Howard Hughes Corp
Form 10-Q
November 10, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2014

or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission file number 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-4673192**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

13355 Noel Road, 22nd Floor, Dallas, Texas 75240

(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

The number of shares of common stock, $0.01 par value, outstanding as of November 5, 2014 was 39,638,094.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

	September 30, 2014	December 31, 2013
	(In thousands, except share amounts)	
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,605,814	$ 1,537,758
Land	263,032	244,041
Buildings and equipment	907,283	754,878
Less: accumulated depreciation	(138,176)	(111,728)
Developments	899,827	488,156
Net property and equipment	3,537,780	2,913,105
Investment in Real Estate and Other Affiliates	85,344	61,021
Net investment in real estate	3,623,124	2,974,126
Cash and cash equivalents	805,606	894,948
Accounts receivable, net	25,827	21,409
Municipal Utility District receivables, net	122,515	125,830
Notes receivable, net	12,724	20,554
Tax indemnity receivable, including interest	333,877	320,494
Deferred expenses, net	73,230	36,567
Prepaid expenses and other assets, net	314,266	173,940
Total assets	$ 5,311,169	$ 4,567,868
Liabilities:		
Mortgages, notes and loans payable	$ 1,880,916	$ 1,514,623
Deferred tax liabilities	41,038	89,365
Warrant liabilities	444,680	305,560
Uncertain tax position liability	231,904	129,183
Accounts payable and accrued expenses	516,461	283,991
Total liabilities	3,114,999	2,322,722
Commitments and Contingencies (see Note 15)		
Equity:		
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued		
Common stock: $.01 par value; 150,000,000 shares authorized, 39,638,094 shares issued and outstanding as of September 30, 2014 and 39,576,344 shares issued and outstanding as of December 31, 2013	396	396
Additional paid-in capital	2,835,753	2,829,813
Accumulated deficit	(638,864)	(583,403)
Accumulated other comprehensive loss	(7,677)	(8,222)
Total stockholders equity	2,189,608	2,238,584
Noncontrolling interests	6,562	6,562
Total equity	2,196,170	2,245,146

Total liabilities and equity	$	5,311,169	$	4,567,868

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	$ 59,351	$ 53,734	$ 260,186	$ 166,981
Builder price participation	5,311	2,002	13,251	5,703
Minimum rents	24,380	21,538	66,929	60,598
Tenant recoveries	7,601	5,291	20,509	15,681
Condominium rights and unit sales	4,032	810	11,516	31,191
Resort and conference center revenues	8,150	8,169	27,198	30,543
Other land revenues	4,112	3,579	9,322	10,211
Other rental and property revenues	6,291	4,492	18,601	14,557
Total revenues	119,228	99,615	427,512	335,465
Expenses:				
Master Planned Community cost of sales	27,743	27,063	93,540	82,616
Master Planned Community operations	10,995	9,764	31,645	28,054
Other property operating costs	15,198	20,329	45,603	52,126
Rental property real estate taxes	4,559	3,698	12,540	10,814
Rental property maintenance costs	2,313	2,048	6,402	5,996
Condominium rights and unit cost of sales	2,026	406	5,788	15,678
Resort and conference center operations	8,910	7,381	22,833	22,537
Provision for doubtful accounts	119	204	293	910
Demolition costs	760	1,386	6,711	1,386
Development-related marketing costs	6,387	1,050	15,909	1,771
General and administrative	14,759	11,914	49,138	34,310
Other income, net	(11,409)	(6,314)	(27,468)	(11,727)
Depreciation and amortization	13,018	9,986	35,000	23,210
Total expenses	95,378	88,915	297,934	267,681
Operating income	23,850	10,700	129,578	67,784
Interest income	(1,162)	2,061	19,651	6,484
Interest expense	(12,136)	(1)	(28,354)	(144)
Warrant liability gain (loss)	24,690	(4,479)	(139,120)	(148,706)
Increase (reduction) in tax indemnity receivable	5,454	730	(5,473)	(8,673)
Equity in earnings from Real Estate and Other Affiliates	5,509	3,594	18,164	12,034
Income (loss) before taxes	46,205	12,605	(5,554)	(71,221)
Provision for income taxes	590	5,172	49,895	21,012
Net income (loss)	45,615	7,433	(55,449)	(92,233)
Net income attributable to noncontrolling interests		(98)	(12)	(110)
	$ 45,615	$ 7,335	$ (55,461)	$ (92,343)

Net income (loss) attributable to common stockholders								
Basic income (loss) per share:	$	1.16	$	0.19	$	(1.41)	$	(2.34)
Diluted income (loss) per share:	$	0.48	$	0.17	$	(1.41)	$	(2.34)

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Comprehensive income (loss), net of tax:				
Net income (loss)	$ 45,615	$ 7,433	$ (55,449)	$ (92,233)
Other comprehensive income (loss):				
Interest rate swaps (a)	784	(413)	902	2,120
Capitalized swap interest (b)	(180)	(293)	(357)	(1,024)
Other comprehensive income (loss)	604	(706)	545	1,096
Comprehensive income (loss)	46,219	6,727	(54,904)	(91,137)
Comprehensive income attributable to noncontrolling interests		(98)	(12)	(110)
Comprehensive income (loss) attributable to common stockholders	$ 46,219	$ 6,629	$ (54,916)	$ (91,247)

(a) Net of deferred tax expense of $0.1 million and $0.2 million for the three months and nine months ended September 30, 2014, respectively. Net of deferred tax expense of $0.4 million for both the three and nine months ended September 30, 2013.

(b) Net of deferred tax benefit of $0.1 million and $0.2 million for the three and nine months ended September 30, 2014, respectively. Net of deferred tax benefit of $0.2 million and $0.5 million for the three and nine months ended September 30, 2013, respectively.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

UNAUDITED

		Common	**Additional Paid-In**	**Accumulated**	**Accumulated Other Comprehensive**	**Noncontrolling**	**Total**
[redacted]							
Balance, January 1, 2013	39,498,912	$ 395	$ 2,824,031	$ (509,613)	$ (9,575)	$ 5,759	$ 2,310,997
Net income (loss)				(92,343)		110	(92,233)
Adjustment to noncontrolling interest						1,616	1,616
Preferred dividend payment on behalf of REIT subsidiary						(12)	(12)
Interest rate swaps, net of tax of ($376)					2,120		2,120
Capitalized swap interest, net of taxof $542					(1,024)		(1,024)
Stock plan activity	77,432	1	4,111				4,112
Balance, September 30, 2013	39,576,344	$ 396	$ 2,828,142	$ (601,956)	$ (8,479)	$ 7,473	$ 2,225,576
Balance, January 1, 2014	39,576,344	$ 396	$ 2,829,813	$ (583,403)	$ (8,222)	$ 6,562	$ 2,245,146
Net income (loss)				(55,461)		12	(55,449)
Preferred dividend payment on behalf of REIT subsidiary						(12)	(12)
Interest rate swaps, net of tax of $135					902		902
Capitalized swap interest, net of tax of $126					(357)		(357)
Stock plan activity	61,750		5,940				5,940
Balance, September 30, 2014	39,638,094	$ 396	$ 2,835,753	$ (638,864)	$ (7,677)	$ 6,562	$ 2,196,170

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30, 2014	2013
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	$ (55,449)	$ (92,233)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation	31,330	20,197
Amortization	3,670	3,013
Amortization of deferred financing costs	2,927	1,060
Amortization of intangibles other than in-place leases	462	271
Straight-line rent amortization	1,113	(2,087)
Deferred income taxes	47,925	19,712
Restricted stock and stock option amortization	5,940	4,111
Gain on disposition of asset	(2,373)	
Warrant liability loss	139,120	148,706
Reduction in tax indemnity receivable	5,473	8,673
Interest income related to tax indemnity	(18,856)	(5,555)
Equity in earnings from Real Estate and Other Affiliates, net of distributions	(14,666)	(5,408)
Provision for doubtful accounts	293	910
Master Planned Community land acquisitions	(69,930)	(5,667)
Master Planned Community development expenditures	(93,080)	(95,061)
Master Planned Community cost of sales	86,044	73,201
Condominium development expenditures	(34,358)	(10,891)
Condominium and other cost of sales	5,788	15,678
Proceeds from sale of condominium rights		47,500
Percentage of completion revenue recognition from sale of condominium rights	(11,516)	(31,191)
Non-monetary consideration relating to land sale	(13,789)	
Net changes:		
Accounts and notes receivable	26,188	1,850
Prepaid expenses and other assets	(3,436)	12,143
Condominium deposits received	125,002	
Deferred expenses	(32,028)	(7,156)
Accounts payable and accrued expenses	18,055	5,773
Condominium deposits held in escrow	(125,002)	
Other, net	(8,888)	1,217
Cash provided by operating activities	15,959	108,766
Cash Flows from Investing Activities:		
Property and equipment expenditures	(6,213)	(26,527)
Operating property improvements	(3,581)	(22,623)
Property developments and redevelopments	(467,497)	(126,819)
Proceeds from insurance claims	12,901	
Proceeds from dispositions	11,953	10,831

Acquisition of 1701 Lake Robbins		(1,484)		
Investment in Summerlin Las Vegas Baseball Club, LLC				(10,350)
Investment in KR Holdings, LLC				(16,750)
Investments in Real Estate and Other Affiliates, net		(3,929)		(1,031)
Change in restricted cash		(8,136)		(18,268)
Cash used in investing activities		(465,986)		(211,537)
Cash Flows from Financing Activities:				
Proceeds from issuance of mortgages, notes and loans payable		414,046		360,788
Principal payments on mortgages, notes and loans payable		(45,443)		(271,871)
Deferred financing costs		(7,906)		(2,437)
Preferred dividend payment on behalf of REIT subsidiary		(12)		(12)
Distributions to noncontrolling interests				(2,134)
Cash provided by financing activities		360,685		84,334
Net change in cash and cash equivalents		(89,342)		(18,437)
Cash and cash equivalents at beginning of period		894,948		229,197
Cash and cash equivalents at end of period	$	805,606	$	210,760

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(In thousands)	
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 49,617	$ 23,228
Interest capitalized	34,760	26,537
Income taxes paid	1,487	2,127
Non-Cash Transactions:		
Special Improvement District bond transfers associated with land sales	7,496	11,549
Property developments and redevelopments	59,819	56,763
Acquisition of 1701 Lake Robbins		
Land	(1,663)	
Building	(3,725)	
Other assets and deferred expenses	(848)	
Mortgages, notes and loans payable	4,600	
Other liabilities	152	
Non-cash increase in Property due to consolidation of Real Estate Affiliate		3,750
Transfer of condominium buyer deposits to Real Estate Affiliate		34,220

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the Securities and Exchange Commission (the SEC). Such condensed consolidated financial statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (Quarterly Report) should refer to The Howard Hughes Corporation s (HHC or the Company) audited Consolidated Financial Statements which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2013. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods have been included. The results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for the full fiscal year.

Certain amounts in 2013 have been reclassified to conform to 2014 presentation. As a result of the increasing significance of development-related marketing costs in our operations, we have chosen to present, as a separate line item in the Condensed Consolidated Statements of Operations, the amount of development-related marketing costs expensed. Previously, these expenses were included in the line item Other property operating costs. Development-related marketing costs include salaries, benefits, agency fees, events, advertising, online hosting, marketing-related travel and other costs that we incur for the benefit of our developments and re-developments.

Management has evaluated for disclosure or recognition all material events occurring subsequent to the date of the Condensed Consolidated Financial Statements up to the date and time this Quarterly Report was filed.

NOTE 2 RECENTLY ISSUED ACCOUNTING PRONOUCEMENTS

In August, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, *Presentation of Financial Statements Going Concern: Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern.* Before the issuance of this ASU, there was no guidance in U.S. GAAP about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern or to provide related footnote disclosures. This guidance is expected to reduce the diversity in the timing and content of footnote disclosures. This ASU requires management to assess an entity s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. This ASU becomes effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of this ASU to have an impact on the Company s Consolidated Financial Statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers.* This ASU states that entities should recognize revenue to properly depict the transfer of negotiated goods or services to customers in an amount that properly reflects the agreed upon consideration which the entity expects to be exchanged. The standard is effective for interim and annual periods beginning after December 15, 2016 and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The Company is evaluating the impact of the adoption of this ASU on the Company s Consolidated Financial Statements.

In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* The amendments in the ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Company has adopted this guidance. There is no impact of the adoption on the Company s Consolidated Financial Statements because the Company does not have any discontinued operations.

NOTE 3 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010 (the Effective Date), we issued warrants to purchase 8.0 million shares of our common stock to certain of our sponsors (the Sponsors Warrants) of which 1.9 million remain outstanding. The initial exercise price for the warrants of $50.00 per share and the number of shares of common stock underlying each warrant are subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. The Sponsors Warrants expire on November 9, 2017.

In November 2010 and February 2011, we entered into certain agreements (the Management Warrants) with David R. Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our Chief Financial Officer, in each case prior to his appointment to such position, to purchase shares of our common stock. The Management Warrants representing 2,862,687 underlying shares, which may be adjusted pursuant to a net settlement option, were issued pursuant to such agreements at fair value in exchange for a combined total of approximately $19.0 million in cash from such executives at the commencement of their respective employment. Mr. Weinreb and Mr. Herlitz s warrants have exercise prices of $42.23 per share and Mr. Richardson s warrant has an exercise price of $54.50 per share. Generally, the Management Warrants become exercisable in November 2016 and expire by February 2018.

As of September 30, 2014, the estimated $195.0 million fair value of the Sponsors Warrants representing warrants to purchase 1,916,667 shares and the estimated $249.7 million fair value of the Management Warrants representing warrants to purchase 2,862,687 shares have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsors Warrants and Management Warrants were $141.8 million and $163.8 million, respectively, as of December 31, 2013. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 7 *Fair Value of Financial Instruments*. Decreases and increases in the fair value of the Sponsors Warrants and the Management Warrants are recognized as either warrant liability gains or losses, respectively, in the Condensed Consolidated Statements of Operations.

NOTE 4 EARNINGS PER SHARE

Basic earnings (loss) per share (EPS) is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding. Diluted EPS is computed after adjusting the numerator and denominator of the basic EPS computation for the effects of all potentially dilutive common shares. The dilutive effect of options and nonvested stock issued under stock-based compensation plans is computed using the treasury stock method. The dilutive effect of the Sponsors Warrants and Management Warrants is computed using the if-converted method. Gains associated with the Sponsors Warrants and Management Warrants are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti-dilutive.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Information related to our EPS calculations is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Basic EPS:				
Numerator:				
Net income (loss)	$ 45,615	$ 7,433	$ (55,449)	$ (92,233)
Net income attributable to noncontrolling interests		(98)	(12)	(110)
Net income (loss) attributable to common stockholders	$ 45,615	$ 7,335	$ (55,461)	