

InvenTrust Properties Corp. NYSE:IVT

FQ3 2025 Earnings Call Transcripts

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Call Participants

EXECUTIVES

Christy L. David
COO, Executive VP, General Counsel &
Corporate Secretary

Dan Lombardo
Vice President of Investor Relations

Daniel Joseph Busch
CEO, President & Director

Michael Douglas Phillips
Executive VP, CFO & Treasurer

ANALYSTS

Andrew Reale
BofA Securities, Research Division

Cooper R. Clark
Wells Fargo Securities, LLC, Research
Division

Hong Zhang

Linda T sai
Jefferies LLC, Research Division

Michael Patrick Gorman
BTIG, LLC, Research Division

Michael William Mueller
JPMorgan Chase & Co, Research
Division

Paulina Rojas Schmidt

Presentation

Operator

Thank you for standing by, and welcome to Invest Trust's Third Quarter 2025 Earnings Conference Call. My name is Becky, and I will be your conference call operator today. Before we begin, I would like to remind our listeners that today's presentation is being recorded, and a replay will be available on the Investors section of the company's website at invventrustproperties.com. [Operator Instructions] I would now like to turn the call over to Mr. Dan Lombardo, Vice President of Investor Relations. Please go ahead, sir.

Dan Lombardo Vice President of Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today. On the call from the InvenTrust team is DJ Busch, President and Chief Executive Officer; Mike Phillips, Chief Financial Officer; Christy David, Chief Operating Officer; and Dave Heimberger, Chief Investment Officer. Following the team's prepared remarks, the lines will be open for questions. As a reminder, some of today's comments may contain forward-looking statements about the company's views on the future of our business and financial performance, including forward-looking earnings guidance and future market conditions. These are based on management's current beliefs and expectations and are subject to various risks and uncertainties. Any forward-looking statements speak only as of today's date, and we assume no obligation to update any forward-looking statements made on today's call or that are in the quarterly financial supplemental or press release. In addition, we will also reference certain non-GAAP financial measures. The comparable GAAP financial measures are included in this quarter's earnings materials, which are posted on our Investor Relations website. With that, I'll turn the call over to DJ.

Daniel Joseph Busch CEO, President & Director

Thanks, Dan, and good morning, everyone. I'm pleased to report another strong quarter for InvenTrust, one that reflects the consistency of our execution and strength of our strategy. Since our public listing 4 years ago, we've increased FFO per share by nearly 30%. That track record is a direct result of a deliberate and disciplined approach that has remained consistent. Our success stems from a proven playbook, maintaining high occupancy, embedding contractual rent escalators, attaining strong tenant retention, achieving healthy renewal spreads and pursuing selective accretive acquisitions. This quarter, those fundamentals once again delivered tangible results as same-property NOI grew over 6%. Rent spreads remained healthy and leasing activity was positive across both anchors and small shops. We've built a scalable, high-performing platform that allows us to operate efficiently and grow strategically. Our hub-and-spoke operating model enables us to manage a broad network of top-tier assets across Sunbelt markets with minimal incremental G&A impact. As we expand our portfolio, our structure provides both operating leverage and flexibility, positioning us to continue scaling efficiently while maintaining the hands-on oversight that defines our approach. Turning to the macro environment. We continue to see encouraging fundamentals in the Sunbelt consumer base. While national data presents a mixed picture, we view the region's underlying dynamics as a net positive. Census data shows retail sales are up year-over-year and industry research points to sustained strength in suburban centers across the Sunbelt, where foot traffic and occupancy remain well above national averages. Hiring momentum in major Sunbelt MSAs remains healthy, and CoStar recently noted that 9 of the top 10 U.S. retail metros are in the Sunbelt, the same markets where we are most heavily concentrated. That said, we're not ignoring the data points that signal caution. Household debt levels are edging higher and consumer confidence has weakened. While sentiment has softened, day-to-day consumer behavior in our centers remains resilient, underscoring the essential nature of our tenants and the stability of our asset base. Another competitive advantage we see is the limited level of new open-air retail development. The economics for new strip center construction remains challenging, rising costs, tight capital markets and restrictive zoning have kept new supply muted. Meanwhile, obsolete retail inventory continues to exit the market. Strategic capital deployment has been an important part of our success this year. During the quarter, we completed the full redeployment of proceeds from the sale of our California portfolio into higher-growth Sunbelt markets, a rare and highly accretive rotation of capital. Two of our newest assets located in Asheville and Charlotte, North Carolina, which Christy will discuss shortly, are perfect examples of what we seek, strong grocery anchors, exceptional demographics and embedded rent growth potential. In addition to these recent acquisitions, we have been awarded 2 properties totaling over \$100 million. Our capital allocation strategy remains measured and disciplined. We continue to target opportunities that align with our strict return thresholds and enhance the overall quality of our assets. Roughly 70% of our portfolio is comprised of neighborhood and community centers, with the remaining balance consisting of power and lifestyle properties that share similar market dynamics and demographic profiles. This balanced approach provides diversification while maintaining focus on the formats where we have the greatest operational advantage. Looking ahead, strip center fundamentals appear to remain favorable, supported by low vacancies, limited new development and steady leasing demand. With a focused Sunbelt footprint, high-quality tenant base and financial

flexibility, we are confident in our ability to deliver solid total returns for our shareholders. With that, I'm going to turn it over to Mike to review our financial results.

Michael Douglas Phillips
Executive VP, CFO & Treasurer

Thanks, DJ, and good morning, everyone. Same-property NOI for the quarter was \$44.3 million, representing a 6.4% increase compared to the same period last year. The growth was driven by embedded rent escalations, which contributed 160 basis points, along with occupancy gains and positive rent spreads, each adding 100 basis points. Further contributions of 60 basis points from redevelopment activity, 60 basis points of percentage and ancillary rents and a 220 basis point lift from net expense reimbursements. These gains were offset by a 60 basis point impact from the bad debt reserve. Year-to-date, same-property NOI totaled \$128.3 million, a 5.9% increase over the first 9 months of 2024. For the third quarter, NAREIT FFO came in at \$38.4 million or \$0.49 per diluted share, representing an 8.9% increase compared to the third quarter of last year. Core FFO also increased 6.8% to \$0.47 per diluted share for the 3 months ending September 30. Components of core FFO growth per share for the quarter were primarily driven by same-property NOI and net acquisition activity and partially offset by the impact of an increased share count. For the first 9 months of the year, NAREIT FFO was \$111.1 million or \$1.42 per diluted share, reflecting a 6% year-over-year increase, while core FFO was \$1.37 per diluted share, up 5.4% compared to 2024. Turning to the balance sheet. We continue to strengthen our financial position during the quarter by executing on an extension of our existing term loans. This recast moved the maturity dates on the 2 \$200 million tranches to August 2030 and February 2031, increasing our weighted average maturity to 4.7 years. We entered into 4 starting interest rate swaps that locked in fixed rates of 4.5% and 4.58%, respectively, and will take effect upon the expiration of the in-place swaps in 2026 and 2027. As of September 30, total liquidity stood at \$571 million, including \$71 million in cash and the full \$500 million available under our revolving credit facility. Our weighted average interest rate is 3.98%, and our net leverage ratio is 24%. Net debt to adjusted EBITDA remained at a sector low 4x on a trailing 12-month basis. With a long-term debt policy targeting a leverage range of 5 to 6x, we have ample capacity to execute our capital plan while maintaining balance sheet strength. We also declared an annualized dividend of \$0.95 per share. During the quarter, we completed 4 acquisitions totaling \$250 million. These transactions were funded primarily with cash on hand and secured mortgage that we assumed with the transaction. Turning to guidance. Based on the year-to-date results and current visibility, we are raising our full year same-property NOI growth guidance to a range of 4.75% to 5.25%, while reducing our bad debt reserve to 55 to 75 basis points of total revenue. We're also increasing the midpoint of our NAREIT FFO guidance to \$1.87 per share and raising the low end of our core FFO guidance to a range of \$1.80 to \$1.83. As reflected in our guidance, we expect some deceleration in the fourth quarter, primarily due to property operating expenses being more backloaded in the fourth quarter and our remaining bad debt reserve. Finally, we have revised our net investment guidance from \$100 million to a range of \$49.6 million to \$158.6 million. Further details on our guidance assumptions are available in our supplemental disclosure. And with that, I'll turn the call over to Christy to discuss our portfolio activity.

Christy L. David
COO, Executive VP, General Counsel & Corporate Secretary

Thanks, Mike. Operationally, we continue to see strong tenant engagement and healthy leasing momentum across our portfolio. Our focus on necessity-based convenience-oriented retail continues to pay dividends. Anchor tenants are renewing at solid rates and small shop demand has been steady. Our proactive asset management approach emphasizes relationship building and real-time market awareness. By staying close to our tenants, we're able to anticipate needs, identify early renewal opportunities and support them in ways that enhance retention and portfolio stability. The result is consistent occupancy and strong rent collections across the platform. We also continue to manage expenses effectively, supported by active oversight and strong vendor partnerships. At the same time, we are investing selectively in property enhancements that improve curb appeal, energy efficiency and tenant and consumer experiences. These targeted upgrades help sustain the long-term competitiveness of our centers while supporting both rent growth and retention. A key area to highlight this quarter continues to be the consumer preference for dining out. Quick service restaurants and convenience-driven dining concepts remain a significant catalyst for retail demand. Restaurants, bars and coffee shops represent a meaningful share of new leasing activity, reflecting the public's sustained appetite for experiential and on-the-go dining. These macro trends have translated into meaningful small shop demand. New leases for the third quarter achieved a 25.6% spread, while renewals averaged 10.4%, producing a blended leasing spread of 11.5%. Notably, more than 90% of our renewal leases include annual rent escalators of 3% or more. These built-in mechanisms, while straightforward, are a powerful driver for sustainable NOI growth over time. Our retention rate year-to-date is 82%, reflecting the impact of a single anchor space at our Gateway property in St. Petersburg, Florida, which will be going through a transformational redevelopment. Excluding that space, our retention rate was 89%, consistent with previous quarters. On the tenant health side, our exposure to bankruptcies or at-risk tenants remains minimal with a modest and actively monitored watch list. When an occasional vacancy does occur, our operations team is well positioned to mitigate downtime and secure high-quality replacements. At quarter end, total lease occupancy was 97.2%. Small shop lease occupancy maintained its portfolio high of 93.8% and anchor space finished at 99.3%. Equally important for our cash flow visibility is that approximately 90% of 2026 leasing is already executed. As DJ mentioned, since our last call, we added 2 high-quality assets in North Carolina, Asheville

Market in Asheville, anchored by Whole Foods and Ray Farms in Charlotte, anchored by Harris Teeter. Asheville offers a strong health care and education foundation, a vibrant tourism economy and population growth projected to exceed the national average over the next 5 years. Charlotte, one of the fastest-growing large metros in the U.S. continues to see in-migration, job expansion in financial services and technology and above-average household income. These transactions demonstrate our acquisition strategy in action, investing in high-growth markets and premier properties that fit our operating model. Looking ahead, we remain encouraged by the leasing pipeline as we move into the final quarter of the year. Renewal discussions are active and small shop inquiries remain strong across the portfolio. With that, I'll turn the call back to the operator for Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Andrew Reale from Bank of America.

Andrew Reale
BofA Securities, Research Division

DJ, I appreciate some of your comments at the beginning just on the Sunbelt consumer overall. And obviously, bad debt has been trending favorably. But I'd just be curious if you could talk a bit more about tenants in some of your more discretionary categories, including restaurants. And I know, Christy, you mentioned that consumer preference for dining out remains strong, but obviously, there have been some negative headlines in recent months just around quick service restaurants and dining out. So would just be curious to hear your thoughts on some of those categories and how you're thinking about renewals if we do see a pullback on discretionary spend.

Daniel Joseph Busch
CEO, President & Director

Yes, Andrew, thanks so much. To your point, I mean, I think from our perspective, and Kristy said it in her prepared remarks, we still see a lot of demand from quick service, both fast casual and sit-down dining. I think we in our portfolio, we're fortunate to where we can kind of go through on a tenant-by-tenant basis and kind of identify whether there's an overarching theme related to some of the tenant disruption or if it's really an operator -- an operating issue. And in our case, it's mostly been the latter. There's certainly a tremendous amount more restaurants doing quite well in our portfolio versus the ones that we're seeing that are struggling. And there's a lot of different reasons for that, whether it's concept, operations or whatnot. But generally speaking, we still see a lot of demand. We will have a couple of restaurants turn over going into the end of this year. But we already have solid demand. And frankly, some of those have already been leased to another food use.

Andrew Reale
BofA Securities, Research Division

Okay. And if I could just ask a follow-up. I guess, broadly, just within the acquisition pipeline, what percentage is core grocery versus more power and lifestyle? And then just any color around the size of the pipeline and the latest on what you're seeing on pricing?

Daniel Joseph Busch
CEO, President & Director

Yes. Yes, it's a good question. I think our pipeline still remains pretty robust. I would say, at any given time, we're looking at over \$1 billion of assets. And to your point, it kind of runs across the spectrum of open-air retail. Obviously, most of the stuff we look at has some sort of grocery component or essential nature to the merchandise mix. The 2 assets that I alluded to and that Christy mentioned that we've been awarded, both are grocery anchored as well, in some cases, multiple grocers. But the mix that we look at is really just the -- when you look at our pipeline and what you should expect us to continue to transact on is very similar to the makeup of the current portfolio. We really like the idea of having the predominant or the majority of our assets having that core grocery component, whether it be a smaller neighborhood center or community center with grocery. But we also do like having a small mix of power centers as long as they fit our strategy and are in markets that we truly believe in, and we're certainly looking at some of those opportunities as well as some of the smaller lifestyle deals that you've seen us do in the past. So as I mentioned, over 70% has some sort of core grocery component. And then we have a small mix of other open-air assets that fit our strategy within our markets. I think that, that's a fair kind of mix within the portfolio that you can expect us to look at going forward.

Operator

Our next question comes from Linda Tsai from Jefferies.

Linda T sai
Jefferies LLC, Research Division

Occupancy over 97%, how are you thinking about the trajectory over the next couple of quarters?

Daniel Joseph Busch
CEO, President & Director

Yes. Good question, Linda. Obviously, we had a high watermark this quarter again in small shop. We do expect the small shop to decline a tad going into the end of the year and into the first quarter with the reacceleration in '26. And at some point in '26, hopefully hitting yet another high watermark. That just speaks to the demand that we're seeing on the small shop side, even with a small amount of fallout, which is nothing out of the ordinary. As a matter of fact, we don't expect to hit or exhaust our bad debt as has been the case in the years past. And then on the anchor side, I think we have about -- I think we have 4 anchor vacancies today. By the end of the year, I think we'll have 5. 3 of those are at a redevelopment opportunity in West Florida. So we've strategically kind of deleaded those spaces with the expectation that we're going to do a redevelopment and a rebuild with a grocer. And then the other 2, one is in Southern California. Obviously, our last asset there, we're expecting to sell and another really good opportunity in Dallas. So it's always nice when you can fire off the amount of vacancies quickly. That just speaks to kind of the demand that we're seeing there. But there will be a little bit of cadence change going into the year, but we expect it to reaccelerate, like I said, in '26.

Linda T sai
Jefferies LLC, Research Division

That's helpful. And then from where you sit today, how are you thinking about CapEx for leasing and TIs in '26 versus '25?

Daniel Joseph Busch
CEO, President & Director

Yes. So in '25, I think it's been a similar kind of spend. We do have some redevelopment opportunities that are more value-add going in, like I said, some of these grocery opportunities, we have a couple of those coming up. Those tend -- those do cost a decent amount of money. We get a tremendous amount of return out of those opportunities. And I know we've spoke about this in the past. I think now that we have a lot of our anchor leasing and build-outs done, especially as we look into the mid-2026, our expectation is that our CapEx burden will come down just due to where the occupancy is in the portfolio, which should lead to greater free cash flow as we look into '26 and beyond.

Linda T sai
Jefferies LLC, Research Division

That's really helpful. Just one quick one for Mike. I think earlier, you mentioned that there are more back-end loaded expenses in 4Q. Can you just give us some context there?

Michael Douglas Phillips
Executive VP, CFO & Treasurer

Yes. Just the last couple of years, we've had in the fourth quarter, just our normal operating cycle, we've had higher property operating expenses in the back half of the year. This year, that will show up in Q4. And then on top of that, our corporate expenses typically in Q4 just tend to run a little bit higher.

Operator

Our next question comes from Cooper Clark from Wells Fargo.

Cooper R. Clark
Wells Fargo Securities, LLC, Research Division

I was curious if you could walk through the puts and takes as we think about the current net investment range with respect to the last California disposition and the acquisition pipeline. Just thinking about some of the moving pieces into the end of the year that get us to the high or the low end of the range from a timing perspective?

Daniel Joseph Busch
CEO, President & Director

Yes. No problem. Basically, the reason we changed the range is we do have 2 deals that have been awarded to us, and it's going to be really close on whether they close in 2025 or not. So really, it's just a timing issue. The low end of the range is things that we've already transacted on. The high end of the range is things that we are hopeful that we can get across the finish line before the end of the year. But if not, those will show up in early 2026. On the disposition side, as you mentioned, in California, really that one, we're expecting to sell probably early in '26 or at some point in '26. We're just dealing with some administrative issues with that asset based around environmental. But it's a great asset in the last asset in Southern California, and we do expect to transact on that one as well, but it probably won't be this year.

Cooper R. Clark
Wells Fargo Securities, LLC, Research Division

Okay. That's helpful. And then could you just talk about the confidence level to grow accretively from here on acquisitions as we move into '26? I appreciate the positive spread on the California dispositions year-to-date, but curious on growth from here as you shift towards funding acquisitions with balance sheet capacity?

Daniel Joseph Busch
CEO, President & Director

Yes. Obviously, we look at our -- and it's a great point. We look at our different pockets, our sources of capital differently. Obviously, the California rotation gave us an opportunity that's unique. We were able to, from our perspective, upgrade the portfolio materially in markets where we've seen really good growth and that we're excited about. And we're able to do that on a positive spread day 1 with even better growth over time. Now obviously, when we're looking at growing on our balance sheet, that cost of capital is a little bit different. And we've already kind of made that shift as we go through investment committee and we're looking for those new opportunities because it is important. I mean, at the end of the day, this platform is scalable, but we got to do it in a responsible way, and we got to do it on an accretive manner for our shareholders, and that's kind of where we're at today. So that comes -- when we think about our overall transaction opportunity set, it really is as a response I mentioned earlier, we're looking at a lot of different formats, a lot of different property types. And we can get to accretive cash flow in many different ways because of the opportunity sets that we see in our markets.

Operator

Our next question comes from Mike Mueller from JPMorgan.

Michael William Mueller
JPMorgan Chase & Co, Research Division

First, when it comes to the remaining budgeted bad debt expense for the year, does most of what's being assumed for the fourth quarter fall into the -- it's visible or more into the -- it's still an assumption bucket?

Michael Douglas Phillips
Executive VP, CFO & Treasurer

Yes. I think -- I can take that. This is Mike. I think it's a little bit of both. So in our forecast, our range is 55 to 75 basis points right now in our forecast, we have visibility probably into the bottom of that range at 55 basis points. And then to get the top of the range is kind of reserve for unforeseen fallout that might not be right in front of us.

Michael William Mueller
JPMorgan Chase & Co, Research Division

Got it. Okay. And then going back to occupancy for a second. The small shops are a little under 92% occupied. What do you see as being a ceiling for that metric? And do you think the current backdrop is one where you can ultimately get to it sometime over the next few years? And I understand the comment about near term, we may see a little drop off though.

Daniel Joseph Busch
CEO, President & Director

Yes, Mike, from what we see in the pipeline and the demand that we continue to see, I think we expect that we can continue to kind of march higher. Obviously, once you get into the mid-90s from an occupied standpoint, you're really only talking about frictional vacancy, and it's hard to push that further and further just because some space is just always going to be a little bit more structurally challenging to lease. We do have a full strategy around that, whether it be lower rents, percentage rent deals, giving tenants an opportunity to succeed in areas that have probably been vacant for quite some time, which is an issue across the industry. There's always space that's a little bit less desirable no matter how high of quality your center is. So we'll continue to do that. But at the end of the day, if we can hold occupancy where we're at, and continue to get the escalators that we have been getting, and that continues to deliver real NOI growth on a year-over-year basis. And then we get our double-digit spreads that we've gotten 8 quarters in a row on a renewal basis. All that with a very high retention, it's just a tremendous opportunity for us to accelerate free cash flow growth because we're not churning our tenants as much as we have in the past. Now there will be churn, there always is in retail. But from when we look at -- and I think I've heard some of our peers mentioned this on their calls as well, the quality of our tenant base is just so much -- it's far superior than it has been in the years past. The credit quality, the merchandising of our tenants, we just don't have the large

tenants that -- specifically anchor tenants that are struggling right now. And -- whether that changes over the next couple of years, we'll see. But right now, we feel very confident in our anchors. We feel very confident in our national and regional small shops. And then obviously, the local flavor of our small shops have been doing phenomenal for quite some time.

Operator

Our next question comes from Michael Gorman from BTIG.

Michael Patrick Gorman
BTIG, LLC, Research Division

Just wanted to ask a question on the lease to economic occupancy spread continued to compress in the quarter. And I'm just curious, given the strength of the leasing in the pipeline, strength of demand, the strong retention rate, can that compress below the 2021 levels? Or where should we expect that to stabilize as you move into 2026 and beyond?

Daniel Joseph Busch
CEO, President & Director

Yes, Michael, it's a good question. When we look at our -- when we look at the spread, a lot of that just comes down to timing. And I kind of mentioned it like depending on when we're signing new deals versus when we're expecting a tenant to vacate and then obviously, when we're expecting to that tenant -- the new tenant to take ownership or occupancy. So a lot of the spread comes down to timing. I think from our perspective, anywhere between 150 to 200 basis points is probably the normal run rate, and that's going to ebb and flow. The way we think about that spread is more just what's in the pipeline. We have \$5 million in our signed but not open pipeline. And we're expecting about 80% of that to be captured next year. So a substantial portion getting open and occupied and paying rent in the first quarter. And then driving substantial new NOI in the next -- in the upcoming year. But that spread will always kind of ebb and flow. But you're right, it did contract a little bit this quarter.

Michael Patrick Gorman
BTIG, LLC, Research Division

Great. That's helpful. And then, Vijay, you talked about some of the macro signals that you were looking at but not seeing in your portfolio yet. One of the things that we've been trying to understand a little bit more is, obviously, the grocer sector continues to be pretty strong. But at the same time, you're seeing a climbing percentage of spend on eating out and takeaway food and QSRs and everything. How do you think about that balance going forward? Can both of those sectors continue to grow and be strong here? Or how does the consumer adapt if it continues to show some weakness and the economic environment continues to soften? Like how do those 2 balance out?

Daniel Joseph Busch
CEO, President & Director

Yes, it's a great question. And I don't have a great overarching answer. But I will tell you, within our portfolio, it's been interesting because we haven't seen those 2 categories, whether it be our grocers versus our quick service or eat away from home, as you said, being as substitutes. They've been more complements. We've had our quick serve -- our restaurants across the different formats have continued to do quite well. Also, our groceries have been doing very well. Some of that is inflationary driven, certainly, but our grocers continue to march forward. I think it speaks to, one, the markets that we're in, we've just seen a lot of in-migration growth kind of -- which rises -- the tide rises all boats in that case. and the types of grocers that we're dealing with, obviously, one of our top tenants is Publix. I know in the Southeast, they're a formidable grocer, a phenomenal operator, HEB in Texas, obviously, Kroger and Albertsons are at the top of our top 10 list as well. So the types of grocers that we're dealing with, I think, have been more or less been investing in their stores, we've been able to grow ID sales. And it's been an interesting dynamic over the past couple of years where food at home and food away from home have been able to grow.

Operator

Our next question comes from Paulina Rojas from Green Street.

Paulina Rojas Schmidt

Looking at your recent acquisitions, I see that they have skewed towards secondary and tertiary markets. And I'm curious, would you be comfortable if tertiary Sunbelt markets grew to represent a materially larger portion of your portfolio and perhaps doubling their current share? How do you think about that?

Daniel Joseph Busch
CEO, President & Director

Yes, it's a good question, Wally. And look, it's a good observation. I we tend to not get caught up in gateway secondary primary, secondary, tertiary. I think the predominantly -- obviously, the vast majority of our portfolio are in cities that we like to call 18-hour cities, obviously, big CBDs perhaps considered primary or secondary markets. But I mean, I would argue that Charlotte is one of the fastest-growing markets, albeit has traditionally been called a secondary market. Certainly, the dynamics on the ground in a market like Charlotte are quite different. And what we found in for our ability to grow our portfolio, I mentioned it in my prepared remarks, we really, really like the hub-and-spoke model. So Charlotte is a core market for InvenTrust. From that market, we can also invest in markets like Asheville, which has seen tremendous amount of migration. It's gone from something that's been more of a secondary residence area to a primary residence area. Now obviously, Asheville has its own tragedy in not-too-distant past, but we feel very confident that, that market is going to rebound in a big way. Now having said that, when you mentioned secondary and tertiary markets, our quality -- the level of quality has to be higher. If we're going to be in that secondary market, we got to make sure that we're going to own and operate the best asset in that market or the second -- the best asset in the market where certainly in larger gateway markets or primary markets, you certainly can own a lot more because there's certainly just a lot more population and density to accommodate that.

Paulina Rojas Schmidt

Do you think cap rates change if you go to markets that are less by typical institutional investors where local trade area demographics are equally strong. Do you see the cap rate different?

Daniel Joseph Busch
CEO, President & Director

Sure. Well, it all comes down to what's the risk-adjusted return that you're trying to get. And that's why I mentioned the quality is very important. We got -- you have to make sure that you're at the high end of the quality spectrum when you do go into a smaller market. I wouldn't call it a tertiary market. Certainly, some of them are tertiary. We've tended to stay away from markets that are very thin in population unless there is green shoots of impressive growth coming in the future. But there -- what we tend to look at, Paul, is anywhere from, call it, high 5s to high 6s from an initial yield standpoint. And that tends to get us to our risk-adjusted returns that are comfortably in the 7s. I know people quote IRRs quite differently, but from the way we look at the world, we can make that accretive to our business. But certainly, there are cap rate nuances, not only from market to market, but property type to property type and depending on your merchandise mix.

Paulina Rojas Schmidt

Yes. I guess what I was getting to is something that is more an opportunity, more a market inefficiency because fewer investors are looking at those markets and where perhaps the return that you were able to get it is not really explained by higher risk and that it's really a function of that demand.

Daniel Joseph Busch
CEO, President & Director

No, that could be the case. I mean, look, I think one of the interesting dynamics, obviously, our decision to move -- to exit out of California was a strategic one for InvenTrust. It's a core market for almost every other private or public operator. And California trades differently than most any other state or the markets in California trade differently than any other markets in the country. And to your point, it's because of the demand and the liquidity that it offers. Now we're as a public REIT, as a perpetual vehicle, that's really not as important to us. What's important to us is to create sustainable free cash flow growth over a long period of time for our shareholders. And we can do that in other areas outside of California, which allows us to take advantage of for lack of a better term, some sort of arbitrage.

Operator

Our next question comes from Cooper Clark from Wells Fargo.

Cooper R. Clark
Wells Fargo Securities, LLC, Research Division

You spoke to operating leverage in your prepared remarks and margins look to be up about 100 basis points year-over-year. I was curious if this is mostly timing related as you noted some backloaded expenses earlier on the call. And if you could provide color on the potential for further upside to margins as additional occupancy comes online.

Daniel Joseph Busch
CEO, President & Director

Yes. So like, obviously, we get operating leverage as our occupancy climbs higher, as you mentioned. We do expect to continue to get marginal operating leverage as we continue to grow the portfolio. That's one of the best things about having the platform that we have is we can continue to scale it, and there should be real tangible benefits not only at the operating margin level, but also at the EBITDA margin level. And that's just going to come as we continue to grow the asset base. The piece that you're probably alluding to this quarter is our recovery rates continue to get stronger as we continue to transition to a more fixed CAM model.

Operator

Our next question comes from Hong Zhang from JPMorgan.

Hong Zhang

I guess if I think about same-store growth, you've managed to sustain mid-single-digit same-store growth historically. But just reading between the lines of your comments about occupancy, do you expect that to be sustainable going forward? Or do you think occupancy is going to be a little bit of a headwind to same-store growth in the near term?

Daniel Joseph Busch
CEO, President & Director

Thanks for the question. I wouldn't call it a headwind. And this goes back to my comments on CapEx. As we move forward, obviously, you do get a decent amount of same-store growth out of occupancy gains, no doubt. But with those occupancy gains as you're doing new leases comes with real costs, especially in the retail business. So we look at it as an opportunity even if our same-store NOI growth would slow down from what's been a real nice run of, I think, 5% for several years running now. Even if that were to moderate a little bit, it would only be due to a higher retention rate across the portfolio. So we'd be doing more renewals. We'll get our embedded escalators, a little bit of redevelopment. And then with that should be stronger free cash flow growth.

Operator

We currently have no further questions. So I'll hand back to Mr. DJ Bish for closing remarks.

Daniel Joseph Busch
CEO, President & Director

Thank you, everyone, for taking the time. Thank you for your interest in InvenTrust. We're excited about finishing the end of the year strong, and we're even more optimistic as we move into 2026. Looking forward to seeing you guys at many of the conferences coming up later this winter and into next year. Have a great day.

Operator

This concludes today's call. Thank you for joining us. You may now disconnect your lines.