

Q1 2020 Cap Rate Report



Quick Stats



6.51%

Average Cap Rate



11.6 Yrs

Average Lease Years (2020)

Cap Rates Hold Mostly Steady Amid Market Slowdown

The first quarter of 2020 bore witness to an economic and global-health crisis unprecedented in modern history, creating uncertainty across all classes of investments. The net lease sector remains one of the most cyclically durable segments of the commercial real estate market, but it nevertheless felt the impact of the coronavirus pandemic.

Activity slowed dramatically quarter-over-quarter, dropping from 586 deals in Q4 2019 to 416 in Q1 2020. The average cap rate across all sectors did not flinch, and in fact dropped 7 basis points from 6.58% to 6.51% as the average remaining lease term increased from 10.5 years to 11.6 years. This finding suggests that depressed volume is caused not by a lack of investor confidence in the sector, but rather by coronavirus-related obstacles to transacting efficiently. Unavailability of debt, inability to inspect properties and difficulty negotiating in a fully remote work environment are chief among these obstacles.

Although net lease cap rates overall did not move much in Q1, this report will take a closer look at some of the sectors most impacted by the coronavirus and its counter-measures – casual dining and QSR. We will also look at the performance of pharmacies, dollar stores and convenience, which, deemed essential businesses, have experienced the fewest hindrances to their daily operations.

Sectors in Brief

Sectors	4Q 2019					1Q 2020					Avg Cap Rates (bps)	Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size		
Automotive	6.65%	4.65%	12.03%	12.0	50	6.38%	4.00%	11.90%	10.4	52	-27.2	(1.6)
Bank	6.07%	4.19%	8.96%	7.9	31	6.03%	4.55%	8.23%	8.3	18	-4.0	0.4
Big-Box	6.91%	4.66%	9.50%	13.8	25	7.28%	6.05%	10.01%	5.5	9	37.8	(8.3)
Casual Dining	6.51%	4.25%	9.60%	11.9	56	6.30%	4.49%	7.83%	14.2	31	-21.2	2.3
C-Store	5.95%	4.15%	11.38%	14.3	35	5.00%	4.03%	6.50%	12.5	19	-94.8	(1.7)
Dollar Store	7.10%	5.75%	11.95%	12.0	113	6.94%	5.85%	9.23%	11.8	64	-15.7	(0.2)
Educational	7.33%	6.00%	9.00%	10.4	5	6.48%	5.87%	7.09%	15.0	2	-84.6	4.6
Medical	7.17%	5.12%	11.30%	7.0	12	7.22%	5.44%	9.40%	9.2	23	4.6	2.2
Pharmacy	6.63%	4.18%	10.65%	11.4	68	6.51%	4.70%	15.40%	13.4	43	-11.5	2.0
QSR	5.75%	3.60%	8.61%	13.8	163	5.57%	3.12%	9.10%	14.5	123	-18.2	0.8
Other Retail	6.33%	4.39%	9.01%	8.9	28	7.45%	4.56%	12.39%	12.3	32	111.8	3.5
Average	6.58%			10.5		6.47%			11.6		-11.2	0.4
Sample Size					586					416		

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.

The casual dining sector saw a 21-bps decline quarter to quarter, likely because the average remaining lease term increased significantly from 11.9 years to 14.2. Looking only at deals with 10 years or more term remaining, cap rates increased 13 bps from 6.06% to 6.19%. The number of trades decreased by nearly half, from 56 to 31.

QSR remained the largest sector by deal volume, though the number of trades dropped from 163 to 123. The average cap rate fell 17 bps, from 5.74% to 5.57%, despite average lease terms remaining roughly the same, suggesting that investors draw confidence from corporate credit even in a time when QSRs are restricted to drive-through and delivery services only.

Dollar store cap rates dropped 13 bps, from 7.07% to 6.94%. Dollar stores remained the second-largest sector by volume, though the number of trades dropped from 113 to 64 in Q1.

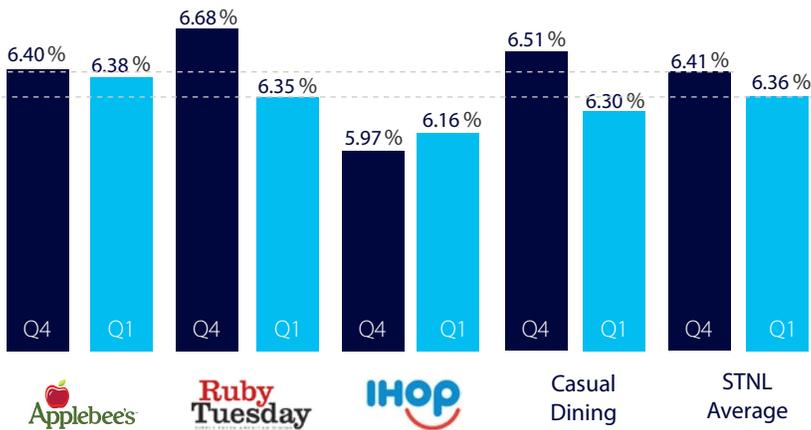
The pharmacy sector overall saw a 9-bps decrease in average cap rate, although pharmacy sales with more than 10 years term remaining saw a significant jump, from 5.82% to 6.65%. The number of transactions fell from 69 to 43, which could result in our picture of the pharmacy market being low-resolution this quarter.

The convenience sector's decrease of 94.8 bps was exclusively a function of the fact that almost all deals that traded (1/2 of typical volume) were 7-Elevens. By way of comparison in Q4 only 6 of the 35 deals tracked were 7-Eleven, but in Q1, 17 of the 19 were 7-Eleven. This is likely an aberration magnified by the reduction in overall deal volume in the sector.

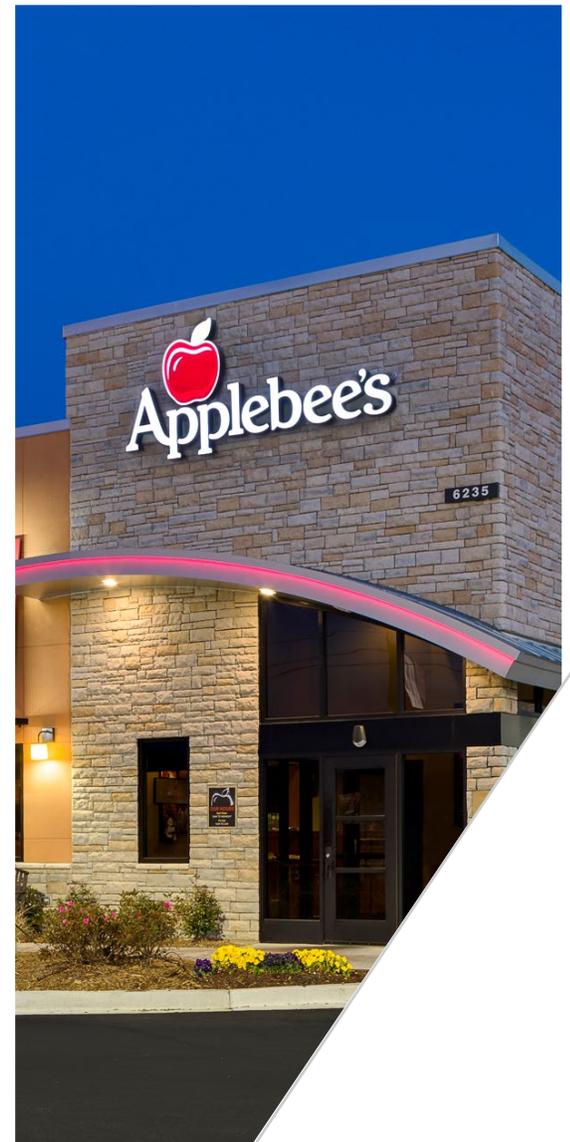
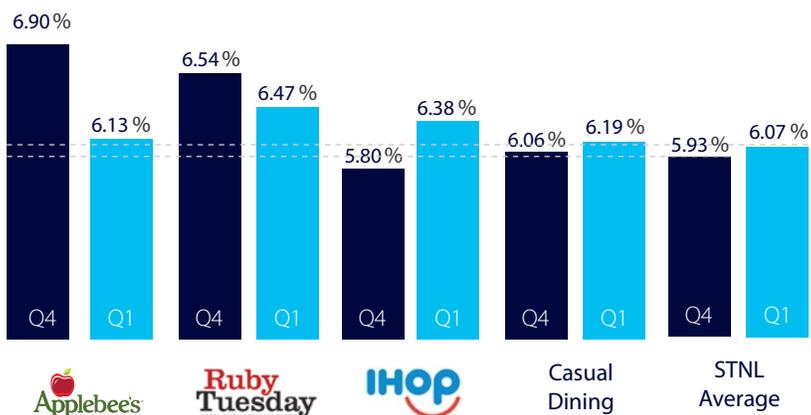
Markets in Depth | Casual Dining

Cap rates in casual dining fell 21 bps in Q1 due to a 2.3-year increase in average lease term. The average cap rate for deals with more than 10 years of term remaining increased slightly, from 5.93% to 6.07%, although the three most traded brands in this category – Applebee’s, Ruby Tuesday and IHOP – saw decreases of 77, 6 and 42 basis points respectively. This sector is likely to be amongst the hardest hit of all by COVID-19 so looking to Q2 we will likely see deal volume down considerably.

Casual Dining Cap Rates



Casual Dining Rates Cap Rates w/ 10+ Years

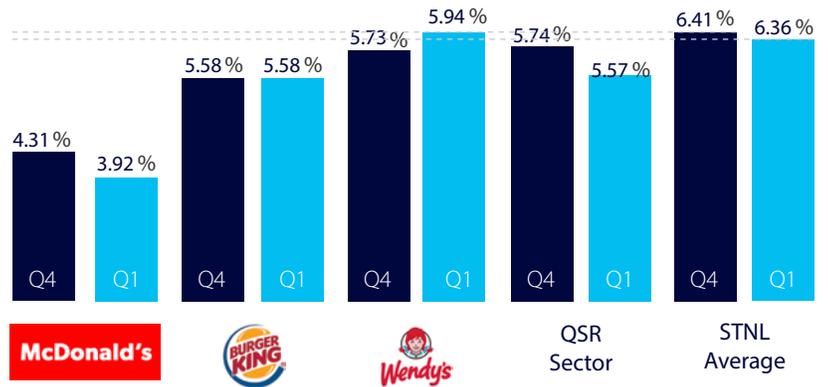


Markets in Depth | QSR

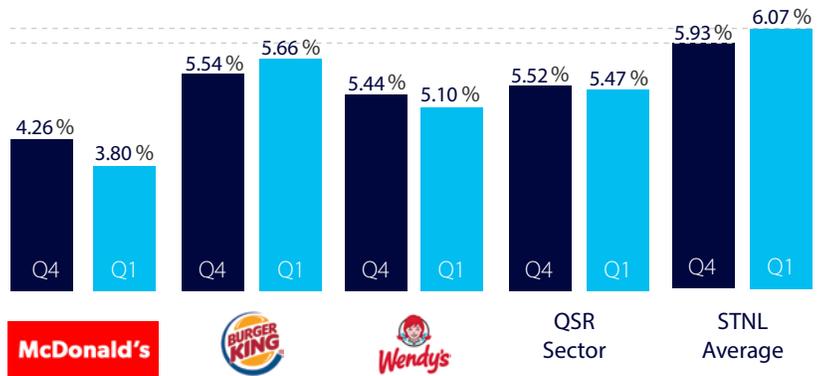
The QSR sector saw a 17-bps decline in cap rates overall to 5.57%, while cap rates for deals with at least 10 years of term remaining declined by 5 bp to 5.47%. Average term length increased slightly, from 14.0 to 14.5 years. Looking to Q2 it remains to be seen how affected the different brands will be. Anecdotally, concepts with drive-thrus have weathered this storm reasonably well. That being said, this sector is known for having low operating margins and any drop in sales volume is going to hurt the bottom line.



QSR Cap Rates



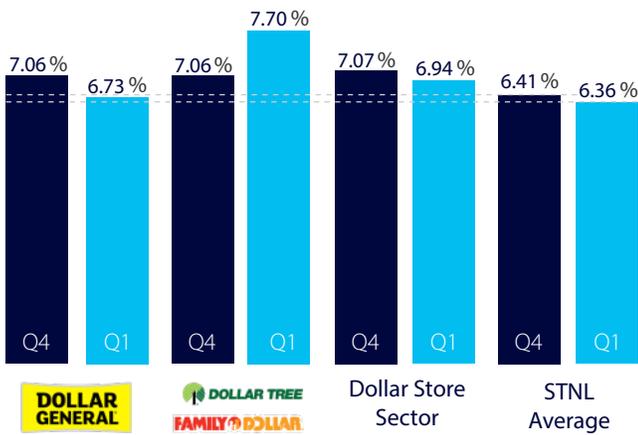
QSR Cap Rates w/ 10+ Years



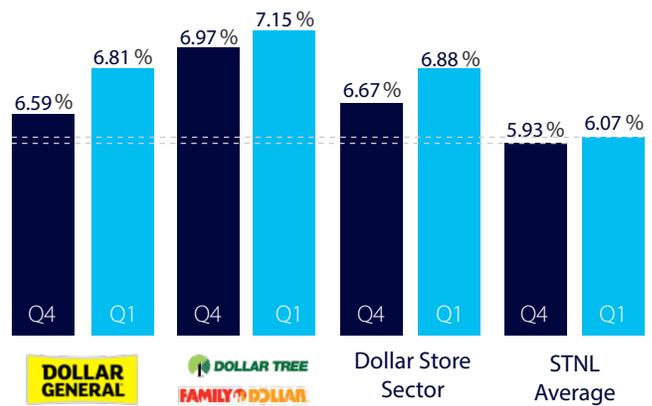
Markets in Depth | Dollar Store

Cap rates among dollar store sales fell 13 bps to 6.94%. Among sales with at least 10 years term remaining, cap rates increased 21 bps to 6.88% despite no significant change in average lease term. We think that this sector is poised to come out of this pandemic stronger than it went in. Both operationally speaking, and STNL marketwise. A large inventory of dollar stores is likely to thin out in Q2 as buyers flock to pandemic resistant brands like Dollar General and Family Dollar.

Dollar Store Cap Rates



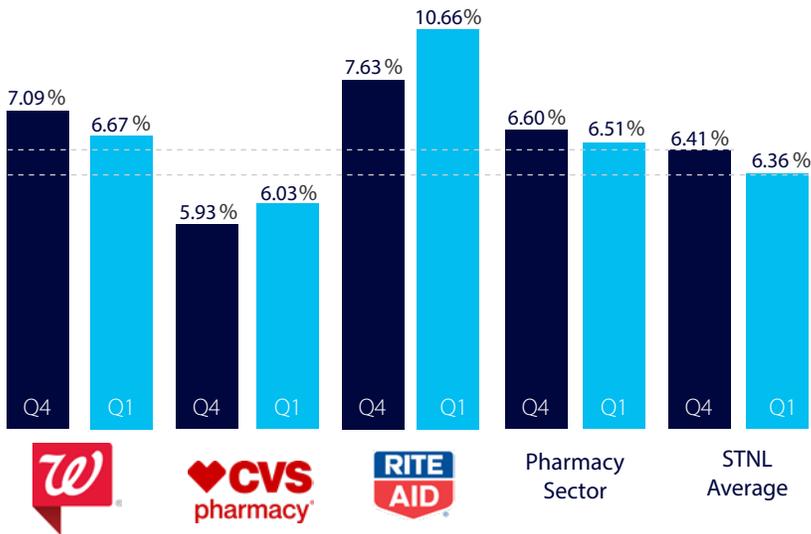
Dollar Store Cap Rates w/ 10+ Years



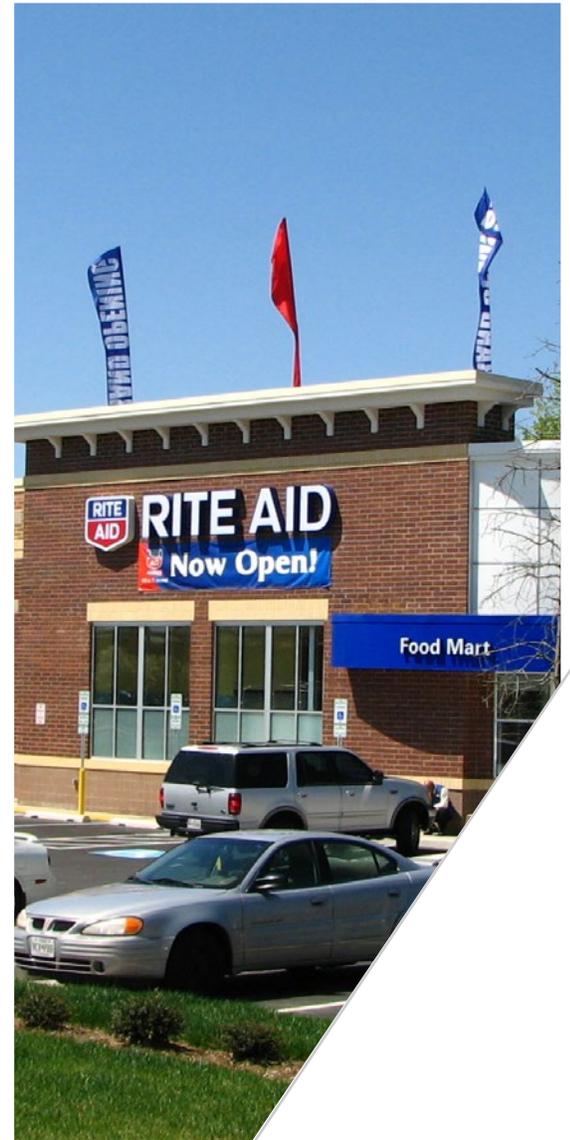
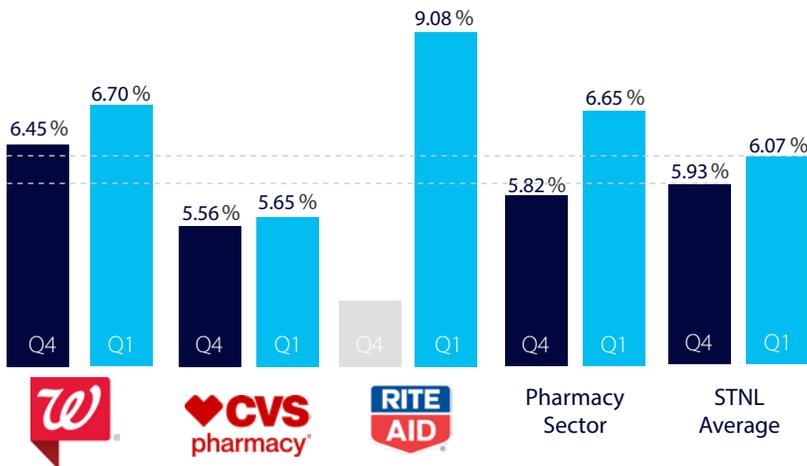
Markets in Depth | Pharmacy

Cap rates in the pharmacy sector overall dropped 9 bps to 6.51%. Among long-term deals, cap rates rose 83 bps to 6.65%. A drop in average lease term from 15.4 years to 14.6 years could account for a portion of that increase. As with the dollar stores, pharmacies are likely to benefit from this crisis. We are already seeing asking prices on pharmacies deals stubbornly staying in low 5% for newer stores and with some of the best credit in the STNL world and good locations to boot, look to this sector to outperform in Q2 and the remainder of the year.

Pharmacy Cap Rates



Pharmacy Rates Cap Rates w/ 10+ Years



Brand-by-Brand Average Cap Rate Changes

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.

Tenants	Q4 2019 Average Cap Rates	Q1 2020 Average Cap Rates	Change in Average Cap Rates (bps)
7-Eleven	4.50%	4.89%	39.3
Arby's	5.70%	5.98%	28.2
Burger King	5.51%	5.58%	7.0
CVS	5.59%	5.96%	37.0
Dollar General	6.60%	6.95%	34.6
Ruby Tuesday	6.54%	6.50%	-3.8
Taco Bell	5.84%	5.69%	-14.6
Walgreens	6.45%	6.91%	45.9
Wendy's	5.44%	5.81%	37.3



STNL Cap Rates Vs. 10-Year Treasury Rates

The first increase in the 10-Year Treasury since mid-2018 contributed to a closing of the cap rate spread. As discussed elsewhere, these remained virtually unchanged from the third to the fourth quarter of 2019. In addition, the total number of transactions continues to rise.

