EDITED TRANSCRIPT

Agree Realty Corporation's
Fourth Quarter 2023 Earnings Conference Call
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PRESENTATION

Operator

Good morning and welcome to the Agree Realty Fourth Quarter 2023 Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Note today's event is being recorded.

I'd now like to turn the conference over to Brian Hawthorne, Director of Corporate Finance. Brian, please go ahead.

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 2023 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 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 and thank you all for joining us today. I'm pleased to report that 2023 was another strong year for our Company. Looking back on the past year, we executed several strategic initiatives that positioned our Company for continued success. In anticipation of capital markets volatility, we pre-equitized our balance sheet in the 4th quarter of 2022 with $560 million of forward equity raised at a net price of just over $67.50. While at the time, many thought our mindset was conservative, we were confident that while interest rates rose rapidly, cap rates would be slow to exhibit expansion in our large, illiquid, and fragmented space. We were determined to avoid deviating from our core strategy, by providing debt financing, expanding into new verticals or going up the risk curve either via credit or tenant concentrations.

Instead, we continued to execute our disciplined and time-tested strategy of investing in the country's biggest and best retailers. Those that have the balance sheets to invest in price, labor, and fulfillment, while creating a unique value proposition for customers.

While the performance of our stock has certainly been frustrating, we have not wavered. Management and our tremendous Board of Directors put their money where their mouths are with almost $12 million of insider purchases during 2023.

Net lease is a long-term business. We believe in consistency, reliability and quality of cash flows will ultimately lead to outperformance. While we can't control macroeconomic volatility, we can execute with a mindset of value creation, not simply short-term earnings accretion.

The days of free money and ubiquitous capital are behind us, which demands a strong and strategic change in capital allocation philosophy. We have seen the result of investing at de minimis spreads. It drives little to no AFFO per share growth.

In this new economic paradigm, our focus is on achieving outsized investment spreads on the best risk-adjusted opportunities, not simply aggregating volume. We will not grow the denominator without driving meaningful AFFO per share growth, nor will we move up the risk curve to create short-term opportunities and growth. We are laser focused on allocating capital in a disciplined manner to drive growth that is sustainable.

On last quarter's call, we outlined a "do nothing" scenario in which we would drive over 3% AFFO per share growth in 2024 with conservative assumptions and the absence of external growth. With over $235 million of forward equity raised at the end of the year and anticipated free cash flow of approximately $100 million, we have visibility beyond the do-nothing scenario. We can invest approximately $500 million this year on a leverage neutral basis, excluding any disposition proceeds and without the need for any additional equity capital.

Most importantly, we remain nimble and opportunistic, ensuring we are well positioned to capitalize on the opportunities as we uncover them. With over $1 billion of total liquidity including the outstanding forward equity raised in the fourth quarter, we have ample runway and complete optionality. In addition, we have no material debt maturities until 2028 and proforma net debt to EBITDA stood at just 4.3 times at year end. Our fortress balance sheet is paired with a best-in-class portfolio, and our record investment grade exposure of over 69% provides for highly durable cash flows in today's dynamic environment.

The strength of our balance sheet and the quality of our portfolio are evidenced by the positive outlook that S&P placed on our BBB credit rating last week. We believe that our credit metrics are emblematic of a higher rated company, and the positive outlook is another step in gaining recognition for the manner in which we operate our company and manage our balance sheet.

Moving on to our standard update… this past quarter we worked through significant market turbulence and ultimately invested nearly $200 million in 70 high-quality retail net lease properties across our three external growth platforms. This included the acquisition of 50 properties for over $187 million. The properties acquired during the fourth quarter are leased to leading operators in sectors including home improvement, farm and rural supply, off-price, tire and auto service, as well as convenience stores.

As our fourth quarter activity demonstrated, we continue to push cap rates higher, piercing 7% for the first time since 2019. The acquired properties had a weighted-average cap rate of 7.2%, a 30-basis point expansion relative to the third quarter, and 80 basis points higher than the prior year. The weighted-average lease term was 10.1 years and approximately 71% of annualized base rents are derived from investment grade retailers. We acquired seven ground leases during the quarter representing approximately $30 million, or 14.8% of total acquisition volume for the quarter.

In 2023, we invested more than $1.3 billion in 319 retail net lease properties spanning 41 states. We continue to leverage all three external growth platforms to find compelling risk adjusted opportunities. For the full year, nearly 74% of the annualized base rents acquired were from investment grade retailers while ground leases represented almost 9% of rents acquired.

Notably, we increased sale-leaseback activity in 2023, partnering with leading operators in the farm and rural supply and convenience store sectors. Sale-leasebacks represented one third of our acquisition activity in 2023 compared to just over 10% in the year prior, further demonstrating our ability to be a full-service, comprehensive real estate solution for our retail partners.

Switching to our development and DFP platforms, we had a record year with 37 projects either completed or under construction representing approximately $150 million of committed capital. We're continuing to see increased activity across both platforms as we work with our retail partners to help them execute their store growth plans and provide struggling merchant developers with the ability to lock in funding for their pipeline.

We commenced four new development and DFP projects during the fourth quarter with total anticipated costs of approximately $13 million. The new projects include a Burlington and a HomeGoods in Yuma, Arizona, and two Starbucks in Illinois. Construction continued during the quarter on 12 projects with anticipated costs totaling approximately $51 million. Lastly, we completed construction on four projects during the quarter with total costs of approximately $16 million.

We disposed five properties during 2023 for total gross proceeds of approximately $10 million, including three properties that were sold during the fourth quarter. The weighted-average cap rate for dispositions in 2023 was 6.1%. I anticipate additional opportunistic dispositions in 2024 as we will seek to sell assets at attractive cap rates and redeploy that capital on an accretive basis.

On the leasing front, we executed new leases, extensions or options on 425 thousand square feet of gross leasable area during the fourth quarter, including a TJ Maxx in New Lenox, Illinois and a Walmart Supercenter in Hazard, Kentucky. For the full-year 2023, we executed new leases, extensions or options on approximately 1.9 million square feet of GLA. We are in a great position for 2024 with only 28 leases or 110 basis points of annualized based rents maturing.

At year-end, our best-in-class portfolio spanned 2,135 properties across 49 states, including 224 ground leases representing 11.7% of total annualized base rents. Occupancy ticked up slightly to 99.8% and again, our investment grade exposure reached a record of over 69%.

Lastly, I'd like to welcome Linglong He to our Board of Directors. Linglong was Rocket's first software engineer over 25 years ago and today serves as the Chief Leadership Advisor of Rocket Central, where she is responsible for executive leadership development for the Rocket Companies. Prior to that role, she served as Chief Information Officer of Rocket Mortgage, one of the nation's largest mortgage lenders, for 10 years. Linglong has over 25 years of experience in technology and leadership, and we're truly excited to add her expertise to our esteemed Board of Directors.

I'll now hand the call over to Peter and then we can open it up for questions.

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

Starting with earnings, Core FFO per share was $0.99 for the fourth quarter and $3.93 per share for full-year 2023, representing 3.4% and 1.6% year-over-year increases, respectively.

AFFO per share was $1.00 for the fourth quarter and $3.95 for the full year, representing 5.2% and 3.1% 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 approximately a half penny 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 24.7 cents per share for October, November, and December. On an annualized basis, the monthly dividends represent a 2.9% year-over-year increase.

For the full year, the Company declared dividends of approximately $2.92 per share, a 4.1% increase year-over-year and almost a 12% 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.

Subsequent to year end, we declared a monthly cash dividend of 24.7 cents per share for January and February 2024. The monthly dividends reflect an annualized dividend amount of over $2.96 per share, or a 2.9% increase over the annualized dividend amount of $2.88 per share from the first quarter of 2023.

General and administrative expenses decreased quarter-over-quarter to 5.7% of revenue, adjusted for the non-cash amortization of above and below market lease intangibles. For the year, G&A expense totaled $34.8 million, or 6.1% of adjusted revenue. With our continued investments in systems including ongoing enhancements to our proprietary arc database, we anticipate that G&A expense will continue to scale as percentage of adjusted revenue in 2024.

We recorded $709 thousand of income tax expense during the fourth quarter. This brings the total for the year to $2.9 million, near the midpoint of our guidance.

Turning to our capital markets activities, we raised over $370 million of gross equity proceeds during the year via the forward component of our ATM program. With more than $235 million of forward equity raised late in the fourth quarter, we anticipate putting in place a new ATM program in the coming weeks in normal course.

We also demonstrated our ability to access attractive bank debt with a market-leading $350 million 5.5-year term loan at a fixed rate of 4.52% inclusive of prior hedging activity. The term loan received strong support from our key banking relationships, and the 5.5-year term allowed us to extend the maturity into 2029. As Joey mentioned, our debt maturity schedule remains in an excellent position with no material maturities until 2028.

Our capital markets activity further fortified our balance sheet and positioned us for continued growth in 2024. We ended the year with over $1 billion of total liquidity, including more than $235 million of outstanding forward equity, $773 million of availability on the revolver and approximately $15 million of cash on hand. In addition, our revolving credit facility and term loan have accordion options, allowing us to request additional lender commitments of $750 and $150 million, respectively. In addition to our strong liquidity position, free cash flow after the dividend is now approaching $100 million on an annualized basis.

As of December 31st, proforma for the settlement of our outstanding forward equity, net debt to recurring EBITDA was approximately 4.3 times. Excluding the impact of unsettled forward equity, our net debt to recurring EBITDA was 4.7 times. Our total debt to enterprise value was approximately 27%, while our fixed charge coverage ratio, which includes principal amortization and the preferred dividend, is in a very healthy position at 5.0 times.

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

Joey Agree | Agree Realty Corporation | President & CEO

Thank you, Peter. To summarize, we are very well positioned to execute in 2024 and to drive sustainable earnings and a growing and well-covered dividend.

At this time, operator, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. (Operator Instructions). Spenser Allaway of Green Street Advisors.

Spenser Allaway | Green Street Advisors
Given that you guys have capital locked in, and as you mentioned, you have a very strong liquidity position, why not provide some formal acquisition guidance at this time?

Joey Agree | Agree Realty Corporation | President & CEO
So I think first of all, we're in an extremely volatile macroeconomic environment, including interest rate volatility here that's going on. And so I think our number one focus is not going to be aggregating volume today at de minimis spreads, as we talked about in the prepared remarks. We're 100% focused, and the team is disciplined here, focusing on deploying capital at 100-plus basis point spreads into our sandbox of the country's leading retailers. And frankly, with 70 days of visibility in the net lease space, that's our average duration from letter of intent to close, I can't tell you what's going to happen in 71 days, let alone later the summer or fall.

Spenser Allaway | Green Street Advisors
Okay. And then as you think about the three different kind of investment verticals that you play in, can you just talk about where you're seeing the best spreads today?

Joey Agree | Agree Realty Corporation | President & CEO
The best spreads, of course, would be in development, right? Duration, development duration, we don't take speculative risk in terms of acquiring land, or inspecting buildings without a tenant in hand, without

that being fully bid and all permits secured. So the best returns would, of course, be on the development spectrum and so duration equals risk. So we're looking for a significant spread if we're going to develop to where we can acquire a like-kind asset; and the other end of the spectrum would be acquisitions -- again, where our focus here is deploying capital 100 basis points wide of where we see our cost of capital. And as we've noted significantly before, our cost of capital, we perceive it as a forward AFFO yield at a 75-25 split with 10-year unsecured pricing. We're not using unburdened free cash flow here. It's a conservative approach to that cost of capital, but our goal again, is to deploy that capital 100 basis points wide of that.

Spenser Allaway | Green Street Advisors
Okay. Thank you for the color, Joey.

Operator
Smedes Rose of Citigroup.

Smedes Rose | Citigroup
So I guess you don't want to provide a full year kind of outlook and thinking about acquisition activity. But could you maybe just talk about what you've seen kind of year-to-date, and kind of where cap rates have moved sequentially from the fourth quarter, were you were able to lock in at 7.2%? Maybe just a little color on kind of what you're seeing near term?

Joey Agree | Agree Realty Corporation | President & CEO
Sure. I would tell you, cap rates right now are all over the board, given the volatility in the underlying markets that we see and the interest rate. Fourth quarter was a roller coaster. Obviously, we saw the base rate for the world go up 25% from 4% to 5% in 70 days; then dropped to 28% over the subsequent 21 days. This morning, I'm not sure what it's going to do, or what Goolsbee and all the Fed speakers are going to say. I think it's more likely that we get a rate hike this year than a cut in March at this point, and so cap rates are all over the board; as you would imagine, the sellers' expectations of the overall economy and interest rate environment are all over the board.

What I will tell you is building upon my last answer, that 100-basis point spread to where we see our cost of capital will result in a material jump in our cap rates in Q1, 30 to 40 basis points most likely, still focusing a 30 to 40 basis points jump over Q4, again, without sacrificing credit quality. And that will be an aggregation on the acquisition side of unique opportunities, short-term blend and extend opportunities, high-performing stores directed by our retail partners and asymmetric opportunities, but the market in terms of transactional volume is effectively fractional of where it was historically and sellers' expectations are all over the board.

And so we really don't have -- unfortunately, when the 10-year was at 4% early in the fourth quarter, we were approaching it. It seems like a new normal, a 4% [tenure]. Since then, obviously, the volatility has got some consternation, some hope, amongst borrowers that kind of vacillates back and forth.

Smedes Rose | Citigroup
Okay, thanks. And then I just wanted to ask, you mentioned G&A expense will continue to move up as a percent of revenue. Do you have a sense of kind of what percentage that we should expect that to move to over the course of 2024?

Joey Agree | Agree Realty Corporation | President & CEO
So embedded in our guidance -- I'll let Peter add any color. Embedded in our base case of over 3% AFFO growth, which clearly, is off the table right now given, the forward equity that we've raised and the color I've given on the pipeline, the percentage of G&A -- of revenue will go down. The absolute number we anticipate going up because auditors, professional services and everything else continues to go up in this world.

Peter, anything I'm missing?

Peter Coughenour | Agree Realty Corporation | CFO
No, that's correct. I think in recent years, we've seen scale in G&A as a percent of adjusted revenue of approximately 40 or 50 basis points on an annual basis on average. It's difficult at this point to predict how much scale we'll see in 2024, but we do anticipate that G&A as a percentage of revenue will continue to come down.

Smedes Rose | Citigroup
Great, thank you. Appreciate it.

Operator
Ki Bin Kim of Truist.

Ki Bin Kim | Truist
So the first question, I noticed you guys have about 10 Big Lots, so the question is about your guidance. And I think you embedded about 50 basis points credit loss reserves. So curious how much of that accounts for the known or highly likely move-out versus the unknown and Big Lots. What is that as a percent of ADR please?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, so our total watch list today is approximately inclusive of any Big Lots exposure, of any At Home exposure where we have one -- these are real estate plays for us at the end of the day. You can take a look at our At Home in Provo, Utah. That's a real estate play across a mall that's undergoing renovation with a new large format Target. Big Lots, we continue to monitor. It's an immaterial piece of our overall, obviously, portfolio. And it's embedded in that 1% approximately watch list amongst At Home.

And so I'll give you an example. We had one Big Lots that didn't renew. We just were at lease right now with a national retailer in the auto parts space, a great partner of ours for approximately a 5% lift on the NOI on a 15-year new base term. So we're very comfortable with our exposures, and frankly, the underlying real estate here. So again, that total watch list that we're focused on is basically 1% and a lot of it, frankly, we want back.

Ki Bin Kim | Truist
Okay. And the Big Lots ABR percentage?

Peter Coughenour | Agree Realty Corporation | CFO
Yes, Ki Bin, it's sub-50 basis points today in terms of our overall exposure to Big Lots. And I'd also note, on average, to Joey's point, in terms of being comfortable with the basis, they're paying just over $6 per square foot on average.

Ki Bin Kim | Truist
Okay. And I appreciate your comments about being more disciplined on capital deployment if the pricing doesn't make a whole lot of sense. Since your last equity raise, obviously, your stock price has drifted slightly lower. So if you had to raise a new round of equity today, and if you still want to hold on to the 100-basis point spread target, it would imply that you would probably have to buy something closer to an 8% GAAP cap rate. I'm not sure if there's enough desirable product at those prices, so if you can provide some commentary? And if that is the case, would you just be comfortable slowing down the acquisition pace again?

Joey Agree | Agree Realty Corporation | President & CEO
Well, we started the year by putting out a base -- we started the year -- what is it, last year -- by putting out a base case with no investment volume, with over 3% AFFO growth, with those conservative inputs that we just went through, and Peter gave more descriptive analysis to. So we will not put out capital south of that 100-basis point spread unless it is a unique, compelling opportunity, a mark to market, or something that justifies -- has the merits to justify that business case.

And so where our stock price is, where our stock price goes, where cap rates go, I'll be honest, I don't anticipate material expansion throughout the course of the year, absent more economic macro volatility, incrementally more volatility than we see now. This is a large liquid fragmented space. Our focus is again, is being 100% focused and disciplined on deploying that capital, a material accretive spread.
This business is very simple. At a forward AFFO yield, if you deploy capital inside of that forward AFFO yield, it does not work, forget that. I don't care if you're using overnight paper. We price our cost of capital using 25% 10-year unsecured bonds; that's how we look at our cost of capital. But if you're deploying capital inside of your forward AFFO yield, it's not going to work, and it's going to drive no shareholder accretion on an AFFO per share basis.

And so we're not going to be out there collecting nuts, growing our denominator, not driving per-share value and per-share growth for our shareholders. The relationship between cap rates and volume, at the end of the day, is exponential and not linear. And so again, people have heard me say, inside of 75 basis points is the red light. We've seen the anecdotal evidence, as well as the empirical evidence, of some large-volume numbers not producing annualized [gross] in the subsequent year.

75 to 100 basis points is a yellow light in this business, you could invest selectively; over 100 basis points, when you look at your true cost of capital, not including unburdened free cash flow or short-term debt, the white becomes -- starts to be turn green. If you get to 150 basis points, you can slam on the gas, like we did for several years. We're not at that 150-basis point space in this market today, unless you want to go significantly up the risk curve, which is adverse to everything we believe in at this company.

And so that 100-basis point bogey, not sure how much we're going to be able to aggregate for the year. I don't have that crystal ball, but we're certainly not going to deploy capital inside of it just to grow our denominator in our asset base.

Ki Bin Kim | Truist
Okay. Thank you, Joey.

Operator
Joshua Dennerlein of Bank of America.

Farrell Granath | Bank of America
This is Farrell Granath on behalf of Josh. I know you already made a few comments about your development pipeline. I was curious, I know over 2022, 2023, it was about, say, like a 23% increase. Is it fair to assume maybe a comparable amount going into 2024 for a total amount of development?

Joey Agree | Agree Realty Corporation | President & CEO
We are consistently and constantly answering the phones and responding to inquiries from merchant developers, from retailers, from all different types of constituents, given the lack of liquidity out there in the construction lending market, and the lack of ability for merchant builders to develop net new stores. Where that number ends up this year is going to be frankly, subject to where we can get returns. We're just not going to grow that number to put shovels in the ground, take duration risk, and not provide for the appropriate levels of ultimate accretion on our deployed capital, so it's difficult to say where that will go. It can change by the day.

We announced a number of new projects, as well as completed, in this quarter. Our pipeline continues to grow the pace at which it grows; it's really up in the air. Retailers want to grow today, that's the ultimate bottom line. If the retailers in our portfolio, inclusive of Walmart, who just announced a slew of new stores, really since the first time since the GFC, want to grow today. The question is construction costs, availability of capital, return on cost and what rent per square foot they can pay.

And so calibrating those things, ultimately, our goal is to calibrate those things, and figure out what projects make sense for us with those retail partners. What that number is again, I wish I had that visibility.

Farrell Granath | Bank of America
Great, thank you. And I believe this is along the lines of what you were just mentioning, that last quarter. You made some comments about partnering up with retailers to kind of assist with bringing stores to a close. Is there any other further update on that?

Joey Agree | Agree Realty Corporation | President & CEO
Continue discussion. The team is at two national retailers that you're familiar, with today and tomorrow, frankly. We're constantly in dialogue trying to help break this log-jam that's occurring right now in the development of new stores. That said, we're not going to do it, obviously, to the detriment of our shareholders; we're going to get the appropriate spreads.

So the dialogue is ongoing. It is very fluid, as you can imagine, with the world going inside-out in the fourth quarter. But we're going to continue to have those conversations. And I think our full service value proposition is -- I know it is, I know it is unique to retailers and they appreciate all of our capabilities, inclusive of our asset management capabilities.

Farrell Granath | Bank of America
Great, thank you.

Operator
Rob Stevenson of Janney.

Rob Stevenson | Janney
Can you talk about what the cash spread on leasing done in the fourth quarter and for 2023 as a whole was? And have the size of the bumps or other lease terms changed, given the persistently higher inflation these days?

Joey Agree | Agree Realty Corporation | President & CEO
On the first one, Peter, do you have a number handy? I mean it's fairly de minimis.

Peter Coughenour | Agree Realty Corporation | CFO
Yes, Rob, I would just say first that we don't have a ton of actually re-leasing activity in our portfolio. The vast majority of leases that are up for expiration (inaudible) the tenant exercise an option which typically has an embedded bump within that option. That said, the recapture rate for Q4 and for the full year was north of 100%.

Rob Stevenson | Janney
Okay. And then what about the lease terms? Are you guys trying to push higher bumps, more frequent bumps, etc., given the higher inflation, or trying to mitigate people to CPI? How are you guys thinking about that as you're starting new leases on any of these development deals, or any of the other stuff?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, so no national retailers will generally acquiesce to CPI-based bumps. They want to know what the rent is going to be on a go-forward basis, so they can plan. But yes, that's thematic since we've seen inflation at 8%, 9%, let alone over 3%, and everybody is, I think, understanding that we're in an inflationary environment. And so the frequency as well, as the size, of those bumps, I think most tenants are amenable to relooking at their lease terms there.

Rob Stevenson | Janney
Okay. And then can you talk about the difference between cap rates on ground leases in the fourth quarter for the year overall, versus the fee simple acquisitions? Has that spread sort of stayed relatively

consistent? Are you seeing better opportunities or less opportunities in ground leases today and going forward? How should we be thinking about that?

Joey Agree | Agree Realty Corporation | President & CEO
Very, very consistent; if any, a de minimis spread between the ground leases and net leases. We're generally working with our retail partners there. I think you'll see more of the same in the first quarter. Some of them are shorter term, some of them are targeted by retailers in partnership with us, so very de minimis spread if any.

Rob Stevenson | Janney
Okay. Thanks, guys, appreciate the time.

Operator
Haendel St. Juste of Mizuho.

Haendel St. Juste | Mizuho
Joey, I think you mentioned earlier in the call that you're anticipating -- let's see -- opportunistic dispositions this year. Curious what categories you're more inclined to call, potentially how much you like to call and potential range of cap rates or any pricing color expectations?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, I'd tell you from a category perspective, we're not overly interested in decreasing our Walmart exposure or anything like that. The opportunistic dispositions will generally be into the pretty tenuous 1031 market, dominated in markets where you have significant capital, seems to be significant capital, still chasing things at fairly low yields. We'll look to redeploy that capital at approximately 150-basis point spreads.

You can see it in the auto service space; you could see it amongst other categories, the farm and rural supply space, the car wash space, potentially, generally, spaces where we're very comfortable with our exposure. But there is still opportunistic, maybe tax-motivated purchasers out there in geographies which seem to still have heat to them.

Haendel St. Juste | Mizuho
Got it. That's helpful. And then just going back to the messaging here, clearly, you're guiding to a capital-light deployment, earnings growth, minimum 3%, probably looks like 4% now, expecting cap interest rates to be higher for longer. So I guess I'm curious, kind of from your perspective, what's the investment case for investors buying the stock here today? 3% to 4% earnings growth isn't too shabby in this environment, I get it. But still likely to lag a number of your peers, I think. Are we basically in a wait-and-see mode to a degree here?

Joey Agree | Agree Realty Corporation | President & CEO
So let's take a step back. We have a 5%-plus and growing dividend that's covered at the low end of our target payout ratio of 75%. We have a 5-year CAGR of 6% AFFO growth while qualitatively improving the portfolio to now approaching 70% investment-grade and 12% ground leases. It is the strongest retail portfolio, I think, without exception, in the country and most investors and analysts would agree. We have a balance sheet that is fortified with $1 billion of liquidity, has no material debt maturities until 2028, no floating rate exposure except anything outstanding on the line of credit.

So if you take your 3% to 4%, and you go ahead and take the high end, then take the 5% and the growing dividend, you're at 9% total returns there alone, assuming no dividend growth, which it will grow this year, with an underlying fortress balance sheet and an underlying fortress portfolio. I think that is a very compelling case in today's environment to invest in ADC, and I think, as I said in our prepared remarks, insiders here, inclusive of myself, agree.

What we have done and what we have built, without diminishing the qualitative aspect of our portfolio, I think, is without peer. We haven't loaded up on pharmacies; we've ran from Walgreens exposure. We don't have double-digit pharmacy exposure and double-digit Dollar Store exposure. We're not just out there checking the IG box. We've been talking about Walgreens now for years, reducing our Walgreens exposure to an inconsequential number; watching CVS overtake Walgreens in the pharmacy space.
I think we have a proven track record now of not only being correct in our retail predictions and predilections about the concerns in an omnichannel world, but we also have the balance sheet management, the earnings growth profile to, frankly, to bank on. And so I think there's something to be said, especially in today's environment, for stability and predictability.

Haendel St. Juste | Mizuho
Great, thanks for the thoughts, appreciate it.

Operator
Mitch Germain of JP Securities.

Mitch Germain | JP Securities
I know it's early in the year, but I'm just curious if you're seeing any changes to the buyer pool?

Joey Agree | Agree Realty Corporation **|** President & CEO
Mitch, honestly no. This market is so fragmented and large to begin with, that you stress it in a higher interest rate environment and in a liquid credit environment, the buyer pool kind of becomes a toss-up in the air. So it's very difficult. Sometimes, I'll be honest, I'll ask an investment or disposition committee, who is this, who is buying this, who is selling this? And the answer turns into something like a riddle.
And so I'll be honest, there are no parallels to be drawn. There is not a fluid market right now. It is hit-or-miss, it's about being disciplined and it's about throwing darts and being decisive in what you want to accomplish.

Mitch Germain | JP Securities
Thanks for the color.

Operator
RJ Milligan of Raymond James.

RJ Milligan | Raymond James & Associates
So I just want to follow up. I think Smedes asked this and I'm not sure if you provided an answer in terms of what the year-to-date activity has been so far?

Joey Agree | Agree Realty Corporation **|** President & CEO
No, we haven't provided any answer or any update on the year-to-date activity, although I did mention that we anticipate cap rates jumping in Q1 by approximately 30 to 40 basis points on the acquisition side.

RJ Milligan | Raymond James & Associates
Got it. And so I know there's a difference between capital previously raised, right, via the ATM last quarter, versus trying to go out and raise new capital, equity capital, today. So I'm just curious if you are seeing that -- or 7.5% average cap rate or that cap rate expansion. Would the goal then be to deploy the Q4 ATM proceeds quickly? I guess, what is the outlook for cap rates? Is it go and deploy at a 7.5% today, given that that's a pretty high absolute cap rate, or is it still more of a wait-and-see even with the previously-raised proceeds?

Joey Agree | Agree Realty Corporation **|** President & CEO
Yes, just to clarify, that's not market. These are manufactured transactions where we work out there creating value. That is nowhere near market cap rates today on like-kind product. We're not out there buying glossy brochures here that are highly marketed and sent through the auction process. And so if

we can achieve those types of cap rates, we'll look at that spread relative to our cost of capital, deploy that equity.

But I think as we highlighted, we have $500 million in leverage-neutral buying power today, not inclusive of any disposition proceeds. And so as the year materializes, again, as the pipeline and the pipeline grows, we'll look at all capital options for us, but we don't need to do anything today. I think that's pretty clear with $1 billion of liquidity and that $500 million in leverage-neutral power.

RJ Milligan | Raymond James & Associates
Thanks. And just one follow-up. So Joey, you've talked a lot or very often about the lack of visibility, 70 days. However, you have been able to provide, despite that lack of visibility, a sort of a guidepost at least for acquisition volume. And I understand that we are in a volatile capital markets environment. I'm just curious, what do you need to see in the capital markets or the transaction market to get the confidence to resume an external growth guidepost?

Joey Agree | Agree Realty Corporation | President & CEO
I think we have to get to a level of normalcy again. I think we have to get to a level of stability in the underlying macroeconomic environment. I haven't -- I'll be honest, I haven't seen an economist who's gotten this right since we pumped $6.5 trillion into the economy and lowered rates to zero. And so for us to sit here -- and me specifically to sit here -- as a dumb real estate guy and try to anticipate what's going to materialize over the course of the next 11 months during this year, I would frankly be getting ahead of myself.

And so we were able to provide those historic guideposts because we had a level of visibility into anything, absent an aberration or geopolitical event or some type of crash today, with the underlying volatility that we're seeing in these markets and frankly, the lack of clarity we're seeing in these markets, it's a foggy world out there today. And so when we get -- and if we get -- that level of clarity based upon that stability, we will 100% provide it, but I think anything -- if we did anything else, we would just be getting ahead of ourselves.

RJ Milligan | Raymond James & Associates
Thanks. And one additional is clearly, you guys have been pretty proactive in selling down your Walgreens exposure over time. I'm curious if there's any other categories that you're looking to sort of get ahead of the curve over the next year or two?

Joey Agree | Agree Realty Corporation | President & CEO
Not really from a category perspective. We saw something very specific with Walgreens in context of the pharmacy space, the degradation of the front end, the constant need and desire to do M&A to increase store count, which didn't make sense to us; the failure of Walgreens to repurpose the front end of the store with their attempts at beauty and fragrance, their attempts at the W-Café, we saw that very specifically.

And frankly, we had an overabundance of Walgreens exposure. It was 45% Walgreens exposure in 2012, I think, approximately; in 2013, we were 45% Walgreens exposure and we had a lot of intimate experience developing approximately 40 to 50 of them in 6 states. And so that was abundantly clear to us, watching those stores erode.

I'll tell you, the retailers in our portfolio are generally doing really well and are really healthy. Now we stayed away from the casual dining space; we've stayed away from the experiential stuff and we'll continue to. But if you look at our portfolio today, the retailers are really doing well. The big are getting bigger, they're getting stronger; they're investing in price, labor and distribution, and figuring out how to drive EBITDA in this omnichannel world.

RJ Milligan | Raymond James & Associates
Thanks, guys.

Operator
Linda Tsai of Jefferies.

Linda Tsai | Jefferies
Regarding what you referred to as manufactured cap rates in 1Q being up 40, 50 bps through the auction process, any more color on how you drive that level of expansion and how easy or difficult it is to achieve this?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, just to clarify, those cap rates are effectively us creating value out there, seeking off-market opportunities, blend and extend opportunities. These aren't highly-marketed glossy brochure to national brokers. We're working with our retail partners to find opportunities where they want to be there long term, and we want to be their landlord long term.

Will you repeat the second part of that question?

Linda Tsai | Jefferies
Oh, just how easy it is to -- or difficult to achieve this and its sustainability?

Joey Agree | Agree Realty Corporation | President & CEO
Not easy. Look, this is -- I don't think anything is easy in this world today. It takes grit; that's one of our core values here. Greatness requires grit, it takes grit. We leverage our relationships. The team here has tremendous relationships and credibility with retailers. We aren't in the wholesale buying process anymore out there that's going -- given where costs of capital are.

But I'm 100% confident that the team will continue to be able to uncover opportunities across all three external growth platforms that provides outsized returns relative both to the market and hopefully, our own internal expectations.

Linda Tsai | Jefferies
And then if sale leaseback was 1/3 of the acquisition volume, what can it grow to in 2024? And similarly, where can DFP grow to as a percentage of the volume?

Joey Agree | Agree Realty Corporation | President & CEO
From a sale-leaseback perspective, any tenant that doesn't need capital -- and those are the only tenants that we typically do business with; we don't want to become a large unsecured creditor to any retailer that's private equity sponsored. So if you looked at the retailers we did sale lease, they're on pause, right? Their CFOs, their real estate departments, are watching the volatility. They know where they can issue paper in the unsecured market today. They're waiting for things to settle down here as well. And so I wouldn't anticipate, given today's status quo, that number approaching 1/3. It's fully possible if we get stabilization later in the year.

In terms of DFP, every day, it changes. We have built that team out, we've built that system out in context of ARC. We have improved and made our process more efficient. Again, it's just a question of pricing. And the pricing is both with the developers, as well as the retailers, the returns they're willing to accept and ultimately, the rents they're able to pay on those specific sites. And if it works in context of our -- obviously, return profile.

Linda Tsai | Jefferies
Thank you.

Operator
Ronald Kamden of Morgan Stanley.

Jenny Li | Morgan Stanley
You have Jenny on for Ron. I just have two quick questions. The first is can you talk a little bit on the competition environment today for the IG-focused market? And you mentioned like transaction volume is kind of low like this year. But if you compare on a year-over-year basis, is that like getting worse, or it's actually better than last year?

Joey Agree | Agree Realty Corporation | President & CEO
Competition in our specific sandbox is really hit or miss, right? There are the random and infrequent 1031 or high net worth individuals. They tell you the competition is very similar to what it was historically, except the amount of competition. The composition is similar, but the amount of competition, given just the transactional slowdown, the 1031 slowdown, is very de minimis. And so I often say our largest competitors are sellers' expectations themselves.

Would you repeat the second part of that question?

Jenny Li | Morgan Stanley
The second is the transaction volumes. You mentioned like the transaction volume this year is kind of low. But if you compare on a year-over-year basis, it's actually better than last year, or actually worse than last year?

Joey Agree | Agree Realty Corporation | President & CEO
Well, the transaction line between the closed acquisitions?

Jenny Li | Morgan Stanley
Of the pipelines and just overall?

Joey Agree | Agree Realty Corporation | President & CEO
We're still early. Look, we have visibility into the Q1 pipeline. We're just starting to build Q2. Transaction volume for Q1 will be down year-over-year relative to Q1 undoubtedly. But as I mentioned, our focus is on improving those cap rates very significantly on a relative year-over-year basis. So I think looking forward, again, we'll see what type of normalcy we get or stabilization we get in the underlying macro. It's very difficult to predict, impossible for us.

Jenny Li | Morgan Stanley
Yes, it makes sense. If you talk about dispositions, I think you mentioned you're expecting to dispose more this year. And based on your target cap rates, do you think -- just maybe talk a little bit more about like the disposition cap rate is trending and the overall environment?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, we're looking for those opportunistic areas where we can sell an asset generally in the -- plus-or-minus in the 6-[cap] range, and then redeploy it north of 100 basis points, minimally, above that in assets that we don't think long term necessarily have the growth potential profile to fit within the portfolio.

Jenny Li | Morgan Stanley
Okay, sounds good. Thank you.

Operator
Alec Feygin of Baird.

Alec Feygin | Baird
First off, where are the current yields on the new development funding deals?

Joey Agree | Agree Realty Corporation | President & CEO
When you say "new development funding deals," generally, we're targeting new and net new in terms of approvals. And starting now, we're targeting the DFP transaction that is, let's call it, 6 months until rent

commencement. This would be approximately 50 to 75 basis points over like time cap rates in the acquisition. If it's an overall project that takes entitlements, we're significantly wide of that just because of the duration risk.

Alec Feygin | Baird
Okay. Thank you. And second, you kind of put on your macro hat earlier, said you think the chance of a rate hike is -- might be higher now than a rate cut. Kind of curious what's the most attractive source of debt today? And does the company have any plans on issuing long-term debt to reduce the revolver anytime soon?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, just I'll let Peter answer the second question. Just to repeat, the chance of a rate hike is probably better -- this year is probably better than the chance of a rate cut in March. We'll see more data, obviously, tomorrow. But I think that rate cut expectation that the market had for March is clearly off the table. And we'll see if we get any more hot prints that come out.

Peter, in terms of the debt market, I'll let you take that.

Peter Coughenour | Agree Realty Corporation | CFO
Yes, I think we came into this year with $1 billion of total liquidity available to us, and so there's no near-term need to access the debt markets. We have no material debt maturities until 2028, and so we can continue to be opportunistic in terms of how and when we access the debt capital markets. We have access to both the unsecured markets, as well as the bank debt markets, where we continue to have strong support from our bank group. I think our preference is typically for longer-term fixed rate unsecured financings that match the underlying lease duration of our portfolio. And to that end, as disclosed in the 10-K, we entered into $150 million of forward starting swaps during the fourth quarter.

Those swaps contemplated a future 10-year unsecured debt issuance, and they're swapped at an effective rate just under 4%. So we have optionality in terms of when we use those swaps. They have a mandatory termination date in June of 2025, but contemplates us coming back to that market at some point in the future.

Alec Feygin | Baird
Thank you. That's all for me.

Operator
Eric Borden of BMO Capital Markets.

Eric Borden | BMO Capital Markets
Just a quick one on the watch list. What's the mark to market on the assets in there today? I think you mentioned Big Lots expiring or taking back space in the mid-single digits. Just curious about the rest of the portfolio.

Joey Agree | Agree Realty Corporation | President & CEO
The Big Lots expiration that I mentioned, which was now at least within auto parts, that mark to market is [approximately] 5% on a new 15-year lease -- in reference to where we think the remainder of the overall portfolio is?

Eric Borden | BMO Capital Markets
Just the remainder on the portion of the portfolio that is on the watch list, or space that you anticipate taking back?

Joey Agree | Agree Realty Corporation | President & CEO
I'd tell you, we're extremely comfortable, given the rental rates that we've recorded across those. We're extremely comfortable. Again, these are mid-single-digit rental rates. Today, to even build a box like that,

is $160, $150 vertical a foot. These are mid-single-digit rental rates that we feel extremely comfortable, that if we were to get any of these boxes back, that we'll have no challenge here marking them to market. Where market is, it varies across the board, but to find any box today that has any merit to it in mid-single-digit range is almost impossible.

Eric Borden | BMO Capital Markets
All right. Thank you very much.

Operator
Connor Siversky of Wells Fargo.

Jesus Garcia | Wells Fargo Securities
Jesus on for Connor this morning. Just in your conversations with tenants, can you offer a temperature check on the willingness for some of these retail operations to continue to expand in this current macro backdrop?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, as I touched on earlier, the retailers that we talk to want to continue to expand, and continue to expand aggressively. I don't remember a time when Home Depot, Walmart and Lowe's before -- except it's prior to the GFC -- were expanding. The large-format C-stores, the auto parts operators, the off-price retailers, it's all the TJX concepts, Ross, Burlington, 5 Below, these operators have the desire to continue to expand across all of their different flags. And again, the challenge today is construction costs and ultimately, what they can pay on a per-square foot rental rate.

But there is voracious demand in the discount space. Again, we're focused in the necessity-based arena here. It is a voracious demand to continue to expand and open stores. We're seeing that really across the board, whether it's all the way from O'Reilly and AutoZone to Tractor Supply to Walmart to ALDI, which is obviously making a large acquisition and opening net new stores. I think you see that across the arena in terms of discount-oriented operators.

Jesus Garcia | Wells Fargo Securities
Great, appreciate the color. Thanks, guys.

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

Joey Agree | Agree Realty Corporation | President & CEO
Thank you all for joining us this morning and we look forward to seeing you at the upcoming conferences. We appreciate everyone’s time.

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