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PECO.OQ - Q4 2021 Phillips Edison & Co Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, and welcome to Phillips Edison & Company's Fourth Quarter 2021 Results Presentation. My name is Carmen, and I'll be your conference call operator today. Before we begin, I would like to remind our listeners that today's presentation is being recorded and simultaneously webcast. The company's earnings release and quarterly financial supplements were issued yesterday, February 10, after market close. These documents and a replay of today's presentation can be accessed on the Investors section of the Phillips Edison & Company website at phillipsedison.com.

I would now like to turn the call over to Michael Koehler with Phillips Edison & Company.

Michael Koehler - *Phillips Edison & Company, Inc. - Director, IR*

Thank you, operator. Good afternoon, everyone, and thank you for joining us. I am Michael Koehler, Vice President of Investor Relations with Phillips Edison & Company. Joining me on today's call are our Chairman and Chief Executive Officer, Jeff Edison; our President, Devin Murphy; and our Chief Financial Officer, John Caulfield.

During today's presentation, Jeff will provide a brief overview of Phillips Edison & Company, discuss our differentiated strategy and touch on the highlights of the quarter. Devin will discuss our fourth quarter operational results. John will review our fourth quarter financial results and discuss our 2022 financial guidance. Lastly, Jeff will return to provide an update on our acquisition and disposition activity and give our 2022 acquisitions guidance and provide some closing comments. Following our prepared remarks, we will answer questions from the institutional analyst community.

Before we begin, I would like to remind our audience that during the course of this call, management may make forward-looking statements within the meaning of federal securities law. These statements are based on management's current expectations and beliefs and involve risks and uncertainties that could cause actual results to differ materially from those described in these forward-looking statements.

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Such forward-looking statements are made only as of today and will not be updated as actual events unfold. Please refer to yesterday's earnings release and our filings with the SEC for a detailed discussion of the risks that could cause actual results to differ materially from those expressed or implied in any forward-looking statements made today. In addition, we will also refer to certain non-GAAP financial measures. Information regarding our use of these measures and reconciliations of these measures to our GAAP results are available in our earnings release and supplemental disclosure, issued yesterday, which are on our website.

With that, it's my pleasure to turn the call over to Jeff Edison, our Chief Executive Officer. Jeff?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Michael. Good afternoon, everyone, and thank you for being on the call. Phillips Edison Company is exclusively focused on owning and operating neighborhood, grocery-anchored, omnichannel shopping centers. We are one of our nation's largest owners of this type of center.

As we speak today, you will notice that we call our tenants our neighbors. We do this, because we work hard to create community at our centers, and we treat our retailers as neighbors in that community. We also prioritize customer service and believe that this nomenclature reminds our team to treat our tenants like we would our neighbors.

When it comes to our centers, we believe that format drives results and also facilitates attractive long-term growth. Our average center is 115,000 square feet, which is among the smallest average size in the REIT universe. We believe our smaller centers allow for better growth because of our average tenant space of 2,300 square feet aligns well with leasing demand. Approximately 70% of leases in strip centers are executed in spaces smaller than 2,500 square feet. This demand drives higher retention rates, higher re-leasing spreads and overall positive leasing dynamics for PECO. Higher retention rates result in less downtime, lower TI costs and higher NOI growth.

When it comes to our properties, our strategy is simple. We focus on owning centers with the #1 or #2 grocer in the market. Our centers have an omnichannel neighbor base where the grocer and the center have both delivery and buy online and pick up in the store or BOPIS capabilities. Our centers have a high exposure to neighbors selling necessity-based goods and services. In fact, 72% of our rent comes from neighbors offering both necessity goods and services. We focus on owning centers in trade areas with favorable demographics where our neighbors can be successful.

Looking forward, we believe we are well positioned for long-term growth. Our long-term growth includes both strong external and internal growth. We improved our balance sheet with the capital we raised during our underwritten IPO last July. Subsequently, we executed our debut $350 million public bond offering as our investment-grade issuer. With our leverage currently at 5.6x debt-to-EBITDA, our goal is to execute $1 billion of acquisitions, net of dispositions over 3 years. Our strategy creates significant opportunity for acquisitions, which I'll discuss later.

This external growth will complement our strong internal growth over the long term. The key drivers of our internal growth include, growing rents through new and renewal leasing spreads, executing leases with annual fixed rental increases, leasing vacant space to new neighbors and executing redevelopment opportunities, which are primarily single-tenant, ground-up, outparcel developments and tear down and rebuild opportunities for our grocer anchors.

We believe our strategy has historically and will continue to prospectively generate superior risk-adjusted returns. We do believe that format drives results. Our differentiated strategy allows us to realize higher initial yields on acquisitions plus higher NOI growth plus lower CapEx. This leads to superior economic returns. Our results in the fourth quarter were no exception. The fourth quarter continued the momentum we have seen through 2021.

For the full year, we exceeded our annual core FFO per share and same-center NOI guidance. The key components of our results are as follows. The operating environment remains as strong as we have seen it in our 30 years in the business. Our rent collections are at pre-pandemic levels. We enjoyed continued high demand for retail space in our well-located small format centers. We realized strong internal growth. Leased occupancy reached an all-time high of 96.3%. Comparable new and renewal rent spreads were healthy at 18.3% and 7.8% respectively. On average, our new and renewal in-line leases executed in the fourth quarter had annual contractual rent bumps of 2.4%.

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We also realized strong external growth. We continue to execute our goal of acquiring $1 billion of real estate by June of 2024. Since our IPO in July, we acquired $350 million of assets, which we believe meet our internal return requirement of an 8% unlevered IRR. Looking forward, we believe the strong operating environment enhances our ability to execute our internal and external growth plans. It positions us for meaningful long-term growth. John will provide more details on our outlook in a few moments during our 2020 guidance discussion.

Now I'd like to turn it over to Devin who will speak in more detail about our operating results for the quarter. Devin?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Thank you, Jeff. Good afternoon, everyone, and thank you for joining us today. Our differentiated strategy of owning and operating small format centers anchored by the #1 or #2 grocer continues to generate strong results and resulted in positive results for the fourth quarter.

At the end of the fourth quarter, lease portfolio occupancy totaled 96.3% compared to 94.7% at December 31, 2020. Occupancy reached an all-time high in the quarter. Anchor leased occupancy increased to 98.1%. In-line leased occupancy increased to 92.7%. Our leased occupancy to economic occupancy spread was 100 basis points for the quarter, primarily as a result of our anchor leasing activity. Our in-line spread compressed to 80 basis points this quarter. We believe that we can increase in-line occupancy to 95% over time, which will add approximately 70 basis points to our total occupancy rate.

During the quarter, we executed 121 new leases and 132 renewal and option leases, totaling 1.4 million square feet of space. We have leased approximately 1.4 million square feet now for 4 consecutive quarters, illustrating the continued strong demand from retailers for space at our centers. Comparable new lease rent spreads were 18.3%, and comparable renewal leased rent spreads were 7.8%.

Our in-house leasing team has been busy executing new in-line leases with neighbors, including Sports Clips, Dunkin Donuts and retailers for many different lines of necessity retail. Demand for our retail space is coming from retailers in many different businesses. A growing trend that we have seen is national retailers such as Chipotle, Starbucks and Humana, looking to expand their footprints in our suburban markets.

Additionally, we have a dedicated renewals team focused exclusively on keeping our existing neighbors in our centers. We enjoyed a retention rate of 86% for the quarter, which is just shy of our full year retention rate of 88% and in line with our 2017 to 2020 average retention rate of 87%. We believe our retention rates are market leading. These high retention rates are important because we suffer no downtime and have to invest less tenant improvement dollars into the space. In Q4, our average TI for renewals was only $1.29 per square foot, and for the year averaged $0.95 per square foot. No downtime and lower TIs results in better cash flow growth. These solid retention rates are evidence that our retail space is a great place for our neighbors to successfully operate their businesses.

An important part of our internal growth story is redevelopment. During the quarter, we stabilized 2 ground-up outparcel developments. One at Plaza 23 in the Newark, New Jersey MSA and one at Alameda Crossing in the Phoenix MSA. This additional GLA of 7,300 square feet is fully leased, and the neighbors took possession of the space during the quarter.

We have 17 additional redevelopment projects that we began during 2021. The total projected cost for these ground-up redevelopment project is $45 million. We currently expect incremental underwritten yields on these projects to be between 10% and 12% unlevered. Our pipeline currently includes 8 additional projects in 2022, which represents an additional $23 million of investment. We expect this pipeline of redevelopment opportunities to grow throughout the year.

For full year 2022, we expect to invest approximately $45 million to $50 million in ground-up and redevelopment opportunities. In addition, we expect to spend $50 million to $55 million on capital improvements, tenant improvements and leasing commissions at our centers. The results that I just reviewed exhibit the strong operating environment that we currently enjoy and believe we'll continue to enjoy through 2022.

I will now turn the call over to John for a discussion of our financial results, our recent capital markets activity and our 2022 financial guidance. John?

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John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

Thank you, Devin, and good afternoon, everyone. Fourth quarter 2021 NAREIT FFO increased 7.3% to $49.4 million or $0.39 per diluted share. Fourth quarter core FFO increased 24.5% to $60.8 million or $0.47 per diluted share. The increase in both NAREIT and core FFO for the fourth quarter of 2021 was driven by increased revenue at our properties and improved collections. Further driving the increase was a reduction in interest expense versus the fourth quarter of 2020.

We had a non-cash charge of $7.4 million for our earn-out liability in Q4 2021, impacting our NAREIT FFO. And we expect an additional charge in the first quarter of 2022, totaling $1.8 million to cover the final settlement of the earn-out in January 2022. Approximately 1.6 million operating partnership units were delivered in January, marking the end of the earn-out period.

As we look at the fourth quarter, our general and administrative expenses were higher than other quarters, primarily due to performance-based compensation on our short and long-term incentive programs realized in the quarter. We anticipate our full year 2022 G&A to be in line with our full year 2021 G&A, which was $48.8 million.

Also in the quarter, our capital expenditures were higher on a run rate basis than other quarters due to timing and increased tenant improvement dollars spent in the quarter driven by the high volume of leasing activity. Compared to 2020, our NAREIT and core FFO per share results were impacted by a 15% increase in our weighted average share count as a result of issuing 19.55 million shares during our July 2021 IPO. For the full year, our core FFO per share of $2.19 exceeded the high end of our guidance of $2.14 to $2.18.

Several things lined up for us during the quarter, which pushed our results above the top end of our guidance. We had a number of acquisitions in the pipeline that we were able to close before the end of the year. Our occupancy increased and exceeded expectations. Our neighbors began paying rent more quickly than anticipated and our prior period collections were higher than expected. We still have a little over $3 million outstanding on payment plans with our neighbors. We will continue to be conservative in our estimates for collections at the midpoint of our guidance range for 2022, which I will get to shortly.

Our fourth quarter 2021 same-center NOI improved to $88.8 million, up 15.2% from a year ago. This improvement was primarily driven by a 2.4% increase in average base rent per square foot, stronger collections compared to 2020 and out-of-period collections for the quarter of $2.3 million. When comparing our results for the quarter ended December 31, 2019, our same-center NOI increased 3.9%. We believe this is a true indicator that we are experiencing growth in our same-center portfolio above and beyond the COVID recovery.

As of December 31, 2021, we had approximately $604 million of total liquidity comprised of $116 million of cash, cash equivalents and restricted cash, plus $489 million of borrowing capacity available on our $500 million credit facility. As of December 31, 2021, our net debt to adjusted EBITDAre was 5.6x compared to 7.3x at December 31, 2020. At December 31, 2021, our debt had a weighted average interest rate of 3.3% and a weighted average maturity of 5.2 years. Approximately 99% of our debt is fixed rate.

Our debt ratios and maturities have improved as a result of our IPO in July and debut public debt offering that closed in the fourth quarter. The $350 million 2.625% coupon 10-year notes significantly extended our debt maturity profile, while also diversifying our capital sources. Given our growth plans and maturity profile, we believe we can become a serial issuer in this market.

On February 10, we filed a shelf registration statement and a $250 million ATM equity offering program. Following our July IPO, this is the logical next step for us and allows us to efficiently access the capital markets as opportunities arise. We have no immediate plans to utilize the ATM program, but wanted to have this option available to us as we continue to evaluate market conditions and capital needs.

Yesterday, on February 10, 2022, we issued our 2022 full year guidance in our earnings release. For 2022, our same-center NOI growth guidance is between 3% and 4%. This is consistent with the growth we have delivered on a historical basis and what we believe we can continue to deliver going forward. Our NOI growth will be one of the core drivers for our core FFO growth. Additionally, we expect to see a reduction in interest expense due to less debt on our balance sheet. For 2022, our core FFO guidance range is between $2.16 and $2.24. When compared to 2021, we expect total core FFO to increase by approximately 11% to $282 million using the midpoint of our guidance.

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With that, I would like to turn the call back over to Jeff to discuss our recent portfolio activity, provide our 2022 acquisition guidance and recap our long-term growth strategy. Jeff?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thanks, John. Following our IPO in July of 2021 through December 31 of 2021, we acquired 7 grocery-anchored centers and 2 outparcels for $267.4 million. This was at the high end of our guidance range. So far, in 2022, we've acquired 2 additional grocery-anchored shopping centers for $82.9 million and have an additional center under contract for $17.5 million.

Our 2022 acquisitions included Cascades Overlook in Arlington, Virginia, a suburb of Washington, D.C. This 151,000 square foot center is anchored by Harris Teeter, a Kroger banner. And Oak Metals Marketplace in Georgetown, Texas, which is in the Austin suburb. This 79,000 square foot center is anchored by Randalls, an Albertsons banner. We believe the centers we have acquired since our IPO will meet or exceed our unlevered IRR target of 8%.

Our acquisition pipeline is healthy. For 2022, we are guiding to acquire between 300 and $400 million of assets net of disposition activity. As we have discussed in the past, we identified 5,800 grocery-anchored shopping centers in the United States that fit our strategy. These centers are all anchored by the #1 or #2 grocer in their respective markets and meet our demographic requirements.

We are focused on the 3 mile area around each center. We believe this strategy presents a wider and deeper pool of assets to choose from versus a strategy strictly focused on a limited number of markets. To meet our stated goal of $1 billion of net acquisitions by June of 2024, we need to acquire approximately 15 assets per year. This represents approximately 2% of our targeted shopping centers that trade each year. We are well on our way to meeting our $1 billion goal.

To optimize our internal growth, we will continue to selectively recycle assets. These proceeds will be deployed into higher quality, higher growth assets. Since our IPO, we have disposed of 11 wholly-owned centers, 2 outparcels and one land parcel, totaling approximately 1.1 million square feet for $91.7 million. This was slightly below the low end of the guidance range of $95 million to $105 million, which we gave on our third quarter earnings call.

Now before we get to the Q&A section, I would like to quickly recap our quarter. The operating environment remained strong. We realized strong internal growth. We also realized strong external growth. Our differentiated strategy produced strong results for the quarter and have set high expectations for 2022.

With that, we'll begin the Q&A portion of our call. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Rich Hill at Morgan Stanley.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

First of all, congrats on a really nice quarter. I wanted to talk through the guide. It is very strong on an absolute and relative basis compared to your peers. And I wanted maybe just to understand and unpack a little bit more if there's something differentiated about your portfolio. Many of your peers talked about bad debt being a headwind in 2022. And I think back to your portfolio already being above 2019 levels on a same-store NOI basis. So I guess that's a long way of saying, is there something different about your portfolio? Do you not have as much bad debt or is this really about your portfolio just holding up and bouncing back a little bit better than peers, which is leading to a guide that looks really strong?

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Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Rich, thanks for the question and being on today. As you know, we really do believe that our -- that format drives results. And we do think that our format of having the grocery store with the necessity-based goods does perform -- has performed well during the pandemic and we'll continue to do that going forward. So I would say that we are optimistic about the year, but we also -- we've taken a really hard look and we think these are achievable goals for us and we wouldn't have there if we didn't believe that. So I would say that, overall, it is the format that we've got that I think is driving use results.

But John, do you want to give or Devin a little more detail on that?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

Sure, and thanks for the question, Rich. So as we look at it, the biggest component to the core FFO growth is really the NOI growth. And so our peers have talked about the bad debt impact. And ultimately, because our impact in '21 was not as significant as we go to '22, we've got a base of stability. So we've been communicating and our properties have been operating in a new world of post-COVID world. And ultimately, it's a combination of the organic growth that we're driving as well as the acquisitions that we've been able to make and that were projected to make.

And so just to get ahead of the question that I'm sure I'll be asked, the impact on the quarter specifically of out-of-period collections is about $2.3 million. So that's the quarter that was kind of the bad debt reversal in the quarter. And as we look to the next year, we only have $3 million of payment plans outstanding left. And so as we looked at our guidance on a same-store basis and on an FFO, we do anticipate collecting that and it is kind of -- it is accounted for in the upper end of our guidance.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

And if I may, just one more question. I know you guys focus on unlevered IRRs when you're acquiring properties. So forgive a sell-side question here. But could you maybe give a little bit of a guidance on what the cap rates for your acquisitions would be in 2022?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Rich, thanks for being on the call this morning. Where we are acquiring assets, Rich, today in the market is between a low of 5.75% and up to 6.75%. So it's in that range that we are acquiring assets. And you'll note that for full year '21, the weighted average cap 6.4% on acquisitions. And in the first quarter, the cap rate was almost 6%, just under 6%. So it's in that range and that's where we expect it to stay on a go forward.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

So somewhere between 6% and 6.25% for 2022, maybe as tight as 5.75%. Okay, I got it. Congrats on a good quarter again.

Operator

Your next question comes from Caitlin Burrows with Goldman Sachs.

Caitlin Burrows - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Maybe one on occupancy. You guys had some meaningful increases in occupancy in the third quarter. And again, in the fourth quarter, Devin, I think you mentioned that you think in line occupancy could get to 95%, increasing occupancy 70 basis points overall. So I was just wondering if

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you could give some more detail on your expectations for 2022? And given the strong operating environment, how much additional increase is realistic near-term?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Caitlin, as you saw both in the fourth quarter and through full year '21, we were successful in increasing our occupancy to the level that we're currently reporting. We've guided on that occupancy increase to occur over the next 2 years. So we believe that we will get that in-line occupancy up to 95% over the next 24 months. And how much of that we're going to get in '22 is hard to know, but based on how strong the pipeline is currently, we will probably get a meaningful component of that in calendar year '22.

Caitlin Burrows - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

And then maybe just one on development. You guys have a number of development and redevelopment projects, and it looks like a few had either the stabilization quarter, pushed out a little or a little change in cost. So just wondering if you could give some detail or background on the trends you're seeing in time to complete projects and also on the cost side and the impact that has on PECO?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

So on our redevelopment, Caitlin, you know that they are smaller redevelopments, and therefore, they have shorter cycle times. And so that makes it a little bit easier for us to anticipate when they're going to come online. We have seen increases in costs and we have included those increases in costs in our budgeted numbers and the returns that we've articulated include the increases that we're seeing on costs.

Where we're seeing delays is in the permitting process, and then in some instances, in terms of the availability of the necessary goods. But all of that is built into our expectations. And therefore, the numbers that we gave in our earnings release, we're confident we will deliver on. And we continue to be very happy with the kind of returns we're able to generate on this activity.

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

And Caitlin, we are seeing -- we continue to see really strong demand for these particular outlet. So we are -- I would say, we're optimistic that we will continue to have that strong demand from the retailers looking to expand into these locations. So we're -- and we're not seeing anything on the leasing side. There is some stuff on the permitting side, and as you point out, the cost side. But in terms of tenant demand, it is extremely high for these locations. And they do have drive-throughs and they do have the conveniences that a lot of the retailers are focused on right now.

Operator

Our next question comes from Craig Schmidt with Bank of America.

Craig Richard Schmidt - *BofA Securities, Research Division - Director*

I guess throughout the fourth quarter earnings, we've been hearing about a transaction market that's getting much more competitive and seeing compressing cap rates. I'm just wondering, given your different approach to servicing your acquisitions, are you seeing that same challenge or are you able to circumvent it?

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Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Craig, it's a great question. And the answer is yes, we are seeing more competition for the properties that we're buying than we have historically. We are starting to see we think a fairly significant increase in volume of product that's coming on to the market. It's early days, but it does look like we are starting to see a lot more product on the market. The major competition is coming on the portfolio side, as you know, I mean, there's some really aggressive pricing happening on the portfolio side.

On the individual asset, which is what we're buying in that smaller size sort of smaller bite size, we are -- again, we are seeing increased competition. But in terms of dramatic pricing changes, no, certainly not what we're seeing on the portfolio side. I think there's been probably 50 basis points of compression in our markets, 25 to 50, and we think that will continue. As we said earlier, with Rich's question, we're seeing that 5.75% to 6.25% as the range on the cap rates. But again, we continue to selectively find the assets where we can get that 8% unlevered IRR, and that part we continue to be optimistic about.

Craig Richard Schmidt - *BofA Securities, Research Division - Director*

And then just as the follow-up. Store closings were unusually low in '21, and they have remained so heading into '22. What are your expectations for store closing the rest of the year? And what does your watchlist look like?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

So we are -- I would say, we're optimistic this year about store closures. We don't think there's going to be a spike. We're not hearing anything that would give us a spike in store closures in the second half of this year. We did have -- we've had a lot of fallout over the last couple of years. And we think a lot of our retailers are on pretty stable ground right now. And the ones that we have been most concerned about, have stabilized to a big degree.

We are fortunate in not having much exposure to that second anchor. And our grocers who are -- who make up 34% of our income, they're doing really well. And they're working through the inflation and supply chain issues in a way that we think is really positive and certainly are seeing really good results on the ground in terms of their sales. The other areas, the non-grocery, non-necessity-based, you're always watching those and how the consumer is going to be affected by that.

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Jeff, the only thing I would add to that is, Craig, on our watchlist, the largest tenants in our watchlist are in fitness, pet supplies, office supplies, on those categories. But the top 5 tenants on our watchlist represent less than 2.5% of our total ABR. So it's not a meaningful exposure. And as we come out of the pandemic, a lot of these retailers' businesses are improving, particularly fitness. So again, it's something we watch closely. But the beauty of our business model is we are highly diversified in terms of our exposure to tenants. And therefore, the watchlist exposure is well diversified.

Operator

Our next question comes from Juan Sanabria with BMO Capital Markets.

Juan Carlos Sanabria - *BMO Capital Markets Equity Research - Senior Analyst*

Just a big picture question for me. Do you have a sense of the latest trends across your portfolio from a consumer perspective just given some of the inflationary pressures, be it a headline consumer confidence today take a ding, people are clearly feeling a little more soft in a rising prices. But just curious what you guys are seeing on the ground from your pockets of consumers?

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Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

It's a great question, and we are watching it in real time. We continue to see strong use of our centers. And if you look at the stats, we have more customers visiting our centers today than '19. So that part -- and that continues happening in real time. So we're optimistic about that and looking at it sort of closely for any kind of potential changes in that. The -- but the -- certainly, you're hearing a lot about inflation and it is affecting specific retailers more than others. But I would say, overall, our view of the consumer is that -- and again, we're in the necessity part of the business. So we're not as variable to some of retail as others are. In our space, we would say that we're very positive about the environment that we're in right now. And we're not seeing the consumer really pulling back, particularly on the necessity side. If anything, we're seeing really solid growth, and our retailers are seeing solid growth as well.

I don't know, Devin, if you have any other thoughts on that, but that's been...

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

I think you nailed it, Jeff. I mean, the thing that protects us to a degree is the fact that 73% of our rents are coming from necessity-based goods, necessity retailers. And obviously, the consumer had less discretion in terms of necessity goods than they do in non-necessity goods. And so we have not seen the current environment yet become a meaningful headwind. But again, it's something that we're concerned about and are watching closely.

Juan Carlos Sanabria - *BMO Capital Markets Equity Research - Senior Analyst*

And then just a follow-up on the balance sheet. Recognizing the ATM is maybe more just best practice and gives you optionality, but any rethinking of leverage targets to maybe keep it lower for longer and use your strong cost of capital? You guys have performed well since the IPO to kind of match on an equity perspective rather than using up the dry powder over the -- with the $1 billion target for acquisitions?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

We continue to be committed to the fact that if we can find projects that we can get an 8% unlevered IRR on a consistent basis with our strict underwriting criteria and we're buying the #1 or #2 grocer in a market that has really strong potential. So if we can do that, we're going to continue on our acquisition strategy. The market will drive us to reduce that. We will -- but again, we are -- as we made the big jump at the IPO, we are committed to keeping our balance sheet at investment-grade.

And then could we get up to the low-60s in terms of debt to EBITDA? Yes, that's a possibility that we will -- that the market will drive us to. But the -- so that's our strategy. We continue to believe there are strong opportunities to buy selectively. And at that pace of $350 million, we're not -- we're at a very cadenced acquisition pace that's not putting pressure on us to get money out, but giving us the opportunity to get the right amount out, and we'll stay disciplined on it. And that will -- but if we're getting 8% unlevered IRRs with our criteria for the grocery, we think that's a really strong -- going to give us really strong returns and be able to outpace our peers, we hope, in terms of results.

Operator

Your next question comes from Haendel St. Juste with Mizuho.

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Haendel Emmanuel St. Juste - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Equity Research Analyst*

First question is on the leasing spreads. I know they could be lumpy, especially on the new's side. But with that in mind, I guess, can you discuss the jump in new lease rates in the fourth quarter? Is that more an anomaly, maybe perhaps due to mix? And then how would you assess the near-term outlook for spreads as you look at your expiring rents here over the next year or 2 versus market rent?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Haendel, if you look at our new leasing spreads over time and you take the pandemic year of 2020 out of the picture and you go back to 2017 and look at 2017, 2018, 2019 and 2021, the average new leasing spread for us was 14.9%. And so the metric that we put up in 2021 of 15.7% is in line with what we've been able to do historically. So we don't tend to see the volatility in leasing spreads. I mean, if you look at that 4-year window, the low was 13.3% in '19 and the high was 15.9% in '17 with an average of 14.9%.

Haendel Emmanuel St. Juste - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Equity Research Analyst*

Devin, I suppose that's perhaps more due to having less big-box space in the mix? Is that part of the sense?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

I mean, again, it's no, Haendel. One of the things that we think really differentiates us is the fact that our average center is 115,000 square feet and that ex the grocer, our average tenant is less than 2,500 square feet, and we have less exposure to the b-box retailer. And that's one of the reasons why there's less volatility in our leasing spreads than there may be in others.

Haendel Emmanuel St. Juste - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Equity Research Analyst*

I think I heard, maybe it was John who mentioned this in his comments that TI dollars for leasing in the fourth quarter were higher. Can you talk about that a bit more? Is that a bit of an anomaly, something to do with some specific space that might have been, I don't know, for some reason, perhaps more difficult to lease? And how we should think about those -- that level of spend into 2022?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

So Haendel, you did hear that. So in the fourth quarter, they were higher dollars. And I wouldn't say it was any space in particular, absolutely the kind of cost per space does vary by the use and the size. But I would say in terms of the timing, it was higher when you look at the quarter individually. On both the TI and the capital side, just the capital improvements, if you look at the supplement, almost 2/3 of our capital improvements were spent in the fourth quarter. So TI is really a function of we've had increased leasing volumes. And I would say that that will carry into 2022. But I believe it was in Devin's remarks we provided some comments that it would be approximately $50 million to $55 million for that lump sum for the full year is what we're expecting. And that would be CI, TI as well as leasing commissions.

Haendel Emmanuel St. Juste - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Equity Research Analyst*

And then if I could, just one follow-up on an earlier comment, I think it was Craig who was asking about redevelopment. I know your projects are a bit more bite-sized, but I guess I'm curious how you're thinking about the sizing of the overall pipeline here? Obviously, cap rates are compressing. There's strong demand for space. I guess how much of a capacity or maybe a desire to make this a more meaningful contributor to earnings? I know you're guiding a few more projects this year, but not moving needle too dramatically. So I guess I'm curious, in light of what's going on around, why not expand it more?

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Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Haendel, it's a great question. And the answer is we do more if we could. We are working really hard to build that up. We have a really disciplined view of what we want to do on the development side. And it's primarily single-tenant and small multi-tenant spaces adjacent to our centers and then some of the tear down or rebuilds we do for the grocers that we get good economics on.

If we could do a bigger volume, we would. We just don't -- given the timing it takes to get these up and running and the volume they're in, they're 1 million to 3 million kind of bites. It takes a lot of time and effort to get those in, and that's why we do it. But at the kind of returns that we're getting in that 9% to 10% return on that investment, it's a really -- it is a great vehicle. And if we could get it bigger, we would. And we will continue to work on ways to do that. But for the foreseeable future, I think looking at it as about a $50 million a year business, I think that's a good way of looking at it.

Operator

Our next question comes from Mike Mueller with JPMorgan.

Michael William Mueller - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So $0.47 in the fourth quarter, if we bank out a couple of cents of prior period, you're at $0.45, annualized this to about 180. I guess, the average annual -- the average quarterly number to get 220 is about $0.55. Can you help us bridge the gap in terms of the ramp from $0.45 to that average of $0.55 or the higher at the end of the year, because it seems like you get a couple of cents from or a few cents from core growth? And is the rest just acquisitions?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

Mike, thanks for the question. On the quarter, the $0.47, one thing I would say is that, yes, there was the prior period collections, but we did have higher expenses going through that goes through that NOI number because of the corporate kind of what we call corporate property operating. We mentioned that on the G&A side that we had higher performance compensation. And that also is true for those that were in our properties because they had an amazing year as well.

So I think those 2 kind of neutralize. They kind of offset each other. And then -- so when you take that, you add in the same-center growth, the acquisitions that we made in 2021 and then the net acquisitions that we are looking at for 2022. It's really -- when you look at the jump, the core is at NOI. I also, in my prepared remarks, I had mentioned that on a cost level, G&A actually will be pretty constant. It will be in line at about that number. And then interest will be a little less than it was in 2021 because of the lower debt load.

Michael William Mueller - *JPMorgan Chase & Co, Research Division - Senior Analyst*

And then just thinking about your escalators, can you talk about what you were getting on 2021 leases in terms of bumps versus the in-place for the portfolio?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

John, go ahead. I wasn't sure of Mike's question, if he was asking about what the built-in rent CAGR is on new leases. Was that your question, Mike?

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Michael William Mueller - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Basically, what's your average in-place today? And in terms of the 2021 lease signings, how did those bumps on to new leases compared to what's in-place?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

I'll go ahead and take that. So we continue to -- our new leasing and our renewal leasing, we continue to push and add embedded rent bumps that I would say are in the 2% to 2.5% range. I would say in the embedded base in the portfolio today that comes through an NOI at about 60 to 70 basis points. And again, that's because the 2% is primarily on our in-line neighbors. And then when you consider that's about half of our rent that would be 100 basis points. But then in our portfolio, it weights to about 70 basis points.

Operator

Our next question comes from Tammi Fique with Wells Fargo Securities.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Just a question on guidance. I'm just wondering if you can maybe help us, and you've answered this a little bit just a moment ago about the 70 basis points of contractual bumps embedded in the portfolio. But what are the other components of 2022 same-store NOI growth guidance? Just maybe help us frame that up beyond the 70 basis points from the rent bumps.

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

I'll go ahead and take that one. So in our 3% to 4% same-store NOI guidance, I did just mention that the rent bumps piece, we would say, is 60 to 70 basis points from the embedded portfolio. I would say new leasing spreads are, and again, this is for '22, 70 to 80 basis points. I would also say that redevelopment is 70 to 80 basis points. That's the outparcel projects that we've been discussing previously.

The big lift is in occupancy, we have meaningfully increased occupancy, and that will continue to carry income into 2022 as well as our projections. And so that's 200 to 250 basis points of our growth. And then the math is actually similar to what is that we have about, call it, 80 basis points assumed the loss in same-center NOI related to bad debt. So in the 2022 year, we are anticipating that our bad debt will return to historical levels, which is between 60 and 80 basis points of revenue. And that range is what's giving us the 3% to 4%.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And then I appreciate the comments around the consistency in re-leasing spreads. But given currently high occupancy and expectations for continued growth there, I mean, should we be thinking about bigger re-leasing spreads going forward if you can sustain that occupancy level or do you feel like you're putting tenants up against kind of higher occupancy costs at this point?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Tammy, it's a great question and it's one that we -- you're balancing as we get to improve the occupancy and at levels where you have more pricing power than you have -- that we've had historically. Can we realize that in higher rent spreads? The answer is, we have not assumed that in our assumptions, but we do think that there is that opportunity. We're -- and we're going to be testing that this year to see if we can do that. That's I'd say it's early in terms of whether we're going to be able to go above those numbers on a go-forward basis, but we are in about as good of an operating environment as we've ever been. So we're hopeful that we can push those a bit.

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John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

And Jeff, just to add on to that. Tammy, the second part of your question was whether the pressure that we're putting on our neighbors. I would first say that our grocer health ratio we reported was 2.4%. And really, those are very long leases, so that's not really where the pressure will be applied. When we look at our in-line neighbors from a ratio standpoint, our estimates are we're about 10% of their cost, and that varies based on the usage. And so as we look at the growth that they're realizing, given the necessity-based nature and their ability to push those costs, we believe we can achieve these and maintain that relationship without putting excess pressure on our neighbors.

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

The last piece is, we don't believe that our in-line tenants are feeling pressure because, as you noted in our retention rate at 88%, 9 out of every 10 tenants are renewing and they're renewing at these kind of spreads that we've been talking about. So the evidence is clear that the tenants do not feel pressured. Their businesses are thriving in our centers, and therefore, they want to stay in our centers, and the retention rate is reflective of that dynamic.

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

And Tammy, one thing that I would add in as well as when you think about inflation, I mean, we've been getting these kind of spreads in a 2% inflation environment. If we were to move to 3% to 5% inflation, that would also -- we believe that would give us additional impetus to be able to grow our rental spreads, but we'll see. I mean, again, that is to be seen as we progress through the year.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And then maybe just one last question. Just as we think about dispositions in 2022, curious if you have anything teed up there? And maybe what you're expecting for the year in total? And just if you can give us a sense for cap rates on the pool of assets that you're looking to sell?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

So as we talked about, we do know like we are -- the $350 million is a net number. So our dispose will be on top of that. So our acquisitions would be higher by whatever that number is. And that range we've given of $300 million to $400 million, we think that will be in a -- we haven't given guidance in terms of what our dispose are. I mean, historically, they've been $100 million to $125 million a year. And I think as we think about it, we're probably thinking in that kind of a frame. But again, we're really focused on making sure that we get the incremental growth from the net acquisitions.

Operator

Our next question comes from Todd Thomas with KeyBanc.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

Just first question, I just wanted to follow-up on investments and the strategy. There does seem to be a bit of product coming to the market. Is there any appetite for sort of a small or mid-sized portfolio or should we generally expect the one-offs primarily? And would there be a scenario where it might make sense to grow the joint venture and asset management platform?

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Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Todd, it's a great question. Yes, there is additional product coming on the market. Yes, we are looking at every portfolio that is for sale and have looked at -- obviously looked at all the ones that have either transacted or been committed to date. I would not anticipate us getting involved in a portfolio in the current environment where there is a large premium paid.

We believe there's a portfolio of premium paid. If that continues to be the case, then we would anticipate continuing to grow through individual acquisitions. But again, if we can find something that meets our unlevered IRR on a portfolio basis that we think we're getting market, not a premium to market, we obviously -- we would be very -- we'd love to look at that, and we'd love to buy that if we can. So it's -- but again, it's going to be driven by can we underwrite it to an 8% unlevered IRR and do we think we're buying it at more of a market rate than a portfolio premium type of rate.

So that's how we're kind of thinking about it. We do -- we look at basically everything that comes on the market because that's -- we've been doing this for a long time. We have the relationships and we're on the top of the list of anybody who is selling open-air centers to talk to us. And so we will continue to review those and try and find the best opportunities.

I don't know, Devin, if you have any other thoughts on that?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

The only thing I would add, Todd, is as you know, we've built this portfolio over time asset-by-asset. And the reason we haven't been successful in buying a lot of portfolios is because we believe that there is a portfolio premium that's typically paid and that makes it more difficult for us to hit our return objectives. And that would be the answer on that part of your question.

And then on the second part of your question regarding the asset management business, we are constantly approached by institutional investors to partner with them so that they can get the benefit of our operating platform for their investment dollars. It's something that we will continue to look closely at. And if we can find the right partner that allows us to meet our objectives for our on-balance sheet growth, et cetera, we would entertain it.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

And then in terms of some of the acquisitions that you completed here in the quarter and also what's in the pipeline, I was wondering if you could speak to Arapahoe, both Arapahoe maybe and Town & Country, about 200,000 square feet or a little bit more, not out of bounds. You have a number of centers that are a little bit larger in size, but they are typically larger than what the company owns today with a bunch more boxes. Should we expect to see some investments going forward be a little bit larger or a little bit boxier in nature or is it just sort of mix in the quarter?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

I would say it's mix in the quarter. And the 2 -- I mean, the 2 centers, Arapahoe and Town & Country. Town & Country is a very specific case, which it does -- it is larger, but it does have 2 grocery-anchors. It operates as 2 different centers, and it's a physical-ish, you got to look at. But it's almost like we bought 2 different centers. And in that case, they are not large -- it's not a large property acquisition when you think of it as 2 centers.

Arapahoe was a very unique situation where we felt a part of the center operated as a grocery-anchored shopping center and the majority of that, and we had 2 boxes that we had to buy in order to get that. And those 2 boxes were long-term, but good credit properties that we felt like, okay, we will take that in order to get what we really wanted, which was the grocery-anchored shopping center part of the center. And fortunately, to date, it's worked out extremely well, both of them from a new leasing and our ability to grow rents at both of those locations. Really early on obviously in their acquisition -- our ownership process. So we're very happy with sort of the progress we've made on those centers in a very short time.

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Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

And then if I could, real quick, John, 2 questions related to the guidance in the quarter here. First, was there any benefit to straight-line rent realized in the quarter that we should think about moving forward or is the roughly $2 million of straight-line rent in the quarter. Is that a good run rate to think about for '22? And then also in the core FFO reconciliation, I think there's the $0.07 to $0.08 for transaction costs and other. What is that exactly? And where does that show up in the income statement?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

So in terms of straight-line rent, I would say that for the quarter, I would think that as I look to 2022, the fourth quarter was a little higher. I would say kind of $2 million to $2.5 million is a good estimate for straight-line rent specifically. And then to your question on transaction costs and transaction activity, at this time, I believe those are actually going to go through on our income statement. I think we have a caption right now, and I'm pulling it up. That actually is -- it's going to be in the other expense and income net line on our income statement. And then in our reconciliations, they'll come through as that transaction and acquisition expenses, which we have as an add back to core FFO, but it does impact NAREIT FFO.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

And so what is that exactly the transaction? How much of it is related to sort of abandoned or I guess acquisition costs versus other?

John P. Caulfield - *Phillips Edison & Company, Inc. - Senior VP, CFO & Treasurer*

So those are -- it's more a transaction over on the corporate side. So it would be -- some of it has failed transaction or failed acquisitions, but other components are just expenses that we had related to the IPO that we are paying. And it's actually some of it is non-cash expenses that we're recording going forward. So I would expect it to be at this level in 2022 and then kind of tapering from there.

Operator

And this concludes our Q&A answer session. I would like to turn it back to Mr. Edison for some closing comments.

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you. Thanks everybody for being on the call and for your questions. We had a really nice quarter. We entered 2022 I think in a really good position. We're excited about some of the opportunities that's going to create for us. And again, we appreciate your questions. And obviously, we are here to answer them as we go forward. We'll root for the bangle this weekend because we have to because we got our Cincinnati base. But for you guys, we thank you for your time today and look forward to hopefully having a really good 2022. It's certainly starting off really well. So let's keep our fingers crossed. Thanks, guys. Appreciate it.

Operator

And you may now disconnect.

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