EDITED TRANSCRIPT

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

Operator

Good morning, and welcome to the Agree Realty Fourth Quarter and Full-Year 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 Brian Hawthorne, Director of Corporate Finance. Please go ahead, Brian.

Brian Hawthorne | Agree Realty Corporation | Director, Corporate Finance

Thank you. Good morning, everyone and thank you for joining us for Agree Realty's Fourth Quarter and Full-Year 2022 Earnings Call. Before turning the call over to Joey and Peter to discuss our record results for the year, 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 a 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, Brian. Good morning, everyone and thank you for joining us today. I am pleased to report that 2022 was another record year for our Company. Notable milestones over the past twelve months included:

- Record investment activity of over $1.7 billion, surpassing our record high by 20%
- The addition of over 440 high-quality net lease properties to our growing portfolio
- The commencement of a record 28 development and Partner Capital Solutions projects for total committed capital of nearly $110 million
- The receipt of an upgraded investment grade credit rating of Baa1 from Moody's Investors Service
- And.... positioning our balance sheet to execute in 2023 without the need for additional capital while raising approximately $1.7 billion including $1.3 billion of equity

We closed 2022 with approximately $1.5 billion of liquidity at year end, including more than $550 million of outstanding forward equity available at our election. Including our forward equity, proforma net debt to recurring EBITDA was approximately 3.1 times at 12/31.

As demonstrated by our fourth quarter acquisition activity, cap rates crept higher, but a bid/ask spread remains as sellers are slow to adjust to current market dynamics.

As always, we will remain disciplined to our investment strategy and refrain from going up the risk curve via credit or residual risk to create the appearance of a quickly expanding cap rate environment.

Similarly, we will not chase cap rates down to levels that fail to create sufficient spreads to drive appropriate returns for our shareholders. Our focus remains on the best retailers in the country with strong balance sheets that will allow them to withstand the current macroeconomic environment regardless of the level deterioration.

Our Team is doing a terrific job navigating this environment, leveraging our strong industry wide relationships and track record, while uncovering opportunities to add to our growing portfolio. Our pipeline includes both smaller one-off transactions and larger sale-leasebacks with our leading retail partners. Given that pipeline, I am confident our team will be able to source north of $1 billion of acquisition activity at spreads that are appropriately accretive.

During the fourth quarter, we invested approximately $421 million across 157 properties via our three external growth platforms. 131 of these properties originated through our acquisition platform, representing acquisition volume of approximately $405 million. The properties acquired during the quarter are leased to best-in-class operators in the auto parts, tire and auto service, home improvement, dollar store, off-price retail, convenience store, and farm and rural supply sectors, among others.

The acquired properties had a weighted-average cap rate of 6.4% and a weighted-average remaining lease term of 10.6 years. Over 73% of the acquired rents are derived from investment grade retail tenants.

For the full year 2022, nearly 70% of the annualized base rent acquired was derived from leading investment grade retailers, while ground leases represented more than 5% of rents acquired.
Moving on to our development and PCS platforms... we again had a record year with 31 projects either completed or under construction representing over $118 million of committed capital. This includes 28 projects commenced during the year with total anticipated costs of almost $110 million.

During the fourth quarter, we commenced six new development and PCS projects with total anticipated costs of approximately $37 million. We completed the development of two projects, while construction continued on another 18 projects.

We continued to cull non-core assets from our portfolio with seven properties sold during the prior year for gross proceeds of over $45 million. These dispositions were completed at a weighted-average cap rate of 6.5%.

On the leasing front, we executed new leases, extensions, or options on approximately 850,000 square feet of gross leasable area in 2022, including 198,000 square feet during the fourth quarter.

Notable new leases, extensions or options included a Chase Bank ground lease in Stockbridge, Georgia, where we had our first opportunity to recapture a ground lease due to the tenant's lack of options. We eventually executed a new 15-year lease with Chase and were able to increase the rent by approximately 160%. The NOI lift we were able to generate is emblematic of the embedded value in our ground lease portfolio.

Moving into this year, we are in a very strong position with 1.3% of annualized based rents maturing. Subsequent to year end, we have executed a number of lease extensions, bringing this number down to only 1% for the remainder of this year.

At year end, our portfolio encompassed 1,839 properties across all 48 continental United States, including 206 ground leases representing 12.4% of total annualized base rents. Occupancy remained at a very healthy 99.7%, again, our investment grade exposure stood at nearly 68%, and all our top 10 tenants carry an investment-grade credit rating. Our best-in-class portfolio is very well positioned to withstand the current macroeconomic environment.

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.

I'll start by recapping our balance sheet and capital markets activities during the year. As Joey mentioned, we were highly active in the capital markets, raising approximately $1.7 billion to further bolster our balance sheet and position us for continued growth. Notable activities include:

- $1.3 billion of gross equity proceeds raised through two overnight offerings and our at-the-market equity program and

- a $300 million public bond offering of 4.8% senior unsecured notes due 2032, with an effective all-in rate of 3.76% inclusive of prior hedging activity.

Our capital markets activities during 2022 provided us with approximately $1.5 billion of liquidity at year end, including $557 million of outstanding forward equity, $900 million of availability on the revolver and $29 million of cash on hand. Our existing liquidity, plus free cash flow after the dividend of approximately $85 million and any disposition proceeds, enable us to opportunistically execute our growth strategy in 2023 without the need for additional capital.

As of December 31st, proforma for the settlement of the $557 million of outstanding forward equity, our net debt to recurring EBITDA was approximately 3.1 times. Excluding the impact of unsettled forward equity, our net debt to recurring EBITDA was 4.4 times.

At year end, our weighted-average debt maturity stood at approximately eight years. With limited variable rate debt and no material maturities until 2028, we remain well positioned to withstand interest rate headwinds and capital markets volatility.

Total debt to enterprise value at year end stood at 23%, while our fixed charge coverage ratio, which includes principal amortization and the preferred dividend, remained at a healthy level of 5 times.

Moving to earnings, Core FFO was $0.96 per share for the fourth quarter and $3.87 per share for full-year 2022, representing 3.5% and 8.1% year-over-year increases, respectively.

AFFO per share was $0.95 for the fourth quarter and $3.83 for the full year, representing 3.9% and 9.2% year-over-year increases, respectively.

As a reminder, treasury stock is included in our diluted share count prior to settlement if ADC stock trades above the deal price of our outstanding forward equity offerings. The aggregate dilutive impact related to these offerings was less than half a penny in the fourth quarter, and roughly two cents for the full year.

Our consistent and reliable earnings growth continues to support a growing and well-covered dividend. During the fourth quarter, we declared monthly cash dividends of 24 cents per common share for each of October, November and December. On an annualized basis, the monthly dividends represent a 5.7% increase over the annualized dividend from the fourth quarter of 2021.

For the full year, the Company declared dividends of just over $2.80 per share, a 7.7% increase year-over-year and a 16% increase on a two-year stacked basis. Our payout ratios for the fourth quarter and full year remained at or below the low end of our targeted range of 75% to 85% of AFFO per share.

After year end, we announced a monthly dividend of 24 cents per share for each of January and February. The monthly dividend reflects an annualized dividend of $2.88 per share, or a 5.7% increase over the annualized dividend of approximately $2.72 per share from the first quarter of 2022.

General and administrative expenses in 2022 totaled $30.1 million. G&A expenses were 7% of total revenue, or 6.5% excluding the non-cash amortization of above and below market lease intangibles. We achieved 50 basis points of G&A leverage during 2022. Given our investments in systems including our recently implemented ERP system and further improvements to our proprietary arc database, we anticipate achieving similar G&A leverage this year.

Lastly, total income tax expense for 2022 was approximately $2.9 million, including $723 thousand of expense during the fourth quarter.
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
Ladies and gentlemen, at this time, we will begin that question-and-answer session. (Operator Instructions). Our first question today comes from Nick Joseph from Citi.

Nicholas Joseph | Citi
Joey, I was just hoping to get some more color on kind of the current cap rate trends, maybe specific to what you're seeing on the merchant-builder side and the impact it's having on any recent deals.

Joey Agree | Agree Realty Corporation | President & CEO
Well, first, on the merchant-builder side, you saw during the during the fourth quarter, we had a number of transactions with merchant-builders for Dollar General, O'Reilly, Dollar Tree Family, Dollar -- we were taking advantage of distressed situations where they need to clear their inventory. I'll tell you, we're still talking to a number of retailers that historically, have leveraged their merchant-builder platform for net new stores since that business is effectively interrupted on a time-out at this point. And so for 2023 year-end and 2024 new openings, retailers that were focused on merchant-builders are all looking for new solutions, and that's where we think we can potentially play a part.

In terms of cap rates, it's a complicated situation, frankly. I think cap rates, I wouldn't call it bifurcated; I would call it trifurcated. If you want to go up the risk curve, which we will not do here, that is something that is readily available. You can clearly go acquire things with seven handles in front of them; they're private equity-backed operators, or second or third tier-operators in their respective spaces. What we see in the IG space, there is no shortage of opportunities out there. We could acquire over $2 billion if we wanted to in 2023. It's finding the right opportunities where we can drive AFFO per share while maintaining our quality of this portfolio in those qualitative hurdles.

And so there's a lot of nuances to it. Much of it is price point-driven, much of it is credit-driven. But cap rates have obviously come off their lows in 2021 and 2022. But I think first of all, everyone understands that this is a bond-like business, right? And that leads to bond-like assets. And so in the last year, we witnessed debt financing costs, both short-term and long-term, go up significantly. We have yet to see commensurate cap rate expansion in the space. And so what we're seeing as a result is, frankly, private and public investors in the net lease space moving up the risk curve to drive the appearance of spreads. That's just something that we won't do; we will never sacrifice long-term value creation for a short-term pop. And so we'll remain disciplined and we'll see how this year plays out.

Nicholas Joseph | Citi
Thanks. It's very helpful. And then just maybe on the current pipeline, you talked about at least $1 billion of acquisitions, maybe less specificity than normal, given the environment. How are you thinking about the timing of those? Maybe you can talk about the current pipeline? And then is the opportunity more in the back-half of the year to exceed that $1 billion if deals start to materialize?

Joey Agree | Agree Realty Corporation | President & CEO
I love when I hear the opportunity is going to be back-half of the year weighted. I don't know what's going to happen in the back-half of the year, let alone tomorrow. I'll tell you, our current pipeline for Q1, as I mentioned, has larger scale sale leasebacks with industry leaders, has one-off transactions. We're starting just to build our Q2 pipeline; we're about a fifth of the way through that. We have nothing for Q3 and Q4, I'll be honest, not one deal today for Q3 and Q4.

I don't know that this is going to be a soft landing or it's going to be a meteor hitting earth here in terms of this economy. So again, I think it's most appropriate for us to be flexible, which we are, with our balance sheet. We don't need a dollar of equity, and then be disciplined as we deploy that capital as this year materializes. And I think everyone has a different perspective there.

Nicholas Joseph | Citi
Thank you.

Operator
Rob Stevenson from Janney.

Robert Stevenson | Janney
Joey, can you talk about your future pipeline of development and Partner Capital projects? How aggressive are you being with new projects today? And you see the current dollar volume of that pipeline growing, stable, shrinking over the course of 2023 as projects go in and come out?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, Rob, it's very similar to my last answer in terms of acquisitions. We're not going to chase yields down, given a potential, I'll call it, rise in cap rates throughout the course of this year. Obviously, when you enter into any development transaction, or PCS transaction, there's duration to it. So some of those transactions take 6 months, some of them take 12 to 18 months. And so you have to be appropriately compensated in terms of the return on cost.

Now, we announced a number of projects in the fourth quarter. We have some in our pipeline, obviously, today that are unannounced still. But the most important thing is we're getting that appropriate premium for that duration risk. It's not going to be credit risk, it's not going to be the residual risk, but it will be the duration risk. And so if we have the ability to buy something with a similar credit profile, or from a third-party from our retail partners, and it's well inside -- or close to, I should say -- where we could develop or enter into a PCS transaction, we'd much prefer to have visibility into that 70-day closing period, or as much visibility as possible.

Robert Stevenson | Janney
Okay. And then talking to your core tenants, where is retailer expansion demand today versus where it's been over the last few years? And how does that sort of match up with your understanding of merchant-developers' ability to get capital to start new projects to fund that sort of development?

Joey Agree | Agree Realty Corporation | President & CEO
It is a great question, it is extremely topical. We are having literally weekly conversations with our retail partners, the biggest retailers in the world. The vast majority of them aren't afraid of the overall macro environment because they know they would benefit from the trade-down effect. Large format C stores, we have 2 entering Metro Detroit, both Sheetz and Kum & Go, and we've had various levels of discussion with; the dollar stores, obviously, trade-down effect; deep-discount grocery or discount groceries, Aldi, wants to continue to grow throughout this country; Dollar General, the Dollar General Market format, Dollar General with Popshelf; Five Below and now Five Beyond; the auto parts operators.

Obviously, with cars on the road eclipsing 12 years, and still not able to get a car, because of chips shortage, the auto parts operators, AutoZone, O'Reilly, Napa want to continue to grow. The tire and service operators in this country, the National Tire and Batteries, Bridgestone, Firestone, Goodyear want to continue to grow. The challenge for these retailers is they historically don't have a self-development

platform and/or don't have the stomach to keep them on balance sheet, and then offload them via sale leaseback or permanently keep them on balance sheet as the merchant-builder business is dead.

And so our conversations with these retailers revolve around which three of our external growth capabilities, acquisition, development and Partner Capital Solutions, could potentially be a solution for them. And so these are conversations that are ongoing, and they're producing some interesting dialogue. We'll see if any of them strike.

Robert Stevenson | Janney
Okay.

Joey Agree | Agree Realty Corporation | President & CEO
By the way, you can add to that with Sam's Club for the first time in, what, 12 years, announced 30 net new stores. And so you see that these discount-oriented retailers, these value-oriented retailers, want to grow here regardless of the storm clouds on the horizon. But frankly, the ability to grow is their challenge.

Robert Stevenson | Janney
All right. That's helpful, thank you.

Operator

RJ Milligan from Raymond James.

R.J. Milligan | Raymond James
Joey, your comments that there's plenty to buy, if you were willing to sort of hit the pricing expectations, but obviously, being a little bit more prudent here, I'm just curious, what do you think has to happen for sellers to adjust those pricing expectations?

Joey Agree | Agree Realty Corporation | President & CEO
It's a great question. I think first of all, we see the sentiment swings and shifts daily with new data and the fed speakers rambling on like Tony Romo during a football game. Nobody knows if this is going to be a soft landing, a hard landing, this economy is going to flow up there like the Chinese spy balloon for a while; we have no certainty to this market. Still hopeful, inclusive of real estate sellers, that the fed is going to cut rates at the end of this year; maybe that got washed away yesterday. And so I think the current status quo results in a bid-ask spread. Now, we have more data this morning with consumer sentiment or consumer spending.

And so the challenge here is that nobody has visibility into how this economy is going to evolve here. And hence, unless you are a middle-market or a private equity-sponsored retailer who needs capital today via a sale leaseback, where banks have pulled back and lenders have pulled back on LTVs, rates are obviously extremely elevated. You can find a lender of last resort in terms of a sale leaseback who will be there as a secured creditor with your real estate to help you with your growth.

Now, the challenge on the third-party market specifically is that there's still too much hope out there. And until that clears up, I think we're still going to have a bid-ask spread. Now, what we're doing is scouring the market through all of our contacts, all of our different distribution groups, all of our different stakeholders and partners out there, and looking for the capitulation, and we're finding it. The question is, how much will we find as the economy evolves? And that, I just don't have any idea because I don't know how the economy is going to evolve.

R.J. Milligan | Raymond James
That makes sense. And I guess a question for Peter. I'm just curious what you're seeing on the debt market side. Obviously, the market's opened up a little bit for the REITs here. And I'm just curious, what are you hearing in terms of banks' appetite for debt and what pricing might look like today?

Peter Coughenour | Agree Realty Corporation | CFO
Yes, I think first, RJ, in terms of the unsecured market, I think we could probably price 10-year unsecured debt today in the mid-5s. This is down from, call it, the 6s we discussed on last quarter's call. But frankly, still isn't overly attractive today, given we view our cost of equity to be in a similar range.

In terms of the bank debt market and the term loan market, assuming we enter into swaps to fix the rate, I think we could probably price a 5-year term loan today in the high-4s. And I view a 5-year term loan to be more attractive today than a 10-year bond given the current pricing.

All that being said, the good news is we have, as Joey mentioned, $1.5 billion of liquidity, more than $550 million of outstanding forward equity. And so we don't need the capital today, either debt capital or equity capital. And we can continue to monitor our options and be opportunistic in terms of any future capital raises.

R.J. Milligan | Raymond James
That's helpful. Thank you.

Operator

Ki Bin Kim from Truist.

Ki Bin Kim | Truist
So within the IG realm that you guys invest in, I'm just curious how the triple-net financing option compares to your tenants' alternative financing options, and how that spread may have migrated over the past few months?

Joey Agree | Agree Realty Corporation | President & CEO
First of all, Ki Bin, it's great to hear an operator say your name correctly on an earnings call. Apologies for the last one. So when you say the financing options, are you talking about a seller's potential financing options relative to a sale?

Ki Bin Kim | Truist
No, I mean for financing, they can tap the unsecured bond market, they can go to a bank market. For your IG tenants, I'm just curious how triple-net financing compares to those type of traditional debt financing options?

Joey Agree | Agree Realty Corporation | President & CEO
Well, as Peter mentioned, we think the term loan market is a possible avenue for us. He quoted where we think the 10-year market, unsecured market, is today. We'll continue to be an unsecured borrower. We think that's the most efficient way for us to continue to borrow capital.

Go ahead, Peter.

Ki Bin Kim | Truist
Sorry, I meant for your tenants.

Joey Agree | Agree Realty Corporation | President & CEO
Ki Bin, are you asking in terms of our retailers --

Ki Bin Kim | Truist
Yes.

Joey Agree | Agree Realty Corporation | President & CEO
or for the region? Well, that's a very interesting bifurcation today. So some of the most transactions that we have in our pipeline today are with sophisticated retailers, so S&P 500 companies that recognize where their relative costs of capital are, where they can issue 10-year paper; and say, you know what? A sale leaseback makes sense and similar to what I referenced prior. Now, when we compare, just to take a step back, IG versus non-IG, first, let's reframe this as high-quality retailers versus other retailers because I continue to remind people I love Chick-fil-A, I love Hobby, I love Publix, I love Aldi. These are not investment-grade retailers; they're privately held, closely-held companies that don't have a rating.

The high-quality retailers have options. A low-quality private-equity-sponsored retailer has very limited options today. One of those options, and the largest option, is a sale leaseback on their real estate. And so we will not be the lender of last resort, or one of the largest creditors to a carwash-startup, an urgent care. There are 4 car washes literally expanding in Metro Detroit as we speak that are all private-equity-sponsored with REIT capital behind them; they own none of their real estate. I can't figure out where all these new cars that need to be washed are from, and how many monthly memberships are required by Metro Detroiters.

So I think in reality, we're back to the pre-Covid days here. We're back to the days where the high-quality retailers are going to thrive. They have the liquidity, the balance sheets. The low-quality retailers are now faced with a stressed economic environment. They need whatever capital they can to shore up their balance sheet or frankly, offload their real estate.

Ki Bin Kim | Truist
And in terms of your balance sheet strategy, your leverage is at 4.4x. How should we think about this as the year progresses? I'm curious if you would let the leverage kind of drift up here or keep it this way?

Joey Agree | Agree Realty Corporation | President & CEO
Our leverage is definitely going to drift up. We ended pro forma for the settlement of the $552 million in equity at 12-31 at effectively 3.1x leverage. Leverage is going to drift up to the 4x to 5x targeted-leverage range. We are not interested in the equity markets; we're not coming back to the equity markets via regular way or the ATM anytime soon. We have the capital and the flexibility to execute on our strategy for this upcoming year. And we're going to obviously drift leverage higher here to what we think is appropriate, that 4x to 5x.

Ki Bin Kim | Truist
Okay. Thank you.

Operator

Tayo Okusanya from Credit Suisse.

Tayo Okusanaya | Credit Suisse
I just wanted to follow up on my buddy RJ's question. Joey, again, part of your response to his question was who knows where the economy's going, no one has a crystal ball; no one can call Miss Cleo, so to speak. But I'm just curious, in either economic scenario, how do you kind of see ADC faring? Do you see

yourself faring better if the economy continues to kind of do well, or starts to improve; or if the economy goes south and you start to see distressed opportunities, is that your time to pounce? Just curious how you're kind of thinking about different economic scenarios and how ADC would do in each one.

Joey Agree | Agree Realty Corporation | President & CEO
I appreciate the question. Obviously, with the caveat that good news is bad news with economic data today, look, I think we're in a very unique position. We have a defensive portfolio, the most defensive, a defensive balance sheet, or at least the most defensive; and we're able to play offense. And so we can play both sides of the ball here, so whether we see a significant deterioration in the underlying environment, this portfolio is going to perform the best.

Now, if all of a sudden, you know what, there's a soft landing and everything takes off again, we have the cost of capital, the balance sheet and the liquidity to execute. And so we're in a very unique position. It's hard, nearly impossible, to poke a hole in this company through any single aspect today. And that was strategic coming into this year, given all of those unknown factors that are out of our control. And so it's not time -- and I've said this repeatedly, and I apologize -- not time to slam on the gas, and it's not time for us to hold up the stop sign.

Right now, we're going to be disciplined and prudent, but if one of those two things happen, we'll pivot and we'll pivot very quickly, just like we did during Covid, and just like we did when we launched the acquisition platform. So I think in both environments, we're going to grow AFFO, we are going to grow our dividend, and this portfolio and balance sheet is going to be a fortress.

Tayo Okusanaya | Credit Suisse
That's helpful. And then, Peter, could you talk a little bit about again how you're -- again I know you guys don't give guidance, but in terms of just kind of credit and credit provisioning and how you kind of think about the impact to 2023 versus 2022. Could you just kind of walk us through that? And then granted, you guys are massively IG, have barely seen any credit issues, but I don't think you've seen any, but just kind of curious how you're thinking about that?

Peter Coughenour | Agree Realty Corporation | CFO
Sure. I guess just to recap 2022 first, we recorded about $400,000 of bad debt expense in 2022. That's, call it, roughly 10 basis points of revenue and that's slightly below our longer-term average, which is probably closer to, call it, 20 or 25 basis points of revenue. But as you mentioned, we specifically identify tenants or instances of bad debt and so predicting bad debt on a go-forward basis can be difficult. With the current macroeconomic environment where it is, I think that obviously presents some challenges for retailers. But we certainly feel with our portfolio and 68% of rents coming from investment-grade tenants, that it's very well positioned to withstand the current environment and wouldn't really anticipate any significant deviation from what we've seen historically.

Tayo Okusanya: Great, thank you.

Operator
Josh Dennerlein from Bank of America.

Joshua Dennerlein | Bank of America Securities
Joey, just kind of curious how you think about disposition as a potential source of capital in today's environment?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, we didn't give disposition guidance this year because frankly, entering into the world of dispositions outside of a seller who -- or sorry, a buyer, excuse me -- who is pre-screened, is an-all cash buyer, is frankly, an inefficient use of our time. We went through the 1031 gyrations. This portfolio is nearly in pristine position. If anyone wants to buy a couple of AMCs, please tell them to call. But it's effectively in pristine position here and so I'm just hesitant to waste our time out there in the 1031 market.

We've got 77-ish team members here that are extremely busy. There's just so many stops and starts in that space today. And given the nature of this portfolio, I don't think we need to execute any significant amount of dispositions this year.

Joshua Dennerlein | Bank of America Securities
Okay. Appreciate that. And has the competitive landscape for acquisitions in your spaces, has it shifted at all? Are you seeing less competition, or maybe are the certain asset classes, people are really gravitating towards today?

Joey Agree | Agree Realty Corporation | President & CEO
No, I appreciate the question. We've seen less competition. We see less competition for the assets that fit within the context of our portfolio. 1031 buyers continue to wane as transactions grind slower in the country overall and so we see less competition. If you talk to brokers, transactional volume is down 60% in the space right now. In the month of January, they're effectively down 60% were my most recent conversations. Where that will go, nobody knows. And so there's less downleg of 1031 buyers. Obviously, you remove leverage out of the equation or leverage, frankly, doesn't do much for you, negative leverage almost into the equation, it will inhibit some buyers from entering the space.

And so we're seeing tons of opportunities, we just won't pay up for them. So we're not going to take $1 and break it into four quarters, at the end of the day, we're not a change machine. We want to earn money on our capital, just not cycle it. And so less competition, we're counting capitulations, and we hope that continues to accelerate.

Josh, did we lose you?

Joshua Dennerlein | Bank of America Securities
No, I'm good. Thanks, Joey.

Operator

Haendel St. Juste from Mizuho.

Ravi Vaidya | Mizuho
This is Ravi Vaidya on the line for Haendel St. Juste. I just wanted to follow up here. Given that there's less competition for the assets that you're targeting, are you able to secure better terms, maybe better annual escalators?

Joey Agree | Agree Realty Corporation | President & CEO
Well, again, historically, the minority of what we've done is third-party acquisition, so we're not negotiating a lease with escalators. I'll tell you, in the sale leaseback transactions or the development arena, retailers are more comfortable today and more amenable to increasing acquisitions -- excuse me -- increasing those increases that are scheduled for every 5 years.

Ravi Vaidya | Mizuho
Got it. That's helpful. Just one more here. Are you expecting any impact of the portfolio from the Kroger-Albertsons merger?

Joey Agree | Agree Realty Corporation | President & CEO
Absolutely not. Kroger is one of our largest partners, we have full Kroger guarantees. The recent speculation has a 250-store divestiture. We'll see how that materializes with the 2024 potential closing as they've telegraphed. We'll see how that materializes through the FTC. But we expect absolutely no -- we have we have no Albertsons in the portfolio, I should mention.

Ravi Vaidya | Mizuho
Got it. Thank you.

Operator

Linda Tsai from Jefferies.

Linda Tsai | Jefferies Group, LLC
Can you remind us what percentage of your acquisitions have been from the 1031 market versus sale leasebacks historically?

Joey Agree | Agree Realty Corporation | President & CEO
Peter, I'm going to try to throw that one to you; I don't have that number on hand. I'll tell you, approximately last year, 7%, does that sound right, with sale leasebacks?

Peter Coughenour | Agree Realty Corporation | CFO
Yes, sub-10%, I think, in 2022.

Joey Agree | Agree Realty Corporation | President & CEO
Sub-10%, we anticipate that number being elevated in Q1. I can't give you historic -- when you say 1031 market, don't forget, these are sellers and so there are maybe 1031 buyers competing with us. What they do with the proceeds, whether they enter into a down-leg, they have the ability to do a new purchase agreement, or they just pay capital gains tax, we're not always privy to it, frankly, Linda. We're not privy to it.

Linda Tsai | Jefferies Group, LLC
Got it. And then just earlier, you were talking about the ground lease situation with the Chase Bank in Georgia. You noted a lack of options that resulted in a high recapture rate. Was that more of a one-off situation or something you think happens more in the current environment?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I appreciate the question. It was a very unique situation. It was the first time in the history of the company we had ever had a ground lease expire with no options remaining. We had another tenant at the table who was ready to take the property at over $170,000 a year, which was a, what, 60%-plus lift?

Peter Coughenour | Agree Realty Corporation | CFO
Um-hum.

Joey Agree | Agree Realty Corporation | President & CEO
Chase came around and signed a new 15-year lease at that 60%-plus lift with 10% bumps every 5. And so I think that demonstrates the embedded value in the ground lease portfolio when a building reverts for

free. Again, this was the first instance; I look forward to future instances of it. But when you get a building back for free, and then all of a sudden, somebody has to pay rent on it, you're going to see NOI go up. And again, I remind everybody, we have a fee simple ownership of the land; this isn't a leasehold split, fee-simple leasehold split. And the tenant paid for the construction of that building.

In this instance, it was a predecessor to Chase that was on a ground lease paid for the building. Then Chase had taken that lease, and hence, why there was no options remaining. And so we were obviously able to negotiate a very favorable outcome there. We actually bought that ground lease with 2 years remaining and no options.

Linda Tsai | Jefferies Group, LLC
Thanks for that. And then how do you feel about the overall retailer environment, Regal, Party City, Tuesday Morning, Bed Bath? They're not issues for you, but do you think this is a limited situation, or indicative of more distress forthcoming?

Joey Agree | Agree Realty Corporation | President & CEO
Oh, no, I think it's what's coming. I think we're on the pre-Covid train. So there will be no timeouts called like Covid, where everyone just tried to call a timeout and flood the system with capital and cheap debt. Obviously, you mentioned we saw another bankruptcy just recently with Tuesday Morning. Bankruptcies will occur; we can probably say hello bankruptcy to at-home and office supply operator, pet supply stores, sporting goods operators. We saw TOMS Capital, a large Burger King franchisee; we disposed of all of their assets in years prior. If you look at our disposition we developed for them in the Chicago MSA filing bankruptcy.

There will be more -- the carwash space, the childcare space, the urgent care space, the quick lube oil change operators, the experiential entertainment operators. There will be private-equity-backed companies that have to again either have fixed or variable rate short-term debt where their LTVs and their rates are going to go way up; those loans don't last longer than 5 years, as we all know. And then again, we're going to see retailer attrition akin to the pre-Covid days, as we march towards this omni-channel world where 25% e-commerce penetration, either through online, delivery, BOPIS, click and collect, it's coming. And so it's just a matter of time. So I am very confident that we are now on the pre-Covid train for a rationalization of retailers.

Linda Tsai | Jefferies Group, LLC
Thanks.

Operator

Wes Golladay from Baird.

Wes Golladay | Robert W. Baird & Company
Are you guys seeing a lot of opportunity for the multi-tenant PCS openings? Looking at the earnings release, you had a few in, I think, Brenham, Texas and then Onalaska, Wisconsin, it almost looked like a shopping center at first glance. So what is going on there?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, the TJX multi-tenant effectively development, we're doing a number -- looking at a number of opportunities with both them, off-price retailers, TJX, Burlington, the Rosses of the world, Hobby Lobby -- again, those retailers that are looking to expand that were historically working with developers and/or merchant-builders that can no longer finance these projects and make them work. And so that's an area where we can continue, we think, to invest capital and continue to seek out opportunities.

Wes Golladay | Robert W. Baird & Company
Got it. And then, I know maybe 2 quarters ago, there seemed to be a bid-ask spread between what you wanted to do these transactions at and what the retailers thought the pricing should be. Has that narrowed at all now that debt markets have calmed down a bit? I think you mentioned your cost of debt is down about 100 basis points over the last few months?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I think Peter referenced about 20 basis points over the last few months, 10-year specifically, right?

Peter Coughenour | Agree Realty Corporation | CFO
The 10-year came down from maybe, call it, low-6s to what's mid-5s today relative to what we discussed on the last quarter call, but less than 100 basis points.

Joey Agree | Agree Realty Corporation | President & CEO
I think everybody's looking at the relative cost of capital. I think from the merchant-builders' perspective specifically, they're looking at not only the relative cost of capital; they're looking at their construction loans, the availability of construction loans, the interest rate on the construction loans; the labor shortage we have in this country leading to the inflationary pressures. Construction costs in this country haven't gone down since 1904 year-over-year.

And so now you combine that with an exit cap rate that's unknown, to put a shovel in the ground as a private developer and build a TGX combo store with a Burlington or a Ross, you've got to be pretty bold. And so we think those are the types of asymmetrical opportunities where we can step in with our divergent capabilities and create value, and create the appropriate spread for shareholders, while not going up the risk curve into assets that we don't think are appropriate.

Wes Golladay | Robert W. Baird & Company
Thanks, guys.

Operator

And ladies and gentlemen, with that, and showing no additional questions, I'd like to turn the floor back over to the management team for any closing remarks.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, operator, and thank you, everyone, for joining us today. And we look forward to seeing you in the coming weeks at the upcoming conferences. Thank you.

Operator

And ladies and gentlemen, with that, we'll conclude today's question-and-answer session as well as today's presentation. We thank you for joining. You may now disconnect your lines.