# Net Takeaways

Stan Johnson Co.

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## Bold Predictions for 2020

**Dear Clients & Colleagues –**

With the holiday season now behind us, and a new decade underway, its time for our annual Bold Predictions Column! One of our favorite traditions is looking out over the next twelve month horizon and making wild guesses and shot-in-the-dark speculations on what the Net Lease Market has in store for us, and then looking back 12 months later to see how completely wrong (right?!) we were!!

With that in mind, let's look back at **Bold Predictions for 2019**:

- Equity market & recessionary pressures increase demand for Net Lease assets and transactional volume grows by 15%
- Conventional financing will not be more expensive than 5.40%
- Prevailing cap rates will increase no more than 25 basis points

So…TECHNICALLY we went three for three! But, we might have missed the magnitude of those factors by [just] a touch! The most marked factor that influenced the NNN market in 2019 was the massive downward movement of the 10 Year Treasury from north of 3.00% to as low as 1.50%. That change made both of our predictions around Market Volume and Cap Rates easily come to fruition, with Cap Rates essentially flat, and market volume up roughly 18.00%.

So with that out of the way, here are three chances for us to look foolish in our Bold Predictions for 2020!

### 2020 Net Lease Volume will be Flat

- As noted above, the NNN Market grew substantially in 2019 buoyed by low-low interest rates
- While the appetite for further growth in the marketplace exists this coming year, we believe the constraint on market growth is driven by supply-side constraints
- Put simply, there are not enough long-term investment-grade leases in the market to satisfy demand. Conversely, the depth of the buyer demand for shorter-term, or sub-investment grade credit is dismal
- We believe this will result in a marketplace that is largely unchanged in transactional volume size

### Net Lease Cap Rates will rise 10-25 Basis Points in 2020

- The NNN market remains close to its all-time low return-offering environment and saw stabilization of pricing in 2019 after a modest cap rate rises in 2018
- The marketplace likely will see some modest expansion of cap rates in 2020, driven largely by the cost of debt which appears to have a propensity to move higher this year
- Additional pressure will come from the retail segment which remains under scrutiny from investors and could plausibly see additional disruption from the online retail marketplace, and potential private equity M&A (see Walgreens LBO). Investors tend to shy away from the credit that they simply can't understand or evaluate quickly
- Any impact in NNN Cap Rates from retail will likely be softened by continued aggressive pricing in the industrial warehouse and distribution segment

### Net Lease "Alternative Tenants" will get substantial traction in 2020

- As mentioned above, the biggest ceiling on the size of the NNN market is supply, particularly long-term leases; and to a lesser extent, the amount of deemed "credit-worthy" tenants backing leases
- The last five years have seen the entry of more alternative-style tenancy into the portfolios of mainstream NNN investors, including early childhood education, dialysis and car washes, amongst others
- We believe that 2020 will be a breakout year for alternative-style net lease tenants, driven largely by continued relative cheap debt, and a quest for longer-term risk-adjusted assets providing positive leverage and real cash-on-cash returns
- Maybe most noted, we believe that the Cannabis NNN market will get substantial traction this year as the list of legalized states continues to grow and expand

We look forward to working with each of you in 2020, and as always invite you to reach out to discuss any of these ideas further!


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