AVISON YOUNG

Q1 2023 Cap rate report

U.S. Capital Markets Net Lease Group

While turbulent financial markets, and general macroeconomic uncertainty has sent shockwaves through the broader commercial real estate sector, the Net Lease portion of this ever—encompassing space emerged, yet again, as an outlier as it relates to stability. The Federal Reserve has continued to hike interest rates with the goal of getting inflation under control, but this has seemingly not affected the world of single tenant net lease (STNL) assets, with cap rates on the aggregate only increasing three basis points from 5.64% to 5.67%. Relative to other asset classes, this is trivial at most, and makes sense given the lower price point of STNL deals, and the irrelevance that chaotic debt markets play in making said deals.

Many investors have looked to STNL as an alternative form of a bond, with many viewing the sector as “bonds wrapped in real estate.” Stock markets have proven to be tumultuous at best, and this has caused institutions and high net worth individuals alike to continue to favor the STNL sector. While transaction volume was down from Q4 2022 (847 observed deals in Q4 2022 vs. 494 in Q1 2023,) cap rates on the aggregate remained relatively unchanged, along with the average term remaining on the lease, which ticked up 0.1 years on average across all tracked STNL verticals. Probably the most interesting observation that can be made is the ~94 bps cap rate compression on bank transactions, which registered an average cap rate of 5.97% in Q4 2022 vs. 5.03% in Q1 2023.

In Q3 2022, we tracked 494 deals with an average cap rate of 5.67% and an average term remaining of 12.0 years.

Of course, a closer look at the performance of specific sectors reveals much more complex and nuanced market conditions. Of particular interest were the Convenience Store (C-Store), Medical, and quick service restaurant (QSR) sectors.

Average Cap Rate
5.67%

Average Lease Term Remaining
12.0

Sectors in brief

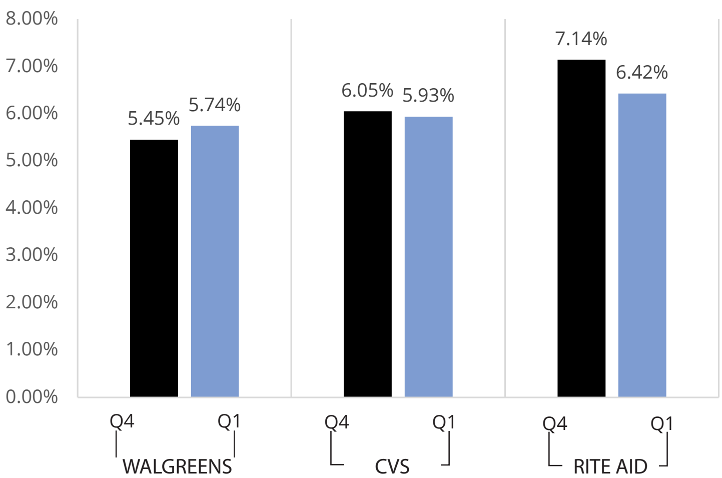
Sectors	Q4 2022					Q1 2023						
	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rates (bps)	Lease Years (Rem)
Automotive	5.79%	3.90%	7.85%	14.9	77	5.92%	4.25%	8.08%	9.5	46	12.90	-5.4
C-Store	5.97%	4.50%	11.67%	6.1	17	5.03%	3.20%	9.06%	11.1	8	-93.84	5.0
QSR	5.06%	4.10%	7.24%	13.8	70	5.09%	3.68%	11.05%	13.5	31	2.40	-0.3
Dollar Store	5.50%	3.75%	8.22%	13.4	87	5.60%	3.23%	7.79%	14.4	26	10.00	1.0
Casual Dining	6.15%	4.80%	9.00%	10.0	106	6.04%	4.75%	7.60%	11.9	77	-10.54	2.0
Medical	6.26%	5.06%	8.00%	13.9	12	7.42%	6.25%	8.50%	12.4	4	116.31	-1.5
Other Retail	5.83%	2.00%	8.73%	8.1	35	5.87%	5.00%	6.58%	8.0	18	4.05	-0.1
Pharmacy	5.50%	0.00%	12.64%	12.6	184	5.54%	3.40%	9.00%	10.3	95	4.00	-2.3
Bank	5.00%	3.25%	8.97%	14.0	210	5.07%	3.25%	8.00%	14.3	116	7.04	0.3
Educational	5.83%	3.73%	8.15%	12.0	49	5.86%	4.23%	10.00%	14.4	73	3.58	2.4
Average	5.64%			11.9		5.67%			12.0			
Sample Size					847					494		

[1] Other retail includes retailers who don’t otherwise neatly fit into one of the above categories such as grocery stores, cellular stores, mattress stores, and fitness centers.

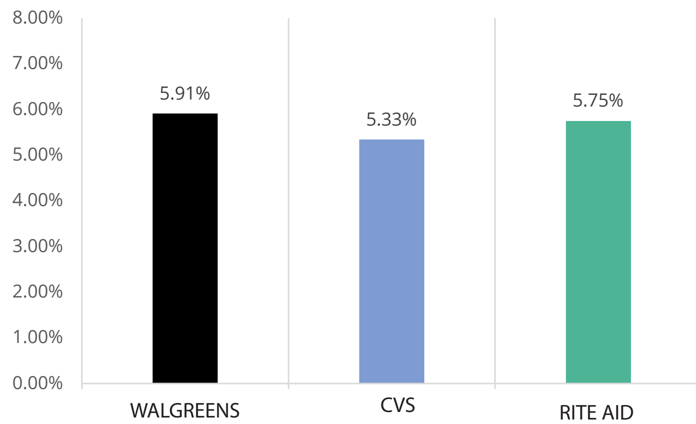
Markets in depth: Pharmacy

The pharmacy sector saw increased transaction volume in Q1 2023, registering 73 transactions in Q1 2023, as opposed to 49 in Q4 2022. While the vertical not only saw increased transaction volume, it also observed a slight increase in average cap rate on tracked sales, averaging 5.86% vs. 5.83% in Q4 2022. The largest change to this vertical quarter-over-quarter was the 2.4 year increase on average lease term, landing at 14.4 years on average. Given the mission critical nature of pharmacies, it is unsurprising to see the resilience the sector offers, especially given the fact that very few new players enter the space, with legacy brands such as CVS, Rite Aid or Walgreens capturing tremendous market share.

Overall Pharmacy Cap Rates



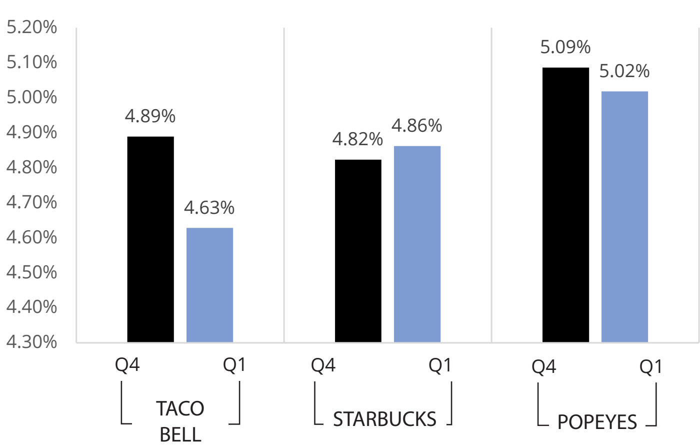
Pharmacy Cap Rates w/ 10+ Years



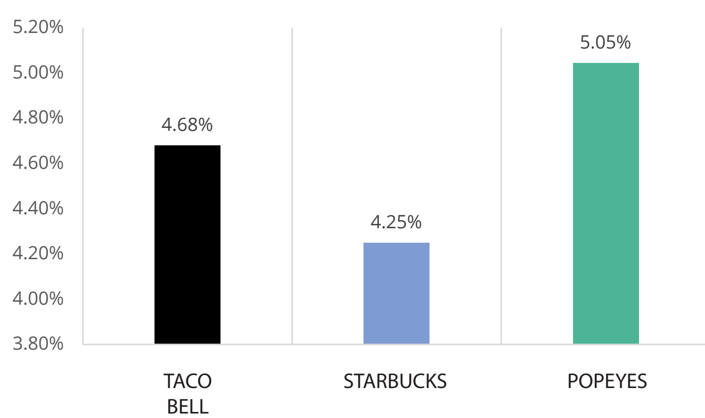
Markets in depth: QSR

Like Q4 2022, QSR represent the most transacted of any of the tracked STNL verticals, registering 116 transactions in Q1 2023, with an average cap rate of 5.07%, a 7 bps increase from Q4 2022. This vertical also saw a slight increase in the average term remaining on the lease, landing at 14.3 years in Q1 2023 vs. 14.0 in Q4 2022. For more information on this sector, please see our recent **QSR Sector Report**.

Overall QSR Cap Rates



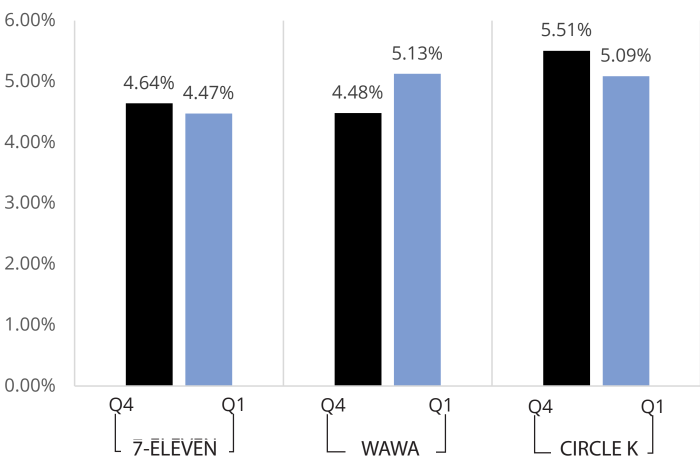
QSR Cap Rates w/ 10+ Years



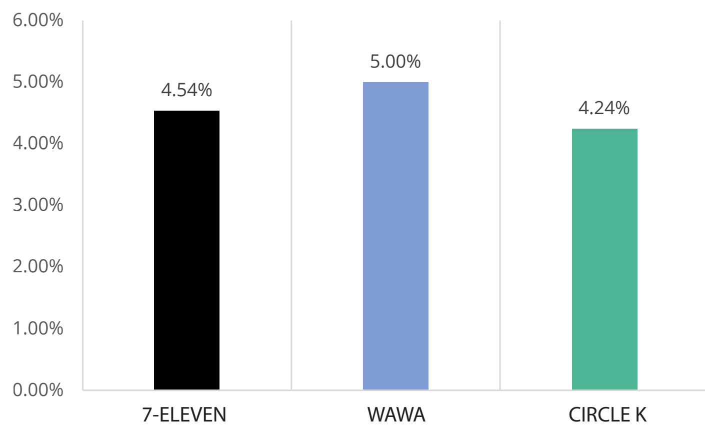
Markets in depth: C-Store

Like the aforementioned sectors, C-Stores have remained resilient despite macroeconomic headwinds. Despite suppressed transaction volume, only registering 31 transactions in Q1 2023 vs. 70 in Q4 2022, cap rates have remained relatively unaffected, only increasing three basis points in the same time frame, landing at 5.09% vs. 5.06% in the prior quarter. C-Stores also saw a slight decrease in the average term remaining, averaging 13.5 years in Q1 2023, down from 13.8 in Q4 2022.

Overall C-Store Cap Rates



C-Store Cap Rates w/ 10+ Years

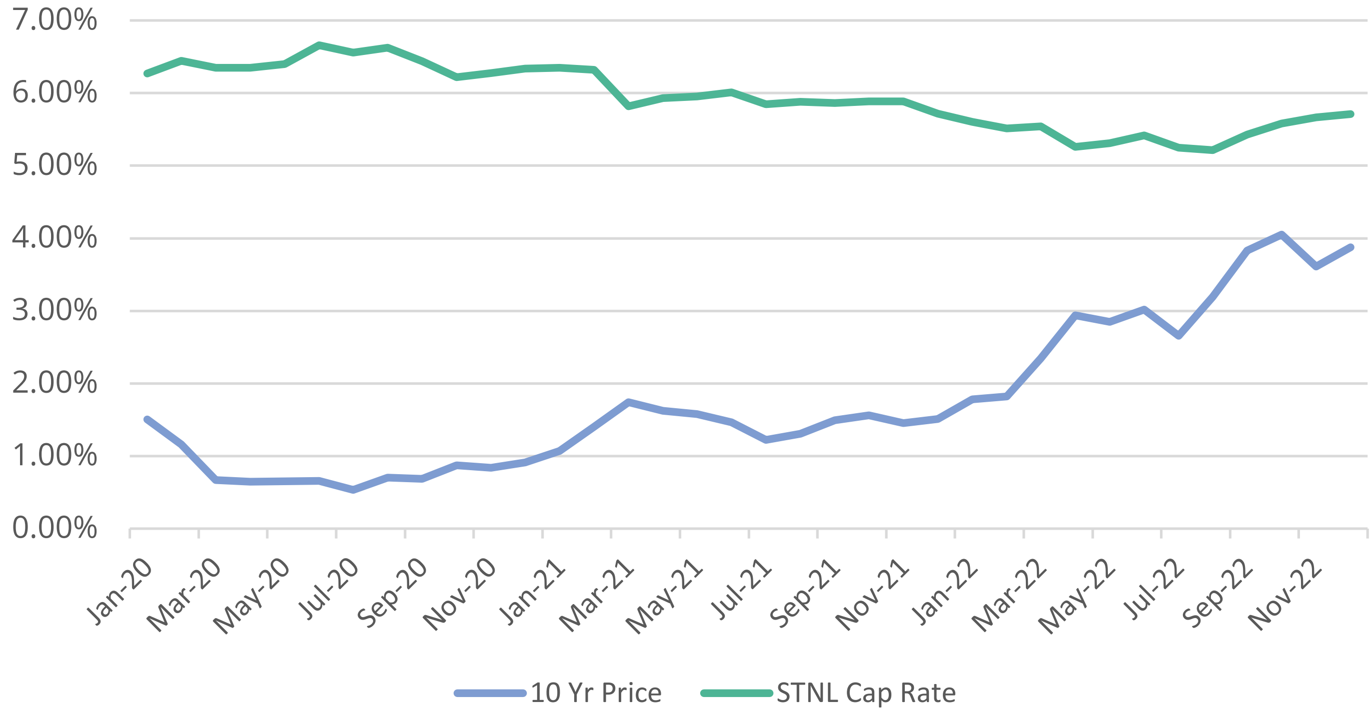


Brand by brand: Average cap rate changes

Tenants	Q4 2022 Avg Cap Rates	Q1 2023 Avg Cap Rates	Change in Avg Cap Rates (bps)
7-Eleven	4.64%	4.47%	-16.80
AutoZone	4.51%	5.29%	78.29
Burger King	4.98%	5.74%	75.47
Chick-fil-A	3.88%	4.02%	13.42
CVS	6.05%	5.93%	-11.23
Dollar General	6.03%	5.95%	-7.95
Taco Bell	4.89%	4.63%	-26.12
Walgreens	5.45%	5.75%	30.30
Starbucks	4.82%	4.86%	3.88

*All calculations are based upon available comps for each specific quarter with 10+ lease term remaining.
The total number of sale comps for respective tenants in each quarter also varies significantly.

STNL Cap Rates vs. 10-year Treasury Rates



Conclusion

With many indicators pointing to a troublesome 2023 for commercial real estate on the aggregate, STNL should remain a safe haven for investors. With massive amounts of CMBS debt maturing in the coming years, more mainstream sectors such as office are in for a day of reckoning, which will cause continued investment in the STNL sector as a result of its resilience in times of turmoil. That said, look to see continued institutional investment in the sector, as these investors have large amounts of dry powder that they are obligated to deploy. While institutional investment should increase, private investors alike will continue to favor the sector, due to its low-price point and STNL tenants general resistance to economic turbulence.

Let's connect.

SUBSCRIBE

Jonathan Hipp
Principal, Head of U.S. Net Lease Group
D 703 787 4725
C 571 926 2009
jonathan.hipp@avisonyoung.com

AVISON YOUNG