NET LEASE PROPERTY REPORT

Q2 : 2022

Los Angeles
Orange County
Portland
San Diego
San Francisco

NNetAdvisors

2022 CAP RATES PUSH LOWER

Q2 Cap Rates Drop to Historic Lows

2022 Q2 Cap Rates finished at their lowest levels on record. Average Cap Rates for Net Lease property finished the quarter at 5.33% while Median Cap Rates dropped to 5.14%, both representing an approximately 25 basis point drop from the prior quarter. Despite the Fed's aggressive interest rate hikes and the subsequent increased costs of capital, Net Lease Cap Rates have yet to show any increases, in fact they now sit at historic lows. Interest rate increases began in April, so we had expected that the effects of this would begin to be reflected in Net Lease Cap Rates in June, however, median Cap Rates in June were in line with the quarter as a whole, coming in at 5.14%.

While overall Cap Rates were down for the quarter, there were a few property sectors that deviated from the averages. Bank properties, which had dropped to an all-time Cap Rate low of 4.81% in Q1, increased to 5.64% in Q2. Drug Store properties, which also hit an all-time Cap Rate low of 5.21% in Q1, increased to 5.71% in Q2. Cap Rates for Drug Store properties currently sit at their second lowest quarterly levels on record. This remains a bit of a head scratcher as Drug Stores continue to face mounting headwinds in the form of direct prescription delivery options and decreasing in-store foot traffic. Auto related properties were the one sector that experienced a decrease in Cap Rates, moving from 5.42% in Q1 to an all-time low of 5.16% in Q2. The Cap Rate lows in this sector continue to be driven by properties offering on site Auto Services such as replacements, oil changes, repairs, and maintenance. Auto Parts stores, which were once the primary driver in this sector, continue to remain flat.

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Q2 2022

Sold Property Data

Median Cap Rate

5.14% (↓25 bps)

Average Cap Rate

5.33% (↓26 bps)

Average Days On Market

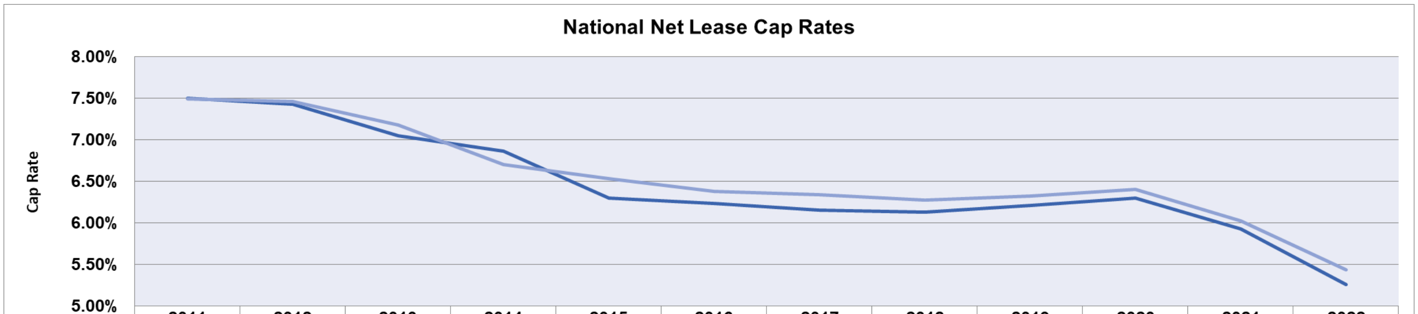
137 Days (↓5)

Average Base Term

11.5 Years (↑0.1)

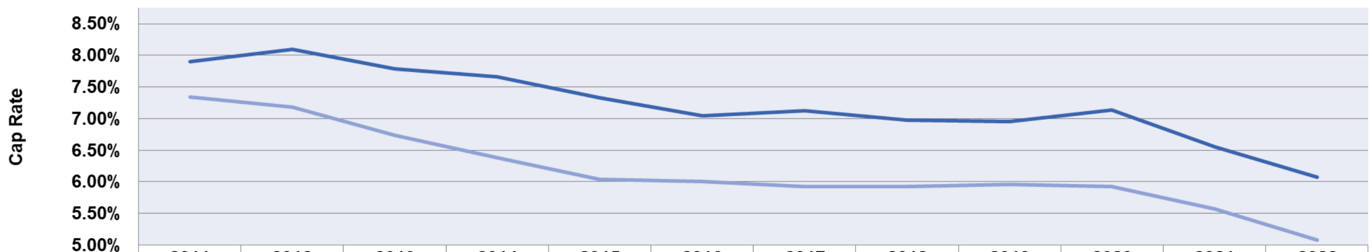
Ask Price vs. Sales Price

2.70% Under Asking (↑4 bps)



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Median	7.50%	7.43%	7.05%	6.86%	6.30%	6.23%	6.15%	6.13%	6.21%	6.30%	5.92%	5.26%
Average	7.49%	7.46%	7.18%	6.70%	6.53%	6.38%	6.34%	6.27%	6.32%	6.41%	6.03%	5.44%

National Average Cap Rates By Term of Lease



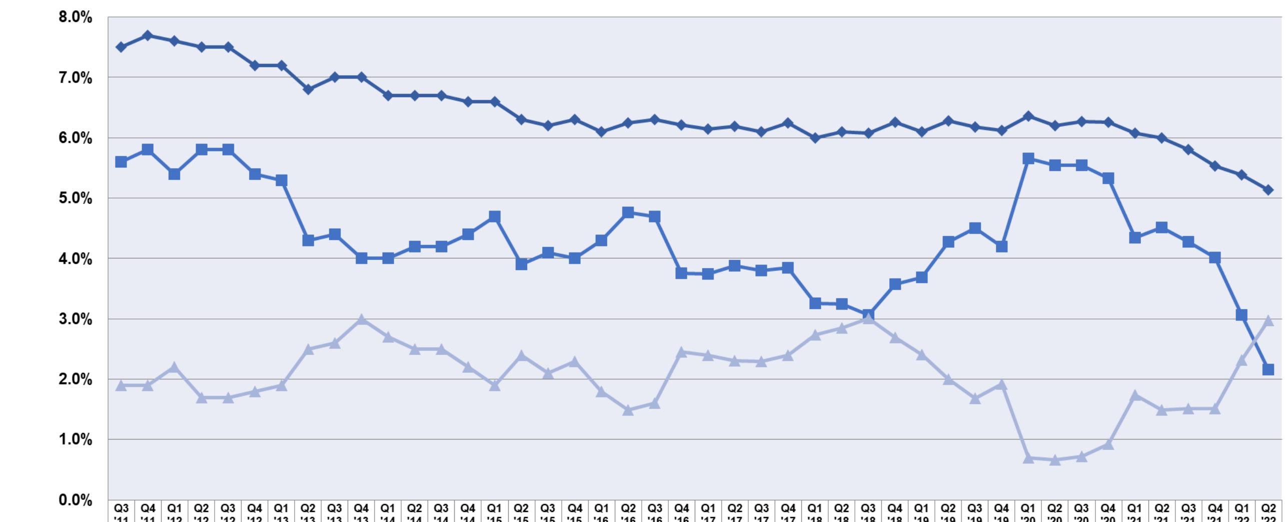
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<10 Years	7.90%	8.09%	7.79%	7.66%	7.33%	7.04%	7.12%	6.98%	6.95%	7.14%	6.55%	6.07%
>10 Years	7.34%	7.18%	6.74%	6.38%	6.04%	6.00%	5.93%	5.92%	5.96%	5.93%	5.57%	5.08%

In Q2, the spread between Median Cap Rates and the 10 Year Treasury was only 2.2%, which was the smallest spread on record. The second smallest spread was 3.1%, which was recorded in both Q1 of this year and in Q3 of 2018. This measure indicates that the general cost of capital is exceeding cap rate returns, creating negative leverage for many investors. The burden of this scenario is lessened when borrowing at lower loan-to-value levels, but nevertheless creates a lower return than would be received in an all cash acquisition. This seems to indicate that there still exists more capital in the market than there is quality product. Another driver is that 1031 exchange buyers continue to trade out of properties with low enough cap rates to enable them to trade into cap rates on replacement property that are at or near historic lows. The spread between Median Cap Rates and the 10 Year Treasury will be an important measure to keep an eye on as we move through the second half of the year.

Investors continue to pay a sizable premium for properties with long term leases. Properties with at least 10 years remaining reached an all-time cap rate low of 4.9%. As costs of capital continue to rise, even buyers of these long term deals could potentially face cash flow challenges down the road.

All markets, including the Net Lease property market, evolve and shift over time as varying demand and supply shifts are magnified by monetary policies and interest rate fluctuations. The resulting market changes usually play out quicker in liquid markets like the stock market, as opposed to sectors with less liquidity, like the Net Lease property market. While the well seems to be drying up for Net Lease property sellers looking to cash in for top dollar, the pendulum has started to shift back in the direction of historical norms. This shift will favor buyers that have been sitting patiently on the sidelines over the past few years, waiting for this correction before making their next move.

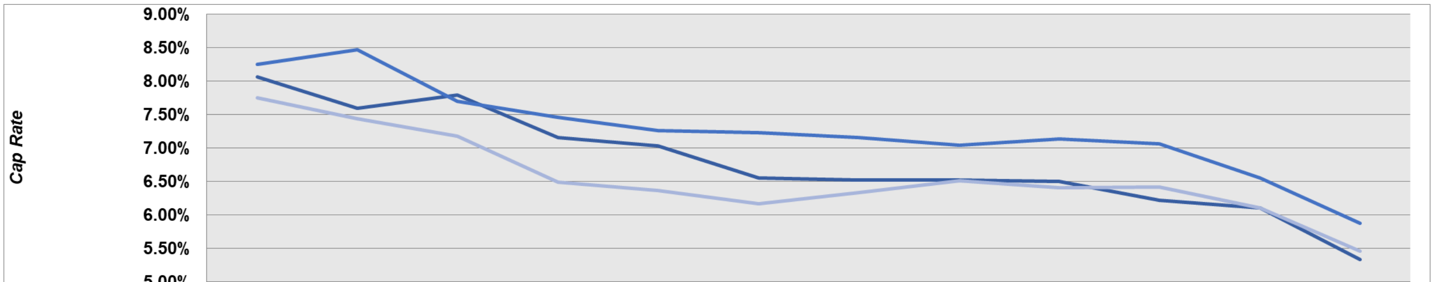
Spread Between Cap Rates & Treasuries



	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
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%
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%
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%

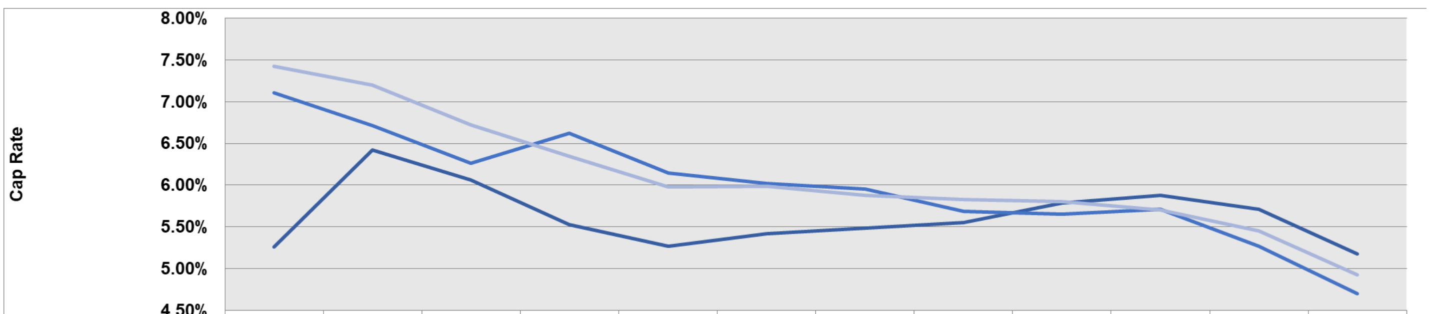
	Q3 '16	Q4 '16	Q1 '17	Q2 '17	Q3 '17	Q4 '17	Q1 '18	Q2 '18	Q3 '18	Q4 '18	Q1 '19	Q2 '19	Q3 '19	Q4 '19	Q1 '20	Q2 '20	Q3 '20	Q4 '20	Q1 '21	Q2 '21	Q3 '21	Q4 '21	Q1 '22	Q2 '22
Cap Rates	6.3%	6.2%	6.1%	6.2%	6.1%	6.3%	6.0%	6.1%	6.1%	6.3%	6.1%	6.3%	6.2%	6.1%	6.4%	6.2%	6.3%	6.3%	6.1%	6.0%	5.8%	5.5%	5.4%	5.1%
Spread	4.7%	3.8%	3.7%	3.9%	3.8%	3.9%	3.3%	3.3%	3.1%	3.6%	3.7%	4.3%	4.5%	4.2%	5.7%	5.5%	5.5%	5.3%	4.3%	4.5%	4.3%	4.0%	3.1%	2.2%
10-Year	1.6%	2.5%	2.4%	2.3%	2.3%	2.4%	2.7%	2.9%	3.0%	2.7%	2.4%	2.0%	1.7%	1.9%	0.7%	0.7%	0.7%	0.9%	1.7%	1.5%	1.5%	1.5%	2.3%	3.0%

Auto Related | Discount Store | Drug Store



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Auto Related	8.06%	7.59%	7.79%	7.16%	7.03%	6.55%	6.52%	6.52%	6.50%	6.22%	6.10%	5.33%
Discount Store	8.25%	8.47%	7.70%	7.46%	7.26%	7.23%	7.15%	7.04%	7.13%	7.06%	6.55%	5.87%
Drug Store	7.75%	7.44%	7.18%	6.49%	6.36%	6.17%	6.33%	6.51%	6.40%	6.42%	6.10%	5.46%

Bank | Convenience / Gas | Restaurant



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Bank	5.26%	6.42%	6.06%	5.53%	5.27%	5.42%	5.49%	5.55%	5.79%	5.88%	5.71%	5.18%
Convenience/Gas	7.11%	6.71%	6.26%	6.62%	6.15%	6.02%	5.95%	5.69%	5.65%	5.71%	5.27%	4.70%
Restaurant	7.42%	7.20%	6.72%	6.35%	5.98%	5.99%	5.88%	5.83%	5.80%	5.70%	5.45%	4.93%

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