The Net Takeaways

July 2018 Market Trends

Stan Johnson Co.

Dear Clients & Colleagues –

We hope that this note finds you well and you're enjoying summer 2018! As we head into Q3, we wanted to take a moment to provide the latest thoughts on the conditions impacting the Net Lease Marketplace.

2018 continues to be one of the most fluid years in the last decade, and we would all be well-served to closely monitor the evolving marketplace conditions. Rising interest rates & cap rates are layered against geopolitical concerns and the shifting retail landscape. This may well be thought of as the "Year of the Crosswinds," where market players must carefully assess a multitude of varying forces impacting their businesses in unequal ways.

In the below, we outline a few of the most prominent current dynamics we are seeing in the net lease market:

Net Lease Jenga: Buyer Engagement Increasing...On Their Terms

Both institutional and private buyers have been actively hunting for acquisitions throughout 2018, however Q1 saw significantly depressed deal making and closing activity as buyers showed patience and discipline, reflecting a view that seller pricing would improve as the effect of rising rates started to "trickle down" into the marketplace.

In the last 8 weeks, we have noted a substantial uptick in deal-making activity, with buyers writing more offers and striking more deals. This is true for all classes of buyers, but it is particularly true of the private buyer market. There seems to be both a desire to get money "into the game" after it's been sitting on the sidelines, and an acknowledgement that cap rates may not increase as widely as they had hoped.

That being said, we are seeing buyers who are picky with the deals they are chasing, and who are unafraid to bid on an increased number of deals in order to ferret out the most attractive pricing. Think of a game of Net Lease Jenga, in which buyers are poking many blocks to find which one presents them with the best opportunity.

The 2:1 Ratio: Take More Good With The Bad

Tying in with the above theme, we are seeing a more pronounced preference for the "good" attributes of net lease assets. Since 2010, buyers have displayed these preferences, but we have seen the bias towards these characteristics increase even more markedly in the last 6 months:

The Good

- Rental Growth A- or Better
- Market Location
- Great Sales Performance
- Below Market Rent
- Investment Grade Credit
- 11+ Year Lease Term
- Favorable Deal Size (<$3mm)

The Bad

- Flat Leases
- Above Market Rents
- Short-Term Leases
- Internet-Vulnerable Retail Uses
- Sub-Investment Grade Credit
- Tertiary Locations
- Mid & Big Box Retail
- Deal Sizes Greater Than $5M, and Even More So Greater Than $10M

As a rule of thumb, we've seen that for each "Bad" attribute a deal has, it needs to have at least two "Good" attributes to maintain pricing that is within 25-50bps of 2016 levels.

For assets that have a 1:1 ratio or worse, we are seeing very limited buyer engagement regardless of pricing. There's simply not as much liquidity for these assets currently, given the increased supply of assets.

Preparing For The Final Push: 2018 EOY Deal Cycle

Although it feels like there is a long time until Labor Day, football season, and the fall holidays, they are far closer than they seem!

Given the choppier marketplace conditions, we strongly advise clients to be preparing now for any deals they think may be disposition candidates in 2018.

Can we be of assistance to your business by providing strategic guidance or valuation services? If so, we invite you to reach out to us. Until next month, we wish you happy hunting and excellent summer fun!

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