EDITED TRANSCRIPT

Agree Realty Corporation's
Second Quarter 2019 Earnings Conference Call
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Rob Stevenson | Janney, Montgomery, Scott | Analyst
Todd Stender | Wells Fargo Securities | Analyst

PRESENTATION

Operator
Good morning and welcome to the Agree Realty First Quarter 2019 Conference Call.

(Operator Instructions)

I would now like to turn the conference over to Joey Agree, President and CEO. Please go ahead, Joey.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Operator. Good morning everyone and thank you for joining us for Agree Realty's Second Quarter 2019 Earnings Call. Joining me this morning is Clay Thelen, our Chief Financial Officer.

I'm very pleased to report that our strong start to the year gained momentum during the second quarter. Robust investment activity, largely comprised of leading, investment-grade retailers, picked up pace during the quarter and continues to accelerate into the third quarter. Our investment activities during the quarter were supported by strategic capital markets transactions that further reinforced our best-in-class balance sheet as well as a number of dispositions aligned with our long-term asset management strategy.

Investment activity during the quarter was again of superior quality. A record 73% of the annualized base rent acquired was derived from leading retailers with an investment-grade credit rating. Activity across our three external growth platforms totaled $183 million in 37 properties. 31 of these properties were sourced through our acquisition platform, representing aggregate acquisition volume of more than $176 million for the quarter. The properties were acquired at a weighted-average cap rate of 6.7% and had a weighted-average remaining lease term of 10.6 years.

The acquired properties are located in 20 states and are leased to leading retailers operating in 13 different sectors, including off-price, convenience stores, auto parts, dollar stores, warehouse clubs, consumer electronics, and farm & rural supply.

We are very pleased to have completed several noteworthy acquisitions during the quarter that reinforce our real estate emphasis. As previously announced in May, we acquired Wawa's flagship store in Philadelphia's historic Center City. The 11,500 square foot store is located on the ground floor of the Public Ledger Building, just steps from the Liberty Bell, Independence Hall, and Congress Hall.

Additionally, we acquired our first Costco during the quarter, located on a dominant retail corridor in Newport News, Virginia. Costco is on a ground lease, where they have paid for the construction of the building and improvements, with approximately 15 years of remaining term.

Going forward, and absent any unique transactions such as the Wawa or Costco, you can anticipate that our acquisition yields will be more in-line with our historical returns of approximately 7%.

Through the first six months of the year, we've invested a record $327 million into nearly 90 retail net lease properties spread across 31 states. Of the $327 million invested during the first half of 2019, approximately $317 million was via our acquisition platform. The 79 properties acquired in the first half of the year are leased to 33 leading retail tenants operating in 20 distinct sectors. A record 72% of the annualized base rent acquired during the first six months of the year is derived from investment grade operators.

Given our record acquisition volume in the first half of the year and our robust and high-quality pipeline, we are increasing our 2019 acquisition guidance to a range of $625 to $675 million. The low end of this range would represent record acquisition volume for our company, surpassing the $607 million acquired in 2018, which, of course, included the Sherwin Williams sale-leaseback transaction.

Notably, we have not closed nor are we contemplating executing any large-scale transactions in this guidance. Our activities continue to be granular in nature; leveraging our unique relationships & capabilities to execute on opportunities with superior risk adjusted returns.

We continue to source a number of ground lease opportunities with leading retailers. Today, our ground lease portfolio spans 56 assets comprising 9.2% of our total annualized base rents. We've increased our ground lease concentration by approximately 200 basis points year-over-year, adding premier retailers such as Walmart, Costco, Home Depot, 7-Eleven and Sheetz convenience stores. At quarter end, nearly 90% of our ground lease rents were derived from investment grade retailers and conversely only 1% is leased to sub-investment grade operators. The remaining 10% of the ground lease portfolio is leased to leading unrated retailers.

At quarter end, our total investment grade exposure stood at 54.2%, representing a substantial year-over-year increase of approximately 770 basis points. It's important to note that the investment-grade makeup of our activities is a result of our distinct focus on industry-leading operators, rather than an explicit focus on investment-grade rated retailers. Our pipeline continues to be of the highest quality in the history of our company, and we anticipate our investment grade concentration to continue this upward trajectory.

Our top tenant roster continues to positively evolve. During the quarter, we acquired three Walmart supercenters; consequently, Walmart is now the second largest tenant in our portfolio behind Sherwin-Williams.

Turning to our development and Partner Capital Solutions platforms, we had nine development and PCS projects either completed or under construction during the first half of the year that represent total committed capital of approximately $30 million. Our pipeline continues to progress nicely with several additional projects anticipated to commence yet this year. Retailers continue to leverage our expertise to execute across the full lifecycle of their assets.

During the quarter, we completed our second development with Sunbelt Rentals in Batavia, Ohio. The project had total costs of almost $2 million and is subject to a new 10-year net lease.

Subsequent to quarter end, rent commenced for the Company's third project with Sunbelt Rentals in Carrizo Springs, Texas. Construction continued during the second quarter at our fourth Sunbelt Rentals and our first ground up project for the retailer in Georgetown, Kentucky. The project is anticipated to be complete by the third quarter of this year.

Construction continued during the quarter on three additional development and PCS projects with total anticipated costs of more than $15 million. The projects consist of the Company's first development with Gerber Collision in Round Lake, Illinois; the Company's redevelopment of the former Kmart in Mount Pleasant, Michigan for Hobby Lobby; and the Company's redevelopment of the former Kmart in Frankfort, Kentucky for ALDI, Big Lots and Harbor Freight Tools.

While our record year-to-date investment activity has improved the quality of our portfolio, we've also solidified and diversified our portfolio through proactive asset management and disposition efforts. These efforts continued during the second quarter as we sold four assets for gross proceeds of approximately $17 million.

Included in these activities was the sale of three franchise operated Sonic restaurants; reducing our exposure to franchise tenants to just 3.9% of annualized base rents. This represented a reduction of 160 basis points year-over-year. We continue to see opportunities to dispose of franchise restaurants at favorable cap rates and recycle the capital into higher quality assets.

Additionally, we continue to be highly selective in our approach to the health & fitness space. Rapid unit growth, a proliferation of specialty and discount operators, single purpose boxes, as well as private equity sponsorship continue to make this a sector that is challenged to surpass our stringent underwriting criteria. To that end, during the quarter, we also disposed of a 24-Hour Fitness in Fort Worth, Texas.

Dispositions for the first six months of the year have totaled six assets for gross proceeds of just more than $27 million with a weighted-average cap rate of approximately 7.3%.

Subsequent to quarter end, we disposed of another Walgreens in Grand Blanc, Michigan; the third Walgreens that we have disposed of year to date. This sale reduced our Walgreens exposure to approximately 4% of annualized base rents, representing a year over year decrease of 290 basis points.

Given our year to date disposition activities, as well as additional visibility into our pipeline, we are increasing the bottom end of our disposition guidance from $25 million to $50 million for the full year.

Our asset management team also continues to focus on upcoming lease maturities. As a result of these efforts, at quarter end we had only three remaining lease maturities in 2019 representing just 0.4% of annualized base rents. During the second quarter, we executed new leases, extensions or options on approximately 56,000 square feet of gross leasable space. Notably, Dave & Buster's exercised their five-year option during the quarter on their 40,000 square foot location in Austin, Texas.

We were also very pleased to have executed a new 15-year lease with Panera Bread to backfill our only former vacant Applebee's at the corner of Bayou Boulevard and 9th Avenue in Pensacola, Florida. We are recapturing 108% of rents at this location with zero landlord investment or tenant improvement allowance. This transaction is emblematic of the high-quality real estate that underlies our portfolio.

As of June 30th, our rapidly growing retail portfolio consisted of 722 properties across 46 states. Our tenants are comprised primarily of industry-leading retailers operating in more than 28 retail sectors, again with 54.2% of annualized base rents coming from investment grade tenants. The portfolio remains effectively fully occupied at 99.7% and has a weighted-average remaining lease term of 10.1 years.

Before I turn the call over to Clay to discuss our second quarter and first half financial results, on behalf of all of our Directors, I would like to welcome Simon Leopold to our Board. As many of you are familiar, Simon currently serves as the Chief Financial Officer and Treasurer of Taubman. Prior to Taubman, Simon had an extensive career in real estate investment banking. We are very pleased to have Simon's finance; capital markets and REIT industry expertise join our Board of Directors. With Simon's addition, we have added three new Directors within the past 12 months, adding REIT, operational and human capital expertise at the highest level.

Thank you for your patience.

And with that, I'll turn it over to Clay to discuss our financial results for the quarter.

Clay Thelen | Agree Realty Corporation | CFO

Thank you, Joey. Good morning, everyone. I'll begin by quickly running through the cautionary language.

Please note that during this call, we will make certain statements that may be considered forward-looking under federal securities law. Our actual results may differ significantly from the matters discussed in any forward-looking statements. In addition, we discuss non-GAAP financial measures including Core Funds from Operations, or Core FFO, Adjusted Funds from Operations, or AFFO, and net debt to recurring EBITDA. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures can be found in our earnings release.

Core Funds from Operations for the second quarter was $31.0 million, representing an increase of 38.6% over the second quarter of 2018. On a per share basis, Core FFO increased to $0.75 per share, a 5.5% year-over-year increase.

Adjusted Funds from Operations for the second quarter was $30.6 million, a 37.5% increase over the comparable period of 2018. On a per share basis, AFFO was $0.74, an increase of 4.7% year-over-year.

General and administrative expenses in the second quarter totaled $3.9 million. G&A expense was 8.6% of total revenue or 8.1% excluding the non-cash amortization of above and below market lease intangibles. We continue to anticipate G&A as a percentage of total revenue to be an approximate 50 basis point improvement from 2018 or in the upper seven percent range for 2019, excluding the impact of above and below market lease intangible amortization in total revenues.

Income tax expense for the second quarter was approximately $195,000. For the full-year, inclusive of the one-time tax credit of $475,000 realized in the first quarter, we anticipate total income tax expense to be in the range of $350,000 to $400,000.

On a quarterly and year-to-date basis, Core FFO per share and AFFO per share were impacted by dilution required under GAAP related to the forward equity offerings we completed in September 2018 and April 2019. Treasury stock is to be included within our diluted share count in the event that, prior to settlement, our stock trades above the deal price from the offerings. Since our average stock price for the second quarter was above the deal price for the September and April forward offerings, we included dilution related to both transactions. The aggregate dilutive impact related to these offerings was a penny to both Core FFO and AFFO per share for the three-month period and roughly two cents for the six-month period. There will be no additional treasury stock dilution for future quarters related to the September 2018 forward equity offering given we settled the transaction in conjunction with the April forward offering.

Now moving on to our capital markets activities… we had another active quarter, further strengthening our balance sheet and positioning the Company for continued growth. We continue to maintain significant capital, both debt and equity, to execute on our robust pipeline.

On May 1st, we settled the entirety of our September 2018 forward equity offering and received net proceeds of $186.0 million.

In conjunction with the settlement of our September forward offering, we completed another follow-on public offering of 3.2 million shares of common stock in connection with a forward sale agreement. Upon settlement, the offering is anticipated to raise net proceeds of approximately $200 million after deducting fees and expenses. To date, the Company has not received any proceeds from the sale of shares of its common stock in connection with the April offering. We retain the ability to settle the transaction, in whole or in tranches, at any time between now and May 1st of 2020.

The settlement of the September 2018 forward equity offering and the launch of the subsequent April 2019 forward equity offering provide the company the capacity to invest an incremental amount of approximately $700 million and remain within our stated leverage range of 5-to-6 times net debt to recurring EBITDA.

During the quarter, we were also active in sourcing long-term debt financing. In June, we entered into an agreement for a private placement of $125 million senior unsecured notes. Once the agreement is funded, the notes will bear interest at a fixed rate of 4.47% and have a 12-year term. We can elect to fund the private placement and receive the $125 million of gross proceeds anytime between now and October 30th of this year. I would note that we continue to execute on longer term, fixed rate debt that matches the underlying duration of our asset base.

In March, we entered into forward starting interest rate swap agreements to fix the interest for $100 million of long-term debt until maturity. The Company terminated the swap agreements at the time of pricing the $125 million senior unsecured notes. Taking into account the effect of the terminated swap agreements, the blended all-in rate for the $125 million private placement is 4.42%.

As of June 30th, our net debt to recurring EBITDA was approximately 4.4 times, well below our stated range of 5.0 to 6.0 times. Proforma for the settlement of the approximately $200 million in proceeds from our April 2019 forward equity offering, our net debt to recurring EBITDA is approximately 3.2 times. Total debt to enterprise value was approximately 21.6% and our fixed charge coverage ratio, which includes principal amortization, remains at a very healthy 4.1 times.

The Company paid a dividend of $0.570 per share on July 12th to stockholders of record on June 28th, 2019, representing a 5.6% year-over-year increase. This was the company’s 101st consecutive cash dividend since its IPO just 25 years ago.

For the first six months of the year, the Company declared dividends of $1.125 per share, a 6.1% increase over the dividends of $1.06 per share declared for the comparable period in 2018.
Our quarterly payout ratios for the second quarter were 76% of Core FFO per share and 77% of AFFO per share. For the first six months of 2019, our payout ratios were 76% of Core FFO per share and 77% of AFFO per share, respectively. These payout ratios are at the low end of the Company's targeted ranges and continue to reflect a very well-covered dividend.

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

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Clay.

To conclude, I'm very pleased with our performance in the first half of the year. We're in an excellent position for the remainder of 2019 and I look forward to updating you in the quarters ahead.

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

QUESTIONS AND ANSWERS

Operator
Thank you. (Operator Instructions) The first question comes from Rob Stevenson from Janney. Please go ahead.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
Joey, how much did the Wawa and Costco transactions pull down the cap rate for the quarter?

Joey Agree | Agree Realty Corporation | President & CEO
So, we're talking of approximately 25 basis points between the Wawa flagship and the Costco ground lease. Incrementally, I'd tell you the 3 Walmart Supercenters, two of which were ground leases, one is a very low rental rate on a Walmart Supercenter. It's a former smaller format that they demolished and added a full-size center. As I mentioned in the prepared remarks, we fully anticipate that the cap rates going forward, absent any unique transaction, will be back at the 7% range.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
Okay. And then after selling the 24-Hour Fitness, I guess, more than 70% of the health and fitness bucket is now LA. Fitness. Are we likely to see more non-LA Fitness assets sales? Will we see an LA Fitness sale as well? How are you feeling overall about that segment given your comments?

Joey Agree | Agree Realty Corporation | President & CEO
Yes, it's a good question. I'll be honest, we're really watching that space continue to develop. I think it's the fragmentation of just all the concepts that continue to proliferate across this country. I mean population is getting older in this country. I don't think they have any more people, frankly, who are working out. And so, you have the low price point operators, the Planet Fitness' of the world and the like as well as the LA Fitness, 24 Hour Fitness, the specialty operators and the high-end operators like Life Time Fitness, which we don't invest capital in. So, I'll tell you we're very pleased to sell the 24-Hour Fitness that has about 7.5 years of term left. We're comfortable with where our health and fitness exposure is today. I think it's more of we just want to watch and see this space develop.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
How much of the non-LA Fitness bucket is 24 Hours and a bunch of other smaller operators comprising the $2 million or so of annualized rent?

Joey Agree | Agree Realty Corporation | President & CEO
Right. We just have one additional 24-Hour Fitness. I believe it's in Colorado. And then we have 3 or 4 Planet Fitness's. So, the vast majority is LA Fitness, mostly urban locations or early extensions that comprises all our health and fitness exposure.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
Okay. And then you said that you sold 3 Sonic franchisees during the quarter. What percentage of the portfolio today is franchisees?

Joey Agree | Agree Realty Corporation | President & CEO
We're down to 3.9% as of 6/30 of franchise restaurants, and so we're really focused on reducing that. I'd tell you the IRRs that we're achieving on these franchise restaurant dispositions are typically in the 12% to 14% on an unlevered basis. And so, we're selling these opportunistically, obviously, most likely into the 1031 market. We'll continue to look for opportunities. Burger King, Wendy's, a few Sonics remaining in the portfolio as well as Taco Bell, to divest of those at approximately 6% cap or lower and really redeploy the capital of the higher-quality operators as well as real estate.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
Is that part of the increase in disposition guidance?

Joey Agree | Agree Realty Corporation | President & CEO
So really, it's the bottom end of the disposition guidance we brought up from $25 to $50 million year-to-date inclusive of the Walgreens sale in Grand Blanc that closed subsequent to quarter end. We've disposed of almost $32 million, and our disposition pipeline includes additional franchise restaurants and then noncore assets will recycle the capital. So, we thought it would be appropriate as of today at $31 million to bring that bottom end up.

Rob Stevenson | Janney, Montgomery, Scott | Analyst
Okay. And last one for me. Clay, what share and unit counts you'll be using for third quarter estimates?

Clay Thelen | Agree Realty Corporation | CFO
Sure. In terms of fully diluted share count, inclusive of units, we should be at 42.3 million shares.

Operator
The next question comes from Katie McConnell with Citi.

Katie McConnell | Citi | Analyst
So, with investment-grade tenant exposure moving up a good amount again this quarter, can you just give us an update on what you see as the target level? And has your view on this changed much in light of the retail environment?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. As I mentioned in the prepared remarks, I would tell you our investment-grade exposure is predominantly of function of really our targeted sandbox of that 30-year plus or minus retailers. And so, investment-grade exposure is up almost 800 basis points year-over-year. We anticipate that to continue to trend upward. There's no targeted level. I think, frankly, more investment grade is obviously better. No distinct targeted level. I'd tell you our pipeline is of superior quality for Q3 with even higher investment-grade exposure than Q2, hence, the upward trajectory. But our focus remains on those top omnichannel or e-commerce-resistant operators in their respective sectors, and it's about 30 retailers and, frankly, the majority of those retailers carry investment-grade credit ratings because they're large publicly owned companies.

Katie McConnell | Citi | Analyst
Okay. Great. And then can you also just update us on the watch list tenant exposure, including, I think, you had a few Fred's stores. And at this point, if you know any plan to close.

Joey Agree | Agree Realty Corporation | President & CEO
Our watch list continues to shrink. The biggest piece of our watch list, frankly, was our PetSmart, which, I believe, we have 6 or 7 in the portfolio. The Chewy IPO and the subsequent paydown of debt in PetSmart upgrade really gave us some breathing room we think with PetSmart and gave the company a continued runway. In terms of the Fred's, we have 3 or 4 in the portfolio. We don't have any finite outcomes with Fred's. It's only $300,000, $400,000 in annualized ABR.

Operator
Our next question comes from Collin Mings with Raymond James.

Collin Mings | Raymond James | Analyst
First, I just wanted to start with the increase in acquisition guidance. I know in the past, Joey, you've noted the company typically has, call it, about 60, 70 days of visibility on deal flow. In the prepared remarks, you made the point that guidance does not reflect any larger transactions. So just as we think about going forward, are you thinking about, call it, a $150 million per quarter of acquisitions as being a run rate the platform should be able to execute on, on a go-forward basis? And maybe just talk a little bit more, again, in context of the increased guidance and, really, no larger-scale transactions being included in the back half of the year at this point.

Joey Agree | Agree Realty Corporation | President & CEO
Those are all the logical data points for us in terms of that 60 to 70 days visibility from LOI execution to close. Transactions by their very nature are lumpy. I'll tell you right now, we have visibility into our Q3 pipeline, hence, the 70 days, and the Q3 pipeline is quite substantial. As I mentioned earlier, it's of superior quality. It's over 80% investment grade today, and it is really a number of unique transactions, additional potential urban infill or urban retail transactions, some blend-and-extend opportunities, really leveraging our relationships with our retail partners. And the acquisition team has done a fantastic job originating those opportunities. So today, I can tell you we have visibility in the Q3. We don't have any visibility into Q4 absent a couple of smaller transactions, but we are, obviously, confident that we're going to be able to achieve that guidance.

Collin Mings | Raymond James | Analyst
Okay. I also wanted to touch on it, there was a measurable uptick in your exposure to Best Buy during the quarter. Can you maybe just discuss the specific opportunities?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. Best Buy continues to be a fantastic partner. We're really pleased with our relationship with Best Buy and the opportunities. Today, in the portfolio, we have 4 Best Buys. We added 1 in Visalia, California. It's a relocation of an existing store immediately adjacent to a high-performing Target. That's typically predominantly what our Best Buy exposure looks like similar to Hillsboro, Oregon, relocation of a former store adjacent to a high-performing Target just outside of Portland. So, we continue to work with Best Buy. Obviously, this is the last man standing in the consumer electronics space. Hu Joly and the team have done a fantastic job turning around that company and positioning it for future growth. And we'll continue to work with Best Buy across all 3 platforms.

Collin Mings | Raymond James | Analyst
Got it. One last one for me. Just again in context of the increased acquisition guidance and the continued growth of the platform, just any sort of updated thoughts on G&A as we go through the balance of the year as we look forward?

Clay Thelen | Agree Realty Corporation | CFO
So, we maintained our G&A guidance for the year, Collin. We're guiding excluding the impact of the amortization of above and below market lease intangibles and then total revenue. We're guiding to a 50-basis point decrease to last year, which is in the upper 7% range.

Operator
Our next question comes from Ki Bin Kim with SunTrust.

Ki Bin Kim | SunTrust | Analyst
Can you just talk more about the acquisitions you made this quarter beyond just the cap rate and touch on things especially about the ground leases? How do you guys view the full all-in LTV when you do a ground lease? And what type of rent escalators are you getting versus regular fee simple type of acquisitions?

Joey Agree | Agree Realty Corporation | President & CEO
So, escalators vary across the board, typically fixed every 5 years as you expect for most national superior tenants. Just a little color on acquisitions during the quarter. 3 Walmart Supercenters, as I mentioned, one in Lake Geneva, Wisconsin; York, Pennsylvania as well as a third one in Wichita, Kansas across from the airport; the Best Buy in Visalia, California, the relocation store. We acquired an Ulta and a Ross, 4 TJXs that includes 2 HomeGoods, a Marshalls and a flagship, a number of AutoZones, O'Reilly, a couple of QuikTrip's, obviously, a dominant large-format convenience store also within there. We continue to work with Tractor Supply. So really, again, those industry-leading operators. In terms of your ground lease question, you ask that again, Ki Bin?

Ki Bin Kim | SunTrust | Analyst
Yes. Sure. How do you view the full LTV, all-in LTV on a ground lease, including the building cost? I guess I'm trying to get a sense of if you do a ground lease, what percent of the actual building and land that represents the ground lease value?

Joey Agree | Agree Realty Corporation | President & CEO
So just for clarification for everybody, it's a point of confusion often for investors. So, these are ground leases where the tenant constructed the building and the improvements at their own expense. We buy the fee simple interest, typically, from a third party unless we develop it. These aren't sale leaseback transactions, of course. So, the Walmart transactions, we acquired approximately a 20-acre parcel on each transaction. Walmart has constructed approximately 190,000 square-foot supercenter at their expense, including improvements as well as the building. What we look forward to is high-performing stores and dominant retail corridors, no out lots in front of the Walmart or in front of the Costco as we talked about with Newport News. And then we look for the potential to redevelop that property if Walmart were to ever, or Costco, would ever vacate. So, we have no basis in the building. We have no depreciation tied to it or book value tied to it. We simply own the land with Walmart or Costco or Home Depot or Lowe's having an obligation to pay rent on an annual basis. Does that make sense?

Ki Bin Kim | SunTrust | Analyst
Yes. And in terms of your balance sheet, leverage dropped to 4.4x. Obviously, you guys seem to have over-equitized the deals in the short term. It sounds like there's lot more coming in the 3Q and later in the year. But on a medium-term basis, how do you think about that leverage ratio? And as we go into next year, should we see Agree go back into the 5 to 6x range?

Joey Agree | Agree Realty Corporation | President & CEO
Well, I think we haven't changed our stated range of 5 to 6x. We'll continue to maintain the dry powder and the capability to execute on our platform. I think when we did the most recent equity offering, we

started to gain visibility into the transactional market, our role in that space, and the depth and breadth of the relationships that the team here has created. And so, we'll continue to maintain a conservative balance sheet, be opportunistic in terms of capital sources, but, at the same time, be able to deploy that capital in the short term when and if we do raise equity or debt capital.

Ki Bin Kim | SunTrust **|** Analyst
And just one last question. Obviously, the tenure going down is good for your cost of capital, but it probably also creates a little bit more competition with traditional lenders. And you've seen a couple of them report already with shrinking NIM margins. Are alternative capital sources for your tenants becoming more competitive relative to your business?

Joey Agree | Agree Realty Corporation **|** President & CEO
No. Again, being a third-party aggregator, we've only executed on the single sale leaseback transaction this year with National Tire and Battery. Being an aggregator in the third-party space, really, our tenants' cost of capital or access to capital doesn't impact our ability to source opportunities.

Operator
Our next question comes from Todd Stender with Wells Fargo.

Todd Stender | Wells Fargo **|** Analyst
And just to keep on the Walmart theme, just because they're your second largest tenant. So, 3 separate investments. Can you tell us how you got these? And can you just maybe describe the yields? Or if you don't want to talk about the specific yield, maybe just the spreads between the ground lease and then the true real estate acquisitions?

Joey Agree | Agree Realty Corporation **|** President & CEO
Yes. So 3 separate transactions, Wichita, Kansas; Lake Geneva, Wisconsin; York, Pennsylvania, all through different sourcing mechanisms, a one-off transaction, one through a local broker in Wichita, Kansas; one through a joint venture partnership between a developer and an investment fund; and frankly, the third, I can't recall where it originated from, I think, direct from the seller. So, our Walmart portfolio today, as you mentioned, our #2 tenant, almost $8 million in GAAP ABR, 2 Sam's Clubs, a number of Walmart Supercenters and a single Walmart Neighborhood Market on a ground lease in Vero Beach. The average cap rate on the Walmart Supercenter transactions was, call it, 6%, 7% range for these 3 transactions, all high-performing stores. Obviously, Walmart has made significant investments in these assets, and we're very happy to add them to the portfolio.

Todd Stender | Wells Fargo **|** Analyst
So none of which were sale leasebacks? And then can you address the Costco, too? Because Costco owns the real estate. So, who was that seller?

Joey Agree | Agree Realty Corporation **|** President & CEO
Yes. No sale leasebacks this quarter. Again, the only sale leaseback we've executed on year-to-date was with TBC, i.e., National Tire and Battery. I believe it was a 6-store portfolio in Q1. So, no sale leasebacks. All private sellers. All very low rental rates, given the nature of the ground lease. For example, in York, Pennsylvania, they're paying $3.31 a foot. In Wichita, Kansas, they're paying $2.22 a foot. So, these are very, very low basis assets for Walmart and for us if we are ever to get the real estate back. The Costco, similarly, a ground lease. They built their own store. We're very familiar with the Newport News market and the number of transactions there. And so again, third-party seller, you're correct, they own the vast

majority of the real estate, significant barriers to entry, and so it's a phenomenal store and a great piece of real estate.

Todd Stender | Wells Fargo | Analyst
These anomalies, I mean, it's rare to see the Walmart transact and certainly you got them all at once. Should we expect more? Really, there's not many that do transact in your pricing area.

Joey Agree | Agree Realty Corporation | President & CEO
Yes. Just for clarification, 3 different transactions, different sellers, not all at once. Walmart owns the majority of the real estate. With that being said, there's a significant number of Walmart's in third-party hands, typically, on ground leases. Our focus is on high-performing supercenters, select neighborhood markets. I'd tell you they're fairly rare, but, look, the acquisition team has fantastic relationships and continues to source these opportunities, and we've seen the result. Walmart is our #1 ground lease tenant at 21% of our total ground lease exposure, approximately, followed by Lowe's, Home Depot, Wawa and Costco now. So, we'll continue to look for and execute on high-performing ground leases to industry-leading retailers.

Todd Stender | Wells Fargo | Analyst
Great. And then Clay, I guess, just for modeling purposes, when we look at the private placement on the debt side from last month, if Q3 looks to be heavy on the acquisition front, is it fair to assume maybe you'll use the line at this point, maybe a higher propensity to draw down line and then tap the private placement proceeds as we get close to that October deadline?

Clay Thelen | Agree Realty Corporation | CFO
Yes. I think that's right, Todd. We have ample liquidity under the line of credit just given where the balance was at the end of 2Q. And we have up until the end of October to draw on the debt private placement. So, our funding of the debt private placement will either be late third quarter or certainly early fourth quarter.

Todd Stender | Wells Fargo | Analyst
And then you have a year on the forward equity agreement. Is that right?

Clay Thelen | Agree Realty Corporation | CFO
Correct. May 1, 2020.

Operator
Our next question comes from John Massocca with Ladenburg Thalmann.

John Massocca | Ladenburg Thalmann | Analyst
So, is there maybe, kind of touching on the ground leases again, a maximum exposure to ground leases you want as a percentage of the portfolio? And I'm just kind of thinking how do you balance kind of the quality of that rent versus maybe the ground lease transactions inherently kind of coming in at lower cap rates and, therefore, being less accretive maybe limiting how much of your portfolio can kind of come from ground leases.

Joey Agree | Agree Realty Corporation | President & CEO
Well, I'll tell you there's no cap. I think they're the best risk-adjusted transactions in retail net lease by a vast margin. There's certainly no cap. Frankly, we're surprised to be able to be north of 9%. But again, the team continues to source these opportunities, and we continue to hit them. Look, I think the ground lease

transactions are unique. It's a unique part of our portfolio. We'll continue to add assets to the portfolio. And we look at our total comprehensive investment strategy, and we pick out the best risk-adjusted returns on there. I mean, I think that's really the key.

John Massocca | Ladenburg Thalmann | Analyst
Okay. And then you highlighted how low your exposure to franchise restaurants is today. Is that property or tenant type kind of basically redlined even from kind of a development PCS perspective in terms of acquiring more of these assets? I'm just kind of asking because you had kind of franchise restaurant assets in your development pipeline as recently as a 1.5 years ago. So, is it a structural change? Or is it more kind of the cap rates are driving out of that space?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. I think it's both. I would hate to say we redline anything. As a real estate underwriter, we focus on really a bottoms-up approach. I would hate to say we redline anything. It certainly isn't at the top of our list. Look, the franchise restaurant space, the restaurant space in general, I personally believe has become overheated because of the low price point nature of those assets in the 1031 market. And we will be happy to sell into that market and continue to deliver 12% to 14% unlevered IRRs and, frankly, in a short period of time. In terms of developing for franchise restaurants or restaurants in general, I'll be honest, this is a really busy team here today. We have approximately 40 people that are really focused and developing $1.5 million or $1.2 million franchise restaurant, it really isn't the best use of our time. We've really almost grown out of it. And so, when we look at our relationships and our tenant relationships, we really want to be able to deploy $10 million on an annual basis into any relationship with a 3-year run rate. So, we want visibility and the ability to deploy, obviously, on an accretive basis hitting our hurdles and objectives, $30 million over 3 years. And so, developing 7 franchise restaurants per year at $1.3 million or $1.4 million on average, I mean, these are basically stick-built houses with drive throughs, probably not the best use of our time. Given where those cap rates have gone, we think it's opportunistic and prudent to sell into that space.

John Massocca | Ladenburg Thalmann | Analyst
Okay. And then apologies if I missed this in the prepared remarks, but what drove the impairment in the quarter?

Clay Thelen | Agree Realty Corporation | CFO
Sure. We recorded a $1.2 million impairment for the quarter. That was related to assets that were being marketed for sale and really just reflects an entry to adjust the previous book value to what we view market value to be today.

Operator
Our next question comes from Jon Petersen with Jefferies.

Jon Petersen | Jefferies | Analyst
On the Wawa transaction, obviously, that's street retail, which is different than most of the rest of your portfolio. I'm just kind of curious the availability out there of street retail type opportunities like that and how you underwrite that versus a kind of stand-alone piece of real estate.

Joey Agree | Agree Realty Corporation | President & CEO
Again, it's an area of interest for us. We're not going to stretch outside of our sandbox. And we have a number of assets that are street retail; the Ann Arbor Walgreens, the Harris Teeter in downtown Charlotte, the Dave & Buster's in downtown Orleans. Obviously, this Wawa in Philadelphia. And we have

a couple of opportunities that we're looking at that are really urban infill locations with retailers that fit within our sandbox with superior underlying real estate. So, it's a unique subset of our portfolio similar to the ground lease, not as big as the ground lease subset of our portfolio, but an area where we continue to look for additional opportunities to either develop or acquire or typically redevelop or acquire.

Jon Petersen | Jefferies **|** Analyst
Okay. That's helpful. And then on dispositions, you mentioned some, I guess, specific areas, I guess, 24-Hour Fitness’s and franchise fast food that you're trying to reduce exposure to. But I'm kind of curious higher level, how you think about dispositions in the long run. Like is there a certain age of a building or remaining lease duration where it makes sense to look to dispose of the building?

Joey Agree | Agree Realty Corporation **|** President & CEO
It's a good question. It's property specific. All real estate is local. It's a calibration of where is the market, where can we dispose of the asset, what's our cost basis, how does it fit within our portfolio from a concentration perspective, where do we see that tenant sector or industry trending, and then most importantly, does it fit within the leading 21st century retail portfolio, which we've constructed here at this company. So, I'll tell you, Sonic franchise restaurants and Burger King franchise restaurants and are here to stay. Every day we decide to hold an asset is a day we decide not to sell. And so, we'll continue to be aggressive with assets that we don't believe fit within that context.

Jon Petersen | Jefferies **|** Analyst
All right. Makes sense. Sonic does have the best ice in the industry. It's amazing.

Joey Agree | Agree Realty Corporation **|** President & CEO
Yes. I think they've got some good ice, and we like Burger King's French Fries, but at a 6% cap or 5.9% cap, more power to the purchaser.

Operator
Our next question is a follow-up from Christi McElroy with Citi.

Christi McElroy | Citi **|** Analyst
Just sort of a follow-up from Ki Bin's leverage question. How should we think about the equity capital raising strategy? Would you expect to continue to do these bigger sorts of forward deals and then reset the balance sheet periodically? Or when would you consider moving to more of a slower ATM-type strategy to match fund as you buy? And how does your broader view of the capital markets factor into this?

Joey Agree | Agree Realty Corporation **|** President & CEO
Look, I think people tend to forget that we raised almost $240 million off of the ATM in Q4 and Q1. So, the forward instrument is a tool for us to lock in an attractive cost of equity when we have visibility into a pipeline where we'll be able to deploy it in the near or medium term. At the same time, I think most important and I think most interesting, frankly, is it doesn't preclude the ability to use the ATM or any other capital raising tools on the debt or equity side. So, you can look at it almost as an insurance policy, if anything. We're pretty confident in our ability to source transactions as we've demonstrated this quarter with the increased guidance. At the same time, it's almost setting a floor on the cost of your equity, which is the most important component in the net lease space and for REITs in general.

Christi McElroy | Citi | Analyst
Okay. And then you mentioned that you expect cap rates closer to 7%. Just following on some of the earlier questions about potentially doing more ground lease deals and growing that portfolio at lower cap rates or maybe doing more flagship deals like Wawa, more philosophically, does your cost of equity in that capital today currently warrant buying more at lower cap rates today? Is the market effectively giving you license to do more of these deals?

Joey Agree | Agree Realty Corporation | President & CEO
It's a good question. We really -- honestly, we don't think it's a proverbial green light or red light or license to do one. We focus really on the underlying real estate and how it fits within our 30,000 perspective of retail real estate and operators. So, we'll continue to execute on unique transactions. We work with our retail partners, and we have unique expertise to really bring those transactions to fruition. A lot of them have hair on them. For example, the Wawa took 6 or 7 months. My transaction team was very deep into that transaction for a long time. At the same time, we're not only focused on those types of deals. And so, there's a broad range of the transactions we're interested in and we're executing on. And I think the ground leases, the urban infill, the street retail stuff really just fits into the larger picture of what we think, again, a leading portfolio of retail should resemble in this country. It should have urban assets, suburban assets. And it should have hard corners. It should have dominant out lots. It should have boxes next to super Targets and the like. And so that's really our focus. Does that make sense?

Christi McElroy | Citi | Analyst
Yes. And then just lastly, congrats on the Simon Leopold addition. You've made a lot of progress on Board rotation over the last year. Maybe you could just provide your updated thoughts on the potential for de-staggering of the Board and then also providing FFO guidance at some point.

Joey Agree | Agree Realty Corporation | President & CEO
We're very excited to have Simon join the Board. As I mentioned, we've had 3 new directors in 12 months. it's really an ongoing Board transition, and so we've temporarily expanded the Board. We anticipate contracting it while this transition takes place. And so, with Simon's addition, Craig Erlich's addition and Greg Lehmkuhl's addition, we've really brought what we think is 3 high-quality really fantastic directors on board. In terms of providing earnings guidance, again, with a small denominator and, frankly, with a ramping company with the growth trajectory like we have, we just continue to believe that it would be such a wide band, given the visibility of 60 to 70 days that it would be almost really counterproductive to what we're doing today.

Michael Bilerman | Citi | Analyst
Joey, it's Michael Bilerman. So, I guess the de-staggering, will that be put forth next proxy season?

Joey Agree | Agree Realty Corporation | President & CEO
That's not currently on the radar. Possibly we haven't had any recent Board discussions, but the Board is always considering any potential inclusion.

Michael Bilerman | Citi | Analyst
I mean, in this day and age, the majority of companies -- in corporate America, the majority of REITs have de-staggered boards. Why wouldn't you, as a CEO, be telling your fellow board members that they should be de-staggered?

Joey Agree | Agree Realty Corporation | President & CEO
I think there are multiple different perspectives on de-staggering the boards. Obviously, there's a perspective that de-staggering in classified boards, people believe that they no longer make sense. At the same time, I think there's really truly a flip side to that coin. And I think that shareholders today through say on pay, all the other mechanisms that they have, I think, frankly, de-staggering a board today could potentially provide for activism, could have the potential for disruption, could get in the way of the continued execution of our operating strategy. Now if this company had not performed, shareholders can vote, ultimately, with their wallets and then also with their shares. If this company hadn't performed over the short, medium or long term, then I think there will be a much more validity to potentially opening yourself up to disruption short-term investors or, frankly, just activists that are looking for pops.

Michael Bilerman | Citi | Analyst
Yes. I think proxy adviser firms, the majority of long-only as well as hedge fund investors and institutional investors would disagree with those comments and that's why the majority of companies do have de-staggered boards. But if that's the way you guys want to operate, that's the way you want operate. In terms of FFO, I mean, you're north of a $3 billion company. You're no longer a couple-hundred-million-dollar company where I would argue that a number of years ago, providing individual details in terms of G&A, capital raising and all the various components, you would have wider ranges. But you are now a much larger organization where providing that detail would allow, given that your shares are owned by a variety of constituencies, a much broader constituency today than they ever were, providing and being in that way of expectations would be, I think, very helpful. So, I don't think you can hide behind “we're still a small company that's growing” where you are a major player now within the net lease space.

Joey Agree | Agree Realty Corporation | President & CEO
I have no intent of hiding behind anything. I think what we try to do would be as forthright as potentially possible. We do that with our initial guidance of the year for $350 million to $450 million. I didn't expect to be sitting here, say, increasing guidance to $625 million to $675 million. I mean this company, while it has grown and, you're right, it is no longer a couple-hundred-million-dollar company. The company is still growing top line approximately 30% even with that denominator. And frankly, we are still learning about our capabilities across all 3 platforms. And I think we give the components, and I know Clay works with everybody to give the components of how to build appropriate models and expectations. But at the same time, I have continued concerns about providing benchmarks out there that necessarily could skew perspectives. And we have no interest in providing benchmarks out there that would simply be beat and raised on a quarterly basis, right? And we run a business with a long-term perspective here, and quarterly numbers and short-term guidance can really defy retail net lease real estate today.

Michael Bilerman | Citi | Analyst
Right. I think people would be very interested in how you think about sources and uses in terms of the acquisitions that you're targeting and then the uses of capital and how management and the Board thinks about both debt and equity, the relative costs, the term of that debt, when you're going to raise it, how much equity you're raising before to replenish the pipeline. All of those are important inputs as people model and think about the cash flow and earnings growth that the company produces. And so, having that insight even at the beginning of the year, if you had targeted $300 million of deals, this is the way we're planning on financing, this is how we think about our debt and equity components, this is when we'd want to raise it. And then as the deals have accelerated, you can then update that to the market. I think having that capital discipline and communicating that to The Street only begets a higher multiple, which will allow you to do more accretive deals.

Joey Agree | Agree Realty Corporation | President & CEO
I'll be honest I would never want to telegraph to The Street how we anticipate raising debt or equity on a go-forward basis in a volatile environment like we have today. I never anticipated the 10-year being at 2% today. We were the first net lease company to do forward equity offerings. We've had a number of companies subsequently to execute on and we've done 3. We'll also want the ability to take advantage of capital markets and cost of capital and provide that firepower for our balance sheet on a whim and take advantage of those windows inclusive of the ATM, forward equity offerings, block trades, debt private placements. So, to telegraph how we're going, frankly, to source capital for the year, I would tell you we go into every year with conservative assumptions internally and then we look for opportunities both on the use side as well as the source side to take advantage of and provide returns for our shareholders. Does that make sense?

Michael Bilerman | Citi | Analyst
Yup.

Joey Agree | Agree Realty Corporation | President & CEO
So I think the most important thing we can do is continue to do, historically, what we have been doing, chopping wood day in, day out, focusing on underlying real estate, constructing the highest-quality portfolio, we think, in the retail world today in this country and providing a balance sheet for the continued growth that we anticipate that is conservative, that is nimble, that is flexible and that allows us to execute on our operating strategy. And frankly, anything that gets in the way of that, whether it's shareholder activism or noise or setting expectations and playing the game with Wall Street, we really want to avoid it. This is a real estate company to its core. It's an entrepreneurial environment with 40 people that put their blood, sweat and tears in day in and day out. And we want to put our heads down and get to work on real estate and not placate all of the different constituencies out there. It's impossible. If everybody is happy, then we've probably got a problem.

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

Joey Agree | Agree Realty Corporation | President & CEO
Well, thank you, everybody, for joining us. We look forward to speaking with you soon and, hopefully, everybody gets through earning season. Talk to you soon. Thanks.