Net Lease Properties Maintain Pace

With political and financial uncertainties looming, single tenant net lease retail properties had a strong year in 2017.

Randall Shearin

The market for single tenant net lease properties in 2017 operated in an environment of ambivalence. At issue were the political uncertainty following the election of a new U.S. president along with uncertainty regarding how proposed changes to the nation's tax code would treat investors used to the benefits of a 1031 exchange. Rising interest rates over the past 18 months factored into net lease transactions, compressing yields on properties. All of these elements come into play at a time when retail itself is going through changes, forcing investors to look more closely at not only the real estate and location, but the viability of a tenant for a long-term lease.

"The interest rate increases have had an effect on the industry and the new presidential administration may have had some effect on the market. There is some concern among buyers that we could be heading into a downturn," says Jereme Snyder, executive vice president and a director of the net lease group at Colliers International. "A lot of investors have become more risk-averse. They are leaning toward safety and security and they want options that provide that. Unfortunately, most net lease assets don't fit that box; consequently, these properties have been harder to sell."

While these factors have aided in slowing the velocity of activity in the net lease space, the space is still healthy and transaction volume remains steady. Some brokers report 2017 as a record year. Demand for strong quality assets remains high from investors, and supply of assets remains balanced. Deals are closing — as long as they are priced correctly and sold effectively, meaning that brokers on both sides of the table are earning their keep through negotiations.

Shopping Center Business spoke with more than 20 investment sales professionals and buyers specializing in net lease properties to get their take on the sector's trends and what they mean for 2018 and beyond.

Faris Lee Investments recently arranged the $6.1 million sale of a 14,990-square-foot retail property triple-net-leased to Walgreens in Northglenn, Colorado, 20 miles north of Denver.

CHANGES IN RETAIL

Ten years ago, drug stores and banks were hot properties for investors. While they remain popular, investor interest in them has cooled from its once white-hot level. Why? Banks are beginning to scale back, with more transactions done online. And the drug store sector has seen a lot of uncertainty with the impending Walgreens-Rite Aid merger and other consolidation in recent years. Investors are recognizing that a drug store is dependent on factors like the sales of a supermarket that sits behind it or the impact of another store that sits across the street. Investors are also focused on making sure their property is going to be more internet-proof — and more recession-resistant — than in the past.

"Retail is going through a substantive shift, and net lease is adjusting as part of that," says Jonathan Wolfe, managing partner of Stream Capital Partners.

The changes in retail have made investors perform deeper due diligence on properties than in the past. They want to know that the location is strong, the tenant is strong, and even more so that the tenant in that particular location is performing better than average and has the potential to do so in the future.

"As the retail landscape remains volatile, investors will continue to look at an asset's location, the tenant's credit worthiness, the tenant's physical store expansion and store closure plans across different geographical markets, as well as demographic shifts and whether a particular retailer can withstand and thrive in a strong e-commerce environment for years to come," says Daniel Kukes, co-founder and partner with Landmark Investment Sales.

"The market is still active, but it has softened over the last six to nine months," says Robert Horvath, executive vice president of Horvath & Tremblay. "It is still a very active market for net lease properties, but it is more active in some sectors than others. We are going under contract, then falling out more often now than we were six or nine months ago."

With taxation and political concerns, 1031 buyers have felt the pressure to buy now or, perhaps, look elsewhere in the future. The possibility that the tax code would be replaced with no 1031 like-kind exchange provision had investors concerned for much of the year. It is important to note that the most recent tax bill, as of this writing, did include the Section 1031 like-kind exchange provision.

"Our clients are looking at two main factors — updated tax law and monetary policy with the upcoming Fed changes," says Arthur Kaplan, with the net leased properties group of Marcus & Millichap. "With favorable results, money and investments will continue to accelerate and flow into the United States, with a fresh boost in new construction for single tenant net lease properties, keeping the cap rate tentatively compressed for the near term."

SPERRY
COMMERCIAL
GLOBAL AFFILIATES
THE O'SHEA NET LEASE ADVISORY
OF BRC ADVISORS

Sean O'Shea
Managing Director

Q: What has been the biggest challenge: supply or demand?

A: Supply: Securing truly acceptable spreads, if debt is involved, due to continuing compressed cap rates.

Q: How have buyers shifted their criteria over the past five years?

A: With the sustained lower cap rates, being viewed as 'new normal'; buying "Best-of-Breed" NNN can resume with more confidence. With historically lower cap rates, some escalations, preferably annually, will be a prized component with solid credit.

Q: How active a year will 2018 be?

A: Now that IRC 1031 status has been clarified, going forward, we expect a more rational process. Value accretion will be key due to lease structures.

Advertorial

Change has been constant in the industry, but the types of changes affecting the industry have themselves changed, says Fred Berliner, president of United Trust Fund, who has been buying net leased properties for 35 years.

"Historically, every five to 10 years, the challenges we face change," he says. "There was a period of time when there was no financing available. There was a period of time when interest rates were very high, and a period when they have been very low. Both of those scenarios present their own challenges. In the last five years, the challenge has been sourcing transactions. That is related to the shortage of investments where investors can obtain a yield. With interest rates so low, there is a competition about where to place their dollars. There are not enough quality transactions in the marketplace and there are a lot more people wanting to do them, which drives yields down even more."

PRICING

With a new administration in Washington, there was immediate fear at the end of 2016 that interest rates would rise. Post-election, there was a jump in the Treasury rate, which spooked a number of real estate investors. As a result, 2017 started a little slower than the average year in the net lease sector. As a counter-reaction to that, many sellers lowered prices to spur buyer interest.

"A flood of underpriced properties hit the market early in the year due to brokers reacting to the rising Treasury rates after the election," says Michael Yuras, executive managing director at Cushman & Wakefield. "We advised our clients to be patient and let the supply and demand drive the market, and not act as a 'self-fulfilling prophecy' with pricing. As such, we were able to transact our listings in 2017 at similar, if not lower, cap rates than we experienced in 2016."

Record pricing is still found in many areas, on many top assets. Hanley Investment Group set a number of records for clients in 2017, including one sale in a co-listing with SRS' National Net Lease Group for a McDonald's in Asuza, California, that set a record for a new construction unit for the retailer, achieving a 3.25 percent cap rate. The company also set records for 7-Eleven and Rite Aid in various areas.

"Buyers continue to pay premium yields in the 4 percent to 6 percent range, unleveraged, and even some 4 percent in supply-constrained markets in California for tenants such as 7-Eleven, Chick-fil-A and Starbucks," says Jeremy McChesney, executive vice president of Hanley Investment Group Real Estate Advsiors.

He adds, "This single tenant category will be the last to see price adjustments as most buyers are acquiring these hard-to-find assets will all cash. However, we are seeing cap rates starting to push up in the secondary markets where retail single tenant properties with regional or local tenants might transact closer to a 7 percent or 8 percent cap rate."

While cap rates remain low for high-quality, well-located new construction projects, there is some movement on assets that will face challenges from e-commerce and the shift in retail's fundamentals.

"We have seen a slight shift in cap rates as interest rates have risen, and e-commerce pressure on big box retailers has increased," says Kukes. "Just as in the first quarter of 2017, we expect there to be continued volatility in the retail sector as certain retailers will undoubtedly file for Chapter 11 bankruptcy in the first quarter of 2018 after the holiday season. This will be followed by underperforming store closures and potential large-scale company liquidations altogether."

"The interest rate environment and net lease pricing go hand-in-hand, although not necessarily in immediate terms," notes Alan Pontius, senior vice president and national director, specialty divisions at Marcus & Millichap. "The marketplace is sophisticated enough to recognize that a short spike in interest rates may not be a trend and things can settle down. Pricing isn't quite in lockstep with short-term movements in rates. Generally speaking, transaction velocity and yields have been relatively flat during 2017."

As with all real estate, top location and credit will win the race in the long run.

"We see cap rates for quality assets remaining low as there continues to be a flight to quality," says Chad Adams, principal of Patriot Equity Partners. "As the retail landscape evolves and some companies feel the negative financial impact, they lose momentum with both shoppers and the country's most active net lease investors. These changes are happening fast and, in return, this gets us back to what we saw several years ago in the net lease market. One of my partners referred to supply in the form of either 'trophies or train wrecks.' The trophies create demand and, in return, continue to trade at all-time low cap rates. The train wrecks will be substantially more difficult to trade, but will eventually find a home. History has shown investors rationalize risk as they look to achieve higher yields."

Hanley Investment Group arranged the sale of a new single tenant absolute net-lease Rite Aid in Menifee, California. The purchase price was $9 million, which represented a cap rate of 4.72 percent.

Due to interest rate concerns, as well as supply and demand fluctuating, pricing has been difficult to pin down and buyers have been slower to find the properties and deals that fit their needs. As a result, brokers have had to work harder for clients on the buy side and sell side.

"Price adjustments happen on a regular basis across the sector," says Horvath. "There are fewer buyers on the market today than there were six to nine months ago. As a seller, and as a broker, you don't have the leverage you once had. You have to be cautious how you position assets and who you select as a buyer."

Pontius adds, "Clearly, investors do not have the leverage of a yield environment that is expanding," says Pontius. "Conversely, the industry continues to face questions about the overall dynamic of retail, especially the online versus bricks-and-mortar world. Yield expectations in the marketplace have been pretty flat. Liquidity has remained high; you simply have a flat volume market."

SUPPLY

Supply of single tenant net lease properties is bifurcated based on the quality of the retail. The supply of older net leased properties, with less term remaining on the lease, is strong, as is the supply of certain sub-classes like dollar stores and banks that are out of favor with some investors.

"There is a lot of supply coming on the market," says Horvath. "There is an oversupply of certain asset classes, like the dollar stores and drug stores. Good deals in the market are still limited. Those well-located, well-positioned assets with good credit are still moving well."

Snyder of Colliers International agrees: "Banks, drug stores and dollar stores are hard to sell these days."

Meanwhile, the supply of net lease retail properties that have strong credit tenants in top locations has been constrained by slow retail growth and cautious site selection by retailers.

"Lack of supply has been one of the problem areas for several years," says Ian Harrison, vice president of AEI Funds, a buyer of net lease properties. "In the past year, as some retailers have failed and others have smartly halted store growth, supply in the marketplace is at an all-time low. The pipeline of new development is limited to a short list of retailers, restaurants and gas/convenience stores. The latter two segments are trading quite aggressively."

Horvath notes that properties selling quickly include convenience and gas stores, quick service food locations, and lower price point drug stores and urgent care centers. New development, in particular, is always of interest to buyers who want to know the property will be around for a long time. Buyers of newer properties are also taking their time and doing their due diligence to make sure the retailer's business model is fit for the full term of the lease.

"Investors want to understand the retailer's business model," says Wolfe. "Whether a company is public or private, they want to know if they see a future with that retailer."

While some product types may be out of favor, that doesn't mean that they are not moving off the market. What is a contrarian play to some investors may be a winner to others, and taking a risk on a location can have its rewards.

"Dollar stores are still moving very well, even in the middle of nowhere," says Glen Kunofsky, founder and chairman of the NNN Pro Group and senior director of the national retail group and net leased properties group at Marcus & Millichap. “We sold 161 in 2017. It becomes a risk versus reward; if the real estate is weaker, the investor will want a higher return to take that risk.”

With retailers vetting locations and doing more due diligence than ever to justify a new location, new construction today is considered more valuable than in the past.

“We have been selling brand new development very consistently,” says Snyder. “Why? You have new long-term leases. You have new construction so there are no concerns about the building having issues. You have typically strong financials for the tenant since they are in an expansion mode. And you have perceived safety and security with those fundamentals. The only factor you don’t have is sales history since the store is new.”

Meanwhile, many investment sales professionals feel that now is a good time to be a seller in large part because of the constrained supply for top credit retail locations.

“Inventories have increased; many landlord/investor/owners wish to take full advantage of the low cap rate environment,” says Sean O’Shea, managing director of BRC Advisors/The O’Shea Net Lease Advisory. “The result has been magnificent for sellers and challenging for buyers, whether they are tax motivated in a 1031 exchange or simply investors looking for stable, predictable income streams.”

New supply in the industry is also being created from older properties by renewing or extending lease terms. That is creating a strong supply, especially for locations that have a record of healthy sales.

“The majority of the supply of new single tenant net lease retail is a result of the restructuring of the existing tenant leases,” says McChesney. “The leases have been renegotiated or extended in order to increase the value of the property. Redevelopment of functionally obsolete buildings located on quality real estate has also contributed to the increase in supply.”

It has also become more common in the industry for sellers shedding A-quality assets to buy one or more B-quality assets, lease or re-lease the location and renovate the property. These value-add properties have a larger yield than some A properties, even though there is an upfront capital expense needed for renovation or reformatting.

"Existing owners are 'trading up' by buying B/C properties after selling their A properties to get a higher return due to all the work typically needed to clean up the leases and renovate," says Kaplan.

Kunofsky and his NNNPro Group recently sold a portfolio of Burger King locations in California. The seller, who will likely see sub 5 percent on the cap rate of its properties, is seeking to acquire properties with the proceeds where the cap rate will be around 7.5 percent.

DEMAND

Demand has remained steady for single tenant retail properties throughout the past few years. Sales volume for single tenant net lease retail has been steady throughout 2016 and 2017, according to Real Capital Analytics. In 2015, the industry had a remarkable year, with sales totaling more than $20.2 billion; 2016 saw that volume drop to approximately $15.1 billion. The first three quarters of 2017 saw just over $11 billion in sales in the sector, about $1 billion over the same three quarters in 2016.

"Demand for net lease properties is going to continue to be strong," says Wolfe. "The 1031 market is still very active, and the 10-year Treasury today is strong. Investors are still yield-starved so net lease is still a good place for investors to put their capital."

The sale of this 4,411-square-foot McDonald's in Atlanta was recently brokered by Faris Lee Investments.

Like supply, demand varies by subcategory within single tenant net lease retail. There is a strong demand on the top end of the market for properties that are newly built with long terms on their strong credit leases. At the same time, there is demand for assets that can be repurposed or where the lease can be restructured due to strong performance of the property. In the middle sits underperforming retail, or properties whose future is uncertain in the eyes of investors. These include areas like pharmacies, some categories of restaurants and retail that may be vulnerable to e-commerce. Drug stores, once a darling of the industry, have scared some investors because of the prolonged merger of Walgreens and Rite Aid.

"Pharmacy has been out of favor in the last 18 months, simply due to the Walgreens and Rite Aid merger," says Rick Chichester, president and CEO of Faris

ENVOYNNN

Ralph Cram
President

Q: With cap rates rising slightly, have you altered your investment criteria, or changed the assets you are acquiring?
A: As a lender to net lease developers, we focus closely on the developer's initial profit margins on each transaction. With construction costs increasing and cap rates rising slightly, developer profits will be under pressure next year. Therefore, having an adequate profit margin going into the transaction prevents developers from becoming "upside down" on the project and thus defaulting on our loans to them.

Q: Is it challenging to acquire properties in this market? What strengths does your company have in acquisitions?
A: Our core strength is that we can provide more proceeds than the average community bank, thus reducing the need for outside equity. On a weighted cost of capital basis, our high-leverage construction and bridge loans are less expensive than a lower-cost but moderate leverage bank loan combined with JV equity partner requiring back-end profit participation. What makes us different on the JV equity side is that we are generally more willing to fund equity for properties of newer companies and concepts, or for special situations, than many of our competitors. We also focus on smaller properties of less than $10M, which is usually too small for most institutional partners. Unlike many HNW and family offices, our sole focus is on net lease real estate. We understand the market, and have made informed and firm funding commitments on 39 net lease transactions over the past three years. During our history, we have closed on all the term sheets that we have issued where the developer was able, willing and prepared to close.

Q: What do your investors expect from your firm?
A: No loan defaults and higher return on their short-term (less than 24 months) investment than other short-term real estate investments.

Q: What are your predictions for 2018?
A: We anticipate that higher construction costs, especially interior finishes, are going to put upward pressure on rents or downward pressure on profit margin. Saying that, we expect strong demand to continue for new properties with long-term leases from the right tenants. We also expect to see more high net worth investors looking at smaller medical net leased properties to reduce the risk of "Being Amazoned" over the term of the lease and having their tenant go out of business. The good news is that the tax reform bill keeps the 1031 tax free exchange unchanged for real estate assets. If it survives, the 1031 tax code provision should survive until the next administration change.

ADVERTORIAL

Lee Investments. "What wasn't known then has crystalized as to what will remain Rite Aid and what will remain Walgreens. Another factor for the pharmacy space is Amazon's potential impact. I expect that 2018 will be more active in this category with more clarity among the three big pharmacy brands."

The threat of e-commerce sales encroaching traditional retail location, while not a concern for seasoned investors, has made some investors wary of certain property types. Buyers are looking for tenants who have a strong history, or a resistance, to e-commerce.

"We have seen strong demand for discount soft goods tenants such as Burlington, Ross Dress for Less, TJ Maxx, dollar stores, as well as non-retail uses such as gyms, theaters, entertainment businesses and quasi-medical assets like dialysis, plasma, transfusion and physical therapy centers," says Kukes.

"The preferred property types for buyers remain quick service restaurants (QSR), automotive parts, pharmacy, dollar stores and grocery," says Chichester. "Big box single tenants are out of favor to the passive investor. In some cases, QSR is less favorable because we've seen a lot more risk in the restaurant business and certainly some fast casual restaurants are being challenged."

"In the course of 2017, things were rather frozen in place for a long time," says O'Shea. "That didn't mean that people weren't completing transactions, but they were not completed in the same velocity that was expected." He noted that some buyers were playing catch up at the end of the year.

Uncertainty regarding the inclusion of a 1031 like-kind exchange provision in the new tax code was one factor that played into the volume of demand in 2017. And there was some anxiety among 1031 investors as to whether the rule would be revisited by legislators again if a reform failed to pass. As Congress passed the tax reform act in December, it did include a 1031 provision.

A big factor limiting demand for net lease in the last 18 months has been the plateauing volume of transactions in the multifamily business. Many 1031 transactions are done by individuals exchanging multifamily properties for net lease retail properties, as they seek more passive investments.

"Cap rates have gotten aggressive on multifamily properties, and a lot of buyers in that sector just can't make the numbers work," says Jon Hipp, CEO of Calkain Companies. "There's no question there's been a slowdown in exchangers from multifamily, but it seems like we've gotten an uptick from those exchanging farm land. That has generated some large exchanges in the market. Older industrial properties are also hot; those two have really taken over where multifamily was."

"We are still seeing private investors exiting from management-intensive investments and moving to purchase single tenant net lease assets to eliminate landlord responsibilities," says McChesney.

"However, they are approaching the purchase of single tenant retail assets with more caution than we have seen in the past."

Institutional buyers have continued to purchase at a regular pace. Their negotiating strength is the fact they are generally purchasing with cash and are able to close quickly. Institutional investors tend to know the market well, and will wait for the right property rather than join a feeding frenzy over an asset.

"We are patient," says Harrison of AEI Funds. "Many of our competitors, including the 1031 market, cannot afford to be so and, as a result, discipline tends to wane. This lack of discipline could come back to bite in years to come."

"Institutional buyers are still sitting on a ton of cash," says Hipp. "Some of them have recycled capital by selling assets and creating cash; they are looking to place that money in properties. Most institutional buyers want to purchase properties with cap rates in the high 6s to 7.5 percent."

Hanley Investment Group completed the sale of a new Popeyes with a drive-thru, which opened in April 2017, in Perris, California. The purchase price was $2,380,000, representing a cap rate of 4.41 percent, a record-low cap rate for a single-tenant Popeyes located in the Inland Empire.

For some institutional investors, moving from retail to more single-tenant user facilities has been the answer to filling demand. United Trust Fund continues to find strong companies who are one-of-a-kind to provide capital for build-to-suit investments.

"We might go a little further down the credit spectrum than we would have done years ago, given a stronger quality real estate," says Berliner of United Trust Fund (UTF). "What we look at is how we are going to repaid, in terms of our return. We want to be able to get our principal back at any given time. You do that with quality real estate, because that continues to appreciate over time."

UTF recently helped build a new headquarters for lettuce producer Taylor Fresh Foods in Salinas, California. While that is not a top location, with a 20-year lease in place, UTF felt comfortable because the company has a strong history and bright future.

"With some retail, there is a lot of fear of e-commerce and that you may have a lot of empty boxes," says Berliner. "We are a little more cautious with retail today. We're selective in certain areas of retail. We still think there is a place for some retailers, but not all of them."

There is much excitement among brokers that a number of capital players are eyeing the single tenant net lease sector.

"The institutional side of our business continues to evolve and is gaining interest

CALKAIN
AMERICA'S NET LEASE COMPANY®

Andrew M. Fallon
Executive Managing Director

Q: What has been the biggest challenge: supply or demand?
A: The biggest challenge in 2017 has been supply — not to say there isn't a lot of supply of net lease in the marketplace. In fact, there are more net lease assets marketed for sale now than there were 5 years ago. The asset class has become more mainstream and owners have been listing more properties given the increase in asset valuation. The difference between then and now is the quality of the asset available and the supply is limited for high quality assets. We've seen fewer brand new build to suit deals and ground lease assets based on retailers being more selective on locations and site criteria.. The majority of what's been available and trading in 2017 are second generation properties that have shorter lease durations. These are now being recycled back into the marketplace. Demand remains very strong from all buyer profiles including private capital, 1031 exchanges and REIT/institutional investors. As a result 2017 volume was strong and right in line with the record number of transactions we saw in 2016.

Q: Within retail, what assets are most readily available? Do they line up with buyers' expectations?
A: In terms of new construction, dollar stores are the most readily available retail assets in the net lease space today. Dollar General's growth plans are to open 1,000 stores a year. As a result, there are hundreds of new dollar stores available as preferred developers build and sell these assets. At any given time, there can be 500+ dollar stores available for sale.

Given the fact that the Dollar Generals are brand new construction, with a passive 15 year NNN lease, they meet the demand of many private capital and 1031 exchange buyers. However, there is a disconnect based on the fact that dollar stores are typically located in secondary and tertiary markets. While they offer investment grade credit and favorable lease terms, they don't always satisfy buyers' expectations and requirements in terms of quality of real estate and intrinsic value of the location. For this reason, dollar stores generally trade at higher cap rate in the 6.5 to 7% range. Buyer's expectations need to be adjusted when they are seeking high quality assets with long-term NNN leases in the primary markets.

Q: How active a year will 2018 be?
A: The net lease market peaked in 2015 and leveled off in 2016 and 2017 with record transaction volume both in number of deals and total volume. We expect this to continue in 2018 and are planning a very active year in the net lease space. We'll see an uptick in activity where shopping center owners are capitalizing on the current values of pad sites and outparcel ground leases — a trend we expect to continue given the compressed cap rates in the net lease space versus the blended cap rate for an entire shopping center. The limited supply of high-quality assets will continue to drive pricing and valuations.

ADVERTORIAL

from many of the country's largest asset managers seeking a steady return," says Adams of Patriot Equity Partners. "Every few years, there seems to be a new type of institutional investor entering the market and adding diversity to the buyer pool. The evolution on this side of the business has gone from limited partnerships, publicly traded REITs, non-traded REITs, TICs, DSTs and today we are seeing an ever growing interest from private equity. This type of investor will likely be the next big player in net lease due to their sophistication and financial fortitude to invest in all aspects of net lease, including developer equity, reverse build-to-suit, long-term ownership and large corporate sale-leasebacks."

The slowdown has occurred with individual investors seeking net lease properties. Compressed cap rates combined with rising interest rates have impacted the yields that investors can obtain. One broker says he has even advised clients that unless they are tax motivated, it will be difficult to achieve an acceptable return.

"Many buyers look to the past and say they must have a 7 percent or 8 percent return," says O'Shea. "That is probably not going to happen in the short term."

"Investors today are trying to evaluate what their credit profiles are for tenants: What is this concept as it relates to online risk? What kind of physical location do I have?" says Pontius. "The higher the quality of real estate, the more re-leaseable the asset is itself and the more interesting the asset will be to the continued evolution of concepts who will want that space."

BROKERAGE

With the challenges ahead, and the market as it is at the present time, having a strong, experienced broker pays off. Negotiation is where a lot of the margin in a deal will occur.

"You want to position your asset so that the broad-based market reacts; you don't want to be waiting for a purple squirrel to come buy your property. Understanding the market and properly underwriting the assets, as well as properly positioning a property for sale are paramount in today's environment," says Horvath.

Hanley Investment Group arranged the sale of a single-tenant corporate MedExpress urgent healthcare center in Battle Creek, Michigan. The 4,716-square-foot building is situated along one of Battle Creek's main retail corridors.

With supply limited and with some supply unfamiliar to return buyers, brokers have had to educate investors on new retail concepts, show evidence of the viability of locations and provide proof of a retailer's long-term viability. Brokers representing sellers have had to justify pricing and closely watch market comps asset by asset; net lease has become a localized business where one corner can be more valuable than the next.

"Brokers have had to work a lot harder in the past year," says Snyder. "We focused heavily on market comps and sales comps. We presented a lot of data to clients so they could make a more educated and informed decision regarding their deal. You have to be right on target with price. If the market is at a 6 percent cap rate and you price your deal at 5.75 percent, you may get no interest. You price it at 6 percent and the offers come. The margin for error has been reduced. Clients understand this and they have priced more conservatively for properties to move."

Knowing each buyer's and seller's desired outcome – rather than simply a return figure – is also paramount to brokers. They are no longer simply charged with selling a property or finding a property; there is much more involved in a deal today.

"The fundamentals sought by buyers are primarily determined by their investment objectives," says Philip Wickstrom, managing principal of The Net Lease Group. "Buyers seeking to maximize their return may prefer net lease properties with shorter remaining lease terms, various landlord responsibilities or less creditworthy tenants. Buyers seeking to preserve wealth and achieve stable, predictable income will prefer tenants with investment-grade credit ratings, longer remaining lease terms and minimal to no landlord responsibilities. Buyers seeking net lease properties with tax advantaged structures may prefer properties that are or can be highly leveraged, have minimal or no free cash flow and at least 15 years of remaining lease term."

Being a broker today means doing a lot of legwork, no matter how simple a transaction may seem, say investment sales specialists.

"Many brokers know the math, but not the equation," says Matthew May, president of May Realty Advisors. "They can give you the cap rates of any retailer across the country. But to know the equation, you have to understand a specific location of a specific retailer."

May recently had a deal he was working on for a drug location in Ohio for a client. The sales history was strong and the location appeared, on paper, to be great, located in front of an automobile manufacturing plant. In his due diligence, he discovered the auto manufacturing facility would be closing in the next year, taking with it a lot of business to the drug store.

"A broker needs to dissect the real estate and understand the retailer – how are they doing, what are the comp sales, is this retailer growing, what are they projecting, what is their history and where are they in the cycle?" says May. "If you don't understand retailing to its core, you cannot in good faith represent a property to your client."

As retail evolves, investors are evolving to understand the assets they are buying. Whereas a few years ago they were concerned with parking cash in net lease

Landmark Investment Sales arranged the sale of an OptimEyes location in Clinton Township, Michigan.

properties for steady returns, that has changed with the times.

"Investors have to remember that single tenant net lease retail is real estate, and real estate is not a commodity," says Chichester. "You can't assume that the tenant or rent is predictable throughout its term. A property is either 100 percent leased or 100 percent vacant. Investors have to know the fundamentals of the real estate and strength of the tenant, and whether the terms of the lease are appropriately valued."

Many brokers are expecting 2018 to be similar to 2017 — slow but steady. In a rising interest rate environment, investors will be cautious about the properties they buy, especially in a period where retail is changing.

"There will be some volatility with waves of demand in the market," says Snyder. "Overall, I think transaction volume will be down, but there will still be demand for properties. It takes time for buyers' expectations and sellers' expectations to meet."

"The supply and demand fundamentals and interest rate indices continue to favor sellers," says Yuras of Cushman & Wakefield. "With that said, we believe that broker expertise and attention to detail will be a major factor in maintaining pricing."

SCB

Join *SCB* for InterFace Net Lease West, February 27 at the Omni Los Angeles Hotel. For more information, visit www.interfaceconferencegroup.com/nlwest2018