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PECO.OQ - Q1 2024 Phillips Edison & Co Inc Earnings Call

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CORPORATE PARTICIPANTS

Kimberly Green *Phillips Edison & Co Inc - Head of Investor Relations*

Jeffrey Edison *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Robert Myers *Phillips Edison & Co Inc - President*

John Caulfield *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

CONFERENCE CALL PARTICIPANTS

Caitlin Burrows *Goldman Sachs - Analyst*

[Lizzie Doitken] *Bank of America - Analyst*

Ronald Kamdem *Morgan Stanley - Analyst*

[Roger Dave] *Mizuho Securities - Analyst*

Michael Mueller *JPMorgan Chase & Co. - Analyst*

Juan Sanabria *BMO Capital Markets - Analyst*

Dori Kesten *Wells Fargo - Analyst*

Tayo Okusanya *Deutsche Bank - Analyst*

Todd Thomas *KeyBanc Capital. - Analyst*

PRESENTATION

Operator

Welcome to Phillips Edison & Company first quarter 2024 earnings call. Please note, this call is being recorded. I will now turn the call over to Kimberly Green, Head of Investor Relations. Kimberly, you may begin.

Kimberly Green - *Phillips Edison & Co Inc - Head of Investor Relations*

Thank you, operator. I'm joined on this call by our Chairman and Chief Executive Officer, Jeff Edison; President, Bob Myers; and Chief Financial Officer, John Caulfield. Once we conclude our prepared remarks, we will open the call to Q&A. After today's call, an archived version will be published on our website. As a reminder, today's discussion may contain forward-looking statements about the company's view of future business and financial performance including forward earnings guidance and future market conditions.

These are based on management's current beliefs and expectations and are subject to various risks and uncertainties as described in our SEC filings specifically in our most recent Form 10-K and 10-Q. And our discussion today will reference 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 press release and supplemental information packet which have been posted on our website. Please note that we have also posted a presentation with additional information. Our caution on forward-looking statements also applies to these materials.

Now I'd like to turn the call over to Jeff Edison, our Chief Executive Officer. Jeff?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Thank you, Kim, and thank you everyone for joining us today. The PECO team delivered another solid quarter of growth with same center NOI increasing by 3.7%. NAREIT FFO increased 4.9 percent and core FFO increased 4.5%. The continued strength of our operating performance is attributable to our differentiated and focused strategy of owning grocery anchored neighborhood shopping centers anchored by the number 1 or 2 grocer by sales in the market, the PECO team's ability to drive results at the property level and the many advantages of the suburban markets where we operate our centers. The continued strong performance of our portfolio has allowed us to affirm our 2024 core FFO guidance range. The midpoint represents year over year growth of 3%, Despite significant interest expense headwinds of nearly $0.10 per share, we believe we can continue to deliver positive earnings

growth despite interest expense headwinds. Today, we see a continued strong operating environment and the transaction market is increasingly more active. The consumer remains resilient and our grocers continue to drive strong recurring foot traffic to our centers. Occupancy remains high at 97% leased, which gives us pricing power. Leasing demand continues to be elevated for our in-line spaces and we have limited exposure to big box retailers.

Retention remains strong and the PECO team continues to be proactive in getting spaces back and driving significantly higher rents. This is reflected in our continued strong new rent spreads. In addition, PECO continues to benefit from a number of positive macroeconomic trends that create strong tailwinds and drive strong neighbor demand. We have a great balance sheet and we are well positioned for accretive acquisitions and growth. During the Q1, we acquired 2 shopping centers and 1 land parcel for a total of $56,000,000

We remain confident in our ability to acquire high quality centers at attractive returns as the transaction market opens up further. While it's early in the year, we continue to successfully find attractive acquisition opportunities. Activity in the 2nd quarter remains strong. Given the current environment, we are reaffirming our guidance of $200,000,000 to $300,000,000 of net acquisitions for the year. We have the capabilities and leverage capacity to acquire much more if attractive opportunities materialize. We continue to target unlevered IRRs of 9% or greater for our acquisitions. As a reminder, the acquisitions that we completed in the second half of ‘23 underwrote to over 9.5% unlevered IRR. We will maintain our disciplined approach and focus on accretively growing our portfolio.

We're hopeful that volumes will continue to increase throughout the year. Looking beyond 2024 and assuming a more stable interest rate environment and acquisitions market, we continue to believe our portfolio can deliver mid to high single digit core FFO per share growth on a long-term basis. This will be driven by both internal and external growth. We remain committed to successfully executing our growth strategy. Our high-quality portfolio anchored by top grocers in favorable suburban markets supported by one of the best balance sheets in the sector provides a long-term steady earnings growth profile.

PICO generates more alpha with less beta given our focused and differentiated strategy. As previously announced by Kroger and Albertsons, the estimated closing date for the proposed merger was pushed back to later this year. Also this week, Kroger added 166 stores to the disposition list to CNS. We remain cautiously optimistic about the impact of this merger on PECO. We continue to believe it is ultimately a positive for PECO for our centers and for the communities that our centers serve. The market still gives the merger a low probability of occurring. But should the merger close and 579 stores now on the list are sold to CNS, we believe the impact on Pika is a net positive.

Our Adbertsons stores will be operated by Kroger, which we invest regularly in their stores and produces higher sales volumes. If the merger does not occur, our Albertsons anchored centers will continue the strong performance that they have produced to date. I will now turn the call over to Bob to provide more color on the operating environment. Bob?

Robert Myers - *Phillips Edison & Co Inc - President*

Thank you, Jeff, and good afternoon, everyone, and thank you for joining us. We had another quarter of strong operating results and leasing momentum. We continue to see high retailer demand with no current signs of slowing down. PECO's leasing team continues to convert retailer demand into high occupancy with higher rents at our centers. Portfolio occupancy remained high and ended the quarter at 97.2% leased. Anchor occupancy remained high at

98.4 percent. And during the quarter, we executed 5 anchor leases including Ulta Beauty at Hill Figer Shopping Center, 5 Below at Bear Creek Plaza, Crunch Fitness at Kirkwood Marketplace and 2 medtail uses RISE Center at Ocean Breeze Plaza and a medical center at Colonial Promenade. In the Q1, we received 6 anchor boxes back. We currently have just 15 vacant anchored spaces in our portfolio.

Importantly, we are able to drive significantly higher rents on these units. For reference, these 6 spaces had an average ABR of $8.06 and the 5 we executed this quarter had an average ABR of $18.37 a 128% average increase. Activity for anchor leases currently out for signature is extremely positive and we are currently experiencing the strongest anchor demand we've seen in over 20 years.

In line occupancy ended the quarter at 94.8%, an increase of 50 basis points year over year and a sequential increase of 10 basis points from the 4th quarter. New neighbors added in the Q1 included quick service restaurants such as Nashville Hot Chicken, The Great Greek, Starbucks and Wingstop, several medtail uses, health and beauty retailers such as Hand and Stone, Sola Salons and other necessity-based goods and services. Our acquisitions in the Q1 were 96% leased at closing.

Buying centers with some vacancy will continue to allow us to drive growth. Given PECO's unique external growth strategy, we have added new disclosures for same center leased and economic occupancy, which you can find in our supplemental information packet. We continue to believe that we can push same center in line occupancy another 100 to 150 basis points given the continued strong retailer demand. In terms of new lease activity, we continue to have success in driving higher rents.

Comparable new rent spreads for the Q1 were 29.1%. Our in line new rent spreads were a record high 37.4% in the Q1, which compares to our trailing 12-month average of 27.7%. We continue to capitalize on strong renewal demand and are making the most of the opportunity to improve lease language at renewal and drive rents higher.

In the Q1, we achieved a 16.9% increase in comparable renewal rent spreads. Our in-line renewal spreads remained high at 19.2% in the Q1, which compares to our trailing 12-month average of 18.2%. These increases in spreads reflect the continued strength of the leasing and retention environment. We expect new and renewal spreads to continue to be strong throughout the balance of this year and into the foreseeable future. Progress continues in terms of neighbor retention and while growing rents at attractive rates. PECO's retention rate remained strong in the Q1. Our in-line retention rate is 83%, well ahead of the historical 5-year average of 78%. Higher retention means less downtime and lower TI spend. In the Q1, we spent only $0.54 per square foot of tenant improvements for renewals. We also remain successful at driving higher contractual rent increases. Our new and renewal in line leases executed in the first quarter had average annual contractual rent bumps of 2% 3%, respectively, another important contributor to our long-term growth. The leasing spreads that we are achieving and the strength of our leasing pipeline are clear evidence of the continued high demand for space in our grocery anchored neighborhood shopping centers.

PECO's pricing power is a reflection of the strength of our focused strategy and the quality of our portfolio. PECO continues to benefit from a number of positive macroeconomic trends that create strong tailwinds and drive robust neighbor demand. These trends include a resilient consumer, hybrid work, migration to the Sunbelt, population shifts that favor suburban neighborhoods and the importance of physical locations and last mile delivery. The impact of these demand factors are further amplified due to limited new supply over the last 10 years and going forward given that current economic returns do not justify new construction. A healthy mix of national, regional and local retailers adds many benefits to our grocery anchored portfolio. 70% of our rents come from neighbors offering necessity-based goods and services and our top grocers continue to drive strong reoccurring foot traffic to our centers.

PECO's 3-mile trade area demographics include an average population of 67,000 people and an average median household income of 87,000 which is 12% higher than the U. S. Median. These demographics are in line with the store demographics of Kroger and Publix, which are PECO's top two neighbors. Our centers are situated in trade areas where our top grocers are profitable and our neighbors are successful.

We also enjoy a well-diversified neighbor base. Our top neighbor list is comprised of the best grocers in the country. Our largest non-grocer neighbor makes up only 1.2% of our rents and that neighbor is T.J. Maxx. All other non-grocer neighbors are below 1% of ABR. To put a finer point on neighbor mix, PECO has no exposure to luxury retail and very limited exposure to distressed retailers. Our top 10 neighbors currently on our watch list represent just 2% of ABR with no one retailer representing more than 40 basis points of ABR. While our bad debt was slightly elevated in the Q1, we actively monitor the health of our neighbors. We are not concerned about bad debt in the near term, particularly given the strong retailer demand. To note, this is not attributed to national bankruptcies as we don't have any meaningful concentrations. From an operations standpoint, we have always taken an aggressive stance to get spaces back. And in today's environment, the PECO team is taking an even more aggressive stance on opportunities where we can get higher spreads. We are sitting 40% in line rent spreads on the units we are getting back. 27% of our ABR is derived from local neighbors.

The majority of our local neighbor rents come from retailers offering necessity-based goods and services. Our local neighbors are successful businesses run by hardworking entrepreneurs. They have healthy credit and are less susceptible to corporate bankruptcy caused by weaker performing locations. Local neighbors offer favorable economic returns. A typical local retailer receives less capital at the beginning of their lease, accepts more PECO friendly lease terms and has high retention rates.

PECO retained 85% of local neighbors in the Q1. For in line local neighbors, renewal rent spreads remained strong at 20.2%. Importantly, local retailers meaningfully differentiate the merchandise mix that our neighborhood centers offer our customers. Our in line local neighbors are resilient and have been in our shopping centers for 9.7 years on average. In addition to our strong rental growth trends, we continue to expand our pipeline of ground up outparcel development and repositioning projects.

During the Q1, we stabilized 4 projects and delivered over 180,000 square feet of space to our neighbors. These four projects add incremental NOI of approximately $2,300,000 annually. They provide superior risk adjusted returns and have a meaningful impact in our long term NOI growth. We continue to expect to invest $40,000,000 to $50,000,000 annually in ground up development and repositioning opportunities with weighted average cash on cash yields between 9% 12%. This activity remains a great use of free cash flow and produces attractive returns with less risk. Our team continues to stay focused on growing this pipeline as the returns are accretive to the portfolio.

In summary, the PECO team remains optimistic given the current strong operating environment and the continued positive momentum we are experiencing across leasing, redevelopment and development. Our healthy neighbor mix and grocery anchored strategy positions PECO well for continued growth. The overall demand environment, the stability of our centers, the strength of our grocers and the capabilities of our team gives us great confidence in our ability to continue to deliver solid operating results.

I will now turn the call over to John. John?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

Thank you, Bob, and good morning and good afternoon, everyone. I'll start by addressing the Q1 results, then provide an update on the balance sheet, and finally speak to our affirmed 2024 guidance. Q1 2024 NAREIT FFO increased 4.9 percent to $80,100,000 or $0.59 per diluted share, driven by an increase in rental income from our strong property operations. Results were partially impacted by higher year over year interest expense.

1st quarter core FFO increased 4.5% to $81,700,000 or $0.60 per diluted share, driven by increased revenue at our properties from higher occupancy levels and strong leasing spreads, partially offset by the aforementioned higher interest expense. Our same center NOI growth in the quarter was 3.7%, driven by minimum rent growth of 4.2% year over year. Regarding acquisitions during the Q1, we acquired 2 shopping centers and 1 land parcel for a total of $56,000,000 We had no dispositions during the quarter. Turning to the balance sheet, we have approximately $570,000,000 of liquidity to support our acquisition plan and no meaningful maturity until November 2025. Our net debt to adjusted EBITDA remained at 5.1 times. Our debt had a weighted average interest rate of 4.3% and a weighted average maturity of 3.8 years when including all extension options.

During the quarter, we entered into an interest rate swap agreement totalling $150,000,000 The new instrument swaps SOFR to approximately 3.45 percent effective September 25, 2024, and matures on December 31, 2025. This swap helps us manage our floating rate exposure as we have swaps that expire in September October of 2024. We ended the quarter at 76% fixed rate debt with 24% floating. We continue to monitor the debt market and work to access it opportunistically. While the recent move in long term treasuries has not been favorable, credit spreads have improved from year end. We are continually looking at opportunities to enhance our liquidity and extend our debt maturity profile. Our lack of near-term maturities provides us with flexibility to be patient. Between the significant free cash flow generated by our portfolio this year and the capacity available on our revolver, we can be strategic in our timing to access the debt market.

Turning to our guidance for 2024, we have updated the net income per share range to $0.51 to $0.55 We've affirmed our guidance for NAREIT and core FFO, which reflects a 6% and 3% growth over 2023 at the midpoints respectively. In addition, we've affirmed our range for same center NOI growth of 3.25% to 4.25 percent given the continued strong operating environment.

Included in our guidance is the negative impact of uncollectible reserves. We are affirming the range previously provided given the continued strong health of our neighbors. However, we will likely be at the high end of the range for the year, but it's still early and this is being influenced by our team taking an aggressive stance on getting spaces back to drive higher rent spreads as Bob mentioned earlier.

We currently have several acquisitions in our pipeline either under contract or in contract negotiation. This activity provides a strong start for the year. As Jeff mentioned, it is still early, so we are affirming our acquisition guidance and expect net volume to be in a range of $200,000,000 to $300,000,000 If the transaction in capital markets improve, we have the capacity to meaningfully increase this number, but we are comfortable with this guidance range in the current environment.

Looking beyond 2024, we believe our internal and external growth opportunities give us a long term growth outlook in the mid to high single digits for core FFO per share growth. We expect a comparable or faster growth rate for AFFO because there should be less tenant improvement dollars invested as we continue to increase same center occupancy.

In the near term, we continue to be impacted by interest rate increases as all borrowers are, which impacts our earnings growth. That said, we are pleased to guide to positive per share growth. For 2024, we are updating the range of interest rate expense to $98,000,000 to $106,000,000 We estimate that higher interest rates could be a headwind of $0.07 to $0.11 for the year. If we added back the per share impact of interest rate increases to our updated 2024 guidance, this would be 7% core FFO growth in mid-twenty. 2024 is continuing to present challenges with high inflation, volatile and rising interest rate and global conflict. However, the strength of our integrated operating platform positions PECO well for long term steady earnings growth. We're excited for the additional growth opportunities ahead this year, both internal and through acquisitions.

With that, we will open the line for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Caitlin Burrows, Goldman Sachs.

Caitlin Burrows - *Goldman Sachs - Analyst*

Hi, everyone. I guess, good afternoon. Maybe just following up, John, on that last point on the bad debt headwinds. So I know the guidance was 60 to 80 basis points, and you mentioned now it could come in at the high end granted it's still early in the year. It sounds like your neighbors are performing generally very well. So just wondering what's driving the updated view and the 1Q results? And if anything is kind of PICO driven, can you go through that nuance?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Well, hi, Caitlin, it's Jeff. Thanks for the question. Our As we look at the operating environment, when we get to levels of occupancy that we're at right now, we're taking a very aggressive stance on getting property getting back neighbors who are not paying. That has some impact on what we're talking about here. But we're generally going to continue to be really aggressive at getting spaces back on a go forward basis and that will have an impact. And but we are not seeing anything sectorally that's happening that is changing those numbers and we do think they will more normalize over as the year goes through. John, did you have any additions to that?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

No, I think that captures it. I mean, Caitlin, when we look at it, it is still early in the year and it can move from quarter to quarter. But as we look at it, as Jeff said, we're not seeing anything that is pervasive. I mean, this is not driven by national bankruptcies or things. And so we are taking an aggressive stance on getting the space back and taking the steps that Bob's team has talked about. We do have we do expect that at this time, we'll be at the higher end of the range, but it's still early to tell. And ultimately, the important thing for us is that we were able to reaffirm our same store NOI guidance for the year. So we feel very strong about that. I guess maybe then just go on Jeff or someone.

Robert Myers - *Phillips Edison & Co Inc - President*

No, I'm sorry, it's Bob. I'm just going to add to that. In light of what we're seeing on the operations platform and the demand that we're seeing for the space, even in the spaces that we receive back, we were able to get over 40% new leasing spreads. So as long as we continue to see the demand there, it is a space-by-space decision and how hard we push, but it is a strategy that we're seeing some benefit from. So I'm encouraged by the demand and the spreads we're seeing

Caitlin Burrows - *Goldman Sachs - Analyst*

Got it. And then maybe just on the point of the same NOI guidance being reaffirmed and the FFO target being reaffirmed despite higher interest expense. I guess, can you guys go through some of the offsets of what might be performing better than expected?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

John, you want to take that one?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

Sure. I'll take that. So yes, so ultimately the leasing spread and the leasing activity that Bob is talking about is on at the operating level, as long as we do that. We are actually also having better and this goes to the FFO. We are having and forecasting better expense experience than we had anticipated.

I mean, our NOI margin increased a little this quarter, but still we're seeing that things like G and A as well as some of our property level expenses are offsetting. So the increase in interest is something, but we're able to manage that and feel good about our guidance ranges.

Caitlin Burrows - *Goldman Sachs - Analyst*

Got it. Okay. Thank you.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Thanks, Caitlin.

Operator

[Lizzie Doitken], Bank of America.

[Lizzie Doitken] - *Bank of America - Analyst*

Hi, everyone. I was just hoping you if you guys could talk a little bit more about the 2 centers acquired in the Q1. Both seemed pretty well leased at the point of acquisition. So just wondering on the opportunity set that you see at each of those centers. And then just wondering on plans for the land parcel that was acquired. Thanks.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Why don't I I'll cover the 2 properties. Bob, you can talk through the land parcel that we purchased. The first project we bought, Lake Mary, was a center that we have actually been looked at for a long time It is a Publix anchored center. It's one of the best Publixes in its trade area. We really like that particular market outside of Orlando. And so we and we did find that there was some very good mark to market opportunities there. I think our underwriting was sort of in the between 9% and 9.5% on an unlevered IRR basis. So we felt pretty good about that acquisition.

Our second acquisition was a very, I guess, in our mind, a very opportunistic purchase. It was a property that we had seen for a long time in a market that we were very familiar with and very active in with it was in a higher end market with density with a dominant grocer not in the center, but within a short distance from the center. So it was in a major, in our mind, corridor for the suburban shopper. And that was one where we had we were getting a very strong IRR well north of 9.5% and in a market that we knew really well and we thought it was an opportunity to take advantage of.

And those were the 2 acquisitions, I would say, going into Q2. I would say that we have a good pipeline. We've seen almost in terms of investment committee, we put almost twice as many projects through investment committee this year through the Q1 as we did last year. Obviously, last year was a pretty tough first and second quarter for product coming on. So we are encouraged by that, that we may see a little bit better opportunities this year than we did in the difficult market from last year.

Bob, do you want to go through the outlet that we purchased as well?

Robert Myers - *Phillips Edison & Co Inc - President*

Yes, absolutely. So it's called Goldsby Point and it's in Tampa, Florida. And this is one that we've had our eyes on. And it's about a 3-acre parcel. We paid right around $2,000,000 for it. And our national account team has really been marketing this actually for the last 6 months. So we currently are thinking about separating the 3-acres and the three 1-acre parcels. And we already have strong interest from national retailers and the Chase Banks and the Dutch Brothers and the Tropical Smoothies and Urgent Care. So again, you're going to continue to see demand for these opportunities in the medtail and the fast casual space. So as we can find these opportunities and generate the 9% to 12% returns that we're focused on, they're great complements to our existing assets. So we want to stay opportunistic and continue to look for land.

[Lizzie Doitken] - *Bank of America - Analyst*

Okay. That's good color. Thank you. And just a follow-up to that. How did you fund Q1 acquisitions? And is there any change in thinking around the match funding strategy you guys been employing to fund the rest of this throughout the year or if you could just give your updated thoughts on funding acquisitions? Thanks.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Yes. The I would say, Lizzie, we have reaffirmed pace. So we anticipate that we will be in that $200,000,000 to $300,000,000 range for the acquisitions. And we from a pricing standpoint, the market is actually continues to have quite a bit of volatility in terms of buyers and sellers and expectations. And that's not generally a real positive for volume. But it's harder because that match funding that you're talking about is changing in this environment almost daily. And so you are it's a difficult time to sort of figure that out. But we're I think we're staying very disciplined in terms of the where we see the returns that we've got to get to make them accretive to our model. And the so that's sort of how we're doing. In terms of the match funding, Last year, we did tap the ATM on the equity side and extended all of our debt maturities as well.

So we've got our line that we will be using for these acquisitions and then we will be looking to tie in longer term fixed rate debt as we tie in those acquisitions. John, did you have anything additional on that?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

No, I think that hits it. I mean, we have $570,000,000 of liquidity, and we're looking to maintain our flexibility as we are looking to get to our long term target of 10% floating, but ultimately feel good about the assets that we're buying and the opportunities in front of us.

[Lizzie Doitken] - *Bank of America - Analyst*

Thank you.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Lizzie, does that answer your question?

[Lizzie Doitken] - *Bank of America - Analyst*

Yes. That was great. Thank you.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Okay. Great.

Operator

Ronald Kamdem, Morgan Stanley

Ronald Kamdem - *Morgan Stanley - Analyst*

Hey, just my first quick one was. I remember back at the Investor Day, you talked about sort of asset management partnerships and so forth. Just wondering. Was there any update on that and what the thinking was?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

I -- we do. We are making progress there, and I think in the second quarter, we should be at a point where we will be more openly discussing -- giving a lot more detail on what they are. But our goal here is do we -- we want to have projects but into these projects -- into these funds it -- before we make any public announcements. So we continue to progress and we hopefully will have more news for you in the second quarter.

Ronald Kamdem - *Morgan Stanley - Analyst*

Right. And then my second question was just going to be back to the acquisition pipeline and so forth. I think you talked about seeing a lot more volume for this year versus last year. Is it all been just because of the environment? Or are you guys doing anything to source differently or to be more creative look at deals?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

I think it's general volume. I mean, we are -- we have a system that we put in place and refined over probably 25 years of being in this -- acquiring the grocery-anchored shopping centers. So we have, but we're obviously updating technology and those things. But in terms of our core strategy of focusing on 5,800 centers that we want to own and making sure that we're in front of both the owners and the brokers to make sure we see those when they come available, that part really is -- it stayed pretty consistent.

Ronald Kamdem - *Morgan Stanley - Analyst*

Great. That's it for me. Thank you.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Thanks, Ron.

Operator

[Roger Dave], Mizuho.

[Roger Dave] - *Mizuho Securities - Analyst*

Hi there. This is Roger Dave on the line for Haendel. Hope you guys are doing well. Just curious, if you were to issue 10-year money today, what would it cost? And I guess, what is your interest in doing any alternative financing arrangements, can be a convertible debt deal or short-term debt. Just, what's your appetite for these different options?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Great question. Um, we are looking at all of them and the primary focus at this point is to get into the public -- the longer-term public debt markets. And so, the alternatives, though interesting and something that we could -- that could work for us, we have not sort of actively pursued those yet, but we are reviewing them because they are -- there are some pretty attractive options there that we will -- that we're continuing to look at. But John, any additions to that?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

Sure. So we are looking at everything. I would say that our long-term cost currently, if we were to issue, would be, let's say, six to six in a quarter. The important thing for us is building a track record in the unsecured bond market. We've made great progress with investors and speaking with them in building that. But we've been waiting for the right opportunity. As I mentioned in the prepared remarks, the spreads were a little wide at the beginning of the year and now they've improved, but the base rate has expanded.

It is something that we are actively monitoring but because we have built this time in our maturity calendar, we have the ability to be patient. And so, we're just wanting to make sure we're accessing and building that reputation and track record in the market that has the most liquidity and availability. But that said, depending on the market timing and things like that, we do evaluate all strategies. If you look at our current balance sheet funding, we use them all. We have bank debt, we have secured debt, we have unsecured bonds.

So it's something that we're watching and we're looking forward to accessing and getting more capital to buy more assets.

[Roger Dave] - *Mizuho Securities - Analyst*

Thank you. That's helpful. Just one more here. Regarding cap rates, this year, this quarter's acquisition cap rate was a bit higher than last year's. And going from a modeling perspective, can we kind of assume that this year's acquisitions would hang around in the 6 to 7 range. Is that what you're seeing based on what's in your pipeline right now?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

I would stay at the 6.5. There were specific stories on these two acquisitions where we got pretty favorable pricing. But we haven't really come off of that guidance of 6.3 to 6.7 kind of a range. So that's how we're thinking about the year. And again, we'll see how it progresses. Two marks don't make the year but we don't think there's that much movement from the 6.5 kind of midpoint at this point.

[Roger Dave] - *Mizuho Securities - Analyst*

Got it. Thanks so much, guys.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Yes.

Operator

Michael Mueller, JPMorgan.

Michael Mueller - *JPMorgan Chase & Co. - Analyst*

Yeah, hi. Just a quick occupancy question. Where do you see anchor and overall economic or physical occupancy ending up the year?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Bob, do you want to take that?

Bob, we're missing you.

Robert Myers - *Phillips Edison & Co Inc - President*

Sorry, Jeff. Looking at our anchor pipeline and the demand we're seeing, I definitely believe that our in line and our anchor occupancy will be elevated and it's hard to exactly know what that is, but I would certainly think that we would be at the higher range of the 98.8 or 98.9 on the anchor and in the in-line, I certainly think that will be north of the 94.8 that we're seeing today given the demand. So at this point, I'd say it will certainly be elevated, but it's really hard for me to pinpoint exactly what it will be.

Michael Mueller - *JPMorgan Chase & Co. - Analyst*

Got it. That was it. Thank you.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Thanks, Michael.

Operator

Juan Sanabria, BMO Capital Markets.

Juan Sanabria - *BMO Capital Markets - Analyst*

Hi. Good afternoon. Just hoping you could give a little bit more color on the bad debt. It sounds like it's not driven by national tenants. Is it being driven more by some of the smaller mom and pop in mind. And just curious if you could break it out how much of that bad debt was related to just tenant closures or bankruptcies versus you guys been proactive in trying to get higher leases upon renewal or re-leasing of that space?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

John, do you want to take that one?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

Sure. Good afternoon, Juan. As we look at the bad debt, it is not -- when I say it's not related to national, I would say it could be disputes as well. So I was saying it's not national bankruptcy. So when you're looking at those names that are going, that's not impacting. There was contribution to the bad debt from national, from regional, and from local neighbors.

As we look at it, I would say the majority of it was just kind of a few neighbors that might have had larger balances. But I would say the portion that we influence is probably close to half, maybe a little bit less than that in terms of that. But when we take those actions, it takes us to a more conservative place, which is why it becomes outsized and the leasing momentum that we've got is enough that we are taking action more quickly, which does kind of trigger our internal processes too, to take them to full reserve more.

So it's specific instances, which is why we're not seeing anything. Trend-wise or saying that we've got any concerns on a broad basis. And as we look ahead, we're quite opportunistic or else we would have made other adjustments. But I think it's complemented by the rent growth that you're seeing, the leasing activity and the spreads that we're seeing. And so, we continue to be bullish.

Juan Sanabria - *BMO Capital Markets - Analyst*

And then maybe if I could just push back, I guess what change to where you felt that you needed to take reserves around this disparate group of tenants with demand still strong and you guys feel good about the neighbors in general.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

John, in terms of why we took the dosing, I think that when you change -- when you move your sort of strategy thinking to, look, we want to get the spaces back as quickly as we can and mark them to market. That is a -- in this environment where you have the level of demand from the retailers, we're taking -- that is a natural sort of strategic movement. It's not like we haven't always done that, it's just that there is an increased impetus to do that when you're getting 40% rent spreads.

And that is going to -- that will accelerate the process of putting someone who is on the -- right on the edge of whether or how you're going to do it. You're going to want to go, you're going to want to be more aggressive about that and you're going to be more aggressive in terms of the retention on those rents. And that's is I think you're going to see among a number of our peers as they get closer to have a high level of occupancy, like what where we are at.

And for us, it's we see it as a huge opportunity for us and we're going to pursue it aggressively. And it will have -- I think you will see some bumps up and down in bad debt. But with the opportunity we have, we're going to do that and we think we'll see outsized growth on the top line knot, not in this line, but that will weigh more than off ways any negative sort of accounting impacts that you have from reserves. Does that answer --

It does. I'm not just sure if John wanted to add anything (multiple speakers)

Sorry, John.

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

No, I was just going to say you're good.

Juan Sanabria - *BMO Capital Markets - Analyst*

And then just on the acquisition side, I'm a little bit surprised that you guys are as bullish group, but with similar cap rates, given changes in the cost of capital, not so much on the debt side with the push and pull of rating spreads, but just on the on the equity side. How do you think about when your implied cap rate has gone up as the equity markets have broker sold off and then need to maybe and require higher returns on a cap rate or IRR? And just, you guys have been very acquisitive, but your cost of capital changes every day has deteriorated a little bit. So how do you guys probably think about that.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

As you recall, when we first came of the IPO, our targeted unlevered IRR was in eight, and as the market has moved, we moved that to a nine. And the product that we are seeing is underwriting north of a nine and some of that well north of nine. To us, those are accretive opportunities at where things are today and one of the advantages of being in the market on a regular basis is you will take advantages and there will be times where you won't hit the cycle perfectly, but you will -- you look at what we bought last year and that underwrote to north -- well north of a 9.5. And we feel good on a long-term basis that that will more than be -- that will be significantly accretive to the company.

So that's how we think about it. We get more aggressive and less aggressive based upon that spread between where we can invest the money and where -- what our cost of capital is and that, you will see that throughout the history of the company that that's been a very successful strategy for us. So, are we going to be as aggressive this year if we don't get the kind of pricing? Low-cost capital is more, so the answer's no. But we will be in the market and we will -- I'm comfortable we'll find opportunities will be highly accretive for what we do.

Does that -- Juan, does that answer your question?

Juan Sanabria - *BMO Capital Markets - Analyst*

Yeah. Thanks, Jeff. I appreciate it.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Yeah.

Operator

Dori Kesten, Wells Fargo.

Dori Kesten - *Wells Fargo - Analyst*

Hi. Thanks. Good morning. Can you comment on your intentions with the swaps maturing later this year? And then just generally, what floating rate exposure are you most comfortable with over the next few years?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Dori, thanks for the question. John, do you want to sort of walk through that?

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

Sure. We are 24% floating today. We do have swaps that mature later this year. We did opportunistically execute a swap agreement for $150 million in the first quarter. At that point in time, it was -- we believe it was going to be higher for longer. And it was ultimately there were six rate cuts at the time. So we move opportunistically. But on a long-term basis, our plan to get to our long-term fixed rate target of 90%, we would like to do that through incremental financing with fixed rate instruments, primarily in the unsecured bond market.

So as we move forward, we are at an elevated rate with regards to our floating rate debt exposure. But as we look at it also, I mean, even though it is higher for longer, there is stability there and we do that. There's more likelihood that the rates will come down then go up from here. And so, we are choosing to maintain that flexibility. And as we look at swaps, swaps are useful as you have into the floating rate debt instrument underneath it.

And so, as we are moving towards and choosing to exercise in the unsecured bond market, which we would certainly hope to do in the next 6 to 12 months, that will help move us up. And in the near term, we are having a higher rate -- higher percentage of floating. But we are also positive because our overall earnings growth is allowing us to deliver positive FFO growth. And so, as we were just waiting for that right opportunity to lock in locking rates and begin extending our durations.

Dori Kesten - *Wells Fargo - Analyst*

Okay. What category --

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Dori, one of our -- Dori I just want to say, it's Jeff. One of our strategies, as we've talked about, is to make sure we're match-funding when we can. And our view is that a six month or one year swap is not that funding. And that's why we're being patient and waiting till we have -- where we can get duration at rates that we find favorable and we'll continue to do that.

I mean, we set our balance sheet up to be able to do that. And it's one of the advantages of having one of the better balance sheets in the space is that we can be opportunistic and enter these markets. But our strategy over time will be to actually match fund on a longer-term basis, not doing it out three-year swaps or 18-month swaps, those will be part of the thing. But in my mind, they have a very small impact on the true risk of the company. Our longer term is where we're focused on getting the balance sheet.

Dori Kesten - *Wells Fargo - Analyst*

Okay. And then, what category of retailers you found it's been easier to push escalators higher for and which do you continue to have more difficult conversations with?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Bob, you want to cover that?

Robert Myers - *Phillips Edison & Co Inc - President*

Yeah, sure. Great question. Where we continue to see a lot of demand is still in our restaurants and our quick service restaurants, health and beauty, medtail, a little bit from some entertainment like fitness uses as an example. As we mentioned earlier, over 70% of our rent is from necessity-based goods and services. So from a merchandising standpoint, that's where we continue to see the positive leasing spreads of the 29% and the renewal spreads you saw at 16.9%.

And then, we've had a lot of success with escalators, with our local neighbors. So 27% of our in-line our local neighbors. And even when I believe the number was 19%, our renewals spreads for the first quarter with our local neighbors. And you'll find typically with that type of merchandising play that you can generate higher escalators. And we are seeing between 2.5% and 3% renewal escalators in addition to the year one, it's 16.9 overall or are in lines at 19.

So we continue to see opportunities in the segments that are service based necessity based. So I'm not seeing any cracks in terms of -- I'm seeing consistency across the portfolio in terms of retention and then our merchandising strategies. So it's working.

Dori Kesten - *Wells Fargo - Analyst*

Okay. Thank you.

Operator

Tayo Okusanya, Deutsche Bank.

Tayo Okusanya - *Deutsche Bank - Analyst*

Yes, good afternoon. Most of my questions have been asked, but I have a kind of quick one. And it's not PECO specific, but just shopping centers in general. Every month, kind of talking about really strong demand at this point and everyone has very good show, and the environment is very strong. The stocks in general, I think, again, I have been a bit of a rough ride. It's just because of everyone's general 2024 FFO per share growth profile. So the question is, if fundamentals are so strong, stocks themselves, cost of capital is somewhat challenging, is their viewpoint that we start to see private equity get more involved in space again?

Robert Myers - *Phillips Edison & Co Inc - President*

The answer is that -- yes. I don't think Blackstone has sort of said that they're going to do anything on significance on the on the retail side, but there is significant private equity interest out there. Some of it's mispriced. So probably not really a threat in the business or our opportunity to be a buyer in this market. But there is -- we're seeing some, a number of firms that are -- they're circling. They're seeing that these underlying fundamentals are going to create long-term growth and it can be bumpy for a little while, but when they look out three to five years, they're saying, look, I can get those mid 10s levered returns, maybe not 20, but I can get mid 10s in an environment like this. And they will pull the trigger on that.

So our belief is that they are it's going to become more and more part of the retail market that they've been out of pretty significantly for a significant period of time. And it's all -- my read is it's all based on the fundamentals. I mean, they're looking at the lack of new demand. There are some costs in rebidding some of the big boxes to some of our peers that are some of our peers facing. And that is a cost but when you get through that period of time, there's some pretty significant opportunity and you can see it in our rent spreads. Those are not normal rents spreads. Those are rent spreads of a really strong operating environment. And so, I think you're going to see them entering. Where and how? It will be interesting. We'll see how that plays out.

Tayo Okusanya - *Deutsche Bank - Analyst*

Thank you for that color.

Operator

Todd Thomas, KeyBanc Capital.

Todd Thomas - *KeyBanc Capital. - Analyst*

Yeah, hi. Thanks. I just wanted to go back to investment activity a little bit and the comments about the current pipeline, they sound encouraging in terms of what you're underwriting, what's in the pipeline. And John, you mentioned that there are some properties tied up. Does what's under contract get you to the $200 million to $300 million range in guidance such that you have the range sort of accounted for at this point in the year and the volume slowdown a bit more in the second half?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Hey, Todd. Thanks for the call. We do not have -- we have a -- this year would if we were to guess will be a more stabilized year than the last year in terms of more gradual increases. We don't have a full commitment on our guidance yet, but we do anticipate that happening over the year. I don't think it will be like last year that was very a fourth quarter oriented. I think we've got more consistent flow this year, but again, it's early in the year and stuff is going to happen. And we'll see how that plays out. We would assume it will be pretty consistent with the -- on a quarter-by-quarter basis at this point.

Todd Thomas - *KeyBanc Capital. - Analyst*

Okay.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Does that make sense, Todd?

Todd Thomas - *KeyBanc Capital. - Analyst*

Yeah. Sure. Absolutely. And then, can you talk a little bit about the quality of the product that you're underwriting, how that looks compared to what you you've seen more recently. And is everything that you're buying predominantly smaller format, grocery-anchored product similar to what you own today?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Yes. I would say the quality is pretty consistent. When you look at that sort of targeted 5,800 centers we've got, it's a pretty consistent group of projects. I do think there are some select opportunities that don't fit perfectly in the box, but are really great opportunities that we will, that we're willing to take advantage of. Some shadow-anchored stuff where we can get really strong growth and returns. Some stuff that has a small amount of T.J. Maxx exposure, that kind of thing we might -- we would look at.

But as a whole, it's going to be -- it's going to be what you expect from us, 115,000 square foot, number one or two grocer. And we are seeing enough of that to where we see. Obviously, we feel good with our guidance. No drop off. I wouldn't see any drop off or anything in terms of quality that we're seeing. It's a pretty it's pretty consistent with what we have seen on an ongoing basis. Just the volume -- there's more volume in that and it makes us feel a little bit better.

Todd Thomas - *KeyBanc Capital. - Analyst*

Okay. And then just one more if I could here. I think you said previously that you have capacity to acquire about $200 million on a leverage-neutral basis with free cash flow and with I guess, amounts above that being on the line, it sounds like from your comments that you're comfortable taking up leverage a little bit here and utilizing the line in the near term. It's been a fairly volatile capital markets environment and sort of interest rate outlook, which has continued to change.

John, you mentioned you expect rates to come down, but just curious if that's sort of the right strategy and what gives you confidence that that's the right strategy?

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

We are not projecting any kind of significant change in our leverage. We'll be in the -- somewhere between five and 5.25 if we execute our strategy as we anticipated this year. We don't -- I don't think there will be any real movement in that part of it, but the opportunity is going to -- whether it is, we hate giving guidance on acquisitions. We're not -- we're really disciplined in terms of what we buy.

And so yes, if it's not there, it's not there, but if it's there and it's going to get sold and we can get it at our kind of pricing. We're going to be a buyer for it and because we know what we can do there and what that can generate growth wise in and the business over not over just six months, but over a sustained five to seven year period of time that we're doing our underwriting. And that's -- we think that's the right strategy and we don't -- but again, we're not this is not a lever up model that we're trying. I mean, we're committed to keeping a very strong balance sheet and not getting out over our skis on that in that regard.

John Caulfield - *Phillips Edison & Co Inc - Chief Financial Officer, Treasurer*

I'll just add to that. As Jeff said, our long-term leverage target is in the 5.25, 5.5 range. And when we talk about being leverage neutral and the growth that we have, leverage neutral and acquisitions doesn't mean that you are adding debt, you're just maintaining your debt to EBITDA as that cash flow grows.

And with regards to the comment that I made about interest rates, because of the growth that Jeff just spoke to and the assets that we're buying, I will say this, our acquisitions are not being made on a on a basis dependent for rates to go down. I don't mean to imply that at all. I think what we're saying is that we are floating temporarily as we look to execute that long-term match strategy. And so we've got positive leverage today and going forward. And so, we are it is something that we are going to be opportunistic about but managing our leverage cautiously.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Yeah, Todd. I think on that -- the way we look at it is -- I wouldn't say that we're anticipating a decline in rates. But I would say that we think that there's more downside, like if you're looking at it from a pure risk standpoint, we think that it is more likely that they would go down over the next couple of years, then they would go up. They're probably pretty range-bound, which we're really waiting to see if they stay rage on and we're really talking about the 10-year because that's really what our focus is on, is that getting that longer duration capital.

So that's it. But yes, we are not economists, but because we're in this business, we are making bets on where we think interest rates are going to go in terms of what we -- how you lay out your interest-rate exposure. And that's what we're doing. And we'll continue to manage it that way.

Operator

This concludes the question-and-answer session. I will now turn the conference back over to Jeff Edison for some closing remarks.

Jeffrey Edison - *Phillips Edison & Co Inc - Chairman of the Board, Chief Executive Officer*

Great. Well, thank you, everybody, for being on the call, and thank you, operator. In closing, we're proud of what the PECO accomplished in the first quarter. Our differentiated and focused strategy and our talented team combined to create a market leader in the shopping center business. We continue to enjoy a strong operating environment, as we've talked about. Our neighbors remain healthy and we don't see any cracks.

We're confident that the PECO team will continue to deliver market-leading results. We have one of the lowest leverage balance sheets in the shopping center space. And with our fortress balance sheet and ample liquidity, we do remain prepared for opportunities as they arise. PECO is well positioned to continue to successfully grow, as we look forward. We believe we provide our investors with more alpha and less beta.

On behalf of the management team, I'd like to thank our shareholders, PECO associates, and our neighbors for their continued support. Thanks for your time today, and everyone, have a great weekend.
