

The Net Takeaways

August 2018 Market Trends



Stan Johnson Co.

Dear Clients & Colleagues -

With Summer 2018 coming to a close, and schools starting back up for the fall, we want to take a moment to update each of you with the key themes currently manifesting in the net lease marketplace as deal making season prepares to ramp up after Labor Day.

The last couple of months have seen above average levels of activity with many private investors still looking for acquisitions, and a healthy amount of new supply continuing to enter the marketplace. We believe that these trends foreshadow an above average amount of market activity in the time between Labor Day and Thanksgiving, which is traditionally the net lease market's most active period.

Below, we outline a few prominent current dynamics we are seeing in the net lease market:

Stubbornly Resistant Interest Rates Buoying Cap Rates

The 10 Year Treasury Note continues to defy expectation that it would break through the three percent barrier, and instead has settled in around 2.85% as of August 21. Meanwhile, shorter-term treasuries have increased, creating a "flattened" yield curve that some economists suggest is a precursor to more recessionary pressures. The upside is this has provided relief on costs of borrowing and should stabilize cap rates on larger price-point transactions. Buyers are taking advantage of this trend to secure all-in coupons on new loans at 4.85%-5.10% rates with 10-year fixed terms.

All About the Deal Size for Retail

Although the cost of funds for borrowing on real estate has improved in the last 30 days, we continue to witness a sustained push for many investors to avoid financing all together and purchase retail assets in the \$1-3M range. For assets with both long-term leases and solid credit in this price range, cap rates have barely increased from their peak levels in 2014-2015. The most demanded tenants in this segment include all QSRs with substantial net worth/strong guarantors, auto users, convenience stores, and medical tenants. Most of these users are resistant to online retail pressures, and this fact is not lost on investors. We have seen some softening of cap rates in this price range in heartland states, but the coastal markets, warm-weather states, and high-barrier entry states remain at or near peak-level pricing and valuation.

We project that this segment will see utmost demand after Labor Day and we may see some cap rate compression from current levels. This is driven by the fact that demand is likely to outpace supply for the rest of the year for this asset class.

Insatiable Industrial Demand

Industrial is the unquestionably the hottest asset class in the net lease marketplace today. Once a haven for institutional investors, private investors have flocked to the segment over the last few years, chasing assets priced to \$10M and sometimes well-beyond those pricing levels. The tandem impact of limited supply, strong demand, and many tenants of these buildings working with e-commerce has kept cap rates at the lowest levels (highest valuations) without much, if any, increase over the past two years.

The demand for industrial has manifested itself in the loosening of criteria for assets investors are willing to consider. We've seen a pronounced uptick in interest for shorter term leases and more tertiary assets, which may have previously struggled to find real interest. Our expectation is that this segment, much like small retail, will see an incredibly robust finish to the year.

Brad Feller
Managing Director
bfeller@stanjohnsonco.com

Isaiah Harf
Director
iharf@stanjohnsonco.com

Andy Gatchell
Associate Director
agatchell@stanjohnsonco.com

Blaise Bennett
Associate
bbennett@stanjohnsonco.com

Mark Lovering
Associate
mlovering@stanjohnsonco.com

Rachel Walz
Associate
rwalz@stanjohnsonco.com

Justin Wollmershauser
Associate
jwollmershauser@stanjohnsonco.com

Stan Johnson Company
303 East Wacker Drive | Suite 1111
Chicago, IL 60601