EDITED TRANSCRIPT

Agree Realty Corporation's
Second Quarter 2022 Earnings Conference Call
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PRESENTATION

Operator

Good morning, and welcome to the Agree Realty Corporation's Second Quarter 2022 Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note, this event is being recorded.

I would now like to turn the conference over to Reuben Treatman, Director of Corporate Finance. Please go ahead, Reuben.

Reuben Treatman | Agree Realty Corporation | Director, Corporate Finance

Thank you. Good morning everyone and thank you for joining us for Agree Realty's Second Quarter 2022 Earnings Call. Before turning the call over to Joey and Peter to discuss our results for the quarter, let me first run through the cautionary language.

Please note that during this call, we will make certain statements that may be considered forward-looking under federal securities law. Our actual results may differ significantly from the matters discussed in any forward-looking statements for a number of reasons. Please see yesterday's earnings release and our SEC filings, including our latest Annual Report on Form 10-K, for discussion of various risks and uncertainties underlying our forward-looking statements.

In addition, we discuss non-GAAP financial measures, including core funds from operations or core FFO, adjusted funds from operations or AFFO, and net debt to recurring EBITDA. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures can be found in our earnings release, website and SEC filings.

I'll now turn the call over to Joey.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Reuben.

I'm very pleased to report that we continued our strong start to the year, deploying significant capital across all three external growth platforms, maintaining near full occupancy and further solidifying our balance sheet. While these results are readily apparent for investors to see, one of our most notable achievements was our continued progress on our ADC State of the Art initiative. Both our ERP implementation and ARC enhancements made material strides during the quarter and will drive significant efficiencies for our growing organization.

During the second quarter, we invested approximately $430 million in 121 properties across our three external growth platforms. 99 of these properties originated through our acquisition platform, representing acquisition volume of more than $420 million. The 99 properties acquired during the second quarter are leased to 34 tenants operating in 21 distinct sectors, including best in class operators in the dollar store, general merchandise, tire and auto service, home improvement, off-price, warehouse clubs, convenience store, and auto parts sectors.

The acquired properties had a weighted-average cap rate of 6.2% and a weighted-average lease term of 10 years.

Our investment activities were supported by almost $525 million of equity raised during the quarter that fortified our best-in-class balance sheet and positioned us for continued growth.

Through the first half of the year, we've invested a record $860 million across 228 retail net lease properties spanning 40 states and 26 retail sectors. Approximately $828 million of our investment activities originated from the acquisition platform. Nearly two thirds of the annualized base rent acquired during the first six months of the year is derived from leading investment grade retailers. These metrics demonstrate our continued focus on a broad spectrum of opportunities with leading omni-channel retailers through multiple growth avenues...ranging from one-off acquisitions, diversified portfolios, select sale-leasebacks, development and our PCS platform. This diversified tool kit continues to ramp and produce superior risk adjusted opportunities and long-term relationships with our retail partners.

As of June 30th, tire and auto service was our top sector representing 9.4% of the portfolio. We continue to find compelling opportunities across this space and view the sector quite favorably. The average age of US cars on the road hit a record of over 12 years. This combined with the high-quality national operators and the low rents per square foot score very highly in our model.

Given our record acquisition volume year-to-date and our robust pipeline, we are increasing our 2022 acquisition guidance to a range of $1.5 to $1.7 billion from the previous range of $1.4 to $1.6 billion. The low end of this range would represent record acquisition volume for our company, surpassing approximately $1.4 billion acquired last year.

Given our improved cost of equity capital we are able to invest at even greater spreads and provide additional cash flow accretion. Our superior cost of capital combined with our fortress balance sheet positions us to pursue many exciting opportunities while levered competitors have exited the market. We are seeing distress amongst owners and developers and are intent on leveraging our strong positioning. While once again raising our acquisition guidance, we are cognizant of the dynamic macro environment and will remain disciplined to our strategy.

Moving on to our development and Partner Capital Solutions platforms, our team continues to uncover compelling opportunities with a growing pipeline. Cap rate expansion, inflationary pressures and rising construction interest rates have uniquely situated us to deliver projects timely and on budget.

During the quarter, we commenced five development and PCS projects including three additional Gerber Collisions as well as another Sunbelt Rentals. We completed the development of the Gerber in Pooler, Georgia and construction continued on 16 additional projects. In total, we had a record 23 projects either completed or under construction during the first half of the year, representing $74 million of committed capital.

On last quarter's call, I mentioned our expectation to commence between $50 and $100 million through our development and PCS platforms this year. Given our significant activity year to date and our growing pipeline, we have increased that range and now expect to commence between $75 and $125 million this year.

Moving on to dispositions, we sold four properties for total gross proceeds of almost $17 million during the quarter, with a weighted-average cap rate of approximately 7%. This activity includes the previously announced sale of LA Fitness in Houston, Texas, which further reduced our Health and Fitness exposure.

Through the first six months of the year, we've sold 5 properties for gross proceeds of nearly $25 million with a weighted-average cap rate of approximately 6%.

On the leasing front, we executed new leases, extensions or options on approximately 102,000 square feet of gross leasable area. Notable new leases, extensions or options included a Best Buy in El Paso, Texas, a Chick-fil-A in Rocky River, Ohio and a Panera Bread in Nashua, New Hampshire. As a result of our Asset Management team's efforts, at quarter end our 2022 lease maturities stood at just .1% of annualized base rents.

Our portfolio remains nearly fully occupied at 99.6%. At quarter end, it encompassed over 1,600 properties across all 48 continental United States, including 193 ground leases representing 13% of total annualized base rents. Our investment grade exposure stood at nearly 68%, representing a two-year stacked increase of 650 basis points.

Before handing over the call to Peter to discuss our financial results, I want to commend Peter and our ESG Steering Committee for their efforts on our second annual ESG report. The report includes enhanced disclosure through the incorporation of climate-related and investor-preferred frameworks. We encourage you all to read our report, which you can access within the investor section of our website.

With that, I'll hand the call over to Peter and then we can open it up for any questions.

Peter Coughenour | Agree Realty Corporation | CFO
Thank you, Joey.

Starting with earnings, Core FFO for the second quarter was $0.98 per share, representing a 9.7% year-over-year increase. AFFO per share for the second quarter increased 10.4% year-over-year to $0.97. As a reminder, treasury stock is included within our diluted share count prior to settlement if and when ADC stock trades above the deal price of our outstanding forward equity offerings. The aggregate dilutive impact related to these offerings was close to a penny in the second quarter.

In April, we increased our monthly cash dividend to 23.4 cents per share, representing a 3.1% month-over-month increase. We subsequently declared monthly cash dividends of 23.4 cents per share for each of May, June and July. The monthly dividend represents an annualized dividend amount of $2.81 per share and is 7.8% higher than the annualized dividend amount from the comparable periods in 2021. Our payout ratios for the second quarter were a conservative 72% of both Core FFO per share and AFFO per share. Our growing and well-covered dividend continues to be supported by our consistently strong earnings growth.

General and administrative expenses totaled $7.7 million in the second quarter. G&A expense was 7.3% of total revenue, or 6.8% excluding the non-cash amortization of above and below market lease intangibles. While we continue to make investments to support the growth of the Company, our anticipation is that G&A as a percentage of total revenue will continue to scale, decreasing between 20 to 50 basis points as a percentage of total adjusted revenue compared to last year.

Our expectation for total income tax expense this year remains between $2.5 and $3.5 million.

Our capital markets activities during the second quarter further fortified our balance sheet and positioned us for continued growth. During the quarter we raised more than half a billion dollars of additional forward equity. This included our May transaction, of 5.8 million shares of common stock for anticipated net proceeds of approximately $388 million upon settlement. We also sold nearly 1.9 million shares during the second quarter via our forward ATM program, raising anticipated net proceeds of approximately $127 million.

In June, we settled approximately 4.7 million shares of outstanding forward equity, realizing net proceeds of $300 million. At quarter end, we still had nearly 7.1 million shares remaining to be settled under existing forward sale agreements, which are anticipated to raise net proceeds of approximately $476 million upon settlement.

Additionally, in connection with the acquisition of the Walmart and Home Depot portfolio, we assumed a mortgage loan with a principal balance of just over $42 million and a fixed interest rate of 3.63%. The loan is interest only and matures in December 2029.

Our strategic capital markets transactions during the quarter provided us with more than $1.1 billion of liquidity at quarter end, including cash on hand, $630 million of availability on our revolver, and approximately $476 million of outstanding forward equity.

As mentioned on prior calls, we have $300 million of forward starting swaps in place, effectively fixing the base rate for a contemplated long-term unsecured debt issuance at approximately 1.7%. Taken together with our outstanding forward equity, we have hedged the cost of more than $775 million of capital to fund this year's investment activity.

As of June 30th, our net debt to recurring EBITDA was approximately 3.8 times, proforma for the settlement of $476 million of outstanding forward equity. Excluding the impact of unsettled forward equity, our net debt to recurring EBITDA was approximately 5 times.

Total debt to enterprise value at quarter end was approximately 25%, while our fixed charge coverage ratio, which includes principal amortization and the preferred dividend, remains at a very healthy level of 5.1 times.

Our significant liquidity, more than $775 million of hedged capital, and our robust investment pipeline gives us continued confidence in achieving high-single digit AFFO per share growth in 2022. Building upon our nearly 10% AFFO per share growth in 2021, this implies two-year stacked growth in the high teens. Combined with our leading retail portfolio, fortress-like balance sheet and well-covered dividend, we believe this level of per share growth is very compelling.

With that, I'd like to turn the call back over to Joey.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Peter. At this time, operator, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator
[Operator Instructions]. Our first question will come from Ki Bin Kim with Truist.

Ki Bin Kim | Truist
Joey, I want to go back to the acquisition topic. You closed on a lot of deals at about a 6.2% cap rate, which is pretty close to where you've done over the past year. Could you just talk about your outlook on the pricing dynamics and the types of assets that you're looking at?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. I think, as we've talked about in the last call, we're seeing pretty wide dispersion among cap rates, and that cap rate trend, obviously upward, is more concentrated in the high-velocity merchant build product. So I'd tell you, Dollar General specifically, we've seen 75 basis points increasing cap rates. Names like O'Reilly, we've seen 35 to 45 increase in cap rates. Those are merchant builders who are moving through and cycling through product fairly quickly. As you get to the other end of the spectrum, there are still sticky cap rates in the less fluid product out there, so it's a pretty wide dispersion. I'll tell you, we do see an upward trajectory in cap rates. As we've talked about previously, it's a highly fragmented and large space. It will take time. How long, we'll see, but we do see cap rates starting to adjust, again, with greater velocity in that merchant-build-type product.

Ki Bin Kim | Truist
So what does that mean for Agree, meaning, the 6.2%, should we expect that to increase X amount over time?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I can't tell you -- I can't see anything today beyond the third quarter, to be honest with you. I think it's going to be a function of the macro environment, one. It's going to be a function of how, again, how quickly sellers adjust their expectations. We've moved from fear degree, but we still have 1031 buyers that are -- or remnants of 1031 buyers in the market, or sellers who are hopeful to obtain 2021 pricing. I think the most important thing is today, with our cost of capital, our spreads are as large as they've been all year long even at these cap rates. So we'll take advantage of opportunities across all three platforms. Every day a new deal pops up, but at the same time, given our balance sheet, given our cost of capital and our liquidity profile, there's no reason for us to opt out of the market.

Ki Bin Kim | Truist
And just last question: You talked about the disruption you might be seeing. I wasn't sure if that meant the IG space or more into high-yield space. But given your comments about -- not just your comments, but the reality of your cost of capital and your balance sheet, does that make you want to, perhaps, enlarge your bullseye and take advantage of some assets that maybe you traditionally wouldn't have bought, just because the pricing has gotten that much more attractive? How do you think about all that?

Joey Agree | Agree Realty Corporation | President & CEO
No, we're going to stick to our sandbox, and that's the 30 to 35 best retailers in the country. We are seeing disruption among merchant builders today. The pressures that I've talked about in the prepared remarks that they're under today are tremendous. Inflationary pressures, construction interest loans are harder to obtain, and if you do, obviously the rates are much higher. There's obviously cap rate volatility upon the exit. And so I would anticipate our PCS platform to continue to uncover those types of opportunities because we can deliver. We don't need typical construction financing. We have a $1-billion revolver and, obviously, plenty of access to capital. So we're going to stick to the top 30 to 35 retailers. I don't think it makes any sense to go up the risk curve today to achieve or obtain a few extra basis points.

Operator
Our next question will come from Nick Joseph with Citi.

Nicholas Joseph | Citi
Maybe just on that development and PCS, as you look at new leases being signed or deals being struck, are there any changes to the lease terms, either from inflationary, CPI protection or anything else?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, that's a good question, Nick. I would tell you, our sandbox of retailers have their traditional lease terms, and what I'll tell you is that they are now more amenable to higher growth rates, typically every five years and in the options. And so while we were seeing, potentially, one bump or 5% bumps every five years, retailers today, given the inflationary pressures, are more amenable to seeing 10% bumps or multiple bumps during the base term, and then continuing on through the options.

Nicholas Joseph | Citi
Thanks. And then you touched on, I think in your opening remarks, some internal initiatives. Can you just walk through those a little more and kind of the benefits to the organization going forward as you make those investments?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, I'll touch on it briefly. Peter can speak to it much more technically than I can. We went live with our ERP overhaul with MRI with the first phase of it just recently. That was, I'd tell you, a multiyear effort to convert from Timberline to MRI. Peter, I'll let you speak to the specifics of it. Go ahead.

Peter Coughenour | Agree Realty Corporation | CFO
Yes, just to speak on the ERP system in more detail, as Joey alluded to, our team has been very busy in the first half of the year implementing the new MRI software for accounting and financial reporting. We're live with that software and already seeing efficiencies, including using their contract intelligence tool, which leverages AI to abstract new leases or lease documents. We'll continue to make enhancements to that software throughout the year and look forward to realizing additional efficiencies from that software.

And then the other initiative that Joey mentioned is ARC, which we've talked about on prior calls. ARC is a proprietary technology platform that we have developed over the past couple of years in-house, which provides us with real-time access to portfolio and pipeline data from multiple data sources across the organization, including our new ERP system, and it allows us to underwrite and value real estate while also understanding the pro forma impact on portfolio concentrations and other key metrics, and includes modules for departments throughout the organization. It also includes critical lease information and a work order management system for our asset management team.

Joey Agree | Agree Realty Corporation | President & CEO
And I stated in the prepared remarks, Nick, we had a three-year thrust to become state of the art. The -- everything that we've done, whether it's the MRI implementation, ARC, moving to TripleNet with our internal internet this year, or intranet this year, along with a number of other initiatives, including hires, has positioned us now to succeed on that three-year thrust.

Operator
Our next question will come from Brad Heffern with RBC Capital Markets.

Brad Heffern | RBC Capital Markets
Can you talk about ground lease? It slowed down quite a bit from the roughly 30% of acquisitions that it was running at. Is that the market more properly reflecting the value of those assets or is it opportunity-set-related?

Joey Agree | Agree Realty Corporation | President & CEO
It's a great question, Brad. I think it's a little bit of both. I think ground lease, first of all, or ground lease activity, will pick up in the third quarter, I at least anticipate. I think the market has become more positive, frankly. We took advantage of a dislocation in pricing for, call it 18 months in that -- maybe two years in that ground lease phase. There's been more attention brought to the ground lease space, obviously. Peers like [Safe] -- not really a peer, but a company like [Safe] with the initiation by a number of sell-side analysts on this space.

That said, we still continue to uncover high-quality opportunities. This quarter, we bought a Lowe's in Delaware on a ground lease, a Wawa, an Aldi's, a CVS, a Discount Tire, all on ground leases. And so we continue to be interested, obviously, in this space, but like everything in that lease, it is fragmented, and you will see opportunities arise at very disparate times, but I think there has been more, obviously, light shown on the ground lease space in general, as opposed to it would just be really conflated with the triple net space.

Brad Heffern | RBC Capital Markets
Okay, got it. And then I was wondering if you could talk a little bit about the transaction team, how many people you have at this point, and obviously you're scaled for the $1.5 billion to $1.7 billion, but what do you think you're scaled for in addition to that at this point?

Joey Agree | Agree Realty Corporation | President & CEO
Well, we've done a tremendous job building out the -- what we call two teams, really: the acquisition team, which has ten team members in it today, and then the transaction team, which is really overseeing contract and purchase agreement negotiation and diligence through close, with another ten team members led by four lawyers in four different subgroups. And so we have built out and scaled the organization. We are continuing to focus on developing young talent here. That's most important in terms of the acquisition and origination realm. We wanted to bring all of them up in the Agree culture in the Agree way, and so we think we are appropriately scaled there to continue to grow.

Operator
Our next question will come from Rob Stevenson with Janney.

Rob Stevenson | Janney
Joey, how are you thinking about dispositions today? I mean, there still doesn't appear to be a market for well-leased theater assets, but does the market get better from here for selling the stuff in the portfolio

that you may not want to own two, three years from now?

Joey Agree | Agree Realty Corporation | President & CEO
To be frank with you, Rob, there isn't much of that left. Outside of those few theater assets that you mentioned, there really isn't much of that left. The portfolio here today, our watch list, is extremely de minimis if at all. And so we are very comfortable with where the portfolio sits today. We will look at opportunistic dispositions where there's just a pricing or a valuation disparity, but the portfolio has never been in better shape, right? We have all of the exposures where we wanted by sector and by tenant and/or just the specific piece of real estate, really, where we want them today. So again, outside of those few theaters in the portfolio, we're sitting in a really good spot in terms of portfolio quality and concentrations here.

Rob Stevenson | Janney
Okay. And then most of the assets that you guys acquired or bought with someone else's existing lease structure in place, but you guys have ramped the development and PCS stuff, you've done some more sale-leasebacks, so in those cases, you're obviously starting with a blank page; anything that you guys are structuring differently in terms of length of lease, annual bumps, CPI indexing, et cetera, these days when you can start with a blank page rather than take on somebody else's lease?

Joey Agree | Agree Realty Corporation | President & CEO
Well, first, thanks for pointing that out, because that is obviously a very different dynamic. Yes, I think, again, going back to the earlier question, we were able to get -- we were able to obtain better growth rates on an overall basis. I think retailers are more amenable, understanding the inflationary pressures not only in their business but the overall macro environment, so I think that's a great dichotomy that you broke out there, because that is true. In a -- in those select sale-leasebacks in the development area specifically, we're able to start from a blank slate.

Operator
Our next question will come from Haendel St. Juste with Mizuho.

Ravi Vaidya | Mizuho
This is Ravi Vaidya on the line for Haendel St. Juste. Can you comment a little bit on the auto and tire industry, given that it is your largest sector, particularly how you think this industry plays out going forward where work-from-home seems to be persistent?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I think we spoke about it in the prepared remarks. The average age of cars on the road in the U.S. is over 12 years; it's a record. To get a car today is an extremely difficult proposition. Obviously, Congress just passed, and it's on the President's desk, a bill to increase chip production in this country. So I think if you -- the work-from-home trends, we'll see where those go, but I think if you actually look at the miles driven, if you look at the travel trends that are out there, if you look at the length -- cars today, frankly, are made to be run for 200,000 miles. That is very different than automobile construction in the past. The tire and auto service industry and the auto parts industry continue to thrive, frankly, because of the duration of those cars on the road. Cars are more expensive today, whether it's new and/or used cars, although we've seen some de-escalation in the pricing in used cars.

And so it's a great space. It has some of the best retailers in the country. They're low rents per square foot. They typically are in small, fungible boxes between 4,000 and 6,000 square feet on major thoroughfares with retail synergy, and I think if you look at the overall dynamics of the space, all macro trends, especially if you believe we're heading into a recession here, point in the favor of the auto parts and tire service industries.

Ravi Vaidya | Mizuho
Thank you. Just one more here: Can you disclose what the cap rate and the investment-grade exposure would have been for the second quarter acquisitions outside of the large auto portfolio?

Joey Agree | Agree Realty Corporation | President & CEO
I can't. We're under a pretty strict NDA in regard to any transaction. Obviously we have a new tenant in our roster, but we're very comfortable. It's one of the largest, obviously, retailers, especially in their sectors, in the world. It's over a 100-year-old company. We've always said that investment grade isn't a driver of our decisions in terms of investment; it's real-estate-related, it is tenant-, it is sector-related, it's obviously rent per square foot and getting our arms around the residual as well as the store-level performance, and we thought a transaction -- this transaction you're referring to made a lot of sense for us. So on a holistic basis, I would anticipate that our investment-grade exposure in terms of acquisitions for next quarter to be north of 70%, closer to 75%, in line with traditional, really our traditional metrics, especially the last couple years.

Ravi Vaidya | Mizuho
Got it. Thank you. Just one more here if I can. Can you discuss your balance sheet strategy and what your target leverage is? Currently it's 3.8x with the forward equity. What are you willing to let this tick up to?

Joey Agree | Agree Realty Corporation | President & CEO
Well, we've always stated that our target leverage range is 4x to 5x net debt to recurring EBITDA. We brought it down during the pandemic. We hadn't brought it back up to 5x to 6x. I think if you look today at our capital structure, the cost of debt and cost of equity, there is an argument, obviously, to be made that equity is cheaper than debt today outside of our $300 million swapped out at a 10-year at 1.7%. And so our balance sheet strategy is to remain flexible, to remain nimble, and it's to remain positioned to execute on any opportunity that arises.

Operator
Our next question will come from Wes Golladay with Baird.

Wes Golladay | Robert W. Baird & Company
Actually, my question, first one, is related to that last point you just made with the cost of equity extremely attractive and maybe debt less attractive -- still very good, but less attractive to maybe where you could issue later, down the road, if spreads were to come in. So my question for you would be, what is your appetite there if you just continue to fund everything with equity over the near term and then re-lever when spreads fall?

Peter Coughenour | Agree Realty Corporation | CFO
Yes. Wes, thanks for the question. This is Peter. I would say first, just to provide a little bit more detail on what Joey was discussing, we have, as I mentioned in the prepared remarks, $300 million of forward-starting swaps in place, which have effectively fixed the base rate at 1.7%. Including those swaps, we think today we could probably issue 10-year paper [sub-4%], and so we view that as an attractive level, and we'll continue to look for the right access, or right window to access the market in the remainder of the year. Look, that said, we're in a fantastic position from a liquidity perspective and we have a lot of options as it relates to the swaps, and so as Joey said, we'll continue to be nimble and opportunistic in terms of how and when we access the capital markets.

Wes Golladay | Robert W. Baird & Company
Okay. And then maybe going to the ARC platform, it's been -- I think you launched it in May of last year. Is there a way to quantify how this is helping drive acquisition volume? Is it more deal flow coming in? Is it a higher close rate? Just any way to put numbers behind it?

Joey Agree | Agree Realty Corporation | President & CEO
Well, first, ARC is not relegated simply to originations. ARC has lease administration, asset management, portfolio metrics, acquisitions, transactions, diligence, all embedded into it. So that's portfolio-level data and statistics all embedded into it. I think what most importantly there -- I mean, there is no way to quantify it directly. What is most important there is it is a management tool, it's a self-management tool, it

allows us to drive to KPIs, it allows us to drive to conversion rates and make adjustments on the fly in real time. And so I tell you, we haven't spent a lot of time yet quantifying the impact of ARC -- it would be difficult. I'm sure Peter or Reuben here could come up with some algorithm to do so. But we really look at it as a tool of transparency and a tool to measure our progress and manage our progress as we move forward toward our goals and objectives.

Operator
Our next question will come from Ronald Kamdem with Morgan Stanley.

Ronald Kamdem | Morgan Stanley
Two quick ones from me. Just first on just going back to the retail commentary, obviously you mentioned that the tenant health has never been stronger, with almost no watch list and so forth, but as you're looking forward, and obviously there's more talks of going into a recession and so forth, how are you guys thinking about either sectors that you maybe pause on or get more cautious on, or sectors that you lean into over the next 12 to 18 months?

Joey Agree | Agree Realty Corporation | President & CEO
Ron, I appreciate the question. It's really the same for us. We haven't changed it since COVID, from a sector perspective or really even a tenant perspective. We generally avoid discretionary goods outside of superior high-quality operators. The portfolio is constructed with the 30,000-foot lens of recession resistance to begin with, and so we've been anticipating a recession -- I would tell you, not to the day or the month or the year, but over the long term just because of the cyclical nature of the economy. And so we don't venture into experiential, we don't venture into high-end luxury goods or discretionary goods, unless there is an investment thesis there that overrides that 30,000-foot perspective. Does that make sense?

Ronald Kamdem | Morgan Stanley
Great. Sure does. The second question I had, and it's just as we're sort of putting together the breadcrumbs for 2023, and you're thinking -- not asking for guidance, obviously, but if we're running sort of a similar acquisition pace as this year, similar sort of credit losses as this year, it sounds like interest [costs] maybe potentially could be slightly up, but you've sort of locked in rates and so forth, but is there any other sort of big pieces, or is that sort of the right way to think about it?

Joey Agree | Agree Realty Corporation | President & CEO
I think in a static environment, that's probably the right way to think about it. I think everybody across the board, the cost of short-term debt, obviously, with the increase in LIBOR and transitioning to SOFR, is obviously impactful. As Peter mentioned, as you mentioned, the swaps that we have in place put us at advantage for long-term debts. Our cost of equity puts us at advantage in terms of our capital structure as well.

I think, generally speaking, coming off the highs of 2021, when I saw -- I just don't think a static environment is most likely to continue into 2023. We were at such pricing -- I'll call it just insanity in 2021, with Dollar Generals trading in the low 5s and O'Reilly's trading at 5 caps -- those are two tenants we've called out -- I think we're going to continue to see pressures from a labor perspective, pressures from inflationary perspective. They may mitigate somewhat, but we're going to continue to see pressures that are going to continue to show us opportunities to take advantage of dislocations in the market.

When you have our capabilities across our three platforms combined with our balance sheet and our cost of capital, retailers can look at us and know we're going to get the job done. To look at other players in the space, not just simply the REIT space, but in the net lease space, and have that level of confidence that they're going to get it done at the end of the day, is pretty difficult given the changes we've seen, and that's not assuming we enter into some type of deep recession here; that's assuming that there's a soft landing here engineered by the Fed.

Operator
Our next question will come from Spenser Allaway with Green Street Advisors.

Spenser Allaway | Green Street Advisors
Most of my questions have been asked, but maybe just another one in regard to the increased development and PCS guidance. I understand you don't need any construction financing, but can you just comment on your confidence in executing newer developments, just given labor shortages, as you just mentioned, or some permitting backlogs, et cetera, that have been cause for development delays in many other sectors?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. It's -- we have spent capital in terms of building out our construction team. We're not entering into speculative projects, so we're not closing on a piece of dirt until all contingencies have been waived, we have bids in hand from a general contractor on a guaranteed maximum price basis, and we're ready to go. These are single-tenant projects, as you know, Spenser. They're not multidimensional with multiple moving pieces. This is a triangulation of getting the entitlements in place and getting the tenant onboard waiving contingencies. And so once we have that in place, we're all systems go.

Most of the projects that we're even undertaking today, frankly, are open-book, fixed return on cost. And so retailers understand the cost of metal buildings have doubled. Every week you hear about the next logjam or the next inflationary pressure in some building component or material. Retailers understand that today, and so we go into these eyes wide open and our retail partners go into them eyes wide open. But we certainly aren't going to go risk on in terms of development here.

Operator
Our next question will come from Linda Tsai with Jefferies.

Linda Tsai | Jefferies Group, LLC
In terms of the comments on the pressure on the merchant builders resulting in cap rate expansion for Dollar Generals and O'Reilly, it sounds like you might be investing more in these names. Are there any other names you would highlight?

Joey Agree | Agree Realty Corporation | President & CEO
Good question, Linda. I think those are two that come to mind that we've seen material cap rate movement. Dollar Tree is another one. Obviously, any of those tenants that are growing organically through a merchant build program with private developers at high velocity. The bottom line is those developers need to recycle that capital and either try to get new projects in the ground for the tenants that they're working with or get their capital out of the ground for some other reason.

So I'm trying to think off the top of my head for the most high-growth names. Tractor Supply comes to mind, not as growing as quickly, 60 to 70 units per year. But the greatest discrepancy or the greatest material change we've seen is the dollar stores that are growing to the tune of 1,000 and 700 stores per year. Those developers just need to cycle capital. We've had discussions directly with those tenants. They're, obviously, strong retail partners in our interest in development. It's not something that we're interested in doing, necessarily; it's just too widespread, too small of price points for us. But there are challenges there. If you are a net grower today, at any significant velocity, as a retailer, it is a challenging environment to rely on private developers today.

Operator
Our next question will come from Joshua Dennerlein with Bank of America.

Joshua Dennerlein | Bank of America Securities
Joey, just kind of curious on the big picture. One thing I've kind of noticed this earnings period outside of net lease is that the transaction market seems to have slowed down or even paused. What kind of gives

you comfort that the net lease market will remain robust through year-end?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I'm not sure about the net lease market specifically remaining robust through year-end. I think that the private purchasers will slow based upon the availability of leverage. I mean, you're looking at negative leverage in most of these situations and lower LTVs. I'm confident in our ability because our cost of capital is now driving the biggest spreads that we've had all year long, and so what you're going to see us do is take advantage of the best retailers, of the best real estate, at greater spreads, and that's what we're going to do through Q3 and Q4. And so I won't speak to others' cost of capital, but just given our positioning from a balance sheet and cost of capital perspective, we're going to take advantage of those opportunities.

This company has been built to take advantage of dislocations, whether we launched the acquisition platform in the Great Recession, while we doubled the size of the company throughout the pandemic. We are positioned, always, to take advantage of dislocations in the market, whether that's just purchasers being on the sideline, macroeconomic turbulence, lack of debt. We look pretty good with our swaps in place today. We've been wrong on the other side historically. But part of our overall hedging policy, inclusive of forward equity and forward-starting swaps on the debt side, is to position ourselves for disruption in a downturn. And so we will be ready. We will take advantage of opportunities that are both big and small.

Operator
[Operator Instructions]. Our next question will come from R.J. Milligan with Raymond James.

R.J. Milligan | Raymond James
Joey, just a bigger-picture question. You guys are trading at, now, the highest multiple in the space, and there's a varying discount between you and some of your peers, which you could argue is a dislocation, but I'm just curious, with your market cap significantly higher or larger, are there any other public portfolios Agree would be interested in, and how seriously do you guys think about public-to-public M&A?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I think we look at all opportunities. Everything from $1.5 million to a few billion. We look and evaluated all opportunities that are out there. Public-to-public M&A is fairly rare, obviously, in REITdom. I think we're going to see potentially more M&A as we move through this economic cycle. I think efficiency, from a G&A perspective, is critical. I think, obviously, accessing cost of capital is critical. I think everyone's going to be focused at the end of the day on margins. It's not something we spend a lot of time on here. Our threshold has always been we're not going to qualitatively dilute the portfolio that we've constructed over the past, call it 12 years so methodically and meticulously. And then if anything surpasses that qualitative threshold, then we move to the quantitative: Does it make sense at the pricing at that given time.

Operator
This concludes our question-and-answer session. I would like to turn it over to Joey Agree for any closing remarks.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, everybody, for joining us today. We look forward to hopefully catching up in person as we re-enter conference season and get past summer. See you soon. Thanks.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.