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REG.OQ - Q3 2022 Regency Centers Corp Earnings Call

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OVERVIEW:

REG expects 2022 core operating EPS (excluding the impact of non-cash items) to be $3.75-3.78.

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PRESENTATION

Operator

Greetings, and welcome to the Regency Centers Corporation Third Quarter 2022 Earnings Call. (Operator Instructions) And as a reminder, this conference is being recorded.

It is now my pleasure to introduce you to Christy McElroy, SVP of Capital Markets. Thank you, Christy, you may begin.

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

Good morning, and welcome to Regency Centers' Third Quarter 2022 Earnings Conference Call. Joining me today are Lisa Palmer, President and Chief Executive Officer; Mike Mas, Chief Financial Officer; Jim Thompson, Chief Operating Officer; Chris Leavitt, SVP and Treasurer, Alan Roth, Senior Managing Director of the East Region; and Nick Wibbenmeyer, Senior Managing Director of the West region.

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.

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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. 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. Good morning, everyone. Thank you for joining us today. We are pleased to report another quarter of solid results. We've continued to see positive operating trends as tenant demand is strong and rent growth remains at healthy levels despite the challenging macroeconomic backdrop. We do recognize that neither we nor our tenants are immune to macro pressures, especially higher levels of inflation, rising interest rates and lower consumer spending. And this does create some uncertainty in the near term.

But at the last few years have proven anything, it's the resiliency of our people, assets and our balance sheet in tough times. It is through a lens of what I would characterize as cautious optimism that we look ahead, and we remain confident that we are uniquely positioned to outperform. The demographic profile of our portfolio provides greater cushion for inflationary impacts to be absorbed by consumers and for spending to continue through a softer economic environment.

Our dense suburban trade areas also continue to benefit from structural tailwinds, stemming from post-pandemic migration patterns and hybrid work but also by a renewed appreciation for the value of brick-and-mortar retailing. Additionally, and just as importantly, we are well positioned to continue to execute on our self-funded growth strategy. While the cost of raising incremental capital have risen meaningfully over the last several months, our strong free cash flow and balance sheet dry powder enable us to continue to invest in our value creation pipeline on an earnings-accretive basis without the need to raise new equity capital or sell assets into an illiquid transaction market.

We remain focused on further growing our development and redevelopment pipelines and the commencement of our Town and Country project last month is an example of that. Another example is our acquisition of East Meadow Plaza on Long Island as we bought this as a redevelopment opportunity. And with the backdrop of a more challenging financing environment, we are starting to see more opportunities come to us to co-invest in attractive development projects.

On the acquisition side, while we always are looking for compelling opportunities, bid-ask spreads remain wide and volumes are low. So it will likely take time to get real price discovery. But regardless of when or where things settle, we do believe there will be less of an impact to values for well-located, grocery-anchored neighborhood and community centers at the upper end of the quality spectrum. In other words, for the types of assets that we own. But in the meantime, we are fortunate to have the liquidity and balance sheet capacity to take advantage of dislocation or other opportunities that may arise.

Finally, as I step back and think about the potential for operating in a more challenging environment or in any environment for that matter, I feel grateful to be leading Regency with the quality of assets and the caliber of people that we have. I believe we are well positioned to outperform over the long term, acting as both a safe haven and generating solid and sustainable growth, driving total shareholder returns with earnings growth plus dividend.

I always like to remind you that I'm proud that we delivered our dividend consistently during the pandemic, even growing it with another 4% increase just announced for the fourth quarter.

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Jim?

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

Thanks, Lisa, and good morning, everyone. We had another strong quarter and continued to experience healthy operating trends throughout the portfolio. Some of the highlights include: Continued robust tenant demand as evidenced by achieving our highest quarterly total leasing volumes on record, both in terms of square footage and number of deals executed, a strong leasing pipeline including over $34 million of annual base rent forecasted from our 240 basis points of leases signed, but not yet commenced; further occupancy gains as we continue to fill vacant space with percent leased up another 20 bps over the second quarter and up 90 basis points over the prior year; above average retention rates with record high renewals executed in the third quarter; healthy cash spreads of 7% and GAAP rent spreads over 13% in the quarter; continued prudent management of leasing CapEx, resulting in net effective rent growth in the mid-teens; and, a return to pre-COVID historical levels of current year bad debt as a percent of revenues.

Importantly, we're carefully monitoring our portfolio for any signs that these trends are softening, but we remain encouraged by the continued strength and progress we are seeing, leading us to further increase our 2022 same-property NOI guidance, excluding prior year collections by 25 basis points to 5.5% at the midpoint.

Turning to development and redevelopment. We continue to make great progress on our nearly $400 million of in-process projects around the country. Even with the increases in construction costs that we've seen over the last several years, our average yields have held firm in the 7% to 8% range. Notably, we anticipate roughly $15 million of NOI coming online over the next 2 years from development and redevelopment projects currently in process.

At our new much-anticipated ground-up East San Marco development here in Jacksonville, Publix opened their doors in August and the stores outperforming sales expectations. Leasing demand for the shop space was also very strong as the project is already 100% leased. We've also made significant progress over the last quarter at the Abbot, our redevelopment project in Cambridge, Massachusetts. The first tenant successfully opened and rent commenced in Q3, and we've recently signed a 17,000 square foot lease for the entire fourth floor and have good momentum and interest in the remaining penthouse space.

As Lisa mentioned, last month, we commenced construction at the Town and Country Center in Los Angeles, located across the street from the Grove and the L.A. farmers market. This long-awaited project will include a redevelopment of a former Kmart building into new retail space and approximately 300 luxury mid-rise apartments. We have partnered with a leading multifamily developer who will construct the apartments on a ground lease.

Looking ahead, we are very focused on continuing to build our pipeline of value-add development and redevelopment projects by executing on redevelopment opportunities that we have within our existing portfolio, sourcing new redevelopment projects through value-add acquisitions like our East Meadow, and by sourcing new ground-up development opportunities like our recently announced Glenwood Green. This is a key element of our growth strategy and a core competency of Regency and we believe that the tightening of the financing markets will favor our strong balance sheet and access to capital, affording us greater investment opportunities with developers and owners.

In closing, I spent the last 42 years in my career learning and growing this business with this incredible company. There isn't a stronger team or more thoughtfully curated portfolio of shopping centers in this business in what Regency owns today. I have the utmost confidence that our operating and development platforms will continue to thrive under the leadership of Alan and Nick, and I look forward to watching Regency's future successes from the sidelines over the years to come.

Mike?

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

Thanks, Jim. Good morning, everyone. I'll start by addressing third quarter results, walk through a few changes to our current year guidance, provide some comments on 2023 and touch base on our balance sheet. Same-property NOI, excluding prior year collections, was up 2.6% in the third quarter. This metric continues to be impacted by the noisier comps of uncollectible lease income last year, diluting the growth rate.

But as we've indicated previously, we are now back to a more historical run rate on collection losses of about 50 basis points on current year billings. Importantly, base rents contributed 3.9% to that growth rate, reflecting our strong embedded rent steps, combined with the progress we've made, growing occupancy and marking our rents to market as we convert on our strong leasing pipeline.

I'll continue to stress that while we are -- we still have some remaining pandemic-related accounting anomalies impacting our same property NOI growth rate, we believe that base rent growth is the best representation of the trends driving our business today. Included within our Q3 results is close to $3 million of prior year reserve collections, now totaling $18 million year-to-date.

And we have increased our fourth quarter expectations for continued collections by another $2 million, bringing our full year 2022 guidance range to an anticipated total of $20 million. We also converted another 3% of our cash basis tenants back to accrual in the third quarter, resulting in a reversal of straight-line rent reserves that contributed another $4.6 million to NAREIT FFO. Following these conversions, we now have about 9% of our ABR remaining on a cash basis of accounting.

As has been our practice, we have not included any potential fourth quarter conversions in our guidance, but it is possible that we may see another 1% to 2% convert before year-end, which could result in an additional straight-line rent of $2 million to $3 million on top of what's currently in the 2022 guidance range.

We raised our full year 2022 NAREIT FFO range by $0.075 at the midpoint, $0.045 of which was driven by the prior year collections and straight-line rent reversals that I just discussed. But most importantly, a large contributor to the increase was also further improvement in core trends, reflected in an increase in same-property NOI growth ex prior year collections of 25 basis points at the midpoint to a new range of 5.25% to 5.75%. Our revised core operating earnings per share range of $3.75 to $3.78 excludes the impact of noncash items, and when further backing out the impact of prior collections, represents year-over-year growth of 7%.

We also made a few tweaks to our transactions guidance, mostly to adjust for the $30 million acquisition of East Meadow, which closed shortly after quarter end. This is a value-add opportunity for us, a low going in cap rate, under earning center immediately adjacent to the Stew Leonard's anchored center that we bought as part of our Long Island portfolio late last year. This property is an ideal addition to our future redevelopment pipeline.

Looking ahead to 2023, as usual, we will provide full year guidance in February. But recognizing that we still have some pandemic hangover noise in our numbers, we would like to provide some context as you think about modeling our earnings over the next year. I'd also refer you to Slide 8 of our earnings presentation for additional details.

First, with regard to prior year collections, an area where we certainly experienced the most dramatic change over the last several years. Recall that in 2021, earnings benefited from prior year collections by $46 million, and our current 2022 guidance now implies an impact of $20 million. We're proud of the success we've had collecting those rents, much of which we reserved during the height of the pandemic in 2020. These collections are evidence of the strength of our tenant base. But thankfully, there's not a whole lot left in this bucket.

As we look ahead, we only expect to recognize another $3 million next year related to collections of receivables initially reserved in 2020 and 2021. Beyond those anticipated collections, the impact from -- of pandemic-related reserves should start to normalize.

I'd also like to point out the impact of noncash items where our current year guidance of $43 million includes $12 million positive contribution from the reversal of straight-line rent reserves. Our 2023 guidance will not include any further impact from conversions. As of right now, we expect total noncash items, which include straight-line rents, above and below market rents and amortization of above- and below-market debt of approximately $30 million for the full year 2023.

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Turning to the balance sheet. We remain well positioned with one of the strongest balance sheets in the REIT sector, and we're proud to have been recognized for that strength by Moody's, placing us on positive outlook during the third quarter. Our leverage is at 5x net debt to EBITDA, which is the lower end of our target range, and we ended the quarter with full capacity on our revolver.

We are extremely well prepared, whether the future holds further challenging conditions or increasing opportunities for value-add investment. The debt markets have remained volatile and the rise in treasury rates, along with wider credit spreads, has meaningfully impacted everyone's cost of new debt capital. But with no unsecured debt maturities until the middle of 2024, we have no need to access these uncertain credit markets in the near term. We can remain patient.

In addition, 99% of our pro rata debt is fixed rate, and our low leverage and long-dated maturity schedule will help to further suppress any potential negative impacts to our growth rate of marking our debt to market in the coming years.

With that, I'll turn it back over to Lisa.

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

Thanks, Mike. Before turning to Q&A, I do want to take a moment to recognize Jim. Jim has been a cornerstone for Regency success over the past 42 years. And so I thank you, Jim, on behalf of our entire company for your dedication and enormous contributions to Regency, building a legacy that will carry forward with Alan and Nick with all that you've taught them. I also thank you for being such a terrific partner to me and to Mike and also to Hap.

So as a parting gift today for your last earnings call, Alan and Nick will handle the Q&A for you. I wish you all could see a smile right now. Congrats, Jim, and enjoy the next chapters.

With that, we will open it up for Q&A.

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*

Congratulations, Jim. The leasing environment continues to be strong. Can you talk a bit about your pipeline and the visibility you have into it, even as the macro remains uncertain as you said in your prepared remarks? And then on that topic, leased and commenced occupancy continue to move in line. Our construction delays that we've heard about, kind of pushing out the ability to realize some of this leasing faster than maybe at first thought.

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

Thanks, Michael. I'll let Alan address that question.

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Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

Yes, Michael. The pipeline remains really strong. Strong demand is out there for sure. We've got north of 1 million square feet of leases that are still in negotiation right now. So I feel really good about the future. Your last question relative to is construction delays, the issue, not really. In fact, it's actually more permitting delays. So it's more on the front end that we're dealing with. And our teams, whether it's our tenant coordinators in-house that are working on things diligently, whether we're engaging expeditors from the outside, whether we are doing advanced landlord work on some vacant spaces to really help try and speed that process up, there's a number of different levers that we're certainly working on to help compress those dates, but it is more permit-driven than it is necessarily construction driven.

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

Is the permitting -- is that getting better or worse? Like is (inaudible) getting longer? Or is it already narrowing at this point?

Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

I'm going to choose door #3 and say it's staying pretty constant. It hasn't really gotten worse or better, Michael.

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

That's helpful. And then as a follow-up, Mike, on 2023, we appreciate the disclosure on Page 8 of the presentation and your commentary. So it looks like you're expecting prior year collection and noncash items in 2023 that are $30 million less than 2022. Can you kind of walk through the assumptions there? What's included with that? And then I believe straight line is not included, so that could be a potential benefit next year. Can you just walk through that again?

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

Yes. I'll -- I appreciate you noting Page 8 in the deck. It's a very helpful reminder for folks that prior year reserve collections, as we highlighted in the prepared remarks, aren't expected to recur at the same level that they did in 2022. That's frankly less to collect. In fact, our unresolved bucket of [AR] is down to about $5 million, and it's largely out west, and this has been a theme for us over the last 18 months. And we're making -- the teams out there making great progress, and we're really happy to see us in the final innings of that. We're only -- so $20 million in '22 on prior year collections. We're telling you now to expect about $3 million on that line item next year so think about that in the context of 2023 expectations.

From a noncash perspective, that is where the straight-line rent impact is included. It's really the conversions that are the outlier, not the recurring nature of straight-line rent. So we had about $12 million of recurring -- sorry, conversions in 2022. Those obviously won't repeat. I gave a little bit of color on some anticipated Q4 conversions. Again, 1% to 2% of our ABR could convert in the fourth quarter this year. That could lead to another $2 million to $3 million of impact in the fourth quarter be cognizant of that as well as you think about 2023.

And then the $30 million plus or minus guidance on that Page 8 is the combination of straight-line rent above below market rent amortization and the amortization of any debt mark-to-market.

Operator

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

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

I guess a follow-up question on the lease to commence. How do you expect that to evolve next year as you continue to, I guess, lease and also get new stores open?

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

Since we're getting into the guidance (inaudible), I think I'll let Mike address that one.

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

Yes, I'll take that, Anthony. It's a great question. And I'm going to be a little careful with respect to 2023. As we talk about guidance, we want to help with as many themes as we can. As you can imagine, we're still putting the finishing touches on our plan. And there's a -- we have some tailwind, which I'd like to talk about in the SNO pipeline but there's certainly some headwinds forming. So we're going to be patient between now and February.

So I mean, we're fortunate to have this 240 basis point SNO pipeline that we will deliver into 2023, about 75% of that, we anticipate delivering by the middle of next year. We'll deliver all of it by the end of next year for our plan. That's $34 million in total of ABR. Alan mentioned behind that, the 1 million square feet of leasing that's in our pipeline, whether it's in lease negotiation or negotiations of LOIs, that's about 6 months' worth of activity.

We've been carrying that level of activity for quite some time and continue to feel really good about the demand for our space. So those are really good indicators of how we think about the directionality of occupancy going into 2023. You've heard us also talk about post pandemic, our recovery pace being in that 100 basis point area from a commenced occupancy perspective.

I'm really pleased to say that a year ago this time -- Q3 of a year ago, we're now 80 basis points ahead of where we were. So we're delivering space. We're leasing space, we're delivering space. We're really achieving those recovery rates that we had thought we could and that our portfolio deserves.

So the outlie -- I mean, the consideration, Anthony, is going to be move outs. That is when I talk about the finer points of our plan for next year, that will be what really drives our occupancy expectations next year. More to come on that in February, but you would anticipate that some elements like ULI, we are at historical averages now in the third quarter, and we anticipate to stay there in the fourth.

Does 2023 sound like a historical average year, those are the considerations we're having. I would anticipate that ULI expectations probably on the margin are modestly expected to be a little higher. And again, more to come from a details perspective, but those are the elements that I would think about today as you model out 2023.

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

If I may just add one thing because this is something that we have said repeatedly in -- on calls and meetings, who knows what 2023 is going to bring with regards to a recession. But one thing that is different because we've been through cycles before. When we've entered other cycles, we've typically been at peak occupancy. And exactly what Mike just building on exactly what Mike just said, we're entering this one if it happens with still room to move in terms of increasing occupancy, and we expect that to be the case. We're also entering it having been through a really tough 2.5 years for our tenant base.

And so our existing tenant base is really healthy. And I think that, that is a differentiator with regards to what may be coming from an economic cycle. And I think that's a really important difference and one to consider.

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

And maybe one more. I think, Lisa, you mentioned that you're looking to do new developments with partners, ground-up developments. Are you seeing more people getting -- looking to do more ground up developments given kind of the strength in the sector until we see supply growth really finally start to tick up a bit given what we're seeing there?

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

Let me clarify. My prepared remarks were that given the scarcity of capital in today's capital markets, some of the smaller developers are having a more difficult time sourcing debt financing. And so we are starting to have a rising number of incoming calls to potentially partner and help be that source of funding for these smaller developers. So very different than actively just seeking JV development partners. We will, when opportunities are brought to us from JV partners look to that. But we're still very much committed to achieving our strategic objectives of annually having a consistent start and completions of developments and redevelopment dollars, I'd like to say at least at $200 million, if not north of.

Operator

Our next question comes from the line of Craig Mailman with Citigroup.

Craig Allen Mailman - *Citigroup Inc., Research Division - Research Analyst*

Maybe I just want to follow up on that last topic, Lisa, your commentary around the JV partners and just kind of square that up but also your commentary about the lack of movement or more minimal movement potentially in valuations for the quality of assets that you guys see and have in the portfolio.

I mean, would that suggest that maybe you guys would be more interested in the debt side of some of these potential transactions versus the equity side? Or if you do the equity, would it be more opportunistic where you might like to flip it? I'm just kind of curious about the quality of the opportunities relative to what you guys typically would look for?

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

For the last -- I would say, coming out of GFC, I believe that our development program has been very disciplined and focused on the quality of the assets, and that has -- that remains constant. And so any opportunities that we think about in terms of if we have others coming to us to help them, it starts with the quality of the opportunity and the real estate and the asset. Is this something that we want to own long term? And if the answer to that is yes, then the decision tree is to continue the conversations and move forward and evaluate the opportunity. But it always starts with the quality of the shopping center.

Craig Allen Mailman - *Citigroup Inc., Research Division - Research Analyst*

Okay. And you guys noted I think you threw off around $130 million of free cash flow. You kind of lever that up. It's around the $200 million that you kind of like to look out, put out per year rather. Can you guys just talk about how you view that cost of capital versus kind of potential deployment opportunities and kind of the cushion that, that may give you from an accretion standpoint and kind of risk-adjusted returns?

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

Sure, Craig. I'll start, and Lisa may jump in here too. But you're exactly right. We are -- we have talked about $135 million plus or minus in anticipated free cash flow that the portfolio is throwing off in connection with our -- the low leverage that we carry. That whether -- let's call it non-dilutive

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capital, maybe that's a better description for that. So we have access to $135 million of non-dilutive capital. We are also targeting 5 to 5.5x leverage overall. So we can lever that capital at a rate of about 50%, and that provides actually north of the $200 million, about $270 million, approaching $300 million of capacity for us to invest accretively.

Now to your question, how do we then think about investment return thresholds. We have this great source of capital, non-dilutive capital, we can be competitive, we can be aggressive. But we also are very conscious and aware of what valuation -- where valuations are, what risk premiums need to be, especially in the development business. And those remain the same. We do target spreads of 150-plus basis points to what we would determine -- what we would think to be in place cap rates.

Today, those -- that's a little bit more challenging to wrap your head around because of the lack of data points that are out there in the market today. But we are finding, as Lisa mentioned, just good conversations, opportunities to advance conversations in this space and those returns, we have confidence will be accretive to earnings because of that non-dilutive capital source. And we also think we'll end up achieving return thresholds that make sense to us from an NAV basis and from an incremental cost of capital basis.

Operator

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

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

Congratulations, Jim. So first question, your occupancy today is about 94.7%. When you look at the prior peak, it was hovering around 95%. I know this has been perfectly apples-to-apples and your portfolio has shifted, but how should we think about the leased occupancy upside from here on out? And can you describe the existing vacancy quality or desirability as it compares to the rest of the portfolio?

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

I'm -- very quickly, I'll just -- I want to comment on the peak occupancy comment, and then I'll have Alan address the quality of the vacant space, if you will. I'm probably a little bit older than you, Ki Bin. So perhaps I remember the peak occupancy a little bit more clearly. But we -- I mean, we were north of 96%, certainly going into the GFC and that's pretty close to it again, if not exceeded it coming out. I'm getting very, very adamant head nods, yes, around the table. So exceed at 96% and our shop space exceeded 94% in the peak for a very short period of time. And I believe that we have the -- I'm sorry, 92%. And I believe we have the ability to get back there again. And so that's when I talk about entering this potential recession, if that's what it is and becomes that we still have opportunity to continue to grow that occupancy.

Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

Yes. And Ki Bin, this is Alan. To answer your vacancy quality, feel really good about what's there. And I think that's evidenced by if you look at our cash rent spreads for the quarter at 14%, which were obviously strong. And if you think about it also in the context of space that's been vacant for less than 12 months, we actually were driving 20% cash rent spreads. Again, another testament, I think, the quality. And on top of that, if we look at our embedded rent steps, it was the highest quarter we've ever had.

And so our ability to drive those cash rent spreads, our ability to have these embedded rent steps at averaging 2.5% and in many instances, well north of 3% does speak to the quality of the vacancy. And I feel really good about setting our eyes at that 96-plus percent that Lisa had mentioned.

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

And Lisa, you're right. I had unhide a couple of columns in my Excel model, 96% is right. So second question on the assigned, but not leased, pipeline, $34 million of ABR. How much of that is replacing existing vacancy, I mean it's like replacing existing occupancy?

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

Ki Bin, it's all incremental. We -- none of that is replacing anything that is rent paying today.

Operator

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

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

The lease rate pretty close to pre-pandemic, are you now able -- do you feel to focus on rates over occupancy? How does the possible recession kind of impact your underwriting and thinking or actual ability to push rents. And I'll make it a 2-part because you might not answer the second part. But what feels like a realistic goal for the lease rate over the next year?

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

Derek, I'm actually looking at Mike to make sure that I don't speak out of turn too much. So I'll try to stay away from guidance, but -- and keep it at a much higher level in macro. Generally speaking, I think that if you were to run a correlation between percent leased and rent spreads, you're going to see that there's a pretty strong correlation. I mean the more occupied you are, the less space there is available to lease, the more pricing power that you have and we continue to see that. And add on top of that inflation. And I think that we're going to be able to continue to drive healthy increases in rents. I'm -- look, I think that's probably -- I will leave it at that.

And in terms of guidance from rental spreads, well contractual rent spreads we've talked about, we continue to see that in nearly all of our leases, more than the vast majority. And we're always close to averaging close to 3%, and we are seeing that still very, very steadily and in more cases than even last quarter, greater than 3%. So we continue to see increases in rents.

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

Yes, Derek, with respect to '23 guidance, I mean largely from a rent spread perspective, it's largely what's in our SNO pipeline. So the spreads that we've already achieved are what's really going to drive our growth into 2023. The challenge for us and we are up to the challenge is to maintain what we're seeing in today's spreads in that mid- to upper single-digit area. That is our strategic objective. We think we have the right portfolio, the right team sourcing the right tenants and to Lisa's point, in spite of some of these headwinds or challenges to continue to drive rent spreads at those levels to continue that pace of growth in 2024 and beyond.

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

Okay. Great. And then just touching on the Abbot. Can we get a little more clarity on the early leasing that was mentioned in the opening remarks and obviously, how it's tracking versus plan or initial underwriting? And how are you feeling about it? And what about leaning in and possibly commencing some more of these mixed-use projects, given what seems to be a pretty good success in Cambridge?

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

I'll start with the latter part of that question, and then I'll kick it over to Alan to talk about the property specifically. Generally speaking, again, I'll go back to the 12-plus years coming out of the GFC been very focused and disciplined on developing quality primarily grocery-anchored shopping center, doesn't mean that it won't -- that it has to be grocery-anchored, but primarily grocery-anchored shopping centers. And even in those cases where we have had the opportunity to add density to existing shopping centers, we also, again, really focus on participating and developing the

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retail portion of that shopping center. And when there is other opportunities to bring in, for example, Town and Country is a great example since we just started that, where we partnered with a multifamily developer to take -- to do the multifamily development of that.

That's how we will pursue those types of projects. The Abbot was a little bit different. We did -- that did come with our merger with Equity One. It was already in process. And it's also -- it's a lot more vertically integrated.

And I'll let Alan speak to the leasing and how even with our leasing of that, it's still very similar uses to what we would do if it was a horizontal shopping center. So with that, I'll toss it to Alan.

Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

Yes, Derek, I am really proud of what the team has accomplished there. All of our ground floor retail has spoken for and leased and they've done an exceptional job with the uses in terms of merchandising, credit, rents, et cetera. What remains left is our premier penthouse space. It's a space that originally was going to be taken by a fourth floor tenant, and they just decided the $11 just to take one space. But -- if we want to have one space left to lease, it's that one and the demand has been really strong on it. We just hope it hosted a grand opening event there last week, well attended. The feedback from the retailers that are open is that they are doing remarkably well.

So again, we're thrilled with the project, and we're thrilled with the support that we've gotten from the entire Cambridge community.

Operator

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

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

My questions are on Town and Country. First, congratulations to Jim. It's been very interesting to watch you and your work at Regency. But going to Town and Country, I'm just wondering, do you know any of the new retailers you're going to be adding to that complex?

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

We'll let -- Nick has been dying for someone to ask him about Town and Country. So we'll let Nick answer that question.

Nicholas Andrew Wibbenmeyer - *Regency Centers Corporation - Senior MD of West Region*

Yes. No, thank you for the question. No, we're extremely excited, as Jim mentioned in the opening remarks, just a phenomenal piece of real estate, obviously, across the street in the glove. And so retail demand, as you can appreciate, has been extremely strong, even with a long lead time before delivery. But the new anchor tenant to the new phase will be Whole Foods building a new store. So they are currently a tenant in the shopping center. They will be relocating into a new prototype underneath the vertical residential that Holland is developing.

So really excited about having them reimagine what their experience of the consumer will be in that shopping center and clearly excited about future tenants we will add in and around them in the future phase.

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

And do you have a -- obviously comps for luxury apartments in the Mid-Wilshire area?

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Nicholas Andrew Wibbenmeyer - *Regency Centers Corporation - Senior MD of West Region*

We do. But again, just to reiterate, we are leasing the air rights to Holland. And so the good news about that structure is our rent is 100% committed from Holland through an air rights lease structure. And so as you can appreciate, Holland is hyper focused on what those rents are going to be. But we feel very, very confident they're going to achieve their underwritten rents and therefore, feel extremely confident that it's going to be a really successful partnership to both.

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

Great. And then just I was reading about you had robust community feedback. What are some of that feedback? And how does that relate to how you're setting up the property going forward?

Nicholas Andrew Wibbenmeyer - *Regency Centers Corporation - Senior MD of West Region*

The really good news is, again, with the lead time we have, we can be extremely patient. And so the conversations we've been having with tenants are really at the preliminary stage. Now that construction is starting, now that we are going to see shovels in the ground, now that it's become public that Whole Foods will be relocating, it really allows us to lean into those conversations. And so again, with this type of quality of real estate with a couple of years of lead time, we're going to continue to progress conversations appropriately, but also continue to be extremely patient as we expect to be able to pick from the best of the best throughout the industry.

Operator

Our next question comes from the line of Hong Zhang with JPMorgan.

Hong Liang Zhang - *JPMorgan Chase & Co, Research Division - Analyst*

I guess a quick question on how to think about commenced occupancy. Given you've grown commenced occupancy 60 basis points since the beginning of the year, just given your comments about strength of tenant quality and your backlog of commencement. Is it fair to say that you would expect a greater than 60 basis points increase in commenced occupancy by year and next year?

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

We'll take it easy on 2023. I'm sorry, more to come, I think, is something you'll hear from us pretty often. But let me take the opportunity to take your comment and speak to 2022. And then we can extend that from a trajectory standpoint.

Base rent, as I said in my remarks, just continue to focus on base rent as the best indicator. Because of our high degree of cash-based tenancy, 2021 is providing a very sloppy comparison year in our quarter-over-quarter results. We're all accustomed to that. Our disclosure does an excellent job of explaining that phenomenon. But base rent growth, just to repeat some numbers in first quarter of this year was 2.8%. That grew to 3% in the second quarter. That grew to 3.9% in the third. You can imply from our guidance and our revision to guidance that the fourth quarter will continue to march forward, again, consistent with the 60 basis points of rise in commenced occupancy, as you mentioned, Hong.

Pair that with some of the comments we've made about leasing demand about our SNO pipeline that exists today about the shadow leasing pipeline that extends beyond that, that Alan shared some details with us on. I do think it's fair to say that we are we are positioned to grow base rent through what could be a softer economy. And one of the reasons we're positioned to do that is because of the circumstances that Lisa articulated, much of the weakness was eliminated in 2020 and 2021. So we're coming into this position from a period of strength, good, well-located

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vacancy, good demand from the markets, more to come on how much growth we should anticipate in 2023. But I do think we like this trajectory that we're on.

Hong Liang Zhang - *JPMorgan Chase & Co, Research Division - Analyst*

And apologies if you talked about it before, but could you talk a little bit about the value-add opportunity you see at East Meadows?

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

Yes. I'll just start really quickly and again, toss it to Alan to talk about the project. But as I said in my prepared remarks, we bought that as a redevelopment opportunity. And clearly, with our disclosure, you can back into what the ingoing cap rate was. So it's a very low ingoing cap rate. But we are -- we expect unlevered IRR is approaching 10% on that. So it is a development like return. So I'll pass that to Alan.

Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

Yes. Hong, so we bought that from a family that's owned the land since the 1920s. And obviously, coming off the heels of acquiring the adjacent Stew Leonard's anchored asset back in December of last year. We're really excited about our ability to connect these 2 assets. We are going to be working with a local municipality on a redevelopment. But our team up in the Northeast is really excited to do what we do, do best, and that is enhanced merchandising, implement our place-making strategy and connect to the community through the redevelopment of the asset. So a lot to unlock. And I just think the center of gravity by creating both of these assets into one larger project will really be fantastic. So we're looking forward to that completion.

Hong Liang Zhang - *JPMorgan Chase & Co, Research Division - Analyst*

Yes. So it sounds like it's -- we'll see a redevelopment pipeline sooner rather than later.

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

Correct.

Alan Todd Roth - *Regency Centers Corporation - Senior MD of East Region*

Yes.

Hong Liang Zhang - *JPMorgan Chase & Co, Research Division - Analyst*

Congrats, Jim.

Operator

Our next question comes from the line of Wes Golladay with Baird.

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

I want to go back to the comment about talking about the catching up with inflation. Is there a way to measure how much upsides in the portfolio, mean that these are long-duration leases is the best way to look at it with -- as a renewal with no option? And if you have that data, that would be nice.

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

I didn't pick up the words before option. I'm sorry, Wes.

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

Do you have the -- is the best way to look at it the embedded growth in the portfolio to look at the renewals that you're signing that don't have an option?

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

I want to make sure that we do address it as we can. So if you do, I think when you think about how can -- how are we positioned, I think this is what you're saying to capture what may be rising market rents due to inflation. And the best way to look at that really is to look at what percentage of our space is expiring and what market rents are that are expiring, but what -- it's difficult for you to see what the mix is of anchor and shop and that gets a little bit more difficult. So your question because of what percentage of them have options -- is that...

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

Yes. Well, I guess when you do renewals, your renewal spread that you cite is a mix of tenants that have options -- or that were maybe set out a lock rate and then ones where you negotiate with them, hey, this is where the new rate is and you get a big pop on the ones that they don't have an option on. And so I was wondering if you had the delineation between those 2 types of renewals?

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

Okay. The question is more clear now.

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

Yes. The renewal rate renewal -- sorry, Wes, the renewal rate on -- the lease spread on renewals without options is 8%. The bucket that is exercising options is at 5%.

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

Got you. And is that the best way to look at the embedded growth in the portfolio as it stands today in your...

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

I mean it can get a little bit more complex than that. I think we have to start with our lease -- we have to serve our contractual rent increases. Those are -- we are -- we are indeed putting in place -- we have in place 2% contractual increases in our kind of same space portfolio. That contributes

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about 1.3%, 1.4% to our growth profile. So I think you have to start the conversation there. And as Alan mentioned earlier, we're hitting kind of peak levels that we haven't seen from a new threshold from a contractual increase perspective.

Then you add on to that, what we're experiencing on the lease spreads. Yes, some of that is going to be contractual. Some of our tenants have fixed rate options that they have to their benefit that will have, as I mentioned, a bit of a dilutive impact on that ability to grow. But where we can maintain control space, limit options to our tenants, then attack that new market rent growth that's where we -- that is the other lever that we can pull to increase our growth profile.

The third element that is available to us today is all about this peak occupancy level. And we've spent some time today talking about that. We have room to run. And that will be probably more of an amplifying impact going in as we think about the 2023, 2024 in the near term, then the impact coming from the lease spreads.

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

Congratulations, Jim.

Operator

And our next question comes from the line of Ronald Kamdem with Morgan Stanley.

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

Great. Just a couple of quick ones. Starting with sort of the occupancy gains. Just trying to get a sense of, in your mind, just how much more full the portfolio can get or when we're thinking about sort of the same-store growth function in the next couple of years. Clearly, the base rents are a big driver. We're trying to understand how much more occupancy can drive that?

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

Yes. I think it's been...

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

The guidance again.

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

Yes, a little bit of guidance and kind of asked and answered if raised today. But more to come on, on our expectations for '23, but I'll just reiterate, we feel good about the quality of the portfolio. We don't -- the weakness has largely been shed. We feel good about our SNO pipeline and delivering that rent. We feel great about the shadow pipeline that's behind that and the negotiations that are ongoing. So we do see continued opportunities to grow base rent from here. And just more to come on our expectations for achieving a occupancy, whether that's at the end of '23 or into '24, more to come on that in February.

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

Great. And then apologies if it's been asked already, but can you just -- have you commented on sort of the Kroger-Albertsons deal? Just curious what implications for the company pays for the industry, what your take on that is?

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

We have not had that question yet. So generally speaking, as long as I've been in this business, which is now over 26 years, not quite as long as Jim's 42 years, but the grocery industry clearly has always been one of consolidation and of the stronger operators getting stronger and the top grocers getting better. And it's why our strategy has always focused on investing in shopping centers that are anchored by the top grocers in that market, whether it's by market share, but it's really by the productivity of those stores and the sales that they generate.

The combination of Kroger and Albertsons just creates an even better operator. And we think that that's a positive. It will allow them to invest further into their business in all aspects of their business, both digital and also in the in-store experience, which they both were already doing. And now combined, they will be able to do that even better.

Operator

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

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

Can you remind us pre-pandemic, what percentage of your tenants were on cash basis? I know it's been going down about 2% to 3% a quarter and it's at 9%. But where do you think it ends up by year-end '23?

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

Linda, it's Mike. So we're at 9% today. We get this question often, and it's hard to answer only because the policies from a GAAP perspective that we're applying today don't quite match what those policies and GAAP treatment was prepandemic. But we were in the mid-single-digit area, 5% plus or minus previous to that. I called for maybe another 1% to 2% that could convert in the fourth quarter. We're getting down to where we're going to normalize somewhere in that mid-single-digit area.

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

Got it. And then maybe on the idea that you could see a slight uptick in move-outs early next year given the more uncertain environment. But coupled with the idea that your tenant base is a lot stronger headed than versus headed into past recessions, what's the best way to think about bad debt for next year?

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

A couple of questions in there. So we didn't comment on the seasonality expectation of Q1 move-outs. I think you're alluding to the fact that it typically is a stronger move out type of quarter, more to come when we put out full 2023 expectations.

From a bad debt perspective, I'll reiterate what I said earlier. We are at historically average rates today from the third quarter and the fourth quarter from an expectation standpoint. It would not be out of the question, again, is next year a historically average year. It would not be out of the question to think that it would not be and that we would be prudent to plan for some sort of modest increase in our rate, but I don't -- by no means do I anticipate that we will equal the rates that we had in 2021 or 2020.

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

And just reiterating, again, I'll go back to my prepared remarks of I characterize it as cautious optimism in that -- none of us really do know where the economy is going to settle, if you will, with regards to the recessionary if there are recessionary impacts. And what I think to clarify Mike's comments, the question -- the answer to a question earlier is the leasing is essentially accounted for because we have our signed-not-occupied leases that are coming online. The uncertainty is in the level of move-outs, because when you have a move out, that impact is immediate because they stop paying rent. I think that's what you're referring to. We did not indicate that we expect it to be an uptick, said that more to come in February when we give guidance.

Operator

Our next question comes from the line of Paulina Rojas with Green Street.

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

I only have one quick question. Regarding the transaction market, are there any areas or markets where cap rates have increased less or the reaction to the macro headwinds on staying in your mind more market-agnostic?

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

Yes, Paulina, I'll address that by a little bit of what I said in the prepared remarks as well. There has been very low volumes in the transaction market. So very little price discovery. The bid-ask spreads are still really wide. And I would say that is market agnostic. It is not that there's -- there aren't any specific markets where price discovery is better than others and volumes are low across the country. So at this point in time, it's the -- it's still market-agnostic.

Operator

There are no further questions at this time. And I would like to turn the floor back over to Lisa Palmer for any closing comments.

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

First, thank you all for your time this morning. One last. You heard me say when we're closing the prepared remarks that I wish you all could see Jim smile when we said that he wasn't going to answer the questions. You also didn't have the opportunity to see how relaxed he was the whole time while we were answering your question. So Jim, the least -- it is the least that we could give you and you deserve. Thank you so much and enjoy your time.

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

Thank you much. Thanks for the bye.

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

Thank you all. Have a great weekend.

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Operator

This concludes today's conference. You may now disconnect your lines at this time. Thank you for your participation, and have a great day.

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