NET LEASE PROPERTY REPORT

Q3 : 2018

Los Angeles
Portland
San Francisco
San Diego
Tampa

NNNetAdvisor

Q3 CAP RATES RISE SLIGHTLY

The Spread Between Cap Rates and Treasuries Shrinks

2018 Q3 Average Cap Rates rose by 8 basis points while Median Cap Rates rose by only 1 basis point. Increasing interest rates are continuing to put upward pressure on cap rates as investors are getting squeezed while attempting to leverage their acquisitions.

The spread between Cap Rates and the 10 Year Treasury reached its lowest level since we began tracking this metric in 2011. In 2011, this spread was 5.8%, while today, it sits at 3.1%. The results of a recent polling of net lease focused lenders revealed that the average rate for a 10 year fixed term on a stable asset was a margin of 2% - 2.5% plus the 10 Year Treasury, which ended the quarter at 3.01%.

For a clearer understanding of how a ~5.25% interest rate plays out, let us consider investing in one of the most popular and stable product types in net lease, corporate credit quick service restaurants with 10 or more years remaining on their base terms. The average cap rate for this subgroup in Q3 was 4.87%. As you can see, unless you want to drive down your returns to the low 4% range (or lower), it makes little sense to leverage with a loan at market rates. More and more, these negative leverage scenarios are causing a disconnect between sellers and potential buyers.

Q3 2018

Sold Property Data

Median Cap Rate

6.11% (↑1 bps)

Average Cap Rate

6.34% (↑8 bps)

Average Days On Market

175 Days (↓20)

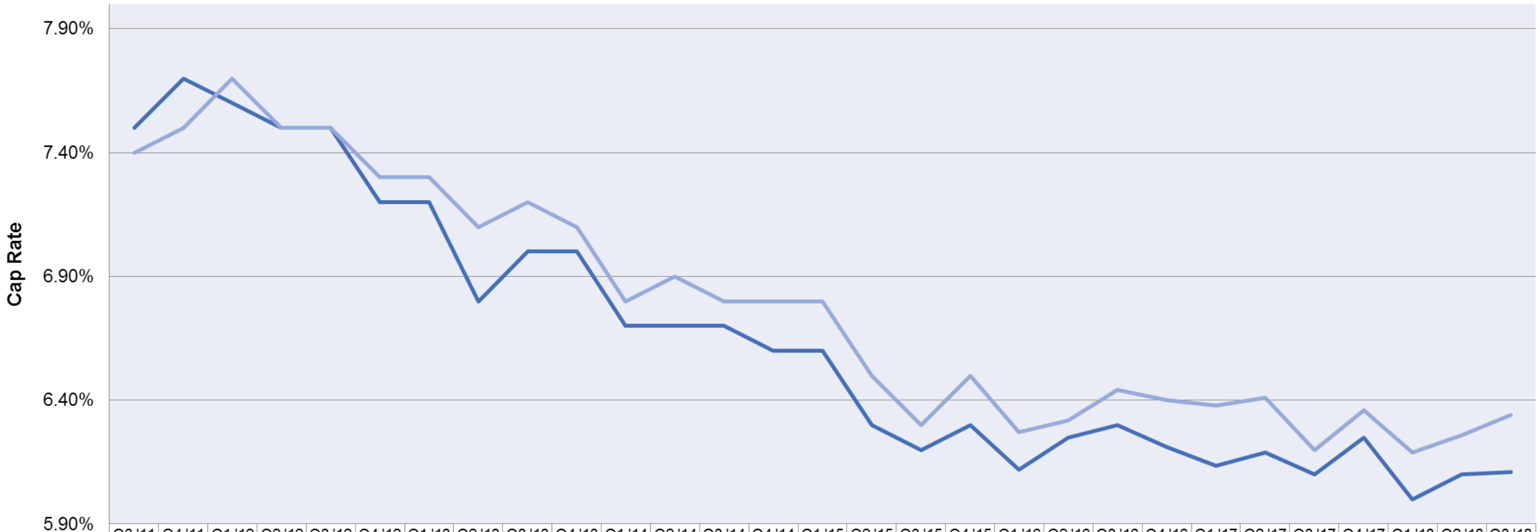
Average Base Term

11.3 Years (↓1.3 Years)

Ask Price vs. Sales Price

6.48% Under Asking (↑64 bps)

National Net Lease Cap Rates



	Q3 '11	Q4 '11	Q1 '12	Q2 '12	Q3 '12	Q4 '12	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14
Median	7.5%	7.7%	7.6%	7.5%	7.5%	7.2%	7.2%	6.8%	7.0%	7.0%	6.7%	6.7%	6.7%	6.6%
Average	7.4%	7.5%	7.7%	7.5%	7.5%	7.3%	7.3%	7.1%	7.2%	7.1%	6.8%	6.9%	6.8%	6.8%

	Q1 '15	Q2 '15	Q3 '15	Q4 '15	Q1 '16	Q2 '16	Q3 '16	Q4 '16	Q1 '17	Q2 '17	Q3 '17	Q4 '17	Q1 '18	Q2 '18	Q3 '18
Median	6.6%	6.3%	6.2%	6.3%	6.1%	6.3%	6.3%	6.2%	6.1%	6.2%	6.1%	6.3%	6.0%	6.10%	6.11%
Average	6.8%	6.5%	6.3%	6.5%	6.3%	6.3%	6.4%	6.4%	6.4%	6.4%	6.2%	6.4%	6.2%	6.26%	6.34%

National Average Cap Rates By Term of Lease

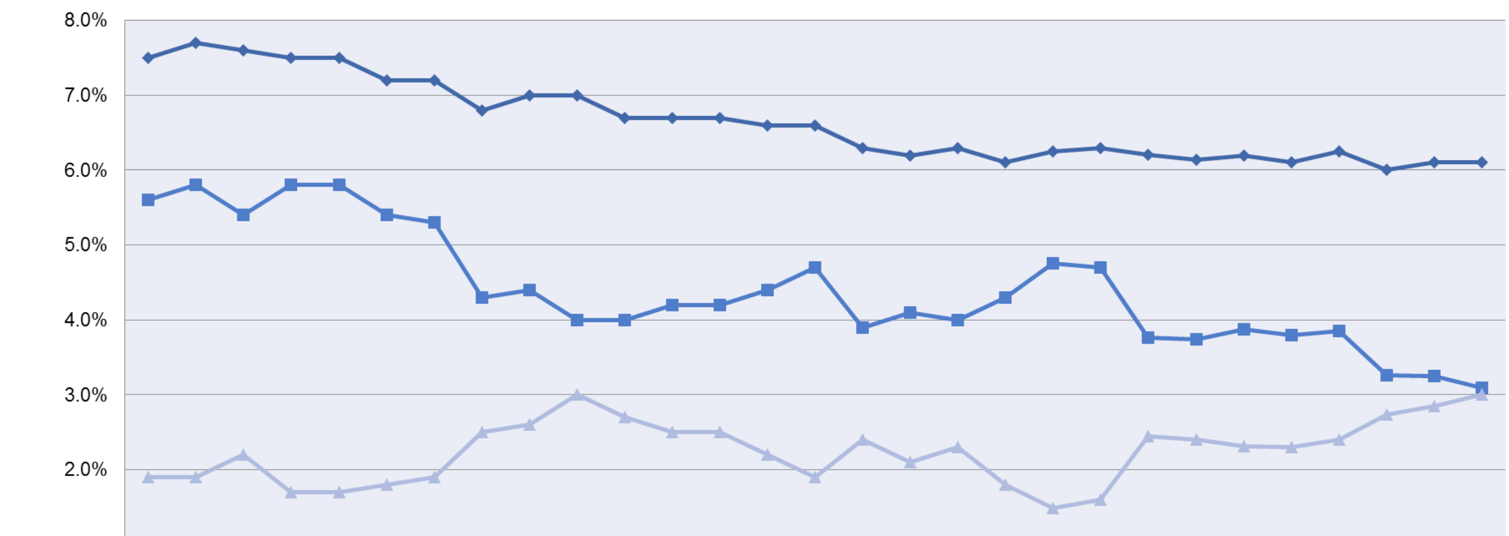
	Q3 '11	Q4 '11	Q1 '12	Q2 '12	Q3 '12	Q4 '12	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14	Q1 '15	Q2 '15	Q3 '15	Q4 '15	Q1 '16	Q2 '16	Q3 '16	Q4 '16	Q1 '17	Q2 '17	Q3 '17	Q4 '17	Q1 '18	Q2 '18	Q3 '18
<10 Years	8.3%	7.8%	8.5%	7.9%	8.2%	8.0%	8.0%	7.7%	7.8%	7.6%	7.4%	7.6%	7.8%	7.8%	7.6%	7.5%	6.9%	7.3%	6.8%	6.9%	7.2%	7.1%	7.2%	7.1%	6.9%	7.5%	6.9%	6.9%	7.0%
>10 Years	7.0%	7.5%	7.3%	7.3%	7.1%	7.0%	6.9%	6.5%	6.8%	6.6%	6.5%	6.5%	6.3%	6.2%	6.2%	6.0%	5.8%	6.1%	6.0%	6.1%	6.0%	6.0%	5.9%	6.0%	5.9%	6.0%	5.8%	5.9%	6.0%

As sellers adjust to this disconnect, net lease cap rates will push higher. A statistic to remember is that in Q2 ‘16, median cap rates were 6.25% while the 10 year was at 1.49%. In Q3 ‘ 18, about 2 years later, median cap rates sit at 6.11% and the 10 year is at 3.01%.

Discount store cap rates increased more than any other sector over the past quarter, moving from an average cap rate of 6.84% to 7.48%. Discount stores last saw their average cap at this high of a level in Q2 2015. The two factors driving this increase were higher cap rates for locations with under 10 years remaining on the base term and the fact that Dollar General continues to put up new builds in tertiary locations. These new builds are great in the sense that they provide consistency and variety in smaller communities across the country. However, the bad news for net lease investors is that if they were to ever leave these remote locations, it would be nearly impossible to replace them with a tenant of similar credit. These factors continue to push Discount store cap rates higher.

While properties are still taking about 6 months from list to sale, we expect that cap rates will continue to push upwards for the duration of 2018 as sellers slowly adjust to the reality that buyers cannot be as aggressive, given the headwinds that they are facing in the debt market.

Spread Between Cap Rates & Treasuries



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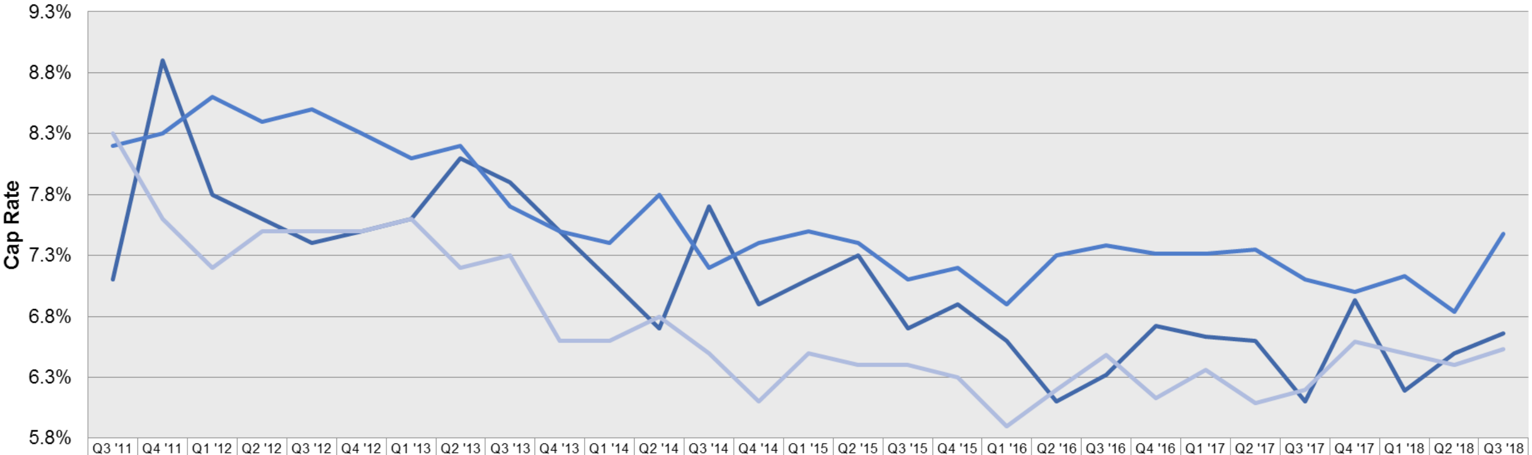
Cap Rates	7.5%	7.7%	7.6%	7.5%	7.5%	7.2%	7.2%	6.8%	7.0%	7.0%	6.7%	6.7%	6.7%	6.6%	6.6%	6.3%	6.2%	6.3%	6.1%	6.3%	6.3%	6.2%	6.1%	6.2%	6.1%	6.3%	6.0%	6.1%	6.1%
Spread	5.6%	5.8%	5.4%	5.8%	5.8%	5.4%	5.3%	4.3%	4.4%	4.0%	4.0%	4.2%	4.2%	4.4%	4.7%	3.9%	4.1%	4.0%	4.3%	4.8%	4.7%	3.8%	3.7%	3.9%	3.8%	3.9%	3.3%	3.3%	3.1%
10-Year	1.9%	1.9%	2.2%	1.7%	1.7%	1.8%	1.9%	2.5%	2.6%	3.0%	2.7%	2.5%	2.5%	2.2%	1.9%	2.4%	2.1%	2.3%	1.8%	1.5%	1.6%	2.5%	2.4%	2.3%	2.3%	2.4%	2.7%	2.9%	3.0%

Auto Related | Discount Store | Drug Store



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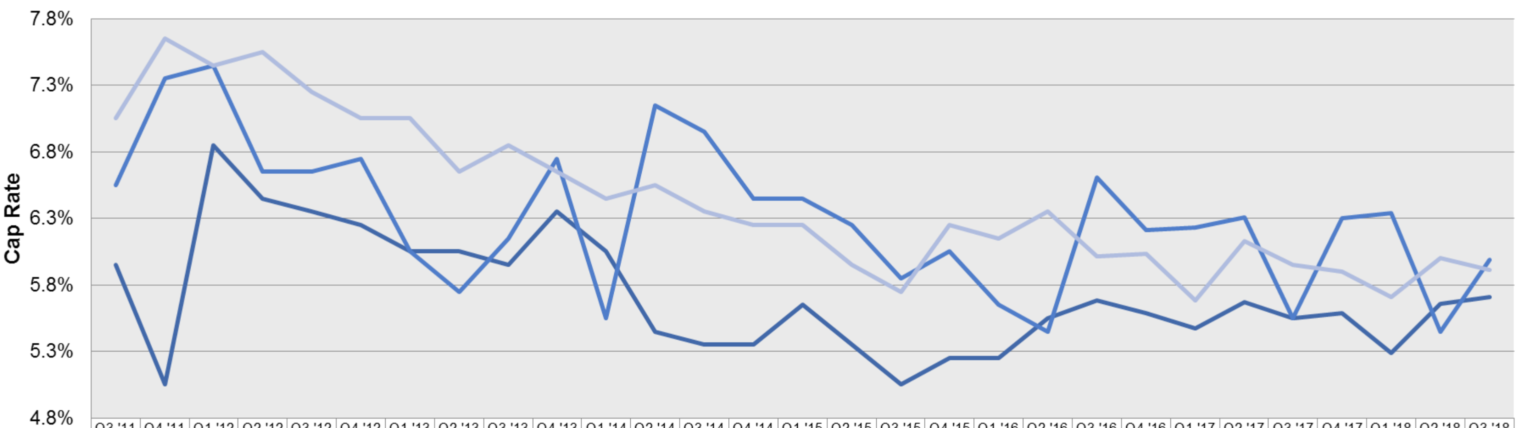
Auto Related	7.1%	8.9%	7.8%	7.6%	7.4%	7.5%	7.6%	8.1%	7.9%	7.5%	7.1%	6.7%	7.7%	6.9%	7.1%	7.3%	6.7%	6.9%	6.6%	6.1%	6.3%	6.7%	6.6%	6.6%	6.1%	6.9%	6.2%	6.5%	6.7%
Discount Store	8.2%	8.3%	8.6%	8.4%	8.5%	8.3%	8.1%	8.2%	7.7%	7.5%	7.4%	7.8%	7.2%	7.4%	7.5%	7.4%	7.1%	7.2%	6.9%	7.3%	7.4%	7.3%	7.3%	7.4%	7.1%	7.0%	7.1%	6.8%	7.5%
Drug Store	8.3%	7.6%	7.2%	7.5%	7.5%	7.5%	7.6%	7.2%	7.3%	6.6%	6.6%	6.8%	6.5%	6.1%	6.5%	6.4%	6.4%	6.3%	5.9%	6.2%	6.5%	6.1%	6.4%	6.1%	6.2%	6.6%	6.5%	6.4%	6.5%

Bank | Convenience / Gas | Restaurant



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Bank	5.9%	5.0%	6.8%	6.4%	6.3%	6.2%	6.0%	6.0%	5.9%	6.3%	6.0%	5.4%	5.3%	5.3%	5.6%	5.3%	5.0%	5.2%	5.2%	5.5%	5.6%	5.5%	5.4%	5.6%	5.5%	5.5%	5.2%	5.6%	5.7%
Convenience/Gas	6.5%	7.3%	7.4%	6.6%	6.6%	6.7%	6.0%	5.7%	6.1%	6.7%	5.5%	7.1%	6.9%	6.4%	6.4%	6.2%	5.8%	6.0%	5.6%	5.4%	6.6%	6.2%	6.2%	6.3%	5.5%	6.3%	6.3%	5.4%	5.9%
Restaurant	7.0%	7.6%	7.4%	7.5%	7.2%	7.0%	7.0%	6.6%	6.8%	6.6%	6.4%	6.5%	6.3%	6.2%	6.2%	5.9%	5.7%	6.2%	6.1%	6.3%	6.0%	6.0%	5.6%	6.1%	5.9%	5.9%	5.7%	6.0%	5.9%

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