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REG.OQ - Q3 2021 Regency Centers Corp Earnings Call

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OVERVIEW:

Co. reported 3Q21 Nareit FFO per share of $1.12.

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PRESENTATION

Operator

Greetings, and welcome to the Regency Centers Corporation Third Quarter 2021 Earnings Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to your host, Christy McElroy, Senior Vice President of Capital Markets. You may begin.

Christy McElroy - *Regency Centers Corporation - SVP of Capital Markets*

Good morning, and welcome to Regency Centers' Third Quarter 2021 Earnings Conference Call. Joining me today are Lisa Palmer, President and Chief Executive Officer; Mike Mas, Chief Financial Officer; Jim Thompson, Chief Operating Officer; and Chris Leavitt, SVP and Treasurer.

As a reminder, today's discussion may contain forward-looking statements about the company's views of future business and financial performance, including forward earnings guidance and future market conditions. These are based on management's current beliefs and expectations and are subject to various risks and uncertainties. It's possible that actual results may differ materially from those suggested by the forward-looking statements we may make.

Factors and risks that could cause actual results to differ materially from these statements may be included in our presentation today and are described in more detail in our filings with the SEC, specifically in our most recent Form 10-K and 10-Q filings.

In our discussion today, we will also reference certain non-GAAP financial measures. The comparable GAAP financial measures are included in this quarter's earnings materials, which are posted on our Investor Relations website. Please note that we have also posted a presentation on our website with additional information, including disclosures related to forward earnings guidance and the impact of COVID-19 on the company's business. Our caution on forward-looking statements also applies to these presentation materials.

Lisa?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Thank you, Christy, and good morning, everyone. Thank you so much for joining us. We feel really good about the progress that we've made toward recovery and also with the improvement we're seeing in our operating trends. Our third quarter results are reflective of a healthy environment for open-air, grocery-anchored shopping centers. And not only are we feeling closer to normal, but we're excited about what the future holds.

I'm also really pleased to report that despite the recent concern about potential impacts from the Delta variant, we've continued to make meaningful progress on rent collections, narrowing the gap further as nearly all of our tenants are in a position to pay us full current rent.

Steady retailer demand is driving strong leasing activity, which, combined with reduced tenant move-outs, has moved the needle on occupancy. We've also had success maintaining leverage in our lease negotiations, driving contractual rent growth and remaining prudent on CapEx while further improving our rent spreads. Our team has been working really hard to drive deals that will lead to long-term growth and the value of our assets.

As a result of these positive trends and an increased pace of improvement, we're again raising full year guidance for 2021. In recent quarters, we've discussed that we believe the recovery of NOI back to 2019 levels would likely occur in the second half of 2022 on an annualized basis. But given the rate of progress we've seen in recent months, we are now pulling that forward to the first half of 2022.

We've also increased our dividend by 5%, a reflection of our confidence in a return to sustained growth over the long term. You'll recall, and I know you're probably sick of this, but I can't possibly remind you enough that we never cut our dividend during the pandemic. We are committed to growing our dividend while also accretively investing our sector-leading free cash flow to drive solid total returns for our shareholders.

And that's a good segue into our investment and capital allocation strategy where we remain on our front foot. The private transaction markets are competitive. They remain competitive, and we've continued to see downward pressure on cap rates as more buyers have emerged for high-quality, well-located grocery-anchored centers, but our strong balance sheet and access to low-cost capital provide a competitive advantage that allows us to be opportunistic. And we do have a long track record of investing with discipline on a leverage-neutral and earnings-accretive basis. Our pipeline is active, and we continue to see good opportunities.

With that, we just announced that we're under contract to acquire Blakeney Shopping Center, a dominant grocery-anchored community town center in South Charlotte. This is a high-quality, well-leased center with strong demographics and a tenant mix that fits well with our strategy. Our Southeast team is excited to bring this exceptional asset into the Regency portfolio, and we expect the transaction to close this month. The addition of high-quality centers like Blakeney, along with our development and redevelopment program, are important to portfolio enhancement.

At the same time, we remain committed to selling centers that are lower growth or nonstrategic or when it's clear to us that maximizing the value of a property involves a predominantly non-retail use. For example, our recent sale of the former Sears box adjacent to our Hancock Center in Austin was in that last bucket where we determined that its highest and best use was medical office. The addition of this office component and the traffic that it will generate to our site will enhance the value of this well-leased center where H-E-B is currently expanding its highly productive store, but our best risk reward proposition is to invest capital into strong grocery-anchored neighborhood and community retail, which is the bread and butter of Regency strategy. This commitment to portfolio enhancement has proven to and will continue to fortify our future NOI growth.

In closing, our shopping centers are well positioned to benefit from long-term migration and flexible work trends that favor suburban trade areas, and we are actively positioning our portfolio to thrive today and into the future. If the industry has learned anything over the last 18 months, during which we saw hyper-accelerated digital commerce and fulfillment and distribution challenges, it's that having brick-and-mortar locations close to where consumers live is critical to retailer success.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Thanks, Lisa, and good morning, everyone. We remain encouraged by the continued improvement in our portfolio operating trends, accelerated by the reopening of the West Coast this summer. Our tenants are generally fully open and operating in all markets with the lifting of restrictions translating into higher rent collections and continued strong leasing activity.

Portfolio foot traffic rebounded back to 100% of 2019 foot traffic levels as of late October despite the slight dip in September related to the Delta variant. Many of our tenants are experiencing positive sales trends in 2021, with grocers holding their gains from 2020 and many restaurants reporting record high productivity.

We continue to see further sequential improvement in rent collections, with Q3 collections at 98%. Notably, our collection rate for deferrals remains high at over 95% year-to-date. Translation, tenants are honoring their commitments.

Our leased occupancy rate is up 50 basis points over the second quarter after adjusting for the sale of the vacant former Sears building at the Hancock Center, Lisa just mentioned. These gains were driven by strong leasing activity and fewer tenant move-outs. Most importantly, our net effective rent-paying occupancy also rose this quarter and is now over 90%. As we've noted previously, this metric is the best indicator of our recovery progress.

As noted, leasing activity continues to be robust, and we remain encouraged by the strength of our pipeline. Q3 total leasing volumes were 125% of 2019 quarterly averages. Shop renewal rates were 80%, elevated over historical trends. Rent spreads continued to improve to a blended rate of over 5%, while our GAAP rent spreads also continued to get closer to pre-COVID levels at over 12%. We are maintaining contractual rent growth on leasing activity in line with recent years, with embedded rent steps on more than 80% of our leases executed this quarter. Additionally, our weighted average lease term for deals has risen back above pre-COVID levels.

So to summarize, our leasing trends are moving in the right direction, enabling us to maximize NOI growth for the long term. All of that said, we are fully aware and acknowledge that retailers today are facing challenges related to labor shortages, cost inflation, supply chain disruptions and permitting backlogs. While these issues are impacting build-out costs and tenant rent commencement timing, so far, this has only been on the margin for Regency. That said, we will continue to monitor these issues, and we'll work closely with our tenants to help them manage through them where we can.

Moving to development activity. We continue to make good progress on our in-process ground-up and redevelopment projects, and we completed a $21 million Bloomingdale Square redevelopment in Tampa this quarter. We reimagine and modernize the center by repurposing a former Walmart box to accommodate an expansion and relocation of a highly productive existing Publix and backfill the former grocery box with a new LA Fitness. We added more visible and functional shop space and made enhancements and renovations to the remaining portions of the center. This successful project helped to cement this center's relevancy and dominance in its trade area while generating a return of over 8%.

Construction cost inflation and labor shortages are real and are creating some pressures, but are not materially impacting the current yields and cost in our in-process projects. We are keeping our finger on the pulse on these trends and are being very thoughtful in our cost projections and delivery timing when underwriting new and potential pipeline projects.

In summary, we are very pleased with the positive momentum that we continue to experience in our operating portfolio and in our value creation pipeline, driving us closer to full recovery and supporting our future growth.

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

Thanks, Jim. Good morning, everyone. I'll provide some color around third quarter results, walk through the changes to full year 2021 guidance and offer some helpful reminders when thinking about next year.

Third quarter NAREIT FFO of $1.12 per share was helped by several items. Uncollectible lease income was a positive $10 million in the quarter, the details of which we've broken out on Page 33 of our supplemental. We reserved over $4 million on third quarter billings, which is down from over $10 million a quarter ago, associated with uncollected revenues from cash basis tenants. This was more than offset by the collection of nearly $6 million of amounts reserved during the first half of 2021 as well as the collection of close to $9 million of revenues that were originally reserved in 2020.

Our full year '21 guidance calls for a $46 million positive impact from the collection of 2020 reserves, of which we have recognized $41 million through the third quarter. We also recognized close to $14 million of onetime promote income in the third quarter related to the USAA JV transaction, which positively impacted NAREIT FFO, but is not included in our core operating earnings metric.

Finally, straight-line rent in the third quarter benefited from the reversal of reserves triggered by the conversion of some cash basis tenants back to accrual accounting as reflected in uncollectible straight-line rent at a positive $4 million. This is a noncash accounting impact that contributes to NAREIT FFO but, again, did not impact our core operating earnings.

Following these conversions, which represent about 5% of ABR, we now have 22% of our ABR remaining on a cash basis of accounting. For this smaller pool, our cash basis collection rate was 91% in the third quarter, a 700 basis point increase from a quarter ago. The collection rate on the old pool before the conversions was 93% in the third quarter, up from the 86% in the second quarter that we disclosed on the last call.

As Jim mentioned, our net effective rent-paying occupancy now exceeds 90% as we've continued to narrow the spread between rent paying and our commenced occupancy rate due to the progress we've made increasing collections on cash basis tenants. We remain in a great position from a balance sheet perspective as cash flows continue to recover and leverage even after excluding prior year reserve collections has returned to prepandemic levels. We ended the quarter with full capacity on our revolver, and we have no unsecured debt maturities until 2024.

You'll recall that we issued about $150 million of equity in Q2 through our ATM program on a forward basis. We settled a portion of that during the third quarter to fund the USAA transaction, generating $83 million of net proceeds. The remainder is unsettled, which we view as capacity for future investment opportunities, and we have until June of 2022 to issue the shares. We did not raise any additional equity capital during the third quarter.

Turning to guidance, we point you to the detail in our business update slide deck posted to our website. A big driver of the $0.12 increase in the midpoint of our core operating earnings range comes from a higher same-property NOI growth forecast as we increased the range by 150 basis points at the midpoint. This increase was driven almost entirely by core improvement, including a higher cash basis collection rate on current year billings and lower move-out activity. As I mentioned, our forecast for the collection of prior year 2020 reserves is up only slightly at $46 million.

Other drivers of the increase to full year core operating earnings expectations include higher lease termination fees and lower G&A. Our NAREIT FFO range has increased by an additional $0.05 at the midpoint on top of the change I just described, primarily driven by the increase in straight-line rent associated with the conversion of tenants back to accrual from cash basis during the third quarter. While it's possible that we may convert additional tenants back to accrual during the fourth quarter, our guidance does not assume any additional reversal of straight-line rent reserves.

I'd like to point out that these noncash accounting impacts are a big reason why we provide and guide to core operating earnings in addition to NAREIT FFO. This metric excludes noncash amounts such as straight-line rent and mark-to-market adjustments and can provide a much cleaner picture of our earnings trajectory. We will provide 2022 guidance with Q4 results in February as we normally do, but we wanted to remind everyone of some of the bigger nonrecurring moving pieces that have been disclosed and discussed throughout the year when thinking about modeling for next year.

First, our $46 million guidance for collection of 2020 reserves is a prior period adjustment, not associated with 2021 billings. Second, we recognized abnormally high expense recoveries of about $3.5 million net of reserves in the second quarter related to the 2020 expense reconciliation process. Third, G&A during the first quarter benefited by about $2 million from the forfeiture of previously expensed share grants related to the departure of our CIO earlier this year. And lastly, although not impacting core operating earnings, we recognized close to $14 million of promote income in the third quarter. We look forward to discussing our 2022 outlook in more detail, together with next quarter's results.

As Lisa mentioned, given the pace of improvement we have experienced to this point of the year, we now expect the recovery of our NOI back to 2019 levels will occur on an annualized basis at some point during the first half of next year. That's about 6 months earlier than we had previously expected.

With that, we look forward to taking your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Michael Goldsmith with UBS.

Michael Goldsmith - *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

Your third quarter benefited from the strengthening of the core business in conjunction with collecting some of the past rent. So presumably, and as your guidance suggests, recovery of prior reserves is going to decrease in the future. And as that winds down, can you talk about the -- you're going to be passing from collection of past rent to continued growth of the core business. So can you talk about the trajectories of those 2 pieces and whether that means an FFO acceleration in the future?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

Sure. Michael, appreciate it. You bring up a good point. First, the deceleration in the implied guidance for the fourth quarter. So I just want to make sure we kind of get that out there and explain some of the pieces here. About -- as you have, you've done the math, it's about $0.06 per share at the midpoint. About 1/3 of that -- and again, I'm speaking to core operating earnings, not NAREIT FFO. About 1/3 of that is going to be, as you mentioned, a result of 2020 or prior year collections, decelerating. So that -- the trajectory there, as you can see, is gone from $20 million -- over $20 million in the first quarter to roughly $9 million in the third. We have guided to that number being about $5 million in the fourth. About 1/3 of that deceleration in the fourth quarter comes from other -- what I would call, other NOI line items, percentage rent, settlement and income. We did have a bit of a frothy third quarter. So that should decelerate in the fourth.

And then we do -- as you look at the G&A guidance, you'll see that the fourth quarter from a run rate perspective will be slightly higher than the third. So those are the drivers kind of decelerating into the end of this year.

As we think about next, it's -- uncollectible lease income is going to -- continue to be a story of accelerating our earnings path. We're at about 250 basis points on current year collections through the third quarter as a bad debt charge or an uncollectible lease income charge. If you think about how we finish the year, we -- we're anticipating that our cash basis tenancy continues to climb from a collection rate perspective. I think we might end the year in the plus or minus 170 basis point range as a bad debt expense charge on current year billings. And remember, our historical run rate is in the 50 basis point range.

So we see a tremendous amount of opportunity to continue to close that gap. That's why we keep talking about net effective rent pay and occupancy. We increased that by 200 basis points this quarter. We anticipate that to continue to grind higher into 2022, much more to come on '22 guidance.

I do want to hold that back to February. I don't know that we'll get back to our 50 basis point historical run rate by the end of next year, but we do feel pretty confident that we'll just continue to close that gap from that 170 where we think we'll end the current year.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

And Michael, I like how you ask the question. So with all of those, there's a lot of numbers and a lot of facts there and a lot of moving pieces. What I want to make sure doesn't get lost is the really vast improvement in the demand for leasing and for space in our properties because we did lose occupancy. And what is going to drive the acceleration is going to be our continued ability to re-lease that space. And that's really important, and we're seeing that demand come through.

Michael Goldsmith - *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

Incredibly helpful. And just as a follow-up, in your guidance, the expected cap rate for dispositions fell from 5.5% to 6% last quarter to 5% to 5.5% this period. In addition, your acquisition cap rate decreased from 5.5% to 5.1%. Is it fair to say that industry cap rates have compressed 40 to 50 basis points since last quarter? And how does that make you change -- how does have you think about doing acquisitions, dispositions, development and redevelopment going forward? Does that change your view?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

I don't believe that the cap rates have necessarily compressed by 50 basis points quarter-over-quarter. Our guidance is a result of the mix. So we did announce the acquisition of Blakeney, which is an exceptional asset. And that -- obviously, the negotiation of that was even prior to last quarter. So the cap rates were already there. With the Blakeney acquisition, we are also, if you will, match funding that with very low cap rate dispositions, nonstrategic, in the fourth quarter. And that's what drove the increased guidance for dispositions with that lower cap rate for that. So it's a mix of properties on both the acquisition side and the disposition side specific to Regency.

Cap rates have compressed all year long. And as I said, quarter-over-quarter, I don't think that there's been much of a change, but there's no question that for the type of property that we already own and, therefore, are looking to add into our portfolio, it's going to be in the 5 -- 4.5 to 5 cap rate range. That's high-quality, grocery-anchored shopping center pricing today. It does not change how we think about acquiring and how we think about adding, as I mentioned in my prepared remarks. Portfolio enhancement has always been a really important part of our strategy, and we do believe that continuing to grow with premier high-quality assets like we already own will help fortify our future NOI growth as we dispose of those that perhaps may have a lower growth profile than our average or maybe nonstrategic.

Operator

And our next question comes from the line of Katy McConnell with Citi.

Mary Kathleen McConnell - *Citigroup Inc., Research Division - Research Analyst*

So on the Carolina deal, can you provide some more background on how the deal was sourced and what you're underwriting for upside opportunity to the property? And then lastly, just wondering how dispositions fit into your funding plans for the deal in fourth quarter.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

There's so much in that question. I think it's going to take 3 of us to answer it. I'll start, and then I'll pass to Jim, and then Mike might tap into the funding. It was a marketed deal. However, it's -- and that we've talked about this in the past. There's no question that we tip -- we have had more success when we're able to get in front of marketed deals and do things off-market, use our relationships. But there are a select number of assets that do come to the market that are marketed that we also have success in when we're able to leverage -- really leverage our local teams. I'm a little biased here.

I believe that if not the best, we're certainly really close to the best in the business. And we have an exceptional Southeast team. We have assets that look a lot like Blakeney already in the portfolio and we had a lot of conviction around the quality of this asset. And then from the funding piece that Mike is going to talk about, that allows us to add this to our portfolio on an accretive basis. So we're adding an exceptional asset that is going to have a growth rate that's above our average on an accretive to earnings basis. There's -- to me, that is why we were able to be aggressive on a marketed deal. And I'll look to Jim to talk specifically about how we think about the growth rate here.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. It -- Katy, it -- I can't overstate how excited our team is about this asset. It's truly a center of gravity for retail and restaurant offerings in that affluent South Charlotte market. But as we look at it, we have a lot of respect for the current ownership. They've owned the asset for a good long while and have done a really nice job in merchandising. But we believe we see a great opportunity to really apply our asset management skillset and eye towards fresh remarketing, re-merchandising and a fresh look, if you will, on the center to really drive what we would believe are higher-than-normal NOI growth out of that asset. And that's the bottom line. We looked at that as an opportunity to get into a great center and have outsized earnings opportunity.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Before Mike gets into the funding, I don't want to miss the opportunity to -- we very affectionately call the asset of Turducken as we're nearing the month of Thanksgiving. That came -- that was tapped that way by our investments officer in our Carolina market. And for those of you that don't know what a Turducken, turkey, chicken and duck. And this asset, really, as Jim said, is a center of gravity, and it offers -- there's a target piece with more of a community center feel. There's a neighborhood center with Harris Teeter anchoring that, and then there's a main street retail. You can choose how you -- what you think is the turkey, the chicken or the duck. But it truly is a center of gravity and an exceptional asset.

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

Katy, just following up and to clean that up from a funding standpoint. You're right -- and this is a little bit to Michael's question as well. When you think about recycling, you typically think about dilution. And we're not -- I mean we're familiar with that. We had some dilutive recycling in our history.

We're in a unique period of time where what we're adding to our disposition pipeline is actually low cap, low -- at the same time low growth nonstrategic assets. And if you click through and just look at our dispositions on the year, you see Pleasanton Plaza. You see Hancock, Sears Pad, non-income-producing assets. Obviously, this is an ability to put that capital back to work.

You see Gateway 101, 2 -- basically 2 boxes, very low cap, very low growth. If any, it's flat as a board. And then we were recently able to sell the Parnassus Heights Medical Center, again, highly sought-after asset class, not consistent with Regency's strategy, low cap rate. We're adding a couple more to the dispo guidance. And what that blend of capital provides us is actually an opportunity to invest that accretively into a property like Blakeney with on the -- which has a headline and on the surface looks to be quite an aggressive cap rate, and it is. But Regency at this unique period of time is able to make sense of that economically.

Unidentified Analyst

It's -- just as a follow-up. It's [Michael Bilerman]. Lisa, you've used institutional capital for a very, very long time. I can remember sitting down with you almost 25 years ago when you're running the fund platform with Bruce. Can you talk a little bit about sort of where institutional capital is in partnering with you for further acquisitions? I assume you're looking at a lot of stuff right now or whether you'd want to do it wholly owned, and conversely, whether you would sell more into JV, your institutional capital and just talk a little bit about the appetite just given your deep history and relationships with that capital.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Of course. Thank you, Michael. And I think I do remember that meeting 25 years ago. Yes, we have spoken with many investors about this over the past few years, especially in light of some of -- the buy-in of USAA and some other dispositions. Back 25 years ago, we really utilized third-party capital. As we always said there's 3 reasons, right, access to capital, access to opportunities and access to expertise. And 3 years ago, it was a combination of access to capital and access to opportunities. We were a much smaller company then.

Today, as we think about it -- I just said, I believe that if we don't have the best, we certainly are really going close to the best of the team in the business. So we don't necessarily need access to expertise. And the capital markets can be a little volatile. We haven't had the need for access to capital. We don't have it -- we don't have that need today. But never say never. So maintaining good relationships with our partners is still an important objective for us and we continue to do that.

However, at this time, the access to opportunity would really be the biggest checkmark for us in terms of where we would need to access third-party capitals. That's how we're thinking about it today. We have great partners. Really appreciate our partners. We appreciate the relationships with our partners and we will continue to sit side-by-side with them. But for new capital, at this point, it's not necessarily high on our priority list.

Operator

And our next question comes from the line of Ki Bin Kim with Truist.

Ki Bin Kim - *Truist Securities, Inc., Research Division - MD*

So you guys have been able to achieve a high level of leasing velocity. I'm just curious about how deep that demand is. And is the velocity at which the top of the funnel is being fed with additional pipeline, is that -- how is that looking compared to the number of deals you've been signing to date?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. Ki, this is Jim. Yes, the velocity has been really good. And as I look at it, I think it's a combination of basically a renewed confidence in the brick-and-mortar business from retailers, certainly pent-up demand from 1.5 years of really not a lot of activity that's opening up. And obviously, we continue to see a nice migration to quality, which we believe we are that answer to migration. But the categories that we're seeing are the ones we've merchandised to for the last 20 years. We're doing a lot of medical deals, pet deals, restaurant, fast casual, banks, personal service. And it -- the demand is really across all regions. It's really -- it's almost imperceptible where there's more demand than others because it's coming from everywhere.

Like I said, the pipeline -- as we look at our existing pipeline into the 90-day future, if you will, it continues to look very robust. So we have more vacancy than we've had in a long time. So we have product, we have availability, and there appears to be good solid retailer demand for that. And so I'm cautiously optimistic we stay on a nice trajectory.

Ki Bin Kim - *Truist Securities, Inc., Research Division - MD*

Great. And I wanted to ask about your leasing spreads, the new lease spreads were essentially flat, but you are using less CapEx than many of your peers as a percent of rental value or just sole dollars. Just help us better understand this dynamic and the choices behind it.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. Jim again. I'll take that, and I appreciate you recognizing that the blended spread is up to -- for this quarter was 5.1%. So we are on a nice trajectory there. But in addition to those initial spreads, I think it's important -- which is obviously an important metric. I'd like to step back and kind of take a broader look at what really is going on long term -- to create long-term sustainable NOI. I think one of the components, contractual rent steps and our ability to manage expense recovery ratios are key contributors. I think appropriate and prudent leasing CapEx, which you touched on, that's a major factor, I think, in long-term earnings growth.

Tenant selection, really making sure we're picking the right mix to drive synergy and traffic at our centers but also having a mine coming out of this pandemic environment, make sure we have an eye towards relevancy and survivability of the folks we're dealing with. We want people that are going to be here with us. We don't like the churn space. And all these things matter. And in combination with what we're seeing from a GAAP and net effective rent growth at the 12% number I referenced in the remarks, I'm confident that our overall results have us on a very good vector towards the long-term NOI and earnings growth objectives that we're looking for.

Operator

Our next question comes from the line of Derek Johnston with Deutsche Bank.

Derek Charles Johnston - *Deutsche Bank AG, Research Division - Research Analyst*

In this environment, which is more attractive development at tighter yields or strategic acquisitions like Blakeney? Add compressing cap rates and just given the competitive backdrop, which do you feel is Regency's wiser capital allocation call?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Derek, I actually don't view it as an either/or choice. We like all. And we are not -- fortunately, the position that we are in, as I just responded to Michael, not in the position where capital is scarce for us. So we are trying and continue to make progress on rebuilding our ground-up development pipeline. We are making progress on our redevelopment pipeline. And we are in the market and see a good pipeline of opportunities for acquisitions. As long as we're able to invest accretively and grow the company's future trajectory for NOI growth and earnings growth, that's the box that needs to be checked.

Derek Charles Johnston - *Deutsche Bank AG, Research Division - Research Analyst*

Got it. Got it. And maybe back to Jim or -- I know everyone wants to talk about demand. How is small shop demand stacking up? So just looking at small shop leasing pipeline now versus prepandemic. And really how does it compare? And if you're seeing outside demand, is it providing the flexibility to bring in the right Regency style merchandising mix, of course, given the center? Or are you feeling the need with the occupancy hole to be a little more flexible on concept or maybe TIs going forward? We haven't seen it yet, but just looking ahead.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. Derek, I think as I previously mentioned, I think the demand is there. We continue to asset manage no different today than we did prepandemic. We are always looking to get the right merchant at the right price to make sure they are successful and, in turn, drive sales and make us successful.

So again, we -- right now, the demand seems to be pretty deep, but we continue to be selective. We are generally never have been and don't intend to be fill it up with anything and hope they stick. We are very, very specific in our merchandising mix and really try to make good long-term decisions.

Operator

And our next question comes from the line of Craig Schmidt with Bank of America.

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

I was wondering if I could get an update on the Serramonte Center, particularly with the JCPenney space and then the crossing, Clarendon.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Craig, we're going to have -- I'm going to have -- I'll have Jim address both, I think.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. Serramonte with the JCPenney space, we are investigating several different redevelopment opportunities. So we're early in the process in trying to identify the best direction for that replacement box. And as far as (inaudible) really in great shape there. Our retail ground floor space is fully spoken for either at lease or in lease negotiation.

As we mentioned, last quarter, I believe the lifetime fitness deal is executed. We are waiting on a use waiver, which we expect to get in the next 30 days, which will clear all contingencies. And by year-end, we should be posting over 90% leased

(technical difficulty)

It's come together nicely and excited to see lifetime (inaudible).

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

I think was I knew I wouldn't be able to help myself from jumping in. Those are both tremendous assets. And we are -- as Jim mentioned, we're continuing to harvest value from those and grow NOI. And both of those assets are going to have outsized NOI growth in the near future.

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

That's good. It's over 1/3 of your redevelopment dollars.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Yes.

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

So the other question I had -- I loved turken reference.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Turducken.

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

Turducken, yes. I was -- when I was examining the center, I had our time putting all 3 pieces together, but you guys did it. So hats off. Anyway, the G&A costs, I'm just wondering, I mean, should we expect a pretty decent increase in 2022 with increased travel? Or have you guys been relatively active throughout 2021 that, that's not going to have a significant pickup?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

I lost my flight status on Delta. If that means, thanks to you, Craig. So we are anticipating a significant increase, kind of all joking aside, and I appreciate you asking the question, it does give us the opportunity to put this out there.

2021's run rate on a quarterly basis is in the $19 million range or so. And again, I'll refer to my remarks, recall that we are benefiting this year from that $2 million for future benefit upon Max departure. Next year's run rate is probably going to be closer to -- in the $21 million range on a quarterly basis. What we're capturing in that number is compensation increases together with filling open positions. Some of the benefit we've been incurring in '21 is we've been running a little bit lighter from a headcount plan perspective.

Increases to T&E, as you mentioned, the entire company is -- we're starting to get back on the road, and there's more conferences being held, businesses being conducted more in-person than on Zoom going forward. And so we're planning for that to return to prepandemic levels.

And then the last point I'd make is development overhead probably going to be in the flat range '21 as we continue to build our pipelines. We have the development spend. We'll look a lot in 2022 like it did in '21, and then we anticipate growing that ability to capitalize '23 and beyond.

Operator

And our next question comes from the line of Rich Hill with Morgan Stanley.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

This is the first call I've had in a while where I'm not double or triple booked. I have one sort of wonky question about 4Q and then one sort of bigger picture question. On 4Q, can you maybe provide us any thoughts on rents becoming straight line and how that will look in 4Q? I noted that moving tenants from a cash basis to accrual accounting was around $0.03 in 3Q. So any thoughts on what that might look like in 4Q?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Rich, we don't guide on it. I would say as we look at -- we have a very strict policy, and we want it that way. Bringing tenants back to accrual accounting is going to take them to prove to us that the credit is there to meet that gap standard, right? So the bar is relatively high. You got to be current on your rent for an extended period of time. And then I would add to that, there's an overlay of what business are you in? And I'll be frank, some of the labor concerns that we're looking at today are impacting how we think about bringing tenants back to accrual accounting.

As I look at our AR and our open AR and think about what tenants may or may not qualify, it could be in the 5% of ABR range in the fourth quarter that converts. I don't have a precise number for you on what that could mean from a straight-line rent perspective. But generally speaking, it kind of works pro rata. So every percentage point that we convert is about worth on a pound-for-pound basis, the same.

I hope that helps. We're going to have to take these as they come, Rich, unfortunately. And I do look forward to being back to the normal when we have everyone -- nearly everyone back on an accrual account.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

From your lips to God's ears, I completely agree with you. I completely understand why it's hard at times. So bigger picture question, occupancy. You've noted in the past and very correctly that occupancy is the key to getting back to normal. You continue to have really good leasing trends. Can you maybe talk about where you feel occupancy is going to get back to normal? Is that a year, 2 years, 3 years? I recognize I'm asking to shake your crystal ball here, and my crystal ball is not great right now. So hopefully, yours is a little bit better than mine.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

We haven't given guidance on occupancy. I think the -- one of the best sort of metrics or measures is when we expect to get back to kind of 2019 annualized levels. And that is now in the first half of 2022. So we are getting the benefit of some contractual rents along the way, which may offset a little bit of the occupancy, but I don't want to get out of -- get in trouble with any future guidance. But I think next year and into 2023, we should continue to see some occupancy lift. So maybe sometime in 2023.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

Yes. That's great. Lisa, I'm sorry, I wasn't trying to get you to talk about '22. I was...

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

I was looking at Mike the whole time I answered that, Rich, to make sure I wasn't getting in any trouble.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

No. I was really just talking about the cadence of occupancy returning to normal, not a 2022 comment.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

2022 will benefit from some of the redevelopment NOI growth that we talked about and contractual rent steps that are already embedded. So while we'll be back to that 2019, it doesn't necessarily mean that occupancy is all the way back at that time, which is a good thing because that means we still have more room to grow.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

Got it. And look, as someone that grew up in the South, I certainly know what the Turducken is. So congrats on the nice quarter.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Thanks, Rich. Thank you.

Operator

And our next question comes from the line of Mike Mueller with JPMorgan.

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

Lisa, I think you talked about cap rates on high-quality centers being 4.5 to 5. Looking at your dispose this year, they're 5.5% to 6%. I guess how much of that 5.5% plus cap rate product do you still have in the company?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

So I think we updated our guidance to be 5% to 5.5% on dispositions, Mike. So make sure that, that's clear because generally speaking, as I said, when we think about portfolio enhancement and the centers that we are selling, they are going to typically have a lower growth profile and/or be nonstrategic. And so you would expect that especially with the lower growth profile that cap rates would be a little bit higher than the 4.5% to 5%, because we, along with everyone out there looks at total returns, and whether it be going in cap plus growth or unlevered IRRs. So that's why you see a little bit of that discrepancy.

I think for the 5% to 5.5%, that's when we -- as Mike talked about our funding, that really -- that works for us, if you will, from a portfolio enhancement standpoint.

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

And the detail that actually doesn't include the non-income-producing land that we're selling. So our effective earnings-based cap rate is in the low 4 range.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

The second half of your question.

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

Okay. And then maybe just switch gears for a second here. Do you see any other JV wind-downs or buyouts over the next few years?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

I think building on the comment Lisa made earlier to [Michael Bilerman's] question, there's nothing to count on there. We like our partners a lot, and they've been good to us for a long period of time, and it's been a very symbiotic relationship. So we -- I don't know, Mike, that I'd count on our ability to do a trade like the USAA transaction. But never say never, and we can't predict what their plans are from a retail exposure perspective. And there may be an opportunity that Regency has presented with to consider buying in a JV partnership. And we would do that.

We like the assets equally that are in those portfolios. There is no fundamental kind of qualitative difference between the assets and our JV portfolios and what's on balance sheet. So we'll take it kind of day-to-day and quarter-to-quarter, but it would take a shift in our partners' mentality right now. Today, our partners are committed to the space, very specifically to the grocery-anchored neighborhood shopping center sector.

Operator

And our next question comes from the line of Anthony Powell with Barclays.

Anthony Franklin Powell - *Barclays Bank PLC, Research Division - Research Analyst*

A question on, I guess, base rent collections. The 2 laggards are personal service and fitness, but we're seeing some pretty big improvements in activity in those sectors real time. So just curious, could you see an improvement in those 2 categories really by the first half of next year, do you think?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

Yes. I would say the answer to that is yes. And really, the lag that you're seeing today is predominantly West Coast where they were the most impacted and the last to recover. And with some certain mask mandates and COVID requirements, that has still probably impacted those 2 categories in the West Coast more than anywhere else. But they're all -- they're basically on the rise. Large-format fitness has bounced back very nicely. It's really more of the smaller boutique folks that have been with limits, and again, predominantly West Coast. But we see strong growth in that sector and fully expect them to bounce back.

Anthony Franklin Powell - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. And how much of the strong leasing demand has been driven by retailers trying to expand their last-mile distribution capabilities? We've heard some of your peers talk about that, and it seems like a pretty strong secular tailwind for the industry. So what are you seeing on that front?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

If I -- let's rewind back to prepandemic. You would have heard us speaking about retail headwinds and -- but that we were confident that retailers placed a very high value on the right real estate, on the right bricks-and-mortar locations and that the -- if you are on the -- if you are in the right trade area in the right market, you were -- retailers would be willing to essentially pay full market rents for that real estate. And what I would say is what's happened over the past 20 months with the disruption, with the hyper-accelerated digital commerce, that's only been validated even further that it is really important to be close to consumers' homes and quality real estate. So I do believe that there has been an increase in demand, maybe a little bit pent-up as people were a little cautious as to how the pandemic would play out.

But now with hindsight being 2020, the retailers have even more confidence in the importance of being close to the consumer because they do need to be more intentional about last-mile distribution. And the quality of that real estate matters. And I think that, that is -- there's no question, that is what is driving increased healthy demand to Regency shopping centers.

Operator

Our next question comes from the line of Linda Tsai with Jefferies.

Linda Tsai - *Jefferies LLC, Research Division - Equity Analyst*

At this point in the cycle, would you consider slightly higher leverage to generate higher returns given your low leverage, the positive retail environment and access to capital?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

It's a great question, Linda. We want to operate where we are. We want to operate in the band of 5% to 5.5%. We're in the low 5x area now.

Let me just make a point that we use trailing 12 months. The $46 million of prior period collection is in that number. It's worth about 1/4 of return, not material. So we're still in very healthy in the band.

This is a big point for us moving forward in our growth trajectory. We have -- with our free cash flow and our balance sheet position, we're going to have -- and growing EBITDA, recall, we're at the low point of this. We're coming out -- we're going to start growing EBITDA, we believe, at a more accelerated rate. We're going to have the opportunity to use a little bit of leverage to that free cash flow to acquire shopping centers or build shopping centers or redevelop shopping centers to amplify and accelerate our growth rate in the near term going forward, all while not putting our balance sheet at any more risk than it is today and operating within that -- the low end, we think, of that band where we want to be. So it's a -- we are in -- we're perfectly positioned, we believe, to remain, as we said, on our front foot from a growth perspective and look at opportunities across all 3 bands, acquisitions, redevelopments and developments.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Mike has been a little bit too humble, so I'm going to pound our chest a little bit more. I think it's something we are really proud of. The fact that we are at 5x with or without prior period collections with not -- with maintaining our dividend throughout the pandemic. So we did not cut our dividend. And in fact, if you read the press release and listen to our prepared remarks, we just raised it another 5%. So sector-leading free cash flow without reducing our dividend, increasing our dividend and still having 5x net debt to EBITDA, I'm really proud of that.

Linda Tsai - *Jefferies LLC, Research Division - Equity Analyst*

That's impressive, for sure. And then also, I read about OP drive-through, grocery opening its first site in South Carolina. Are existing grocers considering adding drive-throughs? I realize BOPIS is similar in concept, but do you see this as an emerging trend? And is this an added benefit having this type of offering at a center?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

I think maybe on the margin, quite frankly, there are -- there have been publics who decided (inaudible) has drive-throughs and they lay fallow, quite frankly. So I think if it catches on, you may see something. But I think with the other forms of distribution, I'm not sure the drive-through is going to be a game-changer.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

I don't know that it's that much more effective than the curbside.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

The curbside pickup is really pretty efficient and effective.

Operator

Our next question is from Wes Golladay with Baird.

Wesley Keith Golladay - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

A quick question on the uncollected rents. Huge improvement going from 10 million to 4 million in the third quarter from the second quarter. Do you have any expectation that will come down further in 4Q? And then when you guide to next year by the midpoint of next year being back to 2019 levels, how do you see this 4 million number playing out?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

Wes, I think it ties into the comments I made at the top. It's effectively -- it's the result of that bad debt expense ratio or the uncollectible lease income rate of finishing the year at 1.7%. We're at 2.5% now. So yes, we are anticipating that number will decline in the fourth quarter. And then I would anticipate that it would continue to decline next year.

We do -- we're moving that net effective rent-paying occupancy again 200 basis points this quarter. We need to compress that to within 50 basis points of commenced occupancy, at which time we can stop talking about it because 50 bps spread to commence is historically averaged. So yes, I do anticipate that number to slowly grind down from here.

Wesley Keith Golladay - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. I guess maybe building off of that comment, so you have -- I guess would you assume all these people to stay in occupancy but just become pain and no, I guess, attrition from this group?

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

Yes. I think we believe around this table that more of those will be survivors than move-outs. And to Jim's point earlier, some of this is category-driven and geographies-driven. So getting the West Coast a couple of months behind, getting them back up on their feet, these uses that are more impacted than others in that geography, I think it's just a matter of time. We will have some move-outs, but we don't -- we anticipate on balance more of those just converting back to rent-paying status.

Operator

(Operator Instructions) Our next question is from the line of Paulina Rojas-Schmidt with Green Street.

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

I really imagine high labor costs or lack of labor availability is accelerating retailers' focus in technology to make their business is less labor-intensive. Of all the potential disruptors ahead, and there are many, right, and more massive adoption of cashier-less stores, further warehouse automation, driverless cars, et cetera, what do you think are the most relevant for you as landlord, of course? Are you keeping a closer eye on anyone in particular? Of course, there is no good or long answer. I'm only looking for your general thoughts.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Yes. I appreciate the question, Paulina. We're really making sure that we are thinking about being proactive to the extent that we can be proactive, whether it be with simply relationships with our retail tenants and our merchants or whether it's what we can do internally. It's all of the above.

I'm going to try to -- there's no question that the most impactful, because it's -- I believe, it's permanent, is more of the BOPIS, right, and the last-mile distribution. And we have seen that accelerate over the past 24 months. And our retailers and our merchants, as you alluded to, are getting smarter about it and are investing more money in technology. But at the same time, they also -- as I just said in my prior response, they also appreciate and value that last-mile distribution being close to a consumer's home. And I've said it on other calls, and if you had listened to a panel with something that I did a conference in September, we had a target real estate representative on the panel, and he said it was like 90% of their orders are fulfilled from the stores.

So that is probably the thing that we think about the most and make sure that we're staying as close to and evaluating how can we take advantage of those opportunities, how can we actually play a part in that and play a role in that and partnering with our retailers. And then, of course, supply chain disruption, as Jim talked about, and labor shortages are something that we hope are temporary and transitional. I think that there's probably a little bit more evidence that the labor shortages may be recovering a little bit faster. And that really does impact us and impacts our -- by impacting our tenants so far more than the supply chain has. So it's all of the above. And we use the terms we're on our front foot for investments. We're on our front foot for ensuring that we're staying ahead and evolving with not just changing retailer and merchant preferences, but also changing consumer preferences, really thinking about the next 10 to 12 years.

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

And then another question. You mentioned in your prepared remarks, I think, embedded rent lease bumps were 80% of the leases executed this quarter. Is it remaining 20% exclusively comprised by Anchors or you're -- you also have flat rent for some small shop?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

It's really just kind of across the board -- it's not...

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

It's predominantly.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

It's predominantly Anchor-driven. You're getting increases from the vast majority of your shops.

Operator

And our next question comes from the line of Tammi Fique with Wells Fargo.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

I'm curious with the fallout from the pandemic that you experienced and the importance and cost of omnichannel. Has there been a general shifting to more national tenants across your portfolio? Or has the local small shop tenant as a percent of GLA or ABR remained steady versus sort of prepandemic?

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

I think the mix is really about the same as it was prepandemic, quite frankly. I think we're roughly 20% local.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Yes.

Michael J. Mas - *Regency Centers Corporation - Executive VP & CFO*

That's right.

James D. Thompson - *Regency Centers Corporation - Executive VP & COO*

So we haven't seen a real shift from that.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And then I'm curious on the acquisition. What are the unlevered IRRs that you are targeting today? And has that changed at all as cap rates have compressed?

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

The thresholds for us are really going to come back to, again, as I spoke about earlier, it's going to -- it will certainly depend upon our cost of capital that we're using to fund the acquisitions because whatever we are acquiring and adding to our portfolio in addition to being accretive to our future growth rate, also should be accretive to our earnings growth rate. So with that said, I mean, today, we can -- with our cost of capital, we could make unlevered IRRs in the 6% range work. And that's been relatively consistent for quite some time now.

Operator

And we have reached the end of the question-and-answer session. I'll now turn the call over to Lisa Palmer for closing remarks.

Lisa Palmer - *Regency Centers Corporation - President, CEO & Non Independent Director*

Thank you all for your interest and participation today. Always appreciate our conversations. Look forward to talking again soon, I think next week with a lot of you. Have a great weekend.

Operator

And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.