Q4 2024 Cap rate report

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The fourth quarter of 2024 experienced an increase in investment sales compared to previous quarters. Prolonged economic headwinds due to high interest rates, inflation, economic uncertainty, and e-commerce disruption contributed to a slowdown in sales volume in previous quarters. Single tenant net lease (STNL) has shown resilience, especially in the quick-service restaurant, dollar store, and convenience store sectors. However, STNL has still experienced significant challenges, especially in the pharmacy and casual dining sectors, which have recently announced major store closures.

Despite the Federal Reserve's decision to lower interest rates, the yield on the 10-Year U.S. Treasury yield has once again risen above 4% to 4.57% as of December 2024. This is unusual since the yield on the 10-year Treasury was always lower in the 100 days after the first rate cut in the previous seven cutting cycles by the Fed since the 1980s, according to JP Morgan. JP Morgan believes this seemingly paradoxical trend is due to stronger growth expectations and macroeconomic uncertainties. Economists initially predicted that the U.S. economy would grow by 1.2% in 2024, but that estimate more than doubled to 2.7% by the end of 2024. The robust growth puts upward pressure on yields as the expectation for more rate cuts by the Fed decreases. As for economic uncertainty, many questions are raised with regards to the Fed's future actions as well as the potential inflationary trends that result from the tariffs that are implemented by the new Trump administration.

While net lease acquisitions are typically viewed as higher risk than U.S. Treasury bonds, STNL investments can generally offer higher returns for a minimal increase in risk. With 10-to-20-year lease terms, creditworthy tenants, and annual rent escalations, investors can benefit from reliable cash flows and various tax advantages that U.S. Treasury bonds do not offer. The Federal Reserve indicates it will hold off on any rate cuts for the time being.

Many high-net-worth investors have significant amounts of liquid assets and finance STNL deals with low-leverage strategies, or just transact all cash, especially for transactions below $5 million. As a result, higher interest rates have had a less significant effect on lower priced deals, which primarily involve high-net-worth investors. Higher priced transactions that exceed $5 million have experienced extended periods on market, resulting in stale listings and slower activity. However, institutional investors, which dominate the market for higher priced assets, have remained active in STNL transactions this quarter. 1031 exchange investors were also active this quarter and sought to defer their capital gains taxes while optimizing their portfolios.

The average cap rate for Q4 2024 was lower compared to the third quarter, falling slightly to 6.35% by 8 basis points for recorded deals. This is still higher than the cap rate for Q1 2024, which indicates elevated risk/return for investors in this sector. Within the STNL sector, the bank, dollar store, big-box, other retail, pharmacy, and QSR sectors experienced increases in cap rates between the third and fourth quarters of 2024. In contrast, the automotive, casual dining, and medical sectors experienced decreases. Overall term remaining for recorded deals in Q4 increased since Q3. The automotive, bank, casual dining, C-Store, dollar store, big-box, and pharmacy sectors all experienced an increase in term remaining. Pricing for STNL sales increased from Q3. Q4 sales averaged $3.0 million, which is nearly $200,000 higher than in Q3.

Sectors in brief

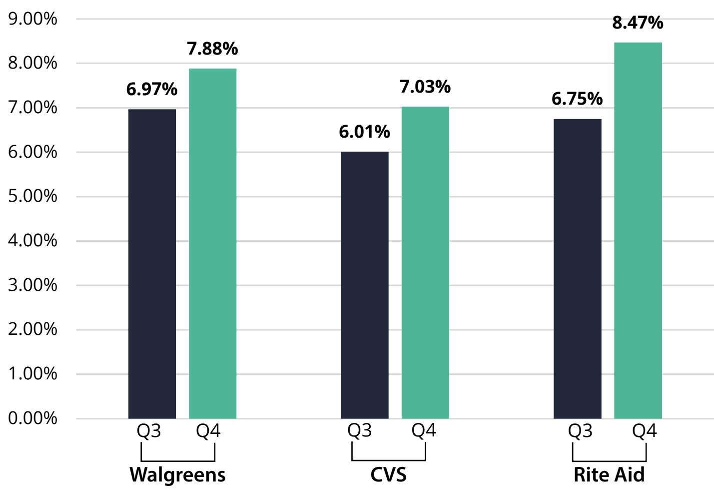
Sectors	Q3 2024					Q4 2024					Change in Avg Cap Rates (bps)	Change in Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size		
Automotive	6.40%	4.25%	11.50%	10.6	49	6.26%	4.43%	9.80%	13.2	69	-14.28	2.6
Bank	5.74%	2.00%	8.33%	9.2	15	5.77%	4.50%	7.97%	9.3	30	2.57	0.1
Casual Dining	6.50%	4.35%	8.38%	9.9	45	6.25%	3.28%	11.00%	11.1	59	-25.06	1.2
C-Store	5.50%	4.50%	13.39%	14.8	29	5.50%	4.60%	8.69%	16.4	41	0.00	1.6
Dollar Store	7.19%	6.00%	10.27%	10.1	91	7.34%	4.92%	12.75%	10.8	79	14.57	0.7
Big-Box	6.67%	5.50%	8.68%	5.7	12	6.81%	4.14%	10.30%	7.3	17	14.19	1.6
Medical	6.83%	5.40%	10.41%	8.8	22	6.69%	3.71%	11.58%	8.3	29	-13.82	-0.5
Other Retail	6.56%	4.64%	10.00%	10.0	27	6.76%	3.75%	11.65%	7.2	37	20.15	-2.9
Pharmacy	6.50%	4.20%	9.92%	12.3	31	7.74%	4.75%	10.11%	16.9	27	123.82	4.7
QSR	5.65%	3.50%	10.18%	13.0	181	5.73%	3.56%	11.59%	11.8	206	7.90	-1.2
	6.43%			11.2	561	6.37%			11.4	665		

[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.

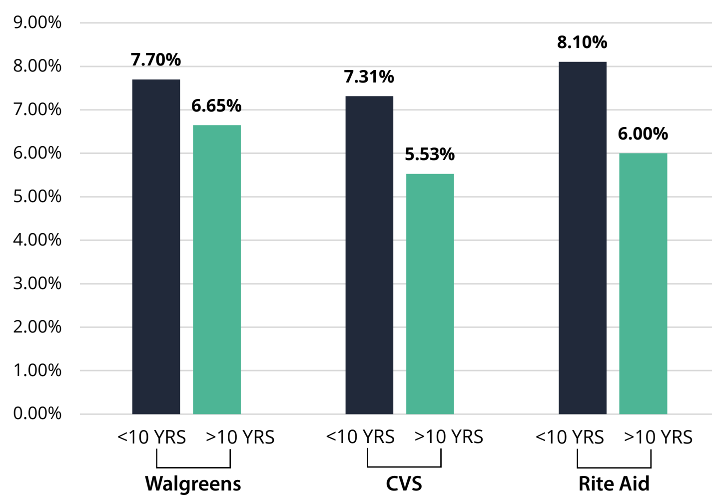
Markets in depth: Pharmacy

The pharmacy sector experienced a decrease in transaction volume in the fourth quarter of 2024 compared to the first three quarters. The average cap rate on observed deals increased by 123.8 basis points to 7.74%. Walgreens, CVS, and Rite Aid are all experiencing significant turbulence. In October 2024, Walgreens announced plans to close 1,200 stores, approximately 14% of its portfolio, over the next three years, an increase from a previous plan to close 300 stores. CVS began closing nearly 900 stores from 2022 to 2024 and cut 2,900 corporate jobs, after closing 244 stores between 2018 and 2020. Rite Aid filed for bankruptcy in 2023 and closed 500 stores. These market trends are a result of changing consumer behaviour, increased competition, and disruptions in the pharmacy industry. The bulk of drugstore sales come from filling prescriptions, but profits from this line of business have dropped in recent years as pharmacy benefit managers have lowered reimbursement rates for prescription drugs. Additionally, demand is shifting from traditional pharmacies to alternative options such as Amazon and Walmart, which have invested in digital services for customers.

Overall Pharmacy Cap Rates



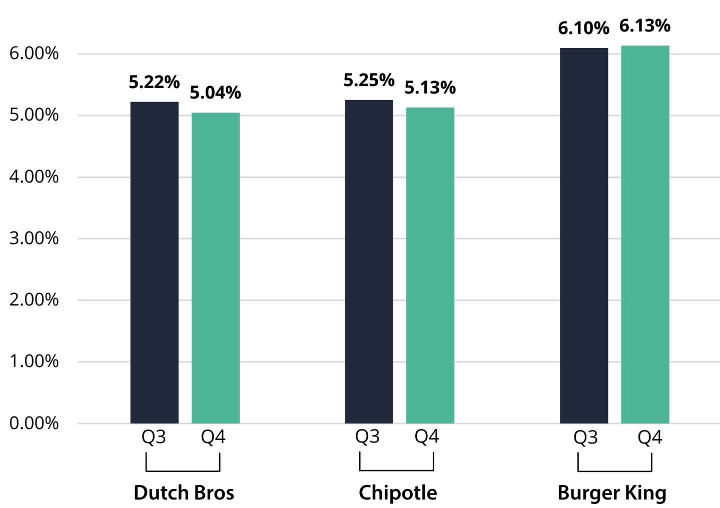
Pharmacy Cap Rates by Term Remaining



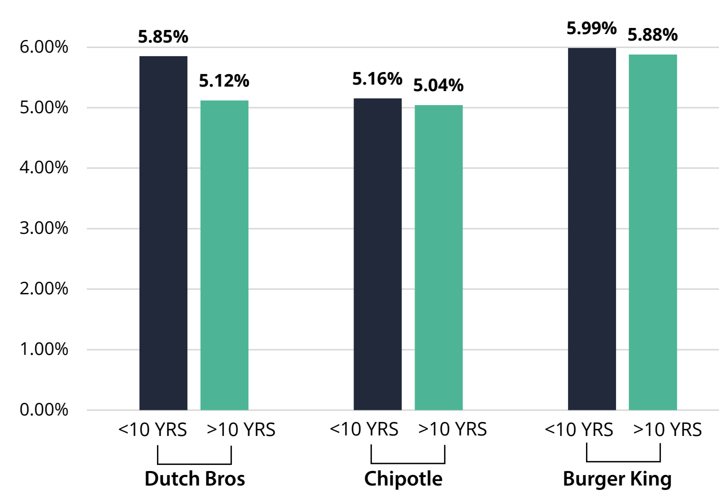
Markets in depth: QSR

Quick service restaurants (QSRs) have experienced an increase in transaction volume this quarter compared to the third quarter of 2024. Cap rates increased slightly by 8 basis points since Q3 2024. Average term length decreased to 11.8 years. Despite macroeconomic challenges and relatively high interest rates, the QSR industry has remained the most stable sector due to longer lease terms, reliable income, low landlord responsibilities, and lower price points.

Overall QSR Cap Rates



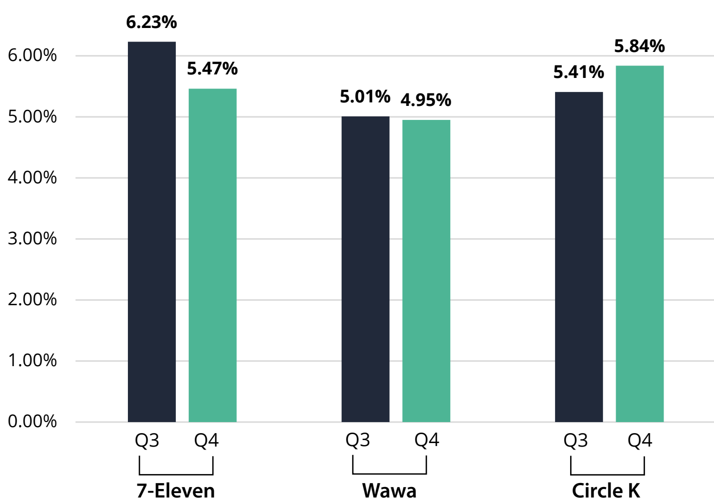
QSR Cap Rates by Term Remaining



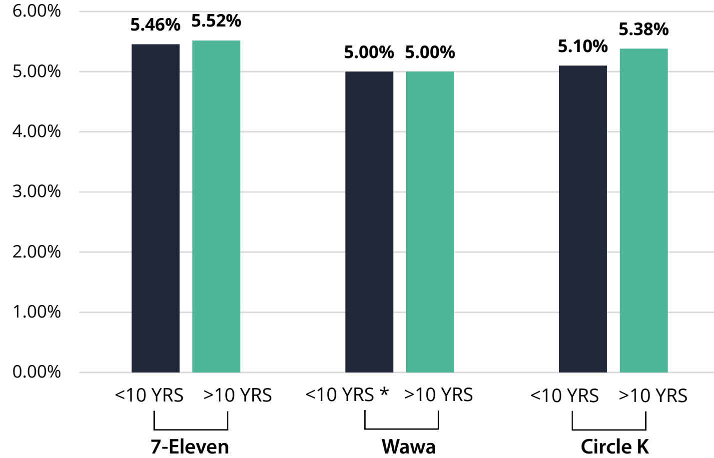
Markets in depth: C-Store

C-Stores have experienced an increase in transactional volume compared to Q3 2024, with 41 observed transactions in Q4 2024. Cap rates held steady while the average sale price increased to $3,987,208. The average term remaining increased to 16.4 years in Q4 2024, as new construction continues. Overall, C-Stores remain stable due to their established customer base and essential role in daily consumer activity.

Overall C-Store Cap Rates



C-Store Cap Rates by Term Remaining

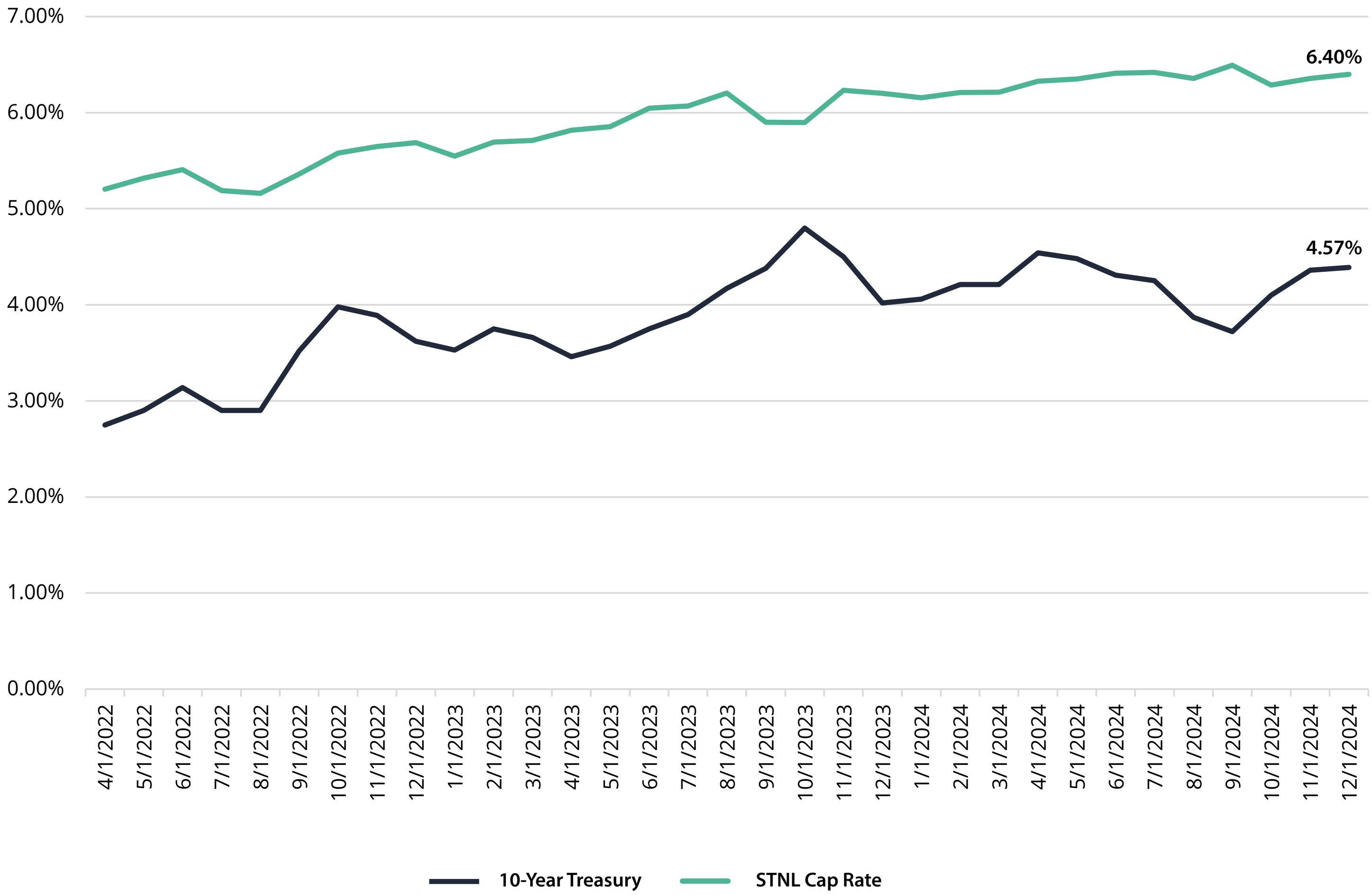


Brand by brand: Average cap rate changes

Tenants	Q3 2024 Average Cap Rates	Q4 2024 Average Cap Rates	Change (bps)
Dollar General	7.10%	7.09%	-0.93
Starbucks	5.74%	5.77%	2.63
7-Eleven	6.23%	5.47%	-76.67
Family Dollar	8.02%	8.29%	26.83
Walgreens	6.97%	7.88%	91.53
DutchBros	5.22%	5.04%	-17.77
Chipotle	5.25%	5.13%	-12.02
Take 5 Oil Change	6.45%	4.98%	-146.57
Taco Bell	5.50%	6.23%	-22.00

*All calculations are based upon available comps for each specific quarter. The total number of sale comps for respective tenants in each quarter also varies.

STNL Cap Rates vs. 10-Year Treasury Rates



Conclusion

With inflation rates continuing to cool, the Federal Reserve has already made interest rate cuts but has indicated that it will hold back on future rate cuts for the time being due to strong economic activity in recent months. Still, investment activity may continue to improve as both private and institutional investors have remained active in the market. STNL has been one of the most stable sectors in terms of cash flows, despite unfavourable economic conditions. However, not all sectors within STNL have performed well in recent quarters, which necessitates investors to understand the nuances of each tenant industry to leverage the most ideal investment opportunities and solutions.

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