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EDITED TRANSCRIPT

PECO.OQ - Q1 2025 Phillips Edison & Co Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to Phillips Edison & Company's first quarter 2025 earnings call. Please note that this call is being recorded. I will now turn the call over to Kimberly Green, Head of Investor Relations. Kimberly, you may begin.

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

Thank you, operator. I'm joined on this call by our Chairman and Chief Executive Officer, Jeff Edison; President, Bob Myers; and Chief Financial Officer, John Caulfield. Once we conclude our prepared remarks, we will open the call to Q&A.

After today's call, an archived version will be published on our website. As a reminder, today's discussion may contain forward-looking statements about the company's view of future business and financial performance, including forward earnings guidance and future market conditions. These are based on management's current beliefs and expectations and are subject to various risks and uncertainties as described in our SEC filings, specifically in our most recent Form 10-K and 10-Q.

And our discussion today will reference certain non-GAAP financial measures. Information regarding our use of these measures and reconciliations of these measures to our GAAP results are available in our earnings press release and supplemental information packet, which have been posted on our website. Please note that we have also posted a presentation with additional information. Our caution on forward-looking statements also applies to these materials.

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

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

Thank you, Kim, and thank you, everyone, for joining us today. The PECO team delivered another strong quarter of growth with same-center NOI increasing by 3.9%. I'd like to thank the PECO associates for their hard work to maintain our unique competitive advantages and drive value at the property level. As we sit here today, we see an ever-changing macroeconomic environment. It's too early to tell what impact tariffs could have on PECO or our neighbors.

That said, we continue to see a resilient consumer. Retailer demand across our portfolio remains strong. This is most evident in our continued high occupancy, strong rent spreads and high retention. Despite tariff concerns, we continue to be strategic in our decision-making to best position PECO to take advantage of opportunities for growth, both internal and external.

We are seeing high retailer demand with no current signs of slowing. PECO's leasing team continues to convert this demand into significantly higher rents. Retailers want to be located at centers where top grocers drive consistent and recurring foot traffic. Given the continued strength of our business, we are pleased to affirm our full year guidance.

Retail categories that have historically been impacted by a softer economy, including necessity-based goods and services. This includes grocery, restaurants, and health and beauty. 71% of our ABR comes from necessity-based goods and services. We believe PECO is relatively more insulated from potential tariff disruption. We have a diversified neighbor mix. We also have limited exposure to big-box bankruptcies and at-risk retailers. We believe that the combination of our unique format and our cycle-tested experience drive high-quality cash flows.

Our performance following both the 2008 global financial crisis and the 2020 COVID-induced downturn demonstrates the resiliency of our grocery-anchored portfolio. We continue to find opportunities in the transaction market. During the first quarter, we purchased $146 million in assets at PECO's total share. Despite recent market volatility, we remain confident in our ability to acquire high-quality centers at attractive returns. While it's early in the year, our pipeline remains strong.

Given the grocery-anchored pipeline we are targeting and the team we have at PECO, we are affirming our guidance range of $350 million to $450 million in gross acquisitions this year. We have the capabilities and leverage capacity to acquire more if attractive opportunities materialize. We are also in a great place to pivot if we should see the transaction market tighten. We continue to target an unlevered IRR of 9% for our acquisitions. We will continue to be disciplined buyers as we look forward.

Speaking of looking forward, the PECO team remains focused on the long term. History tells us that grocery-anchored and necessity-based formats have been relative outperformers during periods of economic uncertainty. We don't expect the current cycle to be any different. While the markets may be nervous about the health of the consumer, we are not seeing anything that changes our view on our ability to deliver on our long-term growth plans, both internal and external.

I want to repeat, we remain confident in this current environment. Our confidence is driven by the stability of our cash flows and the PECO team's ability to deliver solid long-term growth and create long-term value for our shareholders. Given our demonstrated track record through various cycles, we believe an investment in PECO provides shareholders with a favorable balance of quality cash flows, mitigation of downside risk and strong internal and external growth.

In summary, the quality of our cash flows reduces our beta, and the strength of our growth increases our alpha. Less beta, more alpha. I will now turn the call over to Bob Myers.

Bob?

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

Thank you, Jeff, and thank you for joining us. The PECO team delivered another quarter of strong operating results and leasing momentum. The quality of PECO's cash flows is reflected in our market-leading operating metrics. Our long operating history has given us an informed measure of

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what drives quality and value at the shopping center level. We believe SOAR provides important measures of quality, spreads, occupancy, advantages of the market and retention.

In terms of leasing activity, we continue to capitalize on strong renewal demand. The PECO team remains focused on maximizing opportunities to improve lease language at renewal and drive rents higher. In the first quarter, we maintained strong comparable renewal rent spreads of 20.8%. Our in-line renewal rent spreads reached a record high of 21.7% in the quarter.

Comparable new leasing rent spreads for the first quarter were 28.1%, and our in-line new rent spreads remained strong at 27.5% in the quarter. These spreads reflect the continued strength of the leasing and retention environment. We expect new and renewal spreads to continue to be strong throughout the balance of this year and into the foreseeable future.

During the first quarter, our combined new and renewal average annual rent bumps were 2.7%, another important contributor to our long-term growth. Portfolio occupancy remained high and ended the quarter at 97.1% leased. Anchor occupancy remained strong at 98.4%. We currently have just 15 vacant spaces in our portfolio that are over 10,000 square feet. This includes the anticipated Party City and Big Lot spaces. Activity for these anchor leases currently out for signature is extremely positive. Examples of retailers who are showing interest in these spaces include TJ Maxx, Sierra, Total Wine, Fitness, Ace Hardware, Dollar Tree, Ulta Beauty, and For Performance.

In-line occupancy ended the quarter at 94.6%. This was in line with internal expectations as we typically see a nominal change during the first quarter. Given our strong leasing pipeline, we expect in-line occupancy to remain high throughout the year at around 95%, which is very strong.

As it relates to bad debt in the first quarter, we actively monitor the health of our neighbors. Bad debt was lower than a year ago, and we are not concerned about bad debt in the near term, particularly given the strong retailer demand. We continue to have a highly diversified mix with no meaningful rent concentration outside of our grocers.

A key advantage of PECO's suburban locations is that our centers are situated in markets where our top grocers are profitable. PECO's 3-mile trade area demographics include an average population of 68,000 people and an average median household income of $92,000. This is 12% higher than the US median. These demographics are in line with the store demographics of Kroger and Publix, which are PECO's top 2 neighbors.

Our markets also benefit from low unemployment rates, which are below the shopping center peer average. The necessity-based focus of our property is important when demographics are considered. If you are comparing a Publix to an Apple store or a high-end fashion retailer, the demographics that each retailer needs to be successful are very different. PECO's demographics are very strong in supporting our grocers and necessity-based neighbors.

We continue to enjoy a well-diversified neighbor base. Our top neighbor list is comprised of the best grocers in the country. Our largest non-grocery neighbor, TJ Maxx, makes up only 1.4% of our rents. All other non-grocery neighbors are below 1% of ABR. When looking at our very limited exposure to distressed retailers, the top 10 neighbors currently on our watch list represent approximately 2% of ABR.

This is not by accident. It is a product of many years of being locally smart and intentionally cultivating our portfolio of grocery-anchored neighborhood centers located in strong suburban markets. Our neighbor retention remained high at 91% in the first quarter while growing rents at attractive rates. And I want to repeat that the PECO team delivered record high in-line renewal rent spreads in the first quarter.

Higher retention rates result in better economics with less downtime and dramatically lower tenant improvement costs. Lower capital spend results in better returns. The IRR on our renewable lease has been meaningfully higher than the return on annuities. In the first quarter, we spent only $0.61 per square foot on tenant improvements for renewals. We have looked at quality differently over 30 years, and we continue to believe that SOAR is the best metric for quality.

The overall demand environment, the stability of our cash flows, the strength of our grocers, the health of our in-line neighbors and the capabilities of our team give us continued confidence in our ability to deliver strong growth in 2025 and in the long term.

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

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

Thank you, Bob, and good morning and good afternoon, everyone. I'll start by highlighting the first quarter results, then provide an update on the balance sheet and finally speak to our affirmed 2025 guidance. First quarter 2025 NAREIT FFO increased to $89 million or $0.64 per diluted share, which reflects year-over-year per share growth of 8.5%. First quarter core FFO increased to $90.8 million or $0.65 per diluted share, which reflects year-over-year per share growth of 8.3%. Both NAREIT FFO and core FFO benefited this quarter from a onetime lease termination fee of approximately $0.01 per share.

We had a lease for the space lined up at the time of termination so this capital will help pay for the new neighbor's buildout. Lease terminations are a part of our business but this termination fee income was larger than normal, which is why we want to highlight this item as nonrecurring. We see this activity as a long-term value add for PECO. Our same-center NOI growth in the quarter was 3.9%.

Turning to the balance sheet. We have approximately $760 million of liquidity to support our acquisition plan and no meaningful maturities until 2027. Our net debt to adjusted EBITDAre was at 5.3 times as of March 31, 2025. This was 5.0 times on a last quarter annualized basis, which is also important to track in quarters with elevated acquisition volume. Our debt had a weighted average interest rate of 4.4% and a weighted average maturity of 5.6 years when including all extension options.

As a reminder, in January, we amended our revolving credit facility to extend its maturity to January 2029 and increased its size to $1 billion. This gives us additional liquidity and flexibility as we acquire assets and monitor the capital markets.

At the end of the first quarter, 86% of PECO's total debt was fixed rate, which is in line with our target of 90%. We do not have immediate intentions to execute interest rate swaps on our floating rate debt. PECO continues to have one of the best balance sheets in the sector, which has us well positioned for continued external growth.

As Jeff mentioned, we are pleased to affirm our 2025 guidance. As a reminder, our guidance for 2025 NAREIT FFO per share reflects a 5.7% increase over 2024 at the midpoint. And our guidance for 2025 core FFO per share represents a 5.1% increase over 2024 at the midpoint. We also affirmed our guidance range for 2025 same-center NOI growth of 3% to 3.5%. As we continue to enhance our neighbor mix, our actions to improve merchandising and capture mark-to-market rent growth with new neighbors will be a slight headwind to 2025 growth.

As we have said previously, the PECO team is focused on the long term and our actions to replace neighbors are intentional. We believe our low leverage gives us the financial capacity to meet our growth targets. We also have diverse sources of capital that we can use to grow and match-fund our investment activity.

These sources include additional debt issuance, dispositions and equity issuance. Match-funding our capital sources with our investments is an important component of our investment strategy. As a reminder, our guidance does not assume equity issuance in 2025 as we believe we will be in our target leverage range of low to mid 5 times on a net debt to adjusted EBITDA basis. We continue to believe this portfolio and this team are well positioned to deliver mid- to high single-digit core FFO per share growth on an annual basis. This assumes stabilized interest rates which are expected to remain a near-term headwind.

However, we're hopeful that we're near stabilization as we are projecting to deliver earnings growth of over 5% in 2025. We also believe that our long-term AFFO growth can be higher as more of our leasing mix is weighted towards renewal activity. We believe our targets for growth in core FFO and AFFO will allow PECO to outperform the growth of our shopping center peers on a long-term basis.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Caitlin Burrows, Goldman Sachs.

Caitlin Burrows - *Goldman Sachs - Analyst*

Hi, good morning, everyone. Maybe starting with leasing. I feel like normal occupancy seasonality is understood, but can you give any color on the seasonality of leasing? And with that in mind, could you differentiate how March leasing went and then how April leasing has gone and any potential pullback or expectations for the May ICSC?

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

Sure. Thanks, Caitlin. Bob, do you want to take that? I would say, generally, as we've talked about and throughout this call, guys, when you ask -- when you're -- on your questions, I want to make sure that we don't get confused in terms of where we are today versus where we think we're going to be over the year because we're at a time where there's pretty dramatic changes happening. And there's a different view for what's happened in the first quarter versus what we -- all the expectations for the rest of the year.

So we'll -- as we answer, we'll try and be very specific about where we are today. And then if you've got questions about what we think might happen, we're happy to talk to those. But for us, it's really focused on that. So Bob, do you want to take the leasing and occupancy issue that Caitlin asked?

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

Yes. Yes, sure. Thanks, Jeff, and thank you for the question. It's very normal. And doing this for the last 25 years, first quarter, you're typically going to see a little bit of falloff in occupancy. And we're in a very, very good spot at 97.1% with in-line at 94.6%. Anchor's at 98.4%. We have a lot of activity on our anchor spaces. And like I mentioned in the call, we only have 15 of those opportunities, but we're seeing some really, really nice mark-to-market opportunities on the spreads. Retention remains high at 91%.

And the visibility that we have over the next six, seven months, the activity is very strong. I mean, we have more leases out for signature now than we did last year at this point in time. I'm not seeing a slowdown anywhere. And quite honestly, if you even -- you look at our leasing spreads of 28% and I look at where the pipeline is, it's going to be better than that. And when you look at renewal spreads of the 20.8%, I can tell you with the visibility, they're better than that.

So I just want to reiterate that the market, the demand, all the calls that we're making for Vegas right now, retailers are wanting to grow. And Jeff hit on this, right? We're cautiously optimistic and so are the retailers, but they still want to grow and they're still going through our portfolio, looking to be aligned with the number 1, number 2 grocer. And that's where we're seeing success and I don't see it slowing down.

Caitlin Burrows - *Goldman Sachs - Analyst*

Got it, okay. Good to hear. And then maybe switching over to the guidance side. So it does seem like FFO guidance for the year implies that the 2Q to 4Q average will be roughly the same as 1Q even if you take the lease termination fee out. So I was wondering, John, if you could give some more detail on what's creating that headwind and what could get you to the higher versus lower end of the FFO range.

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

Yes. John, before you take it, Caitlin, we want to make sure that we're clear to everybody that like this is our first quarter. It's very early in the year. We're really happy with the results we had for the first quarter. But as we enter the rest of the year with more confusion out there, we're going to necessarily take a conservative approach to looking at what's going to happen throughout the rest of the year, as I think everyone will, because of just the uncertainty with what's going on.

But John, do you want to answer in terms of the specifics of how it would look quarter-by-quarter?

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

Sure. So as we look forward, I mean, you already called out in the first quarter that the lease term wouldn't -- termination fee wouldn't be annualized. And as we look ahead, I think Bob said it is we're cautiously optimistic about the year. And I think as we look over the quarters, what would take us to the higher end would be things like improvement in the capital markets.

I do think that we affirmed kind of each of the guidance ranges. And we just want to make sure that we are setting expectations that we're in this for the long term and that ultimately, we're focused on making the decisions that are going to drive growth not just in '25, but '26, '27, '28. And so I think that more certainty around forward debt costs would be certainly helpful, equity markets.

But overall, from an acquisition standpoint, we're feeling really good about both what we've acquired as well as the pipeline and feel good about the year. And so I think it's just the first quarter we've reaffirmed, I think, each quarter that we've been doing this. So I think we're just making sure we've got room to operate the business as we feel best.

Operator

Haendel St. Juste, Mizuho.

Haendel St. Juste - *Mizuho - Analyst*

Hey there. I guess good morning. But I had a couple of questions. Maybe first for you, John, on the variable rate exposure. You're at 14% today, I think you're going up to around 25%, 26% later this year with the expiration of the swap. It sounds like you said you're comfortable kind of with the level of today. So I'm wanting to get a bit more clarity on your strategy or thinking here and maybe some thoughts on your plans to address some of the upcoming swap expirations.

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

John, do you want to take that?

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

Sure. So I just love questions about interest rate swaps. So you're right and we're about 14% today. I think as we look at it, what we executed and the way we did it in 2024 is a great blueprint for what our plans are in '25.

Ultimately, we are working towards a laddered maturity ladder that will keep us as a repeat issuer in the unsecured bond market. We were able to do it twice last year. We've got -- we're looking at managing our balance sheet prudently. And so when we look at those expirations, our desire is to continue to be an issuer in that market and to replace term loans, which is why those swaps are there in expiring, replace those term loans with fixed bonds as we go forward.

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So I think for us, as we are managing both our liquidity as well as our maturity ladder, that's part of it is that the swaps are helpful. I will say that I think broadly, people, there's uncertainty as to whether or not interest rates will go down or up, but we're now in a positively sloped rate environment.

And so ultimately, we are comfortable with this level. I don't see us getting to 25% variable rate because I'd anticipate that between our acquisitions and other financings that ultimately, we would be kind of laddering out additional debt activity in a year, which is what we're kind of assuming in our base case plan. So we will be managing to a more fixed balance sheet with a long-term goal of 90%.

Haendel St. Juste - *Mizuho - Analyst*

Great. Appreciate the color there. One more for me on transactions. Obviously, there's lots of chatter, deals taking a little bit longer, potentially counterparties moving away from the table. So I guess I'm curious more broadly on kind of what you're seeing.

Are you sensing any deals taking longer? Are you seeing any changes in cap rates? And then maybe some color on what you're expecting for the balance of the year between on-balance and JV acquisitions?

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

Well, it's a great question, and I think it's very relevant to how we kind of opened this is there's -- the first quarter and our experience in the first quarter, we did see -- I mean, that was a very healthy acquisition market. There were -- there's quite a bit of product on the market. There was also quite a few buyers. I think it's too early to project what's going to happen sort of going forward. We do hear stories about some buyers sort of stepping back.

Obviously, that would be positive for us in the event that we would have less competition for what we're buying. But also uncertainty tends to slow down and slow the pace of the acquisition market. So that part will probably be a negative going forward. We haven't seen it yet. We continue to think there's going to be a pretty strong ICSC with the amount of product that's coming on the market.

We, generally, I think, are optimistic that there will be a number of players that will step back in this environment and probably may create some better buying opportunities for us. But it's obviously early days, and we will see if that is the impact through the rest of the year.

But so far, the first quarter was a strong quarter for us. The projects we bought, we feel really good about. Great anchors, great unlevered IRRs well above 9%. So all things that fit sort of the -- were fairway deals for PECO, and we have a good backlog going into the second quarter. So we feel good about the year.

Operator

Samir Khanal, Bank of America.

Samir Kanal - *Bank of America - Analyst*

Good afternoon, everybody. Hey, Jeff. I guess it's nice to see that leasing still remains strong here. Doesn't look like there's a bit of a pullback. But as we just take a step back and look at kind of your approach to dealing with the shop tenants at this point, right, as renewals come up, has there been a sort of a shift in strategy at all? I mean, you look at kind of your exposure to some of the soft goods, right? You're roughly 10%.

So clearly, their margins are going to get impacted, right, with tariffs and costs. So how are you sort of approaching those conversations? Even though you might not be seeing anything today, but as you think about those conversations, I mean, how are you approaching those?

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

So up to today, we basically treat it as a very normal discussion we have with all of our neighbors when they come up for renewals, expecting significant increases and limited TI on the renewals. And we have good sales information, which allows us to have those discussions.

The look going forward, I think the way we've kind of bucketed it and tried to frame the impact of tariffs is, okay, what is the -- and the way -- I think there are two issues here is the tariff impact. There's also been the recession impact, the potential recession impact. But the potential recession impact, I think, is not something we're really talking with retailers on the renewal right now because it's still a percentage number. It's not a reality. So I think that's something that we might see later in the year.

The way we looked at the tariffs, we said, okay, let's look at the -- by category, what we think the impact of the tariffs is going to be. And I think our feeling is that probably or about 10% of our neighbors are going to have a fairly significant impact from the tariffs if they are to be implemented. We think about 10% of our neighbors are in that sort of middle care bucket where there's going to be some impact, but it's not going to be crippling as it is in that first 10%.

And then -- but because of the nature of our business being in focused on necessity-based goods with that grocery anchor being the number 1 or number 2 grocer. That almost 80% of our neighbors are going to be in the service side. They're going to be in -- they're going to have some impact but pretty limited impact from the tariff discussions.

So when we put that together, we don't see big changes in terms of our approach to leasing. And it's very similar in terms of our approach to acquisitions because we're looking on the acquisition side almost the same way as we are in the current leasing side, which is how are we looking at the strength of each of the retailers that we underwrite in our acquisitions.

And when you're looking and having discussions on the leasing side, it's the same -- it's a very similar kind of discussion. But as we said, I'll let -- it is -- we're basing that on the knowledge as of today, and that will continue to evolve over the next 6 to 12 months. And we may be talking a very different thing 12 months from now than we are today. But right now, the demand is strong and we're going to continue to push the way we have over the last 12 months.

Samir Kanal - *Bank of America - Analyst*

Got it. So it doesn't sound like, at least from your conversations you're having with, whether it was your retailers or kind of retailers broadly speaking, no retailer at this point has sort of pulled back? They're open to buy plans at this point, right? That's what it sounds like.

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

Well, we are always having that because for the retail business. So it's like when you deal with retailers are always going to be some of that by category. But we -- what we're finding is that there's -- the demand overall is strong enough to allow us to continue to find those kinds of spreads. And so it's -- we're not at that point where we're actually changing our leasing strategy because we're seeing major shifts in the retail demand.

Again, remember, like we are in the necessity-based side of the business and our -- the impact on us, as we saw in both the great financial crisis as well as the pandemic, it's significantly different when you're in the necessity-based retail part of the business versus the more discretionary side.

And we will be the last to see impact from major changes because of that focus. Does that make sense, Samir?

Samir Kanal - *Bank of America - Analyst*

Yes, no, it does. Thanks so much.

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Operator

Dori Kesten, Wells Fargo.

Dori Kesten - *Wells Fargo - Analyst*

Thanks. Good morning. We know that the portfolio is pretty defensive-leaning, but have you seen any sort of slowing in the receipt of rent payments, whether it's for certain retailers or certain categories or just in certain markets in the last month? I know it's a relatively short time frame.

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

Yes. John, do you want to take that?

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

Sure. No. I would say that actually it's pretty consistent. I mean, we saw a decline in bad debt year-over-year, and ultimately, even in a shorter-term basis, I mean, we continue to monitor the health of our retailers and have discussions.

And while we continue to dialogue, there hasn't been anything that we have really noted on a regional or use specific basis. It kind of aligns with our -- the distribution, I would say, of neighbors that we have across kind of merchandising categories.

Dori Kesten - *Wells Fargo - Analyst*

Okay. Thanks, John.

Operator

Omotayo Okusanya, Deutsche Bank.

Omotayo Okusanya - *Deutsche Bank - Analyst*

Hi. Yes. Good afternoon, everyone. First one is to start off with acquisitions in the quarter. Again, deals done kind of in the low 6s, the implied cap rate on your stock is about mid-6. So particularly, I know again, the investment spread -- initial investment spreads have been getting tighter, but I don't think I've come across the quarter where it's been negative.

So just curious kind of what's happening along those lines, whether there was something unique with these transactions, whether just where market prices are and cap rates keep compressing despite everything that's going on around us.

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

Yes. So first of all, as you know, we are not cap rate buyers. We are looking at assets on a long-term investment basis. And we're very focused on getting to unlevered IRR's 9%-plus. And as you go -- if you look back historically, we always bounce around a lot quarter-to-quarter on cap rates like they'll be up, they'll be down.

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It's really not a great indicator. It will be over the year, like what the blended cap rate is over this year. But there's literally a specific story for every asset we buy every time for -- and always has been. So I would not take the cap rate of this quarter and annualize it and say that's where we're going to be because if you look at our backlog going in, it's actually quite a bit higher than that, the cap rate.

But again, that's not really what we're focused on. What we're focused on is what we can do with the properties that we're buying to make sure that we can get to that 9%-plus unlevered IRR. And we're finding it in this environment. We found almost $150 million of product in the first quarter, and we have some really strong backlog going into the second quarter.

So we're generally optimistic about that. And if you look at our underwriting, we are underwriting a higher chance of a recession going forward than we did in the first quarter. But we're still being able to find the product and that will translate into a cap rate but we're not buying cap rate.

And because so much of this has a story, I mean, one of the projects we bought has -- one of the anchors, the grocery store has a bump next year that will take it from a 6.1% cap rate to almost a 6.7% cap rate. And we've already had discussions with them, they're anticipating doing it.

So you look at that property, you're like, oh, it looks like they bought it for 6.1%. Not really. We really bought it for 6.7% with the ability to grow it so that we were going to get to our 9% unlevered IRR. So we can go through with you property by property and walk through our analysis, but you will find that -- maybe year by year, it's a good analysis, but quarter-by-quarter, it gets a little bumpy.

Omotayo Okusanya - *Deutsche Bank - Analyst*

Got you. That's super helpful. If I could ask one of John. Just again, with where the stock is at this point and you kind of think about capital allocation decisions, I mean, does stock buyback start to sound a little bit more attractive or not?

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

I'll go ahead. So thanks for the question. So we definitely are looking at it. And the piece that I would say to -- on the former question and on this one is we're focused on cash flow growth per share. So we are actively looking at acquiring assets, we're looking at disposing of assets. While we do -- we have a $250 million open plan approved by the Board for stock repurchases, we have not done anything yet. It is something that we have considered. But ultimately, we, even at these levels, still believe that the best place for our capital is continued net acquisitions.

And so it is in our toolkit of things that we can use but we have not done anything yet. And we're looking at things like building a strong investor base, making sure we have adequate float and liquidity and all those pieces that are a bit more qualitative but ultimately would impact quantitative. But even at these quantitative levels, we still are believing in our strategy of growing the platform through continued asset acquisition.

Omotayo Okusanya - *Deutsche Bank - Analyst*

Appreciate it. Thank you, guys.

Operator

Todd Thomas, KeyBanc Capital Markets.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi, thank you. I just wanted to go back first to the sequential decline in occupancy. It was described as in line with expectations and I understand the seasonality that you discussed. But just curious where you are in terms of some of the bankruptcy-related activity. I know PECO had relatively

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less exposure versus some of your peers. Just wondering if you could provide an update there and also discuss occupancy trends into the second quarter and the balance of the year.

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

Yes. Todd, why don't I start, and Bobby, if you could take it, that would be great. But Tom, I do -- we should keep in mind that we have the highest occupancy of any of the people in our space, and we'll talk -- Bob will talk to you a little about the seasonality and some of the stuff that's happened there. But it's really important to note that we are very strong occupancy numbers and small amounts of change can move things a little bit here or there.

We're really good -- we're feeling really good about the leasing environment as of today. And we'll see what happens through the rest of the year, but it continues to be a positive for us. So again, I don't want to lose the fact that we do have the highest occupancy of anyone in the space. And it's because neighbors want to be in the number 1 or number 2 grocer shopping center. And we think we have the highest quality centers that across the portfolio and that's a great indicator of that.

Bob, do you want to fill in on the leasing side?

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

Yes, sure. Thanks, Jeff, and appreciate the question. I think the biggest thing that I've seen in our portfolio, if I look back at third quarter of last year, we were able to take eight spaces over 15,000 square feet and at least those at new leasing spreads of 105%.

And I think what I'm focused on with these bankruptcies is when you look at Joan, you look at Big Lots, Party City, I mean, these are rents that are in the high single digits. So I think the mark-to-market opportunities are very strong. We have LOIs working on about 80% of those that are coming back. And they're with great retailers like TJ Maxx and Sierra and Total Wine, Planet Fitness, Dollar Ulta Beauty just name a few, and the rents are considerably higher, certainly mid- to high double-digit leasing spreads.

So I mean, we're going to take advantage of that. That will strengthen our portfolio over a period of time. So yes, even though there was a decline in occupancy, I'm still very encouraged about the, I would say, anchor demand and spaces over 10,000 feet in our portfolio that we can execute and have that rent come online the following year. So it's positive.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. But so do you expect occupancy to stabilize and start to improve throughout the balance of the year as you backfill some of that space or is there a little bit more.

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

Yes, absolutely. It will.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And then John, I heard you discuss the lease term fee in the quarter. Sorry if I missed some of the detail but was that primarily one tenant or one lease? And is there any additional detail that you can provide around that tenant and the center and maybe the decision by that tenant to terminate the lease, what happened there exactly?

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

Sure. So lease terminations are part of our business. And I would note that even at this level, it was just a few years ago, we had similar levels but it was outlier in the size. But the large increase year-over-year was primarily related to one location.

It is a retailer that is national but they made it on a location-specific basis. It was not bankruptcy-related. And ultimately, they were earned. There was no bad debt. They continue to pay. But ultimately, we had an opportunity to replace them. And so ultimately, we had a lease in hand. We negotiated the buyout. We're able to execute the lease with the buyout at the same time and then apply the cap to the new neighbor coming in.

So I wouldn't say that it's anything that unusual. I would say the size of it was unusual, which is why we made a point of pointing it out. But ultimately, the center is going to continue to do very well. I think it's just an example of what we've been talking about for the last year, which is working to improve the center's push rents and working those opportunities.

So I think that was it. I will note that also, I mean, we did have good strong core operations even outside of that lease termination fee as we look to the year. And so -- but we did want to, for all of my modeling friends, make sure that we did get that accounted for upfront.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Do you see potential in this environment that more tenants, more national tenants that aren't in bankruptcy, that aren't necessarily on your watch list are being a little bit more thoughtful or careful around their store fleets and portfolios and that there could be some additional activity along these lines?

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

Bob, do you want to do that?

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

Yes. Thanks, John. I'm not hearing that concern. I'm not seeing it in our portfolio with the retailers that we're having discussions with. So again, I think there's a lot of focus on growth in 2026, '27.

And look, I mean, in our portfolio, we're not going to see any new supply coming online anytime soon. If anything, things are getting more expensive. So those retailers that we're aligned with are wanting to grow. So I don't see any cracks or issues on that front.

Floris van Dijkum - *Compass Point - Analyst*

Okay, thank you.

Operator

Floris Van Dijkum, Compass Point.

Floris van Dijkum - *Compass Point - Analyst*

Hey, good afternoon, guys. You have in your -- you prepared this little deck that talked about how PECO performed during the last more normalized recession with the great financial crisis. And you saw a 250 basis points drop in occupancy.

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Even though your occupancy back then was a lot lower, and I suspect the assets you own today or the average quality of your portfolio is higher as well, and plus the fact that there was a lot of development going on in 2009, 2010 that's not occurring today.

How do you think -- is that a worst-case scenario in your view? I guess my question is, I'm trying to figure out what the worst-case scenario is if a recession were to hit. Is that sort of the scenario you're trying to point to?

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

First of all, we're -- Floris, thanks for the question. We are not anticipating a recession. So our base model has basically a flat economy, which is kind of a recession anyway but not the dramatic. I mean, we don't anticipate the extent of the GFC or the pandemic. This is relatively a self-imposed recession, which probably is going to have -- certainly, there don't appear to be fundamentals that would drive a deep recession.

So I would say that those are extreme sort of maybe two standard deviations from where -- what we would expect. They could -- obviously, it can happen, but it's not -- we don't think that it's -- we're going to be into that kind of environment. And as you know, I mean, we had the best -- we had the lowest loss of occupancy of anyone in the space in both of those occasions. And we had our stuff back to normal as the fastest as well.

So being in the necessity-based retail business when there is disruption, we just have a lot less disruption. And that is obviously a positive for us. It's not like anybody wants to lose 2.5% of their occupancy. So we're not -- we're hoping there's not one, but we are -- there's just a lot less beta in necessity-based retail.

Floris van Dijkum - *Compass Point - Analyst*

Yes. Sorry, your answer is a lot more well spoken than my question was. My second question is, there is uncertainty in the markets and as rates are volatile. What do you think this does to your IRR expectations? Are you going to raise them, you think? Or you think you're going to stay around the 9%, 9.5% range going forward?

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

I think they will stay in the 9%. I think that what will happen is that the -- if you get into a more recessionary kind of environment, the underwriting is more difficult. So you're going to take lower assumptions on rent spread. You could take lower assumptions on market rents. Like all of the things that happened during a recession are going to be taken into the numbers, which will make getting to a 9% harder, which will probably make it more difficult to buy and reduce the price.

But the pricing will come down from our expectations on the underwriting of the properties more likely than it will a change in the -- what our unlevered IRR target is. Does that make sense?

Floris van Dijkum - *Compass Point - Analyst*

Yes. And that's another way of saying that you think cap rates could go up but your IRR is going to stay similar?

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

Yes. And because you're going to have less in the recessionary, probably you can have less growth and that would obviously impact the IRR.

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Floris van Dijkum - *Compass Point - Analyst*

Thanks, Jeff.

Operator

Mike Mueller, JPMorgan.

Mike Mueller - *JPMorgan - Analyst*

Yeah. Hi, I guess sticking to some macro stuff here. If the economic environment does get worse so a recession scenario, I mean, what does your gut tell you are the categories in your portfolio where you could see the pullback in demand happen first?

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

It's a great question, and we've looked at it a couple of times in our two -- in the two last recessions that we had or the GFC and the pandemic. The areas where you see the most impact is, and it sort of trickles based upon the depth of the recession, it starts clearly with discretionary and those choices are made. It also -- the brand loyalty sometimes evaporates in a recession so you start to see people trading down in product. We see that. And the other thing you see is you see movement towards the groceries. People are eating at home more.

And actually, when you -- it's a little counterintuitive, but the grocers actually do better in the recessions because people are not eating out. And as they compete with restaurants in a tangential way. That's been a reality in the last two recessions, each being very different but still having some commonalities in terms of consumer behavior.

And so we keep -- we never want to say one recession is like another because they all have similarities but they also have a lot of differences. This one where you're starting at a relatively low unemployment rate has complications in terms of understanding how it's going to play out. I mean, there have been -- certainly been discussions of a sort of a higher-end recession where the -- where you're losing employment at higher level of incomes versus the lower and moderate incomes.

Again, early to predict what will happen. We still don't believe there will be one. But if there is, it's going to be -- you're going to have to see major change in employment to find it to be a deep recession, and we just don't anticipate that.

Mike Mueller - *JPMorgan - Analyst*

Got it.

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

Does that make sense, Michael? I mean, obviously, we are talking about from today going forward because it's a really good operating environment today. And we're kind of just trying to and look out and anticipate how we will react if those things -- if those situations would happen. Though we don't -- we actually don't believe they are going to happen.

Mike Mueller - *JPMorgan - Analyst*

Yes. No, got it. But it does seem like one of the areas you flagged where if it does happen, it's probably more in the dining?

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

Yes. I mean, there have certainly been articles about that. We did go back to the last two recessions. And you continue to see growth in not on the higher-end dining but on the fast and fast casual, like that actually continued to grow through the last two recessions.

So it's sort of a -- it's almost like eating out has become a necessity. And I think that is kind of a reality of the country at this point, that it is a -- it's more a necessity in -- than I think it has been historically.

Operator

(Operator Instructions) Daniel Purpura, Green Street.

Daniel Purpura - *Green Street - Analyst*

Good morning, Publix has been pretty active recently buying centers, and it also looks like you have two redevelopments with Publix in your portfolio. Is this just something that's Publix-specific or do you expect to see other grocers more active in the market or pushing to rebuild their stores?

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

I would say it's very Publix-centric and less across the board. Most of the grocers, most of our major grocers do more remodeling, upgrading the thing. But Publix has a very specific strategy of modernizing their pool of stores by a full teardown and rebuild. And we've done that for them for a long time and it's been a great business for us, and I think it's been a great business for them. We sign a new lease, we get upgraded rents to pay for the cost.

I mean, you have a new 20-year lease and that is very -- it's a powerful value creator for us and it secures a location for them that they want to be in for a long time. So that's been great. So we're -- we love that business. We'd love to do more of it. We'd love it more if the grocers decide they want to do the same thing, but I don't see that as part of our core strategy.

Operator

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

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

Thank you, operator, and thank you, everyone, for being on the call today. We tried to shorten our opening remarks a little bit to give more time for questions in this environment. So in closing, the PECO team continued a strong performance in the first quarter. Despite our tariff concerns, we continue to be strategic in our decision-making to best position PECO to take advantage of the opportunities for growth, both internal and external. We're seeing a high retailer demand with no real current sign of slowing.

PECO's leasing team continues to convert this demand into significantly higher rents. Retailers want to be located in our centers, and they want to be near the number 1 or number 2 grocer in the market. 71% of our ABR comes from necessity-based goods and services, 30% of which comes from our grocers.

We believe PECO is relatively more insulated from potential tariff disruption than many. We also have limited exposure to big-box bankruptcies and at-risk retailers. We believe that the combination of our unique format and our cycle-tested experience drives high-quality cash flows.

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Given our demonstrated track record through various cycles, we believe an investment in PECO provides shareholders with a favorable balance of quality cash flows, mitigation of downside risk and strong internal and external growth. The quality of our cash flow reduces our beta and the strength of our growth increases our outflow. Less beta and more alpha. We think it's a great reason to invest in PECO.

So on behalf of the management team, I'd like to thank our shareholders, our associates, and our neighbors for their continued support and for a great quarter of results. So thank you, everyone, for being on the call today, and have a great weekend.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation, and you may now disconnect.

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