REFINITIV STREETEVENTS

EDITED TRANSCRIPT

PECO.OQ - Q4 2022 Phillips Edison & Co Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 10, 2023 / 5:00PM GMT

CORPORATE PARTICIPANTS

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

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

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

Kim Green *Phillips Edison & Company, Inc. - VP of IR*

CONFERENCE CALL PARTICIPANTS

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

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

Floris Gerbrand Hendrik Van Dijkum *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

Juan Carlos Sanabria *BMO Capital Markets Equity Research - MD & Senior U.S. Real Estate Analyst*

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

Omotayo Tejamude Okusanya *Crédit Suisse AG, Research Division - Analyst*

Paulina A. Rojas-Schmidt *Green Street Advisors, LLC, Research Division - Analyst of Retail*

Ravi Vijay Vaidya *Mizuho Securities USA LLC, Research Division - VP*

Ronald Kamdem *Morgan Stanley, Research Division - Equity Analyst*

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

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Phillips Edison & Company's Fourth Quarter and Full Year 2022 Earnings Conference Call. Please note that this call is being recorded.

I would now like to turn the call over to Ms. Kimberly Green, Head of Investor Relations. Please go ahead, ma'am.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, operator. I'm joined on this call by our Chairman and Chief Executive Officer, Jeff Edison; our President, Devin Murphy; and our 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 Once we conclude our prepared remarks, we will open the call to Q&A. After today's call, an archived version will be published on our Investor Relations website.

As a reminder, today's discussion may contain forward-looking statements about the company's views 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. In our discussion today, we 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 to 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 S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Kim, and thank you, everyone, for joining us today.

The PECO team in 2022 delivered another year of strong growth with same-center NOI increasing by 4.5%. We continue to benefit from a number of positive macroeconomic trends that drive neighbor demand and support our growth, including hybrid work, migration to the Sunbelt and population shifts that favor suburban markets. These demand factors are further amplified because limited new supply is being delivered to the market. We accomplished a great deal in 2022 and have a lot to be proud of.

At the macroeconomic level, the year presented many challenges with record inflation, rising interest rates and global conflict. However, the sustainability and consistency of our growth is a testament to our differentiated and focused strategy of exclusively owning grocery-anchored shopping centers and the strength of our integrated and experienced operating platform. As we assess our business today, we're optimistic about the health of our neighbors and the strength and diversity of our neighbor mix. Our team in 2022 delivered record highs in occupancy of 97.4% and combined leasing spreads of 18.1%, our development activity provides attractive risk-adjusted returns on investment and sustainable and meaningful contributions to our same-center NOI growth.

Our acquisitions are performing very well, and our pipeline continues to grow. We closed on an asset in January with more under contract and in negotiation. We observed the market power shifting to the buyer and with our platform, experience and capital, this should position us well to capture additional opportunities. Our centers are located in markets that are growing and have a strong competitive advantage with our grocery anchors. We have grown our cash flows and dividend distributions. We have a great balance sheet, low leverage and flexibility to be both patient and opportunistic. We could not have accomplished these results without the hard work of our PECO associates. I'd like to thank the PECO team for all of their efforts.

As we look ahead to 2023, we remain focused on delivering long-term growth. Our grocery-anchored neighborhood centers continue to benefit from structural and macroeconomic trends that create strong tailwinds and drive strong neighbor demand. These trends include population shifts from the urban to suburban markets, the increase in hybrid work the renewed importance of physical locations in last mile delivery, wage growth and low unemployment and low supply and lack of new construction.

The resiliency of our neighbors, combined with the aforementioned tailwinds position PECO well for all economic environments due to the following: our grocery-anchored necessity-based neighbor mix, our rightsized format, our well-positioned locations in growing markets, our record high occupancy and continued strong labor demand, our strong credit neighbors and diversified mix, the lack of exposure to distressed retailers, our balance sheet and our talented and cycle-tested team. When we consider our pricing power created from continued retailer demand at high occupancy, combined with these aforementioned tailwinds and the resilient necessity-based focus of our neighbors, we believe our growth strategy generates more alpha with less beta.

While John will provide details of 2023 guidance later, I'd like to spend a few minutes walking you through the components of our long-term growth. We believe our portfolio can deliver organic same-store NOI growth of 3% to 4% on a long-term basis. The components of this growth include continued increases in occupancy, which will contribute 50 to 100 basis points. Rental growth, which will contribute 100 to 125 basis points through new and renewal leasing spreads and contractual rent increases, which will add 75 to 100 basis points and redevelopment and development activity, which will add 75 to 125 basis points. This gets us to our 3% to 4% long-term growth.

Beyond the strong internal growth, we remain focused on accretively growing our shopping center portfolio. These investments are core to PECO's long-term external growth strategy, and we continue to be well positioned to capitalize on opportunities as they arise. We are conservatively guiding to $200 million to $300 million in net acquisition this year with the capability and the leverage capacity to acquire more if attractive opportunities materialize. We previously increased our targeted return for new acquisitions to an unlevered IRR of 9% or above. We plan to participate in the market when we can achieve this return objective while exercising the same diligence we've always exercised. We are finding those opportunities today. Therefore, with our combined internal and external growth drivers, we believe PECO can deliver mid- to high single-digit FFO per share growth on a long-term basis.

I'd now like to provide a quick update on the proposed Kroger and Albertsons merger from PECO's perspective. We continue to believe that the merger is positive for PECO and for our centers and for the communities that we -- that our centers serve. We have 33 stores with an overlapping brand within 3 miles that could potentially be impacted. These stores have average store sales of $35 million or $620 per square foot.

This compares to PECO's average of $642 per square foot. These are all productive grocery locations with strong sales and health ratios. These centers are also vital parts of their communities. We believe all 33 locations will remain productive grocery locations regardless of the ultimate outcome of the merger. This merger process will take time to unfold, but we remain positive on the impact it will have on the assets that we own.

I'll now turn the call over to Devin to provide more color on the operating environment. Devin?

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

Thank you, Jeff. Good afternoon, everyone, and thank you for joining us.

As Jeff mentioned, the PECO team is encouraged by the continued positive trends that we are seeing in our grocery-anchored portfolio and in the overall operating environment. We realized strong internal growth in 2022, which is reflected in our financial results. Lease portfolio occupancy increased by 30 basis points sequentially from the third quarter and by 110 basis points year-over-year, reaching an all-time high of 97.4%. We still see some occupancy upside in our portfolio. And when that driver of growth is no longer available, we believe that it will be replaced by incremental rent growth. We are seeing that transition today as our rent spreads have increased above historical levels.

Throughout 2022, our neighbors demonstrated resiliency and successfully managed many challenges, including inflation, supply chain issues and labor shortages. Despite these challenges, our neighbors continue to invest in their stores, their technology platforms and the overall customer experience. Comparable new and renewal rent spreads for 2022 were strong at 32.2% and 14.6%, respectively. Excluding anchors, renewal spreads were 17.7% in the fourth quarter.

Our leasing pipeline remains strong and shows no signs of slowing. The most active neighbor categories include medical, quick-serve restaurants and health and beauty. We are seeing consistently strong neighbor demand across all geographic regions. We continue to have excellent success retaining our neighbors, while growing rent at attractive rates. Our fourth quarter retention rate was 92%, ahead of the historical average of 87% over the last 5 years.

As Jeff mentioned, this factor is a large contributor to our rent growth over time. Our retention means no downtime and less tenant improvement costs. Our TI spend on renewals over the last 5 years averaged less than $2 per square foot. We also have been successful at driving higher contractual rent increases. On average, our new and renewal in-line leases executed in the fourth quarter had annual contractual rent bumps of 2.4%, another contributor to our long-term growth.

In addition to our strong rental growth trends, we continue to focus on and expand our pipeline of ground-up outparcel development and repositioning projects. In 2022, we stabilized the highest number of these projects that the PECO team has ever delivered in a single year. These projects delivered over 300,000 square feet of space and add incremental NOI of approximately $5 million annually.

These projects provide superior risk-adjusted returns and have a meaningful impact on our long-term NOI growth. In 2023, we will invest $50 million to $60 million in ground-up outparcel development and repositioning opportunities with average estimated underwritten cash-on-cash yields between 9% and 11%. We continue to see the many benefits of PECO's grocery-anchored portfolio with our healthy mix of national, regional and local retailers. More than 70% of our rents come from neighbors offering necessity-based goods and services, and our top grocers continue to drive strong recurring foot traffic to our centers.

We are currently seeing a resilient consumer despite the tougher macroeconomic backdrop. We believe our incentives are less impacted by an economic downturn because more than 70% of our rents come from necessity-based goods and services. Our trade areas offer favorable demographics with median household incomes of $77,000, which is approximately 9% higher than the U.S. median. The demographic strength of our trade areas is reinforced by the continued demand from retailers for space at our centers.

In a recession, consumers will continue to frequent the grocery store, the barber, the local quick-serve restaurant and other necessity retailers. Our single non-grocery neighbor is T.J. Mac at 1.4% of ABR. And all other non-grocery neighbors are less than 1% of ABR. PECO has no exposure to luxury retailers, office or theaters and very limited exposure to distressed retailers. The top 10 neighbors currently on our watch list represent just 2% of our ABR. As a reminder, our combined exposure to Bed Bath & Beyond and Party City is minimal. These 2 retailers represent 10 and 20 basis points of ABR, respectively. 26% of our ABR is derived from local neighbors. 64% of our local neighbors rents come from retailers offering necessity-based goods and services.

Our local neighbors are successful businesses run by hard-working entrepreneurs. They have healthy credit and are less susceptible to corporate bankruptcy caused by weaker performing locations. A local neighbor typically receives less capital at the beginning of their lease, accepts more PECO-friendly lease terms, high retention rates and achieved renewal spreads similar to national neighbors. Importantly, they differentiate the merchandise mix that our centers offer our customers. Our local neighbors are resilient and have been in our centers for 8.8 years on average.

According to CoStar's recent Global Predictions report, grocery stores and essential retail are among the most resilient retailers during recessions. During the pandemic, grocery stores and the foot traffic to these centers recovered at a faster rate than that of other retail locations. Since the pandemic, the vacancy spread between grocery-anchored and nongrocery-anchored centers has widened. Grocery-anchored centers are well positioned to maintain these lower vacancies, which we are experiencing in our portfolio. We expect these favorable trends to continue to benefit PECO's well-located, grocery-anchored neighborhood centers in 2023 and beyond. We have added slides to our investor presentation on these recent CoStar insights.

In summary, the PECO team remains optimistic about the current strong operating environment and the continued positive momentum we are experiencing across leasing, redevelopment and development. In addition, our healthy neighbor mix and grocery-anchored strategy positions PECO well for continued steady growth.

I'd now like to turn the call over to John.

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

Thank you, Devin, and good morning, and good afternoon, everyone. I'll start by addressing fourth quarter results, provide an update on the balance sheet and then walk through some highlights of our initial 2023 guidance. Fourth quarter 2022 NAREIT FFO increased 43% to $71 million or $0.54 per diluted share. This result benefited from an increase in rental income and reduced general and administrative expenses. Fourth quarter core FFO increased 22% to $74 million or $0.56 per diluted share driven by increased revenue at our properties from higher occupancy levels and strong leasing spreads as well as lower property operating costs and general and administrative expenses.

Our fourth quarter 2022 same-center NOI increased to $91 million, up 2.8% from a year ago. This improvement was primarily driven by higher occupancy and an increase in average base rent per square foot, driven by our strong renewal and new leasing spreads, which was partially offset by lower collectibility reserve reversals in the current period when compared to 2021.

During the quarter, we acquired 2 grocery-anchored shopping centers and 1 outparcel for $52 million, and we sold 1 shopping center in 1 outparcel for $25 million. Our net acquisitions for the year was $226.5 million. Subsequent to quarter end, we acquired 1 additional grocery-anchored shopping center for $27 million. From a balance sheet perspective, we ended the year with over $700 million of borrowing capacity available on our $800 million credit facility, and we have no significant debt maturity until the second quarter of 2024.

Between the free cash flow generated by our portfolio and the significant capacity available on our revolver, we are confident in our ability to fund our growth plans, which is an important place to be given the current capital market environment. Our leverage ratio continues to be strong as a result of our strong earnings growth as well as our prudent balance sheet management with our net debt to adjusted EBITDA of 5.3x as of December 31, 2022, compared to 5.6x at December 31, 2021.

At year-end 2022, our debt had a weighted average interest rate of 3.6% and a weighted average maturity of 4.4 years. Approximately 85% of our debt was fixed rate. We continue to monitor the debt capital markets for the right opportunity to extend our maturity profile. Our variable rate debt allows us to maintain flexibility such that we can access the bond market or bank market without prepayment penalty and our low leverage reduces the impact of rate volatility to our earnings. We anticipate addressing our 2024 maturities along with long-term funding for our expected 2023 acquisition volume later this year. We believe patience is prudent as we continue to gauge the attractiveness of the market.

Turning to guidance. Please be sure to review the incremental detail added to our press release, which we have also added to our supplemental. Starting with our same-center NOI growth, we are guiding to a range of 3% to 4% growth from our portfolio in 2023. This growth is aided by our leasing activity in 2022 with increased occupancy and favorable rent spreads in our development and redevelopment activity. Included in this range is the negative impact of normalizing our anticipated uncollectible reserves to historical levels of 60 to 80 basis points of revenue.

Our initial core FFO per share guidance range is $2.28 to $2.34. Our internal growth is aided by an incremental lift from our 2022 and anticipated 2023 acquisitions, partially offset by incremental interest costs. As we look to 2023, we anticipate approximately $86 million of interest expense at the midpoint. Our acquisition pipeline is healthy. For 2023, we are guiding to acquire between $200 million and $300 million of assets net of disposition activity. To further optimize our internal growth, we plan to continue to selectively recycle assets with proceeds being deployed into high-quality, higher-growth assets.

As Jeff mentioned, we believe we are well positioned for long-term growth and we are delivering strong internal and external growth. Importantly, we have the flexibility to be patient and pursue accretive opportunities as they arise that will provide meaningful NOI contribution in 2023, 2024 and beyond. And maybe most importantly, as we consider the economic uncertainties, we continue to have one of the strongest balance sheets in the sector allowing us the ability to remain on offense and pivot quickly in response to changing market conditions. We believe our strategy has historically and will continue to prospectively generate excellent risk-adjusted returns. Our results in 2022 are no exception.

With that, we look forward to taking your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll take our first question today from Craig Schmidt, Bank of America.

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

Where will PECO's total occupancy and small shop occupancy end at the end of 2023?

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

John, do you want to take that?

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

Sure. Thanks for the question, Craig. So we still believe that we have room to grow our occupancy. Currently, we're at 99% plus on the anchor. So we're down to a few spaces there. So I think that part holds still, but at 93.8% on the in-line, we still believe we have about 150 basis points that we can grow that. And I would say that's probably over the next 12 to 18 months.

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

Great. And then just on the adjustment for uncollectibility of $3.5 to $4.5 versus $2, when I look at your portfolio, I see very little exposure to bankruptcies and store closings, what's driving you to this higher number?

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

John, do you want to take that?

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

Yes, Jeff, I'll take that one again. So really, what you see in '22 being less than that was the final amount of reversals from previous years coming through. As we look to it, we've said that this portfolio has delivered 60 to 80 basis points of uncollectibles each year. And so that's really the guidelines for that. I mean we believe it's going to be consistent from 1 year to the next, but that's -- on this portfolio, that's what our experience has been.

Operator

We connect now to Haendel St. Juste at Mizuho.

Ravi Vijay Vaidya - *Mizuho Securities USA LLC, Research Division - VP*

This is Ravi Vaidya on the line for Haendel St. Juste. Can you discuss your decision to buy an asset with relatively lower occupancy versus the rest of your portfolio. What sort of upside do you see there? And is this going to be more of a targeted strategy going forward with regard to external growth?

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

Ravi, thanks for the call and appreciate you being on today. So we're -- one of the things we did over the last 30 days, really 60 or 90 days, look at our cost of capital. And as that's going up, we've actually adjusted our unlevered IRR from 8% at the IPO to 9% today. And one of the things that we're looking for are opportunities where we can have growth in a variety of different ways in the properties that we're buying, and where we see lease-up occupancy is one of those opportunities and select locations on select properties. But we're looking at ways that we can find properties with more growth potential than real stable -- flat, kind of returns over time. So yes, I think you could expect us to be more active in that market, but as you know, it's -- the market's got some pretty big bid-ask spread today. And so we do anticipate that volume will be a little slower particularly in the first half of the year.

Ravi Vijay Vaidya - *Mizuho Securities USA LLC, Research Division - VP*

That's helpful. Just one more here. With regards to leasing, it's been a very -- leasing demand is very strong, and it's been very active, but how sustainable do you think the current leasing spreads are, especially with spreads over 30% like how healthier the retailers are from an occupancy cost ratio standpoint to be able to sustain these continued higher leasing spreads.

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

Devin, do you want to take that?

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

Sure. Ravi, thanks for the question. Again, we're not seeing anything that causes us to believe that those spreads are not achievable, at least in the near to midterm. And I know that number at 30% when you see it seems shocking, but you have to realize that these retailers are entering into leases between 5 and 6 years and the CAGR we're getting is less than 3%. And the way we think about it is when we look at our overall ABR, our overall in-line ABR increased approximately 5% year-over-year. And when you think about how retail sales are growing, particularly in the categories that we have large exposure to, so food, health, et cetera, those retail sales have been growing at mid-single digits to low double digits.

And so the fact that our average ABR is growing at mid-single digits makes us comfortable that we can continue to sustain these kinds of spreads. And at the end of the day, the ultimate tail of the tape is the fact that we don't see any slowdown in the demand coming from the retailers to lease space in our centers.

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

In addition to that, we also -- our retention rates are staying really strong. And so that would be an indicator that rents are moving. And they -- if anything, they're higher than they've been. So with what Devin said in that, we're -- we do feel that there is -- this is a long-term sustainable model to be able to increase rents in that 4% to 6% range that overall in terms of rental, the retailers will stay healthy and can absorb that kind of cost increase.

Operator

We go next now to Tayo Okusanya at Credit Suisse.

Omotayo Tejamude Okusanya - *Crédit Suisse AG, Research Division - Analyst*

Just a quick one on interest rates. The swaps that are coming due September '23, just kind of curious what the thoughts are on that and how that's built into your guidance.

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

John, do you want to take that?

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

Sure. Thanks, Tayo. So as we look at it, we have positioned ourselves to be patient and with flexibility. So we do have a maturity of swaps in September. We also are looking at the debt maturities that we have in 2024. And as I mentioned in the prepared remarks, we anticipate addressing those '24 maturities later this year with incremental long-term funding, and we would anticipate that we would sell for it at that time. So we are looking at extending but at this time, we don't have -- we do have assumptions in there that we're refinancing the debt related to '24 as well as taking care of that at that time. And that could be in the bank market, it could be in the bone market. It's really going to be dependent upon our cost of capital and maintaining attractive cost of capital as we can.

Omotayo Tejamude Okusanya - *Crédit Suisse AG, Research Division - Analyst*

That's helpful. The second question, I mean, you're starting to see some signs of inflation coming down. I mean -- I think there's even a view out there that after a while, maybe like food prices, could actually go into a discretionary type scenario, which typically hasn't been -- typically is not a very good environment for grocers. Just think -- are you hearing some of that from your grocery neighbors at this point? And how do they kind of prepare for such a scenario if that does kind of current in the next 9 to 12 months?

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

Yes. So Tayo, thanks for the question. We are not hearing that from our grocers. They are still sort of ringing the bell on inflation, not on a deflationary environment. And they still are having very positive operating results where they're actually, in fact, able to pass those costs on to their customers. So as long as that continues, that will be positive. Certainly, I think you're saying the deflationary environment is not positive. And we would agree. I mean, the grocers, they like -- they love that 2% to 3% inflation. It's certainly too high right now from their perspective, and they don't see from our conversations that coming down in the short term.

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

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

No, that makes sense, Jeff. That makes sense.

Operator

We'll next move to Juan Sanabria at BMO Capital Markets.

Juan Carlos Sanabria - *BMO Capital Markets Equity Research - MD & Senior U.S. Real Estate Analyst*

Just hoping you could provide a little perspective on the acquisition market and pricing and where the bid-ask spreads are today. I'm just curious if you could give us the yields for the fourth and first quarter acquisitions and kind of what is baked in the assumptions for '23 guidance?

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

Let me give you -- I'll give you some general. I don't think we're now putting out there those yet in terms of last year. But John, if we are, you can step in. But what's happening in the market is what happens a lot of times when there's a change in the cost of capital. And that is, it takes time for the buyers and sellers to reduce that spread. And so volume is down clearly in the second half of last year, and we're starting into this year. Overall volume is down. And so I would -- and we would anticipate that continuing until that sort of bid-ask starts to narrow a bit.

We are finding select opportunities that we are very excited about, and we think these were our positions where we've got a seller with -- that is motivated to sell and is moving to what we think is the newer market pricing quicker than maybe the overall market is. And so we are going to actively look for those opportunities and take advantage of them when they come. So I would say it's -- our feeling has been that it's about 100 basis points in terms of that of initial yield, and it's probably at least 100 plus on the unlevered IRR. So that's a pretty big move. And it is going to take some time, I think, to fully realize that. And there's probably, potentially depending on what happens with rates, the ability for that to widen even more. So we will see, but we're continuing to look at everything that's coming on the market. And hopefully, we can find some good opportunities. We feel like we found a couple so far and we're going to continue to look at those and take advantage of that if we can find them.

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

So Jeff, I'll jump in there. So for the full year, our weighted average cap rate was 6.1, but to the points that Jeff is making, there is variability in there because we focus on the IRR, there can be a delta in the going-in cap rate based on the amount of growth that we have. So if you were to look at our third quarter acquisitions compared to our fourth quarter acquisitions, the fourth quarter was closer to our total year weighted average cap rate, but I would -- the IRRs make up for the growth in that asset relative to the third quarter. And I think as we look to '23, if you're -- if '22 was at 6.1%, I can see that we're assuming some -- we'll have a slightly higher cap rate on that assumption. So let's say, anywhere from 15 to 30 basis points, but it could be wider than that, again, dependent upon the amount of growth. And the key element for us is that 9% IRR and exceeding that.

Juan Carlos Sanabria - *BMO Capital Markets Equity Research - MD & Senior U.S. Real Estate Analyst*

And then just a second follow-up question on retention versus pushing the spreads for the small shop tenants. I know the retention is very strong for anchors. But just curious on your willingness to maybe have a little short-term vacancy to drive rates at this point. It seems like you're pretty darn full. So just curious on how strategically you're thinking about that interplay between rate and retention.

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

It's a great question. It's one that there's a lot more R2 than there is science because obviously, the numbers can tell you how much TI you're putting in and what the increase in rent is compared to the lower TI for retention. And that certainly goes into our analysis. But a lot of ours is also making sure we have the right merchant in the center that matches that store because if they can continue to generate and increase their sales, they can, over time, pay us a lot more rent. And so finding the right retailer for us is a critical part of that sort of decision process as we look at filling out our small store space with the right merchandising mix for each market that we go into.

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

The only thing I would add to that, Juan, is that I think our retention rate in the fourth quarter was indicative of our willingness to push rate and potentially be less focused on retention. You saw our retention rate in Q4 at 67%, which is lower than the full year average of 77.5% because the decision we made in that fourth quarter was we wanted to push rate and we wanted to optimize merchandise mix. So at the end of the day, we're not overly [waiting] retention, what we're waiting is our ability to push rates and get the right merchandise mix into the centers. And I think you see that with what our retention rate for in-line did in the fourth quarter.

Operator

We'll go next now to Todd Thomas of KeyBanc Capital Markets.

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

John, first question, I just wanted to go back to the balance sheet. So the swap expires in September and guidance assumes throughout the balance of this year, '23, the cost on the $255 million increases by about 325 basis points for the balance of the year and perhaps in early '24. Is that right? And it looks like the '24 maturities are September and October, when would you expect to refinance those maturities.

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

Sure. Todd, I would say that, yes, the only thing with your 325 basis point increases that if you're comparing where it is to where kind of spot SOFR is, but if you were to actually turn that out over a longer duration, that rate does come down, but I think as a going in, yes, you would see that in September. Look, we continue to assess everyday different opportunities whether it be in the bank of the bond market. you're correct, the maturity in '24, the $100 million is in May, and then the remaining $375 million s basically September 30 of 2024. And we'd be looking to extend those maturities, to refinance those maturities in the middle part of this year could be Q2, it could be any time really. But we are watching and once we actively push that out, I would say, no later than -- I'd prefer it to be earlier, but we have the ability to be patient in the line and the liquidity and the relationships to give us that flexibility and timely. But if I were to model, I would say, the middle to the end of this year would be the right way to think about it.

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

Okay. And then is there any additional capital raising activity embedded in guidance for 2023? And how should we think about funding acquisition, net investment activity during the year?

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

John, do you want to take that one?

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

Yes. So our guidance does not have included any equity raise. I think that is something that as we evaluate our cost of capital, it is something that we are balancing both on the equity side and the debt side. And so when we look at our ability to fund our acquisition plans for the year, we feel very comfortable and confident that we can do that. And then in terms of the debt capacity, I think, again, we have great relationships with our lenders, but also we look at the unsecured market. We looked at the private placement market. We look to the bank market. We really are focused on cost of capital. And as we've discussed internally, it may need to be -- it could be a mix of anything. It could be a mix of all. So -- but specifically, we don't have that. But I also think that when you give the liquidity position in that, we're at 5.3x on the debt to EBITDA and you look at the growth that we have planned, we feel very good that we can manage our funding activities and keep to the guidance range that we've stated.

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

Todd, it's Devin. Just adding on to what John just said, given the amount of free cash flow after dividend that we generate, we can acquire $250 million a year in acquisitions without ever having to go back to the equity market. So given the fact that $250 million is the midpoint of our range for the year, we have not assumed any additional equity given the amount of free cash that the business generates.

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

Okay. Yes, that's helpful. All right. And then I just had one follow-up. I guess, going back to the bad debt expense commentary. I hear the comments about the forecast for '23, the assumption there and guidance being a more historical average of 60 to 80 basis points, but it did increase a little bit in the fourth quarter. The run rate there is above the full year '23 forecast. Can you just touch on that on collectible revenue in the fourth quarter? Sort of what impacted that what you saw in the portfolio.

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

John, do you...

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

Yes. Thanks, Jeff. So I would say on that, the interesting part of this is it has been such a focal point post COVID because there's variability. And I would say that actually, fundamentally, there isn't anything unusual in the fourth quarter? It does tick a little higher. But I would also say that historically, our fourth quarter does typically take a little higher, but then we also have experience in the first quarter where it can actually be better than expected. So when we think about the 60 to 80, unfortunately, it's a challenge to do it on a quarter-by-quarter, and it ends up kind of smoothing out because right now, we're focused on reversals from one period to the next. But in the fourth quarter, I had reversals from Q2 and Q1 which is why, ultimately, we do look at on a smoothed-out basis, but I don't want to -- we do look at it on a granular neighbor-by-neighbor level and including the type of AR that they have and the like. And so it was higher, but actually, there was nothing fundamentally that actually drove us to do that other than a slight seasonality.

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

Okay. So not seeing anything in the fourth quarter regarding the sort of tenant health maybe from some of your local neighbors or anything like that, that you can point to just a little seasonality in the fourth quarter, and you'd expect that to sort of just smooth out a little bit during the course of the year.

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

I do. And in fact, in the first quarter, both at an AR level and even from a health level, the first quarter is actually better than we would have expected otherwise. So we are not seeing any signs that our neighbors are having difficulties.

Operator

(Operator Instructions)

We go next now to Floris Van Dijkum at Compass Point.

Floris Gerbrand Hendrik Van Dijkum - *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

It looks pretty good. Obviously, your portfolio has proven to be very resilient. Something, Jeff, you've been harping on about since you went public here. Encouraging to see that actually show through into the numbers as well. Curious about your small shop. You've got pretty strong leasing spreads, 17.7% for your average spreads for your small shop. Is it correct to assume that the majority of your sign that open pipeline of around 100 basis points is in that bucket in the small shop, which gives you the confidence in terms of your same-store NOI growth for '23?

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

The answer is yes. That is how we're looking at our backlog today, and we feel comfortable in our guidance based upon that. But as you know, Floris, we've been talking about this for a long time. There continue to be really good pricing power for us in the -- on the leasing side. And a point that Devin made earlier, some of these numbers strike you as big numbers like 17% or 35%. But when you figure that's coming over a long period of time and over a piece of our portfolio, just basically getting them to market. It's not -- these are very sustainable numbers in our view. And so we're -- we do feel like that as long as we stay in this kind of environment where the demand is very -- is strong for our space that we should be able to see -- continue to see these kind of returns. I don't know, Dev, if you have any additions on that.

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

No, I think that's the point, Jeff.

Floris Gerbrand Hendrik Van Dijkum - *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

Maybe one follow-up here on maybe the composition of your small shop, how that is changing or how that has changed over the last couple of years. I mean, we always -- I guess, the view on some of your local neighbors is, the barber, the nail salon, et cetera. But are we seeing more coffee shops? Are we seeing -- how is the composition of your small shop change? And how do you expect it to change over the next couple of years?

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

Yes. Jeff, I'm happy to take that.

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

Do you want to take that, yes. Great.

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

Yes. Floris, I mean, where we're seeing growth as a percentage of demand, it's primarily in a couple of categories. One of them is medical retail or what we call [MedTail], and this is across a number of different verticals. So urgent care, primary care, physical therapy, et cetera. And the depth of demand and the depth of the tenant that are in that category is meaningful. And we've seen dramatic growth in the demand from those types of retailers.

The other is what we characterize as health and wellness. And these are uses like a med spa, like a dry bar would be an example of a tenant in that regard, massage, stretch, which is a retailer means stretch lab and then fitness, Club Pilates, Pure Barre Orangetheory, et cetera. And then lastly, there continues to be very strong demand from quick service restaurant concepts. And those are names that you're very familiar with like Chick-fil-A, Shake Shack, Buffalo Wild Wings, but then emerging concepts like Dave's Hot Chicken, First Watch, et cetera. And the depth of demand coming from these various verticals is very strong, and that's where we're seeing the growth.

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

We take the next question now from Paulina Rojas at Green Street.

Paulina A. Rojas-Schmidt - *Green Street Advisors, LLC, Research Division - Analyst of Retail*

Is it fair to say that the midpoint of your guidance assumes your portfolio really navigates this year without any sort of softness related to the macro headwinds that we are seeing. Because in a way, I find interesting that your assumptions, I think, based on what I have heard are really largely in line with an average year, even though this year may not be really average from a macroeconomic perspective.

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

That is a great question. I mean, the reason we give a range is so that we can take where we are today and look at it and say, okay, well, this if things get worse, there's some downside in the range and there's -- and if they go great, then there's some upside in the range. And I think that if you look at the midpoint of our range, our assumption, and it's an informed assumption, Paulina, because we have a lot of what's going to happen this year is already in the leasing and the management and the cost and the contracts. So we have a pretty good vision of this year. So it does assume that we don't have a dramatic change from the way it is today. But it would be hard for us in the environment we are right now to see a -- to go to a really negative scenario.

Now if you get to '24, that's a different story because there could be more in a '24 kind of time frame. But in a '23 time frame, we feel pretty good about these assumptions. I don't know if Dev or John, you guys have any other things to say here.

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

Yes. I was just going to add to that. Paulina, as we look at '23, I mean, the reason that we are giving the guidance we're giving and your perspective on it, as we look at '23, 98% of '23 is baked, if we assume historical renewal rates. So the factor that -- we are thinking about is renewal rates. And given what we're seeing and the continued strength of demand, we're very comfortable making the assumptions that we're making, given how -- what a high percentage of '23 is already in place. And that's the reason why we're confident that we can hit these metrics.

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

And one additional piece that I would add that gives us confidence is that when you look at the diversification of our portfolio, both in terms of geography and we do not have exposure to those large big box retailers that are experiencing that disruption and so that gives us confidence because we have a granularity and just broad diversity of neighbor type and neighbor brand that gives us comfort so that it's more consistent.

Paulina A. Rojas-Schmidt - *Green Street Advisors, LLC, Research Division - Analyst of Retail*

Very good color. And then I have another question regarding your redevelopment activity impact. So you talked about the contribution in the long term. I think we said 75 to 100 and something of positive contribution. How should we think about the cadence of that contribution? Is it -- because I would assume really that could trend down over time after you exhaust the low-hanging fruit opportunities that you have in your portfolio. And because I would assume part of this is bringing your centers 20 standard and doing some pad developments, and there seems to be a limit to that. So if you could provide more color around how you're thinking about that contribution for next year, for this year, and over time, it would be great.

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

Well, I'll take a crack at that and Dev can jump in. I mean the way I think about it, Paulina, is that these are opportunities that we create at the center basis. So there are places where we can continue to find these opportunities to buy adjacent land, to develop parking lots in partnership with some of the grocers to be able to create some more density in specific locations. And but these are small deals. And therefore, they happen in a very bite-sized basis. So they're -- if you look at the -- our plan of $50 million to $60 million a year of this product, Again, most of this -- I mean there's nothing that we're going to get done this year that's going to create revenue that's not already in the book. So we are looking out on a longer-term basis on this, but I will tell you, we continue to push and find these opportunities. And I will give also credit to our acquisition program because in the acquisition program, we're oftentimes buying into opportunities where we can find additional value through specific ground-up development.

So that's how we're looking at it. But we believe it's a very sustainable business, and we wish we could do more of it, but it takes a lot of time and it takes a lot -- it happens in small increments, which we love from a risk standpoint, but from a -- it'd be a lot easier if we were doing it on 1 or 2 big developments, which is not what we're doing.

So Dev, did you have any additions to that?

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

Yes. The only thing that I would add, Paulina, is what we are articulating is that 75 to 125 basis points of our same-store growth will come from this activity. And you're right, we are currently harvesting the low-hanging fruit in the portfolio. But I think the thing you need to consider is: one, this is a 280 asset portfolio and the projects that we've delivered in the last year represent a very small percentage of that portfolio, number one. And then number two, we are growing the portfolio over time. And we're finding, to the point Jeff just made, these opportunities. And then we're aggressively looking to acquire contiguous land where we can successfully develop and redevelop. So we believe that this $50 million to $60 million number is the number that we're comfortable with in the medium term as we continue to look at our existing portfolio, and we continue to add opportunities to the portfolio.

Operator

We go next now to Mike Mueller of JPMorgan.

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

I was trying to get out of the queue. The prior question was mine. So thanks.

Operator

We'll go next now to Ronald Kamdem at Morgan Stanley.

Ronald Kamdem - *Morgan Stanley, Research Division - Equity Analyst*

Just a couple quick ones. Just looking through the occupancy, and apologies if you hit on this already, but I see the economic occupancy is down 20 basis points quarter-over-quarter for the in-line. I'm just curious what sort of drove that? What happened there?

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

John, do you have that just on the economy?

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

I do. I was going to say, actually, I think, Devin has -- had some commentary on that. And I think it was -- what we were talking about is intentional choices around merchandising and instances now where because the leasing demand is so strong that we actually choose to vacate the neighbor and put in a new neighbor.

So Devin, did you have anything you wanted to add to that?

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

No. That's the answer, John.

Ronald Kamdem - *Morgan Stanley, Research Division - Equity Analyst*

Great. And then my second question is a little bit of a sort of a competition and a technology question sort of mixed in. So I was sort of looking at the foot traffic data that you put in the deck, which is really helpful. I mean, clearly, the centers are 2% to 10% above pre-COVID levels. That's really good. when you guys are thinking about sort of sourcing, acquisitions and so forth, being a little bit into the secret sauce, do you use some of that foot traffic data, number one? And number two, does the competition whoever that may be, do they use it as well? I'm just trying to figure out what the secret sauce and the alpha to sourcing some of these deals.

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

Yes. It's -- the realities are, it's all of the above. It is the data and -- as you know, we do use our own proprietary algorithm to actually evaluate every property that we look at, both on the acquisition and disposition side and foot traffic is a big part of it. There the -- for us, I think the special sauce is that we've identified 5,800 centers we want to own. And when they come on the market, we know that it is a center at the right price that we would be interested in. And we know that the trade area will not only support the grocer, but support the small stores that are around it. And so we have a very targeted -- I mean, although it's a very big market, it's very targeted. And we have a very specific niche in the market that we are attracted to and that we want to buy. So that -- I mean to us, that is the -- the secret sauce is the ability to look at those centers and be able to find the ones that will be -- that we believe will be successful and then to bring them into the portfolio.

So the only other thing I would add to that is when you've been doing the sort of continuous learning we have over the last 30 years on this business, we set up our machine to handle this kind of property where you have a large degree of small store space, you have a very strong, but a very defined 3-mile market. That's what I think is, at the end of the day, really, the special sauce is that we have a very specific market and we've built a team that knows how to maximize the value of the properties in those very specific markets.

Operator

Thank you. Ladies and gentlemen, this does conclude our question-and-answer session. I would like to turn the call back over to the Phillips Edison team.

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

Thank you, Bo. Before some closing comments from Jeff, I would like to quickly mention that Phillips Edison's team plans to attend the Wells Fargo Real Estate Securities Conference on February 22, the Wolfe Research Virtual Real Estate Conference on March 2 and Citi's Global Property CEO Conference, March 6th to the 8th. The PECO team looks forward to seeing you on upcoming investor conference. Also in May, we will host our next PECO Grow webcast for financial advisers and retail investors.

With that, I'll turn the call over to Jeff. Jeff?

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

Thanks, Kim. Our results continue to highlight the strength of PECO's focused and differentiated strategy of exclusively owning and operating small format, well-located neighborhood centers anchored by the #1 or #2 grocer in the market, with high recurring foot traffic that drives neighbor demand and results in superior financial and operating performance.

PECO has over 30 years of experience in the grocery-anchored shopping center industry and an informed perspective of what drives quality and success at the property level. The way we think about quality, we call SOAR, which includes spreads, occupancy, advantages in the market and retention. SOAR provides important and sustainable measures of quality in PECO's grocery-anchored centers.

We continue to benefit from a number of positive macroeconomic trends that drive neighbor demand and support our growth plans. Our experienced and cycle-tested team integrated operating platform and grocery-anchored strategy place PECO in a great position. Our fortress balance sheet and liquidity will allow us to take advantage of opportunities as they arise. We remain committed to delivering long-term growth and value for our shareholders.

On behalf of the management team, I'd like to thank our shareholders, our associates and importantly, our neighbors for their continued support. Thank you for your time today, and I hope everyone has a great weekend.

Operator

Thank you, Mr. Edison. Again, ladies and gentlemen, that will conclude the Phillips Edison & Company's Fourth Quarter and Full Year Earnings Conference call. But again, I'd like to thank you all so much for joining us and wish you all a great day. Goodbye.