Q1 2024 Cap rate report

U.S. Capital Markets Net Lease Group

The first quarter of 2024 showed a slight uptick in investment sales compared to the previous quarter; however, the change is within the noise and is still below historic norms. Continuous economic headwinds including high interest rates, geopolitical factors, and supply chain bottlenecks have all had contributing effects to the slow market. Single tenant net lease (STNL) has still shown resilience within the landscape, but is certainly not immune to these challenges.

Debt markets, while better than Q4, continue to remain in a state of turmoil. In Q3, bond yields spiked dramatically with the 10-Year U.S. Treasury Yield touching 5%, falling to 3.75% in mid-December, then rising to 4.2% by the end of March. While certainly not viewed as a "risk-free" investment, a net lease acquisition can be assessed as a "bond wrapped in real estate." With 10 to 20-year lease terms, credit rated tenants, and annual rent escalations, investors can capture tax advantages and annual returns that remain higher, on average, than treasury yields. However, rising cap rates have shortened that gap, but still retain a better return. Naturally, investors have not completely sheltered away to the same extent as other sectors.

Since STNL assets are often purchased on an all-cash basis, interest rates and the cost of borrowing have not put a slow down on lower priced deals (< $5 million). Most high-net-worth investors and 1031 exchange buyers with high liquidity viewed the period of rising interest rates as a time to capitalize on higher yields, as the two correlate with one another. Higher priced assets (> $5 million) saw longer days on market, resulting in stale/lost listings. However, institutional investors have been very active in STNL properties this quarter in comparison to recent quarters, signaling that these investors are diverging their funds away from office properties and into more stable sectors. Additionally, re-trades and longer closing timelines became the norm. 1031 Exchange buyers contributed to much of the deal flow in Q1, which is consistent with previous quarters, while there were investors who opted out to pay their capital gains tax, many were aggressive for the right asset that checked their boxes.

Cap Rates for Q1 2024 continued to rise gradually, climbing to 6.2%, an increase of 7.8 bps on recorded deals. The risk/return for investors in this sector still remains high but has slowly declined from November of 2023 where cap rates sat at 6.4%. Within the SNTL sector, automotive, casual dining, dollar stores, medical and QSRs have all seen increases in their cap rates, while banks, c-stores, big-box, and pharmacies have all seen decreases. Term remaining for recorded deals in Q1 have seen an overall increase, with big-box, automotive, and pharmacy all seeing significant increases, while casual dining and medical assets saw drops to their averages. Pricing for these sales have slightly decreased in comparison to Q4, with Q1 recording an average price of $2.62 million, a drop of nearly $17,000.

Average Cap Rate
6.20%

Average Lease Term Remaining
12.33

Sectors in brief

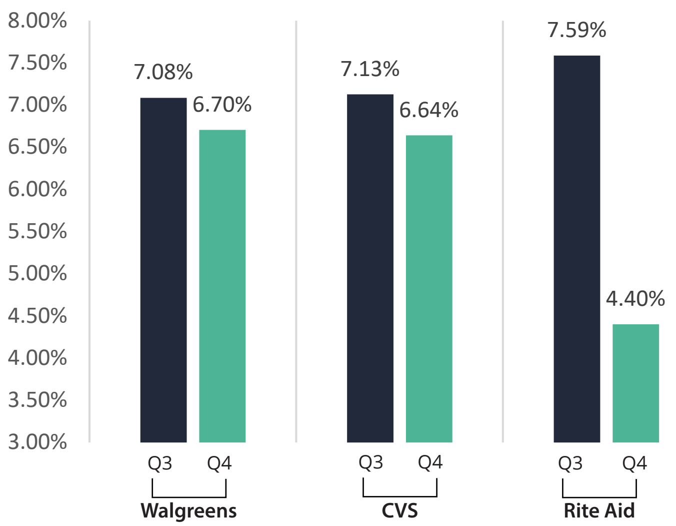
Sectors	Q4 2023 Avg Cap Rate	Q4 2023 Low	Q4 2023 High	Q4 2023 Avg Lease Yrs	Q4 2023 Sample Size	Q1 2024 Avg Cap Rate	Q1 2024 Low	Q1 2024 High	Q1 2024 Avg Lease Yrs	Q1 2024 Sample Size	Change in Avg Cap Rates (bps)	Change in Lease Years (Rem)
Automotive	5.99%	3.81%	8.80%	10.57	37	6.32%	4.54%	9.76%	13.51	62	33.33	2.94
Bank	5.88%	4.00%	7.70%	10.15	22	5.67%	4.25%	7.71%	9.58	20	-21.20	-0.58
Casual Dining	6.10%	4.28%	8.38%	12.04	46	6.21%	3.67%	9.37%	10.70	50	10.94	-1.34
C-Store	5.81%	3.20%	8.78%	13.45	51	5.46%	4.36%	8.14%	14.10	32	-35.67	0.65
Dollar Store	6.70%	5.00%	9.49%	11.31	97	6.89%	5.30%	9.13%	10.87	120	19.07	-0.44
Big-Box	7.00%	5.00%	9.33%	6.13	9	6.10%	5.22%	12.69%	10.72	11	-90.00	4.59
Medical	5.91%	5.00%	6.40%	11.04	4	6.21%	5.37%	8.60%	9.42	18	29.97	-1.61
Other Retail	6.29%	4.06%	9.73%	9.40	40	6.80%	3.35%	8.80%	9.03	20	50.40	-0.37
Pharmacy	7.12%	5.00%	11.26%	10.91	23	6.60%	4.40%	11.81%	11.96	27	-51.08	1.05
QSR	5.46%	3.75%	9.60%	13.68	144	5.59%	3.50%	11.19%	14.02	178	13.07	0.34
	6.12%			11.84	513	6.20%			12.33	570		

[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.

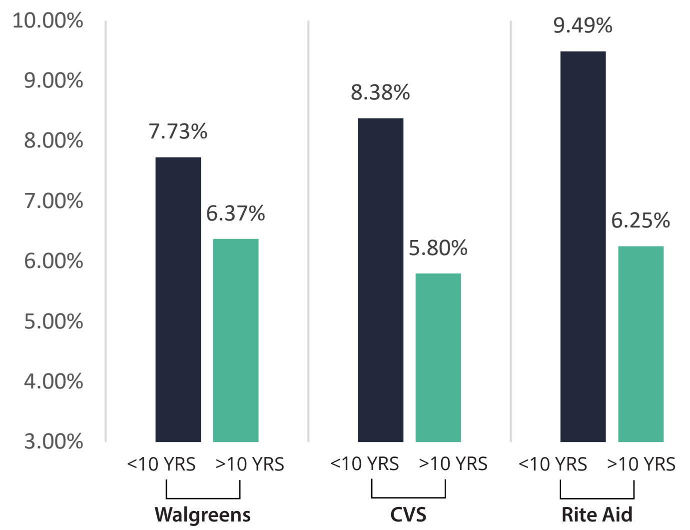
Markets in depth: Pharmacy

The pharmacy sector saw stable transaction volume in the first quarter of 2024. The average cap rate on observed deals dropped 51 basis points to 6.60%, but the spread increased with a low of 4.40% and a high of 11.81%. Rite Aid continues to struggle, as it proceeds to close over 100 stores amid bankruptcy. While Walgreens and CVS have seen their total revenues increase, their stock prices are down year-over-year, which can be attributable to the rising costs of medications.

Overall Pharmacy Cap Rates



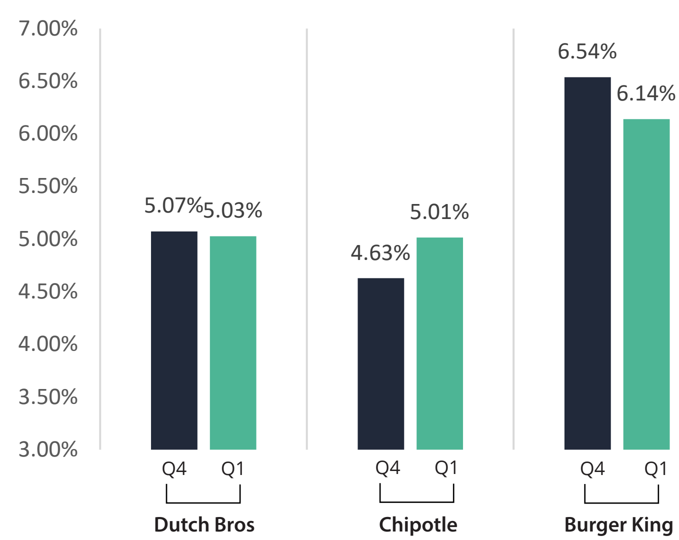
Pharmacy Cap Rates by Term Remaining



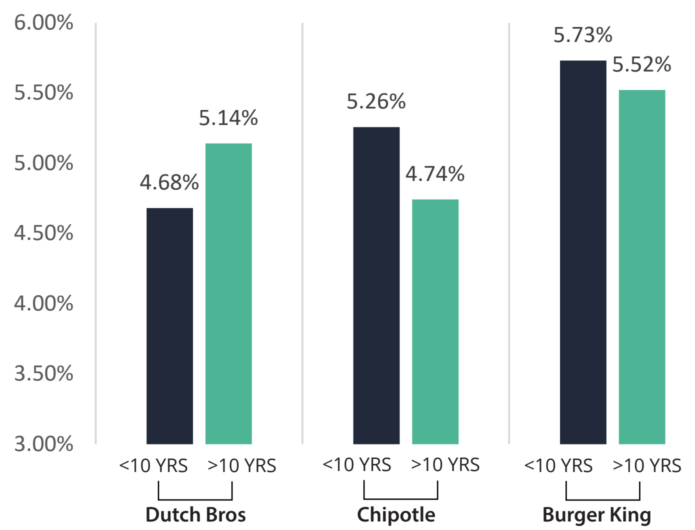
Markets in depth: QSR

Quick service restaurants (QSRs) have seen a high volume of transactions this quarter, and additionally have seen a 24% jump in transactional volume since last quarter. Cap rates have seen a slight increase from Q4 2023, with a 13 basis point hike on observed deals. Average remaining term length also had a slight increase, signaling an increase in deals with new construction/renovation, or new tenants moving into the space. QSR remains the most consistent sector tracked, with stable transactional volume, cap rates, and tenants in the market.

Overall QSR Cap Rates



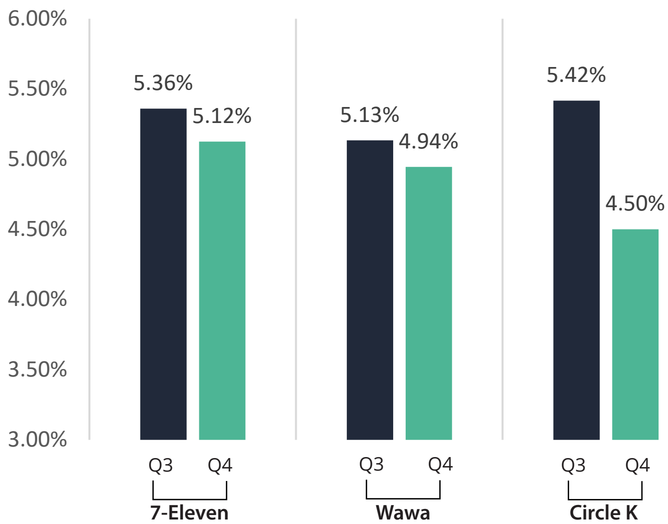
QSR Cap Rates by Term Remaining



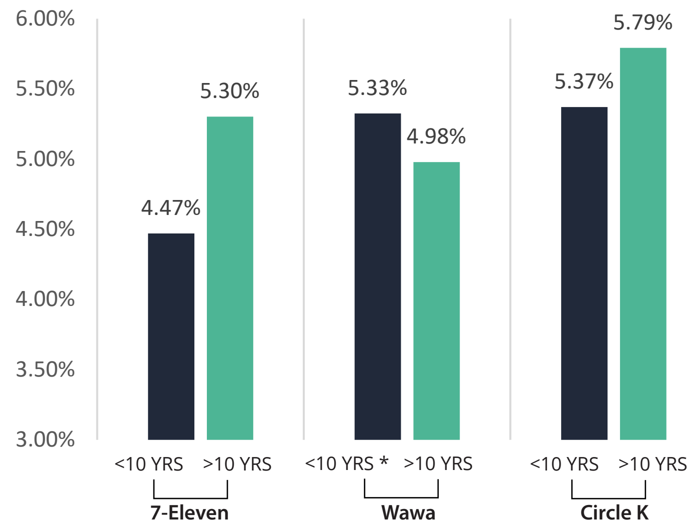
Markets in depth: C-Store

C-Store has seen a drop in transactional volume compared to Q4 2023, with 32 observed trades in Q1 2024. Cap rates also dropped by 36 basis points, while average sale prices increased to $4,044,507. Average remaining term length increased to 14.1 years in Q1 2024, which is a function of more transactions occurring in newly constructed properties.

Overall C-Store Cap Rates



C-Store Cap Rates by Term Remaining



Brand by brand: Average cap rate changes

Tenants	Q4 2023 Average Cap Rates	Q1 2024 Average Cap Rates	Change (bps)
Dollar General	6.63%	6.84%	20.53
Starbucks	5.61%	5.45%	-15.24
7-Eleven	5.36%	5.12%	-23.64
Family Dollar	7.21%	7.63%	42.84
Walgreens	7.01%	6.72%	-28.88
Dutch Bros	5.05%	5.03%	-2.44
Chipotle	4.63%	5.01%	38.61
Take 5 Oil Change	5.92%	5.82%	-10.31
Taco Bell	5.95%	5.79%	-16.63

*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

While turbulence in the broader economy shows no signs of slowing down, coupled with high inflation and the uncertainty of if and when rate cuts will occur, activity will continue to remain in a state of limbo. Private and institutional investors still have capital to spend, and STNL has been one of the most resilient sectors during these economic headwinds. The net lease sector is not immune to the larger economical issues, however understanding of the STNL sector and its tenants continues to be crucial for investors aiming to capitalize on opportunities at hand.

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
avisonyoung.com/netlease