Tanger Factory Outlet Centers, Inc.
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Tanger®

Presenters
Stephen Yalof, President and Chief Executive Officer
Michael Bilerman, Executive Vice President, Chief Financial Officer and Chief Investment Officer

Moderator
Caitlin Burrows – Goldman Sachs

Caitlin Burrows
Hi, everyone. Thanks for joining us. I'm Caitlin Burrows, and I cover REITs at Goldman Sachs. Today, we have Steve Yalof, President, Director, and CEO of Tanger. We have Michael Bilerman, Executive Vice President, CFO, and Chief Investment Officer at Tanger.

So I'm going to start off with some questions here. So as everybody may or may not know, within Tanger, there's a number of new people have been added to the management team since 2020. Steve, in 2020. Michael, more recently. And so I think with new management has come some new strategies. So I think one of those that has been making a meaningful difference is that you've been welcoming some retailers that haven't or uses that haven't historically been in the properties. So I was wondering if you could talk a little bit about that opportunity? And to what extent it increases your universe of potential tenants or retailers to work with?

Stephen Yalof
Well, thanks for the question. Thanks for hosting us, by the way, and welcome, everybody, especially the Acadia intern group. We're thrilled to have you here. So Tanger Outlets, as you all know, we're 36 shopping centers domestic, two in Canada. We have our 37th center that will open up in October in Nashville, Tennessee.

What's interesting about our portfolio and mix, Stanley Tanger, the founder of our company, 42 years ago invented the whole outlet business. And essentially, he was a shirt manufacturer working in Greensboro, North Carolina, realizing you could sell more product out of the back door than he could with customers coming in the front door. And so took all of their excess inventory and turned it into cash by selling that excess product at discounted prices, turned into an industry. And now as the stewards of that particular business, we're finding we need to change with the times.

So particularly during COVID, what we found being an open-air shopping center format that a lot of our customers enjoyed coming, spending time, but other than that power shopping experience that you typically get in an outlet center, there was not a tremendous amount more to do. So we discovered that if we added a better food and beverage program, then maybe our shoppers would come and stay a little bit longer.

And then we realized they were coming with carloads of people because a lot of our markets are in tourist destinations, mostly drive to American shopping destinations.

And what we found was if we had more things for people in that car full of people to do, some might shop, some might go to a restaurant, some might want an entertainment experience. So we started to diversify a bit and go after different uses in our centers. And it's actually become a signature part of what we're doing and how we're growing our portfolio.

Caitlin Burrows
And so I guess, even on the retailer side, I think you guys have given us some examples of not necessarily off-price concepts that you're opening up to. So can you talk a little bit about that and how it ends up giving you more opportunity and also maybe mix in the legacy type tenants that you have, the interest they having maybe going deeper into the portfolio.

Stephen Yalof
Yes. Sure. So just -- I mean, again, just to frame the question a little bit better, 30 years ago, I was leasing outlet space for New Plan Realty Trust for those of you who remember that company, now known as Brixmor. So I've been in the business for quite some time. The profile of an outlet center 30 years ago looks tremendously different than what an outlet center looks like today, especially the tenants. Liz Claiborne and Mikasa were the 2 key tenants back in those days.

Now you can't have an outlet center in this -- in the current environment without a Nike, and a Polo Ralph Lauren. All of that said, we're leasing that new shopping center in Nashville, Tennessee that I was just talking about that opens up in October. Of the 60 stores that we'll have in that initial phase, 14 of those brands that are coming into the center will be brand new to outlet and brand new to our portfolio.

Caitlin Burrows
Another thing that has gotten a lot of attention and coming out of COVID was the strategy of yours was to fill vacancies with temporary tenants. So right now, that's about 10% of the portfolio. Wondering if you could talk about kind of the opportunity of replacing or converting those tenants? And what kind of pace people should expect to see that 10% potentially come down?

Stephen Yalof
Yes. Temporary leasing isn't a new strategy. It's something that we've been doing for a really long time. And temp tenants take form in many different ways. So you'll have a pop-up tenant. That's a tenant that maybe hasn't been in the outlet. And first of all, there's a lot of barriers to entry to go into the outlet business. You need excess product if you're going to sell at outlet prices.

So there's a lot of brands, we just signed a lease with this new brand, Vuori. I'll use them as an example. Vuori probably has fewer than 50 stores across the country right now. So how much excess do they really have? So as they're starting to think about that outlet strategy and open up new outlet stores, they'll probably do 1 or 2. And when they sign a lease, they're saying, well, how do we make sure that we have enough product for that term of that lease. So in their case, we did a short-term lease with them because they don't know how much they need.

We did similar deals 5 years ago with Vineyard Vines; 10 years ago with UGG. And what happened was they found out that, not only did outlet give them an opportunity to turn excess inventory into cash, it also gave them the opportunity to interact with a brand-new customer, one that maybe they never saw at a full-price channel before. So it was a great customer acquisition tool to bring a customer that's always been interested in your brand, maybe a little price resistant at the higher end of the price point and give them an opportunity to engage with that brand in the shopping center.

Caitlin Burrows
And so I think one of the potential drivers from here is just the rent difference of that type of tenant versus the full-term tenant?

Stephen Yalof
Well, yes. So in the case of a pure short-term lease, when I started here 3 years ago, one of the fundamental changes that we made as an organization was we decided that each of our shopping centers was going to be -- we're going to decentralize, and basically run 36 separate businesses as opposed to just the one business, let each of the general managers at the shopping center run their mall like, and run their P&L like they were the CEO of that business. When there's vacancy in the center, we made it incumbent on that general manager and his team on-site to fill that vacancy with short-term leasing.

So that even if it's a frictional vacancy and I'll define frictional vacancy as 1 tenant leaves in January and the next tenant is not going to take delivery of possession until April. How do you fill that space for 3 months to keep it cash flowing? So we lean quite heavily on our general management team in order to fill that space. All of those leases that we do, those short-term leases are 30-day landlord rights of cancel because it gives us the opportunity that if a new tenant comes in that's going to pay us full rent, we have the flexibility to make sure that we can get that tenant out.

Some of these uses are great uses and they wind up staying. We wind up signing long-term leases for them. We wind up taking them from the center that they originally started with us into 2, 3, 4 and 5 centers downstream. So a reason for our historic short-term leasing was about 5% or 6% of our portfolio. It's gotten up to about 9% or 10% of our portfolio. And a lot of it has to do with the fact that we're inducing those center managers to go out and make sure that there's never a vacant space in any of our centers.

Caitlin Burrows
And so as we think about kind of the demand that you guys are creating for the centers, I think for Tanger, and for other retail REITs, we've seen that retention has been high recently. So wondering if you can comment on retention. And I guess, ultimately, then if there's so much demand, how that ends up impacting your pricing power?

Stephen Yalof
We wouldn't -- so I said 30 years ago, I worked in New Plan Realty Trust. I had a couple of tours of duty through both the Gap and Ralph Lauren, leasing retail space from the retailer's point of view. And you learn a couple of things when you have that opportunity, one of which is retailers don't like to give up stores, especially if they're cash flowing positively and they're also fully amortized. So we've had great retention at the end of our renewal cycles, saving tenants, keeping tenants in and getting them to pay more rent.

So if you take a look at our renewal spreads, double-digit renewal spreads, meaning we're getting tenants who have stayed in the shopping center, who've been doing business there for quite a period of time, voting not only to stay, but to pay over 10% more to stay. And that's been great retention. Historically, we probably had 80% retention on the renewal front. Now we're over 90%.

Now some of those tenants, you don't want to keep. Some will attrit. We're looking to drive our sales performance on a per square foot basis. So in order for us to do that, we have to do some -- make some asset management moves. Some of that requires us replacing a tenant with a more productive tenant or taking a tenant that might be oversized in one of our shopping centers and downsizing them.

And like I said, when they have a fully built and fully amortized store, that's, that's quite a feat to get somebody to sort of either relocate into a smaller box and build a brand-new store, especially in the outlet business or in some instances, we'll work with them to downsize them so that we can get a far more productive tenant in an adjacent space.

Caitlin Burrows
Maybe you mentioned the Nashville project and how there's a number of new retailers coming there. Maybe you could talk a little bit more about Nashville. I know Tanger historically was very active in development. This is the first one in a while. Kind of what makes this project special, outlook for future development and kind of return expectations for this one?

Stephen Yalof
We're constantly thinking of the store of the future. Our vision statement talks about how we use the customer insight and customer experience to inform the future of shopping. So that's our corporate vision statement. So basically, what it means is that we listen to our customers, our shoppers. In the outlet business, you have 2 customers, right? We have the shopper, and we also have the retailers, because it's incumbent on us to market to the customers that come and shop in our centers. That's part of our business. In the outlet space, a lot of the brands aren't using their advertising dollars to tell the customers they're in an outlet. They'd rather send their customers to their full-price business.

In the case of Nashville, what we've heard our customers say is hiring people is kind of tricky, particularly in some of these remote markets where there are outlet centers. In the case of Nashville, we're a lot closer into markets than we've been in the past. But

companies like Nike, who employ a tremendous amount of people, are looking for ways that they can be less dependent on a full staff, and one of the ways they're executing to that is they're building a new store that gives them a loading zone in the back of their shopping center -- in the back of their retail store, so it can help facilitate better access to products.

So in the case of those, what we call racetrack design centers, all the parking is on the outside and the shopping centers on the inside. In Nashville, what we've designed is a shopping center with parking on the inside again. And what that does, it allows for curbside pickup.

A lot of our customers want to drive up and have the products brought out, whether it's food and beverage or if it's actually merchandise that they're buying. But similarly, it gives a backdoor and truck-loading access for all of our retailers, so it better facilitates that loading experience for them and their dependency on staff.

Caitlin Burrows
I think one of the other things that you guys have recently gotten into is outparcel activity. So it's something we've see in the strip center REITs historically do. So with the announcements you had about Shake Shack and Dave & Buster's, wondering if you could maybe talk specifically about those projects and then more broadly how big this opportunity could be.

Stephen Yalof
I'm going to turn it over to my friend, Michael, because I'm getting tired of hearing myself talking.

Michael Bilerman
Thanks, Steve. So we think about overall how we can activate and take advantage of the land that we have surrounding our assets. And we've been deploying a lot of different strategies, whether it's F&B concepts or entertainment concepts into the parking fields and the surrounding land that we have. And we've also done other uses.

So we just opened up a hotel in Rehoboth Beach on leased land. We're not taking the hotel income, but we now have an added amenity in the markets that we serve, and we feel that the capital deployment is very attractive from a return perspective because the land basis effectively is free; we already own it. And so we're able to generate significant returns on our capital, but more importantly, continue to drive dwell time at our centers, provide opportunities for the customers to stay and have different amenities at the fore.

We talked -- you talked a little bit about Nashville. Nashville for us is $146 million spend. We're a $3.6 billion company. Nashville overall, delivering for us next year at a -- we've put out a yield of 7% to 7.5%. That's a meaningful driver for our company overall in terms of our cash flow growth.

Caitlin Burrows
And so I guess as we think about the kind of potential for the outparcel strategy, do you think that can be -- I mean, they're obviously, each project is relatively small. Can that be a needle mover? Or is it a nice to have? Or how impactful do you think that could be?

Michael Bilerman
I mean we think at least over half of our centers have some form of peripheral land opportunity that we feel that we can drive increased rent. And I don't think it's going to be a needle mover in 1 year because this is an ongoing initiative, but it's going to add to our cash flow growth as well as our same-store growth.

Caitlin Burrows
I think another thing you guys have been talking about recently is your willingness to look at potential acquisitions. Obviously, the right opportunity would need to come up. So wondering if you could talk about if that's outlet centers and/or something else.

Michael Bilerman
So if we step back, first of all, it's where our balance sheet is, and where our operating platform is, that's giving us the confidence to be able to look externally. So just starting first on the balance sheet where we are. We're 5x net debt-to-EBITDA, which is one of the lowest in the REIT sector and certainly one of the lowest in the retail sector.

But as part of that 5x net debt to EBITDA, we actually have $242 million, just to be exact, of cash sitting on our balance sheet, which is over $2 a share. And so that cash that's sitting on our balance sheet helps to fund the remaining spend in Nashville, but provides us the capacity along with our line of credit as well as leverage capacity to deploy that capital.

And then we think about our operating platform across what we're doing in leasing, operations and marketing, bringing the Tanger operating platform to bear -- we obviously have the outlet business that we can look at opportunities to take over institutionally owned or in venture format with others, but expanding the scope a little bit of what we're looking at to more lifestyle or hybrid where we can inject some value orientation in and fits with the whole operating platform that we have within the value retail space.

Caitlin Burrows
And as you are checking out these potential acquisitions, I mean, one of the things we keep on hearing is how the bid-ask spread is wide and/or just transaction volumes are relatively low. So any commentary you can give on opportunities that you've seen? Or are you still kind of waiting, obviously, nothing’s happened, but just activity?

Michael Bilerman
Yes. We are spending a significant amount of time uncovering a lot of transactions, both that are coming to us, where we have potential parties reaching out to us to see

how we can be helpful to them in their center because of our operating platform. And then we're also curating our own activity trying to find centers that would fit with our capabilities in our portfolio overall.

We haven't closed on anything. We don't have anything under contract to announce, but we're spending a significant amount of time in the marketplace, and there's a fair amount of uncertainty, right? The debt markets are still not at a point where they're allowing for everyone to be able to refinance. And our balance sheet, which is largely an unsecured balance sheet, has the ability to take on some form of secured debt from others to make a transaction work.

Caitlin Burrows
And as -- I think you mentioned how leverage is around 5x. So as you think about this size of a potential transaction, I guess, how high would you be, I guess, willing to bring that number and over a certain point, I guess, is 5 where you want to be and how high could it go? And if it got to a certain level, how would you bring it back down?

Michael Bilerman
Yes. We've talked about a 5 to 6x range of somewhere we feel comfortable with, but that doesn't take into account two factors. One, our EBITDA is still growing. And so we look at our same-store guidance for this year. We started this year at 2% to 4%. We lifted that after the first quarter to 2.75% to 4.75%. And so we feel our same-store continues to grow.

And then the other aspect is, while we pay a dividend and we're returning capital to shareholders, we actually have a very low payout ratio. So running about 60% now. So we have a significant amount of free cash flow that we can use and lever to be able to deploy that allows us a much wider external growth potential than just taking our leverage up. And so it's those factors that give us a lot of confidence they'll be able to deploy capital accretively.

Caitlin Burrows
Switching gears to the balance sheet side. So maybe sticking with you with a different topic or similar topic, they're all related. But maybe if we think about the interest rate swaps that you have that mature in 2024, you guys have addressed some of them. I think you alluded to on the conference call that you might elect to keep part floating. How are you thinking about potentially addressing the rest of those swaps and what amount of floating rate debt could make best sense?

Michael Bilerman
So there's two parts to that question. The first is we do have $300 million of floating rate debt that we swapped previously, and those swaps expire next February on $300 million of debt. We were able to execute those swaps previously at a SOFR rate of 50 basis points. We recognize floating rates today are much higher than that. And we have already gone into the marketplace to reswap on a forward starting basis, 1/3 or $100 million of that $300 million of floating rate debt.

So if we don't do anything from here, we'll have $200 million of debt that's currently costing us 50 basis points plus a spread. That will go up to whatever market rates are at that time, unless we put on new swaps today. That's a certain range of interest rate expense headwind that we're knowledgeable about, all the analysts understand that, the investment community understands it.

The second part of the question is, well, how much floating rate debt should you have, right? We have just the mark-to-market on our cost of debt. And then the question becomes, well, how much floating rate debt exposure should we have as a corporation. And so just general sense, we have $1.6 billion of total debt. I mentioned before, we have $242 million of cash. We only have $109 million today of floating rate exposure, but we actually have $240 million of floating rate assets because that floats. So we're actually in a net positive. We actually have negative floating rate debt where we sit today.

So as we sort of think about, we know the interest rate headwind that we have to deal with that is well understood and as well sort of guided but we're comfortable having some level of floating rate debt on our balance sheet, especially because we are such an operating-intensive business that has shorter duration leases, right. 15% to 20% of our leases roll every year. And so having that momentum and being able to match that side, we think it's okay to have. The REIT industry, by the way, it's got 20% floating rate debt exposure. So if you just took the 20%, we'd be at $320 million, we won't be that where we sit today.

Caitlin Burrows
Another recent update relevant to you Michael is I know you've got an inaugural rating from Fitch of BBB, and that is a step above the current S&P and Moody's ratings. So wondering if you could talk about that, any direct impact it has near term and the outlook for the other agencies if you think it's relevant?

Michael Bilerman
So we're very pleased we were able to get a BBB flat rating from Fitch to recognize the strength of our balance sheet. It does have -- it's not just like you put it on the wall. I did put your buy rating on the wall, but I didn't put the Fitch rating on the wall -- in sense of it does have a direct financial impact. And it's -- we save 25 basis points on our $325 million term loan and 25 basis points on our $520 million line of credit.

We have nothing drawn on our line of credit, so it just effectively lowers our cost of capital as we borrow on that. But we also save 5 basis points on our admin fee. In totality, if you do the math, because I've done it, I just rattled off a lot of numbers. It's about $1 million of annual savings that we've brought to the bottom line. And we think, what we're trying to do is reduce our cost of capital as much as possible to be able to deploy that capital as accretively as we look at potential external growth initiatives.

Stephen Yalof
Have the other agency...

Michael Bilerman
The other -- I mean, I can't speak for Moody's and S&P. If they're in the audience, fine, but they're obviously according to their own committees. We feel strongly about where our current metrics are and the health of our business, which within the retail landscape, we feel the outlet channel is such a critical importance for the retailers and the brands. They're going to choose as they go through their committees whether they want to upgrade and all their other factors that go with it.

Caitlin Burrows
I'm going to ask another one if anybody else while they're speaking has a question, you can raise your hand so that I know. Okay, sounds like there will be. Okay. You can go.

Audience Member
Current environment. Consumers are obviously a little bit more tentative, I mean, you guys see the sales of your tenancy looking for this next let's say 6, 12, 18 months, and then, I guess, you've got more of a value purchasing trends so maybe a little bit different than the...

Caitlin Burrows
Yes. I'm just going to repeat the question. For the people on the line. So the question was just given uncertainty with the consumer, what's the outlook for sales over the next 6, 12, 18 months? And also just noting that the consumer in the Tanger portfolio may be a little bit more value oriented, so how that could play in as well.

Stephen Yalof
So first of all, we're across many, many categories of retail. So it's -- we're not just apparels, just footwear. We're in the cosmetics business, we're in the food and beverage business, we're in the grocery business in some of our shopping centers. But we're pretty optimistic. Pre-COVID our sales per square foot were south of $400 a square foot. Right now, we're about $450 a square foot. So we're about 15% higher than that.

The high watermark for us was '21, where we got to about $465 a square foot. And that's important. In 2021, when basically the government took everybody's passport away, nobody was traveling. We had a pretty well captured market here and to have sustained a lot of that increase over this period of time through this inflationary headwind and increased gas price and all of the other macroeconomic and environmental challenges that we faced, I think what we're seeing and what we've seen in the 42 years in operation through many, many cycles is whether it's a recession or inflation, when people are challenged with regard to what they can buy, they're going to seek the best value for that product.

And what's interesting about our platform is that we're not a discounter. We're not selling a commodity at the cheapest price. So for example, if you're in the market for a pair of sneakers, we're not $1 sneakers. We're looking for the consumer that's looking for branded product at the best possible price. So if it's the sneaker category,

if you want Adidas or Nike or Puma or Under Armour, then that consumer is going to come to us because they're going to get value priced every day.

Caitlin Burrows
Maybe a question on the watch list and general tenant credit. That's something that it seems like it got much better coming out of COVID. I guess where do you see that today? And given this uncertain consumer, how do you expect impacts going forward?

Stephen Yalof
Yes. We have no material issues with regard to watch list right now. A lot of the retailers who are on the watch list are people that -- are retailers that people are keeping their eyes on. Two, in particular, we've just done deals with. So the value channel and particularly the outlet space, the cost of entering the outlet space is relatively low. Our OCRs, our occupancy cost ratio is still south of 9%. So relatively cheap for retailers.

Similarly, the cost of construction in an outlet versus the cost of construction in any other bricks-and-mortar format is increasingly less. And because of that, a lot of those stores will stay open far longer as retailers make decisions to close stores in their fleet. We just all read about Journeys is closing a number of stores, and we've got big Journey exposure across our portfolio. But ICSC, which is the shopping center convention, which was 2 weeks ago, when we sat -- we met with the Genesco team, they have no plans on closing any of their outlet stores. They're productive. They're relatively inexpensive to run, and they contribute a lot of 4-wall profit to their bottom line.

Caitlin Burrows
Are there any other questions in the audience? Okay, I can do another one.

Maybe if you could talk a little bit more about the food and beverage opportunity. I think historically, well, Tanger didn't historically have a lot of food and beverage, even as we saw it be added to the traditional malls pre-COVID. So wondering kind of what's changed and why it makes sense today.

Stephen Yalof
It's interesting, just like the outlet business and the consumers are looking for brands at value. There's always going to be great brands that are very popular in marketplaces. It's our feeling that the food court is the thing of the past, that customers are really looking for more of a bespoke experience, whether it's sit-down, quick service restaurant or a brand that might be more indigenous to the marketplace where we have a shopping center.

So for example, we're building Nashville, and we've got one of the famous hot chicken brands will join us in our Nashville shopping center. We just did a Shake Shack in San Marcos, Texas. It will be our first Shake Shack in an outlet with hopefully more to come downstream.

But what's great about a Shake Shack, just to use them as an example, is in a highly competitive marketplace, Shake Shack might be the draw for the customer. And if that customer is going to park their car in a parking lot and go and sit down and have lunch at Shake Shack, we think we're going to get them to -- we'll keep that car for longer and they'll stay for the shopping. Come for the food and stay for the shopping, which is a far different narrative than the outlet center business of many years ago.

Caitlin Burrows
Well, I think that might be our cue, that it's time to end to -- oh, wait, we can do one quick one. We got a minute and 23 seconds.

Audience Member
Can you just talk about your (inaudible)

Caitlin Burrows
So the question was just about the JVs in Canada and how that fits in.

Michael Bilerman
Did you do this because I'm Canadian?

Stephen Yalof
Yes.

Michael Bilerman
Sure. I can do it with a Canadian accent. Okay. So -- so we have 2 centers up in Canada with our partner, RioCan, the largest retail REIT, one of the largest REITs up in Canada. We have a center in Ottawa and one up in north of Toronto in Cookstown and we have a very good relationship with them. These are 50-50 deals. And we're in constant conversations about looking at potential other opportunities, as Caitlin you asked about our external growth initiatives, part of that, we're not just looking domestically. And so we're looking north of the border as well as potentially ways to grow together and continue a partnership.

Yes. One more over here.

Audience Member
Sure, yes. As you've rolled out food and beverage as additions to retail landscape. How traffic patterns...

Caitlin Burrows
So your question is just how has traffic been impacted by the addition of food and beverage.

Stephen Yalof
I think food and beverage helps. You're creating another draw at the shopping center, but we're seeing the same customer come back far more frequently than we did in the past, and that's a new storyline for our business.

Caitlin Burrows
Okay. Now we're going to end it there. Thank you, everybody.

Stephen Yalof
Thank you.