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Earnings Call

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CALL PARTICIPANTS	2
PRESENTATION	3
QUESTION AND ANSWER	7

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Presentation

Operator

Good morning, and welcome to the Agree Realty Second Quarter 2025 Conference Call. [Operator Instructions] And note, this event is being recorded.

I would now like to turn the conference over to Reuben Treatman, Senior Director of Corporate Finance. Please go ahead, Reuben.

Reuben Goldman Treatman
Senior Director of Corporate Finance

Thank you. Good morning, everyone, and thank you for joining us for Agree Realty's Second Quarter 2025 Earnings Call.

Before turning the call over to Joey and Peter to discuss our results for the quarter, let me first run through our cautionary language. Please note that during this call, we will make certain statements that may be considered forward-looking under federal securities law, including statements related to our updated 2025 guidance. Our actual results may differ significantly from the matters discussed in any forward-looking statements for a number of reasons. Please see yesterday's earnings release and our SEC filings, including our latest annual report on Form 10-K for a discussion of various risks and uncertainties underlying our forward-looking statements.

In addition, we discuss non-GAAP financial measures, including core funds from operations, or core FFO; adjusted funds from operations, or AFFO; and net debt to recurring EBITDA. Reconciliations of our historical non-GAAP financial measures to the most directly comparable GAAP measures can be found in our earnings release, website and SEC filings.

I'll now turn the call over to Joey.

Joel N. Agree
President, CEO & Director

Thanks, Reuben, and thank you all for joining us this morning. I am extremely pleased with our performance during the first half of the year, having invested over \$725 million across our 3 external growth platforms, while further solidifying what we believe to be the preeminent retail portfolio in the country. The \$725 million-plus invested year-to-date represents a more than twofold increase relative to the first half of last year. All 3 of our external growth platforms have broad and expansive pipelines, and we'll see acceleration in the third quarter. Hence, we are raising our full year investment volume guidance once again to an updated range of \$1.4 billion to \$1.6 billion. The midpoint of this range represents a 58% increase over total investment volume for last year.

Most exciting is not the defensive nature of our portfolio or balance sheet in a dynamic world. It is now our dominant market position, driven by a best-in-class team that executes on hundreds of transactions annually across our 3 growth platforms. This value proposition is unparalleled. And when combined with our internal asset management platform and deep retailer relationships has built a differentiated and unmatched company. It has been 15 years in the making since this vision was outlined in our one-page operating strategy, December of 2009 to be exact. And I'm delighted to say that it has been realized. I am confident that these factors will drive an increased earnings algorithm in the coming years without moving up the risk curve in any manner.

We continue to expand our war chest during the quarter, now having raised over \$1 billion of capital year-to-date with \$1.3 billion of outstanding forward equity. With over \$2.3 billion in total liquidity, no material debt maturities until 2028 and pro forma net debt to recurring EBITDA of just 3.1x at quarter end, our balance sheet remains best-in-class and is positioned to support our growth well into next year.

To support this growth, we've continued to scale our team, enhance our systems and refine our processes, building a well-oiled machine and widening our competitive moat. We've added over 20 new team members year-to-date across the organization, increasing the scale of our horizontally integrated platform to support current activities as well as growth for years to come. We have driven industry-leading efficiencies with the deployment of additional systems, including AI and machine learning tools as well as enhanced integrations and streamlined workflows. Additionally, we have commenced the next iteration of Arc, which will come online next year. We've already started to reap these benefits in 2025 as we're raising our full year AFFO per share guidance by \$0.02 at the midpoint to a new range of \$4.29 to \$4.32. This represents over 4% growth at the midpoint and demonstrates our ability to provide consistent and reliable earnings growth without deviating from our investment strategy. Peter will provide further details on the guidance range and its key input shortly.

We continue to see the biggest and best retailers take market share, which acts as a tailwind to all 3 of our external growth platforms. Even in today's uncertain macro environment, we are seeing the highest level of retailer demand for new brick-and-mortar locations since the great financial crisis. Nearly every retailer in our sandbox is focused on adding net new stores, underscoring the critical role that retail net lease assets play in an omnichannel retail world and as outlined in our previous commentary in white papers.

Moving on to the second quarter in detail. We invested over \$350 million in 110 properties across all 3 platforms. This includes \$328 million of acquisition volume across 91 high-quality retail net lease assets. Notable acquisitions during the quarter included a sale-leaseback with a leading national auto parts retailer, a one-off Walmart Supercenter in Ohio and a \$75 million grocery-dominated portfolio, representing one of our largest non-sale-leaseback transactions since the inception of our acquisition platform in 2010. This unique opportunity was owned by an elderly woman and was sourced through 18 months of working in off-market opportunity. These differentiated examples underscore the strength of our platform and its ability to source differentiated opportunities in a substantial and highly fragmented space. The acquired properties had a weighted average cap rate of 7.1% and a weighted average lease term of 12.2 years.

Over 53% of base rent acquired was derived from investment-grade retailers, and we continue to add to our ground lease portfolio during the quarter. We anticipate selling a few lower-yield noncore assets from the aforementioned \$75 million grocery-dominated portfolio, which will include both acquisition cap rate and investment-grade percentage for the quarter post disposition. Although we only commenced one project in our development and DFP platforms during the quarter, don't be fooled, we continue to see increased activity and have a deep pipeline. We anticipate announcing several projects in the quarters ahead, while construction continued on 14 projects during the quarter with aggregate anticipated costs of over \$90 million. We wrapped up 4 projects during the quarter, representing aggregate investment of over \$13 million. These projects were with leading retail partners, including TJX, Burlington, 7-Eleven, Boot Barn, Starbucks, Gerber Collision and Sunbelt Rentals.

In total, we had 25 projects either completed or under construction during the first half of the year, representing \$140 million of committed capital, including \$98 million of costs incurred through June 30. We anticipate development spend to be up at least 50% year-over-year as both platforms continue to ramp. Our asset management team continues to address upcoming lease maturities. We executed new leases, extensions or options on approximately 950,000 square feet of gross leasable area during the quarter. This included a Walmart Supercenter in Ohio, a Best Buy in California and 5 geographically diverse leases with The TJX Companies.

In the first half of the year, we executed new leases, extensions or options on 1.5 million square feet of GLA with recapture rates of approximately 104%. And Notable examples in recent quarters include the re-leasing of our former Big Lots in Manassas, Virginia and Cedar Park, Texas with net effective recapture rates of almost 170% and 150%, respectively as well as the re-leasing of our former Party City in Port Arthur, Texas, with a net effective recapture rate of 115%, demonstrating our emphasis on fungible boxes in dominant retail corridors. At quarter end, our best-in-class portfolio surpassed 2,500 properties spanning all 50 states. The portfolio includes 232 ground leases, comprising over 10% of annualized base rents.

Our investment-grade exposure stood at 68%, and occupancy rebound post the re-tenanting of the former Big Lots by 40 basis points to 99.6%. Dispositions remain limited. However, our only At Home located in Provo, Utah across from a new Target is currently under contract to sell and nonrefundable at a 7% cap. We purchased the At Home as a pure real estate play in 2016 and have had interest in the site from multiple retailers and prospective purchasers. The disposition cap rate of 7% is nearly 50 basis points inside of where we acquired the asset, and we anticipate realizing an unlevered IRR of approximately 9% upon closing this quarter. Although At Home recently exercised a 5-year option and the lease is anticipated to be [affirmed] in bankruptcy, I'm confident that At Home will ultimately suffer the same fate as Party City, JOANN and Rite Aid and ultimately liquidate.

With that said, I'll hand the call over to Peter to discuss our financial results for the quarter.

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Thank you, Joey. Starting with the balance sheet. We had a very active quarter with over \$800 million of debt and equity capital raised, bringing total capital markets activity year-to-date to over \$1 billion. We raised approximately \$415 million of forward equity in the quarter via our ATM program and a 5.2 million share overnight offering in April. In May, we completed a \$400 million public bond offering comprised of 5.6% senior unsecured notes due in 2035. In connection with the offering, we terminated forward starting swap agreements of \$325 million, receiving almost \$14 million upon termination and reducing our all-in rate to 5.35%.

During the quarter, we also settled close to 700,000 shares of forward equity for net proceeds of approximately \$41 million. As of June 30, we had approximately 17.5 million shares remaining to be settled under existing forward sale agreements for anticipated net proceeds of \$1.3 billion. At quarter end, total liquidity stood at \$2.3 billion, including cash on hand, forward equity as well as \$1 billion of availability on our revolving credit facility, which is net of amounts outstanding on our commercial paper program at quarter end. Pro forma for the settlement of all outstanding forward equity, our net debt to recurring EBITDA was approximately 3.1x, representing the lowest level since Q4 of 2022.

Excluding the impact of unsettled forward equity, our net debt to recurring EBITDA was 5.2x. Our total debt to enterprise value was approximately 28%, and our fixed charge coverage ratio, which includes the preferred dividend, remains very healthy at 4.2x. Our only floating rate exposure remains short-term borrowings, and we continue to have no material debt maturities until 2028. Our balance sheet is extremely well positioned to fund our growth into next year as we've locked in an attractive cost of capital, which helps provide visibility into the acceleration in our multiyear earnings algorithm, as Joey mentioned.

Core FFO per share was \$1.05 for the second quarter, which represents a 1.3% increase compared to the second quarter of last year. AFFO per share was \$1.06 for the quarter, representing a 1.7% year-over-year increase. As Joey highlighted, we have updated our full year 2025 earnings outlook to reflect the strong first half to the year. We raised both the lower and upper end of our full year AFFO per share guidance by \$0.02 to a new range of \$4.29 to \$4.32, which implies year-over-year growth of over 4% at the midpoint. The increase in our earnings guidance is largely driven by higher investment activity as evidenced by our increased investment guidance as well as a lower assumption for treasury stock method dilution. As a reminder, if ADC stock trades above the net price of our outstanding forward equity offerings, the dilutive impact of unsettled shares must be included in our share count in accordance with the treasury stock method.

Our stock is trading at lower levels than in late April, and if it continues to trade near current levels, we anticipate that treasury stock method dilution will have an impact of roughly \$0.01 on full year 2025 AFFO per share. That said, the impact could be higher if our stock moves materially above current levels, as was evident in last quarter's guidance or if we were to issue additional forward equity. Our guidance has been updated to include an assumption of 25 basis points of credit loss at the high end of our AFFO per share range and 50 basis points of credit loss at the low end of the range. I want to reiterate that our definition of credit loss is fully loaded. It encompasses not only credit events, but downtime due to a tenant vacating at lease maturity unrelated to credit issues and other partial or nonpayments for any and all reasons. It also includes any operating and tax expense that ADC is responsible for paying while a space is vacant.

in addition to lost rental revenue. We believe this is an important distinction versus narrower definitions of credit loss used by some of our peers as we're looking to provide a more comprehensive picture of not only credit events, but overall economic loss for modeling purposes.

Our growing and well-covered dividend continues to be supported by our consistent and reliable earnings growth. During the second quarter, we declared monthly cash dividends of \$0.256 per common share for April, May and June. The monthly dividend equates to an annualized dividend of over \$3.07 per share and represents a 2.4% year-over-year increase. Our dividend is very well covered with a payout ratio of 72% of AFFO per share for the second quarter. We anticipate approximately \$120 million in free cash flow after the dividend this year, up over 15% from last year. This provides us with another source of cost-efficient capital to fund our growth while maintaining a growing and well-covered dividend. Subsequent to quarter end, we announced a monthly cash dividend of \$0.256 per common share for July. The monthly dividend also equates to an annualized dividend of over \$3.07 per share and represents a 2.4% year-over-year increase.

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

Joel N. Agree

President, CEO & Director

Thanks, Peter. Operator, at this time, let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Linda Tsai from Jefferies.

Linda Tsai

Jefferies LLC, Research Division

Can you give us some color about your ATM activity in 2Q and overall timing given your overnight equity offering in late April?

Joel N. Agree

President, CEO & Director

You're breaking up a little bit, but I think you asked about the ATM activity during the quarter, correct?

Linda Tsai

Jefferies LLC, Research Division

Yes, your overnight equity offering in late April.

Joel N. Agree

President, CEO & Director

Got it. Yes. The ATM activity during the quarter all predated the overnight offering in April. During the overnight offering at post commencement of launch, I promised investors that we would be inactive in the capital markets and we were fully funded, and we held that promise.

Linda Tsai

Jefferies LLC, Research Division

And then I think you said acquisition cap rates would expand going forward. What's the magnitude? And any highlights on the tenants you're targeting?

Joel N. Agree

President, CEO & Director

No new tenants that we're targeting. We're going to stay within our sandbox. I would anticipate Q3 -- again, we just started sourcing for Q4, but Q3 acquisitions to be similar to the first quarter but larger in volume.

Linda Tsai

Jefferies LLC, Research Division

Just one last one. Just given all the macro headline volatility, how are you thinking about retailer and consumer health right now? Do you have a view of whether it's improved or deteriorated year-to-date?

Joel N. Agree

President, CEO & Director

Well, I think consumer health has undoubtably deteriorated, at least consumer sentiment. We've seen those numbers swing. I think this number -- this morning's jobs report most likely affirms that conclusion. Ultimately, this enters to the benefit of our portfolio, which is focused on core durable goods and necessity-based retailers that are biggest in the country. And that has been our focus, will continue to be our focus. We will stay away from experiential. We'll stay away from discretionary and we're going to buy things, as you see in this quarter, whether it's auto parts or in grocery or tire and auto service that continue to be required by consumers to live their daily lives, from the biggest and best operators that can offer the lowest price. And we're seeing that throughout retailer earnings reports, right? The biggest

and best operators here are going to continue to gain market share. And simultaneously, we're going to continue to gain market share.

Linda Tsai

Jefferies LLC, Research Division

Do you think retailer health is improving though overall?

Joel N. Agree

President, CEO & Director

We'll see how retailer health is. I think you're going to see small retailer. I think the Big Beautiful Bill and what we're seeing going on in Washington ultimately is going to impact and tariffs are ultimately going to impact the smaller retailers. Smaller retailers that have to deal with tariff pass-throughs here, right, on goods that they're selling or components of the goods they're selling are going to be -- have to either take margin or pass on and price themselves out. And so at the end of the day, the bigger retailers with the larger balance sheets, not dissimilar from a recessionary-type environment, predicting recession. But not dissimilar, the bigger retailers with the bigger balance sheets are going to be able to have choices and alternatives in terms of passing through incremental costs and inflationary cost to consumers due to tariffs or to eat margin or better negotiating leverage with their ultimate suppliers. And that is just -- that's a fact. This bill hurts. This bill and the tariffs hurt Main Street, right? They help large retailers such as Walmart and Kroger and the biggest and best operators in the country.

Operator

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

Ki Bin Kim

Truist Securities, Inc., Research Division

So looking out at the investment landscape, Joey, can you just talk about some of the opportunities that you see, maybe in particular, the DFP business for developments? And maybe you could just touch on volume, quality and pricing, things like that.

Joel N. Agree

President, CEO & Director

So the opportunities, as I mentioned in the prepared remarks, this is the most excited that I've personally been since COVID. It's the culmination of 15 years of a vision. In the net lease space, everyone loves to focus only on acquisition volumes. Our acquisition volume will be strong. Our third quarter pipeline is very significant. But in terms of development in our DFP business, we're going to break ground on a minimum of \$100 million in projects before year-end. It's over 10 projects. It's geographically diversified with some of the country's largest retailers. Coming behind that is a significant shadow pipeline.

And I'll say this was the vision that we laid out 15 years ago prior to the inception of the acquisition platform when we were still a micro-cap. And it was to become -- it was to be a real estate company in the net lease space and not what everyone in the space refers to as a simple spread investor. Anybody can do that to different degrees of success ultimately. Frankly, I'm not interested in being part of that crew. I grew up on a real estate site. This company is a real estate company. And what you're going to see is all 3 external growth platforms pipeline scale. The results of those pipelines being scaled and the culmination of that vision, to be a full-service real estate company to the biggest retailers in the country.

Ki Bin Kim

Truist Securities, Inc., Research Division

And can you remind us what is the type of margin or spread that you're earning on the development versus an equivalent acquisition yield?

Joel N. Agree

President, CEO & Director

Sure. All subject to duration and scope of the project. And so we benchmark those yields against where we can buy a like-kind asset at pricing today, not where comps are, but where we could purchase it. If we're going to take an existing building and retrofit it for a tenant and they're going to commence paying rent in 120 days from rent commencement, that could be 50 basis points wide of where we'll acquire such an asset.

If it's an 18-month entitlement process and there's significant obstacles and hurdles that we're going to overcome to true organic development, that can be as wide as 150 basis points. So again, duration and scope, internal allocation of time and overhead are critical there. So we're doing all different types of projects. You will see in the second half of this year, round-up projects, retrofit projects. Many of them are \$10 million plus, and we are very close to commencement or have commenced post June 30.

Operator

Your next question comes from the line of Smedes Rose with Citi.

Smedes Rose

Citigroup Inc., Research Division

On the development platform, I wanted to ask you kind of what do you think is kind of the -- or is there sort of an upper limit of where the investment there could go? And I guess just bigger picture, I think when people -- one of the reasons you traded at a pretty premium multiple is the sense that you can grow AFFO by at least kind of 4% plus a year. And that's driven by external acquisition opportunities and your spread to the cost of capital. And I'm just wondering, are you sort of suggesting that you'll be shifting more into this development platform over time because you think the spreads are better and you can grow AFFO faster that way? Or is it is just a growing kind of platform concurrent with your, call it, \$1.5 billion of acquisition activity? Does that make sense? I'm just trying to figure out like the...

Joel N. Agree

President, CEO & Director

Yes. Yes. No. Many parts. Let's first break it down. First, this is not a capital -- these are not capital allocation. We have a war chest of a balance sheet with \$2.3 billion in liquidity and \$1.3 billion of forward equity that we built for a reason. Now we will do every deal that hurdles across our investment guidance and internal underwriting standards across all 3 platforms. So again, our Q3 acquisition pipeline, we just started building Q4, is quite significant. There's no material sale-leasebacks and they are regular way. Q4, we'll see, right? But that grows every day now. We're off to a good start since Monday.

Ultimately, we achieved better returns and yields through development and our DFP program, but that will not dissuade us or not deter us from investing in acquisitions. So that is not a capital allocation decision. These are the same tenants that we are targeting and working with our retail partners in the same sandbox. If you look at our earnings algorithm, which I mentioned in the prepared remarks, if you look at our 5-year historical AFFO growth trend, I think that's a good place to start. I'm not sure that all investors realize we're coming off a 2024 investment volume, which was the lowest level since 2019, just over \$900 million due to the nature of the capital markets and our stock being in the 50s for approximately, I can't recall, the first 6 months of last year. That obviously -- that earns through to the following year, this year's earnings where we're at a midpoint of now of over 4%.

We made a conscious decision last year to remain disciplined. We started with effectively the do-nothing scenario. If people recall, we weren't going to invest inside a 75 basis point margins. We were going to go up the risk curve and invest in real estate or credit that didn't meet our historic underwriting standards. And then additionally, this year, we had to restart with the Big Lots vacancies after the first exit from Chapter 11 failed with Nexus won and purchasing the company. So we paused those leasing efforts in anticipation of all of the Big Lots being affirmed. That deal fell apart the week it was supposed to close. It decreased occupancy during the first half of this year by 40 basis points. You've seen that rebound now to our re-leasing efforts of 99.6% occupancy today at June 30.

So I would look at our 5-year earnings algorithm. I think that's a good place to start. It is higher -- our historic 5-year earnings algorithm, excuse me. I think it is a good place to start. This is a down year for

us, to be frank, in terms of AFFO growth. All 3 platforms will contribute to AFFO growth in the future. Obviously, development, if it's one of those longer duration projects, takes longer to contribute. But again, this is not capital allocation decisions. This is not taking away from acquisitions. This is the envisioned future of having all 3 platforms firing on all cylinders being here and now.

Smedes Rose

Citigroup Inc., Research Division

Okay. I would leave it there, but thanks for the incremental color.

Joel N. Agree

President, CEO & Director

Smedes, did I miss anything there? That was a multipart question, I know.

Smedes Rose

Citigroup Inc., Research Division

No, I think it's good. I mean I guess just on the development platform, I mean, do you see sort of an upper limit of how much you kind of invested there at what time, I mean, is that \$1 billion, \$500 million?

Joel N. Agree

President, CEO & Director

What we foreshadowed and set out about 6 months ago was our intermediate, we called it a 3-year goal of putting \$250 million in the ground per year. We have obviously made significant strides towards that goal. I will tell you our shadow of the shadow pipeline, we are working with new retailers that could come to fruition and have geographic territories assigned to us that could come to fruition. So I can't tell you about an upper limit. Every time I give a number of the size of the company or what we're able to achieve, frankly, we achieve it. So I don't want to put that out there.

My goal when we launched the acquisition platform was to be \$1 billion diversified net lease company. So I don't want to put that number out there. I think there is -- we've made considerable investments and I'm open to making more investments in people and processes and systems to continue to expand that. And again, I want to remind everybody, this is not speculative development, right? We are not speculating on land. We're not speculating on vacant space. These are turnkey or ground lease projects that have guaranteed maximum price bids prior to us closing and returns that are effectively fixed. That is our business. It is nonspeculative in nature, and it is a margin of cushion above where we can acquire a like-kind asset.

Operator

Your next question comes from the line of Michael Goldsmith with UBS.

Michael Goldsmith

UBS Investment Bank, Research Division

Just to follow up on the development in the DFP as it relates to the earnings algorithm. Is the point that the -- when you add in the development in DFP to kind of regular way acquisitions, it provides more consistency, both from like a -- from a magnitude perspective and then also from a stability of that earnings algorithm? I'm trying to get -- just trying to understand like the point with the diversification of the different -- of the three-pronged approach here.

Joel N. Agree

President, CEO & Director

I would think of it quite simply. We have one business that everyone focuses on net lease, one line of business, external growth, acquisitions. And that's what everyone wants to focus on in net lease acquisition volume. Our acquisition volume will be very strong. At the same time, we have been working for years now to build and scale development and then our development funding platform. These are just additive that's all they are. They are additive, both qualitative, excuse me, and quantitative. And they

ultimately build out a holistic relationship with retailers, that we are a critical real estate partner, that we are working along multiple different fronts with them, and we are a differentiated real estate company. That has never been done in the net lease space. again, the "spread investors," anyone can do it. We have no interest in being part of that. Our goal when we created our one-page operating strategy in 2009, over 15 years ago, was to be a differentiated real estate company in the net lease space. I am more than proud to say that this team has now achieved that goal, and we are going to see in the coming months the fruition of the results of all those efforts.

Michael Goldsmith

UBS Investment Bank, Research Division

And just as a follow-up, you've talked a lot about -- in the past about the importance of scale in grocery. Last quarter, you did a sale-leaseback of an ACME backed by Albertsons and now you're taking on more Albertsons with this portfolio deal. So does that kind of put -- like does that reflect a view that Albertsons kind of fits into that -- the scale that you're looking for and the stability within grocery that you're interested in?

Joel N. Agree

President, CEO & Director

Just one correction, this was our first material -- we did not do a sale-leaseback. We've never done a sale-leaseback with Albertsons. This was our first -- we've have one Albertsons, I believe, in the portfolio prior. This was our first transaction with -- on Albertsons leases. It was from a third-party elderly woman in her 80s out of California, whose family was historically in multifamily development and then 1031 into a net lease assets. The \$75 million diversified portfolio had, I believe it was 5 Albertsons, Peter?

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Correct.

Joel N. Agree

President, CEO & Director

5 Albertsons in it. It is aligned with our thesis of investing in the biggest and best grocers in the country. Albertsons is still sub-1% of total rents here, total ABR. Obviously, Albertsons is a BB+ company, the third largest grocer in the country with approximately almost 2,300 stores. As an aside, our peers are investing in small regional and local operators and quoting \$1 billion in revenue for a grocer in a 2% business, which has obviously challenges right now because of just consumer sentiment like we've talked about.

We're going in the opposite direction once again. We are building what we think is -- we have built what we think is the best grocery portfolio in the country. Albertsons is a minority piece of that. The stores we acquired had average sales of \$740 approximately per square foot, rent to sales below 2%. They are very strong performers. Weighted average lease term of approximately 14 years, and they're paying below \$14 per square foot on average. Geographically diversified, Texas, Illinois and Colorado. This is wholly consistent with our white paper on grocery that we're going to invest in the country's largest grocers, again, in a 2% business. That's a 2% margin business to have the scale and the balance sheet to win on price. Otherwise, we think there's going to be significant fallout in the grocery space from those local operators with only \$1 billion in revenue.

And look -- do the math, \$1 billion in revenue at a 2% business is \$20 million in EBITDA. Start doing sale-leasebacks and guess what, your lease-adjusted leverage and your cash flow starts to deteriorate pretty quickly. And then I mentioned in the prepared remarks, this number -- the depression of IG and then investment grade during the quarter and yield in the quarter due to the sourcing of this off-market portfolio will ultimately be enhanced through the sale of the Dutch Bros Coffee shops at 5% caps that we'll dispose of that were included in the portfolio, the corporate Jiffy Lubes that were included in the portfolio that are noncore and 1031-like assets that we will dispose. And ultimately, our returns for the quarter and investment grade will be more aligned with historic standards..

Operator

Your next question comes from the line of Jana Galan with Bank of America.

Jana Galan

BofA Securities, Research Division

Maybe a question for Peter. On the bad debt in the guidance of 25 to 50 bps, is there anything identified? Or does that just give you some room on the potential that the 0.4 of expirations doesn't renew?

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Thanks for the question, Jana. I'd say through the first half of the year, the credit loss -- and again, in my prepared remarks, I mentioned that this is a fully loaded credit loss for us, inclusive of not just credit events and lost rental revenue, but any other OpEx or expenses that we're responsible for during the downtime of an asset that's vacant for any reason related to credit or otherwise. And in the first half of the year, we realized credit loss relatively in line with the lower end of that 25 to 50 basis point range, so closer to the 25 basis point range. As we look to the back half of this year, I would say that based on known credit issues in the portfolio, we would anticipate operating closer to that 25 basis points or experiencing credit loss closer to that 25 basis points. So at the lower end or the higher end of the range at 50 basis points, that includes unknown credit events or cushion of approximately 20 to 25 basis points.

Joel N. Agree

President, CEO & Director

And as Peter -- let me just chime in, Jana. As Peter articulated in the prepared remarks, our definition of credit loss is fully loaded. So credit loss is any and all events where a tenant does not pay rent, plus all of the nets being reimbursed -- not being reimbursed, excuse me, expense coming out from Agree Realty, right, and then maintaining the building itself during that period of vacancy. So when a building is vacant, you have to temper it, heat it and cool it. We don't want mold. We don't want frozen pipes. You've got to arm it, you have fire suppression, you have maintenance of that building in order to re-lease it.

So it is fully loaded. And so once again, net lease companies have been very creative in their definition of credit loss. Now credit loss is due specifically to a credit event and then it's pro forma for the lease-up with the footnote 1 and footnote 2. We are not going to go down that road. We are going to give, as Peter said, the true economic impact, 25 basis points to our total revenues for the year. And that is outflows as well as the lack of inflows to make -- this is real real estate economic underwriting. This is not putting things in a position for investors to have to parse through words and guess in fancy decks.

Operator

Your next question comes from the line of John Kilichowski with Wells Fargo.

Sheryl Kaul

Wells Fargo Securities, LLC, Research Division

This is Sheryl on for John. Could you provide us an update on your watch list? And what is baked in your guide in terms of going-in yields?

Joel N. Agree

President, CEO & Director

Our watch list is very de minimis. At Home was clearly on our watch list. As I suggested during the prepared remarks, I fully anticipate the 2-step into bankruptcy like we've seen, Chapter 11, the unsecured creditors have no recoveries. They emerge like Party City, JOANN, Rite Aid and then there's no ongoing business. And so then the unsecured creditors who take equity and move their nonrecoveries then liquidate the company. That's under contract for a 7 flat. We could have worked through that, redeveloped it. Frankly, we had better use of our time given the aggressive offer we took there. So outside of that, our watch list is very immaterial, frankly, at this point. We continue to monitor the couple of movie theaters

we have in the portfolio. That's really -- that's it. I mean we pared that back to 25 basis points, and that was really comprised of Big Lots this year, right, during the first half year.

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Yes. I think the watch list, to Joey's point, historically, the 2 biggest components there were At Home and Big Lots. And with those now resolved, the remaining credit issues in the portfolio are fairly de minimis one-offs, and there's nothing on the horizon of any material size that we see as imminent and the portfolio continues to perform very well.

Sheryl Kaul

Wells Fargo Securities, LLC, Research Division

That's helpful. And then one quick one on Big Lots. Can you remind us how many assets were sold or re-leased? And what was the final outcome?

Joel N. Agree

President, CEO & Director

Yes, we have 1 or 2 left. One has been approved by -- we will disclose next quarter, by a national retailer you're all familiar with that we will re-lease to. Cedar Park, Texas was re-leased to Aldi, as we mentioned in the prepared remarks with a significant lift in net effective rent and a brand-new term. Manassas, Virginia was re-leased with a significant rent increase on a net effective basis. We disclosed that, obviously, in the prepared remarks. We have 1 or 2 we're continuing again to work through, but we will work through those very quickly here.

Operator

Your next question comes from the line of Brad Heffern with RBC Capital Markets.

Bradley Barrett Heffern

RBC Capital Markets, Research Division

Joey, in the prepared comments, you talked about the highest level of demand for brick-and-mortar locations since the GFC. Obviously, we're still in a pretty uncertain environment and you have the potential tariff headwinds for retailers. I'm curious why you think that demand is so strong?

Joel N. Agree

President, CEO & Director

Brad, we haven't seen any retailer pull back, and it's not that they won't potentially do so due to the tariff noise, headwinds and the 85 different dates that have been handed out by the White House. We just haven't seen it, the biggest retailers in this country, and it's aligned with our thesis going back a decade in our white papers, I encourage everyone to look at them. There's 2 drivers here. One is the bigger operators are taking share. Two, the bigger operators now all realize, and you've probably heard me say it before, that the store is not a spoke, it's the hub, right? Free delivery and free return same day don't work from an EBITDA perspective, not unless you got AWS backing it up in cloud computing and advertising revenue and ancillary sources of revenue.

But from a selling goods perspective, that doesn't work. And so retailers have all realized that. We have never seen Walmart, Home Depot, Target, Lowe's, all growing their store count. It's all public information out there plus, plus, plus since prior to the great financial crisis. Sam's Club, Costco, you can keep going, all of these retailers invested for, let's call it, a 7-year period in distribution and fulfillment and logistics. And then they realized these investments are great. They make us more efficient. But guess what, we still lose money. We need the customer to get their butt in the car and try to get them to pick up those goods from the store rather than delivering them to their house for free because they're accustomed to it now. And if we can get them to the store to pick up those goods or return those goods, which is an absolute disaster, right, I mean those get palletted and sold by the pound, returned goods. We've actually done it

as an exercise here from Amazon. Those returned goods, return them in store and maybe repurchase something else.

So we've had a number of retailers speak to the team here. We have more retailers, national retailers, heads of real estate departments coming in and speaking to the team here that we're partners with and articulating how those impact on the business. The other piece to it is, specifically in some sectors, let's use auto parts, auto parts, we have seen the rise of the hub store. We have a white paper on this, I believe as well, Peter, right, yes?

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Correct.

Joel N. Agree

President, CEO & Director

The rise of the hub store. The rise of the hub store is to fulfill commercial tire and auto service, collisions and dealerships demand for a part within 30 minutes. That is impossible from a central distribution facility. So auto parts retailers realize that the standard stores of 7,000 feet can't carry enough SKUs. So they need hub stores of 20 and mega hub stores up to 50,000 feet, which are effectively storefronts with warehouses in the back to carry all of the different SKUs to get that car off of the lift and get that part there within 30 minutes. That's the business.

So we see all of these different areas, the convenience stores, let's take that, the rise of the large-format convenience stores, which we're obviously very active in. The convenience stores are taking share. It's not because there's more fuel being pumped in this country, not more cars on the road. Convenience stores are taking share from fast food restaurants. They're taking share from the front end of pharmacies. They're taking share from convenience items. You run in, grab milk, you'll overpay instead of go into Walmart, Kroger or Albertsons and navigate 100,000 or 200,000 square foot store. And they're taking share due to their service and offerings, [food enough], beverage for off-premises consumption, primarily breakfast and lunch. And so there's different drivers here, but it's about convenience, time and EBITDA at the end of the day.

Bradley Barrett Heffern

RBC Capital Markets, Research Division

Okay. Thank you for the detail there. Maybe one for Peter on the guidance. The implication is a decent-sized ramp in AFFO per share in the second half of the year. Is there anything lumpy on the expense side that maybe is driving some of that? Or is that purely just the ramp in acquisition volumes?

Peter Coughenour

CFO, Secretary & Investor Relations Professional

No. I think that's largely driven by the ramp in acquisition volume. I also mentioned in my prepared remarks the treasury stock method dilution and our assumption for roughly \$0.01 of impact there for full year 2025 versus \$0.02 last quarter. But there's nothing lumpy from an expense perspective anticipated in the back half of the year.

Operator

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

Wesley Keith Golladay

Robert W. Baird & Co. Incorporated, Research Division

I just want to go back to the comment of \$100 million in starts and getting \$200 million into the ground. Can you clarify if that was for development or development and funding? And then for these assets you're going to develop, would you plan on owning them afterwards?

Joel N. Agree

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President, CEO & Director

We do plan over them, everything, all pieces of real estate for sale. Ultimately, we have no intention of selling. We're not doing them -- we're not doing these projects in a TRS or off balance sheet in any manner. We anticipate again starting over \$100 million in projects between June 30 and the end of the year.

Wesley Keith Golladay

Robert W. Baird & Co. Incorporated, Research Division

Okay. And then you did mention some...

Joel N. Agree

President, CEO & Director

At minimum, at minimum.

Wesley Keith Golladay

Robert W. Baird & Co. Incorporated, Research Division

Yes, go ahead.

Joel N. Agree

President, CEO & Director

At minimum.

Wesley Keith Golladay

Robert W. Baird & Co. Incorporated, Research Division

Okay. And you also mentioned another version of Arc coming out next year. Can you elaborate on what's going to be in the latest addition?

Joel N. Agree

President, CEO & Director

Yes. Peter understands technology way more than I do. I drew it on a piece of paper originally. Peter has handled it from there, but I will mention we have now fully built out our IT team here, and we're thrilled with that team and the partners we're working with. Peter, you're way smarter here than I'm.

Peter Coughenour

CFO, Secretary & Investor Relations Professional

Sure. Specific to Arc, I think the primary goal of that project is to build Arc on effectively a new backbone or system that will allow for more self-service and more dynamic reporting that can be used across the organization and will drive efficiencies in that we can manipulate the data more and drive to the decisions that we're trying to make across the organization. I think in addition to Arc, Joey mentioned some of the industry-leading efficiencies that we've gained through the implementation of AI. We implemented AI for lease abstraction about 3 years ago now. And we've been using that tool to abstract hundreds of leases that we onboard each year with a high degree of accuracy. That has increased over time, the accuracy, and the tool has resulted in significant time savings for the team.

More recently, we've launched an AI tool to complete what we call our lease underwriting checklist, which compares our initial underwriting to the lease and confirms there are no significant issues. With that tool, it used to take an attorney roughly 4 hours to complete each one of those, and that's now a matter of seconds. So we've seen hundreds of hours of time savings there, 400-plus hours from that on an annual basis, hundreds of thousands of dollars of savings just from the implementation of that tool. And then looking forward, I think we'll look to combine AI and incorporate more of that into Arc from a decision-making process moving forward.

Joel N. Agree

President, CEO & Director

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So Wes, we ran a test. Our IT team here ran a test looking backwards into deals that were approved in Investment Committee, and this is far out, this component. But I think it should demonstrate the future of what AI is capable of. Our team ran a test of deals that were brought in to Investment Committee and what they would be approved. With the percentage of approval using AI, they were 90% accurate, and it was just a test. It was a game to see if they could replicate Investment Committee's approval.

We're using AI today, as Peter mentioned, for functional tasks and driving efficiencies. I want to take legal costs and cut them in half. That's my goal here. We have a great team and a great external team, but we don't need lawyers extracting leases, summarizing leases. We can now do them in 15 seconds using artificial intelligence. That is generative AI learning. And so the new Arc, which will be unveiled next year, 3.0, and I look forward to unveiling it, will enable our full data warehouse and multiple tools to be layered on in the future.

Operator

Your next question comes from the line of Rich Hightower with Barclays.

Richard Allen Hightower

Barclays Bank PLC, Research Division

Maybe just to shift gears a little bit on the asset management side of things. I guess traditionally speaking, one of the trade-offs with very high credit quality in the tenant and low escalators would be -- well, one would be low escalators and two would be relatively short WALT. And so just as you're renewing leases and just tell us about any changing parts of the lease structure that might be interesting, especially given just the shortage of good retail space in this country at this point.

Joel N. Agree

President, CEO & Director

Well, the shortage of space due to construction costs in this country, we see, and I think the shopping center reporters have demonstrated this and we've demonstrated with our re-leasing efforts, is the second-generation space that is A, B space is in high demand. That said, C space, functional obsolescence is a challenge, single-purpose boxes will always be challenges. I'll take issue with the first statement. Investment because the portrayal that investment grade has shorter weighted average lease terms and/or less escalators, we have effectively net of credit loss, approximately 100 basis points of internal growth. When you look at the totality of those circumstances, I don't think that is frankly economically true. So anyone can sign a sale-leaseback if you're a private operator or a public operator for 30 years, 50 years. Remember, Nick Schorsch had Red Lobster sign 25-year sale-leasebacks. Anybody can sign...

Richard Allen Hightower

Barclays Bank PLC, Research Division

Blast from the past.

Joel N. Agree

President, CEO & Director

A blast from the past. But guess what, a lot of this stuff is coming back now into net lease. With a lot of the private credit and the private capital that's flowing in, you can sign a sale-leaseback on your house. You can have escalators. You can sign a sale-leaseback at anything, escalators, you can do it for 50 years. The piece of paper isn't worth what it's printed on though. I mean ultimately, this is real estate and can the tenant ultimately afford the compounding impacts of those annual escalators that you're going to write into that lease.

Sale-leasebacks with noncredit tenants are simply financial structures that are akin to a lender. That is all it is. It is not our business. And when we talk about sale-leasebacks being an alternative form of financing for these noncredit small, middle market, private equity-sponsored operators or small private operators, it is not an alternative form of financing. There is no other place where you can pull out 100% of the proceeds from the building. If I am a private equity-sponsored car wash operator and I go to a conventional lender and I say I want a first mortgage, maybe they give me 50%, maybe they give me

60%. Then I go and I try to get mezz on that real estate. Maybe if I'm really lucky, I can ramp that to those 2 combined to 75%. Good luck on that. It can be expensive. Who's filling the last 25% in that primary method of financing this real estate? A hard money lender, a bookie? Nobody, right?

And so what we see is alternative markets aren't alternative markets to finance these assets. And look what we've seen in spaces like the car wash space, the experiential space, they are primary assets that don't provide for risk-adjusted returns that are ultimately appropriate. If I'm going to finance a full capital stack for any of those types of uses, I want a 14 cap and I want my money out in 6.5 years. And I wouldn't even do it there, I don't think. I'd rather just run the business myself and own the equity.

Richard Allen Hightower

Barclays Bank PLC, Research Division

Helpful comments. It'd be fun to get you on another panel with your peers and kind of go at it from multiple directions.

Joel N. Agree

President, CEO & Director

Happy to do it. By the way, by the way, happy to do so. I think it is -- would be educational for investors. I think comparing and contrasting rather than isolation in earnings calls and in meetings, debating these things is healthy for investors. The siloed nature of what has transpired in our subsector as well as read them generally does not give investors a full picture of and transparency. You combine that with reporting, as I mentioned prior, that has all types of discrepancies and footnotes and pro forma. This is a simple business. The second slide of our deck is consistency. We've done the same thing since we started this acquisition platform in 2010, and I took over operating this company. We're going to continue to do it. Making nuanced arguments, let's do them in merit. Let's debate the merits and considerations and ultimately let investors decide for themselves. But I will stand here and I will say, buying those types of uses is a primary function -- source of real estate financing with a 7 handle in front of it, I do not believe is risk-adjusted appropriate, and I'm happy to articulate that further in any form.

Operator

Your next question comes from the line of Jim Kammert with Evercore ISI.

James Hall Kammert

Evercore ISI Institutional Equities, Research Division

Joey, just revisiting one more time the ramp in development activity. Would you say you're more likely just supplanting developer relationships that the retailers had? Or more strategically, are you supplanting more of the in-house development capability at those retailers?

Joel N. Agree

President, CEO & Director

That's an interesting question, Jim. We are definitely supplanting developers that can no longer perform due to capital constraints and volatility. There are also new relationships that we formed. I'm trying to think -- some retailers have internal capabilities. We have not seen them give up those internal capabilities. Frankly, retailers are trying to scale their internal capabilities to be able to execute on their store growth plans to the Street generally. So it's not supplanting retailer self-development, it is taking share.

James Hall Kammert

Evercore ISI Institutional Equities, Research Division

That's interesting. And then what would you say -- have you canvassed? All of your retailers said, "Hey, we can do this for you." Or have you still have new tenants that you haven't really approached and really explained to them Agree's full capabilities? Just thinking about how far this could expand for you.

Joel N. Agree

President, CEO & Director

I'd say we have a scorecard and a scoreboard. It is in Arc. I would tell you there are very few. We have -- there better not be more than a few, but there are not many that we haven't talked to. Time in place, economics has to be correct. We have new relationships that will pull through in '27 and then existing relationships always. A lot of it, again, is time in place, right? We need to -- we're ramping, we need help. You can be a critical partner for us. Our other partners are failing, right? They're not executing on their promises. When you have \$2.3 billion in liquidity and you pair that with expertise of a private real estate developer, you have a very unique combination that no one else can offer in terms of value proposition.

Operator

Your next question comes from the line of Upal Rana with KeyBanc Capital Markets.

Upal Dhananjay Rana

KeyBanc Capital Markets Inc., Research Division

Great. Just a quick one for me. With the development and DFP pipeline ramping, how are you thinking about construction costs today? And you mentioned building 50 basis points wider where you can acquire. So just wondering if construction costs continue to rise, could that potentially eat into your 50 basis points?

Joel N. Agree

President, CEO & Director

No, I appreciate the question. We've done a full internal comprehensive study of the implications of all of these different types of tariffs led by Jeff Konkle here, our Head of Construction. And then we're very fortunate to have John Rakolta, the Chairman of Walbridge, one of the biggest contractors in the country on our Board. And his team ran also a study of the implications of tariffs in the construction area. We estimate that tariffs and if you look at project costs, generally vertical costs, right, moving dirt doesn't cost, buying, acquiring land, obviously, well, not yet, isn't tariffed. We're talking about vertical costs, which are approximately 25% to 35% of entire projects. We think the implication in the current tariff environment is maybe 1.5% of total cost. We generally have a contingency of 7% to 10% in projects. So we're not concerned about this tariff environment right now in projects. But it's certainly something that we'll pay attention to, maybe not daily because we can't monitor X and Truth Social daily. But it's certainly something that we'll monitor, but no material impact in overall construction costs.

Now if you look, there's different sourcing that we will -- sourcing methodologies that will change. We'll buy domestic products. Retailers are also who designate different specifications for building components. HVAC units, things like that. While they may have components that are tariffed, shift building architectural features and engineering features, structural engineering features even potentially to make it most efficient and continue to drive efficiencies to even bring that 1.5% down.

Operator

Your next question comes from the line of Omotayo Okusanya with Deutsche Bank.

Unknown Analyst

This is [Sam] on for Tayo. I hope I didn't miss this, but what gave you guys the confidence around increasing your investment outlook given the uncertainty presented by the macro backdrop as well as potential credit risk stemming some tariffs?

Joel N. Agree

President, CEO & Director

Outside of sourcing acquisitions for Q4 between now and, call it, the middle of October, we already know it's there.

Operator

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

Ronald Kamdem

Morgan Stanley, Research Division

Two quick ones just on ramping on the developments. Maybe can you talk a little more about are the lease structures any different from the acquisitions in terms of duration, yield, contracts? Just curious there.

Joel N. Agree

President, CEO & Director

Yes, Ron, generally, obviously, they're new leases. So these are 10-, 15-, 20-year leases, generally, the fresh-faced terms that are starting. Standard lease structures, nothing different, either ground leases or generally turnkey leases. The economics, again, will subject to project duration and scope will be 50 to 150 basis points wide of where we could acquire and do acquire the like-kind assets. Really no different there, except the methodology of sourcing, obviously, and then the duration and the return requirements internally here.

Ronald Kamdem

Morgan Stanley, Research Division

Great. And then my second one, Genuine Parts Company added to the top tenant list. Just any color there on maybe the opportunity with them to continue to grow?

Joel N. Agree

President, CEO & Director

Look, that's NAPA. Obviously, it's an investment-grade auto parts retailer. They have made it to the top tenant list. Know we're very fond of auto parts as we discussed and wrote in the white paper, fungible boxes, great business, cars and every day setting a new record on the road. I'm not sure if anyone can be able to afford a car after all these tariffs actually hit. We continue to like the space. We like NAPA, but no plans to materially increase exposure from here.

Operator

And that concludes our question-and-answer session. And I will now turn the conference back over to Joey for closing comments.

Joel N. Agree

President, CEO & Director

I appreciate everybody's time today. Thank you for joining us. We look forward to seeing you in the near future, and good luck to the rest of earnings season. Thank you.

Operator

This concludes today's conference call. Thank you for your participation, and you may now disconnect.

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