



Dear Clients –

We hope this note finds you well and that 2018 is in motion with fruitful projects and investments underway. With nascent fluctuations and movement in the capital markets, we wanted to take a moment to share our thoughts on the impact the current conditions are having in the Net Lease marketplace.

## The Elephant in the Room: Interest Rates

- Broader moves in the capital markets and the resultant rise in interest rates are beginning to have a real impact on market velocity and pricing across the Net Lease market. As you're likely aware, the **10 Year Treasury went from 2.35% at the beginning of December, to now right around 2.90%**! It's not often that in a 4 month span the market experiences a 55bps move in rates, in either direction. Based on the conversations we're having daily with buyers, brokers and sellers, there's no question this is top of mind across the full investor spectrum. However, it only represents a true headwind for a portion of market participants.

## Rising Cap Rates Show Resilience Despite Pressure

- Despite pressures the Net Lease market is experiencing from sharply rising interest rates, cap rate increases have not experienced the same degree of upward movement over the same period of time, since Q4 2017.
- Generally speaking, it is our view that cap rates have undergone a net increase on the magnitude of 10-20 basis points over the past 120 days and are trending only slightly higher for deals currently being struck.
- Upward pressure on cap rates is being felt most heavily by Larger Price Point Assets, Flat Leases, and Mid/Big Box Retail. Small price point (<\$2.5M) retail deals continue to move with considerable velocity, as the majority of buyers for these assets are all cash.

## Sustained Deal-Making with Increasing Investor Scrutiny

- **Investors remain relatively upbeat** regarding the general economic outlook and are still seeking to make deals. The amount of Tax-Deferred (1031), Private, and Institutional Capital in the marketplace right now remains very solid and is driving transaction volume.
- We continue to see investors ratchet up scrutiny of various retail segments, assessing their futures in the “post-Amazon” retail environment. Right now, the market overwhelmingly favors uses generally not susceptible (or at least perceived as being not susceptible) to disintermediation by the internet:
  - **Restaurants/QSR's**
  - **Dollar Stores**
  - **Auto Parts**
- If there is one commonality in the marketplace today, it is an emphasis on quality real estate with reasonable residual values. In a dynamic and shifting environment, investors appear to maintain faith that great corners in dense markets will preserve their value regardless of the evolution of the retail landscape.

Please let us know if you have any questions or feedback. We welcome the opportunity to continue this conversation with each of you and look forward to opportunities to partner with you in 2018!

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