



Agree Realty Corporation's
Fourth Quarter 2019 Earnings Conference Call
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CORPORATE PARTICIPANTS

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Clay Thelen | Agree Realty Corporation | CFO

CONFERENCE CALL PARTICIPANTS

Christy McElroy | Citi | Analyst
Ki Bin Kim | SunTrust | Analyst
Collin Mings | Raymond James | Analyst
Nate Crossett | Berenberg | Analyst
Rob Stevenson | Janney, Montgomery, Scott | Analyst
John Massocca | Ladenburg Thalmann | Analyst
Linda Tsai | Jefferies | Analyst
Chris Lucas | Capital One | Analyst

PRESENTATION

Operator

Good morning and welcome to the Agree Realty Third 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 Fourth Quarter and Full-Year 2019 Earnings Call. Joining me this morning is Clay Thelen, our Chief Financial Officer.

Before we begin, I'd like to digress for a moment and start this morning's call with a 30,000-foot perspective. I'll get to our most recent quarter and record full year accomplishments shortly, but first I think it's important to speak to recent activities we have seen in the net lease space.

Recent retailer bankruptcies and negative headlines have served to affirm our investment thesis which is built upon a risk averse perspective of the retail universe. Over the course of the last several quarters, I have tried to emphasize and refocus investors' away from not only per share earnings growth, but also towards real estate fundamentals, market positioning and retailer balance sheets in an omni-channel retail world.

The world today is changing dynamically, and retail is going through constant disruption. Today's retail operators need to be adept, flexible and nimble. A strong consumer and low interest rates can prolong the inevitable; but the reality facing today's poorly capitalized retailers has become abundantly clear. The ability to invest in e-commerce distribution, price and market share are critical. Leveraged balance sheets, private equity sponsorship or lack of liquidity are nearly insurmountable challenges given these strong headwinds.

Our investment strategy has been focused on the brightest & strongest retailers in this omni-channel world. Of the retailers that have been in the headlines recently, we have one prominent location among them. Our Art Van flagship store in Canton Township is the preeminent retail location in the state of

Michigan. The store is located on Ford Road, one of the most highly trafficked corridors in the state. The site shares a signalized intersection with Michigan's only Ikea store and is a regional draw for customers across the state as well as northern Ohio. It is this type of discipline and bottoms up underwriting which is the hallmark of our investment strategy.

I would remind listeners today that we undertook the development of this store prior to Art Van and his family selling the company to TH Lee which has since embarked on their aggressive growth strategy. We subsequently passed on a number of additional opportunities to participate in Art Van's rapid growth. The real estate we own in Canton is in our backyard; we know it extremely well and we are very confident in its long-term value & success. I encourage everyone to visit our YouTube channel and see our drone video of the site themselves.

Moving on to 2019 which marked our 25th anniversary as a publicly traded company and another year of record growth for our Company. During the year we accomplished several notable milestones, among them:

- We significantly improved portfolio quality, increasing our investment grade exposure by nearly 700 basis points. This is on top of a 740-basis point increase in 2018. As of year-end, our portfolio consisted of an industry leading 58% of annualized base rents leased to these leading retailers;
- In 2019 our portfolio exceeded 800 properties while undertaking further diversification. We added over 190 properties during the year across 40 states and 22 distinct retail sectors;
- We reduced our exposure to Sherwin Williams, our top tenant, by 110 basis points to 4.9% of annualized base rents;
- While adding a number of leading retailers to our top tenant roster including Home Depot, National Tire & Battery or TBC Corporation, and Sunbelt Rentals;
- We further solidified our industry-leading balance sheet with several strategic capital markets transactions, ending the year with net debt to recurring EBITDA of 4.5 times pre-forward settlement and 3.7 times inclusive of the settlement of our outstanding forward. And lastly,
- We are proud to have surpassed \$4 billion in enterprise value;

I'd like to take a moment to thank our fantastic and growing Team Members who amazes me with their commitment day in and day out to our dynamically growing Company.

In addition to these milestones, we also completed our state-of-the-art campus to support our growing team which now has 46 team members. Throughout the course of the last year we have continued to add talented team members in all areas of our company, including acquisitions, asset management, finance, accounting, human resources and due diligence.

Our state-of-the-art campus includes the Agree Wellness Center, locker rooms, an auditorium, integrated technology and unique collaborative meeting spaces. We have created a best-in-class work environment to motivate and accommodate our best-in-class team.

During this past year, we invested a record \$720 million in 196 high-quality retail net lease properties. 186 of these properties were originated through our acquisition platform, representing total acquisition volume of more than \$701 million.

While we achieved yet another year of record acquisition volume, our rigorous underwriting standards and continued focus on best-in-class retailers is again evidenced by a record 76.7% of annualized base rent acquired being derived from leading investment grade operators.

We closed out 2019 with a strong fourth quarter, investing in 41 properties across our three external growth platforms while executing several strategic capital markets transactions that fortified our balance sheet and positioned us for growth in the year ahead.

During the fourth quarter, we invested more than \$141 million, of which \$138 million was sourced through our acquisition platform. Consistent with our focus on quality throughout the year, nearly 72% of annualized based rents acquired during the fourth quarter are derived from retailers that carry an investment grade credit rating.

The 39 properties acquired during the fourth quarter are leased to 23 tenants operating in 17 retail sectors, including off-price, convenience stores, auto parts, tire and auto service, dollar stores, and home improvement.

The properties were acquired at a weighted-average cap rate of 6.9% and had a weighted-average lease term of almost 11 years.

We continue to construct a net lease portfolio with sector-leading retailers that are well-positioned for success in the omni-channel retail world of today. As previously mentioned, we welcomed Home Depot, National Tire & Battery, and Sunbelt Rentals to our top tenants during 2019. Concurrently, we eliminated AMC and PetSmart from our top tenants list since the fourth quarter of 2018. We will continue to cultivate our portfolio as we proactively embrace a dynamic omni-channel retail world.

During this past year, we uncovered several opportunities to add to our ground lease portfolio. We added 12 properties to this unique portfolio which now stood at 8.5% of annualized base rents as of December 31st. Notable ground lease assets acquired during the year include our first Costco in Newport News, Virginia; an ALDI in Columbus, Georgia; a Chick-Fil-A in Brockton, Massachusetts; and a Wawa in Cocoa, Florida.

Our ground lease portfolio derives 89% of rents from investment grade tenants and is comprised of leading retailers including Walmart, Home Depot, Lowe's, Wawa, Sheetz, ALDI, AutoZone, Chick-Fil-A, McDonald's and Starbucks. Conversely, only 1% is leased to sub-investment grade tenants and the remaining 10% is leased to leading unrated retailers. We continue to identify and execute on high-quality opportunities to add assets to our ground lease portfolio.

Moving on to our development and Partner Capital Solutions platforms...

We had 10 development and PCS projects either completed or under construction during the year that represent total committed capital of more than \$32 million. Eight of these projects were completed during the past year, representing total investment volume of approximately \$22 million.

During the fourth quarter, we completed landlord's work for ALDI and Harbor Freight Tools at the Company's redevelopment of the former Kmart in Frankfort, Kentucky. Work continued for Big Lots as of December 31st, and we anticipate completion and full rent commencement in the first quarter of this year.

Construction continued during the fourth quarter on our first development with Tractor Supply in Hart, Michigan, which is expected to be completed in the first quarter of this year as well.

Subsequent to quarter end, we commenced construction on two new projects including our first development for TJ Maxx in Harlingen, Texas immediately adjacent to a high-performing Target. Rent is anticipated to commence in the third quarter of this year.

We also commenced our fifth development project with Sunbelt Rentals in Converse, Texas with rent anticipated to commence during the second quarter of 2020.

We continue to focus on providing full-service real estate solutions to leading omni-channel retailers, many of which are on our top tenant roster. The relationships we've built with these retailers continue to create investment opportunities across all three external growth platforms as we seek to leverage the complete spectrum of our real estate investment capabilities.

While we've strengthened our portfolio through record investment activity, we've also diversified our portfolio through strategic asset management and disposition efforts.

The fourth quarter was particularly active on the disposition front, as we sold seven assets for gross proceeds of approximately \$32 million. Notable dispositions during the fourth quarter included an Academy Sports in Belton, Missouri; a Camping World in Tyler, Texas; and an LA Fitness in Maplewood, Minnesota.

I anticipate additional disposition activities during the first quarter of this year as we continue to take advantage of market conditions and aggressively move to divest of assets that no longer fit within our investment philosophy.

For the full year, we sold 16 properties for total gross proceeds of approximately \$67 million. Of note, we sold four Walgreens assets during the year bringing our exposure to 3.4% at year end, representing a 200-basis point reduction over the course of the year. The high per square foot rents as well as continued disruption in the pharmacy space continues to drive our disposition activities. We anticipate our Walgreens exposure to continue this downward trajectory during the course of 2020.

Our asset management team has also been diligently focused on addressing any upcoming lease maturities. As a result of their efforts, our 2020 lease maturities represented just .5% of annualized base rents at year end. Our portfolio remains in the best shape in our nearly 26-year operating history.

During the fourth quarter, we executed new leases, extensions or options on approximately 55,000 square feet of gross leasable space.

For the full-year 2019, we executed new leases, extensions or options on approximately 370,000 square feet. As of January 1st, of this year, we have exercised our recapture right on the last Kmart in our portfolio located in Grayling, Michigan. Kmart has vacated the space, and I am very pleased to announce we have executed a lease with Tractor Supply to backfill the entire box. Additionally, we have carved out a pad in the parking lot for a future outlot development.

This transaction is a testament to our asset allocation decisions and granular approach to real estate analysis. As you may recall, we chose to retain three Kmart stores from our initial public offering that were

not sold in the last several years: Frankfort, Kentucky; Mount Pleasant, Michigan as well as Grayling. We have now redeveloped or re-tenanted all three stores with best-in-class retailers. Our decision to retain these assets has been confirmed by the quick turnaround by our asset management team.

As of December 31st, our rapidly growing retail portfolio consisted of 821 properties across 46 states. Our tenants are comprised primarily of industry-leading retailers operating in more than 28 retail sectors, again with more than 58% of annualized base rents coming from investment grade tenants. The portfolio remains effectively fully occupied at 99.6% and has a weighted-average lease term of 10 years.

Our pipeline heading into 2020 is robust and I am very pleased with our progress to date. As indicated by our strong initial acquisition guidance of \$600 to \$700 million, we are confident in our expanding Team's capabilities to aggregate high-quality transactions while also continuing to review unique opportunities that cross our path.

I would like to take a moment to thank all of our loyal stakeholders for their support during another record year for Agree Realty.

With that said, I again want to be clear that we remain intensely focused on constructing and constantly seeking to improve the highest-quality retail portfolio in the country. I look forward to building upon our momentum in the upcoming year ahead.

Thank you all for your patience. Happy to answer any questions after Clay discusses our financial results for the fourth quarter and full year.

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 FFO was \$0.81 per share for the fourth quarter and \$3.08 per share for the full year 2019, representing 12.3% and 7.9% year-over-year increases, respectively.

Additionally, AFFO was \$0.80 per share for the fourth quarter and \$3.02 per share for the full year, representing 11.5% and 6.6% year-over-year increases.

General and administrative expenses for 2019 totaled \$15.6 million. G&A expense was 8.3% of total revenue or 7.7% excluding the non-cash amortization of above and below market lease intangibles, representing a 50-basis point year-over-year reduction. For 2020, we expect that G&A expenses, as a percentage of revenues, will contract approximately an additional 50 basis points.

Income tax expense for the full year 2019 totaled \$538,000, inclusive of the one-time tax credit of \$475,000 realized in the first quarter. For 2020, we anticipate total income tax expense to be in the range of \$1 to \$1.2 million.

On a quarterly and full-year basis, Core FFO per share and AFFO per share were impacted by dilution required under GAAP related to our forward equity offerings. 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. The aggregate dilutive impact related to these offerings was roughly a penny to both Core FFO and AFFO per share for the fourth quarter and four cents for the twelve-month period.

As Joey mentioned, we had another active year of capital market activities, raising or settling more than \$740 million of capital to fund our continued growth and position our Company for 2020 and beyond. In addition to capital raised, we also generated nearly \$100 million through our disposition activity and free cash flow after dividend during the year.

In December, we entered into an amendment to our revolving credit facility and term loans to increase our credit facility to \$600 million. The credit facility is comprised of a \$500 million unsecured revolving credit facility and \$65 and \$35 million unsecured term loans. The Credit Facility includes an accordion option that allows us to request additional lender commitments up to a total of \$1.1 billion. The Revolving Facility will mature in January 2024 with options to extend the maturity date to January 2025.

In December, we settled the entirety of the 3.2 million share forward equity offering that was originally commenced in April 2019, receiving net proceeds of approximately \$196 million.

During the fourth quarter, we also entered into forward sale agreements in connection with our ATM program to sell an additional 2 million shares of common stock at an average gross price of \$73.34 per share. Upon settlement, the ATM Forwards are anticipated to raise net proceeds of approximately \$145 million after deducting fees, expenses and other adjustments. To date, we have not received any proceeds from the ATM Forward Offerings.

At December 31st, we had \$89 million outstanding on our unsecured revolving credit facility, reflecting additional capacity of \$411 million.

Our balance sheet remains in excellent position to continue to fuel our anticipated growth. As Joey mentioned, as of December 31st, our net debt to recurring EBITDA was approximately 4.5 times. Proforma for the settlement of our forward equity, our net debt to recurring EBITDA is approximately 3.7 times. Total debt to enterprise value was approximately 22% while fixed charge coverage ratio, which includes principal amortization, stood at a company record 4.3 times.

The Company paid a dividend of \$0.585 per share on January 3rd to stockholders of record on December 20th, 2019, representing a 5.4% year-over-year increase. This was the Company's 103rd consecutive cash dividend since our IPO in 1994.

For the full-year 2019, the Company declared dividends of \$2.28 per share, a 5.8% year-over-year increase.

Our payout ratios for the fourth quarter were a conservative 72% and 73% of Core FFO, and AFFO per share. For the full-year 2019 on a per share basis, our payout ratios were 74% of Core FFO and 76% of AFFO, respectively. These payout ratios continue to reflect a growing and 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 record performance during this past year. We're in excellent position for 2020 and we are focused on continuing to execute.

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

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) The first question comes from Christy McElroy with Citi. Please go ahead.

Christy McElroy | Citi | Analyst

Joey, in the context of your comments on dispositions, you talked about taking advantage of market conditions. And we've talked about this in the past, and it also came up as a topic on one of your peers calls yesterday in regard to the narrower spread between where investment grade and non-investment grade assets are being valued and trading today. What could cause that to reverse?

Joey Agree | Agree Realty Corporation | President & CEO

I'll be quite honest. We haven't really seen that spread necessarily contract. In the world in which we operate, we've seen minimal cap rate compression in high-quality assets. The retailers that we are typically doing business with are either investment grade or shadow investment grade if you were to run them through a Moody's risk calculation. So, I tell you, we're not really playing in that typical high yield pool. Our divestments and our disposition activity really fall into a couple buckets. One, it's 1031 buyers, typically franchise restaurants as well as the Walgreens we sold during the fourth quarter. So we sold three Taco Bell franchise restaurants during the fourth quarter as well as our Walgreens in Ypsilanti, Michigan, and then assets such as the Academy Sports or the Camping World, which we discussed, where we just want to pare back exposure and are comfortable with the real estate and/or the operator.

Christy McElroy | Citi | Analyst

Okay. And then, Clay, in terms of the mechanics of settlement of the forwards, how should we think about the settlement of the forward ATM versus the prior settlement of the forward equity, where you did the priors more all at once, should we think about the forward ATM more ratably through the year? Or would you expect that to be all at once as well?

Clay Thelen | Agree Realty Corporation | CFO

Christy, no change in terms of thinking through settlement. Settlement ultimately will be dependent on the timing and uses of capital. And we have until December to settle, and no different than our previous forwards. We can settle in tranches or in whole.

Christy McElroy | Citi | Analyst

Okay. But just in terms of how you expect to do that through this year, how should we be thinking about that from a modeling perspective?

Joey Agree | Agree Realty Corporation | President & CEO

Well, I think it'll be really subject and dependent upon our pipeline and how our pipeline materializes and as we manage the balance sheet. So, there's a number of factors there. One of the most interesting things about that ATM forward, or just any forward, it gives us total discretion to settle in one chunk as we

did at the end of 2019 or settle it ratably or match fund investment activity. So, I wouldn't say there's any M-O for us. I think it will really be dependent upon market conditions and our pipeline.

Operator

Our next question comes from Ki Bin Kim with SunTrust.

Ki Bin Kim | SunTrust | Analyst

Joey, can you talk about your pipeline in 2020? I know everyone says their pipeline is big, but that specific basket of deals that makes sense for you, that type of quality that you're looking at, the pricing that makes sense. How does that specific pipeline look like for you versus the past couple years?

Joey Agree | Agree Realty Corporation | President & CEO

I tell you, and as indicated by our initial guidance of \$600 million to \$700 million in acquisition, our pipeline entering the year was robust. It is very high quality. It's comprised of a typical one-off aggregation. In the last year, our average price point was \$4.2 million per transaction over 140 discrete transactions there. And it also has some other unique opportunities for us to invest in the highest quality retailers in the world. And so, we're very excited about our pipeline for Q1 and building into Q2. We have visibility into the beginning of Q2 at this point. We always talk about having 60 to 70 days of visibility. But I would tell you it is very high quality and emblematic of what we've been executing for the last several quarters.

Ki Bin Kim | SunTrust | Analyst

Any bigger portfolio deals you're looking at, or is it still more one off?

Joey Agree | Agree Realty Corporation | President & CEO

I wouldn't call it necessarily a bigger portfolio. Obviously, that's relative, but not bigger portfolio deals. We will look at and we do anticipate executing on some, I would call it, smaller to medium sized portfolios of single credit industry leaders.

Ki Bin Kim | SunTrust | Analyst

Okay. And just last question. You have about 5% of ABR leased to Tractor Supply and Sunbelt Rentals. Just being honest, I don't really know those companies that well. Part of it is maybe because I live in Manhattan. But I was wondering if you could talk a little bit more about those tenants and why you feel very comfortable owning more of those.

Joey Agree | Agree Realty Corporation | President & CEO

Sure. No, and I appreciate your commentary about living in Manhattan. Well, first of all, we have a, really, a fantastic relationship with Tractor Supply. Tractor Supply is the leading farm and rural retailer in this country. It's a publicly traded company, so everybody can see their performance. They're unrated, so they don't fall into our investment grade bucket. But they're sub-2x, I believe, leased adjusted leverage. A very conservative company, been very successful in their core business. We've spent a lot of time with their real estate team as well as their executive team. Really, a dominant market position. Interestingly, Tractor Supply has also launched very successfully in e-commerce in a BOPUS platform. And so, it's a very unique company, a very conservative company, and we think a real winner in an omnichannel world.

Sunbelt Rentals. There are two large equipment rental companies in this country. There's a few that are smaller as well that consists of Sunbelt Rentals as well as United Rentals. Sunbelt Rentals is owned by the Ashtead group, and it's the only investment grade operator in the country. If you look at the equipment ownership versus rental in this country, and that goes from small equipment to larger equipment, it is very, very low relative to Western Europe. And so, there's a big opportunity in this country for equipment rental rather than ownership.

Sunbelt Rental's owned by the Ashtead group, again, investment grade. It's taking advantage of a lot of that fragmentation and that lack of rental capacity in this country. They service all different types of users -- of renters, I should say. And that goes from gas and oil to general equipment to power and pump. And so, again, a great partner of ours. Obviously, starting our fifth project for them. We've acquired a number of them. Great balance sheet, and we think a business model that really makes sense in 21st century omnichannel world here.

Operator

Our next question comes from Collin Mings with Raymond James.

Collin Mings / Raymond James | Analyst

First question from me is just going back to your prepared remarks on Art Van. Can you maybe just elaborate on what caution flags were raised that led you to not do any additional deals with them? You obviously mentioned private equity, but could you just maybe expand on that a little bit more? And then along those lines, are there any other notable recent examples where you can provide where you've shifted course, whether it be because of private equity or other changes that just impacted your original thesis as it relates to a concept?

Joey Agree | Agree Realty Corporation | President & CEO

So, the first part, I appreciate the question. Art Van is a company that's based in our backyard. I knew Art Van personally. The family office is about 3 miles straight down Woodward from our office here in Bloomfield Hills. I'll tell you; we bought this property directly from Art Van. It was really the preeminent site in Michigan head to head with the IKEA and proceeded with the reverse build-to-suit transaction with Art Van and really a unique retail opportunity. Again, I really encourage people to look at our YouTube site and see this piece of real estate for themselves in the drone video. Ford Road is a dominant retail corridor. We are literally head to head with the only IKEA servicing Michigan, northern Ohio and northern Indiana.

Prior to the transaction with T.H. Lee, Art Van had -- he still does, has a dominant market position in terms of furniture and home accessories in southeast Michigan. Once T.H. Lee entered the equation, we had a second transaction under contract with Art Van. We actually sold that purchase agreement and did not proceed and decided to keep only the flagship store in Canton and proceed with that transaction. So, a combination of the real estate, the residuals, the anticipated and now proven store performance of that location, and obviously being heads up on the traffic signal with IKEA was very unique, and we were very comfortable with that transaction.

In terms of private equity ownership in real estate, I feel like I've been pounding on this for several years now. We just see a total misalignment of investment horizons. And today, as I mentioned in our prepared remarks, the ability to invest in price, to withstand truly bottom-line margin compression, to have a balance sheet that could invest in e-commerce distribution in an omnichannel world is a critical component of almost every single retail sector.

This is a fast and dynamically changing world, and so we will continue to avoid private equity sponsorship. In the limited cases where we have private equity ownership, we will continue to look to divest of those assets, including the franchise restaurant space. And we'll continue to invest in the strongest and best balance sheets in the top retailers in the world.

Collin Mings / Raymond James | Analyst

Okay. And then just want to switch gears. And you previously discussed that on the development front, you've become increasingly selective with regards to committing human capital to one-off deals and really avoiding situations where there wasn't really a chance to enhance a long-term relationship. Sounds like you got a couple of deals through the backlog since the end of last year. But just curious on this front. As your relationships continue to grow, your platform expands, why hasn't the mix of PCS and development

really kept pace with acquisition activity? Again, arguably, this is a little bit of a differentiator for you versus peers, so just your latest thoughts on that front.

Joey Agree | Agree Realty Corporation | President & CEO

Yes. First, we have significantly scaled. You may notice in my prepared remarks, we have not scaled the human capital in regard to development activity. However, we scaled the remainder, effectively, of every department in this company. And at the same time, with return on costs where they are today for emerging developers who are performing turnkeys, generally, for retailers, we're not going to keep or do a turnkey for an industry-leading retailer with a 6% initial unleveraged return on cost. That doesn't make sense for us.

I'm very happy to announce the TJ Maxx in Harlingen subsequent to quarter end. That's our first ground up for TJ Maxx. The fifth project was Sunbelt Rentals in Converse, Texas. And then I'll tell you since we've been together last, we have a number of other projects that we anticipate that have come to fruition. We're really focused, and we'll announce in the next quarter and get a few of them in the ground quite shortly here post winter. I'm really pleased with our efforts and our activities reviewing vacant boxes and then working with, really, our sandbox of retailers to backfill. We have a lot of GLA in this country, 24 square foot per capita. I think there's a lot of press related to that.

I personally think there's a lot of opportunity for retailers to take over vacant boxes, and we've been very focused on former drug stores, the former Pier One sites, the former Shopko sites. And so a number of those opportunities are materializing in our pipeline today, and we're working with our top retailers to look at it. And there should be some interesting opportunities in there as well.

Operator

Our next question comes from Nate Crossett with Berenberg.

Nate Crossett | Berenberg | Analyst

Appreciate the color on Art Van. What else is on the watch list right now? I think there was an article that Bed Bath & Beyond is closing 41 stores. I think you have a couple of those. Maybe just give us an update there. And then just comments on furniture in general. Is this an area that ultimately goes online? Or how do you feel about furniture?

Joey Agree | Agree Realty Corporation | President & CEO

Yes. Great question. I appreciate you joining us, Nate. In terms of the couple Bed Bath & Beyond we had, those were real estate plays. I'll tell you we have a Bed Bath & Beyond in Texas paying \$7.50 a foot in the dominant center there, immediately adjacent to a TJ Maxx and a Home Goods. We're excited we have one in Texas. That's a fantastic piece of real estate. We were frankly never big fans of Bed Bath & Beyond and their merchandise stacked to the ceiling and lack of experience in stores. So, they were very comfortable with those couple of stores in the real estate underneath them and potentially even have some upside.

In terms of furniture, I'll hearken back to an NDR we had in New York. And then it was repeated in Chicago about 12 to 18 months ago. And we really used the opportunity to speak to millennials both in our office and on the road about what their consumer and their -- consumer preferences and buying preferences are. We talked specifically about the furniture space. And I asked a group of millennials, call it an average age of 28 to 30, where they purchased furniture, how they purchased furniture. And I frankly got cross-eyed looks. And they looked at me and said, "Purchase furniture? If anything, we buy it online or it's in the lobby of our building downstairs and we just take it for free."

Now, that's obviously more of an urban perspective. What I'll tell you is that as long as Wayfair will lose \$15 to \$17 online per shipment, as long as you are able to return mattresses that you never see and they'll show up at your house and can just keep them for 60 or 90 days and then send it back, some cases even longer. And as long as the capital markets are willing to support and we don't see any end in sight, startup businesses that don't care about bottom line but only top line, I will tell you, the home accessory and furniture space reminds me very similarly to the old days when the plasma TVs morphed from several thousand dollars to a few hundred dollars.

Furniture in this country for the vast majority outside of high-end furniture is becoming disposable. Today, when you sell your house, you don't bring your TVs with you. They may sit on the wall and the successive purchaser keeps them. I think we're heading down the road where furniture doesn't get moved for the vast majority of residences when they sell their house today, similar to the LCD and the LED TVs we see today on the wall.

And so, there's significant disruption. There is price disruption, there is omnichannel disruption. And American consumer preferences today are changing very quickly. And so, I think it's a space that we will continue to avoid absent a unique circumstance. And it's a space we've been very, very selective in. There are a couple winners in this space I'll mention. La-Z-Boy are a fellow Michigan company. La-Z-Boy is a winner in this space. It has brick and mortar and has a, frankly, a cult-like following among millennials, which is very unique. But at the same time, we're going to be very, very selective in any investment activities there.

Nate Crossett | Berenberg | Analyst

Okay. That's helpful. And then maybe just one on G&A outlook for 2020. Looks like you've been able to keep it flat, roughly, for the last 3 quarters. Can you just remind us the size of the sales force? Are you anticipating any new hires in the near term?

Joey Agree | Agree Realty Corporation | President & CEO

Yes. So, we've benefited from approximately, as Clay mentioned, 50 basis points in terms of G&A as a percentage of revenue year-over-year. We anticipated benefiting approximately another 50 basis points this year. We are actively, with our new building opened next door, we are actively growing and scaling every aspect of this organization.

First quarter is the largest in terms of G&A generally, just from aberrations historically for us, non-run rate activities, which is quarterly activities. But this is a company that's growing over 30% top line. We're going to continue to invest in our people, both individually in their professional development as well as grow this team pretty dynamically. We went from about 33 people, I believe, at the end of last year, 32, 33, to, call it, 46. And so we're growing. We grew head count by about 30%. At the same time, we're gaining efficiencies through all of the system work we've done, the proxies we've instituted and, really, the rapid growth of the portfolio.

Operator

Our next question comes from Rob Stevenson with Janney.

Rob Stevenson | Janney | Analyst

Joey, I think you mentioned completing some dispositions in first quarter here. At this point, is the \$25 million to \$75 million of guidance likely to be front end loaded?

Joey Agree | Agree Realty Corporation | President & CEO

Good question. I think that it is possible that there will be some front-end loading for that disposition

activity. We'll continue to dispose. We have another Walgreens that is under contract. I anticipate them being at or below 3% by 3/31. We have some additional franchise restaurants that are under contract that we will look opportunistically to divest into the 1031 market. And then, we are working on one or two other transactions that are similar to the Academy Sports/Camping World dispositions where we just don't feel that the residuals or the long-term interest on our end is there.

So Q1 could be fairly active on dispositions. Frankly, I hope it is. That's in purchasers' hands today. We're under contract with a number of assets going through diligence. But you will continue to see us be aggressive and even possibly raise the bottom end of that guidance pretty shortly.

Rob Stevenson | Janney | Analyst

Okay. And then, the Kmart in Michigan that you're doing with Tractor Supply, is this a scrape and rebuild, or just a box rehab? And then, how much is that plus the new TJ Maxx and the Sunbelt Rental developments expected to cost you guys?

Joey Agree | Agree Realty Corporation | President & CEO

Yes. So, it's a small format free-standing Kmart, again, the last Kmart in our portfolio. We had waited patiently to exercise that recapture right for upwards of 2 years with Tractor Supply waiting patiently with us, and we thank them for that. We're re-tenanting that whole entire box. It will not be a scrape and rebuild. And then the Sunbelt Rentals as well as TJ Maxx in Harlingen, Texas, I will tell you it's about aggregate cost of approximately \$5 million.

Operator

Our next question comes from John Massocca with Ladenberg Thalmann.

John Massocca | Ladenburg Thalmann | Analyst

It sounds like you're pretty aggressive, and you have been for a while, selling down the Walgreens exposure. I mean, is Walgreens in the same bucket now as some of your franchise restaurant tenants where the ultimate goal is probably to get it down to 0 or close to 0?

Joey Agree | Agree Realty Corporation | President & CEO

Well, no, I don't think it's to get it to 0. I will tell you we've rationalized that exposure. If you hearken back several years, they were 40% of our portfolio. We have some significant gains. I think the challenge with some of the suburban Walgreens and pharmacies in this country is the very high per square foot rent and the 13,000 to 14,000 square foot rectangle plus the drive through that sits on top.

So, you have great pieces of real estate, hard corners, great access, visibility, parking. But I tell you, the tenant pool today and how retailers have morphed, you are either backfilling those boxes generally with dollar stores that are paying anywhere between 25% and 35% of the Walgreens rent or you are forced to demise those 13,000 to 14,000 square foot boxes into small strip centers, which we have no interest in doing. And so we think on a risk adjusted return basis, for us to divest of Walgreens, typically in the mid-6's, lower or mid-6's, mid-6's for approximately the 10 to 11-year Walgreens, into the 1031 market continues to make significant sense for us.

The second half of that is that I continue to see disruption in the pharmacy space and anticipate more disruption. The front end of the stores continues to really suffer from weak sales, and the middle of the stores, frankly, remind me of the middle of the grocery stores in today's environment. And I think we're going to have to see the major drugstore chains in this country, who rely upon Baby Boomers, we're

going to have to see some significant remerchandising efforts to drive traffic into those stores with higher margin items.

And so, we'll continue for all of those above reasons, continue to look to dispose of the stores that we do not like. We have stores in our portfolio that are, frankly, fantastic pieces of real estate. Our flagship store in Ann Arbor, Michigan on the campus of University of Michigan we will not sell unless somebody came with an offer we couldn't refuse. It's the best piece of real estate in Ann Arbor. So, there are a number of stores that are either super-high performing, we really like the real estate, we want to hold it absent a compelling offer. But in terms of suburban pharmacies, we are very critical of their future today.

John Massocca | Ladenburg Thalmann | Analyst

Okay. And bigger picture, there's a perception, and it's played out historically, that larger footprint retail boxes are less fungible, harder to relet in a tenant credit situation. How do you mitigate some of that risk? I know obviously, a lot of your larger box assets are ground lease assets. But is there anything else you do to mitigate the risk associated with these less granular type assets you have on the portfolio?

Joey Agree | Agree Realty Corporation | President & CEO

Yes. Look, another good question. The ground lease portfolio, 8.5% at 12/31. We anticipate that frankly ticking up at 3/31. We have a number of assets currently under contract to purchase or have acquired subsequent to quarter end. I think there's a few mitigants. First, credit. So, number 1, our big box exposure typically on a ground lease, typically very low basis, is with the leading operators in this country. That's Walmart, Home Depot and Lowe's, generally. And so, we have no interest in big box exposure with private equity backed retailers, privately held retailers generally or retailers that are on the sub-investment grade spectrum. That's very challenging.

Second, when we look at any big box transaction, you can assume that we are in conversations with the retailer about the productivity of that store, of that unit, on an isolated basis and then also how it compares relative to other stores in the district. We also get on the ground, and our diligence team does a fantastic job of understanding the local markets in conjunction with our local partners.

And then third, we're looking at the overall parcel, not only the box itself. We're looking at the overall parcel, generally at the amount of frontage it has on a road, if there are any current out lots that are blocking our ability to one day redevelop it. But I'll give you an example. We looked at a large box recently. It had 600 feet of frontage on a major retail corridor. It was leased to the largest retailer in the world. And we looked at it is paying a few dollars a square foot. And we say, "If they ever left this store" -- it's a highly productive store. If they ever left this store, we'll have 600 feet of frontage, which results in 4 to 5 out lots paying \$80,000 a year, and we will quickly recapture the NOI just from the out lots alone even if the big box in the future had to be, if the tenant ever left, self-storage or some other use.

Operator

Our next question comes from Linda Tsai with Jefferies.

Linda Tsai | Jefferies | Analyst

Yes. Joey, you seem pretty emphatic about the eventual demise of lower-cost furniture and mattress stores. Are there other categories where you're concerned like this?

Joey Agree | Agree Realty Corporation | President & CEO

I'm trying to think. Look, I think overall, this country, we are still in the early innings of retail disruption. These aren't binary outcomes. If you look across retail sectors of this country, it's very difficult to find a

sector outside of consumer electronics that has gone through the disruption that we anticipate and will go through additional store closures and retailers disappearing. Consumer electronics, Best Buy is the last man standing because Hu Joly did a fantastic job in the turnaround. They had an investment grade balance sheet. Circuit City, H. H. Gregg, CompUSA and now we see a couple of the smaller regionals failing. It's effectively the last man standing.

I think it's ironic that you look across even sectors such as the office supplies. We still have Max, Depot, and Staples. You look across general merchants, we still have Sears stores in this country. And so, there is going to be, we believe, a lot of closures in this country. I don't think there's necessarily binary outcomes, but our goal is to pick the winner with the strongest balance sheet, the most competent management team and the best underlying real estate.

And so, the furniture space was quite obvious to us what was going on there. There are other sectors that we're not overly interested in, office supplies, again. The movie theater space, I tell you, we are not overall interested in the movie theater space. Sporting goods space not overly interested and easily commoditized hard or soft goods that can be purchased on the Internet without experience. And so, there's a number of sectors that we aren't interested in, pet supplies being another one that I won't say we redlined, but absent a unique piece of real estate or compelling opportunity, we won't touch.

Operator

Our next question comes from Chris Lucas with Capital One.

Chris Lucas | Capital One | Analyst

I had a couple of questions, just really relative cap rate questions. And Joey, so I guess the question for me on the ground leases is could you give us a sense as to what the cap rate gap is between a ground lease you're buying and a fee ownership position that you would acquire on a similar asset tenant?

Joey Agree | Agree Realty Corporation | President & CEO

Yes. Chris, I'll tell you. Well, first off, many of the tenants that we acquire ground leases on, they don't even have turnkey. So, I'll tell you, we bought a Chick-fil-A ground lease during the quarter, or last previous quarter. We bought a Sheetz ground lease, obviously a leading large format gas and convenience store last quarter. They don't have turnkey deals out there. But I would tell you, ground leases typically trade 150 to 200 basis points inside turnkey leases for lifetimed assets. That's the rule of thumb. But there are a number of retailers out there that simply don't have turnkey leases.

Chris Lucas | Capital One | Analyst

Okay. And then, I guess if I look at your top investments in terms of tenant credit concentration, any thoughts about where cap rate movement has been the greatest, either compression or expansion, among those over the last couple of years?

Joey Agree | Agree Realty Corporation | President & CEO

On a tenant-specific basis? Look, all in all, I would tell you cap rates over the last couple years were at historic lows given the interest rate environment have effectively been flat. We've seen some marginal compression in the smaller price points, super-high-quality retailers. Obviously, that flows into the 1031 market. It flows into the franchise restaurant market, which we don't consider super-high quality. It's really fallen, I think, into the O'Reilly's and the AutoZone's of the world, the \$1 million to \$2 million one off transactions that carry fantastic balance sheets, high investment grade credit ratings and a lower price point.

I'll tell you, that said, again, operating in the fragmented space that we are -- we acquired 13 O'Reilly's in Q4 alone. We were able to acquire those O'Reilly's because of our relationship both with the tenant and repeat developers. They range from having 8 years on the lease to full 20-year leases. And so even though you see that cap rate compression in the market, I'm very confident, and I'm proud of our team being able to dig up asymmetrical opportunities out there

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 this morning. We look forward to catching up during the upcoming conference season, and good luck with the rest of earnings. Appreciate your time.