


# US Net Lease Market Topics & Trends – Q1 2021



Fundamentals across the national net lease market dropped a bit in Q1 2021 after a strong Q4 2020 as number of transactions and dollar volume declined. Cap rates across net lease retail properties increased 6 points from Q4 2020 to Q1 2021 and remain lower than pre-covid levels. 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. As we continue into 2021, investors will be monitoring the rollout and distribution of COVID-19 vaccines and potential for full economic reopening.

This report analyzes topics and sales trends in the National Net Lease market from January 2019 to March 2021.

## **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 nine quarters from Q1 2019 to Q1 2021. The search parameters include triple net sales only, excluding portfolio and multi-property sales. Number of transactions and dollar volume are 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. Q1 2021 transactions and dollar volume show a slight dip from a strong Q4 2020.

## Number of Sales Transactions

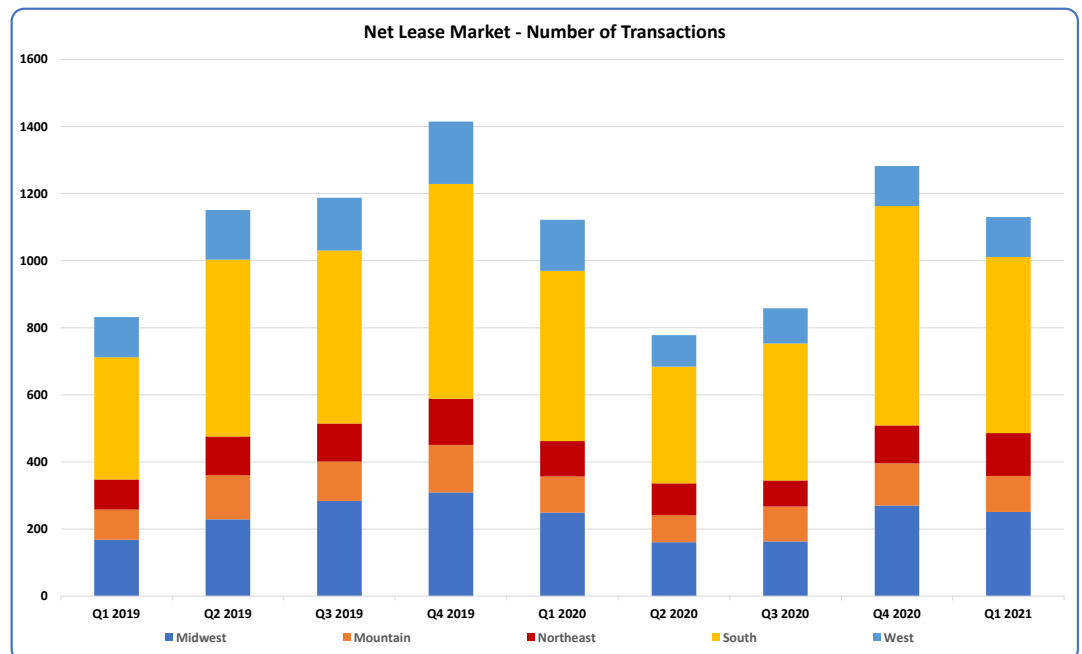
The number of quarterly net lease sales recorded in the US are segmented by region as seen below. From Q1 2019 to Q1 2021, number of sales ranged from 832 to 1,415, averaging 1,141 sales per quarter. In Q2 2020, following the onset of COVID-19, there were only 778 recorded transactions, and in Q3 2020, there were 858 transactions.

### 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	Q1 2021	Total	% of Total
Midwest	168	229	284	309	249	161	163	270	251	2,084	21.4%
Mountain	90	131	117	142	108	80	104	126	107	1,005	10.3%
Northeast	90	116	114	138	105	95	78	113	128	977	10.0%
South	364	527	515	640	508	348	408	654	525	4,489	46.0%
West	120	148	158	186	152	94	105	119	119	1,201	12.3%
Total # Transactions	832	1,151	1,188	1,415	1,122	778	858	1,282	1,130	9,756	100.0%
% Change from Prior Month	-	38.3%	3.2%	19.1%	-20.7%	-30.7%	10.3%	49.4%	-11.9%		

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 analysis but fell off nearly 31% in Q2 2020. Number of transactions increased roughly 10% from Q2 2020 to Q3 2020 and a robust 49.4% from Q3 to Q4 2020. While transactions decreased 11.9 percent in Q1 2021, the market is still above pre-covid levels.

Accounting for the largest geographical area and supply, the South region saw 46% of all transactions over the prior nine quarters, with Texas and Florida leading the way. The percentage share for the remaining regions was more uniform, ranging from 21.4% in the Midwest, to 12.3% in the West, and 10.3% and 10.0% in the Mountain and Northeast regions, respectively.



## 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 2021, with the peak occurring in Q4 2019. Dollar volume increased by roughly 40 percent from Q3 2020 to Q4 2020 and decreased by 22.5 percent in Q1 2021 to dip back below pre-Covid 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	Q1 2021	Total	% of Total
Midwest	\$629.4	\$1,113.7	\$904.9	\$993.8	\$886.1	\$549.4	\$509.0	\$989.1	\$686.6	\$7,262.2	18.8%
Mountain	\$332.5	\$470.3	\$549.8	\$522.6	\$358.5	\$347.5	\$352.6	\$584.9	\$359.0	\$3,877.7	10.1%
Northeast	\$363.2	\$548.8	\$827.2	\$502.3	\$515.6	\$378.7	\$393.3	\$568.7	\$447.8	\$4,545.7	11.8%
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	\$1,254.0	\$14,853.7	38.5%
West	\$633.1	\$967.8	\$966.7	\$1,484.6	\$1,238.9	\$548.1	\$593.0	\$794.6	\$776.9	\$8,003.6	20.8%
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	\$3,524.2	\$38,542.9	100.0%
% Change from Prior Month	-	51.8%	-0.7%	29.6%	-28.3%	-28.3%	0.2%	39.6%	-22.5%	-	-

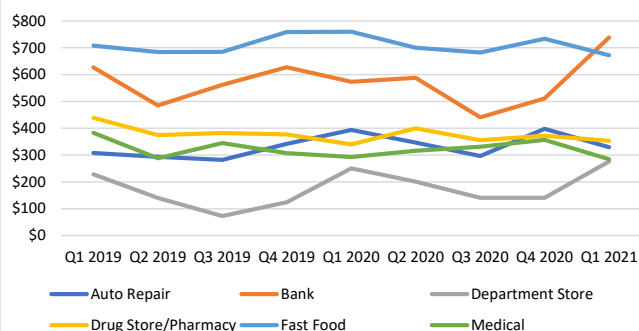
Over the analysis period, the South and West regions saw the highest dollar volume in sales. Although recording fewer transactions, dollar volume for the Northeast topped dollar volume from the Mountain region, at 11.8% and 10.1%, respectively. Dollar volume decreased in all regions in Q1 2021.

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 reopenings 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



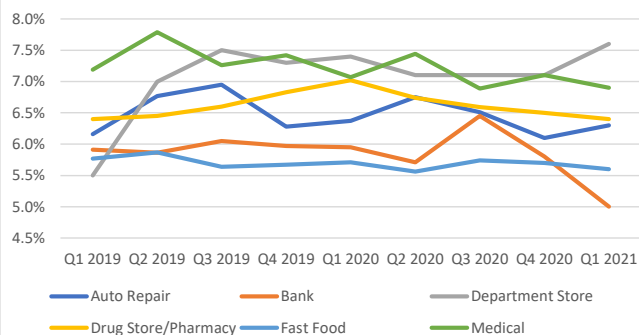
## Average \$/SF on Quarterly Transactions

Price per square foot on quarterly transactions decreased 6.75% from \$474 per square foot to \$442 per square foot from Q4 2020 to Q1 2021. The chart shows the department store sector has historically achieved the lowest price per square foot and the bank sector surpassed the fast food sector to achieve the highest price per square foot. All sectors showed decreases in price per square foot except for banks and department stores.

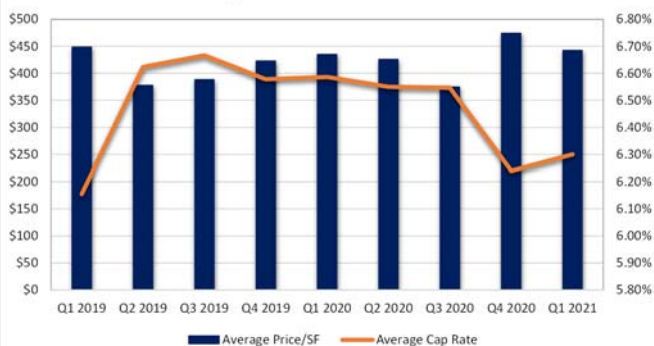
## Average Cap Rate of Quarterly Transaction

Cap rates over the period have ranged from 6.16% in Q1 2019 to 6.67% in Q3 2019. Cap rates in Q4 2020 decreased 31 basis points from 6.55% to 6.24% and increased to 6.30% in Q1 2021. The fast-food and bank sectors command 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.

Historical Cap Rates - Net Lease Market



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



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

From Q1 2019 to Q1 2021, price per square foot and cap rates have generally showed an inverse relationship. 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 considerably as pricing increased substantially. Q4 2020 saw pricing that exceeded all quarters of 2019 and 2020. While the price per square foot and cap rates pulled back a bit in Q1 2021 from the gains made in Q4 2020, investors will keep an eye on this category as we proceed deeper into 2021.

SOURCE: CoStar and Marshall & Stevens



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