

National Net Lease Market Sales Volume and Buying Trends– Q3 2020

Statistics in Q3 2020 point to a modest growth in number of transactions amid stagnant dollar volume, highlighting a decrease in pricing across the national net lease market. Price per square foot decreased from \$426 per square foot to \$375 per square foot from Q2 2020 to Q3 2020. The most profound change in the market over the past quarter was the reopening of nonessential businesses, which has widened the offering of net lease properties on the market. These nonessential businesses, not on the market in the previous quarter, are commanding unfavorable pricing relative to their essential counterparts, which has pushed aggregate pricing downward. Meanwhile, cap rates have leveled off. The Federal Reserve announcement that interest rates would remain near zero until 2023 should propel investor confidence, but new spikes in COVID-19 and a looming presidential election could further alter the net lease landscape in the upcoming quarters.

This report analyzes topics and sales trends in the National Net Lease market from January 2019 to September 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 seven quarters from Q1 2019 to Q3 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 have declined significantly from the pre-COVID to post-COVID time frame.

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, while climbing upward, is still well short of prior levels.

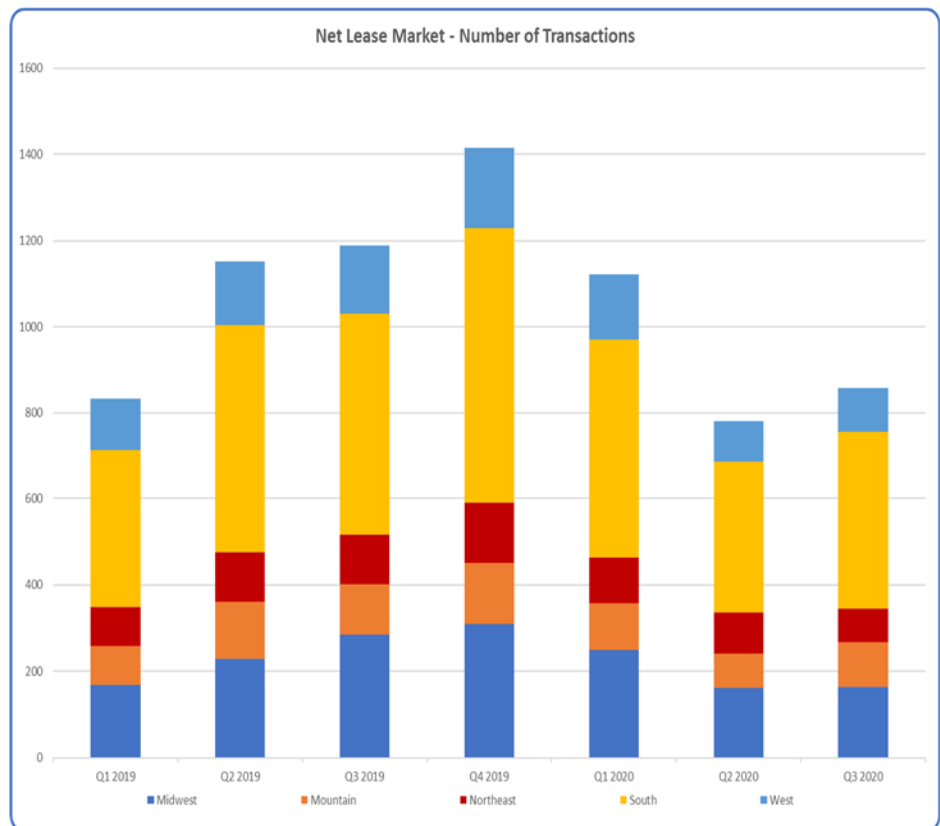
Historical Transaction Volume - Net Lease Market

Number of Transactions	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Total	% of Total
Midwest	168	229	284	309	249	161	163	1,563	21.3%
Mountain	90	131	117	142	108	80	104	772	10.5%
Northeast	90	116	114	138	105	95	78	736	10.0%
South	364	527	515	640	508	348	408	3,310	45.1%
West	120	148	158	186	152	94	105	963	13.1%
Total # Transactions	832	1,151	1,188	1,415	1,122	778	858	7,344	100.0%
% Change from Prior Month	-	38.3%	3.2%	19.1%	-20.7%	-30.7%	1.0%		

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. The number of transactions increased roughly 10% from Q2 2020 to Q3 2020 but is still well below the quarterly average.

Accounting for the largest geographical area and supply, the South region saw 45% of all transactions over the prior seven quarters, with Texas and Florida leading the way. The percentage share for the remaining regions was more uniform, ranging from 21.3% in the Midwest, to 13.1% in the West, and 10.5% and 10.1% in the Mountain and Northeast regions, respectively.

With continued uncertainty related to COVID-19 and worries over a second spike of the virus, number of transactions could be in limbo over the next few quarters.



Dollar Volume of Sales Transactions

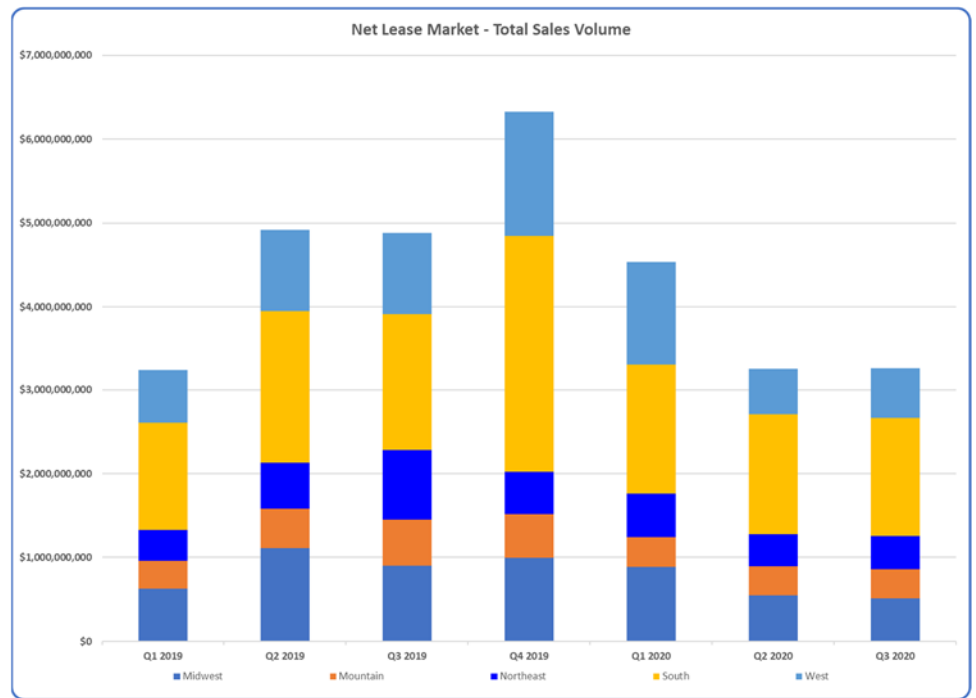
As seen below, we have tracked the dollar volume of quarterly net lease sales by region. Total transaction volume ranged from \$3.24 to \$6.33 billion between Q1 2019 and Q1 2020, with the peak occurring in Q4 2019. Comparatively, quarterly sales volume in Q2 2020 was \$3.25 billion, reflecting a decrease of 28% from the prior quarter. Quarterly sales volume in Q3 2020 increased by 1% from Q2 2020 to \$3.26 billion. Judging by the number of transactions increasing 10% but dollar volume only increasing 1%, it is evident that pricing in Q3 2020 took a hit.

Historical Transaction Volume - Net Lease Market (in Millions)									
Dollar Volume	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Total	% of Total
Midwest	\$629.4	\$1,113.7	\$904.9	\$993.8	\$886.1	\$549.4	\$509.0	\$5,586.5	18.4%
Mountain	\$332.5	\$470.3	\$549.8	\$522.6	\$358.5	\$347.5	\$352.6	\$2,933.8	9.6%
Northeast	\$363.2	\$548.8	\$827.2	\$502.3	\$515.6	\$378.7	\$393.3	\$3,529.2	11.6%
South	\$1,279.3	\$1,814.3	\$1,633.9	\$2,824.3	\$1,536.6	\$1,428.9	\$1,411.9	\$11,929.1	39.2%
West	\$633.1	\$967.8	\$966.7	\$1,484.6	\$1,238.9	\$548.1	\$593.0	\$6,432.2	21.2%
Total Dollar Volume	\$3,237.6	\$4,914.9	\$4,882.5	\$6,327.7	\$4,535.7	\$3,252.6	\$3,259.8	\$30,410.8	100.0%
% Change from Prior Month	-	52%	-1%	30%	-28%	-28%	1%	-	-

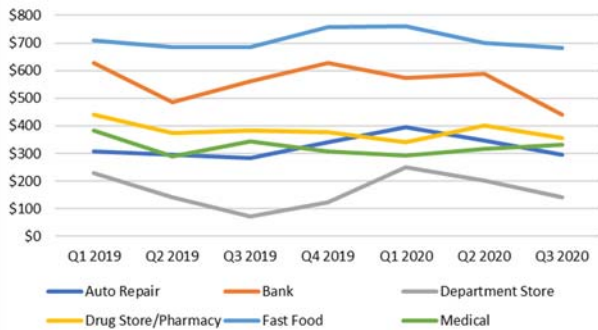
Over the analysis period, the South and West regions saw the highest dollar volume in sales. Not included in this analysis is sale leaseback of the Bellagio Hotel and Casino in Las Vegas, Nevada by MGM Resorts International for \$4.25 billion. This transaction was a net lease recorded in the hospitality/gaming specialty sector, which is not covered in this analysis. Dollar volume dropped considerably in all regions in Q2 2020 and has remained at a similar level in Q3 2020.

Amid the significant decreases in dollar volume was an emphasis on quality, lower-risk investments. CVS, 7-Eleven and McDonalds, three businesses that remained open during the Pandemic, registered some of the lowest cap rates on long-term leases. Conversely, non-essential net lease properties saw the brunt of the market decreases.

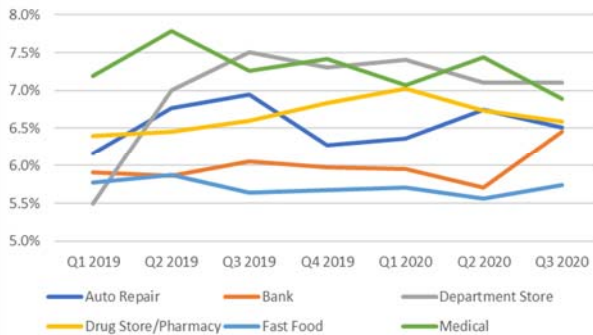
Market participants will be monitoring policy on re-openings and potential shutdowns as the COVID-19 Pandemic continues, and financial health of tenants will remain on the forefront. Below are sales trends pertaining to the key property sectors within the NNN market.



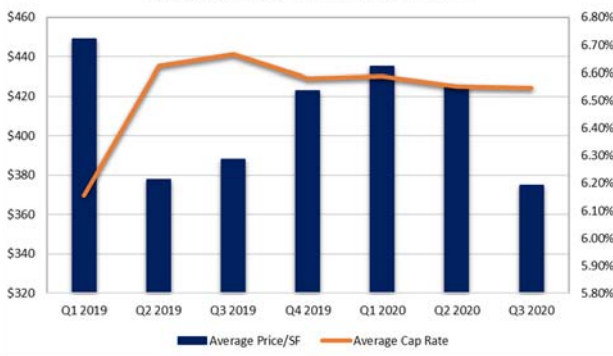
Price Per SF - Net Lease Market



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 fell 11.9% from \$426 per square foot to \$375 per square foot from Q2 2020 to Q3 2020. Pricing in Q3 2020 decreased roughly 3.3% from Q3 2019 and is the lowest over the prior seven quarters. The chart shows the department store sector achieving the lowest price per square foot at \$141/sf, and the fast-food sector achieving the highest price per square foot at \$683/sf in Q3 2020. Price per square foot decreased in all sectors outside of the medical sector, which increased from \$316 to \$331 per square foot.

Average Cap Rate of Quarterly Transaction

Despite the onset of COVID-19, cap rates have held steady over the past two quarters. Cap rates over the period have ranged from 6.16% in Q1 2019 to 6.67% in Q3 2019. The average cap rate of 6.55% in Q3 2020 remains unchanged from Q2 2020 and is slightly lower than cap rates in 2019. 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 Q2 2020, price per square foot and cap rates have generally showed an inverse relationship. Price per square foot dropped considerably in Q2 2019 and cap rates increased. Meanwhile, cap rates decreased and began to level off as price per square foot increased and leveled off. 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.

SOURCE: CoStar and Marshall & Stevens



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



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



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



Matt Schlatter
 Senior Associate
 Real Estate Valuation Practice
 646.438.7603
 mschlatter@marshall-stevens.com