


National Net Lease Market Sales Volume and Buying Trends– Q4 2020

A photograph of a CVS Pharmacy storefront at night. The building is white with large glass windows and a red CVS logo. The interior is lit up, and the parking lot in front has some landscaping and a bench.

Fundamentals across the national net lease market improved in Q4 2020 as the number of transactions and dollar volume returned to pre-COVID levels. Cap rates across net lease retail properties compressed over 25 basis points from Q3 2020 to Q4 2020 and are at their lowest levels since Q1 2019. This was made possible by the historically low interest rate environment and flight to quality in the net lease sector. However, investor confidence appears to be returning in some of the sectors that were previously closed or underperforming due to COVID-19. This is evidenced by the increase in transaction activity and price per square foot across all retail net lease property sectors. As we move into 2021, investors will be monitoring the rollout and distribution of COVID-19 vaccines and potential for full economic reopening. However, as current case counts mount and hospitals are once again pushed to capacity, the threat of additional economic closings exists in the interim.

This report analyzes topics and sales trends in the National Net Lease market from January 2019 to December 2020.

FEATURE: COVID-19 and its Impact on the Commercial Real Estate Market

The global COVID-19 pandemic surfaced in the United States in Mid-March and Federal, State, and local governments responded by issuing strict stay-at-home orders to help to reduce the spread of the virus, negatively impacting most property types. However, a significant portion of the net lease retail market falls under essential business. The

pharmacy, quick-service restaurant, convenience store, grocery store and dollar store sectors of the net lease retail market have remained in operation throughout the Pandemic and have largely been the focus of investor attention.

National Net Lease Market

The net lease market offers a wide range of investment opportunities. Stability is the most important element in this market. As most tenants are affiliated with public companies, financial reporting is required, which offers greater transparency into operations. Long-term leases offer rental escalations, which present NOI upside, and triple net leases spare the landlord the burdens of property management. COVID-19 has underscored the importance of tenant mix, as many local and regional tenants have been unable to satisfy rental payments in lieu of business closures.

Market Sectors

Boulder Group categorizes the different sectors of the net lease market into casual dining, bank, auto parts, big box, medical, drug store, QSR, and dollar store. Fast food (QSR) and bank leases are typically the smallest in size and stipulate the highest rents per square foot, with annual escalations. Auto parts stores and big box stores are much larger and typically offer fewer escalations. Medical properties are broken into dialysis, urgent care, general doctor, and other segments. Trends in consumer preference, discretionary income and economic conditions influence the desirability and performance of each net lease sector.

Overview

We tracked investment sales for net lease properties over the past eight quarters from Q1 2019 to Q4 2020. The search parameters include triple net lease sales only, excluding portfolio and multi-property sales. The number of transactions and dollar volume is broken out by region, encompassing the Midwest, Mountain, Northeast, South, and West regions. We then presented price per square foot and capitalization rates for these transactions over the same period. Based on the data, it is evident that the number of sales and dollar volume dropped off considerably in Q2 and Q3 2020 at the height of the pandemic. However, the market rebounded in Q4 2020 to surpass Q1 2020 levels in number of sales and dollar volume.

Number of Sales Transactions

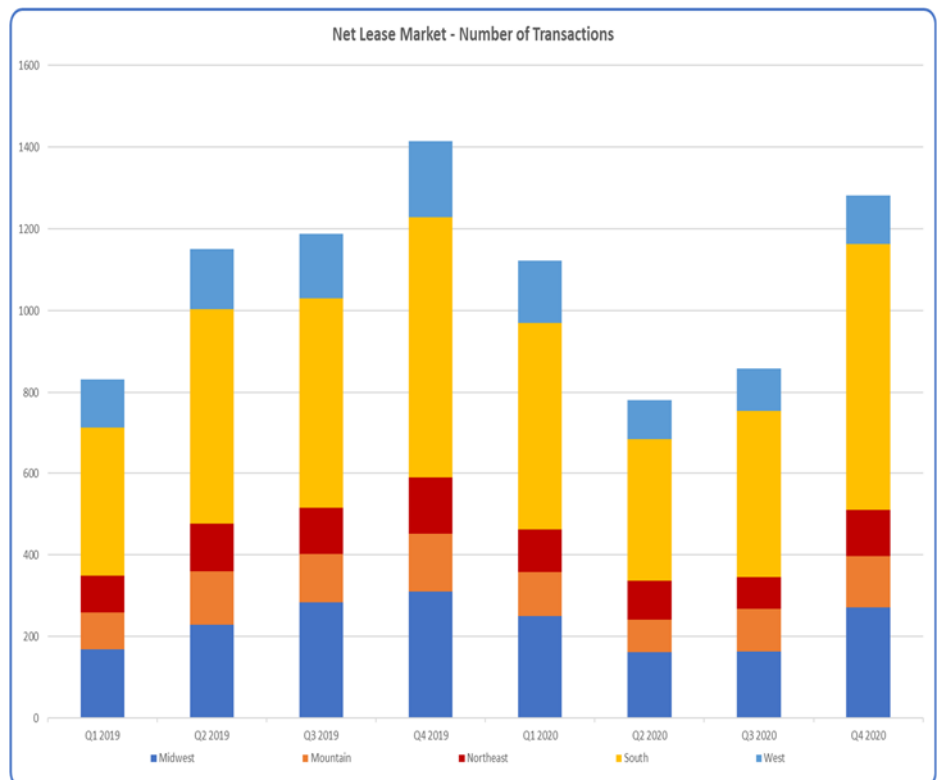
The number of quarterly net lease sales recorded in the US are segmented by region as seen below. From Q1 2019 to Q1 2020, number of sales ranged from 832 to 1,415, averaging 1,141 sales per quarter. In Q2 2020, following the onset of COVID-19, there were only 778 recorded transactions, and in Q3 2020, there were 858 transactions. Transaction activity increased nearly 50% from Q3 2020 to Q4 2020, which is a positive sign.

Historical Transaction Volume - Net Lease Market										
Number of Transactions	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Total	% of Total
Midwest	168	229	284	309	249	161	163	270	1,833	21.2%
Mountain	90	131	117	142	108	80	104	126	898	10.4%
Northeast	90	116	114	138	105	95	78	113	849	9.8%
South	364	527	515	640	508	348	408	654	3,964	46.0%
West	120	148	158	186	152	94	105	119	1,082	12.5%
Total # Transactions	832	1,151	1,188	1,415	1,122	778	858	1,282	8,626	100.0%
% Change from Prior Month	-	38.3%	3.2%	19.1%	-20.7%	-30.7%	10.3%	49.4%		

The highest number of quarterly transactions occurred in Q4 2019 with 1,415 total transactions. Transaction volume per quarter generally increased during the first five quarters of the analysis period but fell off nearly 31% in Q2 2020. The number of transactions increased roughly 10% from Q2 2020 to Q3 2020 and a robust 49.4% from Q3 to Q4 2020.

Accounting for the largest geographical area and supply, the South region saw 46% of all transactions over the prior eight quarters, with Texas and Florida leading the way. The percentage share for the remaining regions was more uniform, ranging from 21.2% in the Midwest, to 12.5% in the West, and 10.4% and 9.9% in the Mountain and Northeast regions, respectively.

Q1 2021 results will shed light on whether the gains seen in transaction volume are sustainable.



Dollar Volume of Sales Transactions

As seen below, we have tracked the dollar volume of quarterly net lease sales by region. Total transaction volume ranged from \$3.24 to \$6.33 billion between Q1 2019 and Q1 2020, with the peak occurring in Q4 2019. Comparatively, quarterly sales volume in Q2 2020 was \$3.25 billion, reflecting a decrease of 28% from the prior quarter, and sales volume in Q3 2020 grew by less than 1 percent. Dollar volume increased by roughly 40 percent from Q3 2020 to Q4 2020 and surpassed Q1 2020 levels.

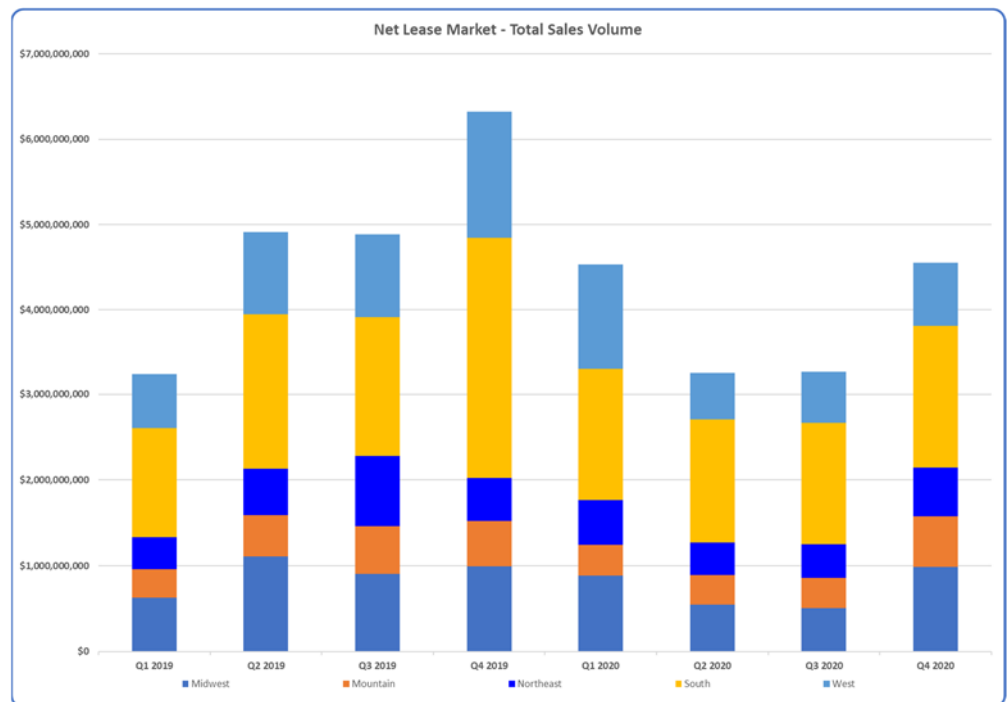
Historical Transaction Volume - Net Lease Market (in Millions)

Dollar Volume	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Total	% of Total
Midwest	\$629.4	\$1,113.7	\$904.9	\$993.8	\$886.1	\$549.4	\$509.0	\$989.1	\$6,575.6	18.8%
Mountain	\$332.5	\$470.3	\$549.8	\$522.6	\$358.5	\$347.5	\$352.6	\$584.9	\$3,518.7	10.1%
Northeast	\$363.2	\$548.8	\$827.2	\$502.3	\$515.6	\$378.7	\$393.3	\$568.7	\$4,097.9	11.7%
South	\$1,279.3	\$1,814.3	\$1,633.9	\$2,824.3	\$1,536.6	\$1,428.9	\$1,411.9	\$1,670.6	\$13,599.7	38.9%
West	\$633.1	\$967.8	\$966.7	\$1,484.6	\$1,238.9	\$548.1	\$593.0	\$716.9	\$7,149.1	20.5%
Total Dollar Volume	\$3,237.6	\$4,914.9	\$4,882.5	\$6,327.7	\$4,535.7	\$3,252.6	\$3,259.8	\$4,549.9	\$34,941.0	100.0%
% Change from Prior Month	-	51.8%	-0.7%	29.6%	-28.3%	-28.3%	0.2%	39.6%	-	-

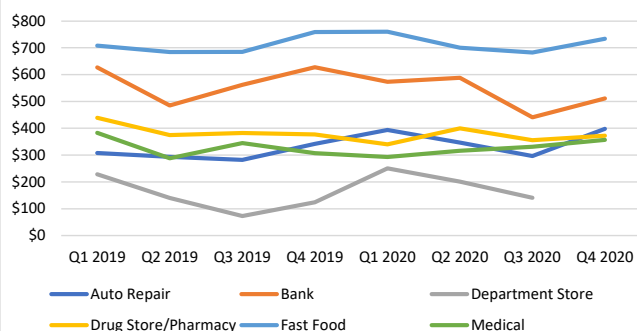
Over the analysis period, the South and West regions saw the highest dollar volume in sales. Although recording fewer transactions, dollar volume for the Northeast topped dollar volume from the Mountain region, at 11.7% and 10.1%, respectively. Dollar volume increased in all regions in Q4 2020.

Total dollar volume in 2019 was approximately \$19.36 billion, anchored by a strong Q4. Total dollar volume in 2020 was roughly \$15.60 billion, representing a decrease of approximately 24%. This decrease was fully attributable to the second and third quarters.

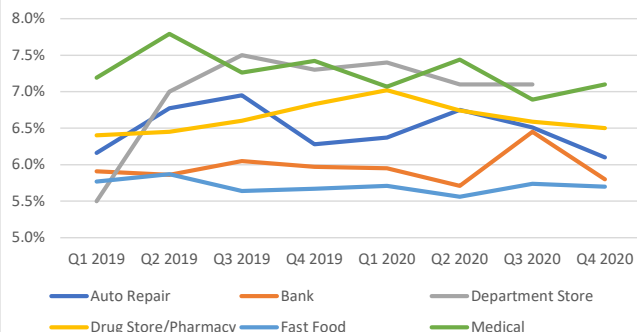
Market participants will be monitoring policy on re-openings and potential shutdowns as the COVID-19 Pandemic continues, and financial health of tenants will remain on the forefront. Below are sales trends pertaining to the key property sectors within the NNN market.



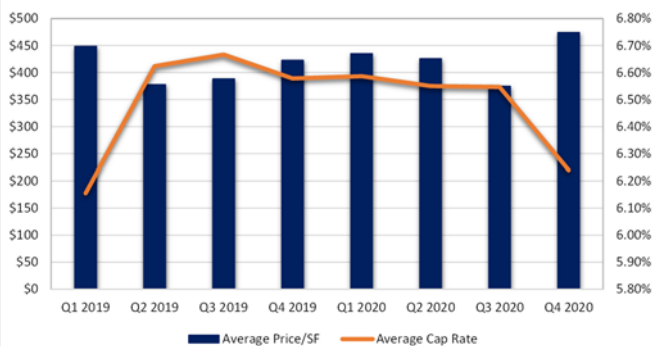
Price Per SF - Net Lease Market



Historical Cap Rates - Net Lease Market



AVERAGE \$/SF & CAP RATE - NET LEASE MARKET



Average \$/SF on Quarterly Transactions

Price per square foot on quarterly transactions increased 26.6% from \$375 per square foot to \$474 per square foot from Q3 2020 to Q4 2020. The chart shows the department store sector has historically achieved the lowest price per square foot and the fast-food sector has achieved the highest price per square foot at \$734/sf in Q3 2020. Price per square foot increased in all sectors from Q3 2020 to Q4 2020, with the most significant increase occurring in the auto repair sector at 34%. Notably, there were no department store transactions in Q4 2020.

Average Cap Rate of Quarterly Transaction

Capitalization rates did not decrease in Q2 and Q3 2020 along with number of transactions and dollar volume, as there was a flight to quality for investors. Cap rates over the period have ranged from 6.16% in Q1 2019 to 6.55% in Q3 2019. Cap rates in Q4 2020 decreased 31 basis points from 6.55% to 6.24%. The fast-food sector commands the lowest cap rates due to long term leases and frequent escalations, and medical properties command the highest cap rates, as they typically offer a blend of retail and office space. Net lease office assets register higher cap rates relative to retail assets but are not covered in this analysis. Cap rate and lease term remaining have an inverse relationship, with cap rates decreasing as lease term remaining increases.

Average \$/SF & Cap Rate: 5 Year Trend

From Q1 2019 to Q4 2020, price per square foot and cap rates have generally showed an inverse relationship. Price per square foot decreased in Q2 and Q3 2019 as cap rates increased. The disconnect between pricing and cap rates in Q3 2020 suggests there is limited competition to acquire assets, mainly in the nonessential sectors, which has sellers offering lower prices that are matched by buyers. In Q4 2020, cap rates decreased substantially as pricing increased substantially. Q4 2020 saw pricing that exceeded all quarters of 2019 and 2020, which is a welcome sign for net lease operators.

SOURCE: CoStar and Marshall & Stevens



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