

National Net Lease Market Sales Volume and Buying Trends– Q1 2023

Asset Class Review

This report analyzes sales trends in the National Net Lease market from Q1 2021 to Q1 2023.

The national net lease market was one of the most resilient asset classes throughout the COVID-19 Pandemic. As fundamentals across the larger retail markets declined, the net lease market continued to generate competitive pricing and low cap rates. However, economic uncertainty continues to overshadow the market through the first quarter of 2023. The Fed's aggressive interest rate hikes not only dampened investor sentiment, but have led to a series of bank failures, further unnerving investors. Investors are looking to find stable ground. Lastly, price discovery needs clarification as we head deeper into 2023.

Economic Uncertainty and a Looming Recession?

Beginning in March 2022, the Fed raised interest rates in nine consecutive sessions by an astounding 475 basis point. Inflation in the United States soared to over 9% by end of June 2022, following 7.0% and 6.5% overall in 2021 and 2022, respectively, the highest annual levels since the early 1980's. Investors are optimistic that the Fed will pause or at least limit further rate increases in 2023. Most pundits forecast that a recession will take hold in the second half of 2023, in which case it is

possible the Fed reverses course on its interest rate hikes, potentially by year end.

Net Lease Market Impact

The net lease market offers a wide range of investment opportunities. Stability is the most important element in this market. Investors prefer long term leases, good credit tenants, NOI upside, while minimizing the burdens of property management.

The large spread between bid and asking price has left many investors on the sidelines. Also, the lower supply of properties has impacted the ability of 1031 investors from entering the market.

Sale / Leasebacks on the Rise

As the cost of capital remains high, sale leasebacks have become an increasingly attractive option for cash strapped corporations. Buyers are thirsty to invest in properties that are backed by tenants with strong credit ratings. For such corporate entities, there will be buyers that are hungry for this type of product.

Fed Rate Hikes 2022-2023

The table below shows the aggressive increases imposed by the Fed.

Date	BPS
3/17/22:	25%
4/5/22:	50%
6/16/22:	75%
7/27/22:	75%
9/21/22:	75%
11/2/2022:	75%
12/14/22:	50%
2/1/2023:	25%
3/2/2023:	25%
Total:	425%

Overview

We tracked investment sales for net lease properties over the past nine quarters from Q1 2021 to Q1 2023. The search parameters include triple net sales only, excluding portfolio and multi-property sales. The 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, the decreasing number of transactions over the past three quarters underscores the decreasing supply of net lease properties on the market. Both the number of transactions and dollar volume decreased substantially in Q1 2023, showing a demonstrative negative shift.

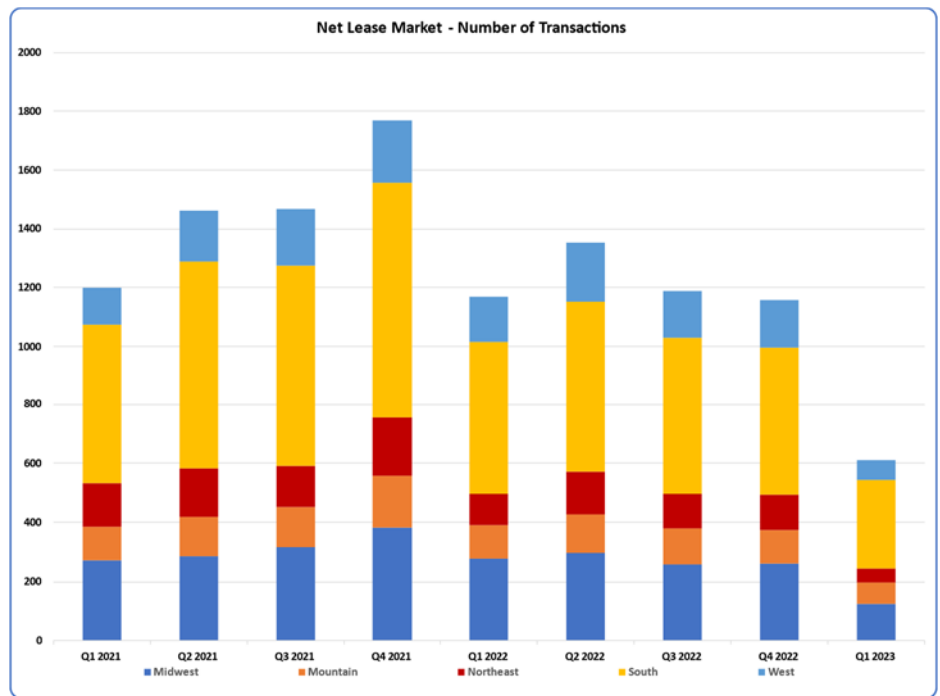
Number of Sales Transactions

The number of quarterly net lease sales recorded in the US are segmented by region as seen below. From Q1 2021 to Q1 2023, the number of sales ranged from 612 to 1,768, averaging 1,264 sales per quarter. The number of transactions has generally trended downward since early 2022 following the aggressive interest rate hikes that began in early 2022. While uncertainty remains about rate hikes going forward, it remains to be seen if and when the supply of properties on the market and number of sales will rebound to 2021 levels.

Historical Transaction Volume - Net Lease Market											
Number of Transactions	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Total	% of Total
Midwest	272	287	318	381	279	299	260	261	124	2,481	21.8%
Mountain	113	130	133	176	112	127	119	114	74	1,098	9.6%
Northeast	148	165	140	199	104	146	117	119	48	1,186	10.4%
South	541	706	683	801	520	580	532	502	297	5,162	45.4%
West	126	175	194	211	154	202	160	162	69	1,453	12.8%
Total # Transactions	1,200	1,463	1,468	1,768	1,169	1,354	1,188	1,158	612	11,380	100.0%
% Change from Prior Month	-	21.9%	0.3%	20.4%	-33.9%	15.8%	-12.3%	-2.5%	-47.2%		

The highest number of quarterly transactions occurred in Q4 2021 with 1,768 total transactions. The market ramped up in 2021 following a sharp decrease in 2020 at the onset of COVID-19. Transaction volume increased during the first four quarters of analysis but fell off nearly 34% in Q1 2022. The number of transactions increased roughly 16% from Q1 2022 to Q2 2022 but has decreased each quarter since, with a robust 47% decrease from Q4 2022 to Q1 2023. In total, 2021 saw 5,899 transactions, whereas 2022 saw 4,869 transactions.

Accounting for the largest geographical area, the South region saw 45% of all transactions over the prior nine quarters, with Texas and Florida leading the way.



Dollar Volume of Sales Transactions

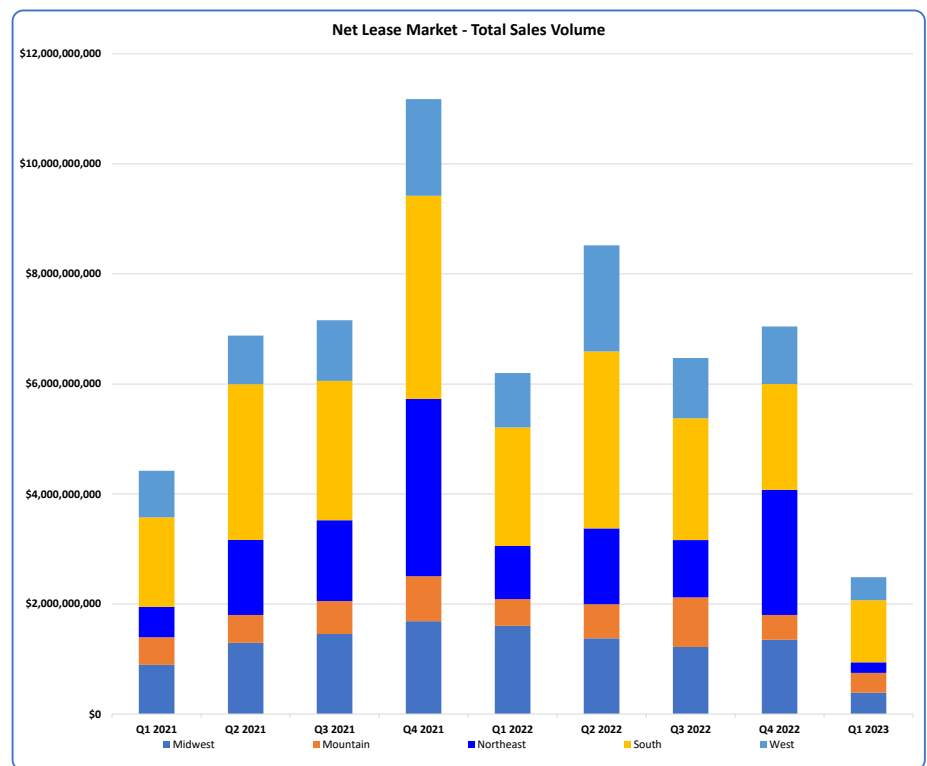
As seen below, we have tracked the dollar volume of quarterly net lease sales by region. Total transaction volume ranged from just under \$2.5 to \$11.1 billion between Q1 2021 and Q1 2023, with the peak occurring in Q4 2021. Dollar volume decreased by roughly 45 percent from Q4 2021 to Q1 2022. Whereas dollar volume rebounded in Q2 2022, it has generally trended downward since.

Historical Transaction Volume - Net Lease Market (in Millions)											
Dollar Volume	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Total	% of Total
Midwest	\$894.0	\$1,293.3	\$1,453.2	\$1,689.5	\$1,604.4	\$1,376.6	\$1,221.1	\$1,350.3	\$387.5	\$11,269.9	18.7%
Mountain	\$504.0	\$508.1	\$601.2	\$816.5	\$485.9	\$621.0	\$900.9	\$451.1	\$360.3	\$5,249.0	8.7%
Northeast	\$549.9	\$1,362.2	\$1,467.6	\$3,219.5	\$964.4	\$1,375.1	\$1,038.9	\$2,273.1	\$192.7	\$12,443.5	20.6%
South	\$1,628.5	\$2,831.0	\$2,533.6	\$3,697.2	\$2,155.0	\$3,219.3	\$2,214.0	\$1,925.5	\$1,127.1	\$21,331.4	35.4%
West	\$846.1	\$883.2	\$1,102.1	\$1,753.8	\$989.5	\$1,925.8	\$1,096.5	\$1,006.5	\$421.6	\$10,025.0	16.6%
Total Dollar Volume	\$4,422.5	\$6,877.8	\$7,157.7	\$11,176.5	\$6,199.2	\$8,518.0	\$6,471.4	\$7,046.0	\$2,489.2	\$60,318.8	100.0%
% Change from Prior Month	-	55.5%	4.1%	56.1%	-44.5%	37.4%	-24.0%	8.9%	-64.7%	-	-

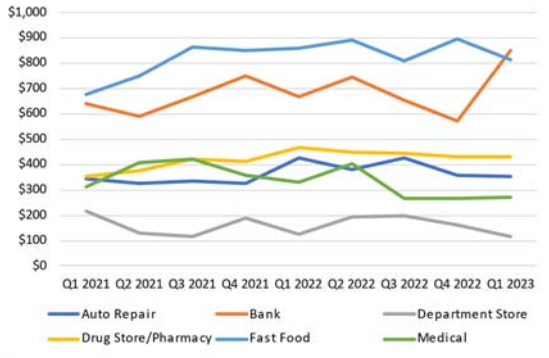
Over the analysis period, the South and Northeast regions saw the highest dollar volume in sales. The significantly higher dollar volume recorded in the South region is attributable to the much larger geographic area of this region. Although recording fewer transactions, dollar volume for the Northeast was second highest, as pricing is substantially higher in the large metropolitan areas of this region. The Midwest and West regions saw an 18.7% and 16.6% share of total dollar volume, followed by the Mountain region, accounting for 8.7% of total dollar volume.

Total dollar volume in 2021 was approximately \$29.63 billion, anchored by a strong Q4. Total dollar volume in 2022 was roughly \$28.23 billion, representing a decrease of approximately 4.7%. This is mainly attributable to the drop-off in transaction volume from Q4 2021 to Q1 2022. Transaction volume was higher each of the next three quarters.

Whereas number of transactions decreased by 21% year-over-year, sales volume decreased by less than 5%, which suggests investors are willing to pay a premium for the highest-quality assets. This underscores the “flight to quality” concept which has become increasingly prevalent in recent quarters. Investors are focusing on assets with strong fundamentals and long-term leases that can provide a hedge against the current economic uncertainty. Furthermore, sellers are more willing to trade these highly marketable properties at competitive pricing that minimizes the bid-ask spread.



Price Per SF- Net Lease Market



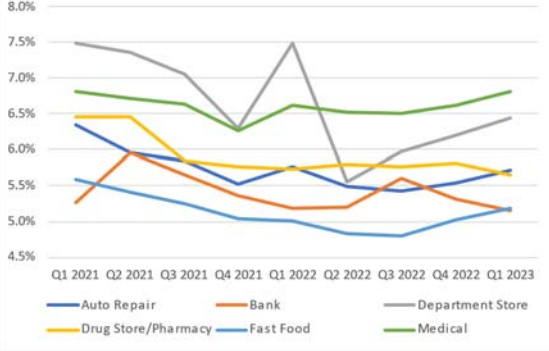
Average \$/SF on Quarterly Transactions

Price per square foot on yearly transactions increased 8.6% from \$451 per square foot to \$490 per square foot from 2021 to 2022. 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. Price per square foot decreased 6.3% from \$505 to \$473 per square foot from Q4 2022 to Q1 2023, with the department store and fast food sectors showing the largest percentage decreases. Several sectors saw price per square foot increases, with bank properties registering a significant 49% increase in price per square foot.

Average Cap Rate of Quarterly Transactions

Cap rates over the period have ranged from 5.57% in Q2 2022 to 6.33% in Q1 2021. Average cap rate in 2021 was 6.10% versus 5.72% in 2022. However, cap rates did increase 17 basis points from 5.66% to 5.83% from Q4 2022 to Q1 2023. 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. Cap rate and lease term remaining have an inverse relationship, with cap rates decreasing as lease term remaining increases. Decreasing cap rates in 2022 compared to rising capital costs point to higher quality assets on the market, although we note the real estate markets typically lag several quarters behind the capital markets. Thus, the increase in cap rates in Q1 2023 may continue throughout the next few quarters.

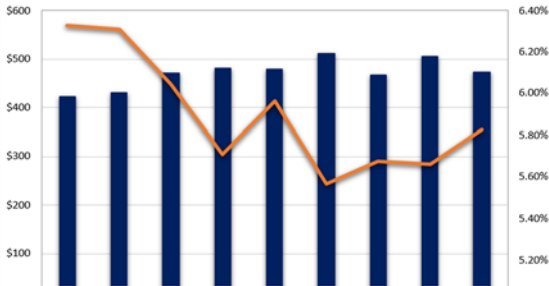
Historical Cap Rates- Net Lease Market



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

Price per square foot and cap rates have generally showed an inverse relationship, Price per square foot increased in each quarter in 2021, and cap rates decreased substantially. Cap rates increased from Q4 2021 to Q1 2022 but decreased 40 basis points from Q1 2022 to Q2 2022. Cap rates have generally trended upward since, a sign that rising interest rates are beginning to impact the real estate markets. Market participants will be closely following monetary policies by the Federal Reserve throughout the remainder of 2023.

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



SOURCE: CoStar and Marshall & Stevens



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