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Federal Realty Investment Trust

Fourth Quarter 2023 Earnings Conference Call

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PRESENTATION

Operator

Good day, and welcome to the Federal Realty Investment Trust Fourth Quarter 2023 Earnings Conference Call. (Operator Instructions)

Please also note, today's event is being recorded.

I would now like to turn the conference over to Leah Brady, Vice President, Investor Relations. Please go ahead.

Leah Brady

Good afternoon and thank you for joining us today for Federal Realty's fourth quarter 2023 earnings conference call.

Joining me on the call are Don Wood, Federal's Chief Executive Officer; Jeff Berkes, President and Chief Operating Officer; Dan G., Executive Vice President, Finance, Chief Financial Officer and Treasurer; Jan Sweetnam, Executive Vice President and Chief Investment Officer; and Wendy Seher, Executive Vice President, Eastern Region President, as well as other members of our Executive Team, that are available to take your questions at the conclusion of our prepared remarks.

A reminder that certain matters discussed on this call may be deemed to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any annualized or projected information, as well as statements referring to expected or anticipated events or results including guidance. Although Federal Realty believes the expectations reflected in such forward-looking statements are based on reasonable assumptions, Federal Realty's future operations and its actual performance may differ materially from the information in our forward-looking statements, and we can give no assurance that these expectations can be attained.

The earnings release and supplemental reporting package that we issued tonight, our annual report filed on Form 10-K and our other financial disclosure documents provide a more in-depth discussion of risk factors that may affect our financial condition and our results of operations.

Given the number of participants on the call, we kindly ask that you limit yourself to one question during the Q&A portion of our call. If you have additional questions, please re-queue.

With that, I will turn the call over to Don Wood to begin our discussion of our fourth quarter results. Don?

Donald C. Wood

Thanks, Leah, and good afternoon, everybody.

Twenty twenty-three is in the books. With a strong $1.64 recorded in the fourth quarter, finish off what is an all-time record earnings year at $6.55 of FFO per share. That's happening, despite over $600 million of construction in progress not yet contributing and higher interest expense that cost the Trust an additional $0.27 per share when compared with the average rate in 2022. Yes, with comparable money cost between 2022 and 2023, FFO growth per share would have been 8%, right up there with our best pre-COVID years.

It says a lot in terms of the power of the portfolio that has grown bottom line FFO per share at a compound annual growth rate of 4.5% over the last 20 years in addition to an average uninterrupted dividend yield of roughly 3% or better. That includes the great financial crisis, that includes the global pandemic, it includes everything. No better portfolio to own for long term Investors in our opinion.

It also feels like we're getting closer to a time where accelerated acquisition activity coupled with our redevelopment and remerchandising expertise on new acquisitions could boost that growth rate over the next few years. As far as today’s environment, demand continues to exceed supply for the highest quality assets in the close-in suburbs, and with the impacts of the pandemic in the rear view mirror and lack of new supply coming on, I don't see this positive supply/demand dynamic changing anytime soon.

Our average in-place rents portfolio wide are $31.60 per foot and the comparable retail deals we did in the fourth quarter were at $44.57 a foot and we're at $36.75 for the entire year. I've been hearing that our rents are high and can't be pushed further for the better part of the last 20 years. I guess on a relative basis they are. Better properties have higher rents. Better properties have higher tenant sales and profitability too. Frankly, it's obvious.

Percentage rents are an interesting barometer on this topic. While we push for a strong fixed rent in nearly every lease, tenant sales above a threshold level equates to additional rent. Percentage rent and overage rent totaled $6 million in the fourth quarter and $19.3 million for the year, an all-time record, which broke the $18.8 million record from the year earlier. Fourth quarter retail leasing continued to crank with another 100 comparable retail deals done at 12% rollover on a cash basis, 23% on a straight line basis. These comparable retail deals account for virtually all 98% of the total retail deals done in the quarter, making them representative of the entire portfolio, not just a fraction.

It was a great leasing year, the third in a row where we exceeded two million square feet, roughly 25% more than the five year average during 2015 and 2019. Just to pound the point home, those cash basis rollover increases come on comp off leases that have had what I believe to be the highest contractual rent bumps throughout their term in the sector, making that rollover all the more impressive. Contractual rent bumps for the deals done in the fourth quarter were roughly 2.5% blended, anchor and small shop, with new and renewal small shop at approximately 3%. The weighted average contractual rent bumps for the entire retail portfolio, anchor and small shop, not just one quarters worth, but the whole thing, approximates 2.25%, best in the business as far as we can tell.

The sustained leasing volume and related economics bode well for the future, especially the contractual rent bumps. We ended the year with overall portfolio leased at 94.2%, pretty strong but with room to grow. That breaks down between anchors at 96% leased and shop space at 90.7%. When you look at occupancy possibilities going forward by looking at our past, it's reasonable to expect another 100 basis points of small shop occupancy and another 200 basis points of anchor occupancy improvement in the coming 12 to 18 months, depending, of course, on the extent of future bankruptcies that we are not seeing today, they're not at all obvious.

The residential and office product at our mixed use properties continues to outperform competing supply in non-mixed use environments and stood at 96% leased for both our comparable resi and comparable mixed use office product at yearend, while commanding premium rents. Progress leasing up our mixed use office under development, 915 Meeting Street at Pike & Rose and Santana West, has been measurably stronger with 215,000 square feet newly leased or in the final stages of the LOI signed lease process. That includes the first signed deal at Santana West with Acrisure, the global Fintech leader to the insurance sector. With those deals complete, 915 Meeting Street at Pike & Rose will be 80% leased and Santana West will be nearly half leased up.

I go through all this to really try to hammer home the obvious health of the business, centered around leasing high quality retail-centric properties in the close-in suburbs of America's greatest cities. While bottom line results are, and will continue to be muted by the higher, but certainly historically reasonable cost of capital that is stabilizing. Rents will likely continue to adjust upward over time to that reality. This is especially true for tenants in locations in affluent areas where customers can absorb higher costs. I hope that higher interest rates don't cloud Investors' appreciation of strong underlying business fundamentals that exist today and likely tomorrow.

With that backdrop, we're also really excited to add a substantial expansion to the 87-unit first phase of residential product that we built at Bala Cynwyd Shopping Center in Suburban Philadelphia a few years back. The first phase opened strong and remains fully leased with growing rents. Strong supply and demand dynamics in this close in part of Philadelphia's mainline, along with construction costs moderating, means that we're able to build an additional 217 residential units, 16,000 feet of additional retail and the covered parking spaces to service it all.

On the former Lord & Taylor site at Bala Cynwyd, the shopping center features an expansive tenant roster including an LA fitness gym, a full service grocer, restaurants and necessary services, which are often cited as the reason residents are choosing it. Project should get underway later this year beginning with demo of the old Lord & Taylor building which should yield a 7% cash on cost return when stabilized, throw out a double digit unlevered IRR based on the rent growth we've seen and expect and be funded from free cash flow.

On to 2024 where we certainly expect another record earnings year with an energized team and a strong sense of optimism. Dan will go into a bunch more detail and I'll turn it over to him and then open it up to your questions. Dan?

Daniel Guglielmone

Thank you, Don. Hello everyone.

Our reported FFO per share of $1.64 for the fourth quarter, and $6.55 for the year were up 3.8% and 3.6% respectively versus 2022. POI was up 6.5% in fourth quarter, a more impressive 7.2% for the year. Primary drivers for the strong performance in 2023, first, POI growth in our comparable portfolio, up almost 5% on a cash basis excluding prior period rents and term fees, driven by both higher rents and higher average occupancy over the course of the year, driven by continued strength, consumer traffic and tenant sales, particularly in our mixed use assets driving parking revenues and overage percentage rent higher, effectively, controlling property level expenses and having a lower credit reserve than we originally forecast.

Second, contributions from our redevelopment and expansion pipeline, which came in at the upper end of our forecast. Lastly, continued focus on overall expense controls, the G&A came in below expectations. This was offset primarily by higher interest rate headwinds totaling $0.27. To reiterate Don's point earlier, with a consistent cost of debt versus 2022, FFO per share growth year-over-year would have been 8% in 2023, reflecting an exceptionally strong year of growth at the property level.

GAAP-based comparable POI growth came in at 4% for the fourth quarter and 3.2% for the year. On a comparable cash basis, excluding the impact of prior period rent and term fees, growth was 5.2% for the fourth quarter and 4.7% for the year. As a reminder, this information including components of prior period rent, term fees and GAAP to cash adjustments can be found on Page 12 of our quarterly 8-K supplement.

Our residential portfolio continues to be a source of strength despite headwinds in the broader residential sector. Same store residential POI growth was 5.8% in 4Q along with revenue growth for the quarter at 6%. We expect this strength to continue into 2024.

The value proposition providing a premium residential offering on top of an attractive retail amenity base is driving outperformance across our targeted residential portfolio. Also, a big driver of our growth in 2023 was continued stabilization of a large portion of our redevelopment and expansion pipeline as $18 million of incremental POI came online from our $750 million in-process pipeline. We expect that to be the case moving forward as well as we add new projects to the lineup and maintain that part of our business as a continued driver of growth.

The scale and skillset of our redevelopment program is a key differentiator for Federal. Notable updates to our in-process pipeline, which will contribute an additional $9 million to $12 million of POI in 2024 include, $115 million Darien Commons project in Connecticut where the residential is fully stabilized 98.4% occupancy with rents above $4 per foot per month, well above underwriting. Tenant retention rates remain above 90% and the retail component approaches 90% leased, a testament to what a strong retail amenity base can bring to a residential project. At the $190 million 915 Meeting Street at Pike & Rose, Choice Hotels fully moved in as they opened in 4Q, plus they've taken additional space. Sodexo's U.S. headquarters is next on deck to open, with multiple other tenants actively negotiating leases.

At Huntington Shopping Center on Long Island this $85 million Whole Foods anchored redevelopment is over 90% leased with new anchor, REI opening during the Q4 in addition to a number of small shops. We feel very good about the yield on this project, approaching the top end of our 7% to 8% return range. For those of you in the New York area, it's worth a trip out to Central Long Island later this year after Whole Foods opens to check it out, as well as the Melville asset a mile further south. Both are exceptional retail redevelopments which truly highlight Federal's skillset.

Additionally in 2023, we incrementally invested over $120 million in properties we only partially owned previously at an effective 8.1% cap rate. No better risk adjusted investment than deploying capital accretively into assets we know extremely well. Unlevered IRRs on these investments are in the double digits.

Now to the balance sheet, and an update on our liquidity position. As you all saw, we refinanced our $600 million bond maturities, which came due on January 15 for a combination of a $200 million secured loan on our Bethesda Row property at an effective 5% fixed rate for the first two years of the loan, plus two one year extensions that are effectively a four year loan and a $485 million, 3.25% exchangeable notes offering due 2029, raised in early January at an effective 3.9% interest rate all-in. As part of that transaction, we purchased a call spread to increase the effective strike price on the convert of 40%, up above $143 per share, so no incremental economic solution unless the common stock trades above that level as adjusted.

Pro forma of the most recent financings and dividends paid, our liquidity stands above $1.3 billion with an undrawn $1.25 billion credit facility and available cash on hand. Plus, we have no maturities remaining in 2024 and no material maturities until 2026. Our leverage metrics continue to be strong as fourth quarter annualized net debt-to-EBITDA stands at 5.9 times and that metric should improve over the course of 2024 and hit our target of 5.5 times in 2025. Fixed charge coverage was 3.6 times at year end and that metric should continue to improve as incremental EBITDA comes online and interest rates fall over the second half of 2024.

Now on to guidance. For 2024, we are introducing an FFO per share forecast of $6.65 to $6.87 per share. This represents over 3% growth at the midpoint of $6.76 and roughly 5% at the high end of the range. This is driven by comparable growth of 2.5% to 4% when excluding prior period rents and term fees, 3.25% at the midpoint. This assumes occupancy levels will increase from 92.2% at 12/31, up to roughly 93% by yearend 2024. Although expect a step back in the Q1 due to expected seasonality post holidays. Then add in additional contributions from our redevelopment and expansion pipeline of $9 million to $12 million. For those modeling, let me direct you to our 8-K on Page 16, where we provide our forecast of stabilized POI and timing by project.

Now this will be offset by modestly lower prior period collections, expected to be roughly $3 million in 2024 versus $5 million in ‘23, modestly lower net term fees forecasted $4 million to $7 million range in '24 versus $7 million in '23 and continued drag from higher money costs. The recent $600 million of notes that we repaid last month at an effective rate of 3.7% versus the new blended cost on our two most recent refinancing of 4.3%. Other assumptions include $100 million to $150 million of spend this year on redevelopment expansions on our existing properties, G&A is forecast in the $48 million to $52 million range for the year and capitalized interest for 2024 is estimated at $18 million to $21 million.

We've assumed the total credit reserve consisting of bad debt expense, unexpected vacancy, incentive rent relief of 70 basis points to 90 basis points for 2024, more in line with pre pandemic historical averages. As is our custom, this guidance does not reflect any acquisitions or dispositions in 2024. We will adjust, likely upwards as we go, given our opportunistic approach to both.

Quarterly FFO cadence for 2024 is forecast that the first quarter being roughly in line with the fourth quarter of 2023 at a range of $1.60 to $1.65, with sequential growth each quarter thereafter. Please see the detailed summary of this guidance in our 8-K on Page 28 and in our press release.

With that, Operator, please open the line for questions.

Operator

Thank you. (Operator Instructions) Today's first question comes from Juan Sanabria with BMO Capital Markets. Please go ahead.

Juan Sanabria

I was just hoping you guys could talk a little bit more about the office leasing. It sounded like there was the Fintech lease at Santana. Was there anything else? Curious as to the momentum or prospects for assigning other tenants there and how you think that evolves in '24?

Donald C. Wood

Yes. No, Juan, I tried to, without mentioning a name or getting myself in trouble, I tried to indicate that there is a large tenant there that we are very close to lease signing on. The LOI is done. We're in the last stages of lease signing. I'm not going to name the tenant today, but you certainly will know them. We would expect that lease, unless something dramatic goes wrong, done very shortly from here on. Along with that for sure and a couple of other smaller things what gets us to that half done on that building in Santana West. Similarly, very close to signing on a couple of deals here at Pike & Rose or at 915 Meeting, which would get that building to 80% leased. Been a very different last few months in terms of, not just tours, but productivity in terms of turning LOIs into leases.

Operator

Thank you. Our next question today comes from Alexander Goldfarb with Piper Sandler. Please go ahead.

Alexander Goldfarb

Hey, thank you for taking the question. Don, just going through your tenancy, overall, it's pretty good list in the top tenants, but obviously there's some not rated, some not investment grade. But holistically, as you push the portfolio occupancy and really upgrade tenancy, are there types of tenants that you're saying no to? For example, the classic private equity, highly levered tenants, even if they are great performer, you're saying, look, historically these types of levered tenants are the ones that cause issues, in the next downturn and therefore, even though they may be promising, let's try to limit exposure. Just trying to think what ways, as the portfolio becomes increasingly in demand, that you may be gaining leverage to sort of push back on

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the types of tenants, even if they're a great performer, but just going, you know what, great performer, but not great balance sheet, we're going to pass.

Donald C. Wood

Yes, Alex. It's really a good question. The bottom line is, when you're trying to improve your portfolio, what you're effectively doing is, taking all of that into consideration for not just next year or the year after that, but the term of the lease. It includes the capital decisions that have to be made in terms of going in. I will tell you that to the extent a tenant—and this just I think makes sense to you, a tenant that we like a lot, but that has a riskier profile to the extent we're limiting significantly the capital we'll get, and we'll give them a shot. To the extent we're investing in that piece of real estate, that particular space in there, then there better be credit, there better be comfort, if you will, that we're going to get paid, that we're very likely to get paid through the entire term of the lease.

As I started out, this is a very good time for supply and demand dynamics. What that means in the better properties is choice. To the extent you have that choice, you absolutely consider things like leverage level, what the owners are planning to do with the asset or with their retailer et cetera. It's a good time to be able to continue to upgrade the portfolio.

Operator

Thank you. Our next question comes from Steve Sakwa with Evercore. Please go ahead.

Steve Sakwa

Thanks. Good afternoon. Don, just maybe following up on Alex's line of questioning, just want to talk a little bit about pricing power. Given where the portfolio is and the potential uptick in occupancy, how are you and Wendy and the team thinking about being able to push rents? Do you expect that to materially change in '24 or is that a little bit longer term kind of runway just given that there's been no supply in the space and demand seems to be very tight at good centers?

Donald C. Wood

It does. It does Steve. Look at the end of the day, it's still a very local business and you're having this conversation based on what the potential choices are for that particular piece of real estate. Where I love it, where I think the—and I just believe this is the most important thing, it is in the contract itself. The leverage generally, whether it comes out in better bumps, you know how I feel about the bumps, that's a contractual increase in cash flow for a long period of time, nothing beats that to me. That's the first thing.

The second thing is, making sure that we have control of the space because the tenant wants control of the rest of that shopping center, not just the space, but the shopping center. I do think we're making, and I've always kind of focused on this as a big thing for us to make sure that contract is as landlord friendly as it could be, but those are places where we have made pretty strong strides in the last 18 months in particular, for strong leases with big bumps. That's where I'd look for it most. That's an insurance policy to know that the foundation of this Company, the basic shopping centers throughout this Company are really strong with rents that whether you believe it or not are under market, as proven by each quarter that we go through.

Now you take that, and you supplement that with things like the redevelopments that we're doing at places like Huntington, with a new residential project that we're doing at Bala Cynwyd with potential stronger acquisition market as we move forward. That's where I get very excited and very positive about the future growth of the Company.

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Operator

Thank you. Our next question today comes from Jeff Spector with Bank of America. Please go ahead.

Jeffrey Spector

Great. Thank you. Don, can you elaborate on your opening remark comment on accretive acquisitions and opportunities? It seems like you're a bit more optimistic or maybe excited at some of the opportunities you're seeing. Is that correct? If yes, is it certain regions, again, type of centers? I know we talk about this all the time, but I think it seemed like you specifically highlighted that in the opening remarks.

Donald C. Wood

Hey, Jeff. First of all, thanks for listening to the opening remarks. I appreciate that a ton. Yes, you are dead right in terms of where I see it. But let me turn it over to Jeff Berkes or Jan. Guys, give us your thoughts on that question.

Jeffrey Berkes

Yes, sure Don. Hey Jeff, it's Jeff Berkes. I'm here with Jan. He'll jump in a minute on what he's seeing kind of day-to-day in the market. But yes, you're right. We are looking forward to a good year in 2024 for acquisitions. We didn't really see anything in 2023 that excited us that much other than the opportunities we had to invest within our own portfolio at very accretive rates. But we think the market is starting to heal and we expect '24 to be a better year, certainly a good year for us for acquisitions.

I know, as well and you probably know what I'm going to say, but keep in mind that we've got a very compelling cost to capital. We are not constrained by any one sub product type within retail. We're format agnostic. We are more focused on location and opportunity with the piece of dirt than exactly the improvements that sit on it today. We have a really well-developed team here that looks at highest and best use and ways to add value through re-leasing, remerchandising and improving the existing improvements, as well as knocking parts of the property down and going vertical and doing things like we're doing at Bala and other shopping centers in our portfolio where we add residential.

We've got great relationships in the market. We're known as a closer, both with the sellers and the brokers. I think we've got a lot of advantages and a really sort of clear eye towards growing the Company through accretive acquisitions that are going to deliver long term growth to the Company and we hope the markets respond and I think they will but let me turn it over to Jan and kind of let him give you his thoughts on what we're seeing in the market today.

Jan Sweetnam

Hi, Jeff, Jan. A lot of sellers have really been sitting on the sideline waiting for the cost of capital and cost to debt, and their situation to kind of settle itself out. I think ‘23 was a record year for sellers asking brokers for their broker opinion of values. It's just a massive BOB year. Super majority of those sellers chose not to put their properties on the marketplace. Now that capital and cost of debt has started to settle in a lot, we're hearing a lot of rumbling about sellers now putting their properties on the market.

In areas, and sometimes in some new markets that are of interest to us that we think we're going to see, so far as we're looking through here in early February, it seems like there's going to be a lot more interesting product for us to look at and try to acquire. To me, I think 2024 is going to be a big year for us.

Jeffrey Berkes

Yes, Jeff, you've heard us talk about this in the past. We are very creative in how we structure deals. We have been for a very long time, good at figuring out ways to solve sellers' issues, particularly private sellers and older sellers that have owned the properties for a long time. A lot of tools in the toolbox here at Federal and we expect to be putting them to good use this year.

Operator

Thank you. Our next question today comes from Greg McGinnis with Scotiabank. Please go ahead.

Greg McGinnis

Hey, good evening. It was a great year overall for retail leasing, but Q4 leasing volumes fell about 25% compared to the first three quarters in 2023 and resi occupancy saw 190 basis points quarter-over-quarter. Could you just provide some details on the trends you're seeing in retail tenant demand as well as what happened on the resi side and expectations built into 2024 guidance for resi occupancy and rent growth?

Donald C. Wood

I have to ask you to go, Wendy or somebody on resi occupancy for a second. Before you do though on the retail occupancy in the Q4, Greg that's just timing. There's nothing in there from a trends perspective that we feel any different about. I know we had a couple of particular anchors that are re-leased that went out in the fourth quarter and again re-leased at good spreads going forward, but just timing in the quarter there. I don't know, Wendy, if there's more to say about that for Greg.

Wendy Seher

No. I think if you look at—it's just timing is number one and number two is our pipeline still remains strong. When I look at where we are, specifically in small shop leasing, I do feel like there we have a runway there, probably another 100 basis points to grow off of. Also, some of the timing is also attributed to several of the deals that we're doing are on spaces that are already occupied. There's some overlap there.

Jeffrey Berkes

Yes, let me, Dan go ahead on resi if you want, but my comment, Greg, would be, we have a couple of markets that are very seasonal, primarily out here in California and New England. We do try and ramp up occupancy, going into the slower winter season. We can ride through first quarter of a little bit slower leasing in those seasonal markets and be in a position where we're not giving up a lot when the leasing season heats up again. Some of that's strategic in the way we build occupancy up in the prior quarter. But Dan, if you got more to add, please do so.

Daniel Guglielmone

Yes. That's exactly right. On the residential portfolio seasonality is really what's driving that move. We're up year-over-year from an occupancy perspective and we fully expect occupancy to pull back in the fourth quarter due to that exact reason. We have a small portfolio. I think that it only takes a handful of units to kind of move things a little bit. I would not read anything into that at all.

Operator

Thank you. Our next question today comes from Craig Mailman with Citi. Please go ahead.

Craig Mailman

Thank you. I just want to go back to the question about acquisitions. It sounded like maybe there could be some more (inaudible) deals in there, but could you just give us a sense of magnitude at this point at the level where you would need to cap some of the equity and some of your trophy mixed use projects or can you guys fund this with kind of current liquidity?

Donald C. Wood

That's a good question, Craig. The funding with the—funding with the trophy assets at some point, is something for the future. It's not something for today, given where the market stand and the appetite and still the uncertainty on that stuff overseas in particular. With respect to boosting the acquisition portfolio now, that's what that line's for. There is short-term financing and there will be long-term financing. But there's a reason that powder is dry, and we'd like to use it.

Operator

Thank you. Our next question comes from Ki Bin Kim with Truist. Please go ahead.

Ki Bin Kim

Thank you. Don, can you just go back to some of the comments you made about the office leasing demand you're seeing at Santana West and 915 Meeting. Just curious if there's been any kind of commonalities for why somebody says—I'm guessing it's relocations, moving to these centers. For 915 Meeting the NOI contribution, is it reasonable to expect that 50% contribution to be backend weighted or more per ratable?

Donald C. Wood

Go ahead, on that.

Daniel Guglielmone

Yes. Pro rata, I would say, effectively in terms of the contribution of the course of the year.

Donald C. Wood

I'm going to take it, (inaudible), the common thread through all of this is either—it's funny, either relocations from downtowns to these mixed-use properties in both of them basically in that first ring suburbs or out further and coming in looking for the full amenities that these properties provide. That's been so darn consistent over the past 3, 3.5, 4 years with respect to what's happening there. I don't see that stopping. It's the demands of these tenants who are generally taking less space than they had, wherever they were, West Coast, some kind of campus, the East Coast—the East Coast, same type of thing potentially. But they are taking less space, but they demand more in terms of the amenity base and that is so consistent in basically the three places, the three big projects, whether it's (inaudible) Boston, with respect to Assembly. That's the common thread.

Operator

Thank you. Our next question today comes from Mike Mueller with JPMorgan. Please go ahead.

Michael Mueller

Yes, Hi. I just have two quick development questions. First for Bala Cynwyd, is there any meaningful NOI that's coming out of the run rate, your 4Q NOI run rate? Then do you have a ballpark estimate of timing for the Santana office rent commencements?

Donald C. Wood

Let you—can you take this?

Daniel Guglielmone

Yes, on Bala, I don't think there's any material—

Donald C. Wood

It's an empty Lord & Taylor which is (multiple speakers).

Jan Sweetnam

No impact.

Daniel Guglielmone

Then the timing, we'll let you know on the timing. We'll start on Acrisure recognizing some revenue this year, 2024. We'll let you know when we sign the leases of the timing of the leases that we have in the pipeline, when those will look to come online.

Operator

Thank you. Our next question comes from Floris van Dijkum with Compass Point. Please go ahead.

Floris van Dijkum

Hey. Good evening, guys. Thanks for taking my question. Following up a little bit on the office activity, obviously congrats on—obviously you haven't gotten over the line yet, but certainly got the first leases going there, both Santana West as well as in Pike & Rose. Are those leases in your guidance? Maybe you can talk about what is happening to the negotiations in terms of the rents there? Jeff, maybe I'd love—because you're on the grounds at Santana West, are you getting pushback from office tenants on rents or other things or is it just—talk a little bit about the competitive situation of and the balance between landlord and tenant because clearly different in office than it is in retail.

Donald C. Wood

Go ahead, Jeff.

Jeffrey Berkes

Yes. I'm actually going to pass it to Jan. Floris, Jan handles all of our large office leasing. Let me turn it over to him.

Jan Sweetnam

Hey, Floris. I think, just in terms of the rent side I would say two things, one of which is, both at Pike & Rose and at Santana West here and also at Assembly, really the tenants are looking for something, as Don said, they're looking for the amenities, they're looking for a better building, they are looking to upgrade their location. They have tended to be less price sensitive on rent. Rents feel like they're holding pretty well, but the tenant improvement packages have in fact gone up. That's really the change that we've seen, and that's where the competitive piece comes in, but the rents have been really rock solid.

Jeffrey Berkes

Just, Floris, to remind you and I think we've talked about this before, and Don alluded to it in his earlier comments. Most of the tenants that are moving into our state-of-the-art buildings in those three locations are coming from inferior buildings where they take more space and they're downsizing. While they may be paying a higher rent per foot in our buildings than they were paying because they're taking less square footage, their overall occupancy costs are less which again goes to them not being as sensitive about rent. I think that's important to understand.

Operator

Thank you. Our next question today comes from Dori Kesten with Wells Fargo. Please go ahead.

Dori Kesten

Thanks. Good evening. Can you walk through your thought process behind the mortgage on Bethesda Row on just addressing the size, maybe loan to value, why Bethesda, specifically?

Daniel Guglielmone

I think the debt markets have been extremely volatile. Interest rates have lacked direction, to say the least. I think back in October when we committed to doing that transaction, the 10 year was at 5%, our stock was at $85, and we saw this as a unique opportunity for us to lock in a spread on a secured loan on one of our best properties and gets attractive financing. The leverage is lower than we typically would, it's a little bit structured. But today, mortgage rates on retail product today at normalized leverage levels are probably 200 basis points over the Treasury, probably 175 basis points to 200 basis points on a floating rate basis above SOFR.

We were able to get 95 basis points through the structuring that we did with our lender. We felt like that was a really, really attractive credit spread. It was certainly more attractive than the 150 basis points to 160 basis points we're looking at back in October to do a five year loan. It was just a unique opportunistic financing that really demonstrates Federal’s historic ability to access different parts of the capital markets at more difficult times in the cycle. I think that in our access of the convertible market, it's another example of that. Don, did you want to add anything?

Donald C. Wood

No, I wanted to ask you Dan too, from a tax perspective, tax basis perspective, putting $200 million on Bethesda Row frees up some flexibility with respect to–

Daniel Guglielmone

For tax planning. I think having the leverage on there and having debt on Bethesda, where we've created significant value over our ownership, created a ton of value above where, if we do want to bring in a joint venture partner, this brings and gives us that optionality and that flexibility from a tax efficient.

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Operator

Thank you. Our next question comes from Linda Tsai with Jefferies. Please go ahead.

Linda Tsai

Hi. Thank you. I think you said earnings growth in 2023 was an 8% absent higher money costs. What level of earnings growth does this mean for ‘24, if you look at it the same way?

Daniel Guglielmone

Eight percent—we had significant headwinds, (inaudible). We have less headwinds heading into 2024, although they're still there. I haven't done the calculation, but it's probably a couple of 100 basis points of incremental—if you back out the cost of that, the 3% probably goes up to something north of 5%, less money cost, at least from my perspective. I haven't done the exact calculation, Linda, but that's roughly where I would see it.

Operator

Thank you. Our next question today comes from Anthony Powell with Barclays. Please go ahead.

Anthony Powell

Hi. Thank you. In the prepared remarks, you talked about how construction costs were going lower, which helps with your decision to do the Philadelphia Residential. Can you maybe expand more on what's going on with construction cost, and do more of your projects and your future redevelopment pipeline look attractive given lower construction cost?

Donald C. Wood

That's a good question. It's not dramatic in terms of a reduction in construction costs. When you think about the components of it, particularly the labor component of it, when business slows down as it obviously has in past a couple of years, you've got better leverage to get labor rates that makes some more sense. When you compare that to really the last five or six years in particular before that, it's a dramatic difference in terms of being able to forecast. That's really the most important thing here is, anytime you want to do a redevelopment or development itself, it's about predictability of costs in addition to growth on the rents.

What's happening now is we're finding much better predictability in construction costs, primarily on the labor side. We're going to tie these things down to GMPs, maximum price contracts. When you're able to do that, then you can then focus more on what the rent growth is, the timing, does it make sense to do. In the case of Bala, it was really a case where supply and demand finally made some sense without new product being added in that particular section of the main line, which is very attractive. We really liked that. Now we couldn’t make sense of that, a year ago or two years ago or three years ago, but we can make sense of it now.

I would hope to see more of those possibilities going forward. Remember, this is land that Federal's owned for a very long-time, and that gives you a huge advantage because the land costs aren't incremental land costs associated with it. That's why that makes sense. When you look at construction, I wouldn't look at it as costs are going to be dramatically lower than they were, but they've certainly stabilized and coming down a few percentage points because of the labor side, it's an important consideration when you're deciding whether to go or not.

Operator

Thank you. Our next question today comes from Paulina Rojas Schmidt with Green Street. Please go ahead.

Paulina Rojas Schmidt

Hello, everyone. My question is related to the prior one. You reported for the Bala project an ROIC of 7. I think you mentioned in your prepared remarks, the unlevered IRR as well. But more broadly speaking, what kind of profit margin we need to see when thinking about this project to compensate for the risks, whether it's cost or leasing.

Daniel Guglielmone

Not quite following your question, Paulina, are you asking kind of what kind of yield premium we need to get to kind of have those—to have the IRRs get up into the double digits?

Paulina Rojas Schmidt

Yes, when we think about comparing your (inaudible) rate or–

Daniel Guglielmone

I think that developing this to a 7 is clearly higher than it would be in today's market. As interest rates come down and stabilize, obviously, what the spread is well north of 100 basis points, 150 basis points and 200 basis points. We are going to expect to be able to grow rents residentially in line with what we've done in our residential portfolio, is amenitize adjacent to great retail and we've been able to grow rents very attractively overtime.

As we grow rents, obviously the POI, it's going to be a big driver of those unlevered returns as well. Those are the inputs that go in there that get us very comfortable, get a double digit IRR unlevered something that's achievable, developing this to a 7 initially, and having it grow from there.

Jeffrey Berkes

Hey, Dan, if I can just add on. Paulina, it's Jeff. One thing to think about too as it relates to Federal and the residential that we develop, and we've got about $900 million pipeline of projects in the design and entitlement phase right now, is almost all of those are at places where we already operate residential property. That's the case at Bala, the case if we do anything at Bethesda Row, Santana Row, Pike and Rose, Assembly Row, other places in Montgomery County, Maryland where we own real estate.

The risk adjusted return for us is really, really strong. We understand the rental market very well, we operate units. We're adding units. We understand the operating costs very well. As Don mentioned in the prior question, when we contract for the construction, we're doing that with full construction drawings, great bid coverage and a guaranteed maximum price contract. The risk adjusted returns for us are exceptionally strong when we add residential to our portfolio.

Operator

Thank you. Our next question today is a follow-up from Alexander Goldfarb from Piper Sandler. Please go ahead.

Alexander Goldfarb

Hey. Good evening. Just going back to the Bethesda Row. I think you guys had spoken previously about possibly joint venturing that asset or maybe there was institutional interest, but I guess bigger picture, historically Federal hasn't been a JV platform, but you talked about it with the potential on Bethesda. In your view, Don, as you guys talk to joint venture capital, what's their appetite for shopping centers and do they believe that truly this burgeoning growth that we all talk about will actually come to fruition, or is there a view that the leases are so locked in, in favor of the tenant that yes, at some point, they can get good economics, but may be a longer timeline than they actually are willing to underwrite and invest. Just sort of curious what's going on the private side as you talk to possible partners.

Donald C. Wood

A couple of things. Alex. Jeff, I'd love you to add to this if you need to, but first of all, don't use me as a proxy for what's happening among the private side. In terms of their appetite, because we have not seriously gone down the road with any of them in terms of serious negotiations because we don't believe this is the right time to effectively do a deal like that on the mixed use assets. When we looked at ourselves and where we see the growth in the portfolio, I think I've said this for the last four or five, five quarters, our mixed use stuff is outperforming the other stuff. It's growing and it's growing fast.

We'd like to get this stuff to have that trajectory continue. I would like to see over the next year or two or three the capital markets, yes solidify themselves. Obviously, we're just in the very early stages of figuring out what that means in terms of capital markets with the country. I don't have much more to add with respect to any specific group of private joint venture Investors because we really haven't had in-depth conversations with them at this point. I don't know. Jeff, anything?

Jeffrey Berkes

Yes Don, I don't really have anything meaningful to add to that. Sorry.

Donald C. Wood

All good.

Operator

Thank you. Our next question today comes from Steve Sakwa of Evercore. Please go ahead.

Steve Sakwa

Yes. Thanks. Just wanted to quick follow-up maybe with Dan G. on the guidance. When you kind of look through the building blocks, just maybe help us think through which ones have kind of the most leverage maybe to the upside and the downside. Maybe just a little bit more color on the POI growth ex-prior period rents and term fees, it's about 100 basis points slower, around 3.25, versus the 4.3 (phon). Maybe just kind of walk us through there. Is that really all bad debt driven or is there something else pulling that growth rate down? Thanks.

Daniel Guglielmone

Yes. It is guidance. I think there are a lot of things that go into now in particular that go into the FFO guidance. As it relates to specifically, the comparable POI growth with 2.5% to 4% occupancy levels and

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how aggressively and how quickly we can push levels up towards 93%. I think, how much percentage rent can we continue to collect, parking revenues, can we control property level expenses the way we have which has been a big help. Term fees, I guess don't apply to that metric but that's going to drive FFO. although it won't necessarily drive the POI metric excluding that. How quickly and how we can get development POI up. I think one of the things that going to be a big driver is, we purposely have $600 million of floating rate debt, how quickly SOFR comes down. I think we're pretty conservative in terms of our assumptions for where interest rates will go. That will have an impact. Then, I think what we've done an exceptional job at which probably drive some of the POI growth is just getting tenants open sooner, keeping tenants in-possession longer, keeping tenants in that we expected to leave. I think that's another driver. I think they all contribute throughout the range.

Operator

Thank you. This concludes our question-and-answer session. I'd like to turn the conference back over Leah Brady for closing remarks.

Leah Brady

Look forward to seeing many of you in the next few weeks. Thanks for joining us today.

Operator

Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.