint venture partners vote of confidence in our company by taking units priced at a meaningful premium to the current market price of our common stock. With our increased focus in the multifamily sector, we've created a new division internally to manage the operations, growth, and opportunities we are seeing in this asset class. This group will focus on a rapidly expanding portfolio and targeted acquisitions combined with a robust pipeline of high-quality apartment developments taking shape. The new division is comprised of seasoned individuals with considerable multi-family experience who have been selected from existing development, construction, and asset management personnel to spearhead all aspects of this initiative. With this increased focus on multifamily, we expect this piece of our business to expand at a faster rate than the office and retail segments, while we strive to grow the portfolio as a whole. To be clear, mixed-use assets, CBD office, and high-quality grocery-anchored retail will also continue to be significant drivers of growth and value for the company. The key to our forty-year track record of success has been the strength of our diversified platform and the flexibility it affords us to adapt and capitalize on the ever-changing landscape of commercial real estate. Over the next few months we expect to establish a timeline for the ramp up of the previously halted development pipeline as well as new opportunities that have come our way. Our expectation is that we will be able to enhance the return on cost of new developments that break ground over the next several months due to our construction division's ability to procure lower subcontractor pricing than was previously estimated. Meanwhile, we have delivered the last two projects from our previous pipeline. Summit Place, one of two student housing complexes in Charleston, South Carolina, is now open and stands at 98% pre-leased for the upcoming 12 months. This asset along with Hoffler place, which is fully leased, gives us two high-quality assets on the historic Charleston peninsula. And combined with our asset at Johns Hopkins University, our student housing portfolio stands at over 95% pre-leased. We've also delivered the Wills Wharf office building at Baltimore's Harbor Point. This trophy office building is nearly 50% leased after the WeWork termination, and we are in negotiations with two high-credit tenants that would fill the rest of the vacancy. Despite the slower pace of lease negotiations due to the pandemic, with the encouraging amount of activity in this sub-market, we are hopeful of having new leases in place by year-end. Turning to the construction business. We continue to collect third party fees at a very brisk pace. As most of you know, this substantial income generator is uniquely ours across the REIT universe. You'll recall that we entered the year with one of our largest third-party contract backlogs ever. As you can see, we ended the quarter with nearly 200 million dollars in remaining contract value, a total that will take us well into 2021. In addition to adhering to all local pandemic guidelines, we have initiated protocols for temperature testing, protective procedures and safety gear at all of our construction jobsites. Our construction group has maintained this high rate of production and profitability despite the difficult conditions. This performance is no different than what we have come to expect from these professionals, and we greatly appreciate their dedication to the company. Assuming no change in government guidelines, we expect this division to earn around 7 and a half million dollars of gross profit which is in line with our previously disclosed estimates. As I said earlier, we look forward to using the unique advantage this division gives us by tightening budgets and schedules on our upcoming development projects. The mezzanine lending program is also yielding very robust income. This aspect of our business, made possible through long-term relationships with seasoned developers and the steady influence that we enjoy through our construction division, will contribute over 17 million dollars of net income for 2020. In keeping with the optionality that this structure provides to us, We expect three of these loans will be retired over the next several months. One, through a pre-negotiated, discounted purchase price-for the Nexton square lifestyle center in the Charleston area. One is on the market-the Delray Whole Foods center, and lastly, Annapolis junction, where we hope to negotiate a purchase. We believe that our ability to create a favorable tax and earnout structure for our partner will prove to be more advantageous to him than taking the property out to market. With these three payoffs, and only the Interlock loans active in 2021, we expect this aspect of our business to diminish over the next few years. This is in keeping with our previously stated goal of using more of our capital and human resources on our own projects to more quickly grow Net asset value. Six months ago, we were on the cusp of achieving one of our long-term goals, financial metrics consistent with supporting a share price in excess of $20, and we were well on our way to a two-billion-dollar market cap. Even with those lofty achievements, we recognized that to sustain and, ultimately eclipse that level of performance, we would need to incrementally refine our business model over the subsequent several quarters. The adjustments entail decreasing the percentage of traditional retail in our portfolio while enhancing our commitment to the multifamily and mixed-use sectors. Also underway is the planned reduction of the mezzanine loan component of our income coupled with the overall reduction in leverage. Although we could not have foreseen the subsequent disruption caused by the pandemic, and we certainly don't want to downplay its horrific human cost, it has enabled us to accelerate these initiatives in a meaningful way. As the company's largest equity holder, management believes the current share price does not come close to representing the value of our diversified high-quality portfolio and our construction and development businesses. Over the next few quarters, we believe that investors will recognize the demonstrable strength of our diversified model and the quality of our portfolio. We expect investors will reward the company in much the same way as they have in previous years. As most of you know, through 2019, we more than tripled the returns of the REIT index over the preceding 5 years. Before I turn it over to Mike, I'd like to thank our board for the swift action in re-instituting our dividend. We believe that it was very prudent to suspend the dividend in early April with so many unknowns surrounding our industry. Although we are far from sounding the all-clear, we believe that our strong results and even stronger prospects for growth over the next couple of years, merit a re-initiation of the payments with an eye towards a measured ramping of the dividend level. Mike.

Mike O'Hara

Thanks Lou. Good morning, these are certainly unprecedented times and I hope you and your families are healthy. Three months ago, on our last earnings call, we discussed how we are reacting to the uncertainty of the pandemic's impact on the health and economy of the country. With this uncertainty, we took steps to prepare the company for the worst. Fortunately, at this time, it looks like the country is on the road to recovery, all be it bumpy, and we look forward to repositioning the company and taking advantage of the opportunities we are seeing. For the second quarter, we reported FFO of 28 cents and Normalized FFO of 29 cents per share. The effects of the pandemic on the quarter include deferred rent of 5.4 million dollars and bad debt write offs of 1.2 million dollars. We are projecting another 1.5 million dollars of bad debt through the end of the year from a combination of rent abatements and bankruptcies. We believe this is a conservative estimate given the current economic environment. The portfolio has performed well in the second quarter under the circumstances with rent collections of 87% portfolio wide, and we expect 96% for the month of July. We have agreements granting rent deferrals with 90% of the tenants that requested them, with the deferred rent being paid over the next 3 months to multiple years depending on the structure. These run the full range from simple letter agreements to lease amendments, renewals, and lease extensions. Please see the new pages we added to the Supplemental Package with detailed information on rent collections and deferrals starting on page 27. Our core operating portfolio occupancy for the second quarter was strong at 94 percent, with office at 97, retail at 95, and multifamily at 88. Multifamily occupancy was down compared to last quarter due to the seasonality of the two student housing projects. Without the effect of the student housing properties, occupancy was 94 percent for multifamily, which is higher than last quarter. The pandemic certainly had a huge impact on our Same store NOI in the second quarter, GAAP was negative 6.7% and cash was negative 28.8%, with retail negative 44.9 percent on a cash basis. The cash NOI numbers exclude 4.3 million dollars of deferred rent. Without the effect of the deferred rent, same store NOI was negative 3.8 percent and retail was negative 6.7 percent. Our releasing spreads were strong this quarter with both office and retail positive on a GAAP and cash basis. Office was positive 8.6% on GAAP and 4.7% on a Cash basis. Retail was positive 7.7% on GAAP and 5.5% on a Cash basis. For further details on the second quarter, please see our supplemental package that was published this morning. We continue to take action to strengthen the balance sheet for the recession and future growth. With our common stock trading at current levels, we are utilizing other sources of capital including asset sales and issuing preferred stock under our ATM program. In May, we sold seven unencumbered retail centers for 90 million dollars. Use of proceeds included, paying down the credit facility by 62 million dollars, with the remainder in cash. We continue to review our portfolio to identify disposition candidates for additional capital. We currently have two additional dispositions of unencumbered assets under LOI that would raise approximately 13 million in cash. In addition to asset sales, we have been active with the preferred stock portion of our ATM program that we put in place last quarter. Through last month, we raised 16.3 million dollars at an average price of $22.88 for a yield of 7.4 percent, and we plan on continuing to be active, assuming favorable market conditions. Given the temporarily depressed level of our common stock, we believe preferred stock and asset sales are our lowest cost of capital at this time. With these steps, we have enhanced our liquidity position. At quarter end, we had 75 million in cash and 20 million available under our credit facility. In addition, we raised $16.2 million of cash through the preferred ATM after the quarter end.

As discussed last quarter, we took steps to position the company immediately after the pandemic became apparent in March. These steps included deferring development projects, non-essential cap ex, and acquisitions as well as reducing expenses including pay cuts for the board and CEO and, lastly, suspended the common dividend. At this time, we have not started any of the suspended development projects but hope to do so over the next several months, if the economy continues to stabilize. Currently, two projects are in the final stages of development, Wills Wharf and Summit Place. The remaining costs to complete these projects will be funded by the construction loans, and therefore no immediate cash requirements. As for redevelopment, the Town Center redevelopment projects are well under way. Columbus Village is now 91% leased and close to completion. The renovations of the Cosmopolitan Apartments continue, but now at a slower pace to conserve cash. The expected cash requirement for these projects is 7 million dollars for the remainder of 2020. We have three development projects that were suspended in the second quarter. The total cost to date of these projects is 23 million including 14 million for the cost of the land. Other than minimal land carry costs, there are no other future cash requirements until construction is commenced. In summary, the total remaining 2020 cash requirements for the development and redevelopment projects are 7 million dollars. As for our mezzanine loan program. two projects are currently under construction, the Interlock and the Solis at Interlock, both of which are located in Atlanta and are scheduled to be completed in the second quarter of next year with the loans expected to be outstanding at least through 2021 to allow for stabilization. We believe both projects are trophy assets that will sell for low cap rates, resulting in significant profits for our partners. As with our development projects, we have no remaining 2020 cash requirements, with the project construction loans funding all remaining costs to complete. With the sale and the loan payoffs of the Delray Whole Foods center and Annapolis Junction being delayed due to the pandemic, we decided to stop recognizing GAAP interest income on these loans effective April 1st. We believe this is prudent to allow for an extended hold period due to the pandemic. As discussed in the past, all mezzanine projects were underwritten to the same standard as our own development projects and we are happy to assume ownership. We believe all of these are top quality assets with long term value, and we are planning on exercising our discounted purchase option on Nexton Square and as Lou said, we are negotiating to acquire Annapolis Junction. As we have discussed in the past, the mezz program will become a smaller portion of our business. With the expected payoff of the three loans this year, only the two Interlock loans will be outstanding in 2021 thus resulting in a substantially smaller mezz program going forward. As for future mezz activity, we will be focused on projects that are smaller and have shorter schedules from inception to payoff. As for debt maturities, we have no maturities for the remainder of 2020 and four loans mature in 2021. We began discussions with the lenders on all four loans and we do not anticipate any issues getting these refinanced. As discussed in the past, our debt strategy has been a targeted mix of 50 percent fixed and 50 percent variable rate debt, along with an interest rate hedging strategy. This past quarter, we continued to be active with our hedging strategy. We bought 100 million dollars of LIBOR caps at 50 basis points for three years. At June 30th, 61% of our debt was fixed and 100 percent was either fixed or hedged. The weighted average interest rate as of June 30th was 3 percent. With these moves and with the current LIBOR forward yield curve, interest expense is expected to be low for the next couple years which lowers our fixed charge, thereby increasing our coverage. As Lou discussed, we issued updated 2020 guidance of $1.09 to 1.13 of normalized FFO per share. This guidance includes an additional 1.5 million dollars of projected bad debt, selling two properties for 13 million dollars, acquiring Nexton Square, the Edison apartments, and raising additional capital through the preferred ATM. The details of our guidance are on page 6 of our supplemental package. In these uncertain times, we will continue to be transparent and keep you informed as it affects our company. Now I'll turn the call back to Lou.

Lou Haddad

Thanks, Mike. Before we start the question-and-answer period, I'll mention that although it might have gotten lost in the midst of the pandemic, the decision to opt out of MUTA as well as the adoption of several other best practices, serve to enhance what we believe was an already stellar ESG stance. I hope you can find time to take a look at our 2019 sustainability report and related enhancements on our website. The current state of affairs only emphasizes the need for good corporate citizenship. Operator, we would now like to begin the question and answer session.

<u>Q&A Session</u>

Operator

[Operator Instructions]

Our first question today comes from Dave Rogers of Baird.

Dave Rodgers

I wanted to maybe start, Lou, on the acquisition side, you kind of made 2 comments. One is more multifamily in the future and then potentially more acquisitions as the year moves on and as you move into 2021. So maybe tell us what you're seeing out there and how you think that maybe some of the multifamily acquisitions from a yield perspective will fit in with the portfolio and kind of get you to the goals that you're looking for.

Lou Haddad

Sure. Thanks, Dave. The -- well, first up is the one we just announced this morning, which is a great project for us. It's been a great project for a number of years. This is our first opportunity to bring it into the REIT. And we're happy to take stock or OP units in exchange for that equity. It's going to be a great addition to the portfolio. Secondly, as we also mentioned, we're hopeful of getting control of Annapolis Junction, which is a great asset, right outside of Fort Meade. And our expectation is that we'll be able to consummate a deal here in the not-too-distant future. Beyond that, the -- what's really taking shape is a lot of exciting opportunities in our development pipeline. As we had pre-announced -- or as we announced that pipeline pre-pandemic, you'll recall that the majority of what was in those projects was multifamily, with one pure multifamily at Chronicle Mill outside of Charlotte as well as Roswell, Georgia, where it has a substantial portion of multifamily. The opportunities that we're seeing coming our way are largely those multi -- in the multifamily sector in really strong markets in the Southeast. And at this point in time, we are basically just cherry picking and deciding which ones that we want to execute on. So we -- this is all in keeping with the same rotation that we talked about a year ago when we did our first portfolio review, our extensive portfolio review and came up with the assets that we wanted to sell, which we subsequently executed on. And you'll see that rotation continue. I believe that where we end up is somewhere around 1/3, 1/3, 1/3 as far as office retail and multifamily, at least in the foreseeable future. And we're very comfortable with that kind of a mix.

Dave Rodgers

Great. Maybe second on Charleston, obviously, great success on the lease-up of the 2 student housing assets there. Maybe any additional detail, if you said at the beginning of the call, I may have missed it. But were these just kind of one- off student leases? Was there a master lease from the university? Any clauses about COVID that we should just be aware of? And I guess, how these end up shaping up relative to pro forma? They leased up pretty quickly this year.

Lou Haddad

Yes. Obviously, we're very pleased with the lease-up on the student housing section. No, there aren't any master leases of any note in any of the 3 properties. Those were all one-off. And with -- in the case of Charleston, there are simply 12- month leases with no contingencies whatsoever. At John Hopkins, students do have the ability for a significant penalty to get out of their lease, at least the preponderance of those leases contain that clause. They contain that clause from the beginning. We don't anticipate a whole lot there. With regard to pro forma, I'll tell you, to be frank, that second student housing project in Charleston is not where we wanted it to be pro forma-wise. We want to make sure it was full. We'll worry about rent escalations later. But the initial lease-up contains some incentives and, therefore, isn't where we want it to be from a return on cost standpoint. But our expectation is that it will stabilize over the next few years and be a great asset for us.

Dave Rodgers

Great. Maybe last question for Lou, you and Mike, just with regard to capital and liquidity, Mike, you ran through the liquidity, which I appreciate. But maybe go back to the dividend and reinstating the common dividend. I think after the first quarter call, you had said that you guys were pretty comfortable putting the dividend back in place at a lower rate, which I understand. On the flip side, you had also indicated that leverage was a little higher coming into this than you wanted. So I guess, maybe help just bridge the gap of reinstituting the common dividend that you didn't need for taxable reasons for the rest of the year and then also issuing on the preferred ATM, which will serve to increase leverage again. So I just tying those comments, that would be helpful.

Mike O'Hara

Dave, so yes, certainly, the -- we've been focused on liquidity right now, more so than leverage with the bad debt and all, obviously, affecting EBITDA, which is increasing our debt to EBITDA, but that will come back over time as we focus on liquidity. So certainly enhance liquidity position certainly makes us more comfortable on putting the dividend back out to $0.11 a share. As well as, as our rent collections continue to go up and looking at 96% for April, we now have more -- I mean, for July, we now have more than enough cash flow in order to cover all our requirements that I went through as well as paying the dividend.

Operator

The next question is from Rob Stevenson of Janney.

Rob Stevenson

Mike, have you had to go to cash accounting on any of your tenants at this point that's fallen below the sort of 75% collectibility threshold?

Mike O'Hara

There's been a change in GAAP recently, Rob, where the new lease as that came out last year. Right now, either deems it's collectible or not. There's no kind of midway anymore. We certainly spent a lot of time going through all our tenants and going through where we thought everybody was going to fall. So certainly, on the $1.3 million that we wrote off, we deemed as uncollectible and all the associated GAAP that goes with that straight-line rent and et cetera. And we continue that going through and said, okay, what are the tenants we have here, who do we think might come into trouble based on what the economy looks like over the next 6 months. And based on that's where we came up with the projection or we're going to say out there, it's another $1.5 million we're expecting this year. Now we don't have a crystal ball. That's what we think it's going to be. Hopefully, it's more on the conservative side.

Rob Stevenson

Okay. And then how many tenants do you have that haven't paid and where you haven't come to some sort of agreement at this point?

Mike O'Hara

Right now, we have -- we got in the deck on Page 28. We've got 16 tenants right now that we expect to collect that we're in some sort of negotiations, but not completely done at this point in time. As of today, that number is down to 14. We've gotten a couple more tenants done at this point in time. We haven't reserved for those bad debt because we expect to get something done.

Rob Stevenson

Okay. And then how are you guys thinking about restarting development and then possibly having to stop it again if there's another significant outbreak? I mean, are you guys planning to try to get to a threshold that makes sense where you could just stop the site? Is that a situation where you're thinking probably wait to early 2021 until some of this is better known to restart this? How is that sort of coming into play because it's typically depending on the project, where you are on the project, it could be difficult to stop construction again?

Lou Haddad

Yes. Yes, Rob, what we suspend -- the development projects that we suspended have not broken ground yet. So had they broken ground, we would not have stopped. We've never stopped a construction project. And as you've seen, all construction sites essentially work right through the pandemic. If we decide to start these, you're looking at 18 to 22 months schedules in terms of delivering. So we don't expect, once we start, to have to stop. And when we deliver nearly 2 years later, our expectation is that the current circumstances will be well over.

Rob Stevenson

Okay. And then, Lou, how are you characterizing the WeWork negotiations on their other locations with you and your partners? Are they still -- is it still in negotiation to try to get back some space and reduce the lease? Are they happy and you're happy with them in your other locations? How is that these days?

Lou Haddad

Well, again, there's -- I want to make sure we're clear. We have one WeWork location, and that is in Durham, North Carolina. They are open, operating and paying rent. They, along with a couple of hundred of our other tenants, had requested some sort of deferral for a couple of months during the year, and that was all worked out. Obviously, in Baltimore, we negotiated an exit. And our partners, the last location, which tangentially we have through our mezzanine loan with our partners, our partners are in negotiations with WeWork to rightsize that lease. So all the negotiations have been very professional. The guys seem to really believe wholeheartedly in their business model, and we're certainly pulling for them, and look forward to them to continue paying the rent in Durham.

Rob Stevenson

Okay. And then last one for me. Mike, what's the sort of max amount of preferred that you'd really want to have as a percentage of your capital stack going forward? I mean how much road do you have to keep issuing preferred before you sort of max out where you want -- where you think it should be as part of the cap stack?

Mike O'hara

Yes. So in the past, we've said we want that to be in the 10% to 15% range, and that's still where we're thinking. Now the only issue now is our market cap is half of what it used to be a while ago. But so if we do more preferred now would be the anticipation of the equity market cap overall increasing, so we stay in that 10% to 15% range

Lou Haddad

We'd like to think that we're not going to continue trading at 9x earnings. So we'll see.

Operator

The next question is from Jamie Feldman of Bank of America Merrill Lynch.

Jamie Feldman

I guess just sticking with the capital stack, how should we think about where you'd be willing to take leverage as you do ramp up these development projects?

Mike O'Hara

Jamie, our target range has not changed on that. That is core debt to core EBITDA in the 6x-something range and maxing out in the high-7s x. That's not going to change. We'll continue to manage to that. We will not start the development projects unless we've got the capital to get those underway.

Lou Haddad

Maybe one thing to keep in mind on our development projects, as I said before, these are 18 to 22 months schedules. The land purchases have already been made, and so you're looking at a very slow ramp-up on any kind of equity need.

Jamie Feldman

Okay. And then as you do look at the preferred more, which I think you'd said something mid-7s yield, how do you just think about your cost of capital versus the returns on these investments?

Mike O'Hara

Yes. So obviously, it would be a mix of debt and equity. Obviously, the equity portion has gotten more expensive. It was an average of 7.4%. But since then, actually, the preferred now is trading above par. So that's certainly going to be helpful on the costs on the preferred side. And on the other side of the equation, the debt side has dropped substantially. So now you're looking at 3% debt. So a mix of the 2. Obviously, you have more debt than equity works out, so the cost of capital works for the development projects we're working at and haven't be accretive.

Lou Haddad

And more important -- perhaps as importantly, obviously, there's no dilution and compilation effect on the preferred.

Jamie Feldman

Okay. So would you say your IRRs are not that different than pre-pandemic based on all the moves in capital costs? Or you've actually -- you've seen some lead or projected fleet?

Lou Haddad

Jamie, like I said earlier in my remarks, we believe it's going to be better. This is, as you guys know and you probably heard me say it too many times, this is our fifth recession. For the first 4, we believe the fifth one is going to be no different. We're going to get a nice discount on construction pricing coming out of it, and that should serve to enhance returns, not by a lot, but by enough to be measurable.

Jamie Feldman

Okay. And then heading into this, you had a good amount of retail and experiential retail in the portfolio. How do you think about, I guess, first, the continued potential pain for those tenants? And if you need to flesh any of those out of the portfolio? And then second, just thinking about your business longer term, what the great type of retailers or right type of mix would be?

Lou Haddad

Sure. Like I said, the percentage of traditional retail is going to continue to fall even though on an absolute basis, it may grow because all of our grocery partners are anxious to expand as opposed to contract. But for us, remember, a large part of what we do is mixed-use. And a large part of mixed-use is having that experiential retail on these ground floors. That's how you enhance your returns on both the office and the multifamily. So that's going to continue to be a part of our portfolio. We've seen this movie before, so to speak. We're going to have to continue working with our tenants over the next several months. We don't believe that on the other side of this thing, that people are going to lose their appetite for going to hair salons and spas and exercise places and restaurants and the like. We think, if anything, that's going to accelerate. And like you guys have heard me say before, you don't build real estate for what's going to happen over the next 6 months. You build it for the long term. And so we believe mixed-use and walkability and less use of commuters is going to be -- continue being a trend. And a part of that trend is having options for people to take advantage of at their place of work and where they live.

Jamie Feldman

Okay. And then just finally, I think you had mentioned more bad debt to come in the back half of the year and lease termination fees. Can you talk specifically about what you expect? And then I'm just curious, why would you -- why wouldn't you have taken it already if you see it coming?

Mike O'Hara

First off, because they're not bad. At this point in time, we expect to collect. But what we're saying is -- the probability is we're not going to collect 100% of the tenants -- of the rent that's due and some other tenants may go into bankruptcy during this pandemic.

Lou Haddad

We thought, Jamie, it was important for us to reestablish guidance. We've come to be known for our transparency. We have a lot of information available. We get as much of it out there as possible. And in order to put that guidance out and not having to revise it, we worked really hard on where the low end of the range could be in a worst reasonable case scenario. And that's where you see what Mike talked about potentially within our guidance, we are taking a conservative view of what may happen. And we're hopeful that none of it happens. But we thought it'd be prudent for -- mainly for our analysts to make sure that you knew that we were taking all that into account.

Jamie Feldman

So would you say that the bad debt is tied to specific tenants or it's more of just a bucket??

Mike O'Hara

We went through, like I was saying, we went through every tenant and put -- and we went through and say, okay, what is the likelihood of these tenants and just went down through the whole list. And what we came up with is we came up with who we think are the most likely candidates to go bad here between now and the end of the year and went through an analysis and went through a probability and from there, just kind of did a matrix and came up with the number.

Jamie Feldman

Okay. And then what about the termination fees? Are those set -- you know you're going to get them? Or that's also speculative?

Mike O'Hara

We are in negotiations with a couple of tenants who want to give back some space. And as part of that is termination fees. They're not done at this point in time, but we expect it to happen.

Jamie Feldman

Okay. What’s the size?

Mike O’Hara

The termination fees?

Jamie Feldman

Yes.

Mike O’Hara

Net of expenses, we think it could be upwards of $1 million.

Jamie Feldman

$1 million total earnings impact?

Mike O’Hara

Correct, yes.

Operator

The next question is from the line of Bill Crow with Raymond James.

Bill Crow

Lou, I've heard your discussion about a $20 share valuation. And I certainly appreciate your comments about how today's value doesn't come anywhere close to reflecting what you all have built and are building. And so that leads to the question of why you issue any equity at $12 a share, OP units at $12 a share, when you wouldn't have done that 4 or 5 months ago and you may not do that 6 months from now. And when you said it was kind of the first opportunity to acquire this particular asset, just talk about how the valuation dynamics would have changed if you had waited 6 months or a year.

Lou Haddad

I think a lot of things could have changed, Bill. What we were looking at was the ability to get -- I mean, I don't think anybody on the phone has heard of a fully leased multifamily project in a capital city that trades at a 6.75% cap. So when you take the 6.75% on top of charging a 20% premium for the stock price, I think as the CEO of the REIT, we've made a very good deal. Add to that, that is immediately accretive, and we didn't see any reason to wait..

Bill Crow

How many more -- I assume there's no pressure from the partners to have -- I'm out to buy it right now, right?

Lou Haddad

No, sir. It was initiated by the REIT.

Bill Crow

Yes. Okay. How many more properties are there that the Board or management team owns interest in that might be a good fit for them and kind of build in that pipeline?

Lou Haddad

I believe that's the last one. Mike?

Mike O'Hara

Yes, we have partial minority ownership in a couple of hotels, and that's the last thing we're going to put in the read, obviously. You're a hotel guy, though, but what we want to do

Bill Crow

And please don't.

Mike O'Hara

I think that's it. Certainly, there's been -- we've talked about the construction company building the 2 buildings at the ocean front that Lou and I aren't involved in. The Hyatt House at the ocean front in the multifamily property is going up next to it, but neither one of those we have any interest in acquiring.

Bill Crow

Got you. And then just bigger picture when you're thinking about shifting increase in your multifamily exposure, you're right, 6.75% cap rate is pretty attractive and really attractive. But do you think you can make the shift kind of a neutral basis, selling retail and redeploying into multifamily? Is that possible at this point?

Lou Haddad

It takes time, Bill. So like I said in my opening comments, we knew we -- even when the stock was trading at 19 something, we knew long term that we wanted to make this move. We thought it would take a few years because we weren't interested in destroying earnings in the process. This -- obviously, the pandemic gives us the opportunity to accelerate it a bit. But at the same time, we're not looking to retrace our earnings footsteps beyond this year. So we'll be measured with it. We have no desire to fire sale anything. More likely, we're going to grow our way out of it. We've got -- we have a significant spread in the multifamily projects that we're developing. And so our hope is that we can approach yields there that will offset the yields that we lose on the retail side. So we've got to be patient in order to reserve the ability to increase dividends and increase earnings

Bill Crow

All right. One last one for me, and I appreciate the time. In your student housing properties, did you approach the schools themselves to see if you could do large leases with them?

Lou Haddad

No. I mean, Hopkins, for years, has had a lease of around 40-or-so units that they didn't do this year. And actually, in Charleston, the college at Charleston put out an RFP to try and get beds. But by time they got around to it, we had already filled up. So we didn't really need to do anything on a master lease side

Operator

There are no additional questions at this time. I would like to turn the call back over to Mr. Haddad for closing remarks.

Lou Haddad

Thanks very much for your interest in the company. We appreciate everybody's time this morning, and we are available to take additional questions if you're -- or any further. Otherwise, we look forward to speaking with you next quarter, and stay tuned for more press releases. Thank you.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.