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PRESENTATION

Operator

Thank you for standing by, and welcome to the First Quarter 2024 Kite Realty Group Trust Earnings Conference Call. (Operator Instructions) As a reminder, today's program is being recorded.

And now I'd like to introduce your host for today's program, Bryan McCarthy, Senior Vice President, Corporate Development and Investor Relations. Please go ahead.

Bryan McCarthy ***Kite Realty Group Trust - SVP of Corporate Marketing & Communications***

Thank you, and good afternoon, everyone. Welcome to Kite Realty Group's first quarter earnings call. Some of today's comments contain forward-looking statements that are based on assumptions of future events and are subject to inherent risks and uncertainties. Actual results may differ materially from these statements. For more information about the factors that can adversely affect the company's results, please see our SEC filings, including our most recent Form 10-K.

Today's remarks also include certain non-GAAP financial measures. Please refer to yesterday's earnings press release available on our website for a reconciliation of these non-GAAP performance measures to our GAAP financial results.

On the call with me today from Kite Realty Group are Chairman and Chief Executive Officer, John Kite; President and Chief Operating Officer, Tom McGowan; Executive Vice President and Chief Financial Officer, Heath Fear; Senior Vice President and Chief Accounting Officer, Dave Buell; and Senior Vice President, Capital Markets and Investor Relations, Tyler Henshaw.

I'll now turn the call over to John.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Thanks, Bryan, and thanks, everybody, for joining today. KRG has maintained our momentum into the first quarter of 2024, delivering exceptional execution across our platform and further strengthening our already best-in-class balance sheet. Heath will walk you through the details of our quarterly results and increased guidance, and I'll focus on recent sector trends, our operating priorities and the series of strategic, well-timed initiatives that have allowed KRG to earn the highest total return in the open-air retail space over the past 5 years.

Open-air retail has demonstrated strong fundamentals and rapidly accelerated recognition of its central role in each community we serve. The re-appreciation of open-air's critical role as the most convenient and profitable distribution channel has resulted in consistent demand across our portfolio from both our tenants and shoppers. The renaissance of open-air retail is amplified in the Sun Belt, where

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our portfolio benefits from migration trends out of higher out of higher cost of living metros into warmer, lower-tax states. The top 10 MSAs for population growth in 2023 account for over 30% of our revenue and includes cities like Dallas, Houston, Atlanta, Orlando, Tampa and Phoenix.

On the operational front, we remain laser-focused on creating the best experience possible at our centers by selectively adding high-quality tenants to our portfolio. Since the beginning of 2022, we've executed 53 anchor leases to 36 different brands, over 90% of which were national tenants, and we increased our grocery exposure by 400 basis points to nearly 80%. We've generated 46% comparable cash spreads and 26% returns on capital. And we are very confident in our ability to continue the robust leasing efforts. Our thoughtful approach, prioritizing quality and value creation, will continue to enhance the merchandising mix at our centers and improve the credit profile of our tenant base.

On the small shop side, we continue to have success pushing higher embedded growth. For new and non-option renewal shop leases signed in the first quarter of 2024, the average annual growth was 3.4%, and 70% of these leases had fixed rent bumps greater than or equal to 4%. To illustrate the tremendous progress we've made, in 2022, the average annual growth was 2.7% and only 3% of the leases had fixed rent bumps greater than or equal to 4%. The benefit of negotiating higher fixed rent bumps will take time to materialize, but our efforts are on track to provide tangible improvements to our long-term embedded growth profile. Maintaining a disciplined leasing approach by keeping quality and growth at the forefront will further strengthen our durable cash flow stream while generating strong risk-adjusted and absolute returns.

Our signed-not-open pipeline increased to $32 million, and we expect 76% of the NOI to commence in 2024. On Pages 6 and 7 of our latest investor deck, we detailed the commencement timing of the signed-not-open pipeline and the compelling opportunity for investors based on current share price at various capitalization rates. These pages do not account for the future opportunity to allocate free cash flow, which we expect will significantly ramp up as our elevated leasing spend normalizes.

Along with our increased free cash flow, we expect meaningful AFFO and dividend growth. While the opportunity for investors is very compelling right now, we believe the future holds an even more convincing case for KRG with better growth and more capital to allocate.

Over the last 5 years, KRG has earned the highest total return in our sector. We were able to accomplish this by improving the quality and location of our portfolio, fortifying our balance sheet, executing on a transformational merger, improving our credit ratings and re-rating our cost of debt. These very well-timed successes could not have dovetailed better with the open-air retail supply and demand imbalance, the acceleration of consumer trends spurred by the pandemic, and the increased commitment to physical retail.

Our continued execution has allowed us to raise the midpoint of our 2024 FFO guidance by $0.02 and our same-property NOI growth assumption by 50 basis points. Our team has produced solid results, and collectively, we've positioned the company to continue outperforming. We have an experienced group across all departments of the organization, and I hope each of you will get time to spend -- will get to spend time with our various team members at our remaining Four in '24 events in Dallas, Washington, D.C. and Las Vegas.

Thank you, as always, to our incredible team. And now I'll turn the call to Heath.

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Thank you, and good afternoon. Following John's remarks about our Four in '24 series, our initial event last February was very well received and showcased the strength of the Naples market, the underlying quality of our "bread-and-butter" assets and the intensity of our operating platform. We are anticipating a great turnout for our next event in Dallas, which is our largest market in terms of ABR and GLA.

In Dallas, we will tour over 5% of KRG's total NOI while demonstrating the prowess of our leasing team using Southlake Town Square as our case study. Southlake is one of the nation's premier mixed-use lifestyle centers, and we can't wait to show you the tremendous progress we have made.

Turning to our results. For the first quarter of 2024, KRG earned $0.50 of NAREIT FFO per share, which was slightly higher than

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anticipated due to outperformance in same-property NOI and a nonbudgeted termination fee. Same-property NOI grew by 1.8%, bolstered by increases in minimum rents and lower bad debt as offset by a decrease in net recoveries, primarily due to the timing of recoverable operating expenses.

Based on the first quarter outperformance and our revised outlook for the balance of the year, we are increasing our 2024 FFO guidance by $0.02 at the midpoint to a range of $2.02 to $2.08. At the midpoint, we assume a full-year bad debt assumption of 80 basis points of total revenues and a full year same-property NOI growth assumption of 2%. This represents a 20-basis point bad debt improvement and a 50 basis point improvement in same-property NOI growth as compared to our original guidance. The improvement in the full year bad debt component is a function of combining the actual bad debt we experienced in the first quarter, which was approximately 30 basis points of first quarter revenues, with the continued assumption of 100 basis points of bad debt of total revenues for the remaining 3 quarters. As we detailed last quarter, our same-property growth for 2024 was adversely impacted by our disproportion of exposure to Bed Bath, the unexpected departure of a large theater tenant and the extremely low bad debt we experienced in 2023. Absent these 3 items, our same-store growth assumption for 2024 would be 3.5%.

In terms of the trajectory for 2024, we expect same-property NOI growth to accelerate in the back half of this year, providing a solid foundation for growth into 2025 and 2026. As always, our goal of giving guidance is to prudently set expectations while leaving room to outperform. With that in mind, our guidance does not include certain recurring but unpredictable items, including lease termination fees, land sale gains or prior period collections, unless and until the same are committed.

Following our well-timed bond issuance, Moody's upgraded KRG to Baa2 and Fitch revised our outlook to 'Positive'. Furthermore, we are optimistic that S&P's 'Positive' outlook will mature into a full upgrade to BBB in the next few quarters. On Page 14 of our Investor Presentation, we show the complete overhaul in our cost of debt relative to the BBB REIT index as we continue to demonstrate our commitment to maintaining a strong balance sheet and show the same commitment to the unsecured debt market, we expect our debt pricing will continue to compress.

As a reminder, we continue to hold the proceeds from our $350 million January bond offering in an investment account earning interest in excess of the yield on our 2024 maturities, which we intend to retire in late June and mid-July. At 5.1x net debt to EBITDA, approximately $1.2 billion in available liquidity, a debt service coverage ratio over 5x and healthy operating fundamentals, our credit profile is one the best in the sector.

As highlighted on Page 7 of our investor deck, the current stock price of KRG represents an extremely compelling entry point. The recent private market transactions serve to solidify our current value proposition. We believe that the catalyst for a change in our equity multiple are clear in the form of outsized occupancy gains over the next 2 years, strong pricing power, higher embedded growth, low leverage, improved cost of debt, and significant free cash flow in the outer years.

Thank you all for joining the call today. Operator, this concludes our prepared remarks. Please open the line for questions.

QUESTIONS AND ANSWERS

Operator

And our first question comes from the line of Todd Thomas from KeyBanc Capital Markets.

Todd Michael Thomas ***KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst***

First question, just around the guidance. And last quarter, specifically, you talked about the $0.02 drag from the theater, vacated at City Center in White Plains. It looks like a lease may have been signed with a replacement tenant. I'm just curious if you can talk about that and provide some detail around the rent -- perhaps timeline for rent to commence. Didn't sound like there was anything factored in the updated guidance as it pertains to that.

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John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Todd, well, you can assume that the guidance does take that into account and that we're not going to obviously get specific about an individual tenant's rent, et cetera. But we can tell you that it's an 80,000 square foot deal and it's a tremendous opportunity for us to quickly backfill something that is not easy to do. And we're really -- we were focused on getting that done. The payback period for this deal is less than 2 years. It's almost a 50% return on cost. So it's a fabulous deal.

And suffice to say, the rent -- the in-place rent is less than the previous tenant was paying but there's definitely a small pickup for the year. It's probably less than -- it's around $0.005 for the year. So it's really more about the fact that we were able to get a great operator in quickly and again, to a difficult situation in terms of going into a vertical retail establishment. So very happy with it.

Tom, if you want to add anything?

Thomas K. McGowan ***Kite Realty Group Trust - President & COO***

Yes. The only thing I'd add, Todd, is one of the things that we really want to accomplish to protect that zone from an exhibitor standpoint was get them open as quickly as possible. They're going to start doing some soft openings next week. And then I think the week after, we should be ready to go. So that was one of our big goals that we have achieved.

Todd Michael Thomas ***KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst***

Okay. And the timeline for -- is there a free rent period or any concessions? Or is rent scheduled to commence relatively soon...

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Yes, rent will commence when they open. So no free rent.

Todd Michael Thomas ***KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst***

Okay. Got it. And then can you provide a little bit of additional detail on the lease termination fee in the quarter? It sounds like that was not previously anticipated. Can you just discuss that a little bit more and provide some additional color?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Yes, Todd, very simple. It was just a bank branch that decided to close, and we did a healthy NPV in the remaining rent payments and they paid us the termination fee. So not something we were expecting, but I'm happy to take that rent termination fee and go ahead and re-lease that space. So it was a win-win for us.

Todd Michael Thomas ***KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst***

Okay. And then just lastly. Heath, you talked about the company's leverage profile and credit metrics. And I wanted to ask about acquisitions again this quarter. It sounds like there's a little bit more deal flow across the industry, just given where the balance sheet sits today and sort of the position that you're in. Just wanted to get a sense of your appetite for investments and if you could discuss kind of price trends that you're seeing in the market.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Sure, Todd. Look, I think we continue to be very focused on the execution in our operating platform right now and a little less focused on external opportunities.

Look, we've been very clear that in the next 2 years, we're going to spend over $200 million in terms of TIs and LCs. Some people may call that redevelopment, but it's leasing. And it's great because the returns on capital are extremely high. Everything is very quantifiable in terms of the risk. So that is really our focus, and it will generate significant free cash flow for us once we complete that lease-up plan.

So that doesn't mean we aren't looking at outside opportunities. We obviously are. We will continue to do some paired trades like we've talked about in the past, where we would sell some assets and then look to redeploy the capital into higher growing, better positioned properties. In terms of what we're seeing in the market, the market is getting more activity, there's liquidity. Look, open-air retail is a very sought-after asset class right now despite the fact that, you look at our -- where our stock trades, you wouldn't think that. But in the

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private market, this is a very sought-after asset class, and our properties are very sought after.

So it's definitely compressed. It's harder to find opportunities at yields that we want to even think about relative to the yields that we're getting in our leasing platform. So we will do some transactions. I would say that the high-quality stuff continues to trade in kind of the high 5 to low 7 area, depending on what it is and where it is. And so obviously, that's quite disproportionate from where we trade in and from a stock price perspective.

Operator

And our next question comes from the line of Floris Van Dijkum from Compass Point.

Floris Gerbrand Hendrik Van Dijkum ***Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst***

So John, I hear you talk about the discounted multiple and the lack of recognition in the market potentially for some of the significant improvements you've done. And I'm curious what your thoughts are to share buybacks because you are generating a fair amount of free cash flow after dividends, you are trading at a discount and your balance sheet, thanks to the work that Heath has done on the balance sheet, is the best or tied for the best or lowest leverage in the shopping center space.

Why would you not at least show the markets that you're undervalued by buying back even if it's a small amount of stock?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Sure. Thanks for the question. Look, I think, first of all -- first and foremost, as a team and as a very focused operating platform, we have priorities. And certainly, when you look at the value creation aspect of our priorities, that is something that we think about and contemplate. I think that we will -- as we move through the next 1.5 years, Floris, and we execute on our leasing plan, which we are doing rapidly, we will certainly be always evaluating that, and it becomes more and more compelling, the greater amount of free cash flow that we have distributable -- I don't think it's our job to go out and buy small amounts of stock to try to prove a point. Our job is to execute, lease the space, create value internally, make great allocation decisions as we have over the past couple of years. And eventually, either the stock -- the value of the business will be reflected, whether that be in the public markets, the private markets, whatever.

So I think -- I don't want you to think we don't evaluate it because we do. But when we do it, we want it to be material if we do it. And we would hope that investors who do, do this for a living would recognize this very quickly.

Floris Gerbrand Hendrik Van Dijkum ***Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst***

John, maybe a follow-up question. I mean, obviously, you put out in your deck, I love the information you guys always provide in your supplemental deck or your investor decks with calls. Significant amount of your leasing over the last 3 years has had higher rent bumps than 3%, and also fixed CAM.

And maybe if you could talk about what do you see as the result of that? What percentage of your existing in-place rents now have those kinds of escalators and CAM recovery? And what's the upside? What does that do to KRG's cruising speeds in 2 to 3 years' time?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Yes. I mean the biggest impact to cruising speed would be on the rent side. Obviously, fixed CAM is important, Floris. But when you look at our total revenue, fixed -- the CAM element, the reimbursement element is probably 20%, 30% of our total revenue. So we're focused on it. It's impactful. And it's also impactful operationally from the efficiency perspective and how we differentiate ourselves against our competition.

So we are focused on fixed CAM. And in terms of totality, in terms of number of leases, it's probably around 50% of the leases that are outstanding. It grows rapidly by quarter. And I think at this point, people that do business with Kite expect that, and they know that is actually better for them. So we continue to grow that.

And yes, it will help. But where it really, really is going to be helpful and more impactful from a time perspective is on the base rent side. And that's why we talked about it. And I think we are absolutely the market leader in pushing that. And certainly, when you see that, we

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gave you the stats about our small shop business, I mean when you're -- when 70% of the deals that you've done in one quarter in the small shop business are at 4% or greater, that really indicates that we have a very focused plan organizationally, not just the people that you're talking to on this call, organizationally.

So we're wildly successful on that effort and that needs to be pivoted also into the anchor space. And I've been very open about the fact that I don't think it's appropriate that we, as an industry, have accepted 1% a year bumps or whatever it is when you do your discounted analysis of a 10% bump after 5 years. So that's also a focus, and we're going to lean into that and that just has to be the entire industry leaning into that. And I think it will. I think as the supply-demand continues to look like it looks today, you'll see the industry move.

So look, this is great. And remember, by the way, you're getting these bumps with very good credit profiles across the board and very durable cash flow across the board. I mean look at what we've absorbed in the last several years in terms of the GFC and then COVID. So this business is a great business. It's just going to -- I just want the investors to recognize it.

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Floris, this is Heath. Also, if you look at our Naples deck, we gave a slide which talks about our cruising speed. Currently, we call it 2.5% to 3.5% is the cruising altitude. But if you're just able to convert the small shops, like John discussed, within 5 years, that moves to 2.75% to 3.75%. And again, that's not assuming any movement in the anchors. So we're hopeful that ultimately, we can see -- get the anchors to also make similar moves in their growth rates. But this is planting seeds for better long-term cruising altitude to your point. So really, really pleased. And I think the numbers that John gave here, 70% of our leases in the small shop side have escalators at 4% or above. That's just an incredible change, what we were seeing 2 years ago. So we are moving in the right direction.

Operator

And our next question comes from the line of Craig Mailman from Citi.

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

Heath, just on the penny coming from same store. How much of that is coming from bad debt versus just better other operational kind of metrics?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

I think John alluded to it, Craig. About half of it is really related to the same property outperformance we had in the first quarter. Some of that was bad debt related. And the rest of it is getting this lease signed up. So that penny is basically split in half between what already happened and the improved outlook for the balance of the year.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Craig, one thing I would point to, though, when you look at pace and when you look at where we are kind of sequentially. Like if you look at the sequential base rent growth we're talking like 4.6% sequentially. And even if you eliminate the term fee, it's 3.5%. So going back over the last 4 quarters, that was a little slow, and now it's accelerating.

So that's all part of what's going on here as these -- as all this leasing, particularly on the anchor side, which takes time to deliver, delivers. That's why you have to look at the business over 2, 3 years, not 2 or 3 quarters. So I think when we look at it, we feel very encouraged by that sequential base rent growth.

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

And as you think about kind of comps, I know you guys are pushing fixed CAM and clearly inflation has -- it's still there, but not as maybe aggressive as it was in the last 2 years. Where you guys are setting kind of the growth in that fixed CAM? Does that become -- or is that becoming less of a -- or somewhat of a tailwind as you think about comps going throughout the year? I'm just trying to think about potential levers, now that you've got the theater done, of further improvements to same-store potentially guidance this year outside of just -- continue to lease up, which again, it takes time to open some of these new stores.

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John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Yes. Look, I mean, I think if you're only looking at that 1 metric of same-store, then I think Heath already covered it in his prepared remarks, the 3 elements that impacted us the most. So the back half of this year, particularly later in the year, then the same-store NOI begins to look a lot like it did last year. It's just a timing thing in terms of that lease-up. And we were definitely disproportionately impacted by Bed Bath. We've already taken care of about 80% of our exposure there. And the rents are great, and the users are way better.

So I think -- look, I think occupancy really matters there. As we talked about in Naples, you were there. I mean that's potentially 500 to 600 basis points to get that when you get that back on track. So bottom line is, you can look at this as if you're purely looking at same-store NOI, the profile hasn't changed at all for us. It's the timing.

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

And Craig, I would say it's your typical levers. We're here after the first quarter. So one of the things that we're thinking about that we can control or not control and going forward into this year, can we get continued lower bad debt? Can we get people turned on faster for rent commencement dates? Can we retain more tenants? Can we sign up some spec deals and turn people on later in the year? Can we do better in overage rents?

So we've got a lot of levers to pull to improve us inter-year. And then as John mentioned, looking out into '25 and '26 and beyond, just the pure occupancy gains that we have, holding aside any other organic growth, and we said this in Naples, we're looking at a 500 to 600 basis point contribution from just getting ourselves back to pre-COVID plus -- over the next 2 or 3 years.

So yes, we've got things that we're going to be working on the entire year to beat that number we're currently guiding at. And then beyond that, we've got a lot of levers to pull. So we're feeling really good at where we're sitting right now.

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

And that's helpful. And I guess the last question. Just as you guys have talked about kind of cost of capital coming down and the flywheel effect of better free cash flow, clearly, there's still pipeline, some of that -- some anchor leases, they're maybe more CapEx intensive and then really the occupancy left is more kind of small shop. So as you think about, from a timing perspective here, as we get through the next 12 to 18 months, is that the time frame you think of to think of CapEx kind of normalizing because more of the work you have to do would be kind of small shops?

And then how do you view -- and maybe it's a relative from here, but you've gotten the benefit of the credit upgrades and you're a more seasoned issuer and so you've seen spreads compressed there, but just having that higher amount of free cash flow coming in at a lower cost like what do you think -- on top of kind of the higher rent you guys have talked about, but just that, that cost of capital advantage 2, 3 years out will be when you guys think about whether you go on certain developments or redevelopments or do acquisitions?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Well, big picture, focusing on the CapEx. Yes, I'm looking -- I'm going to find the question in there. But the big picture, Craig, no doubt when you're spending over $100 million a year in 2 consecutive years on TI and LC, and a normal year for you is $60 million-ish, then you are absorbing a lot more of that cash into that TI/LC. But it's also, as I pointed out in my prepared remarks, at like 30% returns on capital, right?

So the free cash flow that comes out of that exercise in late '25, '26, '27, puts you in a position where there's nothing better than cost of capital from significant free cash flow, right, that we can deploy in a very accretive manner.

And back to Floris' question, if it isn't -- if we don't think the place to put it is external, then it's internal, and you're buying back stock with free cash flow, not with leverage, right, so that we can maintain this incredible balance sheet that we have.

So the optionality is quite significant, Craig. But yes, I mean, look, we've got to -- we're spending money organically, and we're getting

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great returns on that organic spend. So I don't think people should be concerned about it. I think they should be happy about the fact that this is a simple business plan, right? And we just got to go execute it.

Operator

And our next question comes from the line of Linda Tsai from Jefferies.

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

Yes. I know at the beginning of the call, you mentioned since 2022, you've executed 53 anchor leases to 36 different brands. Can you give us an update on your box inventory? How much is left? And are any of those getting leased to grocers?

Thomas K. McGowan ***Kite Realty Group Trust - President & COO***

Sure. At this point, we have 26 boxes in our inventory today. And we have done a great job, not only leasing these boxes, but putting in much better-quality tenants with strong spreads and great return on investments on the capital.

So we feel like that's a manageable number. We're looking very closely at how we continue to make progress on that anchor lease percentage. Right now, we're running at 95.9% on the anchor side.

So if you look at our run rates and how we've been able to chip away at the inventory, I mean, sometimes it's between 5, 10, 11 boxes as we're moving through the year. So we have a good run on it. We have quite a few properties that are in lease negotiation right now. Just on 1 segment, we have 5 or 7 that are ongoing. So I think the sentiment is very positive and now that's being buoyed by the fact that we have a low demand scenario.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

But as it relates to the grocery side, Linda, I mean, definitely, if you just look at our investor presentation, I think we covered it like on Page 19, just in terms of the new deals that we've done recently, but Whole Foods, Trader Joe's, Lidl, Total Wine. We've done a couple of Fresh Market deals, Grocery Outlet out in the West Coast.

So there is real strong demand there, and there continues to be demand across each kind of segment of the grocery business. And I'm sure you've seen a lot of this recent data on -- we've come to the point now where people are shopping multiple types of grocers per week. So they're not just going to one grocer, right? So if you've got a Kroger, you're going to the Kroger, but then you're going to either Whole Foods or Sprouts or Fresh Market for something particular, and then maybe you're going to Trader Joe's in addition to that.

So I think that's why these guys are continuing to expand. And as we mentioned, now we're -- our exposure to grocery is getting up towards 80%. So it's a big part of our business. But again, it's all about your merchandising mix, what's the best thing to bring to that particular center. So yes, the market is strong as it relates to that, Linda. And that's why I just said on the previous question that we're very happy to be kind of self-deploying capital back into that.

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

And then on the shop side, it seems like you have a little bit more leeway than some of your peers. Just as you head into ICSC, what are some of the things that you're looking for or expect to hear?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

I'll start that and let Tom get to the more meat of it. But look, like we always do going into ICSC, Linda, we take it very seriously. And I think our leasing people know that we're going in there and we have an agenda. And it's not -- we're not going there to have fun. We're going there to execute, and I think as it relates to the shop side, the depth of the users has really changed in the last 18, 24 months. The optionality that we see right now and the tenants that are moving from one specific property type into another property type, we're really benefiting from that.

So I think our objective is to continue to do what we're doing, which is not only to sign leases, but to sign leases with embedded growth that reflects the profile that we want, right? So maybe that's why -- maybe we're taking a little bit longer to lease up space because we

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are getting, as we said, 70% of the deals, we did had 4% or greater bumps, that will pay dividends in the future. So that's kind of the overall macro.

Tom, do you want to talk about like the specifics?

Thomas K. McGowan ***Kite Realty Group Trust - President & COO***

Yes. I think we want to focus on what we call our bread-and-butter type tenants, and those being restaurants, service, health and beauty. But at the same time, we also want to pay particular attention to new concepts, and we recently signed some great restaurants that were basically generated out in the Scottsdale area, Culinary Dropout, Flower Child, and we're dealing with what you may particularly see as some higher end mall or mixed-use tenants, in Aritzia, Athleta, Nike, Vuori, Warby Parker, et cetera.

So we've, as a company, really expanded our breadth and our reach to different types of tenants throughout the portfolio. And as that line grays and people find the attractiveness of pull in retail, we can -- we really see that continuing to improve for our company. So we have a very clear strategy, but it hits a lot of different points and does not ignore any as we move forward.

Operator

And our next question comes from the line of Connor Mitchell from Piper Sandler.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

So you guys have talked a lot about like the strength you've had on lease negotiations for the industry and focus on rent bumps and fixed CAM.

Just wondering if maybe you could discuss any other levers that you guys haven't touched on that you're seeing to take advantage of the current environment and maybe increase the cash margin on leases that we haven't talked about yet?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Sure. I mean, Connor, we're always focused on how we can increase margins, which is probably why we have the highest NOI margin in the business and one of the highest recovery ratios consistently over time.

I think frankly, controlling cost and getting better growth, that's what it's all about. And that's how we create free cash flow. We're already very good at it. We're already the market leader in fixed CAM and the open-air space. So we're just leaning into that more. We don't -- we're not going to get into specifics about what those exact margins are, fixed CAM versus triple net, et cetera. Suffice to say, we're the leader. So that ought to tell you something, or generally close to the top.

So -- but the other things that we're doing right now to take advantage of the environment is all the things within the lease. All the things that we look at within the lease. For example, when you look at our overage rent, our percentage rent that comes from sales, it's higher than it's ever been. It continues to be kind of an extra cherry on the top, but it should be because our tenants are doing great when they're paying that percentage rent. That obviously increases margins.

And then just how we look at the leases themselves in terms of exclusives, in terms of co-tenancy requirements, it's a situation where we want to take care of our customer, but we also have to take care of the business. And over time, it's gotten -- continues to improve.

And I don't think people talk enough about when you do business with a company like ours or some others, the retailer themselves would prefer to do business with somebody like us, who delivers. It's one thing that you have a space that somebody wants, but it's another thing, how do we reinvest in our properties. How are we -- going about that, making it very, very attractive to the consumer. So I think retailers appreciate that and they're willing to pay for that in the right circumstances.

Thomas K. McGowan ***Kite Realty Group Trust - President & COO***

Yes. I mean the only other one I would add is one of the key goals for our company is, of course, start rent as quickly as possible. And we have this machine at Kite that's got predevelopment tenant coordination project managers. And it's our job to work with all these tenants

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where they may struggle with permits, et cetera, and run into problems on code issues and really work to get these tenants open as quickly as possible. We don't look at it as just a tenant issue. We look at it as our issue as well. So another big point of trying to generate that revenue earlier.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

Okay. I appreciate all the color there. And then bad debt was -- the guidance was brought down. And just kind of thinking about some factors from the past, Bed Bath and Joann seem to be relatively seamless for the industry. Is there any chance like we could be getting involved into a sense of false fewer credit issues? Or maybe the sector's ability to wrangle troubled tenants?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

I don't know about that. I mean, we're -- as we laid out in our prepared remarks, I mean, when you look at the first quarter for us, if you excluded prior periods, we were around 90 basis points. So the bottom line is you can say when you exclude prior periods, but we're -- that's part of our business. We're always collecting. We just don't want to project that because it's volatile.

So if you're assuming that bad debt is around 1%, and you're always going to be collecting something, that's probably pretty stable. So I don't think we're being lulled. It's a function of the fact that supply and demand is putting us in a position that tenants want to be in these spaces, and they're going to do everything in their power to continue to stay there, which means pay rent.

So I don't think that it's particularly different, but it's better. Look, the reality is it's better. But right now, we're being conservative in looking at the balance of the year, and we'll see where it shakes out.

Operator

And our next question comes from the line of Lizzy Doykan from Bank of America.

Elizabeth Yang Doykan ***BofA Securities, Research Division - Research Analyst***

I was hoping to get more color on the leasing spread on option renewals in the quarter, which looks like that compressed for the third straight quarter. And when I'm looking at the past 4 quarters, it looks like option renewals made up over 60% of the comparable space that's been executed.

So just wanted to see what's going on there? What's sort of been happening in the renewal discussions you're having with tenants? And maybe why is this proportion not coming down? Maybe are you signing renewals with fewer options?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

No. So -- well, first of all, we're not having a lot of discussions on an option renewal because the tenant is just hitting an option. So let's start there. And if you have a particular quarter where you have multiple anchor options -- anchors hitting options, generally speaking, those aren't -- those are lower. So I think a lot of it's timing. And over the last couple of quarters, I think we probably had more anchors. I'm not looking at the data in front of me.

But it really comes down to mix. What is the mix per quarter. It's kind of why we talk about non-option renewals. And when I look over the past, I think, 2.5 years, the non-option renewals have been 12%. So our goal is to have less options. I mean it's part of our strategy around new leasing and containing the options. And if the options do exist that we have to get the appropriate rental increases in those options, but it would be pretty focused on the anchor side, and that's it.

Elizabeth Yang Doykan ***BofA Securities, Research Division - Research Analyst***

Okay. And then back to Heath's comments on the 500 to 600 basis points of occupancy build that's expected over the next 2 to 3 years. Just curious on how much you think that would be weighted towards anchors versus small shops? And then maybe is there thoughts around the cadence over which that would happen, whether that's the most weighted in the back half of '24 versus 2025, 2026?

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John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Well -- I'm sorry. In terms of the -- it's probably going to be basically what our revenue is, 50-50, right? 50% our revenue comes from shops, 50% from anchors. Timing-wise, Heath, do you want to...

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

No, listen, we're -- looking out to our model. I think I'll stick with the 2 to 3 years is the timing. Again, it's getting us to sort of pre-COVID levels. But based on the velocity of the leasing activity that's happening now, based on what we're seeing in this quarter as well, feeling better about that being closer to the 2-year mark than the 3-year mark, but I'll leave it at that in terms of the timing of that.

Elizabeth Yang Doykan ***BofA Securities, Research Division - Research Analyst***

Okay. And just one more for me. It looks like you guys pulled down your interest in Glendale apartments. I think that was the only transaction made in the quarter. It seemed pretty quiet other than that. But just seeing what the rationale was there and if there's any other opportunities to make note of when it comes to dispositions?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Yes. They're pretty simple. We -- that was a great -- first of all, it was a fabulous deal where we took a parking lot, contributed the parking lot into a partnership, got a 12% interest and made a couple of million bucks. So we'll keep doing that as long as we can keep doing that.

And I think the -- our partner, who is obviously the primary partner, the multifamily developer thought that the timing was right to monetize, and we agreed. So I think we will continue to look at those opportunities as we move forward. The multifamily side of our mix of NOI continues to grow. It's small, but it's growing. We have a -- pre the sale of this asset, we have a -- we have an equity interest in around 1,700 units, and we're obviously doing more. And I like the way that we go about it in terms of trying to limit our capital into each deal. But yet thinking about IRR, obviously, this was a tremendous IRR, a tremendous return.

So I think we'll continue to do that. We have a couple of projects that we're working on. And generally speaking, we're going to probably max out around 50% ownership, but it will depend on each individual deal.

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Just to put some numbers, the IRR was 22%. The return on equity multiple is 1.8x. And that's before the benefit of a $7 million TIF, which Kite was a sole beneficiary of. So again, if we can find more of those, we're ready to go. It was a -- grand slam is an understatement for that, that particular deal.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Not to drone on about it, but it is another example that I want people to think about as it relates to our particular space and what you can do with retail real estate, which is very, very different than a lot of these other sectors that seem to be very crowded trades, where all this money goes, but yet the reuse of the real estate is extremely limited, right? It is a very specific piece of real estate, data, industrial, whatever.

Our real estate is so -- it's so fungible, it's got so much flexibility. And when you're sitting on a piece of property that's an unused parking lot, that can be a 22% IRR. That should tell you that the stuff that we own, probably in the sector, but particularly to Kite is really, really attractive. So good small example that I think people should think about.

Operator

And our next question comes from the line of Hongliang Zhang from JPMorgan.

Hongliang Zhang ***JPMorgan Chase & Co, Research Division - Analyst***

I guess it looks like small shop occupancy declined slightly in the first quarter compared to the fourth quarter. Was there anything specific that drove that? Or is that just seasonal friction?

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John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

It's really seasonal. I mean same thing happened last year in the first quarter. It was almost the exact same as -- in the 30 or 40 basis points last year. So it's really timing.

When we look at our pace, our pace is good. And look, I think we did make a -- we're trying to make a pretty significant statement around the type of shop leasing that we're getting is a little different than everybody else, maybe. I don't hear a lot of other people talking about 4% bumps. So I think it's timing.

Hongliang Zhang ***JPMorgan Chase & Co, Research Division - Analyst***

Got it. And when you talk about occupancy going back to pre-COVID levels in the next 2, 3 years, is that on a lease basis or an economic basis?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

It's a lease basis, but it would be both. I mean, ultimately, it flows through to economic occupancy as well. And from my personal perspective, 3 years is probably a long timeframe, but I would say within that -- but yes, I mean, we're very focused on maximizing the portfolio, but a little less focused on the timing of that.

Operator

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

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

Just one for me, a question on some of the coastal gateway exposure you bought in the RPAI deal, Seattle, D.C., New York. I know there has been discussion about whether you keep those long-term. Maybe talk about how those have performed and where you see them kind of fitting your portfolio over the long run?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Sure. Look, I think we've been clear that we think we have a unique kind of footprint, and we like the footprint. Obviously, the great majority of our revenue comes from the Sun Belt. But we think that the kind of the gateway markets that we're operating in, particularly New York, D.C., Seattle are very attractive markets that our retailers want to grow and expand in.

That being said, we're always analyzing, does it make sense to operate in a particular market? And certainly, the coastal markets have their challenges as it relates to the things that we talked about around the tax status of each individual state and the business friendliness of each individual state, right?

So it is something that we're monitoring and talking about, and I'm not -- I would never take off the table that we would look to make changes. But we're never going to make a change just to make a change. It has to make sense economically. And right now, we're happy with the footprint, but we're always analyzing it.

Operator

And our next question comes from the line of Wes Golladay from Baird.

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

I think there was about a $4 million increase in leases opening this year, including the $6 million that opened in the first quarter. Is the SNO opening faster, can you -- point to anything from 2025? Or is it just the new leasing that you're signing this year that's opening later in the year that is driving this?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Yes, Wes. So I'm sorry, can you repeat the question again? You were a little muffled.

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

Oh, yes. So you have about $4 million more in your SNO, including the leases that opened this year. Yes, I'm just curious if that's -- the theater is obviously in there, it's going to be a small part of it. But I'm just wondering what is driving the $4 million increase in the SNO this year opening? Is it the SNO -- opening faster?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Sure. That's all new leases, Wes. So all the new leases we signed up.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

That's just new leases opening greater than the leases that -- in the previous quarter.

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Correct.

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

Okay. And then you also added some new disclosure in your AFFO, the amortization of debt discount premium and hedge instrument. Is the $3.8 million a good run rate going forward for this year?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Hold on one second. I have that answer right here. For the run rate, yes, it's directional.

Operator

And our next question comes from the line of Paulina Rojas from Green Street.

Paulina Alejandra Rojas-Schmidt ***Green Street Advisors, LLC, Research Division - Senior Analyst of Retail***

My question is about the transaction market. So treasury yields have rebounded. Have you seen any change in cap rates given the higher base? Any change in investors' appetite to transact, especially in the last months, really?

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

No, I don't think so, Paulina. I mean, I think, look, the reality of -- we're kind of in a place right now where the market is finding stability. So sure, the curve has changed a little bit in the last 30 days and the 10-year is at 4.60%, 4.70% versus 4%. But the reality is, I think the majority of the investment community believes over time that, that will stabilize lower. And when you look at the rent growth and the NOI growth that people are getting, particularly if something has upside associated with it, I think the IRRs are very comfortable.

And my personal opinion is as we move into next year, you probably see the 10-year begin to settle in the lower 4% range. This is just my personal opinion. And when you can buy something at a 6%, that has 2%, 3% growth embedded, has some upside, that's a great return.

So I think probably back half of this year, you'll probably see it accelerate even more. Again, this is all my personal opinion, but we haven't seen anything slow down because of the volatility over the last month. And quite frankly, the fact that we're tethered to that is unfortunate. And I wish people could look beyond that. And I particularly wish the Fed would think about a range of inflation versus one hard number that just doesn't make sense against an unemployment market at 3.5%.

So one of these days, maybe they'll take my advice, but not looking -- looking really -- I'm not betting it on Draft Kings, let's put it that way.

Paulina Alejandra Rojas-Schmidt ***Green Street Advisors, LLC, Research Division - Senior Analyst of Retail***

Okay. And then you mentioned a drag on expenses net of recoveries that had to do with the timing of some of the recovery. So overall, what's your expectation for this line item for the year? And I think the easiest way for me to see it is if you expect this to be a contributor to same-property NOI growth or not?

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Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

So the expenses in the first quarter, Paulina, there were -- again, this is just timing. And so we have higher expenses. And then you'll see a little bit -- you'll see a little bit of a dip in our recovery ratios because of the fixed CAM. But as the year goes on, we'll see that expense normalize. So again, it was just the timing of sort of front-loaded first quarter expenses.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Yes. In terms of -- I mean, look, it's particularly around real estate taxes. So if you -- if we have previous years' experience in real estate taxes, it's probably a contributor, but we've got to wait and see when we get into the end of the year.

Operator

And our next question comes from the line of Dori Kesten from Wells Fargo.

Dori Lynn Kesten ***Wells Fargo Securities, LLC, Research Division - Senior Analyst***

Heath, can you talk about how the Moody's upgrade may benefit your interest costs going forward? And just when you may look to address your 25s?

Heath R. Fear ***Kite Realty Group Trust - Executive VP & CFO***

Yes. Listen, I don't know I can put an exact spread differential on it. It certainly helped. We had 2 great things happen to us. One, Moody's upgraded us. Fitch put us on 'Positive'. So we're hopeful that they'll move to BBB+ soon. And then S&P, they put us to a 'Positive' outlook as well. And again, we're hopeful that will mature into a pure BBB rating over the next couple of quarters. So all those things combined will certainly help compress it.

Listen, we issued, back in January, when the 10-year was around [3.90%] and the spread was 170 over. Current indicatives have us somewhere between 140 and 150. So we're certainly seeing some compression. And as we go to the market more often and our bonds become more liquid, we only see that getting better and better and better.

So in terms of timing of when we're going to address the 25's. Listen, we're going to be opportunistic. I think we've been really good at sort of looking at the macro environment and picking our spots. I think now in hindsight, when we picked that date to trade in January, it was a really good time. It was before the 10-year started to gap out again.

And so we're going to do our best to sort of read the macro queues and pick a good spot where we think we can also do another nice print. So I would say, late '24, early '25 is when we'd look to be looking to address those maturities.

Operator

This does conclude the question-and-answer session of today's program. I'd like to hand the program back to John Kite for any further remarks.

John A. Kite ***Kite Realty Group Trust - Chairman of the Board of Trustees & CEO***

Just want to say thank you to everybody for tuning in today, and thanks for the interest in the company. Really looking forward to hopefully seeing a lot of you in Dallas in a couple of weeks at our Four in '24, where we're going to see some really awesome properties. And I would also say, please take a look at the stock because it is incredible value. Thank you very much.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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