Net Lease: New Highs

The net lease retail sector saw new records in 2014, with many anticipating 2015 will be an even better year. From new supply to deal velocity, here is what is happening in this booming sector.

Randall Shearin

Drug stores, like this Walgreens recently sold by The Net Lease Group, are a tough commodity to come by. Buyers seeking properties with top credits in primary markets can expect to pay top dollar, say experts in the net lease sector.

Compressing cap rates and continued tight supply are keeping the market for single tenant net lease properties extremely active. Many net lease investment brokers finished 2014 on a high note, and many expect 2015 to be just as good or even better. Buyers of single tenant net lease properties are constrained by supply, but that hasn't stopped the market from being active as re-sales and some new product edge into the market. The net lease market is considered a stable core investment in an age where keeping cash parked in traditionally stable investments — like bonds — is nearly impossible for most investors due to low Treasury rates.

Large buyers — both REITs and equity funds — have transformed the net lease sector from a cottage industry within retail to a sector with the largest deal velocity in commercial real estate over the past few years. Ten years ago, the sector was dominated by drug store and bank branch transactions; today it is far more diverse. Along with drug stores, the most popular retailers today include auto parts stores, discount dollar store retailers and quick service restaurants.

Investor demand in the sector has outpaced supply. This has led to many larger buyers paying premiums for the few top properties that come to market, and many smaller buyers changing criteria to find properties that fit their needs. Many sources say the industry has developed a bifurcated buyer pool: those looking for transactions over $5 million, and those under that bar.

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This article originally appeared in *Shopping Center Business*, January 2015.

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NET LEASE ARTICLE EXPERT SOURCES

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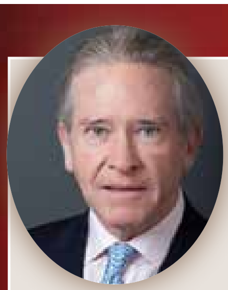

Sean O'Shea
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The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Yes, but with the compressed cap rates and limited spread on debt rates, there is a higher barrier to entry for private investors (since their cost of capital is higher than the funds). It is a daily challenge. Securing acceptable assets with 10-plus-year base terms with non-recourse debt, when available, is a challenge. Investors 'seeking yield' have had to establish a series of 'trade-offs' — not all NNN assets are equal.

Have your clients changed criteria for the properties they are seeking? How?
Yes, out of necessity. We often advise our clients they may wish to refine their short term and long term objectives. Sometimes, the credible residual valuations can allow an investor to reconcile the current cap rates with a stable, predictable income stream and balance it with future believable revenue streams; not merely based on 'broker pro-formas.' I say that with apologies to our friends in the brokerage business.

Does location play as much of a factor as it used to?
Candidly, that depends to a significant degree on tenant credit and corporate guarantees to mitigate the location risk. It really depends on the client's holding period and investment horizon. Secondary and tertiary markets have been in play for a number of years now. However, the spreads are much slimmer than ever. Risk is not properly priced into many offerings in this tight market.

With supply constrained, what properties are must-haves for investors?
We craft client-specific net lease solutions, whether time-sensitive 1031 replacement solutions, portfolio reallocations, or a diversification into net lease properties as a bond alternative. Increasingly, we find that 'not all net lease properties are equal.' Our 63,000+ NNN database allows both buyers and sellers the market intelligence for their best investment decisions. So, in addition to 'location, location, location,' we would add tenant credit, corporate guarantees and lease structure with scheduled increases as critical data points.

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Patrick Luther
Managing Director,
Faris Lee
Investments

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
While institutional investors do represent the bulk of the transactions by dollar volume, the asset class as a whole remains highly suitable for individual investors. There are distinct segments of the net lease marketplace that are passed over by institutional investors, offering opportunities to the individual. For example, assets priced below $2 million are generally not favored by institutional investors, as their cost structures make one-off transactions more expensive. The market is extremely efficient at and under the $2 million price point, the buyer pool is large for assets priced in this range, and debt is readily available from local banks for qualified private investors. Additionally, institutional investor underwriting criteria is far more stringent than that of private investors.

Have your clients changed criteria for the properties they are seeking? How?
The velocity and liquidity in the marketplace, combined with lack of available inventory has affected acquisition criteria for all investor profiles. The obvious change is in yield expectations. The most common set of requirements from our private investor pools includes a 10+ year lease, a 6.50+ cap rate, and a national brand or credit in a major metro. Achieving all of these metrics is, in general, simply not possible in today's market — so the conversation becomes one of what that investor is willing to sacrifice. In addition to changing yield requirements, we have seen more openness to tertiary markets and general geographic preference.

With supply constraint, what properties are must-haves for investors?
Across our inventory of 60+ single tenant assets, the restaurant category — specifically quick service restaurants (QSRs) — receives the greatest interest in terms of offers received. Restaurant leases traditionally offer rental increases either annually or at least every 5 years. The result, in a low cap rate environment, is investor interest in rent growth, in exchange for tolerance of a low going in yield. Drugstore, dollar store, and auto parts store leases, which are in general without increases until the option periods, are incredibly susceptible to interest rate risk. Additionally, the restaurant segment is far easier for a private investor to understand — they see the concept during business hours, they purchase the product.

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Increased Interest

The net lease market is heated because it has long been considered a safe, dependable place to safeguard money and earn a return with little to no management concerns. Net lease deals used to be for prime corners in prime markets. Over the past few years, they have become attractive to a larger audience of retailers, and a much larger pool of investors.

"Net lease is its own asset class, not just a subset of commercial real estate," says Patrick Nutt, managing partner of Reston, Virginia-based Calkain Cos. "The institutional side of the business has made the general public knowledge that every Walgreens is not necessarily owned by Walgreens. It has gone far to educate the average consumer that this product type exists. Yes, they too can buy a building that is leased to a national or regional tenant on a long-term basis with a passive lease."

The net-net-net nature of the lease structure, where lessees are responsible for almost every conceivable expense, translates to win-win-win for an owner looking to earn a predictable return.

"There are a lot of baby boomers who have created an enormous amount of personal wealth, and they are now reaching that milestone in their lives where it is about wealth preservation not wealth creation," says Nutt. "A high net worth individual in their 50s might have been willing to take more risk if they wanted a higher return. In their 60s or 70s today, they are not worried about growing their overall net worth as much as they are about creating consistent cash flow and preserving their net worth."

While net lease retail properties used to appeal to those savvy high net worth investors who had a real estate background — an apartment complex owner seeking to retire, for instance — they have now become more popular with those who realize there is little difference between owning a net lease building or a publicly traded bond.

"Single-tenant net lease retail is a safe-haven investment," says Johnson. "Non-institutional investors tend to gravitate to

Calkain Cos. recently sold this Chase Bank branch in Jacksonville, Fla., for $3.9 million, representing a 4.1 percent cap rate.

Robert Bender
Managing Partner,
Fortis Net Lease

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
There is still ample room for the private investor. Saying that the single-tenant net lease (STNL) market is dominated by any particular buyer class is going too far. Even though it is true that large funds and REITs have aggressively acquired thousands of assets the overall supply of credit worthy properties remains at healthy levels. Total demand has certainly risen however, with the right goals in mind, it is still easy for our private clients to acquire properties of their choosing.

Have your clients changed criteria for the properties they are seeking? How?
We have always asked our clients to select the highest quality locations and tenants while weighing the risk vs. reward factors. Certain macroeconomic factors will always play a large part in which tenants we recommend at any particular time however, the net lease market remains a location and credit play above all else.

Does location play as much of a factor as it used to?
Yes, and it always will (for the vast majority at least).

With supply constrained, what properties are must-haves for investors?
That answer entirely depends on the client's goals. If the acquisition is for estate planning then location and long term appreciation are usually of primary concern. If the property is being selected to provide free cash flow then cap rate becomes more important. Each client has their own needs and their own goals. Good brokers simply provide a path to help them realize those aspirations.

What types of properties are popular with buyers?
The usual suspects (Walgreens, Dollar General, Advance Auto, etc.) remain in high demand. With that said, credit leases with rent escalations are becoming more rare and are always highly sought after.

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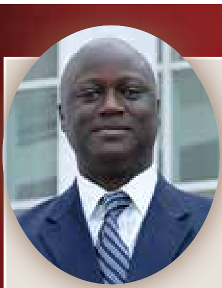

Esmael Hill
Managing Principal
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Philip Wickstrom
Managing Principal
THE NET LEASE GROUP

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
The net lease market has been dominated by REITs, funds, and institutions recently, especially with respect to portfolio offerings. However, NLG's experience working with individual investors to acquire single assets has shown that individual investors can compete with large funds and institutions to acquire net lease assets of all types and credit qualities. This is evident by the current surge in 1031 exchange buyers entering the market across the country.

Have your clients changed criteria for the properties they are seeking? How?
Our clients' investment criteria has remained consistent, but we do see a greater emphasis placed on tenant quality and credit than we did in past years.

Does location play as much of a factor as it used to?
Yes. Due to the latest economic downturn, investor scrutiny and focus on demographics, performance metrics and residual value remains consistent despite limited supply, increased competition and cap rate compression in the current market.

With supply constrained, what properties are must-haves for investors?
Must-have properties include properties occupied by credit-worthy tenants, located in primary or secondary markets with strong demographics and strong unit-level performance metrics.

What types of properties are popular with buyers?
Drug stores, quick service restaurants, auto parts stores, bank branches, distribution centers, grocery stores, freestanding big box retailers, convenience stores, and medical uses.

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Starbucks Coffee has been opening new stores, creating some new supply for the market. Pictured is a location recently sold by The Net Lease Group.

the sector because of the 'sleep-at-night' factor that a high credit, long-term leased property provides."

For those who want even less worry, they can invest in one of the many REITs or private equity funds that now dominate the single tenant net lease sector.

"Investor appetite for the stability and yield of net lease properties continues to be very strong," says Joey Agree, president and CEO of Bloomfield Hills, Michigan-based Agree Realty Corp., one of the larger REITs in the net lease sector. "Net lease REITs comprise approximately 7 percent of the MSCI U.S. REIT Preferred Index today, up from 3 percent just two years ago. The sector, as well as Agree Realty, are both on the radars of institutional as well as individual investors."

Passive investors — who choose to invest in the net lease sector through private equity funds or REITs — are often so intrigued by the success of the sector that they begin investing directly in properties, report a few brokers.

"Many passive investors thought their way of diversifying their overall portfolio and owning real estate was to buy REIT shares," says Nutt. "Rather than spreading $1 million across three to five REITs, they are investing that money in a Wendy's, McDonald's or Dollar General."

Recent Activity

Net lease is a sector whose fundamentals follow supply and demand. Supply can be created through new development or the resale of existing properties. Transactions are the lifeblood of the sector, which, like many others in commercial real estate, uses capitalization rates (cap rates) as its barometer. Net lease brokerage companies, which are on the forefront of activity, saw another year of improving business in 2014. Many brokerage groups report that 2014 was their best year since 2007, which heretofore had been the top volume year for the net lease sector. Many even reported breaking their ceiling that was set in 2007.

"In 2014, we've come back to 2007 levels," says Bernie Haddigan, senior managing director of CBRE's Capital Markets Group. "2007 was the peak of the last cycle. Transactional velocity in 2014 appears to be almost at 2007 levels. It was a great year for everyone in the business; brokers are busy, developers are busy."

"With a relatively small team, we managed to close more than 200 transactions, with 406 transactions in total from 2013 through 2014," says Doug Passon, managing partner with Fortis Net Lease, based in suburban Detroit.

On a recent day at Marcus & Millichap, the company's inventory showed approximately 500 single tenant net lease properties available for purchase. Sample properties included Wells Fargo bank branches, Arby's restaurants, LA Fitness gyms, Dollar General stores and Mattress Firm locations.

"2014 was another exceptional year in the net lease space," says Bill Rose, national director of retail for Marcus & Millichap, the largest investment sales brokerage in the net lease retail space. "We exceeded our 2007 zenith."

Bernard Haddigan

Senior Managing Director,

CBRE | Capital Markets

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Absolutely. While the large fund owners are receiving much of the press, 90 percent of the transactional volume is still purchased by wealthy individuals and partnerships.

Have your clients changed criteria for the properties they are seeking? How?
The market is more sensitive to risk/return estimations. With the significant flight to lower risk returns, prices have been driven up on the perceived lower risk opportunities. This gives rise to those investors looking for outsized returns through their assessment of credit, shorter lease terms, residual value and quality of location.

Does location play as much of a factor as it used to?
Very much. There is a wide range of capital domestically and internationally looking for safety of sustained return. The properties with the best locations have always had the least amount of replacement rent risk and therefore remain highly coveted.

With supply constrained, what properties are must-haves for investors?
By price point, the under $5 million space is on fire. There are many all cash and low leverage buyers in this space. By location, coastal and southern states are very coveted and by lease length, those with at least 15 years of remaining term are actively sought after.

What types of properties are popular with buyers?
Urban infill and high street locations are highly sought after with the broader trend of millenials returning to the cities. Necessity based properties such as food, drug and medical are also very much in demand. Generally, there are buyers for almost any of the net lease offerings in the market. The issue will be pricing as it relates to the markets' perception of risk and how the asset is analyzed and presented to the expanding marketplace.

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Quick service restaurants have become popular among net lease investors. Pictured is a Dairy Queen unit sold in 2014 by The Silver Group.

Cap rates for properties, determined by sales price, tenant credit, location and other factors, have continued their push downward, meaning prices are rising. Some geographical markets still demand premiums. Usually that's due to the demand in the specific market or the performance of assets there, says Nutt.

At press time, Calkain was about to launch the offering of a Family Dollar property in South Florida with a 15-year term on a triple net lease that had rent escalations every three years. Before the offering even went public, Nutt had offers.

"Florida, New York and Texas are great examples of markets where there is just insatiable demand," he says.

"The primary markets will get very aggressive cap rates and buyers might be willing to take a short-term lease in a primary location," adds Sean O'Shea, managing director of The O'Shea Net Lease Advisory group of Los Angeles-based BRC Advisors. "Today, there might be a 25 basis point difference between a prime location and a secondary location. In the last cycle, there would be a 100 basis point difference."

Cap rates can also swing based on a tenant's credit. Retailers with top credit ratings, like Walgreens, CVS and McDonalds, will generally trade for higher prices and lower cap rates, than those with lesser credit ratings in any given market.

"Credit is important if your location is not superior," says Rose. "In a tertiary market, I would encourage the investor to concentrate on the quality of credit. If an asset is BBB rated or not rated, and in a major MSA and the traffic patterns are fantastic, it is ok if you lose the tenant. You will have great residual value and the tenant can be replaced."

In general, there is a flight to quality going on where investors will pay top dollar for better assets. The Matthews Retail Group of Colliers International recently sold a 7-Eleven near the campus of the

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Larger boxes are also popular among investors. Pictured is a Natural Grocers unit sold by The Silver Group in 2014.

University of Pennsylvania in Philadelphia at a 3.75 percent cap rate.

Demand from buyers is heated by a number of factors. Chief among them, the amount of capital chasing the limited number of available properties.“

“Demand in the single tenant net lease retail market continues to be driven by demand from equity looking for alternative fixed-income investments, 1031 exchange buyers, low interest rates and foreign capital looking to invest in U.S. real estate,” says Philip Wickstrom, managing principal of The Net Lease Group, based in Atlanta.

“Public and non-public companies invested in this space have a lot of pressure to put their investors’ money out,” adds Guy Ponticiello, managing director of JLL. “In 2014, the net lease players will raise around $12 billion to $14 billion in equity. When you assume moderate leverage, that means they have to buy $20 billion to $24 billion in assets. Then, you have everyone else, including the large fund players. There is probably $7 of capital for every dollar of available supply. Cap rates will stay low as a result.”

Fueling the demand is the financial stability that the sector provides. With many investors seeking safe harbors for pools of cash, many view net lease properties as a 10-plus year certificate of deposit with stable returns.

“The single tenant sector has performed very well over the years and investors big and small are seeking a risk-adjusted yield on their capital,” says Barry Silver, principal of The Silver Group, a net lease investment brokerage located in the Bay Area. “While cap rates are at a historical low, they still beat out the risk/returns for alternative investments. Single tenant properties have the benefits of real estate ownership: providing shelter through depreciation (except ground leased property), ability to leverage and, in some cases, appreciation.”

Peter L. Block
National Director,
Net Lease Group,
Colliers International

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Absolutely. I would actually qualify the statement that the sector is dominated by the funds. The funds play a larger role than ever before and certainly influence the cap rates with their buying power. The single tenant space though is so fragmented that no one owner, even represents 5 percent of the market.

Have your clients changed criteria the properties they are seeking? How?
The criteria are remarkably uniform among funds and private investors. Most buyers are chasing strong credit and long term leases. The one other sector being sought after is quality tenants with shorter term leases in good real estate locations.

Does location play as much factor as it used to?
Location does not play as strong of a role as it should. Demand is so strong and supply limited, that buyers do not significantly differentiate between prime real estate and less well located real estate as long as there exists a long term lease in place, say 15 to 20 years.

With supply constrained, what properties are must-haves for investors?
Investors choose from quick-service retail, banks, pharmacies and auto supplies.

What types of properties are popular with buyers?
Same sectors as noted in previous question.

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Acquisitions

With heated demand and limited supply, acquiring properties that fit specific needs and return targets has been challenging for many buyers.

Joe Cosenza, vice chairman of Inland Real Estate Group Inc., says it is tougher to find properties today than at any point before in his 47-year career.

"You have too many individuals, too many partnerships, too many corporations that don't want to sell because they say, 'What would we do with our money?'" he says. "It is much tougher to find deals that work; it is not impossible, just tough."

Inland has been sourcing most of its properties directly from sellers, many of whom have done business with the company before. More than 50 percent of the company's purchases have come directly from sellers over the last 12 years, according to Cosenza. The company also sources deals from brokers, who often offer properties off-market to Inland before widely disseminating them.

For public REITs like Agree Realty Corp., only top properties will do so that investors see strong returns.

"REIT investors are looking for a number of different attributes that contribute to the stability and predictability of a net lease portfolio," says Agree. "We focus on two distinct areas: asset quality and portfolio diversification. Asset quality is dependent on a number of factors, but starts with the 58 percent investment grade exposure contained in our portfolio. However, our bottom up underwriting approach focuses on attributes beyond just credit quality, including traffic counts, demographics, retail synergy and adaptability of the box."

Agree Realty made several large acquisitions in 2014, including three large portfolios that closed in November, including a portfolio of 14 AutoZone stores and seven Sonic locations. The company also acquired 11 Burger King properties in a sale-leaseback transaction with franchisee Meridian Restaurants in November.

Most REITs and private equity funds have concentrated on acquiring portfolios valued at $10 million or more to deploy capital more efficiently; individual buyers make of most of the pool of buyers for assets valued at under $5 million. Occasionally, large and small buyers will target the same asset.

"While REITs and institutional buyers have increased demand for properties over $5 million, our experience working with individual investors has proven that smaller investors can compete with investment funds for single properties or portfolios under $10 million," says Wickstrom.

Many high net worth individual buyers are paying all cash or are not applying much debt to a property they are acquiring, so they have the ability to pay a higher price and still receive the return they require.

"Given they are not utilizing debt, they are ok to buy a McDonald's location at a 4 percent cap rate; they will be happy to own it and take the depreciation," says Rose. "That is a unique nuance to net lease; it is not predominant in the sector. About 50 percent of the assets we sell are financed."

"Private investors that are looking to purchase one or two assets are usually motivated to outbid the funds, which really aren't as competitive on a one-off basis due to acquisition costs and fees," says Passon of Fortis Net Lease.

"At some point, sheer asset size will preclude a competitive bid from individual investors, but we are not surprised to see individuals show up to bid — and close on — assets well over $100 million," says

Errold Seiler
President & CEO,
LRCS Real Estate
Advisors

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Absolutely. There are so many different types of net lease investments that our clients rely on us to identify the available opportunities that best suit their individual needs and unique business priorities.

Have your clients changed criteria for the properties they are seeking? How?
The financial aspects of client investment criteria hasn't changed much, they still want high returns. However, they are now considering shorter term leases, often utilizing our ability to restructure the lease terms to increase the value of the property.

Does location play as much of a factor as it used to?
Yes, location has always been a prime consideration, and current market conditions make accurately evaluating the real estate location more important than ever. We like prime corners on core intersections where we know it's a strong trade area with high traffic counts and solid demographics. We are also able to contract deals with short leases because, we discuss renewal terms and confirm demand with potential replacement tenants.

With supply constrained, what properties are must-haves for investors?
Having a long-term view toward investing, along with maintaining a diverse portfolio, is the usual recipe for building true wealth. Diversification within the real estate portfolio of the portfolio is equally important. We recommend holding properties leased to major national corporations in different industries, like retail and restaurant chains, drug stores, automotive, transportation and medical care facilities. We also like the higher returns you get from financially solid, multi-unit franchisees, mixed in with leases having corporate guarantees.

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Harold Briggs
Executive Managing Director, National Sales Manager, Stan Johnson Company

The net lease sector used to be a sweet spot for the individual investor; now it's dominated by large fund owners. Is there still a niche for the individual investor?
The rumor that the net lease sector is a less-welcoming niche, these days, for the individual investor, is grossly exaggerated. Some investors fear that the sector has been taken over by large funds, which are better capitalized and can offer higher prices, but that's not so. Large fund owners have indeed become more important players in the net lease sector, recently, but they tend not to be a hindrance to the smaller private investor.

Have your clients' criteria changed, regarding the properties they're seeking? How?
Competition at all price points is heavy. Consequently, we've seen an important change in investors' criteria over the past two or three years: Given the shortage of supply, buyers are considering properties with shorter leases on them. We hear it said that 15 years is the new 20, and 10 years is the new 15. Institutions need to fill large allocations, and 1031 buyers have to satisfy timeframes, so both groups have to be more inclusive in the assets they'll look at.

Is location as important a criterion as it used to be?
The lease is just one leg of the stool—the others being credit and location. Historically, location has always been the least-heavily weighted item of those three, and in many cases it carries even less weight in the current market. The viability of operations at the individual site is what's important, even if the location's unattractive in theory. Two investors in particular — STORE Capital and Spirit Realty Capital — have been masterful in basing their underwriting on the operational necessity of a site.

Location does become a more important factor with a shorter lease term, however. In that case, the investor will need to consider future uses — and thus the location becomes more important, relative to the performance of the current tenant.

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Walgreens | Creve Couer, MO | $13.1M

Kohl's | Rancho Cordova, CA | $10.5M

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Whole Foods | Flagstaff, Arizona | $11.6M

CVS | Sandy Springs, GA | $11.0M

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Automobile parts dealers and tire centers have become popular as they expand in secondary and tertiary markets. Pictured is a Firestone unit sold by The Silver Group in 2014.

Jeffrey Thomas, of The Thomas Company in Seattle. "Many are surprised to hear that we have completed transactions as large as $250 million with private individual investors."

Due to the heated market, many brokers report that properties on the market don't stay there for long.

"Buyers must react almost immediately," says Silver. "We tell our clients to be prepared to move quickly if a property presented meets their criteria. Prolonged shopping may produce poor results."

"If a property is going to be well received by the market, it is extremely important for buyers to act quickly and follow generally accepted processes with a consistent path towards execution," adds Wickstrom. "Regarding timing, we have seen properties go under LOI within hours of hitting the market. It depends on the degree of correlation between the property's characteristics and the 'must have' characteristics of the current market."

While the nature of the market can be rushed at times, the stability of returns and low management is what continues to attract buyer interest.

"The majority of buyers of net lease investment properties tend to be consistently conservative," says Silver. "Investment grade credit-backed or equivalent property with long-term, absolute net leases are preferred, and have been selling for lower yields than at any time in my 26 years in the business. Investors have witnessed compressing yields for some time and are prepared to do what is necessary to compete in this market."

"The major shift for smaller investors has come in the form of yield expectations," says Stan Johnson, CEO of Stan Johnson Co., based in Tulsa. "While these buyers are likely still looking for the same general type of product they have been in past years, they have just had to move their cap rate expectations down as the market has shifted."

Buyers who are performing 1031 like-kind exchanges — a provision of the IRS tax code that allows capital gains tax to be deferred when proceeds of a sale are used to purchase a similar property — still make up a significant percentage of the market for net lease properties. Many investment sales executives interviewed report

Josiah Byrnes
Vice President,
Embree Capital Markets Group, Inc.

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Yes, absolutely. Despite the increasing securitization and institutional (fund/REIT) ownership of net-leased assets, individual investors still comprise the majority of our purchasers, if for no other reason than the granularity of our product type (small-box retail and medical) and the tax-deferral motivation of most of our buyers that effectively creates the lowest cost of capital.

Have your clients changed criteria for the properties they are seeking? How?
Not really. Overall, buyers are still seeking high-quality, newly-built assets with long-term net leases. What has changed is that they are willing to consider healthcare properties at similar yields to retail assets.

Does location play as much of a factor as it used to?
As clients chase yield, they become less discriminating about location, so long as the contractual rental stream is long-enough and perceived to be durable enough to satisfy their income needs. Many buyers are retirees, so the reversionary value is less important if they can achieve a higher yield in a secondary or tertiary market with the same credit backing the lease.

With supply constrained, what properties are must-haves for investors?
Properties with recession-resistant and demand-driven tenants command a premium. Dialysis clinics, dollar stores, and quick-service restaurants (QSRs) are all extremely popular currently. However, even among these three categories, medical properties seem to be the asset class du jour. For every offer we receive on one of our dollar stores, we receive five or more offers for our dialysis clinics.

What types of properties are popular with buyers?
As mentioned, investors recognize the inherent sustainability of tenants providing necessity retail (discount stores), necessity healthcare services (dialysis clinics), and QSRs. Buyers are gravitating toward tenants with business models that are not easily disrupted by the same technologies that have negatively impacted the performance of discretionary retail purveyors, such as clothing, electronics, and media retailers. For example, consumers cannot (yet) download a cheeseburger or receive kidney dialysis through video conference. Accordingly, we remain bullish on these sectors.

ADVERTORIAL

NATIONWIDE NET LEASE REAL ESTATE SERVICES

Embree Capital Markets Group is a national real estate investment advisory and brokerage firm, specializing in single-tenant assets net-leased on a long-term basis to creditworthy tenants.




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Jonathan Hipp
President and CEO,
Calkain Companies

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Definitely; the net lease market isn't a zero sum game. High net worth individuals continue to look towards net lease investments for wealth building/preservation and estate planning. There is also a vibrant pool of 1031 investors. With near historic low cap rates, it's no doubt a seller's market. However, continuing low interest rates give buyers good margins for income accretion.

Cap rates are at their lowest point in seven years and the lowest cap rates we see in transactions are driven by individual investors. Typically institutional investors have required rates of return in order to satisfy their stockholders, taking them out of the bidding for the most in-demand properties. The McDonald's you see trade at a sub 4 percent cap rate will most likely be purchased by an individual investor.

Have your clients changed criteria for the properties they are seeking? How?
There has definitely been a trend of buyers easing their investment criteria. No doubt, properties with a good location, investment grade credit, and a long lease garner the highest demand. However, the pool of those properties is quite small and constantly dwindling. As a result, net lease investors have become more willing to give ground on one or more criteria to gain a higher return rate.

Does location play as much of a factor as it used to?
There has been a notable shift of importance placed on location to lease term. Good credit properties with long leases demand aggressive cap rates even in tertiary markets. For estate planning or wealth preservation investors, long term guaranteed income streams are key. That said, well located urban properties with long leases and credit tenants still demand some of the lowest cap rates and highest per square foot price in the market.

With supply constrained, what properties are must-haves for investors?
Properties that are well located, have a credit tenant, and long leases (even better with escalations) are the most desired. A long term ground lease will obtain even lower cap rates.

Advertorial

Christopher H. Volk
Chief Executive Officer,
STORE Capital

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
There are a lot of individual net lease investors who participate in the market. Much of the investment activity is driven by tax considerations. Investors who elect to invest in publicly traded REITs in lieu of investing in direct real estate will benefit from greater investment liquidity and diversity, and benefit from income growth opportunities that include not only rent growth from existing assets, but also potential income growth from new asset investments.

Have your clients changed the criteria for the properties they are seeking? How?
No, their objective has not changed. We have always partnered with real estate intensive business owners to free up capital and create wealth through innovative lease financing solutions. We invest in profit center real estate nation-wide for an array of businesses across retail, service and industrial property types. Our customers are the companies themselves and the shareholders who direct those companies.

With supply constrained, what properties are must-haves for investors?
Actually, we do not see a constraint in supply. After all, public net lease REITs, which are generally the largest market participants, have a combined market share of assets less than 5 percent. We believe that this will make the net lease space amongst the fastest growing in the public REIT arena for years to come.

What types of properties are popular with buyers?
Buyers tend to like to invest in real estate with a known brand-name tenant, preferably one with an investment-grade credit rating. They also tend to prefer highly visible assets having strong retail street frontage visibility. As an investor, STORE's focus is on profit center properties leased to middle market and larger retail, service and industrial companies. STORE's leadership team has invested more than $12 billion over the past thirty years, making it amongst the nation's most experienced investors in profit center real estate.

Advertorial

Calkain Cos. sold this REI in Tysons Corner, Va., for $22 million, representing a cap rate of 5.22 percent.

they see the number of exchange buyers increasing, with many citing a possible change in the tax code in future years as a possibility for their entrance.

"Tax-deferred exchange buyers have increased in number over the past 18 months after a lull," says Silver.

While REITs tend to seek more portfolio transactions because of the volume of capital they have to deploy, 1031 exchange buyers generally have a relatively lower cost of capital. They can generally pay a premium on top assets over the REITs and private equity funds. While that is the case, many said they advise exchange clients not to rush into a property without doing proper due diligence.

"As a 1031 exchange buyer who is being asked to pay compressed cap rate prices in a short-term decision period, you do want to step back and take a long-term view of the asset you are buying," says O'Shea. "Is this an asset that is going to be accreting? Is there a minimum of a 10-year lease term that will allow you to benefit from the low debt rate?"

In 2005, Southern California was the target of 30 percent of the 1031 exchange business, according to O'Shea. As buyers seeking that market drove prices up, similar assets outside California would sell for 100 basis points less. In the current cycle, supply is so tight that the spreads between top MSAs and other strong areas are not that noticeable.

Today, California is a market where a number of 1031 exchange buyers are based. Having turned a profit on properties, they are seeking to reinvest those proceeds into other assets. With real estate, especially sectors like multifamily, well in recovery, many are realizing strong gains.

"We see a lot of 1031 exchange buyers coming out of California," says Josiah Byrnes with Embree Capital Markets Group Inc. "A lot are older retirees who are divesting multifamily properties or properties that are otherwise management intensive. Because cap rates are so low in California, when they sell a multifamily property at a 4 percent cap rate, a Dollar General at a 6 percent cap rate looks like a home run."

Regardless of who is buying, brokers and owners report that demand has re-

Edward LaPuma

Co-Founder/
Managing Partner,
LCN Capital
Partners

What types of net lease properties are you seeking?
With global institutional capital from our distinct SEC-registered dollar-denominated LCN North American Fund and Luxembourg-registered Euro-denominated LCN European Fund, LCN looks at all property types — retail, office, industrial, and specialty. We make credit-driven investments and work hard to understand our tenant-clients' business, and how we can help them optimize their capital structure.

Have you changed your acquisition criteria? If so, why? If not, what conditions exist that allow you to continue acquiring?
The market is aggressive now and we've had to work creatively to get deals done. That being said, we've been particularly careful to maintain CPI-linked or high fixed rate increases as a hedge to the inflation we expect over the medium to long term. There's a lot of money in the market now, but it's certainly not all "smart" money. LCN intends to be around for many years to come, to meet our tenant-client's needs.

What do you feel are the pressures on the net lease sector? How could these change?
Typical "commodity" product has been bid up to levels that are unattractive to us. Much of this has been driven by cheap debt, but there's also been a growing acceptance of the net lease market as its own asset class, which has led to increased (equity) investor demand, especially from institutional capital, to compete with public and private REITs and of course 1031 buyers.

What abilities do you have, as a company and buyer, to close a deal (e.g., what makes you attractive to a seller that the deal will get done quickly)?
We are a small team, so are very guarded about our time. What we focus on, we intend to close. Furthermore, our funds are discretionary and LCN's co-founders and sole Investment Committee members, Ed LaPuma and Bryan Colwell, are involved in every transaction, highlighting the certainty of closing and ensuring that complex structures can be accommodated on very short time horizons.

ADVERTORIAL

Guy Ponticiello Managing Director, Jones Lang LaSalle

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Given the high velocity ($60 billion volume in 2014) in the net lease sector, there will always remain a niche for the individual investor, especially with the one off private capital deal under $10 million. 1031 exchange buyers (i.e. private, high net worth individual) dominate the $10 million and under space with the average transaction around $4 million to 5 million. Typically, large fund owners will not bid at cap rates on smaller price point deals due to their return thresholds and capital deployment mandates.

Have your clients changed criteria for the properties they are seeking? How?
The majority are still targeting investment grade credit tenants in primary markets. However with the compression of yields, some of our clients are starting to look at secondary markets with strong demographics to find more of a spread as long as the financing is still accretive. Additionally, we are seeing some of our clients underwriting non-credit tenants as long as there is a solid story with the performance of the tenant, i.e. unit level financials, EBITDA margins, and long term outlook.

Does location play as much of a factor as it used to?
The quality of the intrinsic value continues to play a critical factor with regards to driving pricing in the net lease sector. We are seeing investment grade tenants trading at record setting cap rates in trophy type locations. Credit tenants in primary markets with above average household income are seeing multiple offers and a competitive bidding process often times results in execution over the ask price.

With supply constrained, what properties are must-haves for investors?
We educate our investors to look at an asset as a three legged stool - the lease term, credit of the tenant, and lease structure. Thus, many of our passive investors continue to lock in bank or drug store assets which feature over 20-year primary leases (and multiple renewal options), minimal or no landlord obligations, and investment grade credit with strong financial backing.

Advertorial

Thomas Company Net Lease Capital Markets

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?

We continue to see a large role for the private/individual investor across the net lease sector. The rising number of institutional investors has increased demand for "core" assets, those leased to an investment grade firm with more than 10 years of remaining lease term. The market for these assets has become more competitive due to the institutional demand, but private investors are by no means left on the sidelines. We continue to see private investors tremendously active in this space despite the compressed yields. For example, in 2014 we have transacted on nearly $600 million worth of institutional-quality assets, and all of it was acquired by private capital.

Have your clients changed criteria for the properties they are seeking? How?

For the most part, the net lease sector follows the debt market's lead and investors will generally focus on assets that can be financed at favorable terms. We have seen investors willing to move up the risk curve as a result of improved financing terms. There are now financing options for assets that may not have been financeable several years ago. As lenders have become willing to accept more risk, investors have followed suit. We are now seeing very attractive financing terms available for assets leased to tenants with credit well down the credit spectrum. Some investors have chosen to take on the additional risk of these assets in order to achieve the higher yield they offer. However, we have not seen a market-wide shift up the risk curve. For example, we have not seen investors that traditionally buy core assets move to an asset class with more risk, despite the continued compression of yields for those assets. As the scarcity of available core properties has driven cap rates for core assets lower, we have primarily seen investors accept lower yields or move to the sidelines.

Does location play as much of a factor as it used to?

Location is important, but in the net lease sector it still ranks behind the credit worthiness of the tenant, lease term and structure. We see the bulk of the inventory trading in secondary and tertiary markets, which reflects retailers' focus on growth and the relatively saturated landscape of our major markets. Net leased investors have generally been less focused on geography than the remaining lease term and credit of the tenant. In our supply-constrained, yield-starved environment, we see the market being somewhat bifurcated regarding geography. There is a group of investors that that will take on structural risk (credit and/or term) if the asset is well located and those completely focused on structural security (investment grade long leases) regardless of location. We have seen both strategies succeed over the years, and it's really just a matter of the investor's personal philosophy.

Advertorial

mained strong for net lease properties throughout the past 20 years. Now, it is just greater.

"Single tenant net lease retail properties are always in strong demand," says Michael Ambrosi, vice president of leasing and marketing at Clifton, New Jersey-based ARC Properties.

"The demand for net lease properties has increased exponentially over the last 25 years," adds Keith Strum, principal of Minneapolis-based Upland Real Estate Group. "This property type is now well know and accepeted among most real estate investors and is preferred by many. Buyers are very knowledgeable with regard to net lease properties and the sophistication level of this property segment is ever increasing."

Adding to the demand from REITs, private equity funds and 1031 exchange buyers are a new group of buyers — international funds and high net worth individuals.

"We seen private capital come in from Europe, Israel, South America and Asia that is legitimately buying deals between $2 million and $10 million," says CBRE's Haddigan. "That [price point] was a province of domestic, high net worth buyers. International capital is getting more aggressive."

KZDevCo has developed a number of Longs Drugs in Hawaii for parent company CVS/Health. KZDevCo recently announced it would build 13 more locations for the retailer in Hawaii and California.

Similarly, BRC Advisors works with a number of international buyers, many of whom, O'Shea says, see a 2 percent return as "perfectly acceptable."

Supply

Supply of net lease product has been constrained predominantly due to the lack of development by many retailers over the past seven years. Auto parts stores, quick service restaurants and dollar stores have led the new supply in recent years, but much of that product is in secondary and tertiary markets. Development has overall been sparse, with few exceptions. However, many are seeing a light at the end of the tunnel, with a return in some sectors.

Merchant developers, like Tennessee-based GBT Realty, California-based KZ DevCo and Texas-based Embree Group, are reporting an increase in activity from clients seeking new sites for development of single-tenant net lease retail properties.

GBT has created more than $400 million of ground-up net lease properties over the past few years. The company is the most active net lease developer in the country and has developed properties in 26 states.

"The structure and the process that we have created have allowed us to partner with a lot of net lease users," says Craig Cole, managing director of the company's net lease division. GBT generally holds properties in its own portfolio after development, then sells them into the market after a few years.

Irvine, California-based KZ DevCo has plans to build 13 new CVS/Health and Longs Drugs drugstore properties in Hawaii and California. The company recently completed five Longs' locations in Hawaii and has three more in the works. California locations for parent company CVS/Health include Murrietta, Chula Vista and Long Beach.

Embree assists its clients in monetizing their real estate assets by marketing and selling the properties after development. The company is a preferred developer for Davita Dialysis, Dollar General, Starbucks Coffee, Chipotle, Buffalo Wild Wings and Goodyear Tire, among other retailers.

Josiah Byrnes, vice president of Embree Capital Markets Group Inc., reports that the predominant buyers for the new assets that his company is bringing to market are 1031 exchange buyers who have strong tax motivations to close a deal quickly and the desire to hold the assets for the full term of the lease.

Many retailers are relocating units from shopping centers to freestanding stores to increase sales as older leases expire.

"We are seeing retailers who are in older, less visible strip center locations moving to highly visible outparcels or highly visible mid-block locations," says Cole. "We are also doing a lot of first-generation retail space, as well as some scrape and rebuild work in dense markets."

For Ryan Barr and Ryan Bennett, net lease investment brokers with Lee & Associates who assist developers that are selling new product, timing is key to entering the market with new properties.

"With interest rates still holding very low, our clients — developers — are taking properties out to market immediately to take advantage of the cap rate compression in the market," says Barr, adding that Lee & Associates is still seeing a number of pre-sales — where developers sell the property before construction is complete — coming to market.

While recovering ground-up delivery is bringing some supply to the market, it hasn't been the source that it was during the early 2000s.

"There is some new product, but it is limited," says Haddigan. "Cap rates on existing product have continued to go lower. Rite Aid stores that were trading at 10 percent to 11 percent cap rates in 2010 and 2011 are trading between 7.25 percent and 7.75 percent today. A lot of existing owners have seen appreciation and they want to harvest some of that through a sale. That is part of the source of supply that we are seeing."

There are efficiencies of scale for many buying large portfolios of net lease properties. Large buyers will acquire a portfolio, then prune off specific assets to other buyers, using the economies of scale and the spread in cap rates on single assets to create profit. Adding to that are private equity firms who have been buying retail companies, then selling off some of the real estate. [See "Sellers" section.]

"That is part of the strategy to raise money for those businesses," says Haddigan.

Additionally, REITs and private equity funds that acquire portfolios look to spin off non-core assets.

"Many institutional clients are searching for core product," says Kyle Matthews of The Matthews Retail Group of Colliers International. "Everyone wants to get away from being accumulators of real estate; they want to prune their portfolios and get rid of B and C properties to while upgrading to Class A product in the core markets of top 25 MSAs."

The most dominant delivery in the retail sector in 2015 will be single-tenant properties, says Rose. The company sees a number of units under development, as well as some drug store activity.

"From the developers we speak with, there are numerous single tenant net lease properties coming on line in 2015," says Rose. "There is always an opportunity to grow more. The retail market is driven by consumption, and consumption is a byproduct of the number of jobs. As the economy really heats up, we will see a response from the retail sector opening more stores."

Among the busier clients for some developers are quick service restaurants. Whereas corporate locations have been preferred by buyers in the past, strong franchise operators are now developing new locations, then selling them into the net lease market to raise capital for their operations. Calkain Cos. recently brought to market three Wendy's sale-leaseback deals from a five-unit operator. The offer was well received by investors, says Nutt, and went under contract quickly.

Franchisees of QSRs have also become a new client for Embree. The franchisees see the low cap rate environment as an advantageous time to expand their store counts and quickly monetize the real estate.

Once called alternative tenants, service users like childcare and healthcare facilities have now become popular with net lease investors. Embree is seeing healthcare tenants make a big push into net lease

structures. One of its larger clients, Davita Dialysis, is an example of this trend.

"We are seeing a significant number of opportunities with the changing landscape of healthcare," says Byrnes. "In America, healthcare is developing more a retail delivery. Healthcare assets are also more popular with a broader range of investors, but [interest] is very specific to asset size and tenant credit. Most of the tenants on the healthcare side tend to be less credit-worthy so they won't command the same cap rate premium. Compounding that, if a project is more than $10 million, it narrows your buyer pool."

There are a number of companies in the sector who have seemingly taken matters in their own hands to create new supply.

"There are buyers who are acquiring assets with short-term leases at a discount, then negotiating a lease extension with a reduction in rent, then selling the spread," says Jereme Snyder, executive vice president of Colliers International.

The method isn't just for small players, either, says Silver.

"Some professional investors have focused their energy on identifying well-located properties and blending and ex-

ARC Properties developed this 13,000-square-foot Walgreens in Springfield, N.J. The retailer has a 25-year lease.

tending the lease terms during their due diligence," he says. "Many have been very successful. The large funds and REITs who are landlords to scores of companies have used their connections to create deals."

Sellers

It is a good time to be a seller in the net lease market. *SCB* heard that echoed a number of times in our interviews.

"We are seeing a continuance of the supply-constrained environment," says Nutt. "That, compounded with the low interest rate environment, as well as the lack of alternative investments are paying

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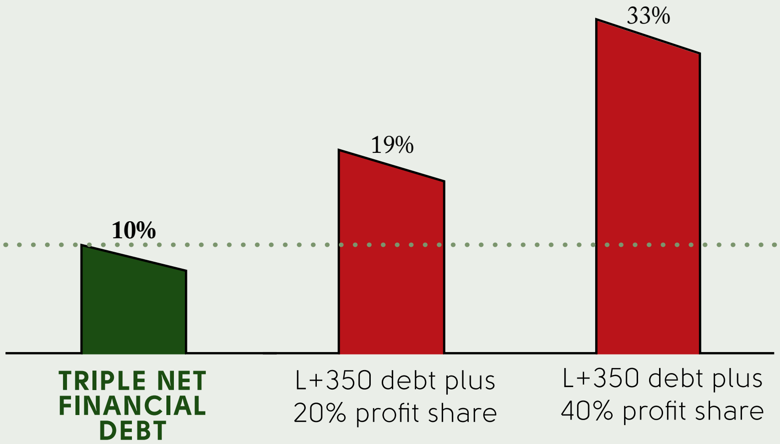

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a material yield. For a passive investor, there are not a lot of alternatives that will give them a safe, credible, reliable and consistent return."

"There has been no shortage of buyers, and not a lot of sellers," adds Snyder.

Why sellers bring properties to market in a time when there is strong demand is dependent on a number of objectives. Larger owners may have criteria that dictate they sell at a specific hold time, while individual buyers may want to trade into a better property.

"Every owner has a different exit strategy," says Snyder. "Developers build to sell. REITs may have a fund that dictates that they sell after a five- or 10-year hold, or they see an opportunity to sell a non-core asset."

With cap rates low, buyer interest motivated by capital and tax concerns, and retailers seeking to exit owning real estate, now is the time. Smaller assets, especially, are quick to go.

"Anything we see that is priced at $3 million or less with good credit — usually fast food restaurants and Starbucks — gets snatched up almost immediately," says Barr. "We bring it to market and it is usually sold by the end of the day with dozens of offers on the property."

ARCTrust acquired this freestanding Hobby Lobby in Gastonia, N.C., for $6.25 million in May 2014. Faris Lee represented buyer and seller in the transaction.

Properties with fresh 15- to 20-year leases sell fast, especially those with a strong regional or national brand.

"We have sold those before the tenant is even in the building paying rent," says Bennett.

Larger assets, if they are priced right, also sell quickly, usually within a week, says Barr. If sellers are more aggressive on price, it may take some time to get buyers interested. Often, 1031 exchange buyers are the first to respond to aggressively priced assets.

"Buyers are predominantly looking for the top MSAs," says Barr. "It is a rarity when you find that buyer that wants a C location with no credit and a short-term lease."

Recent transactions point to success for sellers based on the timing of the transaction. Buyers, as well, are achieving success as long as their investment and return goals are met. JLL completed a $540 million sale of a portfolio of net lease properties for Dallas-based Lone Star Advisors in April 2014 to private owner JDM. It also marketed and sold a $260 million sale-leaseback portfolio for Citibank that closed in January 2014, and is working on another sale-leaseback for the company.

"While the REITs are usually players in the larger deals, you are starting to see the small and mighty owners compete for some of the larger transactions as well," says Ponticiello.

Owners look at the term remaining on the lease, the after-debt cash flow, any rent escalations and their overall leveraged return on equity.

"The best way for a seller to maximize his proceeds is to hire a qualified broker who can give their property national market exposure," says Rob Bender with Fortis Net Lease. "This process is much more complicated than simply putting a property on a web site or emailing it to a handful of brokers. Exclusive listings demonstrate a seller's commitment to closing a sale; this is what 1031 buyers look for when entering a market for a replacement asset and it is also what buyers' brokers look for when presenting their clients opportunities."

Beyond The Property

A number of larger players go beyond buying the properties. They are viewed more as capitalization companies that can assist retailers — and other businesses — by purchasing their real estate assets in sale-leaseback transactions. The companies then use the proceeds to reinvest in their businesses and expand, often repeating the process as they open new store locations.

Ponticiello has seen activity escalate for sale-leasebacks in recent months. Banks, in particular, are making an effort not to own real estate. Year over year, they continue to expand, but they are attempting to do so without adding ownership of real estate assets.

"They are generally trying to be lessees," says Ponticiello. "For those that have large portfolios, there is better use for their capital than having it locked into real estate. We are seeing them take advantage of low cap rates and redeploy that capital into other facets of their business."

"Retailers are becoming more conscious of the value that their signature creates," says Thomas. "We have not only seen far more chain retailers, including pharmacies, restaurants and banks become more interseted in sale-leasebacks, but we've also seen them become more creative in structuring deals that begin to truly maximize the value their tenancy creates."

Arizona-based STORE Capital works with retailers and other service-oriented companies by acquiring their retail assets in a sale-leaseback arrangement and continuing a relationship with the companies to help them grow.

"Our interests don't end the day we write the check for the property," says Chris Volk, president and CEO of STORE Capital. "Our investment goes over a long period of time; it's that after-the-check-is-written piece where you can really make companies much better off."

STORE has worked with retailers like Gander Mountain and restaurants like O'Charley's. The company also works with franchisees of quick service restaurants to aid their business efforts.

"While a sale leaseback is a substitute for debt, it is also a substitute for the eq-

April Ronchetti Little
Vice President Investments,
Spirit Realty Capital

The net lease sector used to be a sweet spot for the individual investor, now it is dominated by large fund owners. Is there still a niche for the individual investor?
Spirit Realty Capital, Inc. (NYSE:SRC), a Real Estate Investment Trust, invests in single tenant triple net leased assets and is a leading provider of sale leaseback financing to middle market companies. Our clients are sellers of free-standing commercial real estate facilities where tenants conduct retail, service or distribution activities essential to the generation of profits. With $8.3 Billion in enterprise value under management, Spirit would be classified as a large fund. Our investment criteria is considerably different than the investment criteria of the niche individual investor leaving a great deal of transactions available to be acquired by this type of niche individual investor.

Have your clients change criteria for the properties they are seeking? How?
2014 was a more competitive market place than 2013 with significant cap rate compression forcing institutional investors to become more creative in generating transaction volume. Spirit continued to focus on sale leaseback financing, with over 71% of transactions in the first half of 2014 making up sale-leasebacks in which Spirit purchased real estate directly from the seller. A considerable amount of our sale-leasebacks were the result of merger and acquisition transactions where the sale leaseback financing of the real estate reduced the amount of equity necessary to fund the overall transaction. Other sale leaseback clients were able to use unlocked capital to repay debt, renovate and expand or provide capital return to shareholders.

Does location play as much factor as it used to?
Spirit's real estate portfolio is diversified geographically across 49 states and among various industry types. Texas, Illinois, Wisconsin, and Georgia accounted for 12.6 percent, 6.7 percent, 5.8 percent, and 4.9 percent of the annual rent contribution of the real estate portfolio, respectively. Spirit is continuing to diversify its portfolio in terms of location, industry and sector with a focus on operationally essential real estate where the asset is generating profit.

Advertorial

uity that these companies would otherwise have to devote to real estate," says Volk. "Our role is to make our customers more financially efficient. We're in the business of creating value for them; the byproduct of that is that our investors end up owning a nice basket of real estate."

STORE generally partners with retailers and service companies that have greater than $25 million in sales, but that may not be large enough to be credit agency rated or have bonds.

"We like companies that have prospered through the Great Recession and that are likely to stay relevant over a long period of time," says Volk. "About 75 percent of our portfolio is in what we call 'service assets.' That could be a restaurant, health club or early childhood education center. These are properties that have services versus a product. About 15 percent of our portfolio is core retail, like Gander Mountain or Ashley Furniture."

Similarly, W. P. Carey, which has been in the sale-leaseback business for more than 40 years, works with companies to acquire assets to free up capital. W. P. Carey has most recently been concentrating on properties in Europe and North America, and goes beyond retail assets. It has interests in 26 countries around the globe. In Europe, the company sees the continent's current slow growth economies and high barriers to entry as competitive advantages.

"We have better protection based on the value of the underlying real estate," says Jason Fox, co-head of global investments for W. P. Carey. "There is also less capital chasing deals in Europe right now, so we are able to be more competitive. Borrowing costs are extremely low for us there as well, given where the economy is with low expected growth."

Companies like STORE and W. P. Carey have their strength as one of their biggest selling points. With the ability to acquire multiple assets at once, and larger assets, and go beyond a hands-off buyer, they are at the top of the list for many corporations whose buildings can only be used for the specific purposes of those companies.

"Sellers, and their brokers and advisors, understand that we have a high likelihood of executing on the terms," says Fox. "That goes a long way in a time when there is a lot of new money coming into the market that does not have a track record."

Forecast

Many executives in the net lease sector see the market improving in 2015.

"There were several interesting transactions and REIT mergers in 2014 that have left the sector searching for equilibrium in terms of the effects on supply and demand and the overall impact on pricing," says Wickstrom. "We expect 2015 to be a robust year with increased activity and growth for the net lease market. The collective read from corporate America, our clients and our real estate colleagues around the country is filled with increased expectations for the next horizon. This healthy sense of optimism in conjunction with recent macroeconomic and capital markets indicators forecasts that 2015 will be a strong year for the net lease industry, and we are looking forward to it."

Transaction-wise, many also see pricing headed upwards.

"The market will continue to get more aggressive," says Snyder. "A lot of net lease buyers who are looking for safety and stability will start looking for multi-tenant assets because they get a little better yield. They're willing to take on some management to get that yield. In 2015, I think you will see pricing for multi-tenant

While credit-rated tenants remain popular, some tenants who have a strong track record, like Chick-fil-A, also bring strong prices. Photo courtesy of The Net Lease Group.

deals start to have cap rate compression."

While, for the most part, the trepidation of buying and selling that existed during the Great Recession, is gone, there are few signs that the highly leveraged nature of the last cycle will return.

"There is still some caution," says Haddigan. "Leverage is lower in the business today than it was during the last cycle. On multi-tenant and single-tenant properties, they are not being leveraged as highly. Lenders want the discipline and I think buyers want it as well."

Many who we interviewed also said that the lack of supply in the industry means a stronger economy overall. While that is showing, retailers are now at the point where they need to grow, not just at a point where they want to grow.

"We are at a point where retailers are running their businesses as efficiently as possible," says Nutt. "Investors and shareholders are saying they want to see top line growth. The quickest path to that is new stores. You are seeing retailers like Starbucks become active and open new locations, and they are just one of a number that are boosting store openings."

Nutt and others say many retailers have been actively cutting deals for new locations throughout 2014, with many planned to open in late 2015. As those open, many will hit the net lease market.

"We think 2015 will again significantly exceed the peak of the market in 2007," says Ponticiello. "Net lease is really the only segment of the commercial real estate capital markets which has made a full recovery and then some from the peak of the market. No other asset class or sector has done that." **SCB**

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