

Edgar Filing: Howard Hughes Corp - Form 10-Q

Howard Hughes Corp  
Form 10-Q  
November 05, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

or

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 (I.R.S. employer  
incorporation or organization) identification number)

13355 Noel Road, 22<sup>nd</sup> 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.

Yes 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).

Yes No

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

Large accelerated filer

Accelerated filer

Edgar Filing: Howard Hughes Corp - Form 10-Q

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting  
company  
Emerging growth  
company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares of common stock, \$0.01 par value, outstanding as of October 30, 2018 was 43,030,209.

---

Table of Contents

THE HOWARD HUGHES CORPORATION

TABLE OF CONTENTS

|   | PAGE<br>NUMBER |
|---|----------------|
| <br><u>PART I FINANCIAL INFORMATION</u>   |                |
| Item 1: <u>Condensed Consolidated Financial Statements (Unaudited)</u>  | <u>3</u>       |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017</u>   | <u>3</u>       |
| <u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017</u>                  | <u>4</u>       |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2018 and 2017</u> | <u>5</u>       |
| <u>Condensed Consolidated Statements of Equity for the nine months ended September 30, 2018 and 2017</u>                                | <u>6</u>       |
| <u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017</u>                            | <u>7</u>       |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | <u>9</u>       |
| Item 2: <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                                    | <u>34</u>      |
| Item 3: <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | <u>48</u>      |
| Item 4: <u>Controls and Procedures</u>  | <u>49</u>      |
| <u>PART II OTHER INFORMATION</u>  | <u>49</u>      |
| Item 1: <u>Legal Proceedings</u>  | <u>49</u>      |
| Item 1A: <u>Risk Factors</u>  | <u>49</u>      |
| Item 2: <u>Unregistered Sales of Equity Securities And Use Of Proceeds</u>  | <u>49</u>      |
| Item 3: <u>Default Upon Senior Securities</u>   | <u>49</u>      |
| Item 4: <u>Mine Safety Disclosures</u>  | <u>49</u>      |
| Item 5: <u>Other Information</u>  | <u>49</u>      |

|                         |           |
|-------------------------|-----------|
| Item 6: <u>Exhibits</u> | <u>49</u> |
| <u>EXHIBIT INDEX</u>    | <u>49</u> |
| <u>SIGNATURE</u>        | <u>51</u> |

Table of Contents

## PART I FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
UNAUDITED

| (In thousands, except shares and par value amounts)  | September<br>30, 2018 | December<br>31, 2017 |
|--|-----------------------|----------------------|
| Assets:  |                       |                      |
| Investment in real estate:   |                       |                      |
| Master Planned Communities assets  | \$1,621,168           | \$1,642,278          |
| Buildings and equipment  | 2,510,945             | 2,238,617            |
| Less: accumulated depreciation   | (359,445 )            | (321,882 )           |
| Land   | 302,858               | 277,932              |
| Developments   | 1,825,847             | 1,196,582            |
| Net property and equipment   | 5,901,373             | 5,033,527            |
| Investment in real estate and other affiliates   | 107,720               | 76,593               |
| Net investment in real estate  | 6,009,093             | 5,110,120            |
| Cash and cash equivalents  | 454,080               | 861,059              |
| Restricted cash  | 158,468               | 103,241              |
| Accounts receivable, net   | 15,437                | 13,041               |
| Municipal Utility District receivables, net  | 237,567               | 184,811              |
| Notes receivable, net  | 40,220                | 5,864                |
| Deferred expenses, net   | 95,811                | 80,901               |
| Prepaid expenses and other assets, net   | 286,194               | 370,027              |
| Total assets   | \$7,296,870           | \$6,729,064          |
| Liabilities:   |                       |                      |
| Mortgages, notes and loans payable, net  | \$3,261,210           | \$2,857,945          |
| Deferred tax liabilities   | 148,770               | 160,850              |
| Accounts payable and accrued expenses  | 705,864               | 521,718              |
| Total liabilities  | 4,115,844             | 3,540,513            |
| Commitments and contingencies (see Note 10)  |                       |                      |
| Equity:  |                       |                      |
| Preferred stock: \$.01 par value; 50,000,000 shares authorized, none issued  | —                     | —                    |
| Common stock: \$.01 par value; 150,000,000 shares authorized, 43,538,420 shares issued and 43,033,127 outstanding as of September 30, 2018 and 43,300,253 shares issued and 43,270,880 outstanding as of December 31, 2017 | 436                   | 433                  |
| Additional paid-in capital   | 3,318,747             | 3,302,502            |
| Accumulated deficit  | (157,602 )            | (109,508 )           |
| Accumulated other comprehensive income (loss)  | 4,450                 | (6,965 )             |
| Treasury stock, at cost, 505,293 and 29,373 shares as of September 30, 2018 and December 31, 2017, respectively  | (60,743 )             | (3,476 )             |
| Total Stockholders' equity   | 3,105,288             | 3,182,986            |
| Noncontrolling interests   | 75,738                | 5,565                |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|                              |             |             |
|------------------------------|-------------|-------------|
| Total equity                 | 3,181,026   | 3,188,551   |
| Total liabilities and equity | \$7,296,870 | \$6,729,064 |

See Notes to Condensed Consolidated Financial Statements.

3

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
UNAUDITED

| (In thousands, except per share amounts)                 | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2018 | September 30,<br>2017 | September 30,<br>2018 | September 30,<br>2017 |
| <b>Revenues:</b>   |                       |                       |                       |                       |
| Condominium rights and unit sales                        | \$8,045               | \$113,852             | \$39,767              | \$342,208             |
| Master Planned Communities land sales                    | 127,730               | 54,906                | 226,727               | 177,531               |
| Minimum rents  | 53,244                | 44,654                | 153,156               | 136,053               |
| Tenant recoveries  | 12,806                | 11,586                | 37,808                | 34,627                |
| Hospitality revenues                                     | 19,108                | 17,776                | 64,738                | 57,190                |
| Builder price participation                              | 8,685                 | 5,472                 | 19,394                | 14,613                |
| Other land revenues                                      | 7,145                 | 4,561                 | 15,988                | 19,606                |
| Other rental and property revenues                       | 20,397                | 5,929                 | 42,266                | 17,309                |
| <b>Total revenues</b>                                    | <b>257,160</b>        | <b>258,736</b>        | <b>599,844</b>        | <b>799,137</b>        |
| <b>Expenses:</b>   |                       |                       |                       |                       |
| Condominium rights and unit cost of sales                | 6,168                 | 86,531                | 41,713                | 253,209               |
| Master Planned Communities cost of sales                 | 57,183                | 29,043                | 109,609               | 88,288                |
| Master Planned Communities operations                    | 13,044                | 8,180                 | 33,956                | 24,881                |
| Other property operating costs                           | 42,942                | 21,354                | 91,847                | 60,153                |
| Rental property real estate taxes                        | 8,519                 | 7,678                 | 24,148                | 21,765                |
| Rental property maintenance costs                        | 4,456                 | 3,380                 | 11,604                | 10,016                |
| Hospitality operating costs                              | 14,723                | 13,525                | 45,707                | 41,534                |
| Provision for doubtful accounts                          | 2,282                 | 448                   | 4,417                 | 1,728                 |
| Demolition costs   | 2,835                 | 175                   | 16,166                | 303                   |
| Development-related marketing costs                      | 7,218                 | 5,866                 | 20,484                | 14,787                |
| General and administrative                               | 20,645                | 22,362                | 71,795                | 63,423                |
| Depreciation and amortization                            | 31,123                | 35,899                | 88,398                | 96,193                |
| <b>Total expenses</b>                                    | <b>211,138</b>        | <b>234,441</b>        | <b>559,844</b>        | <b>676,280</b>        |
| <b>Operating income before other items</b>               | <b>46,022</b>         | <b>24,295</b>         | <b>40,000</b>         | <b>122,857</b>        |
| <b>Other:</b>  |                       |                       |                       |                       |
| Gains on sales of properties                             | —                     | 237                   | —                     | 32,452                |
| Other (loss) income, net                                 | (3,710 )              | (160 )                | (3,444 )              | 750                   |
| <b>Total other</b>                                       | <b>(3,710 )</b>       | <b>77</b>             | <b>(3,444 )</b>       | <b>33,202</b>         |
| <b>Operating income</b>                                  | <b>42,312</b>         | <b>24,372</b>         | <b>36,556</b>         | <b>156,059</b>        |
| Interest income  | 2,080                 | 1,764                 | 6,759                 | 3,171                 |
| Interest expense   | (21,670 )             | (17,241 )             | (57,182 )             | (49,547 )             |
| Loss on redemption of senior notes due 2021              | —                     | —                     | —                     | (46,410 )             |
| Warrant liability loss                                   | —                     | —                     | —                     | (43,443 )             |
| Gain on acquisition of joint venture partner's interest  | —                     | —                     | —                     | 5,490                 |
| Equity in earnings from real estate and other affiliates | 8,612                 | 7,467                 | 39,297                | 25,821                |
| <b>Income before taxes</b>                               | <b>31,334</b>         | <b>16,362</b>         | <b>25,430</b>         | <b>51,141</b>         |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Provision for income taxes                          | 7,487    | 5,846    | 5,628    | 31,846   |
| Net income  | 23,847   | 10,516   | 19,802   | 19,295   |
| Net income attributable to noncontrolling interests | (482 )   | (12 )    | (51 )    | (12 )    |
| Net income attributable to common stockholders      | \$23,365 | \$10,504 | \$19,751 | \$19,283 |
| Basic income per share:                             | \$0.54   | \$0.25   | \$0.46   | \$0.47   |
| Diluted income per share:                           | \$0.54   | \$0.24   | \$0.46   | \$0.45   |

See Notes to Condensed Consolidated Financial Statements.

4

---



Table of Contents

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
UNAUDITED

|   | Three Months    |          | Nine Months     |          |
|---|-----------------|----------|-----------------|----------|
|   | Ended September |          | Ended September |          |
| (In thousands)  | 30,             | 30,      | 30,             | 30,      |
|   | 2018            | 2017     | 2018            | 2017     |
| Net income  | \$23,847        | \$10,516 | \$19,802        | \$19,295 |
| Other comprehensive income:                                   |                 |          |                 |          |
| Interest rate swaps (a)                                       | (367 )          | 180      | 13,031          | (2,070 ) |
| Capitalized swap interest income (expense) (b)                | (25 )           | (40 )    | 34              | (161 )   |
| Pension adjustment (c)  | 2,566           | —        | 556             | —        |
| Adoption of ASU 2018-02 (d)                                   | —               | —        | (1,148 )        | —        |
| Adoption of ASU 2017-12 (e)                                   | —               | —        | (739 )          | —        |
| Terminated swap amortization                                  | (239 )          | —        | (319 )          | —        |
| Other comprehensive income (loss)                             | 1,935           | 140      | 11,415          | (2,231 ) |
| Comprehensive income  | 25,782          | 10,656   | 31,217          | 17,064   |
| Comprehensive income attributable to noncontrolling interests | (482 )          | (12 )    | (51 )           | (12 )    |
| Comprehensive income attributable to common stockholders      | \$25,300        | \$10,644 | \$31,166        | \$17,052 |

Amounts are shown net of deferred tax benefit of \$0.2 million and deferred tax expense of \$0.1 million for the (a) three months ended September 30, 2018 and 2017, respectively, and deferred tax expense of \$3.7 million and deferred tax benefit of \$1.3 million for the nine months ended September 30, 2018 and 2017, respectively.

The deferred tax impact was not meaningful for the three months ended September 30, 2018 and 2017 and for the (b) nine months ended September 30, 2018. Amount is net of deferred tax benefit of \$0.1 million for the nine months ended September 30, 2017.

Net of deferred tax benefit of zero and \$0.6 million, for the three and nine months ended September 30, 2018, (c) respectively.

The Company adopted Accounting Standards Update ("ASU") 2018-02, Income Statement-Reporting (d) Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, as of January 1, 2018. See Note 2 - Accounting Policies and Pronouncements for further discussion.

The Company adopted ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to (e) Accounting for Hedging Activities, as of January 1, 2018. See Note 2 - Accounting Policies and Pronouncements for further discussion.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
UNAUDITED

| (In thousands, except shares)                      | Common Stock |        | Additional      | Accumulated | Accumulated                       | Treasury Stock |            | Total                | Noncontrol | Total       |
|--|--------------|--------|-----------------|-------------|-----------------------------------|----------------|------------|----------------------|------------|-------------|
|  | Shares       | Amount | Paid-In Capital | Deficit     | Other Comprehensive (Loss) Income | Shares         | Amount     | Stockholders' Equity | Interests  | Equity      |
| Balance, December 31, 2016                         | 39,802,064   | \$398  | \$2,853,269     | \$(277,912) | \$(6,786)                         | (12,061 )      | \$(1,231 ) | \$2,567,738          | \$3,772    | \$2,571,510 |
| Net income   | —            | —      | —               | 19,283      | —                                 | —              | —          | 19,283               | 12         | 19,295      |
| Preferred dividend payment on behalf of subsidiary | —            | —      | —               | —           | —                                 | —              | —          | —                    | (12 )      | (12 )       |
| Interest rate swaps, net of tax of \$1,409         | —            | —      | —               | —           | (2,070 )                          | —              | —          | (2,070 )             | —          | (2,070 )    |
| Capitalized swap interest, net of tax of \$86      | —            | —      | —               | —           | (161 )                            | —              | —          | (161 )               | —          | (161 )      |
| Stock plan activity                                | 368,415      | 4      | 16,735          | —           | —                                 | (4,321 )       | (532 )     | 16,207               | —          | 16,207      |
| Exercise of Warrants                               | 3,052,453    | 31     | 375,582         | —           | —                                 | —              | —          | 375,613              | —          | 375,613     |
| Issuance of Management Warrants                    | —            | —      | 50,000          | —           | —                                 | —              | \$—        | 50,000               | —          | 50,000      |
| Balance, September 30, 2017                        | 43,222,932   | \$433  | \$3,295,586     | \$(258,629) | \$(9,017)                         | (16,382 )      | \$(1,763 ) | \$3,026,610          | \$3,772    | \$3,030,382 |
| Balance, December 31, 2017                         | 43,300,253   | \$433  | \$3,302,502     | \$(109,508) | \$(6,965)                         | (29,373 )      | \$(3,476 ) | \$3,182,986          | \$5,565    | \$3,188,551 |
| Net income   | —            | —      | —               | 19,751      | —                                 | —              | —          | 19,751               | 51         | 19,802      |
| Interest rate swaps, net of tax of \$3,710         | —            | —      | —               | —           | 13,031                            | —              | —          | 13,031               | —          | 13,031      |
| Terminated swap amortization                       | —            | —      | —               | —           | (319 )                            | —              | —          | (319 )               | —          | (319 )      |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|  |            |       |             |             |          |           |            |             |          |             |
|--|------------|-------|-------------|-------------|----------|-----------|------------|-------------|----------|-------------|
| Pension adjustment, net of tax of \$620      | —          | —     | —           | —           | 556      | —         | —          | 556         | —        | 556         |
| Capitalized swap interest, net of tax of \$9 | —          | —     | —           | —           | 34       | —         | —          | 34          | —        | 34          |
| Adoption of ASU 2014-09                      | —          | —     | —           | (69,732 )   | —        | —         | —          | (69,732 )   | —        | (69,732 )   |
| Adoption of ASU 2017-12                      | —          | —     | —           | 739         | (739 )   | —         | —          | —           | —        | —           |
| Adoption of ASU 2018-02                      | —          | —     | —           | 1,148       | (1,148 ) | —         | —          | —           | —        | —           |
| Repurchase of common shares                  | —          | —     | —           | —           | —        | (475,920) | (57,267 )  | (57,267 )   | —        | (57,267 )   |
| Contributions to joint ventures              | —          | —     | —           | —           | —        | —         | —          | —           | 70,122   | 70,122      |
| Stock plan activity                          | 238,167    | 3     | 16,245      | —           | —        | —         | —          | 16,248      | —        | 16,248      |
| Balance, September 30, 2018                  | 43,538,420 | \$436 | \$3,318,747 | \$(157,602) | \$4,450  | (505,293) | \$(60,743) | \$3,105,288 | \$75,738 | \$3,181,026 |

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
UNAUDITED

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2018                               | 2017       |
| (In thousands)  |                                    |            |
| Cash Flows from Operating Activities:   |                                    |            |
| Net (loss) income   | \$ 19,802                          | \$ 19,295  |
| Adjustments to reconcile net (loss) income to cash used in operating activities:            |                                    |            |
| Depreciation  | 77,347                             | 84,083     |
| Amortization  | 11,051                             | 12,110     |
| Amortization of deferred financing costs  | 9,424                              | 4,306      |
| Amortization of intangibles other than in-place leases                                      | 1,052                              | (1,071 )   |
| Straight-line rent amortization   | (9,547 )                           | (6,625 )   |
| Deferred income taxes   | 4,621                              | 33,484     |
| Restricted stock and stock option amortization  | 8,833                              | 4,954      |
| Gains on sales of properties  | —                                  | (32,452 )  |
| Gain on acquisition of joint venture partner's interest                                     | —                                  | (5,490 )   |
| Net decrease (increase) in minimum pension liability  | (65 )                              | —          |
| Warrant liability loss  | —                                  | 43,443     |
| Loss on redemption of senior notes due 2021   | —                                  | 46,410     |
| Equity in earnings from real estate and other affiliates, net of distributions              | (30,474 )                          | (20,200 )  |
| Provision for doubtful accounts   | 4,417                              | 1,728      |
| Master Planned Communities land acquisitions  | (3,565 )                           | (1,415 )   |
| Master Planned Communities development expenditures   | (142,000)                          | (136,745 ) |
| Master Planned Communities cost of sales  | 99,062                             | 78,424     |
| Condominium development expenditures  | (234,563)                          | (293,183 ) |
| Condominium rights and unit cost of sales   | 41,713                             | 253,209    |
| Percentage of completion revenue recognition from sale of condominium rights and unit sales | —                                  | (342,208 ) |
| Net changes:  |                                    |            |
| Accounts and notes receivable   | (43,990 )                          | 1,602      |
| Prepaid expenses and other assets   | (555 )                             | (7,113 )   |
| Condominium deposits received   | 73,082                             | 250,352    |
| Deferred expenses   | (11,169 )                          | (11,215 )  |
| Accounts payable and accrued expenses   | (14,294 )                          | (36,607 )  |
| Condominium deposits receivable   | —                                  | 36,361     |
| Other, net  | —                                  | 245        |
| Cash used in operating activities   | (139,818)                          | (24,318 )  |
| Cash Flows from Investing Activities:   |                                    |            |
| Property and equipment expenditures   | (4,667 )                           | (5,936 )   |
| Operating property improvements   | (40,414 )                          | (12,591 )  |
| Property developments and redevelopments  | (387,625)                          | (258,850 ) |
| Acquisition of assets   | (234,541)                          | (15,404 )  |
| Proceeds for reimbursement of development costs   | —                                  | 11,165     |
| Proceeds from sales of properties   | —                                  | 36,560     |
| Proceeds from Tax Incremental Financings  | 16,848                             | —          |
| Distributions from real estate and other affiliates   | 1,072                              | —          |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|   |           |             |
|---|-----------|-------------|
| Note issued to real estate and other affiliates                   | (3,795 )  | —           |
| Maturity of long term investment                                  | —         | 3,595       |
| Investments in real estate and other affiliates, net              | (1,027 )  | (3,579 )    |
| Cash used in investing activities                                 | (654,149) | (245,040 )  |
| Cash Flows from Financing Activities:                             |           |             |
| Proceeds from mortgages, notes and loans payable                  | 1,077,315 | 1,433,437   |
| Principal payments on mortgages, notes and loans payable          | (656,816) | (1,130,337) |
| Premium paid to redeem 2021 senior notes                          | —         | (39,966 )   |
| Preferred dividend payment on behalf of REIT subsidiary           | —         | (12 )       |
| Purchase of treasury stock  | (57,267 ) | —           |
| Special Improvement District bond funds released from escrow      | 3,052     | 6,099       |
| Deferred financing costs and bond issuance costs, net             | (16,585 ) | (13,305 )   |
| Taxes paid on stock options exercised and restricted stock vested | (3,932 )  | (9,201 )    |
| Gain on unwinding of swaps  | 16,104    | —           |
| Stock options exercised   | 11,344    | 19,719      |
| Issuance of noncontrolling interests                              | 69,000    | 50,000      |
| Cash provided by financing activities                             | 442,215   | 316,434     |

7

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
UNAUDITED

| (In thousands)   | Nine Months Ended |           |
|--|-------------------|-----------|
|  | September 30,     |           |
|  | 2018              | 2017      |
| Net change in cash, cash equivalents and restricted cash               | (351,752 )        | 47,076    |
| Cash, cash equivalents and restricted cash at beginning of period      | 964,300           | 915,139   |
| Cash, cash equivalents and restricted cash at end of period            | \$612,548         | \$962,215 |
| Supplemental Disclosure of Cash Flow Information:                      |                   |           |
| Interest paid  | \$122,334         | \$110,034 |
| Interest capitalized   | 58,458            | 55,895    |
| Income taxes paid (refunded), net                                      | 70                | (12,419 ) |
| Non-Cash Transactions:   |                   |           |
| Exercise of Sponsor and Management Warrants                            | —                 | 375,613   |
| Special Improvement District bond transfers associated with land sales | 10,546            | 9,864     |
| Accrued interest on construction loan borrowing                        | 6,175             | 4,978     |
| Acquisition of below market lease intangible                           | 1,903             | —         |
| Capitalized stock compensation   | 1,891             | 584       |
| Acquisition of Las Vegas 51s   |                   |           |
| Building   | —                 | 87        |
| Developments   | —                 | 65        |
| Accounts receivable  | —                 | 633       |
| Other assets   | —                 | 33,313    |
| Other liabilities  | —                 | (2,294 )  |

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

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"), with intercompany transactions between consolidated subsidiaries eliminated. 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"), these Condensed Consolidated Financial Statements do not include all of the information and disclosures required by GAAP for complete financial statements. 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 for the fiscal year ended December 31, 2017, filed with the SEC on February 26, 2018 (the "Annual Report"). Approximately \$103.2 million in restricted cash was reclassified from Prepaid expenses and other assets, net to Restricted cash on the Condensed Consolidated Balance Sheets at December 31, 2017 to conform to the 2018 presentation as a result of the adoption of Accounting Standards Update ("ASU") 2016-18, Statement of Cash Flows - Restricted Cash. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position, results of operations, comprehensive income, cash flows and equity for the interim periods have been included. The results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 and future fiscal years.

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 on Form 10-Q was filed.

Impact of new accounting standard related to Revenue

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, Revenues from Contracts with Customers (Topic 606). The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. HHC adopted Topic 606 and all its related amendments (the "New Revenue Standard") as of January 1, 2018 (the "Adoption Date") using the modified retrospective transition method. Accordingly, prior period amounts presented have not been adjusted.

HHC recorded a cumulative effect adjustment of \$69.7 million, net of taxes of \$19.6 million, to increase Accumulated deficit as of the Adoption Date due to the impact of adopting Topic 606. As discussed in the Annual Report, Condominium rights and unit sales revenues were previously required to be recognized under the percentage of completion method. Under the new guidance, revenue and cost of sales for condominium units sold are not recognized until the construction is complete, the sale closes and the title to the property has transferred to the buyer (point in time). Additionally, certain real estate selling costs, such as the costs related to the Company's condominium model units, are either expensed immediately or capitalized as property and equipment and depreciated over their estimated useful life. The cumulative effect adjustments as of the Adoption Date consist of:

- a decrease to Condominium receivables of \$154.2 million,
- an increase to Buildings and equipment, net, of \$3.4 million,
- an increase to Developments of \$150.8 million,
- an increase to Prepaid expenses and other assets, net of \$5.6 million,
- an increase to Accounts payable and accrued expenses of \$95.0 million,
- a decrease to Deferred tax liabilities of \$19.6 million, and
- an increase to Accumulated deficit of \$69.7 million, net of taxes of \$19.6 million.





Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

The following Balance Sheet line items were affected as of September 30, 2018, as a result of HHC's adoption of the New Revenue Standard:

| Condensed Consolidated Balance Sheets (in thousands) | September 30, 2018                  |                                     |                                 |
|--|-------------------------------------|-------------------------------------|---------------------------------|
|  | Recognition Under Previous Guidance | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 |
| Buildings and equipment, net                         | \$2,150,391                         | \$ 1,109                            | \$2,151,500                     |
| Developments   | 1,390,203                           | 435,644                             | 1,825,847                       |
| Deferred expenses, net                               | 87,095                              | 8,716                               | 95,811                          |
| Prepaid expenses and other assets, net               | 757,512                             | (471,318)                           | 286,194                         |
| Deferred tax liabilities                             | 187,806                             | (39,036 )                           | 148,770                         |
| Accounts payable and accrued expenses                | 562,428                             | 143,436                             | 705,864                         |
| Accumulated deficit                                  | (27,354 )                           | (130,248)                           | (157,602 )                      |

For the three and nine months ended September 30, 2018, the following Condensed Consolidated Statements of Operations line items were affected as a result of HHC's adoption of the New Revenue Standard:

| Condensed Consolidated Statements of Operations (in thousands) | Three Months Ended September 30, 2018 |                                     |                                 | Nine Months Ended September 30, 2018 |                                     |                                 |
|--|---------------------------------------|-------------------------------------|---------------------------------|--------------------------------------|-------------------------------------|---------------------------------|
|  | Recognition Under Previous Guidance   | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 | Recognition Under Previous Guidance  | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 |
| Condominium rights and unit sales                              | \$51,823                              | \$(43,778)                          | \$ 8,045                        | \$422,015                            | \$(382,248)                         | \$ 39,767                       |
| Condominium rights and unit cost of sales                      | 43,916                                | (37,748 )                           | 6,168                           | 346,391                              | (304,678 )                          | 41,713                          |
| Depreciation and amortization                                  | 30,752                                | 371                                 | 31,123                          | 86,059                               | 2,339                               | 88,398                          |
| Operating income before other items                            | 52,424                                | (6,402 )                            | 46,022                          | 119,909                              | (79,909 )                           | 40,000                          |
| Provision for income taxes                                     | 9,114                                 | (1,627 )                            | 7,487                           | 25,022                               | (19,394 )                           | 5,628                           |
| Net income   | 28,622                                | (4,775 )                            | 23,847                          | 80,317                               | (60,515 )                           | 19,802                          |
| Net income attributable to noncontrolling interests            | 28,140                                | (4,775 )                            | 23,365                          | 80,266                               | (60,515 )                           | 19,751                          |

For the three and nine months ended September 30, 2018, the following Condensed Consolidated Statements of Comprehensive Income line items were affected as a result of HHC's adoption of the New Revenue Standard:

| Condensed Consolidated Statements of Comprehensive Income (in thousands) | Three Months Ended September 30, 2018 |                                     |                                 | Nine Months Ended September 30, 2018 |                                     |                                 |
|--|---------------------------------------|-------------------------------------|---------------------------------|--------------------------------------|-------------------------------------|---------------------------------|
|  | Recognition Under Previous Guidance   | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 | Recognition Under Previous Guidance  | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 |
| Net income   | \$28,622                              | \$(4,775 )                          | \$ 23,847                       | \$80,317                             | \$(60,515)                          | \$ 19,802                       |
| Comprehensive income   | 30,557                                | (4,775 )                            | 25,782                          | 91,732                               | (60,515 )                           | 31,217                          |
| Comprehensive income attributable to common stockholders                 | 30,075                                | (4,775 )                            | 25,300                          | 91,681                               | (60,515 )                           | 31,166                          |



Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

The following Condensed Consolidated Statements of Cash Flows line items were affected as of September 30, 2018, as a result of HHC's adoption of the New Revenue Standard:

| Condensed Consolidated Statements of Cash Flows (in thousands)                              | Nine Months Ended September 30, 2018 |                                     |                                 |
|---|--------------------------------------|-------------------------------------|---------------------------------|
|   | Recognition Under Previous Guidance  | Impact of Adoption of ASC Topic 606 | Recognition Under ASC Topic 606 |
| Net income  | \$80,317                             | \$(60,515)                          | \$ 19,802                       |
| Depreciation and amortization   | 86,059                               | 2,339                               | 88,398                          |
| Deferred income taxes   | 24,015                               | (19,394 )                           | 4,621                           |
| Condominium rights and unit cost of sales   | 346,391                              | (304,678 )                          | 41,713                          |
| Percentage of completion revenue recognition from sale of condominium rights and unit sales | (382,248)                            | 382,248                             | —                               |

See Note 2 - Accounting Policies and Pronouncements for further discussion of accounting policies impacted by the Company's adoption of the New Revenue Standard and disclosures required by the New Revenue Standard.

#### NOTE 2 ACCOUNTING POLICIES AND PRONOUNCEMENTS

The following is a summary of recently issued and other notable accounting pronouncements which relate to HHC's business.

In August 2018, the FASB issued ASU 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This standard is intended to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal use software (and hosting arrangements that include an internal use software license). The standard requires an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. This standard also requires the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2019. The new standard may be adopted prospectively or retrospectively with early adoption permitted. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement that eliminates, adds and modifies certain disclosure requirements for fair value measurements. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively. All other amendments should be applied retrospectively. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of ASU 2018-13 may have on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, that allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting

from the Tax Cuts and Jobs Act. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2018. The amendments must be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. Early adoption is permitted. The Company adopted ASU 2018-02 as of January 1, 2018, and an election was made to reclassify \$1.1 million from Accumulated other comprehensive income (loss) to Accumulated deficit.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, to enable entities to better portray the economic results of their risk management activities in their financial statements. The ASU expands an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest rate risk and eases certain documentation and assessment requirements and modifies the accounting

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

for components excluded from the assessment of hedge effectiveness. The ASU also eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same Consolidated Statements of Operations line as the hedged item. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2018. The new standard must be adopted using a modified retrospective approach with early adoption permitted. The Company adopted ASU 2017-12 as of January 1, 2018 and, as a result, \$0.7 million of ineffectiveness recognized prior to 2018 for its swaps was reclassified to Accumulated deficit from Accumulated other comprehensive income (loss).

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting, to provide clarity and reduce the diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation. Stakeholders observed that the definition of the term “modification” is broad and that its interpretation results in diversity in practice. The ASU states that when an entity concludes that a change is not substantive, then modification accounting does not apply. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. The new standard must be adopted prospectively to an award modified on or after the adoption date. Early adoption is permitted. The Company adopted ASU 2017-09 as of January 1, 2018 and, as a result, will apply this guidance to any modifications made to either the stock option or restricted stock award plans.

In February 2017, the FASB issued ASU 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). The standard defines an “in-substance nonfinancial asset” as a financial asset promised to a counterparty in a contract if substantially all the fair value of the assets is concentrated in nonfinancial assets. The ASU also provides guidance for accounting for partial sales of nonfinancial assets such as real estate. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. The new standard must be adopted retrospectively with early adoption permitted. The Company adopted ASU 2017-05 as of January 1, 2018, and it did not have an impact on the Company’s financial position or results of operations as the Company did not have partial sales in the period presented.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350). This standard is intended to simplify the subsequent measurement of goodwill by eliminating step two from the goodwill impairment test. In computing the implied fair value of goodwill under step two, an entity determined the fair value at the impairment testing date of its assets and liabilities, including unrecognized assets and liabilities, following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, an entity will perform only step one of its quantitative goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and then recognizing the impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. An entity will still have the option to perform a qualitative assessment for a reporting unit to determine if the quantitative step one impairment test is necessary. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2019. The new standard must be adopted prospectively with early adoption permitted. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows - Restricted Cash, which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statements of cash flows. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. As required, the Company adopted ASU 2016-18 retrospectively as of January 1, 2018, resulting in presentation of an additional \$39.7 million in Cash used in operating activities and \$2.5 million in Cash provided for investing activities for the nine months ended September 30, 2017, related to an additional \$37.2 million of changes in Restricted cash in the Condensed Consolidated Statements of Cash Flows in the respective period. The nature of these restrictions relates primarily to escrowed condominium deposits and other amounts related to taxes, insurance, legally restricted security deposits and leasing costs held in escrow.

## Edgar Filing: Howard Hughes Corp - Form 10-Q

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The standard addresses how certain cash receipts and payments are presented and classified in the statements of cash flows, including debt extinguishment costs, distributions from equity method investees and contingent consideration payments made after a business combination. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard retrospectively, as of January 1, 2018. ASU 2016-15 had no impact on the Company's presentation of operating, investing and financing activities related to certain cash receipts and payments on its consolidated statements of cash flows.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses. The standard modifies the impairment model for most financial assets, including trade accounts receivables and loans, and will require the use of an “expected loss” model for

12

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The effective date of the standard is for fiscal years, and for interim periods within those years, beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact that the adoption of ASU 2016-13 may have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02 is codified in Accounting Standards Codification (“ASC”) 842. The standard amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The standard allows for either a modified retrospective or cumulative-effect adjustment transition approach for all leases existing at, or entered into after, the date of initial application. The Company is currently evaluating the impact of adopting ASU 2016-02 on its consolidated financial statements. The Company anticipates a material increase to assets and liabilities as it will be required to capitalize its ground leases, office leases and certain office equipment leases where the Company is the lessee. The Company has reviewed the adoption elections associated with the standard and elected to i) not separate lease and nonlease components, ii) not recognize right of use assets and lease liabilities for leases with terms of less than 12 months, and iii) present right of use assets and lease liabilities as separate line items on the consolidated balance sheets. The Company will apply practical expedients that allow certain aspects of existing leases to be scoped out of reassessment under the new standard and will recognize a cumulative-effect adjustment in its consolidated balance sheets as of the adoption date.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which will require entities to recognize changes in equity investments with readily determinable fair values in net income. For equity investments without readily determinable fair values, the ASU permits the application of a measurement alternative using the cost of the investment, less any impairments, plus or minus changes resulting from observable price changes for an identical or similar investment of the same issuer. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017, and it must be adopted via a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The Company adopted the guidance as of January 1, 2018. As none of the Company's equity investments have readily determinable fair values, the adoption of this ASU does not have an impact on its consolidated financial statements. The New Revenue Standard and related policy updates

As discussed in Note 1 - Basis of Presentation and Organization, as of the Adoption Date of the New Revenue Standard, revenues from contracts with customers (excluding lease-related revenues) are recognized when control of the promised goods or services is transferred to HHC's customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services.

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

The following table presents HHC's revenues disaggregated by revenue source:

| (In thousands)                                   | Three Months<br>Ended<br>September 30,<br>2018 | Nine Months<br>Ended<br>September 30,<br>2018 |
|--|--|---|
| Revenues   |  |   |
| From contracts with customers                    |  |   |
| Recognized at a point in time:                   |  |   |
| Condominium rights and unit sales                | \$ 8,045                                       | \$ 39,767                                     |
| Master Planned Communities land sales            | 127,730  | 226,727                                       |
| Hospitality revenues                             | 19,108   | 64,738  |
| Builder price participation                      | 8,685  | 19,394  |
| Total revenue from contracts with customers      | 163,568  | 350,626                                       |
| Recognized at a point in time and/or over time:  |  |   |
| Other land revenues                              | 7,145  | 15,988  |
| Other rental and property revenues               | 20,397   | 42,266  |
| Total other income                               | 27,542   | 58,254  |
| Rental and other income (lease-related revenues) |  |   |
| Minimum rents                                    | 53,244   | 153,156                                       |
| Tenant recoveries                                | 12,806   | 37,808  |
| Total rental income                              | 66,050   | 190,964                                       |
| Total revenues                                   | \$ 257,160                                     | \$ 599,844                                    |
| Revenues by segment                              |  |   |
| Master Planned Communities revenues              | \$ 143,135                                     | \$ 261,665                                    |
| Operating Assets revenues                        | 101,000  | 285,481                                       |
| Strategic Developments revenues                  | 13,025   | 52,698  |
| Total revenues                                   | \$ 257,160                                     | \$ 599,844                                    |

Below is a discussion of the performance obligations, significant judgments and other required disclosures related to revenues from contracts with customers.



Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

Condominium Rights and Unit Sales

Revenue from the sale of an individual unit in a condominium project is recognized at a point in time (i.e., the closing) when HHC satisfies the single performance obligation to construct a condominium project and transfer control of a completed unit to a buyer. The transaction price, which is the amount of consideration the Company receives upon delivery of the completed condominium unit to the buyer, is allocated to this single obligation and is received at closing less any amounts previously paid on deposit.

The Company receives cash payments in the form of escrowed condominium deposits from customers who have contracted to purchase a condominium unit based on billing schedules established in HHC's condominium purchase agreement contracts. The Company holds these contract assets in Restricted cash, unless released from escrow in accordance with the escrow agreement and on approval of HHC's lender to fund construction costs of a project. A corresponding condominium contract deposit liability is established at the date of receipt, representing a portion of HHC's unsatisfied performance obligation at each reporting date. These deposits, along with the balance of the contract value, are recognized at closing upon satisfaction of HHC's performance obligation and transfer of title to the buyer. Condominium receivables, a conditional right to consideration for satisfaction of HHC's completed obligations, were established under legacy GAAP for condominium units for which revenue was previously recognized under the percentage of completion method. As of the Adoption Date, condominium receivables are recorded only in limited circumstances.

Real estate project costs directly associated with a condominium project, which are HHC's costs to fulfill contracts with condominium buyers, are capitalized while all other costs are expensed as incurred. Total estimated project costs include direct costs such as the carrying value of the land, site planning, architectural, construction and financing costs, as well as indirect cost allocations. The allocations include costs which clearly relate to the specific project, including certain infrastructure and amenity costs which benefit the project as well as others, and are based upon the relative sales value of the units. Costs incurred to sell condominium units are evaluated for capitalization in accordance with ASC 340-40, and incremental costs of obtaining a contract and costs to fulfill a contract are capitalized only if the costs relate directly to a specifically identified contract, enhance resources to satisfy performance obligations in the future and are expected to be recovered.

Master Planned Communities Land Sales

Revenues from land sales are recognized at a point in time when the land sale closing process is complete. The transaction price generally has both fixed and variable components, with the fixed price stipulated in the contract and representative of a single performance obligation. See Builder Price Participation ("BPP") below for a discussion of the variable component. The fixed transaction price, which is the amount of consideration received in full upon transfer of the land title to the buyer, is allocated to this single obligation and is received at closing of the land sale less any amounts previously paid on deposit.

The Company receives cash payments in the form of land purchase deposits from homebuilders or other commercial buyers who have contracted to purchase land, and HHC holds any escrowed deposits in Restricted cash or Cash and cash equivalents based on the terms of the contract.

In situations where the Company has completed the closing of a developed land parcel or superpad and consideration is paid in full, but a portion of HHC's performance obligation relating to the enhancement of the land is still unsatisfied, revenue related to HHC's obligation is recognized over time. The Company recognizes only the portion of

the improved land sale where the improvements are fully satisfied based on a cost input method. The aggregate amount of the transaction price allocated to the unsatisfied obligation is recorded as deferred land sales and is presented in Accounts payable and accrued expenses. The Company measures the completion of HHC's unsatisfied obligation based on the costs remaining relative to the total cost at the date of closing.

When developed residential or commercial land is sold, the cost of sales includes actual costs incurred and estimates of future development costs benefiting the property sold. In accordance with ASC 970-360-30-1, when developed land is sold, costs are allocated to each sold superpad or lot based upon the relative sales value. For purposes of allocating development costs, estimates of future revenues and development costs are re-evaluated throughout the year, with adjustments being allocated prospectively to the remaining parcels available for sale. For certain parcels of land, including acquired parcels that the Company does not intend to develop or for which development was complete at the date of acquisition, the specific identification method is used to determine the cost of sales.

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

Hospitality revenues

Hospitality revenues are recognized at a point in time in accordance with the pattern of each related service. Lodging is recognized on daily increments, while retail services such as food and beverage are recognized at the point of sale. The transaction price is fixed, clearly stipulated and representative of a single performance obligation in all cases. The duration of all contracts with customers of HHC's hospitality lodging and related services is generally short.

Builder Price Participation

BPP is the variable component of the transaction price for Master Planned Communities Land Sales. BPP is earned when a developer that acquired land from HHC develops and sells a home to an end user at a price higher than a predetermined breakpoint. The excess over the breakpoint is shared between HHC and the developer at the time of closing on the sale of the home based on a percentage previously agreed upon. The Company concluded that as of the Adoption Date and as of September 30, 2018, BPP was constrained, as discussed below, and accordingly, the Company did not recognize an estimate of variable consideration. The Company's conclusion is based on the following factors:

BPP is highly susceptible to factors outside HHC's influence such as unemployment and interest rates; the time between the sale of land to a developer and closing on a completed home can take up to three years; and historical experience is of little value when it comes to predicting future home prices.

The Company evaluates contracts with homebuilders with respect to BPP at each reporting period to determine whether a change in facts and circumstances has eliminated the constraint and will record an estimate of BPP revenue, if applicable.

Other land revenues - over time and point in time

Other land revenues recognized over time include ground maintenance revenue, homeowner association management fee revenue and revenue from providing exclusive cable and internet services at the Company's Master Planned Communities ("MPC") for the benefit of the tenants and owners of the communities. These revenues are recognized over time, as time elapses. The amount of consideration and the duration are fixed, as stipulated in the related agreements, and represent a single performance obligation.

Other land revenues also include transfer fees on the secondary sales of homes in MPC, forfeitures of earnest money deposits by buyers of HHC's condominium units, and other miscellaneous items. These items are recognized at a point in time when the real estate closing process is complete or HHC has a legal right to the respective fee or deposit.

Other rental and property revenue - over time and point in time

Other rental and property revenues related to contracts with customers is generally comprised of baseball related ticket sales, retail operations, advertising and sponsorships. Season ticket sales are recognized over time as games take place. Baseball-related sponsorships generally cover a season, and the related revenue is recognized over time, as time elapses. Single tickets and retail operations are recognized at a point in time, at the time of sale. In all cases, the transaction prices are fixed, stipulated in the ticket, contract, or product, and representative in each case of a single performance obligation. From time to time, the Company enters into advertising and sponsorship agreements that allow third parties to display their advertising and products at HHC's venues for a certain amount of time.

Consideration for these services is fixed as specified in each respective agreement, is related to a single performance obligation in each case and HHC recognizes the related revenue over time, as time elapses.

#### Contract Assets and Liabilities

Contract assets are the Company's right to consideration in exchange for goods or services that have been transferred to a customer, excluding any amounts presented as a receivable. Contract liabilities are the Company's obligation to transfer goods or services to a customer for which the Company has received consideration.

The beginning and ending balances of contract assets and liabilities and significant activity during the period is as follows:

16

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

| (In thousands)                           | Contract Assets | Contract Liabilities |
|--|-----------------|----------------------|
| Balance as of January 1, 2018            | \$—             | \$179,179            |
| Consideration earned during the period   | (35,834 )       | (58,946 )            |
| Consideration received during the period | —               | 141,166              |
| Balance as of September 30, 2018         | \$(35,834)      | \$261,399            |

Remaining Unsatisfied Performance Obligations

The Company's remaining unsatisfied performance obligations as of September 30, 2018 represent a measure of the total dollar value of work to be performed on contracts executed and in progress. These performance obligations are associated with contracts that generally are noncancellable by the customer after 30 days; however, purchasers of HHC's condominium units have the right to cancel the contract should the Company elect not to construct the condominium unit within a certain period of time or materially change the design of the condominium unit. The aggregate amount of the transaction price allocated to the Company's remaining unsatisfied performance obligations as of September 30, 2018 is \$1.2 billion. The Company expects to recognize this amount as revenue over the following periods:

| (In thousands)                                      | Less than 1 year | 1-2 years | 3 years and thereafter |
|---|------------------|-----------|------------------------|
| Total remaining unsatisfied performance obligations | \$821,664        | \$32,596  | \$371,040              |

The Company's remaining performance obligations are adjusted to reflect any known project cancellations, revisions to project scope and cost, and deferrals, as appropriate. These amounts exclude estimated amounts of variable consideration which are constrained, such as BPP, as discussed above.

## NOTE 3 REAL ESTATE AND OTHER AFFILIATES

The Company's investments in real estate and other affiliates that are reported in accordance with the equity and cost methods are as follows:

| (\$ in thousands)                      | Economic/Legal Ownership |                   | Carrying Value     |                   | Share of Earnings/Dividends           |                                       |                                      |                                      |
|--|--------------------------|-------------------|--------------------|-------------------|---------------------------------------|---------------------------------------|--------------------------------------|--------------------------------------|
|  | September 30, 2018       | December 31, 2017 | September 30, 2018 | December 31, 2017 | Three Months Ended September 30, 2018 | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2018 | Nine Months Ended September 30, 2017 |
| Equity Method Investments              |                          |                   |                    |                   |                                       |                                       |                                      |                                      |
| Master Planned Communities:            |                          |                   |                    |                   |                                       |                                       |                                      |                                      |
| The Summit (a)                         | —                        | —                 | \$76,899           | \$45,886          | \$9,454                               | \$6,480                               | \$34,682                             | \$21,552                             |
| Operating Assets:                      |                          |                   |                    |                   |                                       |                                       |                                      |                                      |
| Las Vegas 51s, LLC (b)                 | 100 %                    | 100 %             | —                  | —                 | —                                     | —                                     | —                                    | (152 )                               |
| Constellation (b)                      | 100 %                    | 100 %             | —                  | —                 | —                                     | 107                                   | —                                    | (215 )                               |
| The Metropolitan Downtown Columbia (c) | 50 %                     | 50 %              | —                  | —                 | 87                                    | 82                                    | 371                                  | 356                                  |
| Stewart Title of Montgomery County, TX | 50 %                     | 50 %              | 3,740              | 3,673             | 165                                   | 113                                   | 393                                  | 322                                  |
| Woodlands Sarofim #1                   | 20 %                     | 20 %              | 2,732              | 2,696             | 30                                    | 15                                    | 66                                   | 45                                   |
| m.flats/TEN.M (d)                      | 50 %                     | 50 %              | 4,168              | 6,521             | (357 )                                | —                                     | (2,661 )                             | —                                    |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|  |    |   |    |   |           |          |         |         |          |          |
|--|----|---|----|---|-----------|----------|---------|---------|----------|----------|
| 33 Peck Slip (e)                               | 35 | % | 35 | % | 8,734     | —        | (452 )  | —       | (452 )   | —        |
| Strategic Developments:                        |    |   |    |   |           |          |         |         |          |          |
| Circle T Ranch and Power Center                | 50 | % | 50 | % | 7,574     | 4,455    | (318 )  | 650     | 3,118    | 650      |
| HMK Development                                | 50 | % | 50 | % | 10        | 10       | —       | —       | —        | —        |
| KR Holdings                                    | 50 | % | 50 | % | 7         | 749      | 3       | 20      | 679      | 36       |
| 33 Peck Slip (e)                               | 35 | % | 35 | % | —         | 8,651    | —       | —       | (240 )   | (156 )   |
|  |    |   |    |   | 103,864   | 72,641   | 8,612   | 7,467   | 35,956   | 22,438   |
| Cost method investments                        |    |   |    |   | 3,856     | 3,952    | —       | —       | 3,341    | 3,383    |
| Investment in real estate and other affiliates |    |   |    |   | \$107,720 | \$76,593 | \$8,612 | \$7,467 | \$39,297 | \$25,821 |

17

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

- (a) Please refer to the schedules below for relevant financial statement information.
- (b) HHC acquired this joint venture partner's interest in 2017 and has consolidated the assets and liabilities of the entity in its financial results.  
The Metropolitan Downtown Columbia was in a deficit position of \$3.2 million and \$2.6 million at September 30, 2018 and December 31, 2017, respectively, due to distributions from operating cash flows in excess of basis. This deficit balance is presented in Accounts payable and accrued expenses at September 30, 2018 and December 31, 2017.
- (c) Property was transferred from Strategic Developments to Operating Assets during the three months ended March 31, 2018.
- (d) Property was transferred from Strategic Developments to Operating Assets during the three months ended September 30, 2018.
- (e) Property was transferred from Strategic Developments to Operating Assets during the three months ended September 30, 2018.

As of September 30, 2018, HHC is not the primary beneficiary of any of the joint ventures listed above because it does not have the power to direct activities that most significantly impact the economic performance of the joint ventures; therefore, the Company reports its interests in accordance with the equity method. As of September 30, 2018, approximately \$199.8 million of indebtedness was secured by the properties owned by HHC's real estate and other affiliates of which HHC's share was approximately \$94.9 million based upon economic ownership. All of this indebtedness is without recourse to HHC.

As of September 30, 2018, HHC is the primary beneficiary of four variable interest entities ("VIEs") which are consolidated in its financial statements. HHC began consolidating 110 North Wacker and its underlying entities in the second quarter of 2018 as further discussed below. As of December 31, 2017, HHC was the primary beneficiary of three VIEs which are consolidated in its financial statements. The creditors of the other three consolidated VIEs do not have recourse to the Company. As of September 30, 2018, the carrying values of the assets and liabilities associated with the operations of the consolidated VIEs were \$154.2 million and \$90.5 million, respectively. As of December 31, 2017, the carrying values of the assets and liabilities associated with the operations of the consolidated VIEs were \$24.8 million and \$2.7 million, respectively. The assets of the VIEs are restricted for use only by the particular VIEs and are not available for the Company's general operations.

During the second quarter of 2018, HHC executed a joint venture agreement with USAA related to 110 North Wacker. At execution, HHC contributed land with a book basis of \$33.6 million and an agreed upon fair value of \$85.0 million, and USAA contributed \$64.0 million in cash. The Company has subsequent capital obligations of \$42.7 million, and USAA is required to fund up to \$105.6 million in addition to its initial contribution. The Company and its joint venture partners have also entered into a construction loan agreement further described in Note 7 - Mortgages, Notes and Loans Payable. The Company has concluded that it is the primary beneficiary of the VIE because it has the power to direct activities that most significantly impact the joint venture's economic performance during the development phase of the project.

Given the nature of the venture's capital structure and the provisions for the liquidation of assets, the Company's share of the venture's income-producing activities is recognized based on the Hypothetical Liquidation Book Value method, which represents an economic interest of approximately 33% for HHC. Under this method, HHC recognizes income or loss in Equity in earnings from real estate and other affiliates based on the change in its underlying share of the venture's net assets on a hypothetical liquidation basis as of the reporting date. After USAA receives a 9.0% preferred return on its capital contribution, HHC is entitled to cash distributions from the venture until it receives a 9.0% return. Subsequently, USAA is entitled to cash distributions equal to 11.11% of the amount distributed to HHC that resulted

in a 9.0% return. Thereafter, HHC and USAA are entitled to distributions pari passu to their profit ownership interests of 90% and 10%, respectively.

During the first quarter of 2015, HHC formed DLV/HHPI Summerlin, LLC ("The Summit"), a joint venture with Discovery Land Company ("Discovery"), contributed land with a book basis of \$13.4 million and transferred Special Improvement District ("SID") bonds related to such land with a carrying value of \$1.3 million to the joint venture at the agreed upon capital contribution value of \$125.4 million, or \$226,000 per acre. Discovery is required to fund up to a maximum of \$30.0 million of cash as its capital contribution, and the Company has no further capital obligations. The gains on the contributed land are recognized in Equity in earnings from real estate and other affiliates as the joint venture sells lots.

After the Company receives its capital contribution of \$125.4 million and a 5.0% preferred return on such capital contribution, Discovery is entitled to cash distributions by the joint venture until it has received two times its equity contribution. Any further cash distributions are shared equally. Given the nature of the venture's capital structure and the provisions for the liquidation of assets, the Company's share of the venture's income-producing activities is recognized based on the Hypothetical Liquidation Book Value method. Under this method, HHC recognizes income or loss based on the change in its underlying share of the venture's net assets on a hypothetical liquidation basis as of the reporting date.

Relevant financial statement information for The Summit is summarized as follows:

18

---



Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

|                   | September<br>30,<br>2018 | December<br>31,<br>2017 |
|-------------------|--------------------------|-------------------------|
| (In millions)     |                          |                         |
| Total Assets      | \$ 216.9                 | \$ 166.9                |
| Total Liabilities | 137.8                    | 118.9                   |
| Total Equity      | 79.1                     | 48.0                    |

|               | Three<br>Months<br>Ended<br>September<br>30,<br>2018 | Three<br>Months<br>Ended<br>September<br>30,<br>2017 | Nine<br>Months<br>Ended<br>September<br>30,<br>2018 | Nine<br>Months<br>Ended<br>September<br>30,<br>2017 |
|---------------|--|--|---|---|
| (In millions) |  |  |   |   |
| Revenues (a)  | \$27.7   | \$14.2   | \$88.6  | \$46.3  |
| Net income    | 9.5  | 6.5  | 34.7  | 21.6  |
| Gross Margin  | 10.8   | 7.7  | 38.3  | 26.4  |

Revenues related to land sales at the joint venture are recognized on a percentage of completion basis as The Summit following the private company timeline for implementation of the New Revenue Standard of January 1, 2019. The Company has evaluated this impact and concluded that at this time it is not material to HHC's Condensed Consolidated Financial Statements.

## NOTE 4 RECENT TRANSACTIONS

On September 19, 2018, the Company closed on the sale of 38 acres of residential land in Summerlin for a total sales price of \$22.1 million.

On September 18, 2018, the Company closed on a \$700.0 million loan, of which \$615.0 million is a term loan and \$85.0 million is a revolver. The loans bear interest at one-month LIBOR plus 1.65% and mature September 18, 2023. The Company has a one-time right to request an increase of \$50.0 million in the aggregate amount of the revolver loan commitment. Concurrent with the funding of the loan on September 21, 2018, the Company entered into a swap agreement to fix 100% of the outstanding principal of the term loan to an overall rate equal to 4.61%.

On September 7, 2018, the Company acquired Lakefront North, two vacant, Class-A office buildings immediately adjacent to the Hughes Landing development. The Company purchased the four- and six-story buildings, totaling 257,025 rentable square feet, as well as 12.9 acres of land for \$53.0 million.

On July 10, 2018, the Company closed on the sale of 123 acres of residential land in Summerlin for a total sales price of \$69.0 million. The transaction included an interest-free seller financing note in the amount of \$35.8 million which will be payable in full on December 7, 2018.

On June 8, 2018, the Company acquired the property at 250 Water Street, an approximately one-acre parking lot in the Seaport District. The Company purchased the site for \$180.0 million plus closing costs, consisting of an initial payment of \$53.1 million and a \$129.7 million note payable. The loan has an initial interest-free term of six months with an initial maturity date of December 8, 2018, and three, six-month extension options at a rate of 6.00%. The second and third extension options each require a \$30.0 million pay down.

On April 30, 2018, the Company and its joint venture partners closed on a \$494.5 million construction loan for 110 North Wacker, of which the Company guaranteed approximately \$89.0 million. The loan initially bears interest at LIBOR plus 3.00% and steps up or down based on various leasing thresholds. The loan has an initial maturity date of April 30, 2022, and two, one-year extension options. On September 25, 2018, the Company and its joint venture partners closed on an amendment to increase the \$494.5 million construction loan to \$512.6 million, as further discussed in Note 7 - Mortgages, Notes and Loans Payable. As part of the modification, the Company increased its guarantee to approximately \$92.3 million.

On February 23, 2018, the Company repurchased 475,920 shares of HHC common stock, par value \$0.01 per share, in a private transaction with an unaffiliated entity at a purchase price of \$120.33 per share, or approximately \$57.3 million in the aggregate. The repurchase transaction was consummated on February 21, 2018 and was funded with cash on hand. The shares were added to the Company's treasury stock upon repurchase.

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

## NOTE 5 IMPAIRMENT

The Company reviews its long-lived assets for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. With respect to the Investment in real estate and other affiliates, a series of operating losses of an underlying asset or other factors may indicate that a decrease in value has occurred which is other than temporary. The investment in each real estate and other affiliate is evaluated periodically and as deemed necessary for recoverability and valuation declines that are other than temporary. No impairment charges were recorded during the three and nine months ended September 30, 2018 or during the year ended December 31, 2017. The Company periodically evaluates its strategic alternatives with respect to each of its properties and may revise its strategy from time to time, including its intent to hold an asset on a long-term basis or the timing of potential asset dispositions. These changes in strategy could result in impairment charges in future periods.

## NOTE 6 OTHER ASSETS AND LIABILITIES

## Prepaid Expenses and Other Assets

The following table summarizes the significant components of Prepaid expenses and other assets:

| (In thousands)  | September 30,<br>2018 | December 31,<br>2017 |
|---|-----------------------|----------------------|
| Condominium inventory   | \$ 78,696             | \$ —                 |
| Straight-line rent  | 47,649                | 39,136               |
| Intangibles   | 34,125                | 34,802               |
| Special Improvement District receivable   | 23,747                | 26,430               |
| Below-market ground leases  | 18,381                | 18,647               |
| Prepaid expenses  | 16,142                | 11,731               |
| Equipment, net of accumulated depreciation of \$7.9 million and \$6.9 million, respectively | 15,961                | 16,955               |
| Security and escrow deposits  | 15,632                | 16,949               |
| Other   | 9,026                 | 4,798                |
| Tenant incentives and other receivables   | 8,880                 | 8,482                |
| In-place leases   | 7,436                 | 10,821               |
| TIF receivable  | 6,048                 | 14,444               |
| Federal income tax receivable   | 2,000                 | 2,198                |
| Interest rate swap derivative assets  | 1,288                 | 4,470                |
|   | 1,183                 | 1,648                |

|  |            |            |
|--|------------|------------|
| Above-market tenant leases             |            |            |
| Condominium receivables                | —          | 158,516    |
| Prepaid expenses and other assets, net | \$ 286,194 | \$ 370,027 |

The \$83.8 million net decrease primarily relates to a \$158.5 million decrease in Condominium receivables, of which \$99.6 million relates to the adoption of the New Revenue Standard, and was partially offset by a \$78.7 million increase in Condominium inventory.

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

## Accounts Payable and Accrued Expenses

The following table summarizes the significant components of Accounts payable and accrued expenses:

|  | September<br>30,<br>2018 | December<br>31,<br>2017 |
|--|--------------------------|-------------------------|
| (In thousands)                                 |                          |                         |
| Construction payables                          | \$ 270,450               | \$ 217,838              |
| Condominium deposit liabilities                | 228,658                  | 55,975                  |
| Deferred income                                | 48,156                   | 53,337                  |
| Accounts payable and accrued expenses          | 32,578                   | 35,887                  |
| Accrued payroll and other employee liabilities | 29,661                   | 41,236                  |
| Accrued real estate taxes                      | 26,541                   | 22,289                  |
| Other  | 22,728                   | 34,699                  |
| Tenant and other deposits                      | 20,975                   | 18,937                  |
| Straight-line ground rent liability            | 16,282                   | 14,944                  |
| Accrued interest                               | 8,086                    | 20,322                  |
| Interest rate swap derivative liabilities      | 1,749                    | 5,961                   |
| Above-market ground leases                     | —                        | 293                     |
| Accounts payable and accrued expenses          | \$ 705,864               | \$ 521,718              |

The \$184.1 million net increase in total Accounts payable and accrued expenses primarily relates to a \$172.7 million increase in Condominium deposit liabilities, \$99.6 million of which relates to the impact of the adoption of the New Revenue Standard, with the remainder representing new sales, primarily at Ae‘o and ‘A‘ali‘i, and a \$52.6 million increase in Construction payables predominantly related to the towers under construction at Ward Village as the projects move toward completion.

Table of ContentsTHE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

## NOTE 7 MORTGAGES, NOTES AND LOANS PAYABLE

Mortgages, notes and loans payable are summarized as follows:

|   | September<br>30,<br>2018 | December<br>31,<br>2017 |
|---|--------------------------|-------------------------|
| (In thousands)                                |                          |                         |
| Fixed-rate debt:                              |                          |                         |
| Unsecured 5.375% Senior Notes                 | \$ 1,000,000             | \$ 1,000,000            |
| Secured mortgages, notes and loans payable    | 635,637                  | 499,299                 |
| Special Improvement District bonds            | 16,058                   | 27,576                  |
| Variable-rate debt:                           |                          |                         |
| Mortgages, notes and loans payable (a)        | 1,644,791                | 1,350,914               |
| Unamortized bond issuance costs               | (6,301 )                 | (6,898 )                |
| Deferred financing costs                      | (28,975 )                | (12,946 )               |
| Total mortgages, notes and loans payable, net | \$ 3,261,210             | \$ 2,857,945            |

As more fully described in Note 9 - Derivative Instruments and Hedging Activities, as of September 30, 2018 and (a) December 31, 2017, \$654.0 million and \$428.3 million, respectively, of variable rate debt has been swapped to a fixed-rate or is subject to fixed interest rate collar contracts for the term of the related debt.

Certain of the Company's loans contain provisions which grant the lender a security interest in the operating cash flows of the property that represents the collateral for the loan. Certain mortgage notes may be prepaid subject to a prepayment penalty equal to a yield maintenance premium, defeasance or percentage of the loan balance. As of September 30, 2018, land, buildings and equipment and developments with a net book value of \$4.3 billion have been pledged as collateral for HHC's Mortgages, notes and loans payable, net. As of September 30, 2018, the Company was in compliance with all of its financial covenants included in the agreements governing its indebtedness.

The Summerlin MPC uses SID bonds to finance certain common infrastructure improvements. These bonds are issued by the municipalities and are secured by the assessments on the land. The majority of proceeds from each bond issued is held in a construction escrow and disbursed to the Company as infrastructure projects are completed, inspected by the municipalities and approved for reimbursement. Accordingly, the SID bonds have been classified as debt, and the Summerlin MPC pays the debt service on the bonds semi annually. As Summerlin sells land, the buyers assume a proportionate share of the bond obligation at closing, and the residential sales contracts provide for the reimbursement of the principal amounts that the Company previously paid with respect to such proportionate share of the bond. In the nine months ended September 30, 2018, no new SID bonds were issued and \$10.5 million in obligations were assumed by buyers.

## Recent Financing Activity

On October 11, 2018, the Company closed on a \$74.0 million construction loan for Two Lakes Edge, bearing interest at one-month LIBOR plus 2.15% with an initial maturity date of October 11, 2022 and a one-year extension option.

## Financing Activity During the Nine Months Ended September 30, 2018

On September 11, 2018, the Company closed on an \$89.8 million construction loan for 6100 Merriweather and an \$85.7 million construction loan for Columbia Multi-family. Each loan bears interest at one-month LIBOR plus 2.75%,

has an initial maturity date of September 11, 2022, has two, one-year extension options and is cross-collateralized.

On September 18, 2018, certain wholly-owned subsidiaries (the “Borrowers”) of the Company entered into a \$700.0 million loan agreement (the “Loan Agreement”), which provides for a \$615.0 million term loan (the “Term Loan”) and an \$85.0 million revolver loan (the “Revolver Loan” and together with the Term Loan, the “Loans”), with Wells Fargo Bank, National Association, as administrative agent and a lender, as well as other lenders. The Loans bear interest at one-month LIBOR plus 1.65% and mature September 18, 2023. The Borrowers have a one-time right to request an increase of \$50.0 million in the aggregate amount of the

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

Revolver Loan commitment. Concurrent with the funding of the Term Loan on September 21, 2018, the Company entered into a swap agreement to fix 100% of the outstanding principal of the Term Loan to an overall rate equal to 4.61%.

The Loans are secured by a first priority security interest in certain of the Company's properties which are directly owned by the Borrowers (the "Mortgaged Properties"). In connection with the Loans, the Company provided the administrative agent, on behalf of the lenders, a non-recourse carve-out guarantee and a hazardous materials indemnity agreement.

The Borrowers drew \$615.0 million under the Term Loan at closing. All the net proceeds after costs and fees related to the Loans were used to repay all outstanding indebtedness encumbering the Mortgaged Properties, including debt held by lenders not party to the Loan Agreement. The total debt repaid was approximately \$608.7 million and was associated with the following properties: 10-60 Columbia Corporate Centers, 70 Columbia Corporate Center, One Mall North, One Merriweather, Embassy Suites at Hughes Landing, The Westin at The Woodlands, 1725-35 Hughes Landing Boulevard and Ward Village. As of closing, the Company did not make any draw under the Revolver Loan.

The Company evaluated the terms of the Loans to determine if the new debt instruments should be accounted for as modifications or extinguishments on a lender-by-lender basis, per Mortgaged Property subject to refinancing. The majority of the transaction was accounted for as a debt modification. As a result, the Company capitalized \$8.6 million in related fees and costs and recognized a \$0.7 million loss on debt extinguishment and modification, which was primarily related to third-party fees incurred in procuring the Loans. The \$0.7 million loss is included in Interest expense in the Condensed Consolidated Statements of Operations.

On July 27, 2018, the Company closed on a \$34.2 million construction loan for Bridgeland Apartments, bearing interest at one-month LIBOR plus 2.25% with an initial maturity date of July 27, 2022 and a one-year extension option.

On July 20, 2018 the Company closed on a \$51.2 million construction note for Summerlin Ballpark, bearing interest at 4.92% per annum and maturing on December 15, 2039. The note is secured by the ballpark and by the proceeds of the Naming Rights and Marketing agreement between the Company and the Las Vegas Convention and Visitors Authority, which provides an annual payment of \$4.0 million to the Company in each of the next 20 years.

On June 8, 2018, the Company closed on a \$129.7 million note payable for 250 Water Street, an approximately one-acre parking lot in the Seaport District. The loan has an initial interest-free term of six months with an initial maturity date of December 8, 2018, and three, six-month extension options at a rate of 6.00%. The second and third extension options each require a \$30.0 million pay down.

On April 30, 2018, the Company and its joint venture partners closed on a \$494.5 million construction loan for 110 North Wacker, of which the Company guaranteed approximately \$89.0 million. The loan initially bears interest at LIBOR plus 3.00% and steps up or down based on various leasing thresholds. The loan has an initial maturity date of April 30, 2022, and two, one-year extension options. On September 25, 2018, the Company and its joint venture partners closed on an amendment to increase the \$494.5 million construction loan to \$512.6 million, modify the lenders and commitments included in the loan syndication and increase the Company's guarantee to approximately \$92.3 million.

On April 13, 2018, the Company repaid the \$11.8 million loan for Lakeland Village Center at Bridgeland.



On March 26, 2018, the Company closed on a \$44.1 million construction loan for Tanager Apartments (formerly known as Downtown Summerlin Apartments), bearing interest at one-month LIBOR plus 2.25% with an initial maturity date of October 1, 2021 and a three-year extension option.

On January 25, 2018, the Company closed on a \$15.5 million construction loan for Lake Woodlands Crossing Retail, a project located in The Woodlands, Texas. The loan bears interest at LIBOR plus 1.80%, matures on January 25, 2023, and has an initial maximum recourse of 50% of the outstanding balance prior to completion of construction, at which point the repayment guarantee will reduce to 15% provided the project is 90% leased.

On January 19, 2018, the Company paid off the \$18.9 million mortgage loan for 110 North Wacker and settled the related swap liability of \$0.3 million.

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

On January 5, 2018, the Company modified and extended the \$65.5 million Three Hughes Landing facility. The loan bears interest at one-month LIBOR plus 2.60% with an initial maturity of December 5, 2018, and two, one-year extension options.

## NOTE 8 FAIR VALUE

ASC 820, Fair Value Measurement, emphasizes that fair value is a market-based measurement that should be determined using assumptions market participants would use in pricing an asset or liability. The standard establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring assets or liabilities at fair value. Market price observability is impacted by a number of factors, including the type of investment and the characteristics specific to the asset or liability. Assets or liabilities with readily available active quoted prices, or for which fair value can be measured from actively quoted prices, generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

The following table presents the fair value measurement hierarchy levels required under ASC 820 for each of the Company's assets and liabilities that are measured at fair value on a recurring basis:

| (In thousands)                            | September 30, 2018 |  |   |  | December 31, 2017 |  |   |  |
|---|--------------------|--|---|--|-------------------|--|---|--|
|   | Total              | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total             | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                            |                    |  |   |  |                   |  |   |  |
| Cash equivalents                          | \$ —               | \$ —   | \$ —  | \$ —   | \$ 50,135         | \$ 50,135  | \$ —  | \$ —   |
| Interest rate swap derivative assets      | 1,288              | —  | 1,288   | —  | 4,470             | —  | 4,470   | —  |
| <b>Liabilities:</b>                       |                    |  |   |  |                   |  |   |  |
| Interest rate swap derivative liabilities | 1,749              | —  | 1,749   | —  | 5,961             | —  | 5,961   | —  |

Cash equivalents consist of registered money market mutual funds which are invested in United States Treasury bills that are valued at the net asset value of the underlying shares in the funds as of the close of business at the end of each period.

The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates derived from observable market interest rate curves.

In 2010 and 2011, the Company entered into warrant agreements (the "Sponsor Warrants and Management Warrants") with various parties to purchase shares of HHC common stock. As discussed further in Note 13 – Warrants, all Sponsor and Management warrants granted prior to 2016, which were accounted for as warrant liabilities, had been exercised as of December 31, 2017. The following table presents a rollforward of the valuation of the Company's Warrant liabilities:

| (In thousands)          | 2018 | 2017        |
|-------------------------|------|-------------|
| Balance as of January 1 | \$ — | \$ —332,170 |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|  |    |            |
|--|----|------------|
| Warrant liability loss (a)                   | —  | 43,443     |
| Exercises of Sponsor and Management Warrants | —  | (375,613 ) |
| Balance as of September 30                   | \$ | —\$—       |

For 2017, this amount represents losses recognized related to each Sponsor and Management Warrant prior to the (a) respective exercise date. Changes in the fair value of the Sponsor Warrants and Management Warrants prior to exercise were recognized in net income as a warrant liability gain or loss.

The valuation of warrants was based on an option pricing valuation model, utilizing inputs which were classified as Level 3 due to the unavailability of comparable market data. The inputs to the valuation model included the fair value of stock related to the warrants, exercise price and term of the warrants, expected volatility, risk-free interest rate, dividend yield and, as appropriate, a discount for lack of marketability. Generally, an increase in expected volatility would increase the fair value of the liability. The

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

impact of the volatility on fair value diminished as the market value of the stock increased above the strike price. As the period of restriction lapsed, the marketability discount reduced to zero and increased the fair value of the warrants.

The estimated fair values of the Company's financial instruments that are not measured at fair value on a recurring basis are as follows:

| (In thousands)               | Fair Value Hierarchy | September 30, 2018 |                      | December 31, 2017 |                      |
|------------------------------|----------------------|--------------------|----------------------|-------------------|----------------------|
|                              |                      | Carrying Amount    | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| <b>Assets:</b>               |                      |                    |                      |                   |                      |
| Cash and restricted cash     | Level 1              | \$612,548          | \$612,548            | \$914,165         | \$914,165            |
| Accounts receivable, net (a) | Level 3              | 15,437             | 15,437               | 13,041            | 13,041               |
| Notes receivable, net (b)    | Level 3              | 40,220             | 40,220               | 5,864             | 5,864                |
| <b>Liabilities:</b>          |                      |                    |                      |                   |                      |
| Fixed-rate debt (c)          | Level 2              | 1,651,695          | 1,644,391            | 1,526,875         | 1,554,766            |
| Variable-rate debt (c)       | Level 2              | 1,644,791          | 1,644,791            | 1,350,914         | 1,350,914            |

(a) Accounts receivable, net is shown net of an allowance of \$9.8 million and \$9.3 million at September 30, 2018 and December 31, 2017, respectively.

(b) Notes receivable, net is shown net of an allowance of \$0.1 million at September 30, 2018 and December 31, 2017.

(c) Excludes related unamortized financing costs.

The fair value of the Company's 2025 Notes, included in fixed-rate debt in the table above, is based upon the trade price closest to the end of the period presented. The fair value of other fixed-rate debt in the table above (please refer to Note 7 – Mortgages, Notes and Loans Payable in the Company's Condensed Consolidated Financial Statements), was estimated based on a discounted future cash payment model, which includes risk premiums and a risk free rate derived from the current London Interbank Offered Rate ("LIBOR") or U.S. Treasury obligation interest rates. The discount rates reflect the Company's judgment as to what the approximate current lending rates for loans or groups of loans with similar maturities and credit quality would be if credit markets were operating efficiently and assuming that the debt is outstanding through maturity.

The carrying amounts for the Company's variable-rate debt approximate fair value given that the interest rates are variable and adjust with current market rates for instruments with similar risks and maturities.

The carrying amounts of Cash and cash equivalents and Accounts receivable, net approximate fair value because of the short term maturity of these instruments. The fair value of Notes receivable, net is based on the fair value of the collateral which exceeds the carrying basis of the notes as of September 30, 2018.

#### NOTE 9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to interest rate risk related to its variable interest rate debt, and it manages this risk by utilizing interest rate derivatives. To add stability to interest costs by reducing the Company's exposure to interest rate movements, the Company uses interest rate swaps, collars and caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company's fixed rate payments over the life of the agreements without exchange of the underlying notional amount. Interest rate collars designated as cash flow hedges involve the receipt of variable

amounts from a counterparty if interest rates rise above an established ceiling rate and payment of variable amounts to a counterparty if interest rates fall below an established floor rate. No payments or receipts are exchanged on interest rate collar contracts unless interest rates rise above or fall below the established ceiling and floor rates. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up front premium. The Company's interest rate caps are not currently designated as hedges, and therefore, any gain or loss is recognized in current period earnings. These derivatives are recorded on a gross basis at fair value.

Table of ContentsTHE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

The change in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in Accumulated Other Comprehensive Income (“AOCI”) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings within the same income statement line item being hedged. During the three and nine months ended September 30, 2017, the ineffective portion recorded was insignificant. As discussed in Note 2 - Accounting Policies and Pronouncements, the Company reclassified ineffectiveness recorded in 2017 and prior to Accumulated deficit as of January 1, 2018, upon adoption of ASU 2017-12.

Assessments of hedge effectiveness are performed quarterly using regression analysis. HHC is exposed to credit risk in the event of non-performance by its derivative counterparties. The Company evaluates counterparty credit risk through monitoring the creditworthiness of counterparties, which includes review of debt ratings and financial performance. To mitigate its credit risk, the Company enters into agreements with counterparties that are considered credit-worthy, such as large financial institutions with favorable credit ratings. As of September 30, 2018, there were four termination events and no events of default related to the interest rate swaps. There were no termination events or events of default in the year ended December 31, 2017.

If the derivative contracts are terminated prior to their maturity, the amounts previously recorded in AOCI are recognized into earnings over the period that the hedged transaction impacts earnings. If the hedging relationship is discontinued because it is probable that the forecasted transaction will not occur in accordance with the original strategy, any related amounts previously recorded in AOCI are recognized in earnings immediately. During the three and nine months ended September 30, 2018, the Company recorded \$0.2 million and \$0.5 million in Other (loss) income, net, respectively, related to missed forecasts and the amortization of terminated swaps.

During the nine months ended September 30, 2018, the Company settled three interest rate swap agreements with notional amounts of \$250.0 million, \$40.0 million and \$119.4 million, all designated as cash flow hedges of interest rate variability, and received total payments of \$16.1 million. The Company has deferred the effective portion of the fair value changes of these interest rate swap agreements in Accumulated other comprehensive income (loss) on the accompanying Condensed Consolidated Balance Sheets and will recognize the impact as a component of interest expense, net, over the next 9.5, 1.6 and 3.0 years, respectively, which are the original forecasted periods. .

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable rate debt. Over the next 12 months, HHC estimates that an additional \$1.4 million of net gains will be reclassified to interest expense.

The following table summarizes certain terms of the Company's derivative contracts:

| (In thousands)     | Balance Sheet Location                     | Notional  | Fixed Interest Rate | Effective Date | Maturity Date | Fair Value Asset (Liability) |                   |
|--------------------|--|-----------|---------------------|----------------|---------------|------------------------------|-------------------|
|                    |  |           |                     |                |               | September 30, 2018           | December 31, 2017 |
| Interest Rate Swap | (a) Accounts payable and accrued expenses  | \$ 18,926 | 2.96                | % 5/10/2011    | 10/31/2019    | \$—                          | \$ (286 )         |
| Interest Rate Swap | (b) Prepaid expenses and other assets, net | 40,000    | 1.66                | % 5/6/2015     | 5/1/2020      | —                            | 299               |
| Interest Rate Swap | (e) Prepaid expenses and other assets, net | 119,359   | 1.14                | % 10/3/2016    | 9/12/2021     | —                            | 4,007             |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|   |            |  |         |                  |              |            |           |             |
|---|------------|--|---------|------------------|--------------|------------|-----------|-------------|
| Interest Rate Cap                       | (c)        | Prepaid expenses and other assets, net | 75,000  | 5.00             | % 9/1/2017   | 8/31/2019  | —         | —           |
| Interest Rate Cap                       | (d)        | Prepaid expenses and other assets, net | 230,000 | 2.50             | % 12/22/2016 | 12/23/2019 | 751       | 164         |
| Interest Rate Swap                      | (e)<br>(f) | Prepaid expenses and other assets, net | 50,000  | 2.65             | % 12/31/2017 | 12/31/2027 | —         | (1,124 )    |
| Interest Rate Swap                      | (e)<br>(f) | Prepaid expenses and other assets, net | 100,000 | 2.68             | % 12/31/2017 | 12/31/2027 | —         | (2,509 )    |
| Interest Rate Swap                      | (e)<br>(f) | Prepaid expenses and other assets, net | 100,000 | 2.62             | % 12/31/2017 | 12/31/2027 | —         | (2,042 )    |
| Interest Rate Collar                    | (e)<br>(g) | Prepaid expenses and other assets, net | 51,592  | 1.50% -<br>2.50% | 7/1/2018     | 5/1/2019   | 26        | —           |
| Interest Rate Collar                    | (e)<br>(g) | Prepaid expenses and other assets, net | 193,967 | 2.00% -<br>3.00% | 5/1/2019     | 5/1/2020   | 168       | —           |
| Interest Rate Collar                    | (e)<br>(g) | Prepaid expenses and other assets, net | 354,217 | 2.25% -<br>3.25% | 5/1/2020     | 5/1/2021   | 343       | —           |
| Interest Rate Collar                    | (e)<br>(g) | Accounts payable and accrued expenses  | 381,404 | 2.75% -<br>3.50% | 5/1/2021     | 4/30/2022  | (394 )    | —           |
| Interest Rate Swap                      | (e)<br>(h) | Accounts payable and accrued expenses  | 615,000 | 2.96             | % 9/21/2018  | 9/18/2023  | (1,355 )  | —           |
| Total fair value derivative assets      |            |  |         |                  |              |            | \$1,288   | \$ 4,470    |
| Total fair value derivative liabilities |            |  |         |                  |              |            | \$(1,749) | \$( 5,961 ) |

(a) On January 19, 2018, the Company repaid in full the \$18.9 million mortgage loan for 110 North Wacker and settled the related swap liability of \$0.3 million.

(b) On September 21, 2018, the Company settled \$40.0 million and \$119.4 million, respectively, in interest rate swaps.

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

Denotes a derivative contract that is not currently designated as a hedging instrument. Interest (income) expense (c) included in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 related to this contract is not meaningful.

Denotes a derivative contract that is not currently designated as a hedging instrument. Interest (income) expense of (d) \$0.1 million and \$0.6 million is included in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018, respectively, related to this contract.

(e) Denotes derivatives designated as hedging instruments.

(f) On May 17, 2018, the Company settled \$250.0 million in forward starting swaps.

(g) On May 17, 2018 and May 18, 2018, the Company entered into interest rate collars which are designated as cash flow hedges.

Concurrent with the funding of the new \$615.0 million term loan discussed in Note 7 - Mortgages, Notes and (h) Loans Payable, on September 21, 2018, the Company entered into this interest rate swap which is designated as a cash flow hedge.

The tables below present the effect of the Company's derivative financial instruments on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

|   | Amount of Gain (Loss) Recognized in AOCI on Derivative Three Months Ended September 30,       |         | Amount of Gain (Loss) Recognized in AOCI on Derivative Nine Months Ended September 30,       |         |
|---|---|---------|--|---------|
|   | 2018  | 2017    | 2018   | 2017    |
| Derivatives in Cash Flow Hedging Relationships          |   |         |  |         |
| Interest rate swaps                                     | \$ 28   | \$ (7 ) | \$ 14,293  | \$(272) |
| Forward starting swaps                                  | —   | —       | —  | (2,316) |
|   |   |         |  |         |
|   | Amount of Gain (Loss) Reclassified from AOCI into Operations Three Months Ended September 30, |         | Amount of Gain (Loss) Reclassified from AOCI into Operations Nine Months Ended September 30, |         |
|   | 2018  | 2017    | 2018   | 2017    |
| Location of Loss Reclassified from AOCI into Operations |   |         |  |         |
| Interest expense  | \$ 394  | \$(68 ) | \$ 1,262   | \$(399) |
|   |   |         |  |         |
|   | Total Interest Expense  |         | Total Interest Expense   |         |



Edgar Filing: Howard Hughes Corp - Form 10-Q

|   | Presented<br>in the Results of<br>Operations in<br>which<br>the Effects of<br>Cash Flow<br>Hedges are<br>Recorded<br>Three Months<br>Ended September<br>30, |          | Presented<br>in the Results of<br>Operations in<br>which<br>the Effects of<br>Cash Flow<br>Hedges are<br>Recorded<br>Nine Months<br>Ended September<br>30, |          |
|---|---|----------|--|----------|
|   | 2018  | 2017     | 2018   | 2017     |
| Interest Expense Presented in Results of Operations |   |          |  |          |
| Interest expense                                    | \$21,670  | \$17,241 | \$57,182   | \$49,547 |

NOTE 10 COMMITMENTS AND CONTINGENCIES

In the normal course of business, from time to time, the Company is involved in legal proceedings relating to the ownership and operations of its properties. In addition, on June 14, 2018, the Company was served with a petition involving approximately 500 individuals or entities who claim that their properties, located in the Timarron Park neighborhood of The Woodlands, were damaged by flood waters that resulted from the unprecedented rainfall that occurred throughout Harris County and surrounding areas during Hurricane Harvey in August 2017. The complaint was filed in State Court in Harris County of the State of Texas. In general, the plaintiffs allege negligence in the development of Timarron Park and violations of Texas' Deceptive Trade Practices Act and name as defendants The Howard Hughes Corporation, The Woodlands Land Development Company and two unaffiliated parties involved in the planning and engineering of Timarron Park. The Company intends to vigorously defend the matter as it believes that these claims are baseless and without merit and that it has substantial legal and factual defenses to the claims and allegations contained in the complaint. Based upon the present status of this matter, the Company does not believe it is probable that a loss will be incurred. Accordingly, the Company has not recorded a charge as a result of this action.

In management's opinion, the liabilities, if any, that may ultimately result from normal course of business legal actions, and the Woodlands legal proceeding discussed above, are not expected to have a material effect on HHC's consolidated financial position, results of operations or liquidity.

As of September 30, 2018 and December 31, 2017, the Company had outstanding letters of credit totaling \$11.6 million and \$13.8 million and surety bonds totaling \$103.3 million and \$88.5 million, respectively. These letters of credit and bonds were issued primarily in connection with insurance requirements, special real estate assessments and construction obligations.

Table of ContentsTHE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

The Company leases land or buildings at certain properties from third parties. Rental payments are expensed as incurred and, to the extent applicable, have been straight-lined over the term of the lease. Contractual rental expense, including participation rent, was \$2.4 million and \$1.9 million for the three months ended September 30, 2018 and 2017, respectively, and \$7.3 million and \$6.1 million for the nine months ended September 30, 2018 and 2017, respectively. The amortization of above and below market ground leases and straight line rents included in the contractual rent amount was not significant.

The Company has entered into guarantee agreements as part of certain development projects. In conjunction with the execution of the ground lease for Seaport District NYC, the Company executed a completion guarantee for the redevelopment of Pier 17 and the Tin Building. As part of the Funding Agreement for the Downtown Columbia Redevelopment District TIF bonds, one of HHC's wholly-owned subsidiaries has agreed to complete certain defined public improvements and to indemnify Howard County, Maryland for certain matters. The Company has guaranteed these obligations, with a limit of \$1.0 million, expiring on October 31, 2020. To the extent that increases in taxes do not cover debt service payments on the TIF bonds, HHC's wholly-owned subsidiary is obligated to pay special taxes. The Company evaluates the likelihood of future performance under these guarantees and did not record an obligation as of September 30, 2018 and December 31, 2017.

## NOTE 11 STOCK BASED PLANS

The Company's stock based plans are described and informational disclosures are provided in the Notes to the Consolidated Financial Statements included in the Annual Report.

## Stock Options

The following table summarizes the Company's stock option plan activity for the nine months ended September 30, 2018:

|  | Stock<br>Options | Weighted<br>Average<br>Exercise Price |
|--|------------------|---------------------------------------|
| Stock Options outstanding at December 31, 2017 | 783,182          | \$ 90.22                              |
| Granted  | 254,000          | 125.53                                |
| Exercised                                      | (178,052)        | 65.81                                 |
| Forfeited                                      | (39,500)         | 121.71                                |
| September 30, 2018                             | 819,630          | \$ 104.95                             |

Compensation costs related to stock options were \$0.9 million and \$2.6 million for the three and nine months ended September 30, 2018, respectively, of which \$0.3 million and \$1.2 million were capitalized to development projects, respectively. Compensation costs related to stock options were \$0.6 million and \$1.6 million for the three and nine months ended September 30, 2017, respectively, of which \$0.2 million and \$0.4 million were capitalized to development projects, respectively.

## Restricted Stock

The following table summarizes restricted stock activity for the nine months ended September 30, 2018:

Restricted Weighted

Edgar Filing: Howard Hughes Corp - Form 10-Q

|  | Stock     | Average Grant<br>Date Fair Value |
|--|-----------|----------------------------------|
| Restricted stock outstanding at December 31, 2017  | 354,519   | \$ 89.00                         |
| Granted  | 141,332   | 82.96                            |
| Vested   | (10,644 ) | 114.33                           |
| Forfeited  | (18,897 ) | 83.16                            |
| Restricted stock outstanding at September 30, 2018 | 466,310   | \$ 86.83                         |

Compensation costs related to restricted stock awards were \$2.2 million and \$6.3 million for the three and nine months ended September 30, 2018, respectively, of which \$0.1 million and \$0.7 million were capitalized to development projects, respectively. Compensation costs related to restricted stock awards were \$1.2 million and \$4.1 million for the three and nine months ended

28

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED

September 30, 2017, respectively, of which \$(0.3) million related to forfeitures and \$0.2 million were capitalized to development projects, respectively.

NOTE 12 INCOME TAXES

The Company has significant permanent differences, primarily from stock compensation deductions and non-deductible executive compensation, which cause the effective tax rate to deviate from statutory rates. The effective tax rate, based upon actual operating results, was 24.3% and 22.2% for the three and nine months ended September 30, 2018, respectively, compared to 35.8% and 62.3% for the three and nine months ended September 30, 2017, respectively. The change in the tax rate was primarily attributable to changes in the federal income tax rate due to the passage of the Tax Cuts and Jobs Act, non-deductible executive compensation, warrant liability in 2017, valuation allowance related to HHC's deferred tax assets, stock compensation deduction and other items which are permanent differences for tax purposes.

The decrease in Deferred tax liabilities between December 31, 2017 and September 30, 2018 is primarily due to both the cumulative effect adjustment of \$89.3 million on adoption of ASU 2014-09 Revenues from Contracts with Customers (Topic 606), resulting in a \$19.6 million decrease in the deferred tax liability, and an offsetting \$6.2 million increase in the deferred tax liability from the utilization of deferred tax assets against income before taxes.

NOTE 13 WARRANTS

In 2010 and 2011, the Company entered into warrant agreements with various parties to purchase shares of HHC common stock. The Sponsor Warrants and Management Warrants were exercised and settled in 2017. Prior to their exercise, the fair values for the Sponsor Warrants and Management Warrants were recorded as liabilities in the Company's Consolidated Balance Sheets because the holders of these warrants could require the Company to settle such warrants in cash upon a change of control. The fair values prior to their settlement in 2017 were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 8 – Fair Value in the Company's Condensed Consolidated Financial Statements. Decreases and increases in the fair value of the Sponsor and Management Warrants prior to their settlements were recognized as warrant liability gains or losses in the Condensed Consolidated Statements of Operations.

On October 7, 2016, the Company entered into a warrant agreement with its Chief Financial Officer, David R. O'Reilly, prior to his appointment to the position. Upon exercise of his warrant, Mr. O'Reilly may acquire 50,125 shares of common stock at an exercise price of \$112.08 per share. Mr. O'Reilly's warrant was issued at fair value in exchange for a \$1.0 million cash payment. Mr. O'Reilly's Warrant becomes exercisable on April 6, 2022, subject to earlier exercise upon certain change in control, separation and termination provisions. On June 16, 2017 and October 4, 2017, the Company also entered into new warrant agreements with its Chief Executive Officer, David R. Weinreb, and President, Grant Herlitz, to acquire 1,965,409 shares and 87,951 shares of common stock for the purchase price of \$50.0 million and \$2.0 million, respectively. Mr. Weinreb's new warrant becomes exercisable on June 15, 2022, at an exercise price of \$124.64 per share, and Mr. Herlitz's new warrant becomes exercisable on October 3, 2022, at an exercise price of \$117.01 per share, subject to earlier exercise upon certain change in control, separation and termination provisions. The purchase prices paid by the respective executives for the O'Reilly Warrant and Mr. Weinreb's and Mr. Herlitz's new warrants, which qualify as equity instruments, are included within Additional paid-in capital in the Condensed Consolidated Balance Sheets at September 30, 2018 and December 31, 2017.



Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

## NOTE 14 ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables summarize changes in Accumulated Other Comprehensive Income (Loss) by component, all of which are presented net of tax:

| (In thousands)   | Three Months<br>Ended September<br>30, |           |
|--|--|-----------|
|  | 2018                                   | 2017      |
| Balance as of June 30  | \$2,515                                | \$(9,157) |
| Other comprehensive income before reclassifications                              | 2                                      | 72        |
| (Gain) loss reclassified from accumulated other comprehensive loss to net income | (394 )                                 | 68        |
| Pension adjustment   | 2,566                                  | —         |
| Terminated swap amortization   | (239 )                                 | —         |
| Net current-period other comprehensive income                                    | 1,935                                  | 140       |
| Balance as of September 30   | \$4,450                                | \$(9,017) |

| (In thousands)   | Nine Months<br>Ended September<br>30, |           |
|--|---------------------------------------|-----------|
|  | 2018                                  | 2017      |
| Balance as of January 1  | \$(6,965)                             | \$(6,786) |
| Other comprehensive income before reclassifications                              | 14,327                                | (2,630 )  |
| (Gain) loss reclassified from accumulated other comprehensive loss to net income | (1,262 )                              | 399       |
| Adjustment related to adoption of ASU 2018-02                                    | (1,148 )                              | —         |
| Adjustment related to adoption of ASU 2017-12                                    | (739 )                                | —         |
| Pension adjustment   | 556                                   | —         |
| Terminated swap amortization   | (319 )                                | —         |
| Net current-period other comprehensive income                                    | 11,415                                | (2,231 )  |
| Balance as of September 30   | \$4,450                               | \$(9,017) |

The following table summarizes the amounts reclassified out of AOCI:

| Accumulated Other Comprehensive Income (Loss)<br>Components | Affected line items<br>in the | Amounts reclassified from<br>Accumulated Other<br>Comprehensive<br>Income (Loss)<br>Three Months<br>Ended September<br>30, |        | Amounts reclassified from<br>Accumulated Other<br>Comprehensive<br>Income (Loss)<br>Nine Months Ended<br>September 30, |        |
|---|-------------------------------|--|--------|--|--------|
|   |                               | 2018   | 2017   | 2018   | 2017   |
| (In thousands)  | Statements of<br>Operations   | 2018   | 2017   | 2018   | 2017   |
| (Gains) losses on cash flow hedges                          | Interest expense              | \$ (498 )  | \$ 108 | \$ (1,597 )  | \$ 636 |
| Interest rate swap contracts                                | Provision for<br>income taxes | 104  | (40 )  | 335  | (237 ) |
| Total reclassifications of (income) loss for the period     | Net of tax                    | \$ (394 )  | \$ 68  | \$ (1,262 )  | \$ 399 |

NOTE 15 EARNINGS PER SHARE

Basic earnings per share (“EPS”) is computed by dividing net income available 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 warrants is computed using the if converted method prior to their exercise.

30

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

Information related to the Company's EPS calculations is summarized as follows:

|   | Three Months        |          | Nine Months         |          |
|---|---------------------|----------|---------------------|----------|
|   | Ended September 30, |          | Ended September 30, |          |
| (In thousands, except per share amounts)            | 2018                | 2017     | 2018                | 2017     |
| <b>Basic EPS:</b>                                   |                     |          |                     |          |
| <b>Numerator:</b>                                   |                     |          |                     |          |
| Net income  | \$23,847            | \$10,516 | \$19,802            | \$19,295 |
| Net income attributable to noncontrolling interests | (482 )              | (12 )    | (51 )               | (12 )    |
| Net income attributable to common stockholders      | \$23,365            | \$10,504 | \$19,751            | \$19,283 |
| <b>Denominator:</b>                                 |                     |          |                     |          |
| Weighted average basic common shares outstanding    | 43,066              | 42,845   | 43,023              | 40,860   |
| <b>Diluted EPS:</b>                                 |                     |          |                     |          |
| <b>Numerator:</b>                                   |                     |          |                     |          |
| Net income attributable to common stockholders      | \$23,365            | \$10,504 | \$19,751            | \$19,283 |
| <b>Denominator:</b>                                 |                     |          |                     |          |
| Weighted average basic common shares outstanding    | 43,066              | 42,845   | 43,023              | 40,860   |
| Restricted stock and stock options                  | 204                 | 420      | 211                 | 455      |
| Warrants  | 47                  | 2        | 47                  | 1,783    |
| Weighted average diluted common shares outstanding  | 43,317              | 43,267   | 43,281              | 43,098   |
| Basic income per share:                             | \$0.54              | \$0.25   | \$0.46              | \$0.47   |
| Diluted income per share:                           | \$0.54              | \$0.24   | \$0.46              | \$0.45   |

The diluted EPS computation for the three and nine months ended September 30, 2018 excludes 375,500 and 398,500 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and nine months ended September 30, 2018 excludes 227,621 shares of restricted stock because certain stock price conditions provided for in the restricted stock awards have not been satisfied.

The diluted EPS computation for the three and nine months ended September 30, 2017 excludes 311,500 and 317,000 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and nine months ended September 30, 2017 excludes 185,573 shares of restricted stock because performance conditions provided for in the restricted stock awards have not been satisfied.

#### NOTE 16 SEGMENTS

The Company has three business segments which offer different products and services. HHC's three segments are managed separately because each requires different operating strategies or management expertise and are reflective of management's operating philosophies and methods. As further discussed in Item 2, one common operating measure used to assess operating results for HHC's business segments is earnings before taxes ("EBT"). HHC's segments or assets within such segments could change in the future as development of certain properties commences or other operational or management changes occur. The Company does not distinguish or group the combined operations on a



geographic basis. Furthermore, all operations are within the United States. The Company's reportable segments are as follows:

• MPC – consists of the development and sale of land in large scale, long term community development projects in and around Las Vegas, Nevada; Houston, Texas; and Columbia, Maryland.

31

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

Operating Assets – consists of retail, office, hospitality and multi-family properties along with other real estate investments. These assets are currently generating revenues and are comprised of commercial real estate properties recently developed or acquired, and properties with an opportunity to redevelop, reposition or sell to improve segment performance or to recycle capital.

• Strategic Developments – consists of residential condominium and commercial property projects currently under development and all other properties held for development which have no substantial operations.

Effective January 1, 2017, the Company moved the Seaport District assets under construction and related activities from Operating Assets to Strategic Developments. The Seaport District operating properties and related operating results remain presented within Operating Assets.

Segment operating results are as follows:

| (In thousands)  | Three Months Ended September 30, |            |           |          |           |           |   |           |          |
|---|----------------------------------|------------|-----------|----------|-----------|-----------|---|-----------|----------|
|   | Operating                        |            | MPC       |          | Strategic |           | Consolidated  |           |          |
|   | 2018                             | 2017       | 2018      | 2017     | 2018      | 2017      | 2018  | 2017      |          |
| Total revenues  | \$101,000                        | \$79,533   | \$143,135 | \$64,929 | \$13,025  | \$114,274 | \$257,160   | \$258,736 |          |
| Total operating expenses  | 59,779                           | 41,837     | 70,237    | 37,223   | 19,302    | 91,080    | 149,318   | 170,140   |          |
| Segment operating income (loss)                                 | 41,221                           | 37,696     | 72,898    | 27,706   | (6,277)   | 23,194    | 107,842   | 88,596    |          |
| Depreciation and amortization                                   | (28,329)                         | (33,885)   | (79)      | (76)     | (472)     | (18)      | (28,880)  | (33,979)  |          |
| Interest (expense) income, net                                  | (18,891)                         | (15,940)   | 6,626     | 6,355    | 4,319     | 6,983     | (7,946)   | (2,602)   |          |
| Other (loss) income, net  | (2,887)                          | (249)      | 18        | —        | (450)     | 122       | (3,319)   | (127)     |          |
| Equity in earnings (loss) from real estate and other affiliates | (529)                            | 317        | 9,454     | 6,480    | (316)     | 670       | 8,609   | 7,467     |          |
| Gains on sales of properties                                    | —                                | —          | —         | —        | —         | 237       | —   | 237       |          |
| Segment EBT   | \$(9,415)                        | \$(12,061) | \$88,917  | \$40,465 | \$(3,196) | \$31,188  | \$76,306  | \$59,592  |          |
|   |                                  |            |           |          |           |           | Corporate expenses and other items                  | 52,459    | 49,076   |
|   |                                  |            |           |          |           |           | Net income  | \$23,847  | \$10,516 |
|   |                                  |            |           |          |           |           | Net income attributable to noncontrolling interests | (482)     | (12)     |
|   |                                  |            |           |          |           |           | Net income attributable to common stockholders      | \$23,365  | \$10,504 |

| (In thousands)   | Nine Months Ended September 30, |           |           |           |           |           |              |           |
|--|---------------------------------|-----------|-----------|-----------|-----------|-----------|--------------|-----------|
|  | Operating                       |           | MPC       |           | Strategic |           | Consolidated |           |
|  | 2018                            | 2017      | 2018      | 2017      | 2018      | 2017      | 2018         | 2017      |
| Total revenues   | \$285,481                       | \$243,498 | \$261,665 | \$211,711 | \$52,698  | \$343,928 | \$599,844    | \$799,137 |
| Total operating expenses                                 | 149,169                         | 123,879   | 143,608   | 113,171   | 70,225    | 264,524   | 363,002      | 501,574   |
| Segment operating income (loss)                          | 136,312                         | 119,619   | 118,057   | 98,540    | (17,527)  | 79,404    | 236,842      | 297,563   |
| Depreciation and amortization                            | (79,190)                        | (88,918)  | (245)     | (247)     | (2,650)   | (1,177)   | (82,085)     | (90,342)  |
| Interest (expense) income, net                           | (52,886)                        | (46,004)  | 19,826    | 17,902    | 18,260    | 18,321    | (14,800)     | (9,781)   |
| Other (loss) income, net                                 | (2,723)                         | (265)     | 18        | —         | (77)      | 137       | (2,782)      | (128)     |
| Equity in earnings from real estate and other affiliates | 1,056                           | 3,739     | 34,682    | 21,552    | 3,556     | 530       | 39,294       | 25,821    |
| Gains on sales of properties                             | —                               | —         | —         | —         | —         | 32,452    | —            | 32,452    |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|             |         |            |           |           |         |           |   |                   |
|-------------|---------|------------|-----------|-----------|---------|-----------|---|-------------------|
| Segment EBT | \$2,569 | \$(11,829) | \$172,338 | \$137,747 | \$1,562 | \$129,667 | \$176,469   | \$255,585         |
|             |         |            |           |           |         |           | Corporate expenses and other items                  | 156,667 236,290   |
|             |         |            |           |           |         |           | Net income  | \$19,802 \$19,295 |
|             |         |            |           |           |         |           | Net income attributable to noncontrolling interests | (51 ) (12 )       |
|             |         |            |           |           |         |           | Net income attributable to common stockholders      | \$19,751 \$19,283 |

We recognized an operating loss of \$(17.5) million for the nine months ended September 30, 2018 in Strategic Developments, primarily due to a \$13.4 million charge for window repairs at the Waiea condominium tower in Ward Village. This charge represents the Company's estimate of total costs to complete the repairs. While HHC expects to recover these costs in future periods, the

32

---

Table of Contents

THE HOWARD HUGHES CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 UNAUDITED

Company will not recognize any recovery until the amount can be estimated and is considered probable for financial reporting purposes. For the three and nine months ended September 30, 2018, Condominium rights and unit sales, net of costs, were also meaningfully impacted by the adoption of the New Revenue Standard as of the Adoption Date. The decrease in segment EBT for the nine months ended September 30, 2018 was also driven by non-recurring gains on sales of \$32.5 million in 2017 in our Strategic Developments segment.

The assets by segment and the reconciliation of total segment assets to the Total assets in the Condensed Consolidated Balance Sheets are summarized as follows:

|                            | September<br>30,<br>2018 | December<br>31,<br>2017 |
|----------------------------|--------------------------|-------------------------|
| (In thousands)             |                          |                         |
| Master Planned Communities | \$2,067,403              | \$1,999,090             |
| Operating Assets           | 2,750,923                | 2,489,177               |
| Strategic Developments     | 2,188,293                | 1,511,612               |
| Total segment assets       | 7,006,619                | 5,999,879               |
| Corporate and other        | 290,251                  | 729,185                 |
| Total assets               | \$7,296,870              | \$6,729,064             |

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis by management should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes included in this quarterly report on Form 10-Q (the "Quarterly Report") and in our Form 10-K for the year ended December 31, 2017 (the "Annual Report"). All references to numbered Notes are to specific notes to our unaudited Condensed Consolidated Financial Statements included in this Quarterly Report.

Forward-looking information

We may make forward-looking statements in this Quarterly Report and in other reports and presentations that we file or furnish with the SEC. In addition, our management may make forward-looking statements orally to analysts, investors, creditors, the media and others.

Forward-looking statements give our current expectations relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to current or historical facts. These statements may include words such as "anticipate," "believe," "estimate," "expect," "forecast," "intend," "likely," "may," "plan," "project," "realize," "should," "transform," "would," and other similar expression. Forward-looking statements should not be relied upon. They give our expectations about the future and are not guarantees.

Forward-looking statements include, among others:

- budgeted costs, future lot sales and estimates and projections of Net Operating Income ("NOI");
- forecasts of our future economic performance;
- expected capital required for our operations and development opportunities at our properties;
- expected performance of our Master Planned Communities ("MPC") segment and other current income producing properties;
- expected commencement and completion for property developments and timing of sales or rentals of certain properties;
- estimates of our future liquidity, development opportunities, development spending and management plans; and
- descriptions of assumptions underlying or relating to any of the foregoing.

There are several factors, many beyond our control, which could cause results to differ materially from our expectations. These risk factors are described in our Annual Report and are incorporated herein by reference. Any factor could, by itself, or together with one or more other factors, adversely affect our business, results of operations or financial condition. There may be other factors currently unknown to us that we have not described in this Quarterly Report or in our Annual Report that could cause results to differ from our expectations. These forward-looking statements present our estimates and assumptions as of the date of this Quarterly Report. Except as may be required by law, we undertake no obligation to modify or revise any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report.

Executive Overview

Description of Business

We create timeless places and extraordinary experiences that inspire people while driving sustainable, long-term growth and value for our shareholders. We operate in three complementary business segments: Operating Assets,

MPC and Strategic Developments. The operational synergies of combining our three business segments create a unique and continuous value-creation cycle. We sell land to residential homebuilders in MPC, and the new homes attract residents to our cities looking for places to work and shop. New homeowners create demand for commercial developments, such as retail, office, self-storage and hospitality offerings. We build these commercial properties through Strategic Developments when the timing is right using the cash flow harvested from the sale of land to homebuilders, which helps mitigate development risk. Once these strategic developments are completed and stabilized, they transition to Operating Assets and increase recurring NOI, further funding the equity requirements in Strategic Developments. New office, retail and other commercial amenities make our MPC residential land more appealing to buyers and increase the velocity of land sales at premiums that exceed the broader market. Increased demand for residential land generates more cash flow from MPC, thus continuing the cycle.

Table of Contents

Third Quarter 2018 Highlights

Capital and financing activities

On September 18, 2018, we closed on a \$700.0 million credit facility, of which \$615.0 million is a term loan and \$85.0 million is a revolver. The loans bear interest at one-month LIBOR plus 1.65% and mature September 18, 2023. The term loan proceeds were used to refinance approximately \$608.7 million of existing debt, and the revolver remains undrawn. We have a one-time right to request an increase of \$50.0 million in the aggregate amount of the revolver loan commitment. Concurrent with the funding of the term loan on September 21, 2018, we entered into a swap agreement to fix 100.0% of the outstanding principal of the term loan to a total rate equal to 4.61%.

On September 11, 2018, we closed on an \$89.8 million construction loan for 6100 Merriweather and an \$85.7 million construction loan for Columbia Multi-family. Each loan bears interest at one-month LIBOR plus 2.75%, has an initial maturity date of September 11, 2022, has two, one-year extension options and is cross-collateralized.

On July 27, 2018, we closed on a \$34.2 million construction loan for Bridgeland Apartments, bearing interest at one-month LIBOR plus 2.25% with an initial maturity date of July 27, 2022 and a one-year extension option.

On July 20, 2018, we closed on a \$51.2 million construction note for Summerlin Ballpark, bearing interest at 4.92% per annum and maturing on December 15, 2039. The note is secured by the ballpark and by the proceeds of the Naming Rights and Marketing agreement between the Las Vegas Convention and Visitors Authority and us, which provides for an annual payment of \$4.0 million to us in each of the next 20 years.

Operating Assets

NOI increased \$1.5 million for the three months ended September 30, 2018 compared to the prior year period, primarily driven by the following:

increases of \$2.5 million and \$0.8 million in NOI at our office and multi-family properties, respectively, primarily as a result of continued stabilization and increased occupancy at several of our office and multi-family assets; and decrease of \$1.0 million in NOI at our retail properties, driven primarily by NOI of \$(3.3) million at our Seaport District properties. NOI at our Seaport District properties was negatively impacted by start-up costs associated with opening new businesses such as our concert series, summer activations and restaurants. These expenses are included in our total estimated costs as shown in the Projects Under Construction table in the Strategic Developments section. On September 7, 2018, we acquired Lakefront North, two vacant, Class-A office buildings immediately adjacent to our Hughes Landing development. We purchased the four- and six-story buildings, totaling 257,025 rentable square feet, as well as 12.9 acres of land for \$53.0 million.

MPC

Earnings before taxes increased \$48.5 million to \$88.9 million and \$34.6 million to \$172.3 million for three and nine months ended September 30, 2018, respectively, compared to the prior year periods. Our MPC earnings before taxes primarily increased due to two land sales in Summerlin, discussed below.

- On September 19, 2018, we closed on the sale of 38 acres of residential land in Summerlin for a total sales price of \$22.1 million.

On July 10, 2018, we closed on the sale of 123 acres of residential land in Summerlin for a total sales price of \$69.0 million.

Recorded \$9.5 million and \$34.7 million in equity earnings from The Summit joint venture for the three and nine months ended September 30, 2018, respectively. This represents an increase of \$3.0 million and \$13.1 million, respectively, compared to the prior year periods.

Strategic Developments

Increased our estimated stabilized NOI by \$9.0 million to \$317.6 million as of the third quarter of 2018, excluding the redevelopment of the Seaport District. Of this increase, \$2.5 million is attributable to two floors added to our 110 North Wacker development, which were incorporated into our plans as a result of strong leasing demand. An

additional \$6.5 million in estimated stabilized NOI is attributable to the acquisition of the Lakefront North property discussed above.

Continued robust sales at Ward Village and contracted to sell 220 condominiums in the third quarter of 2018, including 216 at 'A'ali'i, our newest building that began public sales in January 2018. We broke ground on 'A'ali'i on October 15, 2018, and the building was 77.1% presold as of October 31, 2018.

Since inception, we have sold 1,905 residential units at five towers in Ward Village, bringing the total percentage sold in the five towers to 89.4%.



Table of Contents

Quarterly and year to date Condominium rights and unit sales, net of costs were meaningfully impacted by the adoption of Topic 606 and all its related amendments (the “New Revenue Standard”) on January 1, 2018 (the “Adoption Date”).

The comparable year to date period included \$32.2 million related to the sale of 36 acres of undeveloped land at The Elk Grove Collection. There were no sales in the current period.

## Earnings Before Taxes

In addition to the required presentations using GAAP, we use certain non-GAAP performance measures, as we believe these measures improve the understanding of our operational results and make comparisons of operating results among peer companies more meaningful. Management continually evaluates the usefulness, relevance, limitations and calculation of our reported non-GAAP performance measures to determine how best to provide relevant information to the public, and thus such reported measures could change.

Because our three segments, MPC, Operating Assets and Strategic Developments, are managed separately, we use different operating measures to assess operating results and allocate resources among these three segments. The one common operating measure used to assess operating results for our business segments is earnings before taxes (“EBT”). EBT, as it relates to each business segment, represents the revenues less expenses of each segment, including interest income, interest expense and Equity in earnings of real estate and other affiliates. EBT excludes corporate expenses and other items that are not allocable to the segments. We present EBT because we use this measure, among others, internally to assess the core operating performance of our assets.

EBT should not be considered an alternative to GAAP net income attributable to common stockholders or GAAP net income, as it has limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of the limitations of EBT are that it does not include the following in our calculations:

- cash expenditures, or future requirements for capital expenditures or contractual commitments;
- corporate general and administrative expenses;
- interest expense on our corporate debt;
- income taxes that we may be required to pay;
- any cash requirements for replacement of fully depreciated or amortized assets; and
- limitations on, or costs related to, the transfer of earnings from our real estate and other affiliates to us.

A reconciliation between EBT and Net income is presented below:

|                                 | Three Months Ended September 30, |          |           |           |          |           |           |           |             |              |           |
|---------------------------------|----------------------------------|----------|-----------|-----------|----------|-----------|-----------|-----------|-------------|--------------|-----------|
|                                 | 2018                             | 2017     | \$ Change | 2018      | 2017     | \$ Change | 2018      | 2017      | \$ Change   | 2018         | 2017      |
| (In thousands)                  | Operating                        |          |           | MPC       |          |           | Strategic |           |             | Consolidated |           |
| Total revenues                  | \$101,000                        | \$79,533 | \$21,467  | \$143,135 | \$64,929 | \$78,206  | \$13,025  | \$114,274 | \$(101,249) | \$257,160    | \$258,736 |
| Total operating expenses        | 59,779                           | 41,837   | (17,942)  | 70,237    | 37,223   | (33,014)  | 19,302    | 91,080    | 71,778      | 149,318      | 170,140   |
| Segment operating income (loss) | 41,221                           | 37,696   | 3,525     | 72,898    | 27,706   | 45,192    | (6,277)   | 23,194    | (29,471)    | 107,842      | 88,596    |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|                                     |           |              |          |           |           |           |            |           |             |           |           |
|-------------------------------------|-----------|--------------|----------|-----------|-----------|-----------|------------|-----------|-------------|-----------|-----------|
| Depreciation<br>and<br>amortization | (28,329   | )(33,885     | )5,556   | (79       | )(76      | )(3       | )(472      | )(18      | )(454       | )(28,880  | )(33,979  |
| Interest<br>(expense)               | (18,891   | )(15,940     | )(2,951  | )6,626    | 6,355     | 271       | 4,319      | 6,983     | (2,664      | )(7,946   | )(2,602   |
| income, net                         |           |              |          |           |           |           |            |           |             |           |           |
| Other (loss)                        | (2,887    | )(249        | )(2,638  | )18       | —         | 18        | (450       | )122      | (572        | )(3,319   | )(127     |
| income, net                         |           |              |          |           |           |           |            |           |             |           |           |
| Equity in<br>earnings               |           |              |          |           |           |           |            |           |             |           |           |
| (loss) from                         | (529      | )317         | (846     | )9,454    | 6,480     | 2,974     | (316       | )670      | (986        | )8,609    | 7,467     |
| real estate<br>and other            |           |              |          |           |           |           |            |           |             |           |           |
| affiliates                          |           |              |          |           |           |           |            |           |             |           |           |
| Gains on<br>sales of                | —         | —            | —        | —         | —         | —         | —          | 237       | (237        | )—        | 237       |
| properties                          |           |              |          |           |           |           |            |           |             |           |           |
| Segment<br>EBT                      | \$ (9,415 | )\$ (12,061) | \$ 2,646 | \$ 88,917 | \$ 40,465 | \$ 48,452 | \$ (3,196) | \$ 31,188 | \$ (34,384) | \$ 76,306 | \$ 59,592 |

|  |           |           |
|--|-----------|-----------|
| Corporate expenses and<br>other items                  | 52,459    | 49,076    |
| Net income   | \$ 23,847 | \$ 10,516 |
| Net income attributable to<br>noncontrolling interests | (482      | )(12      |
| Net income attributable to common stockholders         | \$ 23,365 | \$ 10,504 |

Table of Contents

| (In thousands)   | Nine Months Ended September 30, |            |           |           |           |           |           |           |             |   |           |             |          |
|--|---------------------------------|------------|-----------|-----------|-----------|-----------|-----------|-----------|-------------|---|-----------|-------------|----------|
|  | 2018                            | 2017       | \$ Change | 2018      | 2017      | \$ Change | 2018      | 2017      | \$ Change   | 2018  | 2017      | \$ Change   |          |
|  | Operating                       |            |           | MPC       |           |           | Strategic |           |             | Consolidated  |           |             |          |
| Total revenues   | \$285,481                       | \$243,498  | \$41,983  | \$261,665 | \$211,711 | \$49,954  | \$52,698  | \$343,928 | \$(291,230) | \$599,844   | \$799,130 | \$(209,286) |          |
| Total operating expenses                                 | 149,169                         | 123,879    | (25,290)  | 143,608   | 113,171   | (30,437)  | 70,225    | 264,524   | 194,299     | 363,002   | 501,574   | (138,572)   |          |
| Segment operating income (loss)                          | 136,312                         | 119,619    | 16,693    | 118,057   | 98,540    | 19,517    | (17,527)  | 79,404    | (96,931)    | 236,842   | 297,563   | (60,721)    |          |
| Depreciation and amortization                            | (79,190)                        | (88,918)   | 9,728     | (245)     | (247)     | 2         | (2,650)   | (1,177)   | (1,473)     | (82,085)  | (90,342)  | 8,257       |          |
| Interest expense   | (52,886)                        | (46,004)   | (6,882)   | 19,826    | 17,902    | 1,924     | 18,260    | 18,321    | (61)        | (14,800)  | (9,781)   | (5,019)     |          |
| Other income, net  | (2,723)                         | (265)      | (2,458)   | 18        | —         | 18        | (77)      | 137       | (214)       | (2,782)   | (128)     | (2,654)     |          |
| Equity in earnings from real estate and other affiliates | 1,056                           | 3,739      | (2,683)   | 34,682    | 21,552    | 13,130    | 3,556     | 530       | 3,026       | 39,294  | 25,821    | 13,473      |          |
| Gains on sales of properties                             | —                               | —          | —         | —         | —         | —         | —         | 32,452    | (32,452)    | —   | 32,452    | (32,452)    |          |
| Segment EBT  | \$2,569                         | \$(11,829) | \$14,398  | \$172,338 | \$137,747 | \$34,591  | \$1,562   | \$129,667 | \$(128,105) | \$176,469   | \$255,500 | \$(78,031)  |          |
|  |                                 |            |           |           |           |           |           |           |             | Corporate expenses and other items                  | 156,667   | 236,290     | (89,623) |
|  |                                 |            |           |           |           |           |           |           |             | Net income  | \$19,802  | \$19,293    | \$509    |
|  |                                 |            |           |           |           |           |           |           |             | Net income attributable to noncontrolling interests | (51)      | (12)        | (39)     |
|  |                                 |            |           |           |           |           |           |           |             | Net income attributable to common stockholders      | \$19,751  | \$19,281    | \$570    |

Table of Contents

## Results of Operations

Comparison of the three and nine months ended September 30, 2018 to the three and nine months ended September 30, 2017

Segment EBT increased by \$16.7 million and decreased by \$79.1 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods. The increase in segment EBT for the three months ended September 30, 2018 is attributable to growth in land sales in our MPC segment and continued stabilization of our properties in our Operating Assets segment. The increases were countered by decreases in Condominium rights and unit sales, net of costs, which were meaningfully impacted by the adoption of the New Revenue Standard as of the Adoption Date; see Note 1 – Basis of Presentation and Organization for additional information. The decrease in segment EBT for the nine months ended September 30, 2018 was driven by decreases in Condominium rights and unit sales, net of costs, which were meaningfully impacted by the adoption of the New Revenue Standard as of the Adoption Date, and non-recurring gains on sales of \$32.5 million in 2017 in our Strategic Developments segment. The decrease was partially offset by growth in land sales in our MPC segment and continued stabilization of our properties in our Operating Assets segment. As a result, net income attributable to common stockholders increased \$12.9 million to \$23.4 million and \$0.5 million to \$19.8 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods. These changes are explained in further detail below.

## Operating Assets

EBT for Operating Assets are presented below:

| Operating Assets EBT<br>(In thousands)                          | Three Months Ended<br>September 30, |            |           | Nine Months Ended<br>September 30, |            |           |
|---|-------------------------------------|------------|-----------|------------------------------------|------------|-----------|
|   | 2018                                | 2017       | \$ Change | 2018                               | 2017       | \$ Change |
| Total revenues  | \$101,000                           | \$79,533   | \$21,467  | \$285,481                          | \$243,498  | \$41,983  |
| Total operating expenses  | 59,779                              | 41,837     | (17,942 ) | 149,169                            | 123,879    | (25,290 ) |
| Segment operating income  | 41,221                              | 37,696     | 3,525     | 136,312                            | 119,619    | 16,693    |
| Depreciation and amortization                                   | (28,329 )                           | (33,885 )  | 5,556     | (79,190 )                          | (88,918 )  | 9,728     |
| Interest (expense) income, net                                  | (18,891 )                           | (15,940 )  | (2,951 )  | (52,886 )                          | (46,004 )  | (6,882 )  |
| Other (loss) income, net  | (2,887 )                            | (249 )     | (2,638 )  | (2,723 )                           | (265 )     | (2,458 )  |
| Equity in earnings (loss) from real estate and other affiliates | (529 )                              | 317        | (846 )    | 1,056                              | 3,739      | (2,683 )  |
| EBT   | \$(9,415 )                          | \$(12,061) | \$2,646   | \$2,569                            | \$(11,829) | \$14,398  |

EBT increased \$2.6 million to \$(9.4) million and \$14.4 million to \$2.6 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods. For the three month period, the increase was primarily driven by increases of \$8.5 million in Minimum rents mainly due to increased occupancy, continued stabilization and placing assets in service, compounded by \$10.4 million of increased Other rental and property revenues for the Seaport District sponsorship and events revenue. These increases were partially offset by \$13.5 million of increased Other property operating costs due to costs of events in the Seaport District as well as increased interest expense of \$3.0 million. For the nine months ended September 30, 2018, the increase was primarily driven by increases of \$17.3 million in Minimum rents, \$13.9 million in Other rental and property revenues and \$7.5 million in Hospitality revenues, due to increased occupancy, continued stabilization and placing assets in service as well as increased hotel room rates and food and beverage revenue. These increases were partially offset by higher operating expenses, including Hospitality operating costs of \$4.2 million and \$15.7 million in Other property operating costs primarily due to events in the Seaport District.

## Operating Assets Net Operating Income

We believe that NOI is a useful supplemental measure of the performance of our Operating Assets because it provides a performance measure that, when compared year over year, reflects the revenues and expenses directly associated with owning and operating real estate properties and the impact on operations from trends in rental and occupancy rates and operating costs as variances between years in NOI typically result from changes in rental rates, occupancy, tenant mix and operating expenses. We define NOI as operating revenues (rental income, tenant recoveries and other revenue) less operating expenses (real estate taxes, repairs and maintenance, marketing and other property expenses). NOI excludes straight-line rents and amortization of tenant incentives, net interest expense, ground rent amortization, demolition costs, amortization, depreciation, development-related marketing costs and Equity in earnings from real estate and other affiliates. We use NOI to evaluate our operating performance on a property-by-property basis because NOI allows us to evaluate the impact that property-specific factors such as lease structure, lease rates and tenant base have on our operating results, gross margins and investment returns.

38

---

Table of Contents

Although we believe that NOI provides useful information to investors about the performance of our Operating Assets, due to the exclusions noted above, NOI should only be used as an additional measure of the financial performance of such assets and not as an alternative to GAAP net income. A reconciliation of Operating Assets EBT to Operating Assets NOI is presented in the table below.

| Reconciliation of Operating Assets EBT to NOI<br><br>(In thousands) | Three Months<br>Ended September<br>30, |             |              | Nine Months Ended<br>September 30, |             |           |
|---|--|-------------|--------------|------------------------------------|-------------|-----------|
|   | 2018                                   | 2017        | \$<br>Change | 2018                               | 2017        | \$ Change |
| Total Operating Assets segment EBT                                  | \$(9,415 )                             | \$(12,061 ) | \$2,646      | \$2,569                            | \$(11,829 ) | \$14,398  |
| Depreciation and amortization                                       | 28,329                                 | 33,885      | (5,556 )     | 79,190                             | 88,918      | (9,728 )  |
| Interest expense (income), net                                      | 18,891                                 | 15,940      | 2,951        | 52,886                             | 46,004      | 6,882     |
| Equity in earnings (loss) from real estate and other affiliates     | 529                                    | (317 )      | 846          | (1,056 )                           | (3,739 )    | 2,683     |
| Straight-line rent revenue  | (3,632 )                               | (1,421 )    | (2,211 )     | (9,551 )                           | (5,198 )    | (4,353 )  |
| Other   | 3,098                                  | 290         | 2,808        | 2,820                              | \$348       | 2,472     |
| Operating Assets NOI  | \$37,800                               | \$36,316    | \$1,484      | \$126,858                          | \$114,504   | \$12,354  |

Operating Assets NOI increased by \$1.5 million, or 4.1%, to \$37.8 million and increased \$12.4 million, or 10.8%, to \$126.9 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods.

The increase in NOI for the three months ended September 30, 2018 is primarily driven by the following: increases of \$2.5 million and \$0.8 million in NOI at our office and multi-family properties, respectively, primarily as a result of continued stabilization and increased occupancy at several of our office and multi-family assets; and decrease of \$1.0 million in NOI at our retail properties, driven primarily by NOI of \$(3.3) million at our Seaport District properties. NOI at our Seaport District properties was negatively impacted by increased business openings and associated start-up costs.

The increase in NOI for the nine months ended September 30, 2018 is primarily driven by the following: increases of \$3.6 million, \$3.5 million and \$3.7 million in NOI at our retail, office and multi-family properties, respectively, all mainly as a result of continued stabilization at several of our retail, office and multi-family assets; and increase in Hospitality NOI of \$4.7 million, mainly as a result of increased hotel room rates and conference and food and beverage revenue.

The following is a summary of highlights during the current period for the Seaport District:

- launched the inaugural Pier 17 rooftop concert series which wrapped up October 12th after 18 sold-out shows. The full artist lineup included a diverse roster of A-list talent from various genres;

- hosted approximately 2,100 diners during the Seaport Food Lab summer pop-up series;

- celebrated the opening of SJP by Sarah Jessica Parker on September 13th, which is the first standalone shoe store for the collection;

- celebrated the opening of 10 Corso Como on September 7th in conjunction with New York Fashion Week. The store's location in the historic Seaport District is the only U.S. location for the iconic Milan-based fashion destination; and

- signed an agreement with Nike to lease approximately 23,000 square feet of office space at Pier 17.

## Retail Properties

## Edgar Filing: Howard Hughes Corp - Form 10-Q

Some of the leases related to our retail properties are triple net leases, which generally require tenants to pay their pro-rata share of property operating costs, such as real estate taxes, utilities and insurance, and the direct costs of their leased space. We also enter into certain leases which require tenants to pay a fixed-rate per square foot reimbursement for common area costs which is increased annually according to the terms of the lease. Given the unique nature of many of our retail properties, the mix of tenant lease agreements and related lease terms executed during the three and nine months ended September 30, 2018 may differ significantly from those entered into in prior periods.

The following table summarizes the leases we executed at our retail properties during the three months ended September 30, 2018:

39

---

Table of Contents

| Retail Properties (a)    | Total Executed | Avg. Lease Term (Months) | Square Feet  |                                     |                                     | Per Square Foot per Annum |                           |                           |
|--------------------------|----------------|--------------------------|--------------|-------------------------------------|-------------------------------------|---------------------------|---------------------------|---------------------------|
|                          |                |                          | Total Leased | Associated with Tenant Improvements | Associated with Leasing Commissions | Avg. Starting Rents (f)   | Total Tenant Improvements | Total Leasing Commissions |
| Pre-leased (b)           | 1              | 125                      | 2,200        | 2,200                               | 2,200                               | \$40.00                   | \$ 7.68                   | \$ 2.64                   |
| Comparable - Renewal (c) | 5              | 36                       | 6,275        | 1,200                               | —                                   | 23.78                     | 9.72                      | —                         |
| Comparable - New (d)     | 1              | 36                       | 1,200        | —                                   | —                                   | 24.72                     | —                         | —                         |
| Non-comparable (e)       | 3              | 117                      | 9,325        | 9,325                               | 9,325                               | 55.36                     | 8.19                      | 1.23                      |
| Total                    |                |                          | 19,000       | 12,725                              | 11,525                              |                           |                           |                           |

(a) Excludes executed leases with a term of 12 months or less, partnerships, internal leases, and percentage rent leases.

(b) Pre-leased information is associated with projects under development at September 30, 2018.

Comparable - Renewal information is associated with stabilized assets for which the space was occupied by the (c) same tenant within 12 months prior to the executed agreement. These leases represent a 10.9% increase in cash rents from \$21.45 per square foot to \$23.78 per square foot.

Comparable - New information is associated with stabilized assets for which the space was occupied by a different (d) tenant within 12 months prior to the executed agreement. These leases represent a 3.0% increase in cash rents from \$24.00 per square foot to \$24.72 per square foot.

(e) Non-comparable information is associated with space that was previously vacant for more than 12 months or has never been occupied.

(f) Avg. Starting Rent is based on Base Minimum Rent only.

The following table summarizes the leases we executed at our retail properties during the nine months ended September 30, 2018:

| Retail Properties (a)    | Total Executed | Avg. Lease Term (Months) | Square Feet  |                                     |                                     | Per Square Foot per Annum |                           |                           |
|--------------------------|----------------|--------------------------|--------------|-------------------------------------|-------------------------------------|---------------------------|---------------------------|---------------------------|
|                          |                |                          | Total Leased | Associated with Tenant Improvements | Associated with Leasing Commissions | Avg. Starting Rents (f)   | Total Tenant Improvements | Total Leasing Commissions |
| Pre-leased (b)           | 9              | 92                       | 50,690       | 40,690                              | 10,650                              | \$25.78                   | \$ 7.87                   | \$ 2.05                   |
| Comparable - Renewal (c) | 12             | 48                       | 24,262       | 1,200                               | —                                   | 34.95                     | 9.72                      | —                         |
| Comparable - New (d)     | 7              | 67                       | 13,386       | 6,409                               | 7,326                               | 36.60                     | 4.84                      | 1.08                      |
| Non-comparable (e)       | 14             | 104                      | 94,751       | 31,149                              | 84,223                              | 44.24                     | 8.51                      | 0.64                      |
| Total                    |                |                          | 183,089      | 79,448                              | 102,199                             |                           |                           |                           |

(a) Excludes executed leases with a term of 12 months or less, partnerships, internal leases, and percentage rent leases.

(b) Pre-leased information is associated with projects under development at September 30, 2018.

Comparable - Renewal information is associated with stabilized assets for which the space was occupied by the (c) same tenant within 12 months prior to the executed agreement. These leases represent a 3.4% increase in cash rents from \$33.79 per square foot to \$34.95 per square foot.

Comparable - New information is associated with stabilized assets for which the space was occupied by a different (d) tenant within 12 months prior to the executed agreement. These leases represent a 9.9% increase in cash rents from \$33.31 per square foot to \$36.60 per square foot.

(e) Non-comparable information is associated with space that was previously vacant for more than 12 months or has never been occupied.



(f) Avg. Starting Rent is based on Base Minimum Rent only.

The following are retail properties which were completed and transferred to Operating Assets during the nine months ended September 30, 2018:

- certain sections of our Seaport District properties now open for business, transferred from Strategic Developments;
- Lake Woodlands Crossing at The Woodlands, transferred from Strategic Developments;
- Aco retail, anchored by Whole Foods Market at Ward Village, transferred from Strategic Developments; and
- Land subject to a ground lease for our NHL hockey practice facility in Downtown Summerlin, transferred from MPC.

#### Office Properties

Our office properties are located in Summerlin in Las Vegas, Nevada; Columbia, Maryland; and The Woodlands, Texas. Leases related to our office properties in The Woodlands are generally triple net leases. Leases at properties located in Summerlin and Columbia are generally gross leases.

The following table summarizes our executed office property leases during the three months ended September 30, 2018:

40

---

Table of Contents

| Office Properties (a)    | Total Executed | Avg. Lease Term (Months) | Square Feet  |                                     |                                     | Per Square Foot per Annum |                           |                           |
|--------------------------|----------------|--------------------------|--------------|-------------------------------------|-------------------------------------|---------------------------|---------------------------|---------------------------|
|                          |                |                          | Total Leased | Associated with Tenant Improvements | Associated with Leasing Commissions | Avg. Starting Rents (f)   | Total Tenant Improvements | Total Leasing Commissions |
| Pre-leased (b)           | —              | —                        | —            | —                                   | —                                   | \$ —                      | —\$                       | —                         |
| Comparable - Renewal (c) | 5              | 63                       | 23,523       | 13,710                              | 2,202                               | 29.26                     | 1.01                      | 0.84                      |
| Comparable - New (d)     | 4              | 74                       | 17,348       | 14,340                              | 14,340                              | 40.39                     | 3.63                      | 2.30                      |
| Non-comparable (e)       | 11             | 73                       | 69,798       | 68,004                              | 68,189                              | 34.82                     | 4.20                      | 1.75                      |
| Total                    |                |                          | 110,669      | 96,054                              | 84,731                              |                           |                           |                           |

(a) Excludes executed leases with a term of 12 months or less, subleases, and percentage rent leases.

(b) Pre-leased information is associated with projects under development at September 30, 2018.

Comparable - Renewal information is associated with stabilized assets for which the space was occupied by the (c) same tenant within 12 months prior to the executed agreement. These leases represent a 2.8% decrease in cash rents from \$30.10 per square foot to \$29.26 per square foot.

Comparable - New information is associated with stabilized assets for which the space was occupied by a different (d) tenant within 12 months prior to the executed agreement. These leases represent a 0.2% increase in cash rents from \$40.31 per square foot to \$40.39 per square foot.

(e) Non-comparable information is associated with space that was previously vacant for more than 12 months or has never been occupied.

(f) Avg. Starting Rents is based on the gross lease value, including recoveries.

The following table summarizes our executed office property leases during the nine months ended September 30, 2018:

| Office Properties (a)    | Total Executed | Avg. Lease Term (Months) | Square Feet  |                                     |                                     | Per Square Foot per Annum |                           |                           |
|--------------------------|----------------|--------------------------|--------------|-------------------------------------|-------------------------------------|---------------------------|---------------------------|---------------------------|
|                          |                |                          | Total Leased | Associated with Tenant Improvements | Associated with Leasing Commissions | Avg. Starting Rents (f)   | Total Tenant Improvements | Total Leasing Commissions |
| Pre-leased (b)           | 1              | —                        | 58,000       | —                                   | —                                   | \$ —                      | —\$                       | —                         |
| Comparable - Renewal (c) | 12             | 54                       | 50,503       | 29,830                              | 20,396                              | 32.19                     | 1.91                      | 1.26                      |
| Comparable - New (d)     | 6              | 66                       | 21,094       | 15,734                              | 18,086                              | 38.95                     | 3.16                      | 1.74                      |
| Non-comparable (e)       | 32             | 77                       | 201,189      | 195,019                             | 165,622                             | 34.22                     | 4.60                      | 1.65                      |
| Total                    |                |                          | 330,786      | 240,583                             | 204,104                             |                           |                           |                           |

(a) Excludes executed leases with a term of 12 months or less, subleases, and percentage rent leases.

(b) Pre-leased information is associated with projects under development at September 30, 2018. Certain information (b) associated with pre-leasing activity at 110 North Wacker has been excluded for competitive reasons.

Comparable - Renewal information is associated with stabilized assets for which the space was occupied by the (c) same tenant within 12 months prior to the executed agreement. These leases represent a 0.7% decrease in cash rents from \$32.42 per square foot to \$32.19 per square foot.

Comparable - New information is associated with stabilized assets for which the space was occupied by a different (d) tenant within 12 months prior to the executed agreement. These leases represent a 0.8% decrease in cash rents from \$39.26 per square foot to \$38.95 per square foot.

(e)

Edgar Filing: Howard Hughes Corp - Form 10-Q

Non-comparable information is associated with space that was previously vacant for more than 12 months or has never been occupied.

(f) Avg. Starting Rents is based on the gross lease value, including recoveries.

The following are recently acquired or completed office properties which were acquired or transferred from Strategic Developments to Operating Assets during the nine months ended September 30, 2018:

- Lakefront North, two Class-A office buildings totaling 257,025 square feet, in The Woodlands;
- Two Summerlin, a 145,000 square foot Class A office building, in Summerlin;
- Aristocrat, a 12-acre build-to-suit project including two 90,000 square foot office buildings, in Summerlin; and
- Sterrett Place, a 119,000 square foot office building in Columbia, Maryland, which we acquired in the second quarter of 2018.

The following are recently acquired or completed multi-family properties which were acquired or transferred from Strategic Developments to Operating Assets during the nine months ended September 30, 2018:

- certain apartment buildings and the clubhouse at Creekside Park Apartments in The Woodlands; and
- m.flats/TEN.M, a 437-unit multi-family property in Columbia, Maryland, of which we have a 50% ownership interest.

Table of Contents

## Master Planned Communities

EBT for the Master Planned Communities are presented below:

| MPC EBT<br>(In thousands)                                       | Three Months Ended<br>September 30, |          |           | Nine Months Ended<br>September 30, |           |           |
|---|-------------------------------------|----------|-----------|------------------------------------|-----------|-----------|
|   | 2018                                | 2017     | \$ Change | 2018                               | 2017      | \$ Change |
| Total revenues  | \$143,135                           | \$64,929 | \$78,206  | \$261,665                          | \$211,711 | \$49,954  |
| Total operating expenses  | 70,237                              | 37,223   | (33,014 ) | 143,608                            | 113,171   | (30,437 ) |
| Segment operating income  | 72,898                              | 27,706   | 45,192    | 118,057                            | 98,540    | 19,517    |
| Depreciation and amortization                                   | (79 )                               | (76 )    | (3 )      | (245 )                             | (247 )    | 2         |
| Interest (expense) income, net                                  | 6,626                               | 6,355    | 271       | 19,826                             | 17,902    | 1,924     |
| Other (loss) income, net  | 18                                  | —        | 18        | 18                                 | —         | 18        |
| Equity in earnings (loss) from real estate and other affiliates | 9,454                               | 6,480    | 2,974     | 34,682                             | 21,552    | 13,130    |
| EBT   | \$88,917                            | \$40,465 | \$48,452  | \$172,338                          | \$137,747 | \$34,591  |

Three months ended September 30, 2018, compared with three months ended September 30, 2017

EBT increased \$48.5 million to \$88.9 million, mainly as a result of increased lot sales at Bridgeland and large superpad sales at Summerlin. There were 210 single-family lot sales at Bridgeland, which is 130 more lots sold compared to the same period last year. At Summerlin, superpad sales totaled 160 acres, as compared to sales of 57 acres in the prior year period. Also contributing to the increase was a commercial land sale in The Woodlands for \$1.4 million and 29 single-family lot sales in The Woodlands Hills with no comparable sales in the prior period.

Nine Months Ended September 30, 2018, compared with nine months ended September 30, 2017

EBT increased \$34.6 million to \$172.3 million, mainly as a result of superpad sales at Summerlin, increased single-family lot sales at Bridgeland and the initiation of lot sales at The Woodlands Hills. Summerlin sold superpad sites totaling 241 acres in 2018, compared to sales of 144 acres in the same period last year. In addition, there were 380 single-family lot sales in Bridgeland compared to 299 single-family lot sales in the same period last year. There were 115 single-family lot sales in The Woodlands Hills compared to none in the same period last year. These increases were offset in part by two commercial sales and an easement sale in the prior period with no comparable sales in the current period at The Woodlands and Bridgeland, respectively.

MPC revenues fluctuate each period given the nature of the development and sale of land in these large scale, long-term projects. While the volume in timing of land sales can be unpredictable, we view the recent home sales in our master-planned communities as a leading indicator of desirability and demand for our land. Across our MPCs, 504 and 1,723 new homes were sold during the three and nine months ended September 30, 2018, respectively, compared to 446 and 1,295 in the same periods last year.

## MPC Net Contribution

In addition to segment EBT for the MPC, we believe that certain investors measure the value of the assets in this segment based on their contribution to liquidity and capital available for investment. MPC Net Contribution is defined as MPC segment EBT, plus MPC cost of sales, Depreciation and amortization, and net collections from SID bonds and Municipal Utility District (“MUD”) receivables, reduced by MPC development expenditures, land acquisitions and Equity in earnings from real estate and other affiliates, net of distributions. MPC Net Contribution is not a GAAP-based operational metric and should not be used to measure operating performance of the MPC assets as a

substitute for GAAP measures of such performance nor should it be used as a comparison metric with other comparable businesses. A reconciliation of segment EBT to MPC Net Contribution is presented below.

42

---

Table of Contents

| MPC Net Contribution   | Three Months Ended September 30, |           |           | Nine Months Ended September 30, |            |           |
|--|----------------------------------|-----------|-----------|---------------------------------|------------|-----------|
|  | 2018                             | 2017      | \$ Change | 2018                            | 2017       | \$ Change |
| (In thousands)   |                                  |           |           |                                 |            |           |
| MPC EBT  | \$88,917                         | \$40,465  | \$48,452  | \$172,338                       | \$137,747  | \$34,591  |
| Plus:  |                                  |           |           |                                 |            |           |
| Cost of sales - land   | 57,183                           | 29,043    | (28,140 ) | 109,609                         | 88,288     | (21,321 ) |
| MUD and SID bonds collections, net of assumptions                              | (347 )                           | 1,643     | (1,990 )  | (5,351 )                        | 1,961      | (7,312 )  |
| Depreciation and amortization  | 79                               | 76        | (3 )      | 245                             | 247        | 2         |
| Less:  |                                  |           |           |                                 |            |           |
| MPC development expenditures   | (45,444 )                        | (45,772 ) | 328       | (136,705 )                      | (136,745 ) | 40        |
| MPC land acquisitions  | (1,010 )                         | —         | 1,010     | (3,565 )                        | (1,415 )   | 2,150     |
| Equity in earnings from real estate and other affiliates, net of distributions | (8,529 )                         | (6,480 )  | 2,049     | (31,012 )                       | (21,552 )  | 9,460     |
| MPC Net Contribution   | \$90,849                         | \$18,975  | \$71,874  | \$105,559                       | \$68,531   | \$37,028  |

MPC Net Contribution increased \$71.9 million to \$90.8 million and \$37.0 million to \$105.6 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. The only noteworthy changes, in addition to those explained in the EBT section above, are the \$2.0 million and \$7.3 million decreases in MUD and SID collections for the three and nine months ended September 30, 2018, respectively. Both of these changes are related to the timing of the administrative process associated with MUD and SID receivables.

The following table sets forth MPC land inventory activity for the nine months ended September 30, 2018:

| (In thousands)               | Bridgeland | Maryland | Summerlin | The Woodlands | The Woodlands Hills | Total MPC   |
|------------------------------|------------|----------|-----------|---------------|---------------------|-------------|
| Balance December 31, 2017    | \$458,908  | \$16,628 | \$852,233 | \$206,049     | \$108,460           | \$1,642,278 |
| Acquisitions                 | 506        | —        | —         | 3,059         | —                   | 3,565       |
| Development expenditures (a) | 65,086     | 15       | 53,243    | 5,045         | 13,316              | 136,705     |
| MPC Cost of Sales            | (10,606 )  | —        | (83,776 ) | (11,907 )     | (3,320 )            | (109,609 )  |
| MUD reimbursable costs (b)   | (42,972 )  | —        | —         | (1,369 )      | (5,304 )            | (49,645 )   |
| Transfer to Strategic        | (812 )     | —        | —         | (2,008 )      | —                   | (2,820 )    |
| Transfer to Operating Assets | —          | —        | (6,705 )  | —             | —                   | (6,705 )    |
| Other                        | (275 )     | (11 )    | 1,892     | 2,838         | 2,955               | 7,399       |
| Balance September 30, 2018   | \$469,835  | \$16,632 | \$816,887 | \$201,707     | \$116,107           | \$1,621,168 |

(a) Development expenditures are inclusive of capitalized interest and property taxes.

(b) MUD reimbursable costs represent land development expenditures transferred to MUD Receivables.

## Strategic Developments

Our Strategic Developments assets generally require substantial future development to maximize their use. Our expenses relating to these assets are primarily related to costs associated with selling condominiums, marketing costs associated with our Strategic Developments, operational costs associated with the IBM building that serves as a world class information center and sales gallery for the entire Ward Village Master Plan development, carrying costs including, but not limited to, property taxes and insurance, and other ongoing costs relating to maintaining the assets in their current condition. If we decide to redevelop or develop a Strategic Developments asset, we would expect

that with the exception of the residential portion of our condominium projects, upon completion of development, the asset would likely be reclassified to Operating Assets when the asset is placed in service and NOI would become a meaningful measure of its operating performance. All development costs discussed herein are exclusive of land costs.

EBT for Strategic Developments are summarized as follows:

43

---

Table of Contents

| Strategic Developments EBT<br>(In thousands)                    | Three Months Ended<br>September 30, |           |             | Nine Months Ended<br>September 30, |           |             |
|---|-------------------------------------|-----------|-------------|------------------------------------|-----------|-------------|
|   | 2018                                | 2017      | \$ Change   | 2018                               | 2017      | \$ Change   |
| Total revenues  | \$13,025                            | \$114,274 | \$(101,249) | \$52,698                           | \$343,928 | \$(291,230) |
| Total operating expenses  | 19,302                              | 91,080    | 71,778      | 70,225                             | 264,524   | 194,299     |
| Segment operating (loss) income                                 | (6,277 )                            | 23,194    | (29,471 )   | (17,527 )                          | 79,404    | (96,931 )   |
| Depreciation and amortization                                   | (472 )                              | (18 )     | (454 )      | (2,650 )                           | (1,177 )  | (1,473 )    |
| Interest (expense) income, net                                  | 4,319                               | 6,983     | (2,664 )    | 18,260                             | 18,321    | (61 )       |
| Other (loss) income, net  | (450 )                              | 122       | (572 )      | (77 )                              | 137       | (214 )      |
| Equity in earnings (loss) from real estate and other affiliates | (316 )                              | 670       | (986 )      | 3,556                              | 530       | 3,026       |
| Gains on sales of properties                                    | —                                   | 237       | (237 )      | —                                  | 32,452    | (32,452 )   |
| EBT   | \$(3,196 )                          | \$31,188  | \$(34,384 ) | \$1,562                            | \$129,667 | \$(128,105) |

EBT decreased \$34.4 million to \$(3.2) million and \$128.1 million to \$1.6 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods. The decreases for the three and nine months ended September 30, 2018 were primarily driven by decreases in Condominium rights and unit sales, net of costs, which were meaningfully impacted by the adoption of the New Revenue Standard as of the Adoption Date; see Note 1 – Basis of Presentation and Organization for additional information. The New Revenue Standard makes the 2018 and 2017 periods no longer comparable. However, we view condominium closings as a useful metric across both periods. At Ward Village, we closed on two condominium units during the three months ended September 30, 2018 and September 30, 2017. We closed on 15 condominium units during the nine months ended September 30, 2018 compared to 22 units during the nine months ended September 30, 2017. The decrease in condominium closings during the nine months ended September 30, 2018 relative to the prior year period is primarily attributable to the decrease in available inventory for sale at our two towers that have been delivered. As highlighted below, the overall pace of sales at Ward Village remains strong, and as of September 30, 2018, we have entered into contracts for 75.1% of the units at 'A'ali'i since launching public sales in January 2018. At September 30, 2018, our five towers are 89.4% sold, and three and seven units remain to be sold at Anaha and Waiea, respectively. The nine months ended September 30, 2018 were also impacted by a \$13.4 million increase in Condominium rights and unit cost of sales, due to anticipated window repairs at Ward Village. In addition, the nine months ended September 30, 2017 includes \$32.5 million primarily related to the sale of 36 acres of undeveloped land at The Elk Grove Collection with no comparable activity for the nine months ended September 30, 2018. The decrease in the nine months ended September 30, 2018 was partially offset by an increase in Equity in earnings from real estate and other affiliates of \$3.0 million.

The following is a summary of activity during the current period for Ward Village. Ward Village includes five mixed-use residential towers: Waiea, Anaha, Ae'o, Ke Kilohana, and 'A'ali'i. Activity for these towers is presented below.

Waiea - We have entered into 167 contracts and closed on 164 of the 174 units as of September 30, 2018. These units under contract and closed represent 96.0% and 94.3%, respectively, of total units, and 91.8% and 89.2%, respectively, of the total residential square feet available for sale as of September 30, 2018. We closed on two additional contracts during October 2018. The retail portion of the project is 100% leased and has been placed in service.

Anaha - We have entered into 314 contracts and closed on 313 of the 317 units as of September 30, 2018. These units under contract and closed represent 99.1% and 98.7%, respectively, of total units, and 96.7% and 96.2%, respectively, of the total residential square feet available for sale as of September 30, 2018. Additionally, we have leased and placed in service 78.9% of the 16,100 square feet of retail space.



## Edgar Filing: Howard Hughes Corp - Form 10-Q

Ae‘o - We have entered into contracts for 100% of the 465 units as of September 30, 2018. The retail portion of the project is 99.0% leased and has been placed in service.

Ke Kilohana - We have entered into contracts for 395 of the 423 units as of September 30, 2018. We entered into 18 additional contracts during October 2018. As previously announced, we have pre-leased all of the approximately 22,000 square feet of available retail space to CVS/Longs Drugs.

‘A‘ali‘i - Public sales launched in January 2018, and we broke ground on October 15, 2018, expanding the selection of new homes at Ward Village. We have entered into contracts for 564 of the 751 units as of September 30, 2018. We entered into 15 additional contracts during October 2018. These units under contract represent 75.1% and 77.1% of total units and 69.5% and 71.7% of the total residential square feet available for sale as of September 30 and October 31, 2018, respectively.

44

---

Table of Contents

## Projects Under Construction

The following table summarizes our projects under construction and related debt held in Operating Assets and Strategic Developments as of September 30, 2018. Projects that are substantially complete, and therefore, have been placed in service in Operating Assets may still require some capital for remaining tenant build-out. This table does not include projects for which construction has not yet started.

| (In thousands)  | Total Estimated Costs (a) | Costs Paid Through September 30, 2018 (b) | Estimated Remaining to be Spent (C) | Remaining Buyer Deposits to be Drawn (D) | Debt Holdback Drawn (c) (E) | Costs Remaining to be Paid, Net of Debt and Buyer Deposits/Holdbacks to be Drawn (c) (C) - (D) - (E) = (F) | Estimated Completion Date |
|---|---------------------------|---|-------------------------------------|--|-----------------------------|--|---------------------------|
|   | (A)                       | (B)                                       | (A) - (B) = (C)                     | (D)                                      | (E)                         | (C) - (D) - (E) = (F)  |                           |
| <b>Operating Assets</b>                                   |                           |   |                                     |  |                             |  |                           |
| Columbia  |                           |   |                                     |  |                             |  |                           |
| One Merriweather  | \$78,187                  | \$74,422                                  | \$3,765                             | \$ —                                     | \$ —                        | \$ 3,765   | (d)(e) Open               |
| Two Merriweather  | 40,941                    | 32,278                                    | 8,663                               | —  | 9,353                       | (690)  | (d)(f) Open               |
| The Woodlands   |                           |   |                                     |  |                             |  |                           |
| 1725-35 Hughes Landing Boulevard                          | 206,356                   | 190,614                                   | 15,742                              | —  | —                           | 15,742   | (d)(e) Open               |
| Lake Woodlands Crossing Retail                            | 15,381                    | 8,523                                     | 6,858                               | —  | 7,096                       | (238)  | (d)(f) Open               |
| Three Hughes Landing Seaport District                     | 90,162                    | 75,461                                    | 14,701                              | —  | 13,929                      | 772  | (d)(g) Open               |
| South Seaport - Pier 17 & Historic Area Uplands Summerlin | 624,713                   | 500,546                                   | 124,167                             | —  | —                           | 124,167  | (h)(i) Open               |
| Aristocrat  | 46,661                    | 26,151                                    | 20,510                              | —  | 15,369                      | 5,141  | (g) Open                  |
| Two Summerlin   | 49,320                    | 30,145                                    | 19,175                              | —  | 19,139                      | 36   | (g)(d) Open               |
| Other   |                           |   |                                     |  |                             |  |                           |
| Lakeland Village Center at Bridgeland                     | 16,274                    | 14,183                                    | 2,091                               | —  | —                           | 2,091  | (d)(e) Open               |
| Kewalo Basin Harbor                                       | 22,718                    | 12,889                                    | 9,829                               | —  | 10,265                      | (436)  | (f) 2019                  |
| <b>Total Operating Assets</b>                             | <b>1,190,713</b>          | <b>965,212</b>                            | <b>225,501</b>                      | <b>—</b>                                 | <b>75,151</b>               | <b>150,350</b>   |                           |
| <b>Strategic Developments</b>                             |                           |   |                                     |  |                             |  |                           |
| Chicago   |                           |   |                                     |  |                             |  |                           |
| 110 North Wacker  | 712,962                   | 87,821                                    | 625,141                             | —  | 589,302                     | 35,839   | (j) 2020                  |
| Columbia  |                           |   |                                     |  |                             |  |                           |
| 6100 Merriweather and Garage                              | 138,221                   | 18,315                                    | 119,906                             | —  | 89,844                      | 30,062   | (h) Q3 2019               |
| Columbia Multi-family/Retail                              | 116,386                   | 14,426                                    | 101,960                             | —  | 85,657                      | 16,303   | (h) Q4 2019               |
| The Woodlands   | 42,111                    | 33,212                                    | 8,899                               | —  | 30,000                      | (21,101)   | (f)(k) Q4 2018            |

Edgar Filing: Howard Hughes Corp - Form 10-Q

|                                      |             |             |             |    |              |            |        |         |
|--------------------------------------|-------------|-------------|-------------|----|--------------|------------|--------|---------|
| Creekside Park Apartments            |             |             |             |    |              |            |        |         |
| 100 Fellowship Drive                 | 63,278      | 42,069      | 21,209      | —  | 19,518       | 1,691      | (g)    | Q2 2019 |
| Hughes Landing Day Care              | 3,206       | 141         | 3,065       | —  | —            | 3,065      | (h)    | Q1 2019 |
| Bridgeland Apartments                | 48,412      | 5,529       | 42,883      | —  | 34,231       | 8,652      | (h)    | Q4 2019 |
| Two Lakes Edge                       | 107,706     | 2,638       | 105,068     | —  | —            | 105,068    | (l)    | 2020    |
| Seaport District                     |             |             |             |    |              |            |        |         |
| South Street Seaport - Tin Building  | 159,982     | 29,814      | 130,168     | —  | —            | 130,168    | (h)    | 2020    |
| Summerlin                            |             |             |             |    |              |            |        |         |
| Tanager Apartments (m)               | 59,276      | 15,573      | 43,703      | —  | 44,100       | (397       | ) (f)  | Q3 2019 |
| Summerlin Ballpark                   | 114,670     | 27,246      | 87,424      | —  | 37,717       | 49,707     | (h)(n) | Q2 2019 |
| Ward Village                         |             |             |             |    |              |            |        |         |
| Ae'o                                 | 428,508     | 365,128     | 63,380      | —  | 47,598       | 15,782     | (g)    | Q4 2018 |
| Anaha                                | 401,314     | 385,866     | 15,448      | —  | —            | 15,448     | (o)    | Open    |
| Ke Kilohana                          | 218,898     | 146,067     | 72,831      | —  | 70,989       | 1,842      | (g)    | Q2 2019 |
| Waiea                                | 442,298     | 399,090     | 43,208      | —  | —            | 43,208     | (o)    | Open    |
|                                      |             |             |             |    |              |            | (p)    |         |
| Total Strategic Developments         | 3,057,228   | 1,572,935   | 1,484,293   | —  | 1,048,956    | 435,337    |        |         |
| Combined Total at September 30, 2018 | \$4,247,941 | \$2,538,147 | \$1,709,794 | \$ | —\$1,124,107 | \$ 585,687 |        |         |

Two Lakes Edge estimated financing (74,035 )

Estimated costs to be funded net of financing, assuming closing on estimated financing \$ 511,652

Table of Contents

Total Estimated Costs represent all costs to be incurred on the project which include construction costs, demolition costs, marketing costs, tenant allowance costs, capitalized leasing, payroll or project development fees, deferred

(a) financing costs and advances for certain accrued costs from lenders and excludes land costs and capitalized corporate interest allocated to the project. Waiea, Anaha, Ae‘o, Ke Kilohana, One Merriweather and Two Merriweather exclude Master Plan infrastructure and amenity costs at Ward Village and the Merriweather District.

(b) Costs included in (a) above which have been paid through September 30, 2018.

(c) With respect to our condominium projects, remaining debt to be drawn is reduced by deposits used for construction.

(d) Final completion is dependent on lease-up and tenant build-out.

(e) Construction loans for One Merriweather, 1725-35 Hughes Landing Boulevard and Lakeland Village Center at Bridgeland have been paid in full, any remaining project costs will be funded by us.

Negative balances represent cash to be received in excess of Estimated Remaining to be Spent. These items are

(f) primarily related to September 2018 costs that were paid by us, but not yet reimbursed by our lenders. We expect to receive funds from our lenders for these costs in the future.

(g) Positive balances represent cash drawn in advance of costs paid.

(h) Positive balances represent cash equity to be invested.

South Street Seaport - Pier 17 and Historic Area / Uplands Total Estimated Costs and Costs Paid Through

(i) September 30, 2018 include costs required for the Pier 17 and Historical Area/Uplands and are gross of insurance proceeds received to date.

110 North Wacker Total Estimated Costs excludes the land value of \$86.0 million; The Debt to be Drawn includes future draws on the construction loan and anticipated equity partner and JV partner contributions. Costs Remaining to be Paid represent our remaining equity commitment. At loan closing, we received a \$52.2 million cash distribution from the venture and will reinvest funds over future periods to meet its remaining equity commitment.

(k) Creekside Apartments closed on the additional \$30.0 million of financing through our Woodlands Credit Facility in April 2017. The credit facility is available to be drawn, but we have not drawn down the facility to date.

(l) Positive balances represent future spending to be financed with construction loans we are currently seeking and equity to be spent.

(m) Formerly known as "Downtown Summerlin Apartments."

(n) Excludes costs to acquire the baseball team.

The Waiea and Anaha facility was repaid in full on October 27, 2017 in conjunction with the closing of a

(o) substantial portion of Anaha and Waiea. Approximately 98.0% of the units in these towers were sold and closed by September 30, 2018.

(p) Total estimate has been increased primarily as a result of warranty repairs that will be required. However, we anticipate recovering a substantial amount of these costs in the future which is not reflected in this schedule.

Corporate expenses and other items

Corporate expenses and other items increased by \$3.4 million to \$52.5 million and decreased by \$79.6 million to \$156.7 million for the three and nine months ended September 30, 2018, respectively, compared to the prior year periods. The increase in the three month period was mainly caused by the following:

- decrease of \$1.7 million in General and administrative expense driven primarily by decreased stock compensation expense due to stock option forfeitures, partially offset by increased labor costs due to higher headcount;

- decrease of \$1.2 million in Corporate interest expense, net related to higher interest income driven by favorable interest rates;

- increase of \$2.7 million in Demolition costs primarily related to the Tin Building, partially offset by the absence of costs at Ward Warehouse;

- increase of \$1.4 million in Development-related marketing costs primarily related to the Seaport District; and

increase of \$1.6 million in Income tax provision.

The decrease in the nine month period was mainly caused by the following:

• decrease of \$43.4 million due to warrant liability expenses recognized in the comparative 2017 periods that did not recur in 2018;

• decrease of \$46.4 million related to the redemption in the first quarter of 2017 of our \$750.0 million 6.875% senior notes due 2021; and

• increase of \$15.9 million in Demolition costs primarily related to 110 North Wacker and the Tin Building.

#### Liquidity and Capital Resources

Our primary sources of cash include cash flow from land sales in MPC, cash generated from our operating assets, condominium closings, deposits from condominium sales (which are restricted to funding construction of the related developments), first mortgage financings secured by our assets and the corporate bond markets. Additionally, strategic sales of certain assets may provide additional cash proceeds to our operating or investing activities. Our primary uses of cash include working capital, overhead, debt service, property improvements, acquisitions and development costs. We believe that our sources of cash, including existing cash on hand, will provide sufficient liquidity to meet our existing non-discretionary obligations and anticipated ordinary course operating expenses for at least the next 12 months. The development and redevelopment opportunities in Operating Assets and Strategic Developments are capital intensive and will require significant additional funding, if and when pursued. Any additional funding, if available, would be raised with a mix of construction, bridge and long-term financings, by entering into joint venture arrangements and the sale of non-core assets at the appropriate time. We cannot provide assurance that financing arrangements for our properties will be on favorable terms or occur at all, which could have a negative impact on our liquidity and capital resources. In addition,

Table of Contents

we typically must provide completion guarantees to lenders in connection with their providing financing for our projects. We also provided a completion guarantee to the City of New York for the redevelopment of Pier 17 and the Tin Building.

Total outstanding debt was \$3.3 billion as of September 30, 2018. Certain mortgages may require paydowns in order to exercise contractual extension terms. Our proportionate share of the debt of our Real Estate Affiliates, which is non-recourse to us, totaled \$94.9 million as of September 30, 2018. The following table summarizes our net debt on a segment basis as of September 30, 2018. Net debt is defined as Mortgages, notes and loans payable, including our ownership share of debt of our real estate and other affiliates, reduced by liquidity sources to satisfy such obligations such as our ownership share of Cash and cash equivalents and SID, MUD and TIF receivables. Although net debt is a non-GAAP financial measure, we believe that such information is useful to our investors and others who review our financial statements. However, it should not be used as an alternative to our debt calculated in accordance with GAAP.

| (In thousands)<br>Segment Basis (a)         | Master<br>Planned<br>Communities | Operating<br>Assets | Strategic<br>Developments | Segment<br>Totals | Non-<br>Segment<br>Amounts | September<br>30, 2018 |
|---|----------------------------------|---------------------|---------------------------|-------------------|----------------------------|-----------------------|
| Mortgages, notes and loans payable          | \$ 229,934                       | \$ 1,674,875        | (c) \$ 447,442            | \$ 2,352,252      | \$ 1,003,814               | \$ 3,356,066          |
| Less: Cash and cash equivalents             | (111,704 )                       | (b)(91,095 )        | (d)(76,274 )              | (e)(279,074 )     | (239,878 )                 | (518,952 )            |
| Special Improvement District receivables    | (23,747 )                        | —                   | —                         | (23,747 )         | —                          | (23,747 )             |
| Municipal Utility District receivables, net | (237,567 )                       | —                   | —                         | (237,567 )        | —                          | (237,567 )            |
| TIF receivable                              | —                                | —                   | (6,048 )                  | (6,048 )          | —                          | (6,048 )              |
| Net Debt                                    | \$ (143,084 )                    | \$ 1,583,780        | \$ 365,120                | \$ 1,805,816      | \$ 763,936                 | \$ 2,569,752          |

(a) Please refer to Note 16 – Segments in our Condensed Consolidated Financial Statements.

(b) Includes MPC Cash and cash equivalents, including \$63.3 million of cash related to The Summit joint venture.

(c) Includes our \$91.0 million share of debt of our real estate and other affiliates in Operating Assets (Woodlands Sarofim #1, The Metropolitan Downtown Columbia, 33 Peck Slip and m.flats/TEN.M).

(d) Includes our \$1.2 million share of Cash and cash equivalents of our real estate and other affiliates in Operating Assets (Woodlands Sarofim #1, The Metropolitan Downtown Columbia, Stewart Title of Montgomery County, TX, 33 Peck Slip and m.flats/TEN.M).

(e) Includes our \$0.3 million share of Cash and cash equivalents of our real estate and other affiliates in Strategic Developments (KR Holdings, LLC, HHMK Development, LLC and Circle T Ranch and Power Center).

## Cash Flows

## Operating Activities

The cash flows and earnings generated from each business segment's activities will likely vary significantly from year to year given the changing nature of our development focus. Condominium deposits received from contracted units offset by other various cash uses related to condominium development and sales activities are a substantial portion of our operating activities in 2018. Operating cash continued to be utilized in the third quarter of 2018 to fund ongoing development expenditures in Strategic Developments and MPC, consistent with prior years.

The cash flows and earnings from the MPC business may fluctuate more than from our operating assets because the MPC business generates revenues from land sales rather than recurring contractual revenues from operating leases. MPC land sales are a substantial portion of our cash flows from operating activities and are partially offset by development costs associated with the land sales business and acquisitions of land that is intended to ultimately be developed and sold.

Net cash used in operating activities was \$139.8 million and \$24.3 million for the nine months ended September 30, 2018, and 2017 respectively. The \$115.5 million net increase in cash used for operating activities in the nine months ended September 30, 2018 compared to the same period in 2017 was primarily related to the timing of condominium development expenditures.

#### Investing Activities

Net cash used in investing activities was \$654.1 million for the nine months ended September 30, 2018 as compared to cash used in investing activities of \$245.0 million for the nine months ended September 30, 2017. The increase in use of cash of \$409.1 million was primarily the result of the acquisitions of 250 Water Street for \$180.0 million and Lakefront North for \$53.0 million. In addition, we incurred development costs of \$63 million related to the Seaport District, \$48.3 million related to 110 North Wacker, \$33.0 million related to the Summerlin Ballpark, \$21.3 million related to 6100 Merriweather and \$8.0 million related to Lake Woodlands Crossing Retail.

Table of Contents

## Financing Activities

Net cash provided by financing activities was \$442.2 million for nine months ended September 30, 2018 as compared to \$316.4 million for nine months ended September 30, 2017. The increase of \$125.8 million is mainly caused by \$25.9 million and \$13.5 million in construction draws for 110 North Wacker and Summerlin Ballpark, respectively. In addition, the prior period includes a cash outlay of \$40.0 million incurred to redeem the 2021 senior notes, with no comparable outflow in the current period.

## Contractual Cash Obligations and Commitments

The following table includes significant updates to our contractual obligations and commitments since December 31, 2017.

Additional information regarding our contractual obligations and commitments as well as items not included below can be found under the heading “Contractual Cash Obligations and Commitments” in our Annual Report.

The following table summarizes our contractual obligations as of September 30, 2018:

| (In thousands)                             | Remaining<br>in 2018 | 2019       | 2020       | 2021       | 2022       | 2023       | Thereafter   | Total        |
|--|----------------------|------------|------------|------------|------------|------------|--------------|--------------|
| Mortgages, notes and loans payable (a)     | \$ 57,418            | \$ 92,700  | \$ 276,438 | \$ 582,733 | \$ 207,312 | \$ 673,798 | \$ 1,391,597 | \$ 3,281,996 |
| Interest Payments (b)                      | 41,371               | 161,344    | 154,982    | 133,094    | 108,276    | 92,929     | 155,635      | 847,631      |
| Ground lease and other leasing commitments | 2,024                | 8,119      | 8,259      | 8,097      | 7,430      | 7,185      | 306,944      | 348,058      |
| Total                                      | \$ 100,813           | \$ 262,163 | \$ 439,679 | \$ 723,924 | \$ 323,018 | \$ 773,912 | \$ 1,854,176 | \$ 4,477,685 |

(a) Based on final maturity, inclusive of extension options.

(b) Interest is based on the borrowings that are presently outstanding and current floating interest rates.

## Off-Balance Sheet Financing Arrangements

We do not have any material off-balance sheet financing arrangements. Although we have interests in certain property owning non-consolidated ventures which have mortgage financing, the financings are non-recourse to us and totaled \$199.8 million as of September 30, 2018.

## Critical Accounting Policies

Critical accounting policies are those that are both significant to the overall presentation of our financial condition and results of operations and require management to make difficult, complex or subjective judgments. See Note 1 – Summary of Significant Accounting Policies in our Annual Report and Note 2 - Accounting Policies and Pronouncements in this Quarterly Report.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk with respect to our variable rate financings in that increases in interest rates will increase our payments under these variable rates. With respect to fixed-rate financings, increases in interest rates could make it more difficult to refinance such debt when due. We manage a portion of our variable interest rate exposure by using interest rate swaps and caps. As of September 30, 2018, of our \$1.6 billion of variable rate debt outstanding,



\$654.0 million has been swapped to a fixed-rate. We also have interest rate cap contracts for our \$230.0 million Ae'ō facility and our \$180.0 million Master Credit Facility for The Woodlands, \$150.0 million of which is currently outstanding and \$75.0 million of which is capped, to mitigate our exposure to rising interest rates. As the properties are placed in service and become stabilized, we typically refinance the variable rate debt with long-term fixed-rate debt.

As of September 30, 2018, annual interest costs would increase approximately \$9.9 million for every 1.00% increase in floating interest rates. Generally, a significant portion of our interest expense is capitalized due to the level of assets we currently have under development; therefore, the current impact of a change in our interest rate on our Condensed Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income would be less than the total change, but we would incur higher cash payments and the development costs of our assets would be higher. For additional information concerning our debt and management's estimation process to arrive at a fair value of our debt as required by GAAP, please refer to the Liquidity and Capital Resources section of "Item 2. - Management's Discussion and Analysis of Financial Condition and Results of Operations," Note 7 - Mortgages, Notes and Loans Payable and Note 9 - Derivative Instruments and Hedging Activities in our Condensed Consolidated Financial Statements.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13(a)-15(e) under the Exchange Act) that are designed to provide reasonable assurance that information required to be disclosed in our reports to the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and our principal financial and accounting officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and our principal financial and accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2018, the end of the period covered by this report. Based on the foregoing, our principal executive officer and principal financial and accounting officer concluded that our disclosure controls and procedures were effective as of September 30, 2018.

Changes in Internal Control over Financial Reporting

There have been no changes to our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Please refer to Note 10 - Commitments and Contingencies in the Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

There are no material changes to the risk factors previously disclosed in our Annual Report.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following Exhibit Index to this Quarterly Report lists the exhibits furnished as required by Item 601 of Regulation S-K and is incorporated by reference.

Table of Contents

EXHIBIT INDEX

|          |  |
|----------|--|
| 10.1     | <u>Loan Agreement dated as of September 18, 2018, by and among Victoria Ward, Limited; Victoria Ward Center L.L.C.; Victoria Ward Entertainment Center L.L.C.; 1240 Ala Moana, LLC; Anaha Retail Holdings, LLC; Waiea Retail Holdings, LLC; 10 CCC, LLC; 20 CCC, LLC; 30 CCC, LLC; 10/20/30 CCC Parking Deck, LLC; 40 CCC, LLC; 40 CCC Parking Deck, LLC; 50 CCC, LLC; 60 CCC, LLC; 70 CC, LLC; 50/60/70 CCC Parking Deck, LLC; One Mall North, LLC; Crescent Area 1 Holdings, LLC; Crescent Area 1 Parking Deck 1, LLC; HL Champion Holding Company, LLC; Lakeland Village Holding Company, LLC; Waterway Hotel Holdings, LLC; HL-Hotel Holding Company, LLC; CSPV Holdings, LLC; 1701 Lake Robbins, LLC; Wells Fargo Bank, National Association, as administrative agent and a lender; Wells Fargo Securities, L.L.C., as sole lead arranger and sole book-runner; and the other lenders party thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed September 24, 2018)</u> |
| 31.1+    | <u>Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>  |
| 31.2+    | <u>Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>  |
| 32.1+    | <u>Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>  |
| 101.INS+ | XBRL Instance Document   |
| 101.SCH+ | XBRL Taxonomy Extension Schema Document  |
| 101.CAL+ | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB+ | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE+ | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF+ | XBRL Taxonomy Extension Definition Linkbase Document   |

+ Filed herewith

Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017, (ii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2018 and 2017, (iii) the Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, (iv) Condensed Consolidated Statements of Equity for the nine months ended September 30, 2018 and 2017, and (v) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

The Howard Hughes  
Corporation

By: /s/ David R. O'Reilly  
David R. O'Reilly  
Chief Financial Officer  
November 5, 2018