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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Alexander & Baldwin 2019 Third Quarter Earnings Conference Call. (Operator Instructions)

Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. Steve Swett of ICR. Please go ahead, sir.

Stephen C. Swett - *ICR, LLC - MD*

Thank you. Aloha, and welcome to our call to discuss Alexander & Baldwin's 2019 Third Quarter Earnings. With me today are A&B's President and Chief Executive Officer, Chris Benjamin; and Brett Brown, Chief Financial Officer. We're also joined today by Lance Parker, A&B's Chief Real Estate Officer; and Clayton Chun, Chief Accounting Officer, who will participate in the Q&A portion of the call.

Before we commence, please note that statements in this call and presentation that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statements. These forward-looking statements include, but are not limited to, statements regarding possible or assumed future results of operations, business strategies, growth opportunities and competitive positions. Such forward-looking statements speak only as of the date the statements are made and are not guarantees of future performance. Forward-looking statements are subject to a number of risks, uncertainties, assumptions and other factors that could cause the actual results and the timing of certain events to differ materially from those expressed in or implied by the forward-looking statements. These factors include, but are not limited to, prevailing market conditions and other factors related to the company's REIT status and the company's business as well as the evaluation of alternatives by the company related to its Materials & Construction business and by the company's joint venture related development, Kukui'ula, generally discussed in the company's most recent Form 10-K, Form 10-Q and other filings with the Securities and Exchange Commission.

The information in this call and presentation should be evaluated in light of these important risk factors. We do not undertake any obligation to update the forward-looking statements.

Management will be referring to non-GAAP financial measures during our call today. Included in the appendix of today's presentation slides is a statement regarding our use of these non-GAAP measures and reconciliations. Slides from this presentation are available for download at our website, alexanderbaldwin.com.

Chris will open up today's presentation with the strategic and operational update. He will then turn the presentation over to Brett, who will discuss financial matters. Chris will return for some closing remarks, and then we will open up the call for your questions.

With that, let me turn it over to Chris.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thanks, Steve, and good afternoon to our listeners. Today, I will provide an update on our strategic plan and provide high-level comments on our third quarter results. Brett will then review our financial and operational results in more detail, summarize our balance sheet and review our guidance for 2019, which we are maintaining. Then we'll open the call for your questions.

Before I begin, I want to welcome Steve and his ICR colleagues to the A&B team. We have partnered with ICR as a part of our efforts to transition the company and rationalize costs. We look forward to benefiting from their deep knowledge of the REIT sector and leveraging their expertise as we move forward. Our recent strategic planning effort has validated our path toward a Hawaii Commercial Real Estate focus and encouraged us to accelerate on that path, especially as it relates to the simplification of our business model. I will walk through each of the 4 elements of our strategy and update you on our progress and expectations. The first pillar of our strategy is, of course, to increase NOI from our Hawaii Commercial Real Estate portfolio. And we've done that in a significant way this year. In the third quarter, total CRE revenue increased 19% and cash NOI increased 24% compared to the third quarter last year as we continue to capture the benefit of the acquisitions we completed in the last 12 months.

We now own a portfolio of 3.9 million square feet of operating Commercial Real Estate, all of it in Hawaii and 154 acres of income-producing Hawaii ground leases. At quarter-end, our total Commercial Real Estate portfolio is 95% occupied, the highest quarter-end Hawaii occupancy rate we have achieved in the past decade. Our same-store portfolio at the end of the third quarter was 94.2% occupied, 240 basis points higher than 1 year ago. All of this continues to reflect our team's strong execution and the merits of our Hawaii investment strategy.

Significant drivers of these results include strong leasing activity at Pearl Highlands Center on the retail side. And at 2 neighbor island industrial properties, Port Allen Industrial and Harbor Industrial. We executed a lease with Roger Dunn Golf at Pearl Highlands Center to bring occupancy to 99.8%, an increase in occupancy of 6.7% year-over-year. This is a direct result of the repositioning of that asset.

Our leasing activity remains strong as we signed 55 leases in the third quarter for about 114,000 square feet of GLA. For the 77,300 square feet of comparable leases signed, we recorded an average leasing spread of 6%. As you know, our Commercial Real Estate growth strategy is not just about effective leasing of our portfolio, it also includes value-add redevelopment efforts. We're focused currently on Aikahi Park Shopping Center, where we're planning a total capital investment of approximately $18 million. The plan at this 98,000 square foot center in Kailua calls for conversion and repurposing of an old theater space that has been vacant since we purchased the center. This creative and adaptive reuse helps us meet the expansion needs of a local tenant and make their old space available for a new tenant. We also will be doing a general refresh of the center and creating new outdoor gathering spaces, resulting in a vibrant community center with an excellent mix of dining, shopping and service options for area residents and visitors. Completion is expected in mid-2021, with an anticipated 9% stabilized yield on incremental capital. This project follows on the successful redevelopment of nearby Lau Hala Shops, where we will soon have the grand opening of our final tenant.

The well-received 46,000 square-foot community-focused center is fully occupied and will soon be generating a yield of 11% on the total capital investment of approximately $23 million. At Ho'okele Shopping Center, our 66,000 square foot center in Kahului, the grand opening of the Safeway gas station and 2,400 square foot convenience store was celebrated subsequent to quarter-end on October 12. This project represents another element of our CRE growth strategy, which is ground-up development. The total expected cost for the first phase of the project is around $33 million. When completed, we anticipate a stabilized yield of approximately 8% on this phase.

To round out this first pillar of our strategic plan, let me comment on CRE growth through acquisitions. We're extremely proud of our acquisitions earlier this year that fueled the 24% year-over-year growth in portfolio NOI. We're pleased not only with the assets we acquired, but the fact we were able to acquire them with exchange proceeds from the sale of non-income-producing land. This boost to NOI is one of the best demonstrations yet of our strategy to convert difficult to value assets to easier to value Commercial Real Estate. We will continue to look for this kind of opportunity. But we've sold most of our agricultural land. So future exchanges of this type will likely be on a smaller scale, and we plan to augment exchange proceeds with incremental capital when appropriate to fund future acquisitions. It's for this reason that the pace of acquisitions may moderate as we focus on strengthening our balance sheet and simplifying our story. We do, however, have a healthy pipeline of assets we are evaluating for future acquisition and will remain opportunistic. We're often asked if we see enough room for growth in our Hawaii portfolio. And the answer is absolutely, yes. We own about 22% of the Hawaii grocery-anchored supply and only about 2% of the industrial product. We continue to like both of these asset classes and expect to focus our acquisition activity there.

Let me shift now to the second and equally important pillar of our strategic plan, and that is monetization of our non-CRE assets, including our remaining for sale developments, land assets and Grace Pacific. And the resulting simplification this will provide our business model. This is a critical priority for us, not only because we believe simplification will make it easier to value our company, but because monetization helps us improve our balance sheet metrics and positions us for additional CRE growth. Monetization begins with development and land sales, and we continue to unlock the capital we have invested in these projects and land assets. At Maui Business Park, our 125-acre commercial development in central Maui, we closed 0.5 acre lot for $1 million, but more importantly, we have 5 contracts in place, one of which is binding and expected to close in the fourth quarter for $6 million. With the other contracts, we have a strong outlook for sales at the project in 2020. At Kukui'ula, we sold 10 developer units for $23.8 million in the quarter. And have another 8 units currently in escrow. Momentum in the project remains strong, and we have not had to fund any subsidy this year. We also sold one parcel on Kauai for $900,000, and we have our last 3 Kahala properties in escrow with one binding and expect to be sold out of that project in the near future. More broadly, we are accelerating efforts to monetize both land and development assets. These sales are inherently difficult to project, but we will provide more color on our expectations for 2020 early next year.

Turning to Grace Pacific. The third quarter was very challenging as we continued to experience project delays and work our way through low-margin projects in backlog. Adding to the challenge is a year-over-year decline in government solicitations for bids on asphalt paving projects. Still, I have confidence in the work our new management team is doing to right-size the cost structure and improve the discipline of our operations in bidding. During the third quarter, we implemented additional cost reductions that, when combined with the reductions from the second quarter, are expected to yield $3 million in savings on an annualized basis. By focusing on closing out old projects and collecting receivables, Grace was net cash flow positive in the quarter, and our bid win rate ticked up compared to the first quarter -- I'm sorry, to the first half of the year.

Of course, the full payback on these operational improvement efforts will take time to realize because there simply has not been a lot of new work coming up for bid. As a result of the sharp drop in Grace's revenue and profitability this year, we recognized a $49.7 million noncash impairment charge in the quarter to write-down the remaining goodwill associated with the paving operation. As you know, we are actively exploring a potential sale of Grace Pacific. We have a promising list of bidders evaluating our offering memorandum at this time. We will be critical in evaluating offers as we are committed to finding the right next owner to move Grace Pacific forward. I would expect to be in a position to update you further on our next quarterly call.

Wrapping up my comments on the second pillar of our strategic plan, we are focused on the simplification of our company and are pleased with the progress we have made over the past few years, as shown on this slide. We are not done yet, however, and we'll be seeking to monetize additional assets and generate more cash to reduce our leverage. We are fortunate not to be relying on any one transaction. While selling Grace is an objective, we are committed to achieving the best results for our shareholders as we consider any transaction.

The next important element of our strategic plan is organizational streamlining. This is a process that has been underway for some time and will continue. It's not going to be an overnight process, but we will make steady progress along with our simplification efforts. As I often say, we are transforming a 150-year-old conglomerate into a focused Commercial Real Estate company. That entails shedding many legacy processes and policies. And I'm immensely appreciative of the support of our team in that effort. As an example, we announced this month that we are freezing the last elements of our defined benefit plan, which is an important prerequisite to an eventual termination of the plan and reduction of both G&A and operating expense. Other steps have been taken to reduce G&A at both Grace and A&B, and I expect meaningful progress in this regard for 2020. As we achieve strategic milestones to further simplify our business, we will be able to simplify our organizational structure in parallel and reduce costs further. We remain a fairly diversified company working through many legacy issues, and we are committed to managing this transition thoughtfully.

The final pillar of our strategic plan is related to ESG, or environmental, social and governance matters, and how we operate as a company. While this is integral to our business activities, we have identified it as a separate work stream for this planning cycle so that we can convey to all of our stakeholders how important it is to us. There's no question that it is the right way to do business and completely consistent with A&B's values. I'm pleased with the recent engagement we have had with the ESG representatives of our top 20 shareholders and welcome the opportunity to tell this side of our story to all our investors. These themes have been prominent in our communications over the past couple of years and will assume an even more prominent position going forward. We are focusing our ESG efforts on those areas we deem to be most material to our industry and our Hawaii home, in particular, issues of energy efficiency, resilience to climate change, engagement with our tenants and communities, and the culture of our company are all of paramount importance. I'm proud of the progress we're making in these areas and pleased to see the pride that our employees are taking in our commitment to these values.

With that, I will turn the call over to Brett to discuss our operational and financial results in more detail, and then I'll return for some closing thoughts.

Brett A. Brown - *Alexander & Baldwin, Inc. - Executive VP & CFO*

Thanks, Chris, and good afternoon, everyone. Beginning with our financial results. For the third quarter, we recorded a net loss of $49.8 million or $0.69 per share compared to net income of $14.8 million or $0.20 per share in the same period of 2018. The net loss in the third quarter of 2019 includes the impact of a $49.7 million noncash impairment related to Grace Pacific, a negative impact of $0.69 per share. For the first 9 months of 2019, we recorded a net loss of $41.6 million or $0.58 per share compared to net income of $64.6 million or $0.89 per share in the same period of 2018. The net loss in 2019 includes the impact of the $49.7 million noncash goodwill impairment, an impact of $0.69 per share in the first 9 months of 2019 and the net income in 2018 includes a $49.8 million gain on sale of Commercial Real Estate properties, an impact of $0.69 per share in the first 9 months of 2018.

Turning to our Commercial Real Estate segment. Revenues were up 18.9% or $6.8 million over the prior year quarter. Total portfolio cash NOI increased $5.3 million or 24.4% for the third quarter of 2019 compared to the same period last year, primarily due to new acquisitions as part of the Commercial Real Estate investments we made in the last 12 months as well as growth in the same-store portfolio. Year-to-date, revenues are up $13.7 million or 13.1% to $118.6 million. Total cash portfolio NOI increased by 18.7% or $12.1 million to $76.7 million, primarily driven by NOI from 1031 reinvestment acquisitions and strong same-store performance. Same-store cash NOI for the third quarter increased by $400,000 or 2.2% to $19.3 million. Year-to-date, same-store cash NOI increased by $3 million or 5.3% to $59.2 million. As Chris mentioned, we anticipated that same-store cash NOI growth would slow in the third quarter to an expected 3% rate. In fact, growth came in at 2.2% due to a net -- due to a rent reconciliation adjustment with a tenant. We remain on track to achieve our full year expected range of 4.5% to 5.5%.

Moving on to our land operations segment. This business unit produced revenue of $8.5 million in the third quarter of 2019 as a result of sales and distributions related to land and development for sale projects, resulting in EBITDA of $3.2 million in the quarter and $17.1 million year-to-date. Monetization activity for the third quarter includes closing a 0.5-acre lot at Maui Business Park, a parcel of land on Kauai and 10 developer unit sales at Kukui'ula.

Results from our Materials & Construction segments were driven by our Grace Pacific subsidiary, which continues to be challenging, as Chris mentioned. In the third quarter, we incurred the $49.7 million noncash impairment charge to write-down the carrying value of goodwill. Grace Pacific's adjusted EBITDA was negative $4.4 million compared to a positive $5.6 million in the third quarter of last year. In the consolidated financial statements, excluding the noncash impairment charge, operating costs and expenses decreased by 16.4% from the third quarter of 2018 due to lower operating expenses in the land operations and Materials & Construction segments.

Selling and G&A expenses decreased 8.9% to $13.3 million in the third quarter of 2019 compared to $14.6 million in the third quarter of 2018 due to lower costs incurred in the Materials & Construction segment and at corporate as a result of efforts to simplify the company and streamline operations. I have to say, I've been pleased to work with Chris and the rest of our team this year on firming up our strategic direction and setting priorities for the next few years. From a finance and treasury perspective, we need to support future CRE growth, and it's essential we have the capital necessary to do so. Maintaining a strong balance sheet, of course, is a key strategic focus for the company and will support our growth plans over the near and long term. As we continue to execute our portfolio simplification plan, the sale of our non-CRE assets and the use of after-tax proceeds to pay down debt should result in net debt-to-EBITDA commensurate with our REIT peers. In addition, we are working with our existing lenders to enhance our covenant structure, reduce amortization and extend maturities. Finally, as a reminder, we are structured as an umbrella partnership REIT and believe there will be opportunities to utilize OP units as a currency for acquisitions in the future. There are many potential multigenerational property owners here in Hawaii that may benefit from a tax-deferred transaction structure, and we have engaged with several to share the potential benefits of an OP unit deal. Together, we believe these steps to delever, manage our credit facilities and position ourselves to leverage OP units will all help lay the groundwork for future CRE growth.

Moving on to guidance. As you will note, we added a table to our earnings release that summarizes the relevant metrics we have provided as a part of our outlook for our Commercial Real Estate segment. At this time, we are not revising any of our expectations and remain on track to achieve our full year guidance. Finally, as previously stated, our dividend philosophy is to distribute an amount that approximates REIT taxable income. We declared a $0.19 per share dividend for the fourth quarter, following 2 quarters in which we increased our dividend by an aggregate of $0.045 per share or an approximate 31% increase from the first quarter dividend. With this distribution, we will have distributed $0.69 per share for the full year 2019, and our fourth quarter run rate implies a full year annual dividend of $0.76 per share.

With that, I'll turn the call back to Chris for closing remarks.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thanks, Brett. In closing, it's been a very busy and productive year at A&B, and I'm very proud of the accomplishments of our team. We're making positive strides in executing our strategic plan. Markets remain healthy and supportive of our efforts to monetize assets, and we will continue to unlock incremental capital to continue this strategic shift. There is no doubt that further work lies ahead, but we have the right team in place and the right attitude and vision. On January 1, 2020, we will mark our 150th anniversary as a company. As I recently pointed out to our employees, we were founded a century and a half ago in an industry -- sugar - that no longer exists in Hawaii. Our very survival as a company is a testament to our ability to adapt to and thrive in new businesses. And we are demonstrating that once again. I'm immensely proud of our progress and equally cognizant that we are not yet at our destination. I hope our investors continue to see both our results to date and our commitment to completing our strategic evolution. As we look to 2020 and beyond, I'm extremely excited about the opportunities we have and look forward to providing additional updates in the New Year.

With that, we'll open it up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Sheila McGrath from Evercore.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Chris, on Kukui'ula, it's doing so much better than it has historically, and you mentioned it's self-sustaining, that you're not having to put any capital into it right now. Can you tell us what's driving the improved metrics? Where are the end buyers from? And does this change your long-term plans there to potentially hang on to that asset?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thanks, Sheila. Yes, great question. So first of all, I think the thing that -- the 2 things that are driving it really are just general optimism, the strength of the economy, the fact that Kauai has been, I think, generally gaining traction. There's been -- I don't know what it's entirely attributable to. Of course, there was the volcano activity on the Big Island last year, there were the floods on the North Shore of Kauai last year. I think both of those have helped drive more people to the South Shore of Kauai, which has not been subject to either of those. So I think we've been in a kind of a good environment. The economy has been strong. The market has been strong. It's been a good backdrop. But then the thing that really made the sales possible was the fact that we have invested an important but modest amount of money in developing inventory at all price points at the project. We've got our premier lots available with spectacular ocean views in the higher price range of $5 million to $10-plus million, but we also have developed product at the lower price points, both lots just under $1 million and homes in the $1.5 million range, which, for a project of that nature, are on the more affordable end of the spectrum.

So I think having that breadth of inventory available, having more lots available, while also benefiting from just the general movement towards the South Shore of Kauai has been very, very positive. We had questions in the past about whether opportunity zone purchases have driven that. I think we have seen a handful or maybe a little less than a handful of opportunity zone driven deals. I think it's really more just around the general optimism and momentum that the project has gained and the fact that we've had more available inventory.

Shifting to what does that mean for the future and our outlook for holding on to the project. I would say that this still falls in the category of those noncore assets that long term we would like to monetize. We are not actively marketing the project now. But I think if there were an opportunity to pull some equity out of project, we would be open to that. It's part of the reason that we took the impairment in the project last year and revalued it. And I think we continue to be opportunistic in thinking about pulling some money out. Having said that, we're very happy that we're not having to subsidize the project. There may be some more inventory development that we do going forward. So there may be some capital going into the project, but it's not going into subsidizing the day-to-day operations. So that's a nice shift for us.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay. And then another question on Maui Business Park. You mentioned there was a land sale in the quarter. I'm just wondering how you think that project will play out in terms of the mix on land sales versus development to own.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. So let me give a little context there and then ask Lance to elaborate. The first thing that I would say about Maui Business Park is that the activity there of late, and of course, we only had 1 sale in the quarter, but we've got more teed up for the next quarter and next year, is a direct result of the fact that once we got the reinvestment of the land sale proceeds done in the first half of this year, our investments team really shifted its focus to more of our dispositions of both development product and some of our noncore assets. And I think the shift of those resources and the attention that they've been able to pay to Maui Business Park has been directly responsible for the uptick in sales activity. So we do feel good about that. And as I said in my prepared remarks, we would expect some good results from Maui Business Park over the next quarter and the next year.

With respect to the long-term balance of build for hold at Maui Business Park versus land sales, a lot of that is going to be driven by what the prospective tenants want. If -- certainly, if we've got tenants that are willing to do a build-to-suit or a ground lease, and we can retain the land and possibly the improvements and generate space rent, we will certainly do that. But as we've discussed in the past, a lot of our tenants really almost insist on fee simple ownership of their space. And so that's going to be an ongoing evaluation. We are looking at future development opportunities there. And I would be -- I would assume and expect that we will do some more vertical development. But what the balance is, it's hard to predict. So let's see if I left anything for Lance to add to or if I provided everything.

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

No. I would just add that because of the opportunity to self-develop and add product to our CRE portfolio, we do view Maui Business Park as strategic in the long term, unlike another large project like Kukui'ula. So recent examples of our ability to take land within the park and turn it into income-producing long-term assets, Ho'okele, where we just opened the Safeway and more recently, the Gas and C-store that was part of that lease that we did with them. And as Chris indicated, while we've talked in the past about the potential for industrial build-to-suits, we've taken a more active marketing approach where we've actually done some pre-work in terms of design and taken that to market to see if we can find some interest.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay, great. And one last one on Grace. If you could just update us on the interest level, how far along in the process -- the sales process are you? And what is the carrying value that you're now carrying Grace Pacific at?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

So I'll start, and then I'll let Clayton jump in with the answer on carrying value. We've been very pleased with the process and the progress so far. The current status is that we have sent offering memorandums out. By the way, we're working with FMI Capital, which is the leading banking advisory group in the construction industry. They're very well regarded, very well connected, and they've led a very strong process from my perspective. We finished the operating memorandum about a few weeks ago, a month ago, reached out to a long list of prospects. And I don't know that I can disclose exactly how many, but let's just say, dozens of interested parties have signed NDAs and have received offering materials. So we've been very encouraged by that. We are awaiting initial responses, which will come sometime in November. And then from those responses, we will decide on next steps in terms of narrowing the field. But pleased with the process so far, pleased with the process that FMI is leading. And I think that's your question other than carrying value.

Clayton K.Y Chun - *Alexander & Baldwin, Inc. - Senior VP, CAO & Corporate Controller*

Yes. So the carrying value that we have as of 9/30 for Grace as a whole is about $208 million (corrected by Company after the call).

Operator

(Operator Instructions) And our next question comes from Alexander Goldfarb from Sandler O'Neill.

Alexander David Goldfarb - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior REIT Analyst*

So just a few questions. First, just going to the materials, obviously, good to hear that you guys are considering selling it. The $208 million (corrected by Company after the call) carrying value. Is that like a thoroughly vetted, fully impaired number? Or when you go to market this year, your expectation would be that the proceeds are, let's just say, net proceeds net of any debt or associated liabilities would be materially less than that?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

I don't think we can speculate on market valuations. We're too early in the process. So I think, really, we can't opine on that. It's a valuation process that we went through at the end of the quarter. Based on the fact that, quite frankly, even though we had done a valuation at the end of last year, we've had a material change in the performance of the business this year, largely because of market conditions, but also, frankly, because our new management team there, I think, is doing a very good job of kind of cleaning up some of the backlog of work that we've had, trying to collect cash, close out some jobs. And in the process of doing that, they've had to take some painful actions to get us past some of those jobs. So I think that the performance this year is indicative not only of a challenging market, but also of some positive steps to move the company forward. I think that will be reflected in the marketing process, and hopefully, we'll get good value, but it's really too early to opine on what kind of value we'll get.

Alexander David Goldfarb - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior REIT Analyst*

Okay. And then the strategic -- the reviews that you guys keep going through makes sense. Obviously, the Kukui'ula, I -- forgive my pronunciation. But Kukui'ula, I mean, that's just a massive housing project that certainly doesn't seem like something that needs to be with you guys, given the opportunity with the shopping centers and industrial. But you mentioned opportunity zone. Is all of that considered opportunity zone or there's a portion of it that's considered opportunity zone?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

No. Interestingly enough, the entire project does fall within an opportunity zone. Now that doesn't -- most of that project is intended for individuals to buy homes and live in them and enjoy them. And that doesn't fit an opportunity zone project. There are parcels within the project that may be well suited to developing income-producing assets, whether it's a hotel asset or rental properties. But for the most part, the project is attracting homeowners who want to live in and enjoy their homes, and that doesn't give them an opportunity zone -- investment opportunity, so. But it does fall within an opportunity zone.

Alexander David Goldfarb - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior REIT Analyst*

Yes. No, I mean, it wouldn't have struck me as an area that would have qualified for it. But I guess, each state has their own ability to do that. So it's pretty good. And then finally, Chris, as you guys consider the holistic transfer, you guys are a REIT, but you don't report FFO. What are the considerations to converting to FFO as a reporting metric? Howard Hughes reports FFO. There are others with some more complicated businesses that do that. Would seem to be an advantage to make the full conversion.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. And I'll let Brett elaborate on this, but we definitely talk about that often. We're definitely focused on doing that at the right time. The reason we haven't done it to date is really because of the non-CRE businesses that we have and the fact that we think the FFO metrics would be a little bit misleading in light of those but we're looking at some possibilities. Maybe Brett, you can elaborate.

Brett A. Brown - *Alexander & Baldwin, Inc. - Executive VP & CFO*

No, I would agree, Chris. And Alex, as we look at that, spot on with the businesses that are noncore. So as we look going forward, as we have more clarity on the simplification plans, then we'll be in a position then to be able to report and be -- and have FFO as a reported number for the company.

Alexander David Goldfarb - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior REIT Analyst*

Okay. Yes. I mean, we can calculate your NAV, that's easy, and certainly, the market is pretty good at determining high-multiple versus low-multiple businesses. So yes, I wouldn't let where your FFO would fall drive it, but it would definitely be an advantage and make you guys easier to compare to your peers.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Agreed.

Operator

And our next question comes from Steve O'Hara from Sidoti & Company.

Stephen Michael O'Hara - *Sidoti & Company, LLC - Research Analyst*

Just in terms of the REIT asset classes that you're in within the state. Are there other asset classes that you think you would maybe want or need to get into in terms of maybe identifying opportunities or improving diversification? Or do you think you're kind of set in terms of the asset classes you're in?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

Steve, this is Lance. Chris referenced in his earlier comments, our market share of both the retail and industrial sectors in Hawaii, both of which, fundamentally, we feel very good about. And as we look at where we are relative to the remainder of the opportunity set, we feel like focusing on that gives us sufficient opportunity to grow the business in the near term.

Stephen Michael O'Hara - *Sidoti & Company, LLC - Research Analyst*

Okay. Okay. And then just maybe on Grace and the results of the quarter. I missed some of the commentary. But I guess, is most of the issue with the quarter, I think it looks like kind of an adjusted -- if I take out the write-down, it looks like about an $8 million operating loss, worse than the last couple of quarters, I guess. And I'm just wondering, it seems like there were some things that worked through the quarter, some contracts that were unprofitable, et cetera, that were worked through the quarter. Or is it -- is this more of a kind of, this is the way it looks going forward for a little while until we repair it? Or was it kind of, we work through some of the -- more of the issues in this quarter and maybe things are directionally get better, maybe not swing to an operating profit, but?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. Steve, good question. This is Chris. So I think it's a little bit of both. I think that we've taken some pain in the quarter that was necessary to take. And I think we can move past it. And what I mean by that is we had a number of jobs that were bid in prior years that were unprofitable as we got into delivering them, and we had some recognition of that in some of our working process estimation during the quarter. So I think some of that is pain that was one-time, and we've moved past that. I think that what the team is doing now is very, very positive in terms of the quality of the work, the cost effectiveness of the work, some of the G&A reductions that we've undertaken. I think we're improving our cost structure. I think we're improving our bidding process. I think that this all sets us up well for improvement. Having said that, the recent level of bid activity by both the state and the county has been very low. And we have expectations that it will increase in the near term. And I think that when it does, we're well positioned not only to win bids, but also to deliver them, deliver the work profitably. But until that work is bid and that work is there and these more favorable jobs are in our backlog, it's tough to turn the profitability around significantly. So I think the answer is a little bit of both. I don't expect a continuation of the kind of negative margins on old jobs that we experienced in the quarter, but we're still somewhat dependent on an improving bidding environment to really turn the tide in terms of the profitability of the business just because we've got a lot of fixed costs and not the volume of work that we'd like to have right now to cover those and generate some profit.

Stephen Michael O'Hara - *Sidoti & Company, LLC - Research Analyst*

Okay. Thanks for that color. And then just maybe within land operations. I think you said you had a number of units to close the Kukui'ula and/or maybe developer parcels or something. And then there was a couple of things that closed within Maui Business Park, I think, and other areas. And I'm just wondering, in terms of, I guess the flow-through to operating profit, I think it was $2.8 million or so. And I'm just wondering in terms of the value of these properties and maybe the cash flow attached to them as opposed to the operating profit. Is there a big difference between the cash flow from these in the operating profit? Or is it more within the JV, you only recognize a certain period -- a certain amount at a certain time, et cetera?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

I think a lot of that, Steve, has to do with the life cycle of the project and the percentage of completion in the project. I think that when we sell properties as Maui Business Park, for example, the margin recognition is greater because the level of completion of that project is greater. Whereas at Kukui'ula, while, obviously, we've been in a project for quite a while, the percentage of completion of that project is still lower than it is at Maui Business Park. So what happens is some of the profits on a particular lot are not fully recognized because of the percentage of completion model. You also do have, as you pointed out, the fact that it's a JV, and we only own -- we own a majority, but not 100% of the JV. So there's some muting of the impact there. But I can say that on Maui Business Park, the cash flow and the profitability are both generally pretty attractive, and that's why I'm glad that sales are picking up there and why it's been a focus for us. And at Kukui'ula, we're not pulling any cash out right now, but the benefit of these increased sales is we're also not having to put any cash in, which has been positive at least not for operating subsidies. I don't know, Lance, if you have anything to share. No? Okay.

Stephen Michael O'Hara - *Sidoti & Company, LLC - Research Analyst*

Okay. Yes. And then maybe just lastly, in terms of the land that you highlight on -- I think, it's table 20 of the supplement. Can you just -- I don't know if you've done this yet or maybe it's coming. But in terms of the land that is developable with infrastructure, et cetera. And then the land within -- that's actually entitled, how much of this -- is there a way to kind of bucket -- how much of this is land that could be converted within the current CRE or that would have to be, I don't know, transferred into the CRE? Or how do you think about a process where you do something similar to what you did with the ag lands earlier or, I guess, late last year, where you either sell and convert that into the REIT or develop and hold? How much of that, let's say, land bucket is available for development hold on kind of a tax-efficient basis?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes, I'd say that most of the land in the top half of that table, the urban land is within the taxable REIT subsidiary because it is projects that have been intended for sale. And so I believe that's the case, and then probably you can correct me if I'm wrong, but. So most of that land would be more development-for-sale kind of land. We do within some of our development-for-sale projects, for example, in Wailea, we have a parcel that is zoned commercial and would be intended longer term for development for hold. So that parcel sits in the REIT. But most of that land would sit in the taxable REIT subsidiary. The land on the lower half of the table will tend to sit in the REIT because it has been held historically for agricultural purposes. And some of it is leased, but it is not meant for development for sale. So that would tend to sit in the REIT.

Operator

And our next question comes from Sheila McGrath from Evercore.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

I guess, a couple of quick last questions. On Lau Hala Shops, what percent is that leased now? And when will all tenants be paying cash rents to full stabilization of that asset?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

So we are 100% leased, Sheila. And our expectation is that our last tenant will open and go economic later in November. So we're really pleased to be able to bring that entirely online for the residents and community of Kailua.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

And that's a 11% return on cost, correct?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

That's correct.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay. And then on Pearl Highlands, that was a successful redevelopment. I was just wondering if you had available, what kind of return on cost did you achieve on that redevelopment?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

I'd have to go back and look. I know we had it disclosed but it was still on our redevelopment table, and the number is escaping me. We'll have to get back to you on that. But my recollection is it was consistent with some of the other redevelopments that we're doing. So I think in that case, it was high single digits.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

I think it was high single digits. Maybe when we were in the early stages, it was about 10%, but I think it may have been in the high single. A bit of it certainly consistent with or higher than, I think, Aikahi and what we're expecting there.

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

Yes.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay. Great. And then on...

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

And that was a great project because actually, it was not a significant redevelopment. It was, of course, repurposing and freshening up of the food court and the theater. But just those 2 changes alone and a little bit of cosmetic work really helped us get some retenanting going and get some very positive momentum at that center. So it's a -- as we measure the return on that, I think we just measure the direct rent of those spaces that we improved but if you looked at the positive impact on the rest of the center and the fact that we've been able to get it fully tenanted, I think actually the returns would be north of what we're talking.

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & Chief Real Estate Officer*

Yes. So Clayton is just showing me, I think where we closed out on that, Sheila, was at 10% return on that incremental spend or incremental NOI.

Sheila Kathleen McGrath - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay, great. And then, Chris, you mentioned accelerating noncore land sales. Would that include any ag land sales? Or could it include, that you would be able to redeploy in a tax-efficient manner as you did with that other large land sale?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

It could, Sheila. Yes. We have -- we certainly have additional ag lands. We don't have the kind of contiguous footprint that we had when we sold the lands last year, so they would be smaller transactions. But I would expect that we would have probably some continuing modest ag land sales that we would 1031 and there's the potential for some larger transactions. But not nearly -- not a 9-figure kind of transaction, potentially a low to mid-8 figure kind of transaction might be possible. But those are lands that are tough. It's not a deep buyer universe for that, but we certainly will look for more opportunities to convert some of our remaining lands. Always with the objective of, frankly, getting them into the hands of people who can do more with them than we can. We're not a farming company anymore. And a lot of these lands have great potential to be growing crops and be helping Hawaii's energy and food sustainability. And so just as with the land sale last year, obviously, while it's a financially attractive deal for us, it's also an opportunity to get some of these lands back into active agriculture, which I think is a good thing for the state.

Operator

And I'm showing no further questions at this time. I'd like to turn the conference back over to Steve Swett for any closing remarks.

Stephen C. Swett - *ICR, LLC - MD*

Thank you, Candace, and thank you all for joining us today. If you have any follow-up questions, please feel free to call us at (808) 525-8475 or e-mail us at investorrelations@abhi.com. Aloha and have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.
