Q3 2024 Cap rate report

U.S. Capital Markets Net Lease Group

The third quarter of 2024 experienced a continued slowdown in investment sales compared to previous quarters. Prolonged economic headwinds due to high interest rates, inflation, economic uncertainty, and e-commerce disruption have contributed to the lackluster sales volume. 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.

Because the Federal Reserve recently began to lower interest rates, the yield on the 10-Year U.S. Treasury yield had fallen below 4% to 3.73% as of September 2024. 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. If the Federal Reserve continues to lower interest rates as expected, due to the stabilization of inflation rates, lending costs will decrease and make STNL an even more attractive investment.

Many high-net-worth investors have significant amounts of liquid assets and finance STNL deals with cash or low-leverage strategies, especially for transactions below $5 million. As a result, higher interest rates have had a less significant effect on lower priced deals. Higher priced transactions that exceed $5 million have experienced extended periods on market, resulting in 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 Q3 2024 was lower compared to the second quarter, falling slightly to 6.24% by 7 bps 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 automotive, casual dining, C-store, and medical sectors experienced increases in cap rates between the second and third quarters of 2024. In contrast, the bank, dollar store, pharmacy, and QSR sectors experienced decreases. Overall term remaining for recorded deals in Q3 increased since Q2. The bank, C-store, dollar store, medical, pharmacy, and QSR sectors all experienced an increase in term remaining. Pricing for STNL sales increased slightly from Q2. Q3 sales averaged $2.57 million, which is over $35,000 higher than in Q2.

Average Cap Rate
6.24%

Average Lease Term Remaining
11.3

Sectors in brief

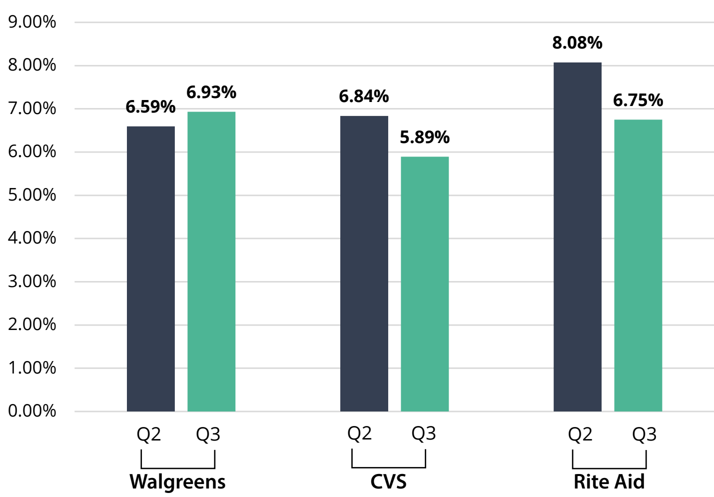
Sectors	Q2 2024					Q3 2024					Change in Avg Cap Rates (bps)	Change in Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size		
Automotive	6.23%	3.74%	9.51%	11.7	75	6.34%	4.25%	11.50%	10.6	49	10.28	-1.1
Bank	6.22%	2.86%	8.58%	6.1	29	5.67%	2.00%	7.59%	9.2	15	-55.38	3.1
Casual Dining	6.38%	4.40%	10.10%	10.3	65	6.68%	4.35%	8.38%	9.9	45	29.84	-4.4
C-Store	5.10%	4.49%	12.04%	14.4	23	5.50%	4.25%	13.39%	14.8	29	40.00	-0.4
Dollar Store	7.22%	5.88%	12.22%	9.7	86	7.15%	6.00%	10.27%	10.1	91	70.79	0.5
Big-Box	6.40%	4.25%	8.50%	10.1	7	6.40%	5.50%	8.68%	5.7	11	0.00	0.4
Medical	6.40%	5.75%	8.00%	7.7	10	6.61%	5.40%	9.90%	8.8	22	20.46	1.1
Other Retail	6.83%	5.00%	9.59%	8.5	32	6.41%	4.64%	10.00%	10.0	28	-41.45	1.6
Pharmacy	6.76%	4.58%	10.15%	10.3	32	6.43%	4.20%	9.92%	12.3	31	-32.18	1.9
QSR	5.65%	2.72%	10.05%	12.6	156	5.60%	3.50%	10.18%	12.9	182	-4.12	0.2
	6.31%			10.9	515	6.24%			11.3	503		

[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.

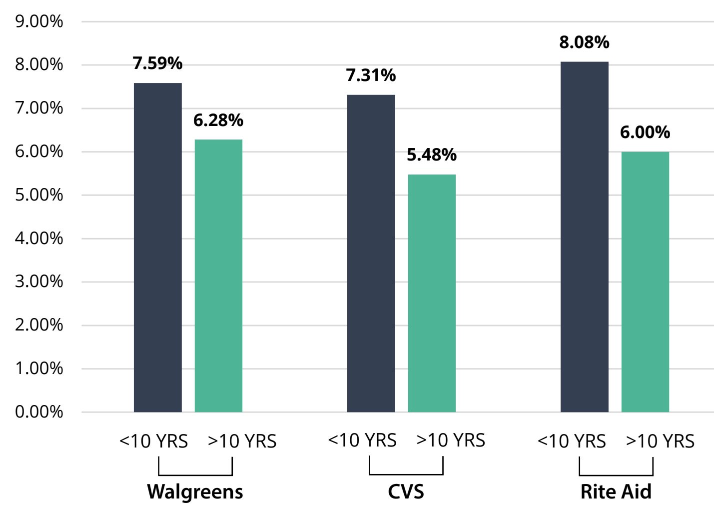
Markets in depth: Pharmacy

The pharmacy sector experienced a decrease in transaction volume in the third quarter of 2024 compared to the first and second quarters. The average cap rate on observed deals decreased by 32 bps to 6.43%. Walgreens, CVS, and Rite Aid are all experiencing significant turbulence. Walgreens recently 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 is restructuring and laid off 2,900 employees; the departure of its CEO, Karen Lynch, is also adding to the company's uncertainty. Rite Aid previously filed for bankruptcy but has now emerged as a private company. Nonetheless, these developments are an indication that 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



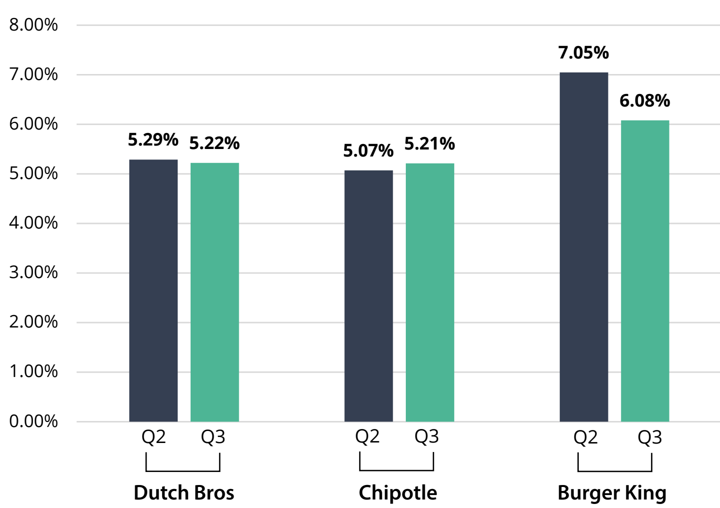
Pharmacy Cap Rates by Term Remaining



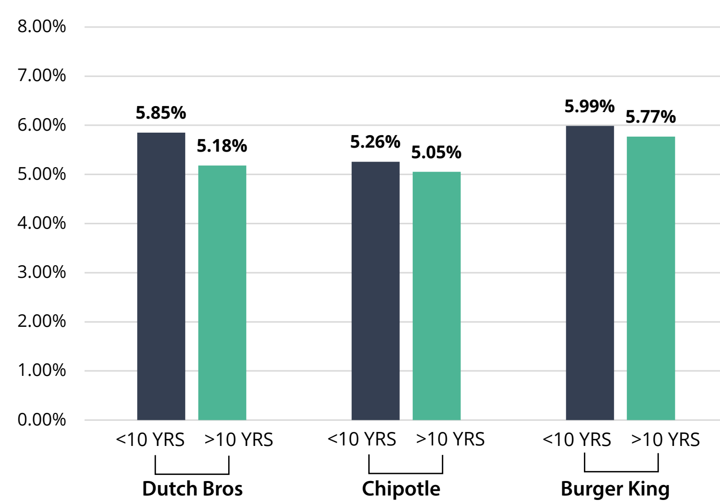
Markets in depth: QSR

Quick service restaurants (QSRs) have experienced a decrease in transaction volume this quarter compared to the first two quarters of 2024. Cap rates decreased slightly by 4 bps since Q2 2024. Average remaining term length increased slightly to 12.9 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



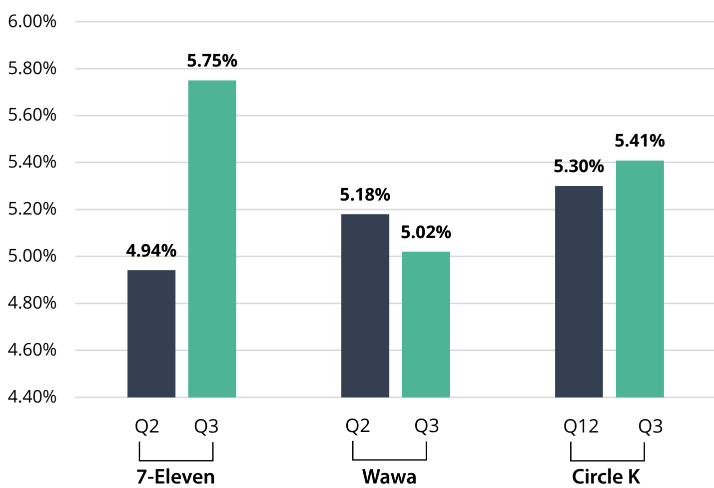
QSR Cap Rates by Term Remaining



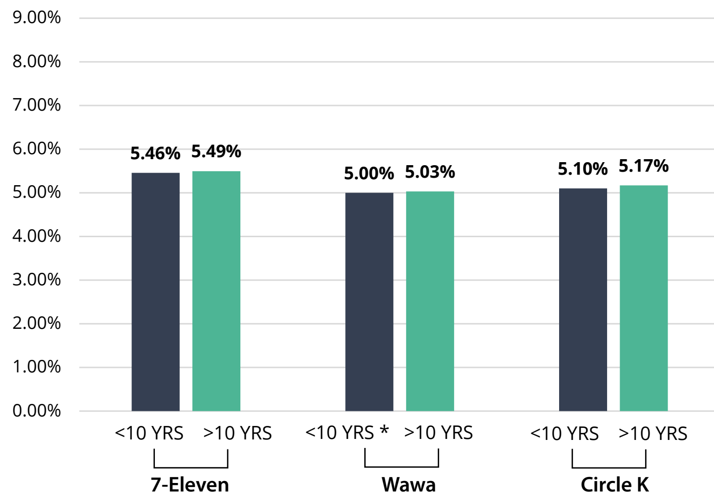
Markets in depth: C-Store

C-Stores have experienced a decrease in transactional volume compared to Q2 2024, with 28 observed transactions in Q3 2024. Cap rates increased by 40 bps while the average sale price decreased to $3,346,630. The average remaining term length increased to 14.8 years in Q3 2024. 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

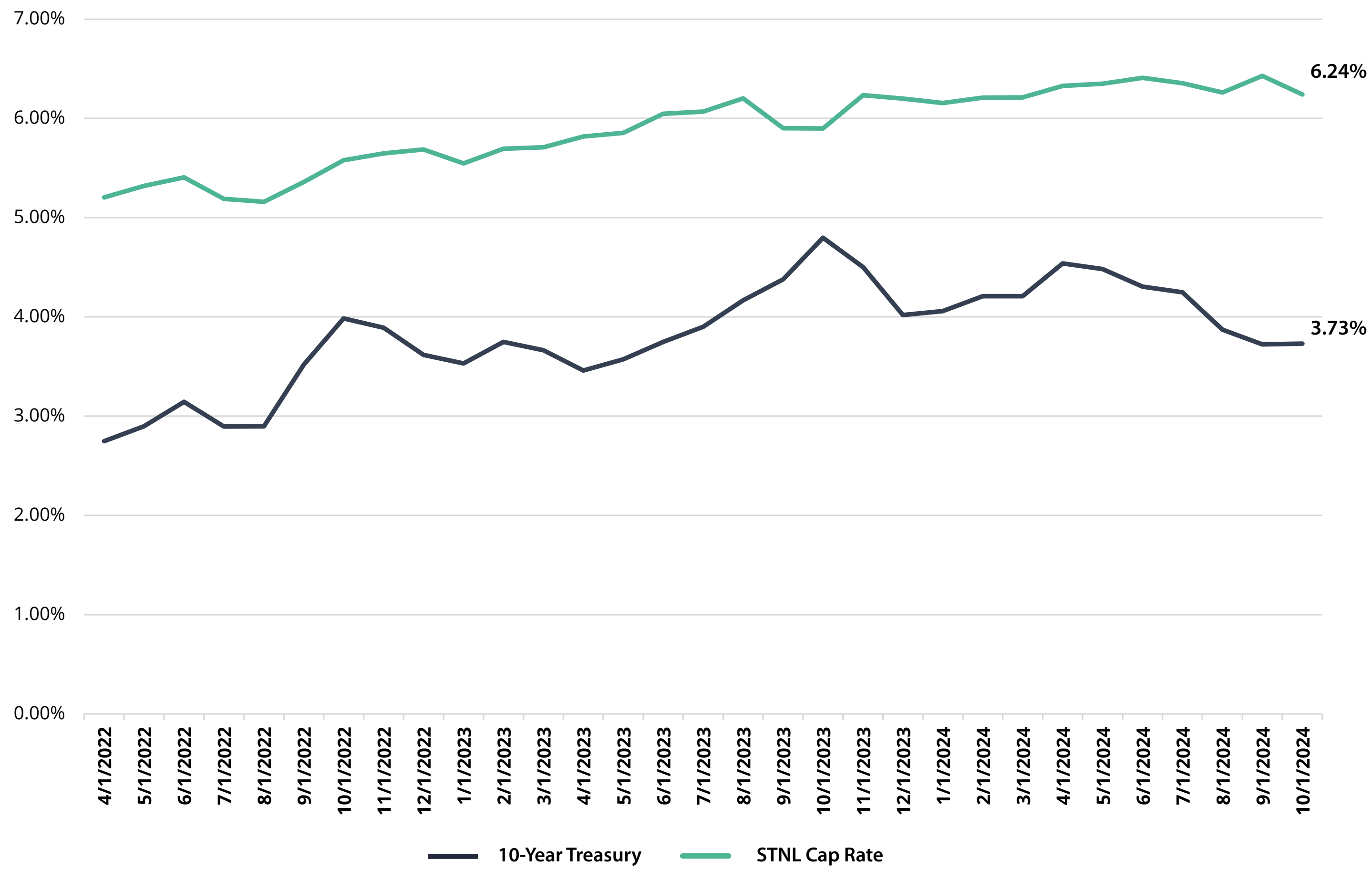


Brand by brand: Average cap rate changes

Tenants	Q2 2024 Average Cap Rates	Q3 2024 Average Cap Rates	Change (bps)
Dollar General	7.04%	7.06%	1.06
Starbucks	5.53%	5.68%	14.86
7-Eleven	4.94%	6.19%	124.63
Family Dollar	8.24%	7.98%	-25.94
Walgreens	6.59%	6.93%	33.57
DutchBros	5.29%	5.22%	-6.63
Chipotle	5.07%	5.21%	14.08
Take 5 Oil Change	6.10%	6.36%	26.29
Taco Bell	5.46%	5.43%	-2.97

*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 and has indicated that it will make additional cuts as inflation continues to stabilize. As a result, investment activity will likely 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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