

Cap Rate Report



Third Quarter 2020 Quick Stats

6.56%



Average cap
rate

**12.9
Years**



Average lease
years (2020)

Essential retail sectors drive slight rebound in STNL activity

With the third quarter of 2020 drawn to a close, investors have now spent over seven months operating in a pandemic-stricken environment and have adjusted their net lease investment targets accordingly. Whereas nearly every sector saw a drop in volume between the first and second quarter, certain sectors that have experienced minimal disruption in their day-to-day business are now seeing significant rebounds in investment volume.

Overall activity rose 13.8% in the third quarter of 2020, up to 329 trades from 289 in the previous quarter, though still far below the 416 transactions in the first quarter. The average cap rate across sectors rose 20 basis points, as the average remaining lease term dropped by half a year, though the average cap rate for deals with 10+ years of term remaining decreased 14 basis points to 5.97%. The fact that cap rates have risen only minimally in 2020 is likely explained by investors' increased focus on the handful of tenant sectors considered to be the most stable.

Assets tenanted by Banks, C-Stores and Medical users saw activity continue to decline, while volume in the Education and Big-Box sectors remained near zero. The four sectors that performed best were Automotive, QSR, Pharmacies and Dollar Stores.



Sectors in Brief

Sectors	Q2 2020					Q3 2020					Change in:	
	Avg Cap	Low	High	Avg Lease Term	Sample Size	Avg Cap	Low	High	Avg Lease Term	Sample Size	Average Cap Rate (bps)	Lease Years Remaining
Automotive	6.29%	4.81%	9.26%	11.2	21	6.50%	4.00%	8.80%	11.5	37	21.2	0.3
Bank	6.15%	4.42%	8.40%	9.8	14	7.59%	5.60%	10.85%	4.5	10	143.9	(5.3)
Big-Box	No Trades Observed										-	-
Casual Dining	6.40%	4.89%	7.70%	16.0	7	6.49%	4.68%	9.77%	7.7	8	9.2	(8.3)
C-Store	6.14%	4.00%	10.80%	13.0	13	5.68%	4.38%	7.13%	10.5	8	-45.8	(2.5)
Dollar Store	7.11%	5.74%	10.34%	12.8	77	6.93%	4.45%	10.20%	12.4	75	-18.5	(0.4)
Educational	No Trades Observed										-	-
Medical	6.92%	5.80%	7.85%	12.7	7	6.20%	6.20%	6.20%	15.0	1	-72.3	2.3
Pharmacy	6.31%	4.67%	9.00%	13.8	43	6.30%	4.05%	14.18%	13.2	56	-0.6	(0.5)
QSR	5.72%	4.10%	7.73%	16.6	49	5.61%	3.75%	36.24%	14.6	91	-11.4	(2.0)
Other Retail	6.44%	4.24%	8.75%	10.6	32	6.88%	5.15%	11.20%	10.7	28	43.1	0.1
Average	6.36%			13.5		6.56%			12.9		20.4	(1.5)
Total Sample Size	264					315						

The Automotive average cap rate rose 21 basis points to 6.50%, while the number of trades in the sector rose from 21 to 37.

QSR cap rates fell 11 basis points to 5.61% despite a two-year decrease in average remaining lease term. The sector saw a major resurgence in trades, up to 91 from just 49 last quarter.

Cap rates for Pharmacies fell less than 1 basis point, staying at 6.30%, while average lease term fell half a year. Activity rose, though not as sharply as in the aforementioned sectors, with volume up from 41 to 56 trades quarter-over-quarter.

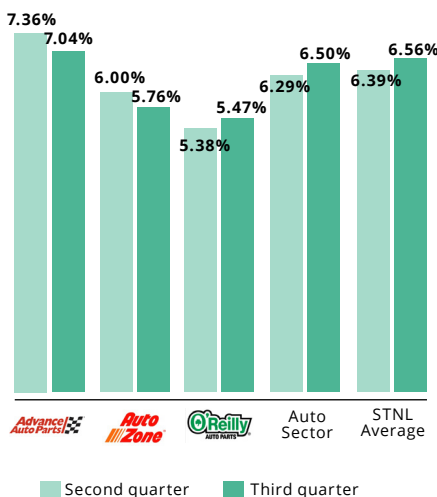
Dollar Store cap rates dropped 18 basis points to 6.93% despite a 0.4-year drop in average remaining lease term, and activity remained roughly constant (75 trades vs. 77 last quarter).

Markets in depth

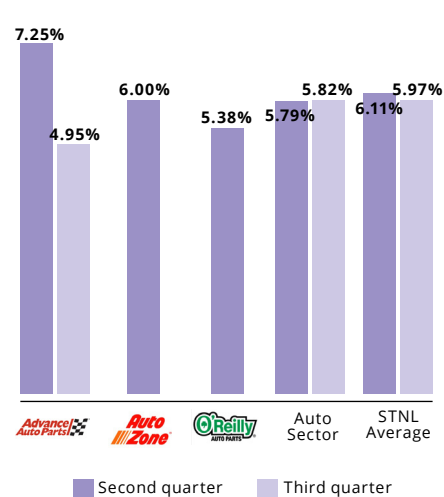
Automotive

Cap rates in the Automotive sector increased 21 basis points, reversing the 8.7-point drop last quarter, despite a slight increase in average remaining lease term. Cap rates on 10+ year deals rose only three basis points, however, to 5.82%. Activity increased dramatically, driven entirely by a resurgence in smaller tenants: last quarter, 11 different tenants comprised a total of 21 trades and the sector's "big 3" (Advance Auto Parts, O'Reilly Auto Parts, and AutoZone) accounted for 52% of volume. This quarter, 27 different tenants comprised the sector's 37 trades of which the big 3 accounted for only 22%.

Average cap rates - all lease terms



Average cap rates - 10+ year lease terms

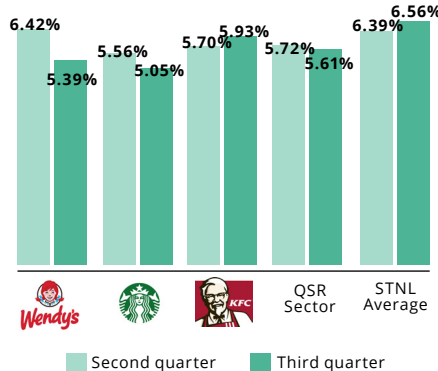


Markets in Depth (continued)

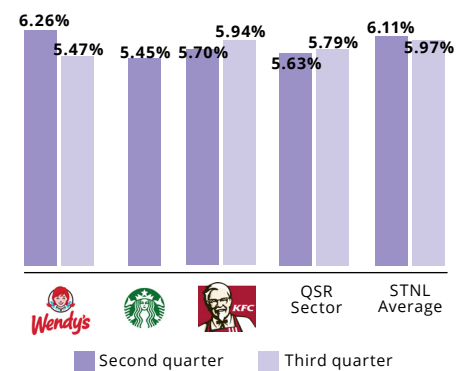
QSR

The QSR sector saw the largest resurgence in activity, up to 91 trades from just 49 last quarter (though still well below the 123 seen in the first quarter of 2020), and the sector's average cap rate fell 11 basis points to 5.61% despite a 2.0-year decrease in average remaining lease term. Forty-seven different tenants were represented in the third quarter volume, up from 25 last quarter, which could signify a return of investor confidence now that most QSR retailers have adapted to operating under pandemic-related restrictions.

Average cap rates - all lease terms



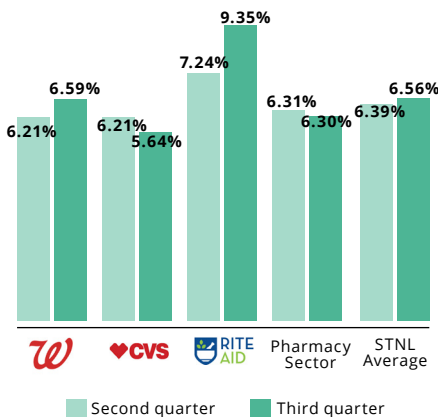
Average cap rates - 10+ year lease terms



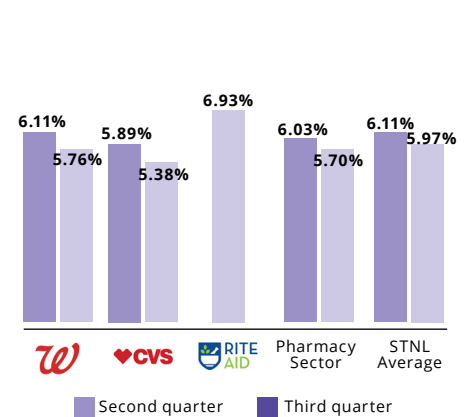
Pharmacy

Pharmacy cap rates changed less than one basis point, averaging 6.30% in the third quarter of 2020, though cap rates for deals with 10+ years of remaining lease term fell 33 basis points to 5.70%. Activity rose from 41 trades to 56, but remained 100% concentrated among the largest three tenants, Walgreens, Walgreens, Rite Aid and CVS.

Average cap rates - all lease terms



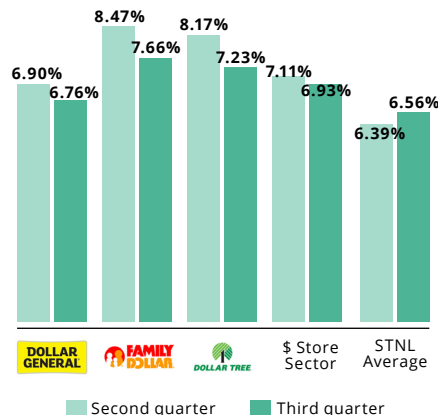
Average cap rates - 10+ year lease terms



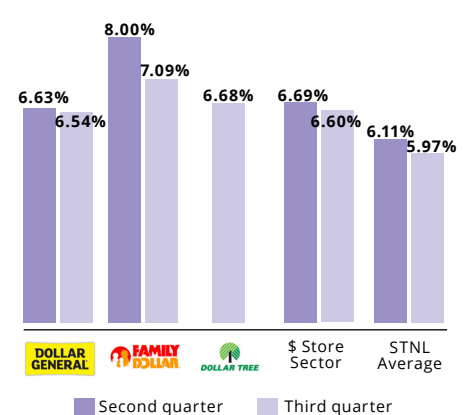
Dollar Store

Cap rates in the Dollar Store sector dropped 18 basis points to 6.93%, essentially returning to first quarter levels. Volume dropped slightly, from 77 to 75 trades, but remains higher than the 64 trades seen in the first quarter. After enjoying the first quarter as the largest net-lease sector by volume, Dollar Stores lost that position in the third quarter due to QSR's major resurgence.

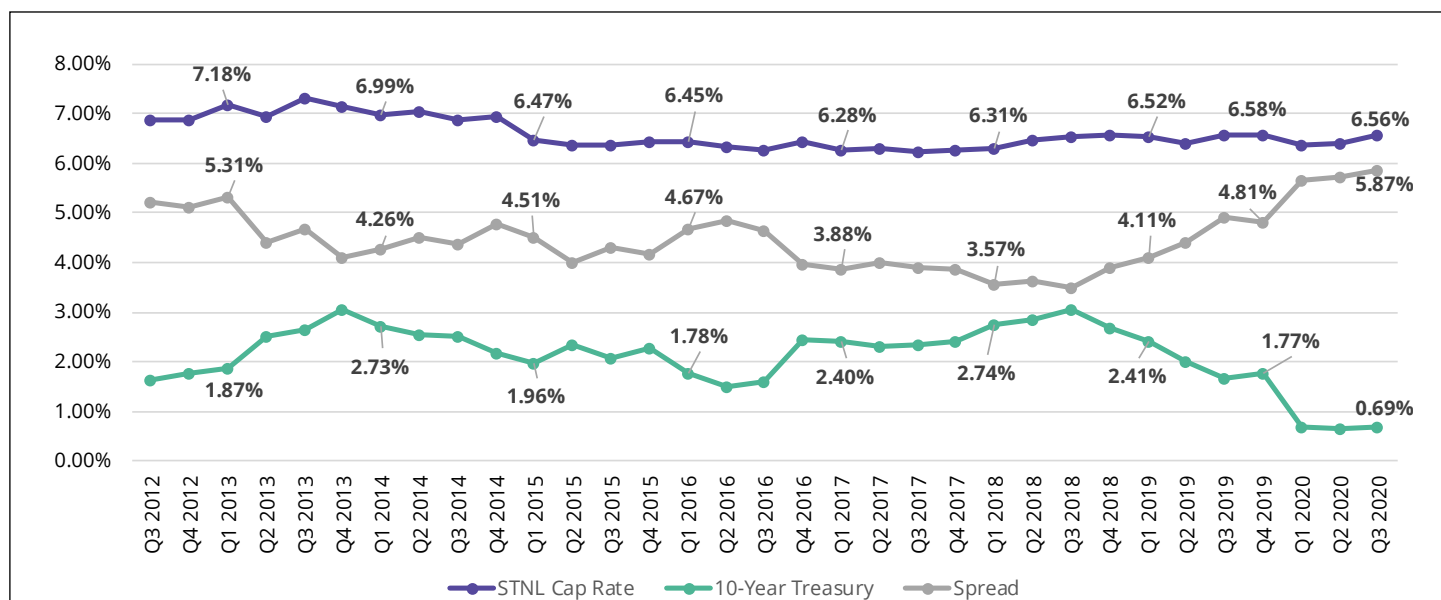
Average cap rates - all lease terms



Average cap rates - 10+ year lease terms



STNL Cap Rates vs 10-Year Treasury Rates



In summary, this quarter's results demonstrate a slight rebound in the number of overall transactions. Cap rates, while up slightly, are still within historical norms. Spreads with the 10-Year are however remain at all-time highs. COVID and the election seem to be dominating not only the headlines these days but also almost every discussion with buyers and sellers. Uncertainty over the future, 1031 exchange rules, and the short-term political issues of the country are weighing heavily on the market's collective mind as well. One thing is for sure though; the fourth quarter will bring closure to a wild year. We expect to see a busy 1031 season regardless of the outcome of the election or a surge in COVID. Pent up demand from institutions and private buyers alike is beginning to result in a noticeable increase in activity.

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