Howard Hughes Corp
Form 10-Q
August 07, 2017
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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 June 30, 2017

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

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

(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant's telephone number, including area code)

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

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
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 July 27, 2017 was 43,187,266.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

(In thousands, except share amounts)	June 30, 2017	December 31, 2016
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,676,263	$ 1,669,561
Buildings and equipment	2,152,915	2,027,363
Land	314,383	320,936
Less: accumulated depreciation	(282,557)	(245,814)
Developments	1,048,849	961,980
Net property and equipment	4,909,853	4,734,026
Investment in Real Estate and Other Affiliates	81,797	76,376
Net investment in real estate	4,991,650	4,810,402
Cash and cash equivalents	660,086	665,510
Accounts receivable, net	11,953	10,038
Municipal Utility District receivables, net	175,822	150,385
Deferred expenses, net	75,351	64,531
Prepaid expenses and other assets, net	752,587	666,516
Total assets	$ 6,667,449	$ 6,367,382
Liabilities:		
Mortgages, notes and loans payable	$ 3,002,846	$ 2,690,747
Deferred tax liabilities	224,097	200,945
Warrant liabilities	—	332,170
Accounts payable and accrued expenses	473,013	572,010
Total liabilities	3,699,956	3,795,872
Commitments and Contingencies (see Note 15)		
Equity:		
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued	—	—
Common stock: $.01 par value; 150,000,000 shares authorized, 43,202,100 shares issued and 43,185,718 outstanding as of June 30, 2017 and 39,802,064 shares issued and 39,790,003 outstanding as of December 31, 2016	432	398
Additional paid-in capital	3,243,342	2,853,269

Accumulated deficit	(269,133)	(277,912)
Accumulated other comprehensive loss	(9,157)	(6,786)
Treasury stock, at cost, 16,382 shares as of June 30, 2017 and 12,061 shares as of December 31, 2016, respectively	(1,763)	(1,231)
Total stockholders' equity	2,963,721	2,567,738
Noncontrolling interests	3,772	3,772
Total equity	2,967,493	2,571,510
Total liabilities and equity	$ 6,667,449	$ 6,367,382

See Notes to Condensed Consolidated Financial Statements.

THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share amounts)	2017	2016	2017	2016
Revenues:				
Condominium rights and unit sales	$ 148,211	$ 125,112	$ 228,356	$ 247,206
Master Planned Community land sales	69,144	61,098	122,625	103,040
Minimum rents	45,073	42,036	91,399	83,345
Tenant recoveries	11,642	10,923	23,041	21,451
Hospitality revenues	19,703	19,129	39,414	32,038
Builder price participation	4,480	6,501	9,141	11,148
Other land revenues	4,463	4,122	15,045	8,170
Other rental and property revenues	5,923	4,593	11,380	7,797
Total revenues	308,639	273,514	540,401	514,195
Expenses:				
Condominium rights and unit cost of sales	106,195	79,726	166,678	154,541
Master Planned Community cost of sales	33,376	29,008	59,245	44,696
Master Planned Community operations	7,307	9,169	16,701	19,778
Other property operating costs	20,291	15,236	38,799	30,978
Rental property real estate taxes	6,550	7,329	14,087	14,077
Rental property maintenance costs	3,608	2,753	6,636	5,885
Hospitality operating costs	14,164	14,242	28,009	24,717
Provision for doubtful accounts	745	(352)	1,280	2,689
Demolition costs	63	490	128	962
Development-related marketing costs	4,716	6,339	8,921	10,870
General and administrative	22,944	20,053	41,061	40,377
Depreciation and amortization	34,770	24,952	60,294	47,924
Total expenses	254,729	208,945	441,839	397,494
Operating income before other items	53,910	64,569	98,562	116,701
Other:				
Gains on sales of properties	—	—	32,215	140,479
Other income, net	223	9,067	910	9,426
Total other	223	9,067	33,125	149,905

Operating income	54,133	73,636	131,687	266,606
Interest income	785	435	1,407	704
Interest expense	(14,448)	(16,533)	(32,306)	(32,526)
Loss on redemption of senior notes due 2021	—	—	(46,410)	—
Warrant liability loss	(30,881)	(44,150)	(43,443)	(14,330)
Gain on acquisition of joint venture partner's interest	—	—	5,490	—
Equity in earnings from Real Estate and Other Affiliates	9,834	20,275	18,354	22,207
Income before taxes	19,423	33,663	34,779	242,661
Provision for income taxes	16,303	26,693	26,000	91,926
Net income	3,120	6,970	8,779	150,735
Net income attributable to noncontrolling interests	—	—	—	—
Net income attributable to common stockholders	$ 3,120	$ 6,970	$ 8,779	$ 150,735
Basic income per share:	$ 0.08	$ 0.18	$ 0.22	$ 3.82
Diluted income per share:	$ 0.07	$ 0.16	$ 0.20	$ 3.53

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

UNAUDITED

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2017	2016	2017	2016
Net income	$ 3,120	$ 6,970	$ 8,779	$ 150,735
Other comprehensive income (loss):				
Interest rate swaps (a)	(2,683)	(5,565)	(2,250)	(15,373)
Capitalized swap interest expense (b)	(46)	(254)	(121)	(317)
Pension adjustment (c)	—	(573)	—	(573)
Other comprehensive income (loss)	(2,729)	(6,392)	(2,371)	(16,263)
Comprehensive income	391	578	6,408	134,472
Comprehensive income attributable to common stockholders	$ 391	$ 578	$ 6,408	$ 134,472

(a) Net of deferred tax benefit of $1.5 million and $3.0 million for the three months ended June 30, 2017 and 2016, respectively, $1.2 million and $8.3 million for the six months ended June 30, 2017 and 2016, respectively.
(b) The deferred tax impact was immaterial for the three months ended June 30, 2017 and 2016, respectively. Amount is net of deferred tax benefit of $0.1 million for the six months ended June 30, 2017 and 2016, respectively.
(c) Net of deferred tax benefit of $0.4 million for the three and six months ended June 30, 2016, respectively.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

UNAUDITED

(In thousands, except shares)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	Treasury Stock Shares	Treasury Stock Amount	Noncontroll Interests
Balance December 31, 2015	39,714,838	$ 398	$ 2,847,823	$ (480,215)	$ (7,889)	—	$ —	$ 3,772
Net income	—	—	—	150,735	—	—	—	—
Interest rate swaps, net of tax $8,245	—	—	—	—	(15,373)	—	—	—
Pension adjustment, net of tax of $350	—	—	—	—	(573)	—	—	—
Capitalized swap interest, net of tax $61	—	—	—	—	(317)	—	—	—
Stock plan activity	131,198	—	6,057	—	—	(12,061)	(1,231)	—
Balance, June 30, 2016	39,846,036	398	2,853,880	(329,480)	(24,152)	(12,061)	(1,231)	3,772
Balance December 31, 2016	39,802,064	398	2,853,269	(277,912)	(6,786)	(12,061)	(1,231)	3,772
Net income	—	—	—	8,779	—	—	—	—
Interest rate swaps, net of tax of $1,221	—	—	—	—	(2,250)	—	—	—
Capitalized swap interest, net of tax of $66	—	—	—	—	(121)	—	—	—
	—	—	—	—	—	—	—	—

Grant of management warrants (a)								
Stock plan activity	347,583	3	14,491	—	—	(4,321)	(532)	—
Exercise of warrants	3,052,453	31	375,582	—	—	—	—	—
Balance, June 30, 2017	43,202,100	$ 432	$ 3,243,342	$ (269,133)	$ (9,157)	(16,382)	$ (1,763)	$ 3,772

(a) Represents the $50.0 million warrant granted to purchase 1,965,409 shares upon receipt of the $50.0 million purchase price for the warrant grant executed on June 16, 2017 between the Company and our CEO, David R. Weinreb. Per the terms of the agreement, Mr. Weinreb has 75 days from June 16, 2017 to pay the purchase price of the new warrant. See Note 3 – Sponsor and Management Warrants for additional information.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended June 30,	
(In thousands)	2017	2016
Cash Flows from Operating Activities:		
Net income	$ 8,779	$ 150,735
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation	51,779	41,126
Amortization	8,515	6,798
Amortization of deferred financing costs	2,940	3,747
Amortization of intangibles other than in-place leases	(791)	(710)
Straight-line rent amortization	(2,553)	(5,187)
Deferred income taxes	24,440	85,927
Restricted stock and stock option amortization	3,407	4,670
Gains on sales of properties	(32,215)	(140,479)
Gain on acquisition of joint venture partner's interest	(5,490)	—
Warrant liability loss (gain)	43,443	14,330
Loss on redemption of senior notes due 2021	46,410	—
Equity in earnings from Real Estate and Other Affiliates, net of distributions	(13,440)	(8,212)
Provision for doubtful accounts	1,280	2,689
Master Planned Community land acquisitions	(1,415)	(69)
Master Planned Community development expenditures	(90,973)	(70,678)
Master Planned Community cost of sales	53,240	41,310
Condominium development expenditures	(191,499)	(155,222)
Condominium rights and unit cost of sales	166,678	154,541
Percentage of completion revenue recognition from sale of condominium rights and unit sales	(228,356)	(247,206)
Net changes:		
Accounts receivable	272	(3,230)
Prepaid expenses and other assets	(7,949)	2,616
Condominium deposits received	31,872	51,573
Deferred expenses	(9,672)	(1,659)
Accounts payable and accrued expenses	(40,526)	(24,798)
Condominium deposits held in escrow	(31,872)	(51,573)
Condominium deposits released from escrow	116,244	15,661
Other, net	(191)	(3,535)
Cash used in operating activities	(97,643)	(136,835)

Cash Flows from Investing Activities:		
Property and equipment expenditures	(4,814)	(7,339)
Operating property improvements	(8,967)	(5,712)
Property developments and redevelopments	(195,189)	(214,276)
Acquisition of partner's interest in Las Vegas 51s	(15,404)	—
Proceeds for reimbursement of development costs	11,165	2,915
Proceeds from sales of properties	36,000	378,257
Proceeds from insurance claims	—	3,107
Distributions from Real Estate and Other Affiliates	—	12,002
Note issued to Real Estate Affiliate	—	(25,000)
Proceeds from repayment of note to Real Estate Affiliate	—	25,000
Investments in Real Estate and Other Affiliates, net	(1,391)	(11,813)
Change in restricted cash	(3,919)	4,658
Cash (used in) provided by investing activities	(182,519)	161,799
Cash Flows from Financing Activities:		
Proceeds from mortgages, notes and loans payable	$ 1,399,843	$ 207,561
Principal payments on mortgages, notes and loans payable	(1,085,438)	(4,492)
Premium paid to redeem 2021 senior notes	(39,966)	—
Special Improvement District bond funds released from (held in) escrow	1,602	—
Deferred financing costs	(11,383)	(1,303)
Taxes paid on vested stock options and restricted stock	(9,029)	(1,231)
Stock options exercised	19,109	—
Cash provided by financing activities	274,738	200,535
Net change in cash and cash equivalents	(5,424)	225,499
Cash and cash equivalents at beginning of period	665,510	445,301
Cash and cash equivalents at end of period	$ 660,086	$ 670,800

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended June 30,	
	2017	2016
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 60,566	$ 57,335
Interest capitalized	35,291	28,681
Income taxes paid	1,873	3,067
Non-Cash Transactions:		
Exercise of Sponsor and Management Warrants	375,613	—
Special Improvement District bond transfers associated with land sales	6,005	3,386
Accrued interest on construction loan borrowing	2,522	3,005
Capitalized stock compensation	765	1,387
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.

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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, 2016 (the "Annual Report"), filed on February 23, 2017 with the SEC. Certain amounts in 2016 have been reclassified to conform to 2017 presentation. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position, results of operations, comprehensive income (loss), cash flows and equity for the interim periods have been included. The results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ended December 31, 2017.

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

NOTE 2 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

In May 2017, the Financial Accounting Standards Board's ("FASB") issued Accounting Standards Update ("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. Once adopted, HHC will apply this guidance to any modifications made to either the stock option or restricted stock award plans. We will adopt the ASU on January 1, 2018.

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 non-financial 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 non-financial assets. 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. We are currently evaluating the potential impact of this ASU on our consolidated financial statements.

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. 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

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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prospectively with early adoption permitted. We do not expect the adoption of this ASU to have a material impact on our consolidated financial statements.

In January 2017, the FASB formally issued, and we early adopted ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, as permitted, on a prospective basis. The standard provides criteria to determine when an integrated set of assets and activities is not a business. The criteria requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. However, to be considered a business, the set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Under the new guidance, the acquisition of a property with an in-place lease generally will no longer be accounted for as an acquisition of a business, but instead as an asset acquisition, meaning the transaction costs of such an acquisition will now be capitalized instead of expensed. Our adoption did not have a material impact on our accounting for acquisitions.

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 statement of cash flow. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period, but any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The new standard must be adopted retrospectively. ASU 2016-18 will impact our presentation of operating, investing and financing activities related to restricted cash on our consolidated statements of cash flows.

In October 2016, the FASB issued ASU 2016-17, Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control. The standard requires reporting entities to evaluate whether they should consolidate a variable interest entity ("VIE") in certain situations involving entities under common control. Specifically, the standard changes the evaluation of whether a reporting entity is the primary beneficiary of a VIE by changing how a reporting entity that is a single decision maker of a VIE treats indirect interests in the entity held through related parties that are under common control with the reporting entity. The new standard was effective January 1, 2017, and must be adopted retrospectively. We currently have no VIEs involving entities under common control, and accordingly, adoption of this ASU had no impact on our consolidated financial statements.

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 statement 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, with early adoption permitted. The new standard must be adopted retrospectively. ASU 2016-15 will impact our presentation of operating, investing and financing activities related to certain cash receipts and payments on our 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 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. We are currently evaluating the adoption of ASU 2016-13 on our consolidated financial statements but do not anticipate significant impact.

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

In March 2016, the FASB issued ASU 2016-09, Compensation–Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting, the standard amends several aspects of accounting for share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. We adopted the ASU as of January 1, 2017, and it did not have a material impact on our accounting for excess tax benefits and tax deficiencies as our stock compensation plans, which permit net-share settlement, had minimal vesting and exercise activity prior to January 1, 2017. The new guidance requires entities to recognize all income tax effects of awards in the income statement when the awards vest or are settled, in contrast to current guidance wherein such effects are recorded in additional paid-in capital ("APIC"). The amounts recorded in APIC prior to our adoption remain in APIC per the new standard. It also allows an employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. Our plans allow us, at the employee's request, to withhold shares with a fair value up to the amount of tax owed using the maximum statutory tax rate for the employee's applicable jurisdiction. We elected to continue to estimate forfeitures as allowed by an election under the new guidance. Our condensed consolidated statements of cash flows for the six months ended June 30, 2017 and 2016 present excess tax benefits as an operating activity and employee taxes paid as a financing activity as required by ASU 2016-09.

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02, 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 requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application. We are currently evaluating the impact of adopting ASU 2016-02 on our consolidated financial statements. We anticipate a material increase to our assets and liabilities as we will be required to capitalize our ground leases, office leases and certain office equipment where we are the lessee. We will also be considering certain services that are considered non-lease components such as common area maintenance under the new guidance. Upon adoption of ASC 842, these services will be accounted for under ASU 2014-09, Revenues from Contracts with Customers (Topic 606), which is further discussed below.

In May 2014, the FASB and International Accounting Standards Board issued ASU 2014-09. 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. The ASU requires companies to identify performance obligations in the contract, estimate the amount of

variable consideration to include in the transaction price and allocate the transaction price to each separate performance obligation. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted. We have concluded that after adoption we will not be able to recognize revenue for condominium projects on a percentage of completion basis, and generally revenue will be recognized when the units close and the title has transferred to the buyer. Entities have the option of using either a full retrospective or a modified retrospective approach. We have elected to apply a modified retrospective approach of adoption. We are continuing to evaluate the new guidance to determine all impacts on our consolidated financial statements.

NOTE 3 SPONSOR AND MANAGEMENT WARRANTS

On November 9, 2010, we issued warrants to purchase 1,916,667 shares of our common stock (the “Sponsor Warrants”) to certain funds of Pershing Square Capital Management, L.P. (“Pershing Square”). The exercise price for the warrants of $50.00 per share and the number of shares of common stock underlying each warrant were subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events.

In November 2010 and February 2011, we entered into certain agreements (the “Management Warrants”) with David R.

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our former Chief Financial Officer, in each case prior to his appointment to such position, to purchase 2,367,985, 315,731 and 178,971 shares, respectively, of our common stock. The Management Warrants represent underlying shares, which may be adjusted pursuant to a net settlement option, and were issued pursuant to such agreements at fair value in exchange for a combined total of approximately $19.0 million in cash from such executives at the commencement of their respective employment. Mr. Weinreb and Mr. Herlitz's warrants became exercisable in November 2016, and Mr. Weinreb and Mr. Herlitz's warrants had an exercise price of $42.23 per share and Mr. Richardson's warrants became exercisable in February 2017 and had an exercise price of $54.50 per share.

Pershing Square exercised its Sponsor Warrants on June 30, 2017, resulting in a net issuance of 1,136,517 shares in accordance with the warrant provisions. Mr. Herlitz exercised his warrants in early January 2017, resulting in the net issuance of 198,184 shares in accordance with the warrant provisions. Mr. Herlitz also donated 6,850 shares to a charitable trust, which were net share settled for 4,400 shares in accordance with the warrant provisions. In February and March 2017, Mr. Richardson exercised 130,000 Management Warrants, resulting in the net issuance of 70,014 shares in accordance with the warrant provisions. In June 2017, Mr. Weinreb exercised all his 2,367,985 Management Warrants and Mr. Richardson exercised his remaining 48,971 Management Warrants, resulting in the net issuance of 1,614,803 and 28,535 shares, respectively, in accordance with the warrant provisions.

As of June 30, 2017, all Sponsor and the original Management Warrants have been exercised. The fair values for the Sponsor and Management Warrants as of December 31, 2016 were recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsor Warrants and Management Warrants were $123.5 million and $208.7 million, respectively, as of December 31, 2016. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 7 – Fair Value of Financial Instruments in our Condensed Consolidated Financial Statements. Decreases and increases in the fair value of the Sponsor and Management Warrants were recognized as warrant liability gains or losses in the Condensed Consolidated Statements of Operations.

On October 7, 2016, we entered into a management warrant agreement with our new Chief Financial Officer, David R. O'Reilly, prior to his appointment to the position. This warrant represents 50,125 underlying shares with an exercise price of $112.08 per share and was issued at fair value in exchange for $1.0 million in cash from Mr. O'Reilly. On

June 16, 2017, we also entered into a new warrant agreement ("New CEO Warrant") with Mr. Weinreb to acquire 1,965,409 shares for the purchase price of $50.0 million. The New CEO Warrant shall become exercisable on June 15, 2022, at an exercise price of $124.64 per share, subject to certain change in control, separation and termination provisions. The new warrants, which qualify as equity instruments, are included within additional paid-in capital in the Condensed Consolidated Balance Sheets at June 30, 2017 and December 31, 2016. At June 30, 2017, the New CEO Warrant is fully offset by a contribution receivable of $50.0 million from Mr. Weinreb. Mr. Weinreb has 75 days from June 16, 2017 per the terms of the warrant grant agreement to pay the purchase price of the New CEO Warrant.

NOTE 4 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 Sponsor Warrants and Management Warrants is computed using the if converted method prior to their exercise. In previous periods, gains associated with the changes in the fair value of the Sponsor Warrants and Management Warrants, if applicable, are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti dilutive.

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Information related to our EPS calculations is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share amounts)	2017	2016	2017	2016
Basic EPS:				
Numerator:				
Net income	$ 3,120	$ 6,970	$ 8,779	$ 150,735
Net income attributable to noncontrolling interests	—	—	—	—
Net income attributable to common stockholders	$ 3,120	$ 6,970	$ 8,779	$ 150,735
Denominator:				
Weighted average basic common shares outstanding	40,373	39,492	40,088	39,483
Diluted EPS:				
Numerator:				
Net income attributable to common stockholders	$ 3,120	$ 6,970	$ 8,779	$ 150,735
Denominator:				
Weighted average basic common shares outstanding	40,373	39,492	40,088	39,483
Restricted stock and stock options	291	337	305	324
Warrants	2,387	2,835	2,689	2,835
Weighted average diluted common shares outstanding	43,051	42,664	43,082	42,642
Basic income per share:	$ 0.08	$ 0.18	$ 0.22	$ 3.82
Diluted income per share:	$ 0.07	$ 0.16	$ 0.20	$ 3.53

The diluted EPS computation for the three and six months ended June 30, 2017 excludes 308,500 and 315,000 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and six months ended June 30, 2017 excludes 167,005 shares of restricted stock, because market conditions have not been met.

The diluted EPS computation for the three and six months ended June 30, 2016 excludes 363,000 stock options and 402,500 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and six months ended June 30, 2016 excludes 153,781 shares of restricted stock because market conditions have not been met.

NOTE 5 RECENT TRANSACTIONS

On May 4, 2017, we announced that Bank of America will serve as the lead anchor tenant to the 51-story, Class A

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downtown office building at 110 North Wacker Drive in Chicago, Illinois. The lease accounts for more than a third of the Goettsch-designed 1.35 million square-foot high-rise. Construction is scheduled to start in the spring of 2018, with a late 2020 opening expected. In conjunction with this transaction, on April 28, 2017, we exercised our termination option in the current lease with the tenant who occupies the existing 110 North Wacker property. The tenant will continue to occupy the building until January 2018 but will no longer pay the $6.1 million annual rent or any operating expenses which were previously paid 100% by the tenant.

On March 16, 2017, we offered, sold and issued $800.0 million in aggregate principal amount of 5.375% senior notes due March 15, 2025 (the “2025 Notes”) to Qualified Institutional Buyers (as defined in the Securities Act of 1933) in accordance with Rule 144A and Regulation S and completed a tender offer and consent solicitation for any and all of our $750.0 million existing 6.875% senior notes due October 1, 2021. We used the net proceeds to redeem all of the 6.875% senior notes and to pay related transaction fees and expenses. On June 12, 2017, we issued an additional $200.0 million of the 2025 Notes at a premium to par of 2.25%. We intend to use the proceeds to repay construction financings and fund ongoing development projects and general corporate needs. Interest on the 2025 Notes is paid semi-annually, on March 15th and September 15th of each year beginning on September 15, 2017. At any time prior to March 15, 2020, we may redeem all or a portion of the 2025 Notes at a redemption price equal to 100% of the principal plus a “make-whole” declining call premium thereafter to maturity. At any time prior to March 15, 2020, we may redeem 35% of the 2025 Notes at a price of 105.375% with net cash proceeds of certain equity offerings, plus accrued and unpaid interest. The 2025 Notes contain customary terms and covenants and have no financial maintenance covenants.

On March 1, 2017 (the “Acquisition Date”), we acquired our joint venture partner’s 50.0% interest in the Las Vegas 51s minor league baseball team for $16.4 million and became the sole owner of this Triple-A baseball team affiliated with the New York Mets. We recognized a gain of $5.4 million in Gain on acquisition of joint venture partner's interest in conjunction with this acquisition relating to the step-up to fair value of the assets acquired. The estimated fair values of the assets acquired and liabilities assumed disclosed as of March 31, 2017 were provisional as they were pending final determinations of the fair value of the intangible assets existing as of the Acquisition Date. Using the income approach, the final adjustments made as of June 30, 2017 to the allocated fair values included a $0.4 million contingent liability recorded in Accounts payable and accrued expenses per the terms of the purchase agreement relating to a credit for the use of seats in a future stadium for the team, if and when constructed by us, and an adjustment to allocate $7.9 million to finite-lived intangibles, which have a weighted average amortization period of 11 years, and $24.9 million to indefinite-lived intangibles, primarily related to the franchise relationship agreement, all of which is recorded in Prepaid expenses and other assets, net. Accordingly, the adjusted values of assets acquired and

liabilities assumed and consolidated into our financial statements total $36.0 million and $3.2 million, respectively, and are included in our Operating Assets segment. Prior to the acquisition, we accounted for our investment in the Las Vegas 51s under the equity method within Investment in Real Estate and Other Affiliates and recognized a loss of $0.2 million in equity in earnings for the six months ended June 30, 2017. Included in the Condensed Consolidated Statements of Operations from the Acquisition Date through June 30, 2017 are revenues of $4.3 million and pre-tax net income from operations of $0.4 million.

NOTE 6 IMPAIRMENT

We review our real estate assets for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment or disposal of long lived assets in accordance with ASC 360 requires that if impairment indicators exist and expected undiscounted cash flows generated by the asset over our anticipated holding period are less than its carrying amount, an impairment provision should be recorded to write down the carrying amount of the asset to its fair value. The impairment analysis does not consider the timing of future cash flows and whether the asset is expected to earn an above or below market rate of return.

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Each investment in Real Estate and Other Affiliates as discussed in Note 8 – Real Estate and Other Affiliates is evaluated periodically for recoverability and valuation declines that are other-than-temporary. If the decrease in value of our investment in a Real Estate and Other Affiliate is deemed to be other-than-temporary, our investment in such Real Estate and Other Affiliate is reduced to its estimated fair value.

No impairment charges were recorded during the three and six months ended June 30, 2017 or 2016. We periodically evaluate our strategic alternatives with respect to each of our properties and may revise our strategy from time to time, including our intent to hold the asset on a long-term basis or the timing of potential asset dispositions. For example, we may decide to sell property that is held for use, and the sale price may be less than the carrying amount. As a result, these changes in strategy could result in impairment charges in future periods.

NOTE 7 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 our assets and liabilities that are measured at fair value on a recurring basis:

	June 30, 2017 Fair Value Measurements Using	December 31, 2016 Fair Value Measurements Using

(In thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:								
Cash equivalents	$							