

US Net Lease Market Topics & Trends – Q2 2021

Fundamentals across the national net lease market appear to be strong heading into the second half of 2021. Total number of transactions and dollar volume statistics are higher than pre-covid levels. Cap rates across net lease retail properties decreased 3 basis points from Q1 2021 to Q2 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. Investor confidence appears to have returned to the market, although performance has varied depending on property type. As we continue into the second half of 2021, investors will be monitoring the spread of the Delta Variant and its impact on economic re-openings around the country.

This report analyzes topics and sales trends in the National Net Lease market from January 2019 to June 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 ten quarters from Q1 2019 to Q2 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. The most recent three quarters have shown a strong recovery, with Q2 2021 recording the highest number of transactions and second highest dollar volume level in the analysis period.

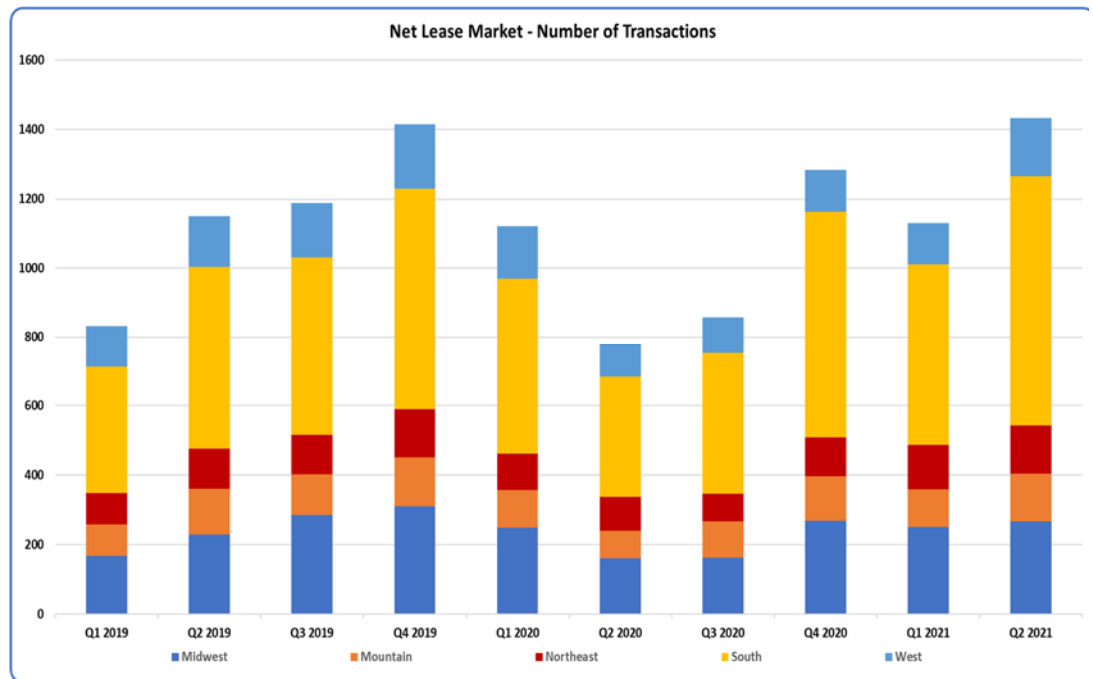
Number of Sales Transactions

The number of quarterly net lease sales recorded in the US are segmented by region as seen below. From Q1 2019 to Q2 2021, number of sales ranged from 832 to 1,433, averaging 1,119 sales per quarter. In Q2 2020, there were 1,433 total transactions which is the highest level in the analysis period.

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	Q2 2021	Total	% of Total
Midwest	168	229	284	309	249	161	163	270	251	267	2,351	21.0%
Mountain	90	131	117	142	108	80	104	126	107	137	1,142	10.2%
Northeast	90	116	114	138	105	95	78	113	128	138	1,115	10.0%
South	364	527	515	640	508	348	408	654	525	722	5,211	46.6%
West	120	148	158	186	152	94	105	119	119	169	1,370	12.2%
Total # Transactions	832	1,151	1,188	1,415	1,122	778	858	1,282	1,130	1,433	11,189	100.0%
% Change from Prior Month	-	38.3%	3.2%	19.1%	-20.7%	-30.7%	10.3%	49.4%	-11.9%	26.8%		

Transaction volume per quarter generally increased during the first five quarters of the 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 demonstrated a strong recovery in Q2 2021.

Activity has been the strongest in the South region as it has recorded 47% of all transactions in the analysis period and 50% of transactions recorded in Q2 2021. The percentage share for the remaining regions was more uniform, ranging from 21% in the Midwest, to 12% in the West, and 10% in the Mountain and Northeast regions.



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 Q2 2021, with the peak occurring in Q4 2019. Dollar volume decreased by roughly 23 percent from Q4 2020 to Q1 2021 and increased by 45 percent in Q2 2021 to climb back above pre-Covid levels.

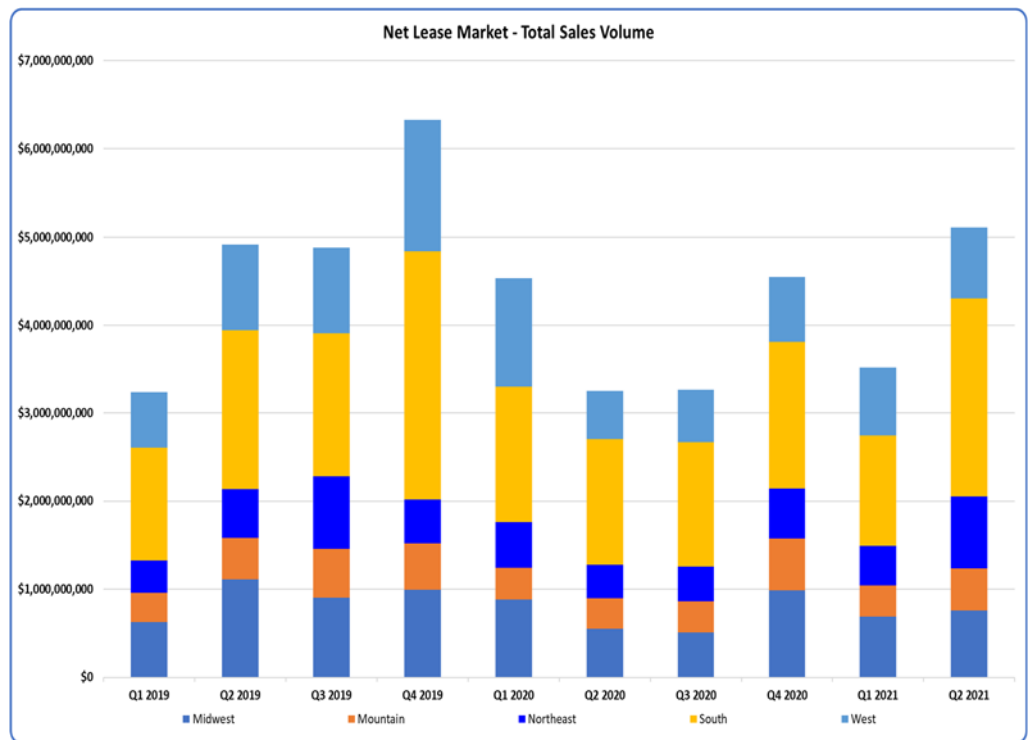
Historical Transaction Volume - Net Lease Market (in Millions)

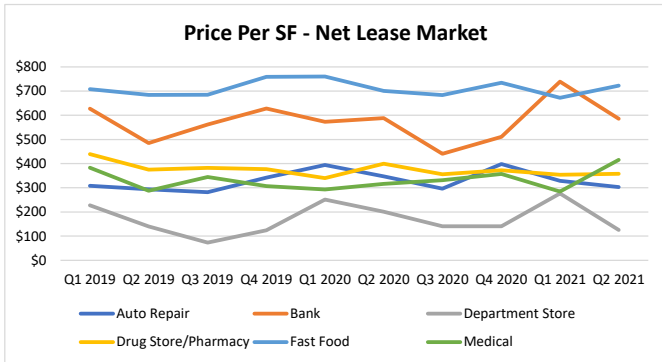
Dollar Volume	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Total	% of Total
Midwest	\$629.4	\$1,113.7	\$904.9	\$993.8	\$886.1	\$549.4	\$509.0	\$989.1	\$686.6	\$758.9	\$8,021.1	18.3%
Mountain	\$332.5	\$470.3	\$549.8	\$522.6	\$358.5	\$347.5	\$352.6	\$584.9	\$359.0	\$480.7	\$4,358.4	10.0%
Northeast	\$363.2	\$548.8	\$827.2	\$502.3	\$515.6	\$378.7	\$393.3	\$568.7	\$447.8	\$812.8	\$5,358.5	12.3%
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	\$2,252.5	\$17,106.3	39.1%
West	\$633.1	\$967.8	\$966.7	\$1,484.6	\$1,238.9	\$548.1	\$593.0	\$875.3	\$776.9	\$807.0	\$8,891.3	20.3%
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	\$5,111.9	\$43,735.5	100.0%
% Change from Prior Month	-	51.8%	-0.7%	29.6%	-28.3%	-28.3%	0.2%	39.6%	-22.5%	45.1%	-	-

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 12% and 10%, respectively. Dollar volume decreased in all regions in Q2 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. So far, 2021 has outperformed the first two quarters of 2019 and 2020.

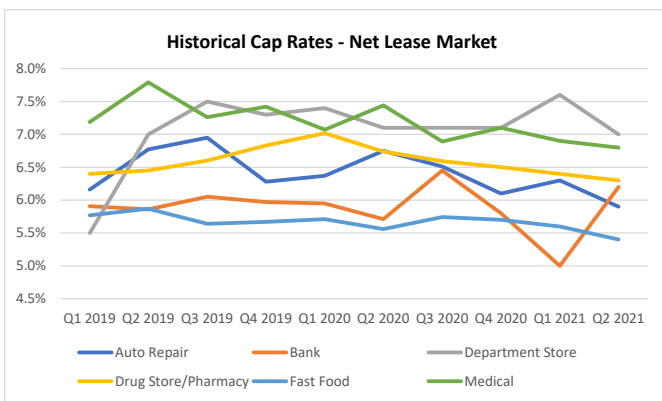
Market participants will be monitoring policy on re-openings and potential shutdowns as the Delta Variant poses a risk in the second half of 202. Below are sales trends pertaining to the key property sectors within the NNN market.





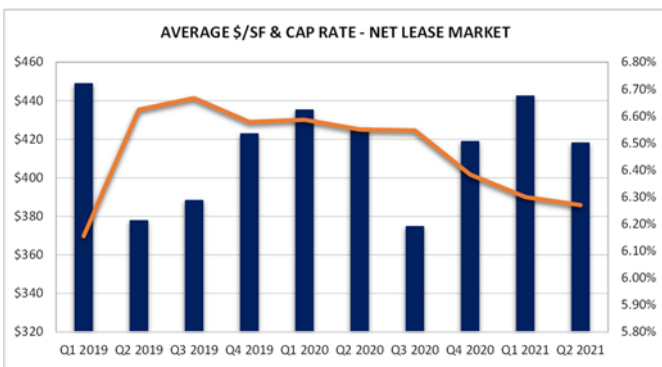
Average \$/SF on Quarterly Transactions

Price per square foot on quarterly transactions decreased 5.4% from \$442 per square foot to \$418 per square foot from Q1 2021 to Q2 2021. The chart shows the department store sector has historically achieved the lowest price per square foot and the fast food and bank sectors have achieved the highest. Performance in Q2 2021 has varied depending on sector, with the Auto Repair, Bank, and Department Store sectors recording quarterly decreases and the Drug Store, Fast Food, and Medical sectors recording quarterly increases.



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 have been steadily decreasing since their Q3 2019 peak. The fast-food and bank sectors typically command the lowest cap rates due to long term leases and frequent escalations. 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 Q2 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. Since Q3 2020, cap rates decreased considerably. Q1 2021 saw pricing that exceeded all quarters of 2019 and 2020. While the price per square foot pulled back a bit in Q2 2021 from the gains made in Q1 2021, cap rates remain low and investors will keep an eye on this category as we proceed deeper into 2021.

SOURCE: CoStar and Marshall & Stevens



Patrick T. Craig, MAI, MRICS
 Executive Managing Director
 Real Estate Valuation Practice
 212.897.9481
 ptcraig@marshall-stevens.com



Gino Alosco
 Director
 Real Estate Valuation Practice
 212.897.9475
 galosco@marshall-stevens.com



Conner Bianchini
 Associate
 Real Estate Valuation Practice
 646.438.7607
 cbianchini@marshall-stevens.com