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Agree Realty Corporation's
Second Quarter 2021 Earnings Conference Call
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PRESENTATION

Operator:
Good morning, and welcome to the Agree Realty Second Quarter 2021 Conference Call. [Operator Instructions]. After today's presentation, there will be an opportunity to ask questions. [Operator Instructions]. Please note, this event is being recorded.

I would now like to turn the conference over to Peter Coughenour, Vice President, Corporate Finance. Please go ahead, Peter.

Peter Coughenour | Agree Realty Corporation | Vice President, Corporate Finance
Thank you. Good morning, everyone, and thank you for joining us for Agree Realty's Second Quarter 2021 Earnings Call. Discussing our results on today's call will be Joey Agree, President and Chief Executive Officer; and Simon Leopold, Chief Financial Officer. Before turning the call over to Joey, let me first run through the cautionary language.

Please note that during this call, we will make certain statements that may be considered forward-looking under federal securities law. Our actual results may differ significantly from the matters discussed in any forward-looking statements for a number of reasons, including uncertainty related to the scope, severity and duration of the COVID-19 pandemic, the actions taken to contain the pandemic or mitigate its impact and the direct and indirect economic effects of the pandemic and containment measures on us and on our tenants. Please see yesterday's earnings release and our SEC filings, including our latest annual report on Form 10-K and subsequent reports 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 these non-GAAP financial measures to the most directly comparable GAAP measures can be found in our earnings release, website and SEC filings.

I will now turn the call over to Joey.

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Peter.

I'm very pleased to report that we continued our strong start to the year, achieving record investment volume of more than $750 million during the first six months of 2021. Robust and high-quality investment activity further increased our investment-grade concentration and raised our ground lease exposure to a record of nearly 13%. Our investment activities during the quarter were supported by more than $1 billion of strategic capital markets transactions that fortified our best-in-class balance sheet and positioned our company for continued growth in the quarters ahead.

During the second quarter, we invested approximately $366 million in 59 high-quality retail net lease properties across our three external growth platforms. 54 of these properties were originated through our acquisition platform, representing acquisition volume of more than $345 million.

The 54 properties acquired during the second quarter are leased to 32 tenants operating in 18 distinct retail sectors, including best-in-class operators in the off-price, home improvement, auto parts, general merchandise, dollar store, convenience store, craft and novelty, grocery and tire and auto service sectors.

The acquired properties had a weighted average cap rate of 6.2% and a weighted average lease term of 11.8 years.

Through the first six months of this year, we've invested a record $756 million into 146 retail net lease properties spanning 35 states in 24 retail sectors. Approximately $732 million of our investment activity originated from our acquisition platform. Roughly 75% of the annualized base rents acquired in the first half of the year comes from leading investment-grade retailers, while almost one-third of annualized base rent is derived from ground leased assets. These metrics demonstrate our continued focus on best-in-class opportunities with leading omni-channel retailers, while still achieving record results.

Given our record acquisition activity date and visibility into our pipeline, we are increasing our full-year 2021 acquisition guidance to $1.2 billion to $1.4 billion.

During this past quarter, we executed on several unique and notable transactions, including a new small format Target on the University of Georgia's campus in Athens. We are extremely pleased to expand our relationship with Target as well as add another unique street retail asset to our growing portfolio.

We continue to invest in market dominant grocers during the quarter, most significant with a five-store sale leaseback transaction with Kroger for approximately $68 million. The stores are located in Texas, Michigan, Ohio, and Mississippi and each location is subject to a new 15-year net lease. With this transaction, Kroger moved into our top 10 tenants at 3.2% of annualized base rents. Kroger's of course a leader in the grocery space. Their fortified balance sheet, strategic omni-channel initiatives and significant investment in e-commerce fulfillment are emblematic of our investment strategy.

Additionally, we closed on the purchase of a ShopRite, which is owned and operated by Wakefern in New Rochelle, New York. ShopRite is a tremendous operator, and the real estate, located at a strategic interchange of I-95, is yet another example of the diligent bottoms-up real estate analysis that we conduct on every asset that we acquire.

Finally, as you may recall, we acquired our first Wegmans Ground Lease in Chapel Hill, North Carolina during the fourth quarter of 2020. We've built upon that momentum this quarter with the acquisition of our second property ground leased to Wegmans. The store, located in Parsippany, New Jersey, is over 100,000 square feet and was constructed at Wegmans' expense. The ground lease has over 21 years of term remaining and is a welcome addition to our growing ground lease portfolio.

Through the first six months of the year, we've acquired 45 ground leases for a total investment of over $240 million. The second quarter contribution to this total was 14 ground leases, representing an investment volume of more than $113 million. Additional notable ground lease acquisitions during the quarter included our first Capital Grille in Whippany, New Jersey; A Walmart Supercenter and Lowe's in Hooksett, New Hampshire; our first Cabela's in Albuquerque, New Mexico; as well as three additional Wawa assets, increasing our Wawa portfolio to 25 properties, including their flagship store in downtown Philadelphia.

As mentioned at quarter end, our overall ground lease exposure stood at a company record of 12.7% of annualized base rents and includes some very unique assets leased to the best retailers in the country.

Inclusive of our second quarter acquisition activity, the ground lease portfolio now derives nearly 90% of rents from investment-grade tenants and has a weighted average lease term of 12.5 years. The majority of the portfolio includes rent escalators that result in average annual growth of close to 1% while the average per square foot rent is only $9.65. This growing portfolio continues to be a source of tremendous risk adjusted returns when reviewing the lease term, credit, underlying real estate attributes and, of course, the free building and improvement if a tenant were ever to vacate. We look forward to continuing to leverage our industry relationships and strong track record of execution to identify potential additions to this expanding and diversified sub-portfolio.

As of June 30, our portfolio's total investment grade exposure was nearly 68%, representing a significant year-over-year increase of approximately 670 basis points. On a two-year stacked basis, our investment grade exposure has improved by more than 1,300 basis points.

The continued growth of our ground lease portfolio and the investment grade exposure demonstrates our disciplined focus on building the highest quality retail portfolio in the country.

Moving on to our development and Partner Capital Solutions platforms. We continue to uncover compelling opportunities with our retail partners.

We had six development and PCS projects that are completed or under construction during the first half of the year that represent total capital committed of more than $36 million. Three projects were completed during the second quarter, including a Grocery Outlet in Port Angeles, Washington; a Gerber Collision in Buford, Georgia; and a Floor & Décor in Naples, Florida.

I'm pleased to announce we also commenced construction during the quarter on our second development with Gerber Collision in Pooler, Georgia. Gerber will be subjected to a new 15-year net lease upon completion, and we anticipate rent will commence in the first quarter of 2022. We continue to work with Gerber Collision on additional opportunities that we anticipate announcing later this year and into next year.

Construction continued during the quarter on our first development with 7-Eleven in Saginaw, Michigan. We anticipate delivery will take place in the first quarter of next year at which time 7-Eleven will be subject to a new 15-year net lease.

We remain focused on leveraging our full capabilities to grow our relationships with these leading omni-channel retailers. I look forward to providing an update on our continued progress in the coming quarters.

While we continue to strengthen our best-in-class retail portfolio through record investment activity, we were also quite active on the disposition front during the quarter. We continued reducing Walgreens' exposure as well as franchise restaurants as we sold seven properties for gross proceeds of approximately $28 million with a weighted average cap rate of 6.7%.

In total, we disposed of ten properties through the first six months of the year for gross proceeds of more than $36 million with a weighted average cap rate of approximately 6.7%. Given our disposition activities during the first half of the year, we are raising the bottom end of our disposition guidance to $50 million for the year, while the high-end remains at approximately $75 million.

Our asset management team has also been proactively and diligently addressing upcoming lease maturities. Their efforts have reduced the remaining 2021 maturity to just three leases, representing 20 basis points of annualized base rents. During the second quarter, we executed new leases, extensions or options on approximately 209,000 square feet of gross leasable area.

Most notably, we are extremely pleased to have executed a new 15-year net lease with Gardner White to backfill our only former Loves Furniture store in Canton, Michigan. As you may recall, this was the Art Van flagship we developed prior to the company's acquisition by TH Lee.

We delivered the space to Gardner White in June and rent commenced in July, allowing us to recover close to 100% of prior rents with just over one month of downtime. I would note this is the second time we have released this asset at effectively full recovery since the Art Van bankruptcy. Gardner White is Michigan-based, family owned and operated, and has been one of the preeminent furniture retailers in the state for more than a century. The company is led by Rachel Tronstein, one of the brightest minds in the retail furniture industry and a former high school classmate of mine. We are extremely pleased to have Rachel and her team as partners in this flagship asset.

I'm also pleased to announce the addition of Burlington to Central Michigan Commons in Mount Pleasant, Michigan, one of the only two remaining legacy shopping centers that we chose to retain during the transformation of our portfolio. To date we have redeveloped the former Kmart space for Hobby Lobby and Ulta and added Texas Roadhouse on an out-lot via ground lease. These transactions are emblematic of our ability to unlock embedded value within the portfolio and support our decision to hold on to this very well located legacy shopping center across from Central Michigan University's main campus.

During the first six months of the year we executed new leases, extensions or options in approximately 275,000 square feet of gross leasable area.

And as of June 30, our expanding retail portfolio consisted of 1,262 properties across 46 states, including 134 ground leases, and remains nearly 100% occupied at 99.5%.

With that, I'll hand the call over to Simon and then we can open it up for any questions.

Simon Leopold | Agree Realty Corporation | CFO
Thank you, Joey.

Starting with earnings, Core funds from Operations for the second quarter was $0.89 per share, representing a record 17.3% year-over-year increase. Adjusted Funds from Operations per share for the quarter was $0.88, an increase of 15.9% year-over-year.

As a reminder, treasury stock is included within our diluted share count prior to settlement if and when ADC's stock trades above the deal price of our outstanding forward equity offerings. The aggregate dilutive impact related to these offerings was less than half a penny in the second quarter.

Per FactSet, current analyst estimates for full year AFFO per share range from $3.40 per share to $3.53 per share, which implies year-over-year growth of 6% to 10%. As mentioned on last quarter's call, we continue to view this level of growth as achievable and expect to end the year toward the higher end of this range given current visibility into our investment pipeline and the broader operating environment. Building upon our 6% of AFFO per share growth in 2020, this implies two-year stacked growth in the mid-teens.

General and administrative expenses totaled $6.2 million in the second quarter. G&A expense was 7.6% of total revenue, or 7.1% excluding the non-cash amortization of above and below-market lease intangibles. Even as we continue to invest in people and systems to facilitate our growing business, we anticipate the G&A as a percentage of total revenue will be in the lower 7% area for full year 2021, excluding the impact of lease intangible amortization on total revenues. As mentioned last quarter, G&A expense for our Acquisitions Team fluctuates based on acquisition volume for the year, and our current anticipation for G&A expense reflects acquisition volume within our new guidance range of $1.2 billion to $1.4 billion.

Total income tax expense for the second quarter was approximately $485,000. For 2021, we continue to anticipate total income tax expense to be approximately $2.5 million.

Moving onto our capital markets activities for the quarter…

In May, we completed a $650 million dual-tranche public bond offering comprised of $350 million of 2.0% senior unsecured notes due in 2028 and $300 million of 2.6% senior unsecured notes due in 2033. In connection with the offering, we terminated related swap agreements of $300 million that hedged to 2033 notes, receiving approximately $17 million upon termination. Considering the effect of the terminated swap agreements, the blended all-in rates for the 2028 notes and 2033 notes are 2.11% and 2.13%, respectively.

We used the portion of the net proceeds from the offering to repay all $240 million of our unsecured term loans. The termination costs related to early pay down of our unsecured term loans total approximately $15 million. Given the one-time nature of the termination costs, these amounts have been added back to our core FFO and AFFO measures. The offering in combination with the prepayment of all of our unsecured term loans extended our weighted average debt maturity to approximately nine years and reduced our effective weighted-average interest rate to approximately 3.2%.

In June, we also completed a follow-on public offering of 4.6 million shares of common stock. Upon closing, we received net proceeds of approximately $327 million.

During the second quarter, we entered into forward sale agreements in connection with our ATM program to sell an aggregate of roughly 1.2 million shares of common stock for anticipated net proceeds of approximately $81 million. In May, we settled roughly 164,000 shares and received net proceeds of approximately $10 million.

At quarter end, we had approximately 3.9 million shares remaining to be settled under existing forward sale agreements, which are anticipated to raise net proceeds of approximately $259 million upon settlement.

Inclusive of the anticipated net proceeds from our outstanding forward offerings, cash on hand and availability under our credit facility, we had nearly $950 million in available liquidity at quarter end.

The balance sheet continues to be a huge strength for us. As of June 30, our pro forma net debt to recurring EBITDA was approximately 3.6x, including our outstanding forward equity offerings. Excluding the impact of unsettled forward equity, our net debt to recurring EBITDA was approximately 4.5x. Total debt to enterprise value of quarter-end was approximately 25%, while fixed charge coverage remained at a record 5x.

During the second quarter, we declared monthly cash dividends of $0.217 per share for April, May and June. The monthly dividend reflected an annualized dividend amount of $2.60 per share, representing an 8.5% increase over the annualized dividend amount of $2.40 cents per share for the second quarter of last year. Our payout ratios for the second quarter were a conservative 73% of core FFO per share and 74% of AFFO per share respectively.

Subsequent to quarter end, we declared a monthly cash dividend of $0.217 per share for July. The monthly dividend reflects an annualized dividend amount of $2.60 per share, or an 8.5% increase over the annualized dividend amount of $2.40 per share from the third quarter of 2020.

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

Joey Agree | Agree Realty Corporation | President & CEO
Thank you, Simon. At this time, operator, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. [Operator Instructions]. The first question comes from Ki Bin Kim with Truist.

Ki Bin Kim | Truist
Joey, when I look back at your transaction history, you've been buying in the past in the mid-7 a few years ago and then 7% in the past, I think, in '19 and '18. And then that yield has gone down to the low 6s lately. So I'm just curious, when you look at that, is it because cap rate compression across the sector, or is it that you're targeting certain types of investments like ground leases which inevitably have lower yields? I'm just trying to understand what was the cause of that and if a low 6% is what we should be expecting from you guys for the foreseeable future.

Joey Agree | Agree Realty Corporation | President & CEO
Yes. No, I appreciate the question, Ki. But I think generally speaking, we've seen in several years of cap rate compression with cap rates at historic lows as of today. And so we continue to target high-quality assets. I don't think you've seen any change there since we've launched the acquisition platform in 2010.

And we've said historically that our ground lease assets generally fall within the range, the cap rate range, of the turnkey acquisitions that we make.

So we continue to see very aggressive capital chasing high-quality net lease retail properties. And I think what you'll see from us relative to other acquirers out there is that we're continuing to drive toward quality without sacrificing yield. And so it's a competitive environment. We don't see that changing, but the team is doing a fantastic job creating value through all sorts of transactions.

Ki Bin Kim | Truist
Okay. And second question. Can you just help me understand the ground lease portfolio strategy? I forget what the lease duration is for that segment of your portfolio. And when the lease does come due, how are you thinking about that? And is there fair market value recess, or is there contractual rent increases built into that? I'm trying to understand eventually when that comes due, what would actually happen.

Joey Agree | Agree Realty Corporation **|** President & CEO
Yes. So the ground lease portfolio is a weighted average lease term, about 12.5 years as we mentioned in the prepared remarks. Rent per square foot is only $9.65 with annual embedded growth of approximately 1% and is 90% investment grade. So when you look at our ground lease portfolio, I'd tell you, from a credit, real estate and return perspective, I think it is a very unique sub-portfolio that obviously is growing, trending toward 13% of our overall portfolio. We continue to find just compelling opportunities there.

Now upon expiration or failure to renew an option, we would effectively get the building and the entire premises for free. Now that is very rare. Tenants typically don't want to give away improvements that are sitting on their balance sheet. And so the upside, upon lease expiration or failure to exercise an option or rejection in the bankruptcy, once that contractual leases is broken, is very compelling as well.

So I think when you look at the front end, the economics, the underlying credit profile, the lease duration, the embedded growth in the portfolio and you combine that with the residual value in real estate that's not on our balance sheet that the tenant paid for, for example, the Wegmans or the Capital Grille that we acquired with in Whippany and Parsippany, New Jersey here, it's a pretty compelling risk-adjusted return.

Ki Bin Kim | Truist
So when you say that the tenant has an option, is that option based on a contractual rent increase of whatever stated X percent? Or is it a fair market value reset type of option?

Joey Agree | Agree Realty Corporation **|** President & CEO
The vast majority is the former. So contractual increases throughout the base term, then contractual increases pursuant to exercising any options.

Operator
The next question comes from Nate Crossett with Berenberg.

Nate Crossett | Berenberg Capital Markets
Maybe just following up on that ground lease question. What can you provide us in terms of helping us value that optionality of the ground lease portfolio? Do you guys track your cost basis versus the appraised value of everything that's on top of the ground lease?

Joey Agree | Agree Realty Corporation | President & CEO
No. Look, first off, we're not going out and appraising every single asset. We're not getting asset-level financing. We're not looking at valuations, really, in that perspective. We're looking at price per pound that we're acquiring the building. If and when we were to get that back, we're looking at price per acre and then we're looking at replacement rents for that specific use.

So again, the ground leases range -- just to give you a sense, the ground leases range from McDonald's or a Chase ground lease on a one-acre parcel, a 3,500, 4,000 square foot building to a Walmart Supercenter or a Costco sitting on 20 acres. And so those are very different constructs. Obviously, if we were to get one of the Walmart or in this case our first Cabela's building back, we would have effectively a 20-acre parcel with 600 feet of frontage where we could develop five to six out-lots plus 100,000 sq. ft. or 200,000 sq. ft. building back for free in the rear, which used to formerly house, obviously, the store.

And so they're very different analyses in comparison to a Wawa C-store, that is a C-store, always a C-store. And I think it really takes an individual bottoms-up real estate analysis to be able to understand each and every asset. But at the end of the day, we are always getting the improvements in the building back for free if the tenant were to vacate for any reason.

Nate Crossett | Berenberg Capital Markets
Okay. That's helpful. I was wondering if you could parse out -- I think the average yield in the quarter was 6.2%. What was the yield on the ground lease stuff versus the non-ground lease stuff?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. Just right in that range. I don't have the exact number in front of me, Nate, but it's really right in that range. We're buying, generally speaking, between 5% at the low end and 7%. They're sometimes higher, frankly, when we're doing things with tenants such as blend-and-extends or early exercises of options or working in conjunction, but that's the general range here. We acquire a number of shorter-term ground leases or medium-term ground leases with asymmetric information, and we're working in conjunction with a tenant on a longer-term prospect.

Nate Crossett | Berenberg Capital Markets
Okay. Maybe just one last one on pricing. I was just curious on what the leasing spreads were like on the renewals and what's the expectation or what is left this year. I know it's not a lot.

Joey Agree | Agree Realty Corporation | President & CEO
Yes. Effectively, every single option has been exercised this year. We're extremely pleased to have Burlington added to Mount Pleasant. That was a former JCPenney, where they were paying $2.50 a foot or something ridiculous. So obviously, it's a significant positive leasing spread. But in the overall scheme of things it is very de minimis, obviously.

And then with the former Art Van, then the former Loves Furniture, we're thrilled to have Gardner White in there. As I mentioned in the prepared remarks, Gardner White has been in business for over 100 years, I think since 1914 or 1916. It is led by a fourth generation leader, Rachel Tronstein, today. This store is now their flagship. They are effectively relocating the store from down the street. They've been in the market. They've been in the state. And this is a stable family-owned company and we recaptured essentially 100% of rent for the second time from Art Van to Loves and then Loves to Gardner White, which we're thrilled to have taken over that asset.

Operator
The next question comes from Katy McConnell with Citi.

Katy McConnell | Citigroup
So on the ground lease acquisitions, were there any other portfolios acquired this quarter? And then just looking at the future pipeline, did you expect to keep out a similar pace of deals relative to the total deal volume?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. Good morning Katy, we did acquire some small portfolios of diversified assets during the quarter. Nothing overly material. In terms on a go-forward basis, look, our Q3 pipeline has a significant ground lease exposure. We're excited about those opportunities, many of them very similar to what we've executed in the past couple of quarters here.

On a go-forward here, we're going to continue to evaluate all opportunities whether they're ground lease or turnkey in the next few best opportunities that we're able to originate. And so it's hard to predict the future. Never thought we'd see the ground lease portfolio approaching 13%. But again, the team continues to do a tremendous job originating opportunities.

Katy McConnell | Citigroup
Okay, great. Now that you've addressed almost all of your 2021 lease expirations, what percentage of that space was ultimately renewed? And how did that compare to historical trends?

Joey Agree | Agree Realty Corporation | President & CEO
Effectively, 100% was ultimately renewed. Obviously, we had the Loves bankruptcy. So that was a unique situation, and JCPenney bankruptcy where they rejected -- I believe the actual rejection took place in 2020, the JCPenney rejection at Mount Pleasant, where we've signed on Burlington. And so I caution everyone, our leasing activity is probably not emblematic of any broader trends in retail. We have very de minimis remaining leases expiring, obviously this year at only 0.2% of ABR and 1.1% of ABR in 2022. And so again, I would caution everybody not to see any larger trends on that.

Operator
Your next question comes from Robert Stevenson with Janney.

Robert Stevenson | Janney Montgomery Scott LLC
Joey, I know it's a relatively small piece of the portfolio, but how are your movie theaters doing these days? Where are rents rebounding to? And then also, have you seen any theater assets trade in the market? And where those asset values versus pre-pandemic if you wanted to sell down some of your portfolio?

Joey Agree | Agree Realty Corporation | President & CEO
Good morning Rob, full transparency, I haven't been to the movies or looked at a movie theater since the pandemic started. Look, we've got five movie theaters in the portfolio today. They're all paying rent, the Reddit Mafia is helping a number of these operators, obviously, in the portfolio. We have no interest in movie theaters, adding additional movie theater exposure. We weren't adding movie theater exposure for several years before the pandemic. My kids do want to see Space Jam 2, so we'll have to put that on the docket here. But besides that, we just don't think the fundamentals of the business plus the residuals on the real estate makes sense in context of this portfolio.

Robert Stevenson | Janney Montgomery Scott LLC
But I guess if you wanted to sell that today, is there a significant haircut? Or has it rebounded enough that you could sell those plus or minus a bit of where you'd want to? Or is this on hold for 2022 or 2023 and hope for a bigger rebound to get out of those?

Joey Agree | Agree Realty Corporation | President & CEO
It's a good question. I'd tell you there isn't a lot of liquidity in the theater market today. We're very comfortable with the five theaters that we have in the portfolio. It's, again, large operators - AMC, Regal, Cinemark. I wouldn't anticipate that pricing with that pre-pandemic levels by any means. But I think you saw pricing weakness pre-pandemic as well in the sector in general.

And so if we see an opportunity to divest of one of the theaters, just like we divested of the Dave & Buster's in Austin, we will do so. But we're very comfortable holding them. Again, it's a fairly de minimis -- it's a very de minimis piece of our portfolio, and we're comfortable with the five assets.

Robert Stevenson | Janney Montgomery Scott LLC
Okay. And then how are you feeling about the furniture segment going forward as a whole these days? And do you still want to be there longer-term on a risk adjusted basis? And then with 15 years now on this Gardner White lease, is now the time to sell that asset as well?

Joey Agree | Agree Realty Corporation | President & CEO
Well, we have very de minimis exposure to furniture. I believe we have one Ashley Furniture and now a Gardner White in the portfolio. So we've never been overly acquisitive in the furniture space. It's obviously highly cyclical related to the housing market and the broader macroeconomic trend. The bigger problem with the furniture space generally in real estate is the lack of parking for most of the stores. And so you take the average furniture store, it's parked one per 1,000. And so a 40,000 square foot furniture store frankly can't park for a grocery operator or a soft good operator. So that's the biggest challenge. So it effectively becomes almost the single purpose building, similar to a movie theater or a gas station. And so we've never been overly attracted to the furniture space.

Obviously, we develop the Art Van flagship in conjunction with Art Van predating, obviously, his death and TH Lee. We're thrilled to have a Gardner White here. We'll look at all opportunities. I think if everybody who hasn't seen this asset goes to the YouTube video, I think it still has Art Van on it.

This is a premier retail location in the State of Michigan sharing a traffic signal with IKEA heads up on one of the three largest retail thoroughfares in Southeast Michigan. So Gardner White is going to do fantastic here. They've been in that submarket for a long time right down the street, and this store is going to do fantastic. And we'll look for any opportunities if it makes sense for us to divest of it or move on from it.

Operator
The next question comes from John Massocca with Ladenburg Thalmann.

John Massocca | Ladenburg Thalmann & Company LLC
With regards to your balance sheet strategy, what should we expect with regards to forward issuance under the ATM? Is there an absolute or relative amount that you're targeting to have outstanding on a forward basis at any one time?

Joey Agree | Agree Realty Corporation | President & CEO

I'll touch on and then hand over to Simon. And I think, look, we'll continue to be opportunistic with capital sources, seeking to maintain a balance sheet that's going to enable our growth like we have historically in the 4x to 5x range inclusive of forwarding settlement of any equity. And then we'll continue to look to reduce our cost of capital at attractive pricing. Simon, go ahead.

Simon Leopold | Agree Realty Corporation | CFO
Yes. I mean, just sort of echoing what Joey is saying. Obviously, the balance sheet's in great shape, we got very little leverage and great access to efficiently price capital. We've raised over $1.2 billion this year in the combination of institutional debt, forward equity, straight common equity, and we're generating very strong AFFO growth while improving an already high-quality portfolio.

So, I think at the end of the day it's working, and we don't plan to change it. If we can find other ways that make sense to give ourselves some more tools in our toolbox to keep funding this company and its growth the right way, then we'll certainly look at them. But we think what we're doing is working, and we're going to keep doing it.

John Massocca | Ladenburg Thalmann & Company LLC
Is there a level you have in mind? Because I just think about that issuance in terms of gives you kind of a set cost of capital no matter what the equity markets do in terms of volatility. But obviously, it's a reserve, that holds, in some way. So, is that, is there a number you have in mind? Could we see that decline over time given the amount you raised on the ATM on a forward basis in this quarter -- or, sorry, Q2 as well as having the follow-on offering in the quarter as well? Or is it just going to be an opportunistic thing on your end?

Joey Agree | Agree Realty Corporation | President & CEO
Well, John, I wouldn't think of it as an absolute or a relative level, generally. Look, forward equity is part of an overall hedging policy we have that we utilize to maintain medium-term visibility into our cost of capital. So very similar, and this is why we derived the forward equity strategy several years ago, and we've seen a number of net lease REITs follow suit either through regular way or ATM, is that we looked out in the marketplace, we knew we are growing at a 33% CAGR. Obviously, there's macroeconomic volatility that is out of our control.

And so companies have historically used forward starting swaps on the debt side. We said, well, 75% of our balance sheet is equity. Why don't we take an overall hedging policy to have a more stable perspective of the larger piece of our capital stack, the equity side? And so it's part of an overall hedging policy.

The last two transactions, I believe, we've done have been regular way transactions. They haven't been forward. Then we utilized the forward structure on the ATM in conjunction with it. And again, the goal here is we know we're going to grow. We have visibility in the 60/70 days of our pipeline, hence the increased acquisition guidance here. We're still just working on Q4. And it gives us that visibility beyond Q4 into our cost of capital, whether it's COVID-20, or the Martians come down, or who knows what happens or inflation runs rampant. We're going to have the ability to execute on our strategy as is.

John Massocca | Ladenburg Thalmann & Company LLC
Okay. That makes sense. And then I know you already touched a little bit on disposition outlook. But with regards to the restaurant space, has that -- it sounds like that was a focus on dispositions in the quarter.

Is that something we can see on the casual dining side go down to zero eventually? Or is there a lower bound for where that may end up in terms of exposure?

Joey Agree | Agree Realty Corporation | President & CEO
Yes. We will continue to opportunistically divest of, generally speaking, franchise fast food restaurants into a very aggressive environment. In Q2, we closed the sale of two Wendy's, a Burger King. I think you'll see us continue selling those assets. We don't have very many left, frankly. We sold the vast majority of them. And so the franchise fast food restaurant space is effectively winding down for us.

In terms of casual dining, we have very few assets that are casual dining. And then the vast majority absent, I think, one or two of the entire portfolio are ground leases. And so we're very comfortable with those positions. As I talked about on the call, in the pre-recorded part, the Capital Grille ground lease is a very unique asset. It's fine dining. I'm not sure we have a category or a sector designated for that. It's the only one in the portfolio, but it's sitting there in Parsippany in New Jersey. Capital Grille/Darden built the entire building. And obviously, it's a beautiful build-out. And so it's a ground lease similar to the rest of the casual dining assets in our portfolio.

John Massocca | Ladenburg Thalmann & Company LLC
Okay. And is there any low-hanging fruit, then, maybe as we think beyond 2021 in terms of dispositions as you solidify into more ground leases in the restaurant space that you're not going to end up selling? And obviously we'll see where theater pricing is. You talked about that earlier on the call. But anything else that stands out as a potential source of dispositions category-wise?

Joey Agree | Agree Realty Corporation | President & CEO
I tell you, our disposition activity over the last several years has reduced our pharmacy exposure, obviously reduced our Walgreens exposure, the restaurant exposure, the Dave & Buster's now where we only have two, including effectively their flagship in New Orleans. I think the portfolio as a whole has never been in a better place. We'll continue to opportunistically divest of assets.

That being said, I think if we roll back the clock to 2010 when we had 70 properties, I would bet you we have less than 20 remaining of those legacy assets of the entire portfolio today. So we have -- it's a new portfolio that's been constructed with an omni-channel future in mind since the advent of our acquisition platform in 2010, and it frankly doesn't have a lot of legacy challenges. And so we're in a good place.

Operator
[Operator Instructions] The next question comes from Linda Tsai with Jefferies.

Linda Tsai | Jefferies Group, LLC
With grocery now your largest tenant type at almost 11%, how does the credit quality of these tenants compare to the overall portfolio average? And would you expect it to grow as a percentage of your whole?

Joey Agree | Agree Realty Corporation | President & CEO
Good morning Linda, our grocery exposure is now led, obviously, by Kroger. Walmart doesn't fall into the grocery store for us, they're in general merchandise. Is now led by Kroger, and it's effectively a 100% or nearly 100% investment grade. So the ShopRite acquisition is Wakefern credit. The Amazon Freshes we acquired are Amazon. The Kroger portfolio obviously has Kroger credit. We have one or two Publix in the portfolio and H-E-B. Now the two Wegmans inclusive of the New Jersey asset on a ground lease.

And so our focus in grocery, we think there's going to be significant shake-up in the grocery industry over the next several years, is on best-of-breed operators who have the balance sheet to invest in price and invest in an omnichannel future through both macro and/or micro fulfillment or whatever permutation of that may take.

And so it's a highly competitive industry with 2% historic margins. It's going to be -- continued to be very competitive with Amazon Fresh continuing to roll out stores in full price transparency. And so we think the best-of-breed, whether it's a super-regional or national, is going to shake out and be on top here. And that's the only place we'll invest capital in the grocery space.

Linda Tsai | Jefferies Group, LLC
Thanks. And then there's a lot of headlines on rising COVID cases and the Delta variant. What kind of conversations do you have internally or might you have had with your tenants on the potential impact if the case counts continue?

Joey Agree | Agree Realty Corporation | President & CEO
Well, we're in a very unique position. Outside of the off-price retailers, TJX being amongst them, the retailers in our portfolio thrived during the pandemic, generally speaking. And so Walmart, Tractor Supply, Dollar General, even Best Buy, the auto parts guys, the home improvement guys, they were thriving during the pandemic frankly to a degree that I wouldn't have anticipated. And I think I mentioned on the last call, I never knew there were so many people that could perform home improvement projects or fix their cars on their own out there. But the sales were absolutely tremendous at the four-wall level.

I think the biggest challenge for every retailer and the conversations we have is labor challenges today, is staffing. That's obviously apparent to everybody who goes out to eat or goes shopping today, is the staffing challenges out there continue to persist. Most retailers in our portfolio have figured out a way to navigate it, but that's the biggest challenge, but nothing specific to the Delta variant or any other variants in terms of impact on their business.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Joey Agree for any closing remarks.

Joey Agree | Agree Realty Corporation | President & CEO
Well, thank you very much. Hopefully, we see everybody in person soon, and stay safe. Thank you, everybody.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.