

Q2 2024 Cap rate report

U.S. Capital Markets Net Lease Group

The second quarter of 2024 showed a slowdown in investment sales. High interest rates, geopolitical factors, and supply chain bottlenecks all had contributing effects on the slow market. Single tenant net lease (STNL) has still showed resilience within the market but is certainly not immune to these challenges.

Debt markets, while better than Q1, remain in a state of turmoil. In Q4 2023, bond yields spiked dramatically with the 10-year U.S. Treasury yield touching 5%, falling to 3.75% in mid-December, then rising to 4.5% by the end of May. 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. Rising cap rates 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 slowdown 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. Higher

priced assets (> \$5 million) saw longer days on market, resulting in stale/lost listings.

Institutional investors have been very active in STNL properties this quarter in comparison to recent quarters, signalling that these investors are diverging their funds away from office properties and into more stable sectors.

Re-trades and longer closing timelines became the norm. 1031 Exchange buyers contributed to a high percentage of the deal flows for Q2, 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 Q2 2024 continued to rise gradually, climbing to 6.36%, an increase of 16.9 bps on recorded deals. The risk/return for investors in this sector remains high but slowly declined from November of 2023 where cap rates sat at 6.4%. Within the SNTL sector, casual dining, dollar stores, medical, QSR, big-box, and pharmacy have all seen increases in their cap rates, while the automotive and c-store sectors have seen decreases. Term remaining for recorded deals in Q2 saw an overall decrease, with only c-stores seeing an increase in their total lease terms remaining. Pricing for these sales have slightly increased in comparison to Q1, with Q2 recording an average price of \$2.78 million, a rise of over \$16,000.



**Average
Cap Rate**
6.36%



**Average
Lease Term
Remaining**
10.97

Sectors in brief

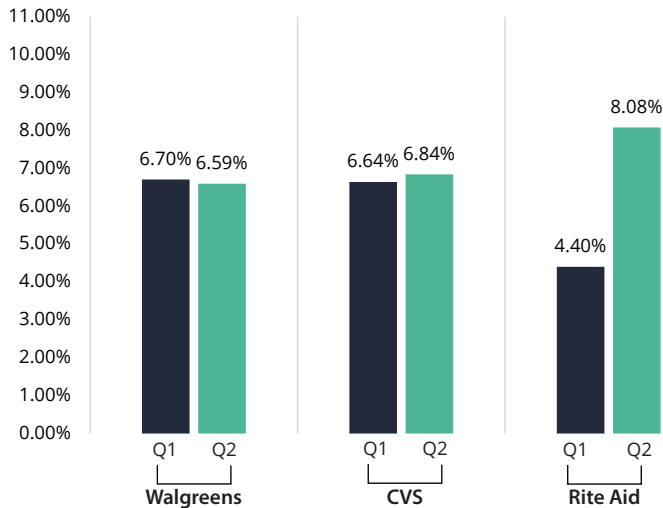
Sectors	Q1 2024					Q2 2024					Change in Avg Cap Rates (bps)	Change in Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size	Avg Cap Rate	Low	High	Avg Lease Yrs	Sample Size		
Automotive	6.32%	4.54%	9.76%	13.5	62	6.23%	3.74%	9.51%	11.7	75	-8.82	-1.81
Bank	5.67%	4.25%	7.71%	9.6	20	6.23%	5.00%	8.58%	6.9	18	55.31	-2.69
Casual Dining	6.21%	3.67%	9.37%	10.7	50	6.59%	4.40%	10.10%	10.3	65	38.74	-0.38
C-Store	5.33%	4.36%	8.14%	14.1	32	5.10%	4.49%	12.04%	14.4	23	-23.00	0.26
Dollar Store	6.89%	5.30%	9.13%	10.9	120	7.22%	5.88%	12.22%	9.7	86	33.14	-1.18
Big-Box	6.10%	5.22%	12.69%	10.7	11	6.40%	4.25%	8.50%	10.1	7	30.00	-0.66
Medical	6.21%	5.37%	8.60%	9.4	18	6.40%	5.75%	8.00%	7.7	10	19.08	-1.73
Other Retail	6.80%	3.35%	10.00%	11.1	51	6.98%	4.40%	11.44%	9.3	67	18.56	-1.77
Pharmacy	6.60%	4.40%	11.81%	12.0	27	6.76%	4.58%	10.15%	10.3	32	15.09	-1.65
QSR	5.59%	3.50%	11.19%	14.0	178	5.65%	2.72%	10.05%	12.6	156	5.76	-1.39
	6.20%			12.33	569	6.36%			10.97	539		

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.

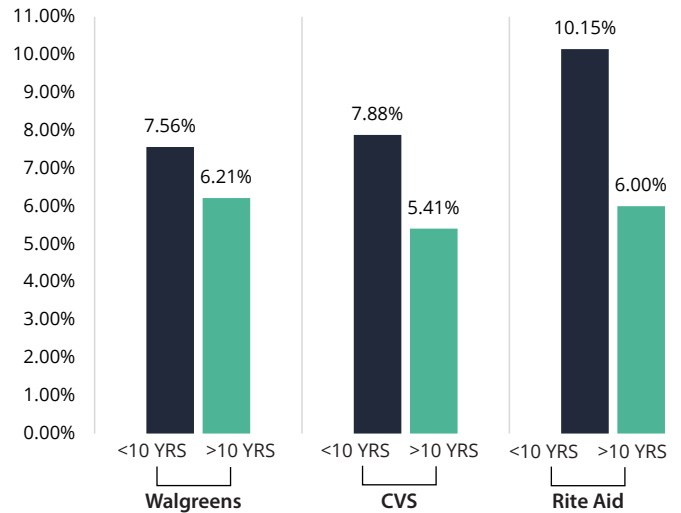
Markets in depth: Pharmacy

The pharmacy sector saw an increase in transaction volume in the second quarter of 2024. However, the average cap rate on observed deals increased 15 basis points to 6.76%, while the spread decreased with a low of 4.58% and a high of 10.15%. Rite Aid cleared to exit bankruptcy, but it comes with the continuation of store closings. While Walgreens and CVS saw 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



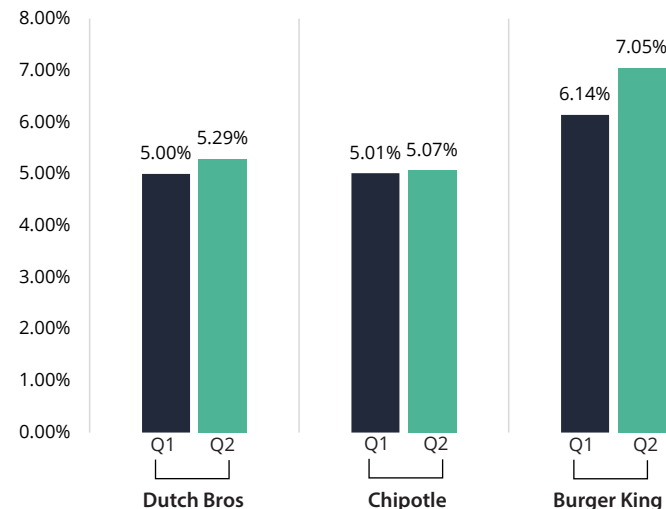
Pharmacy Cap Rates by Term Remaining



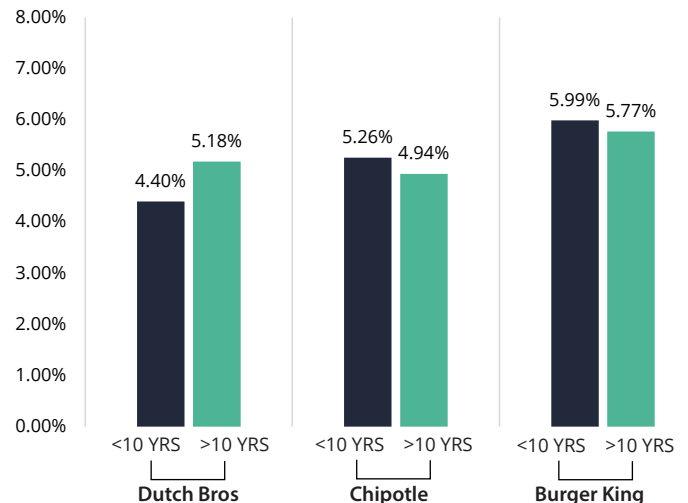
Markets in depth: QSR

Quick service restaurants (QSRs) have seen a high volume of transactions this quarter, but additionally saw a 12% decrease in transactional volume since last quarter. Cap rates saw a slight increase from Q1 2024, with a 5.7 basis point hike on observed deals. Average remaining term length decreased to 12.6 years. Despite all of this, QSR still remains as the most consistent sector tracked, with stable transactional volume, cap rates, and tenants in the market.

Overall QSR Cap Rates



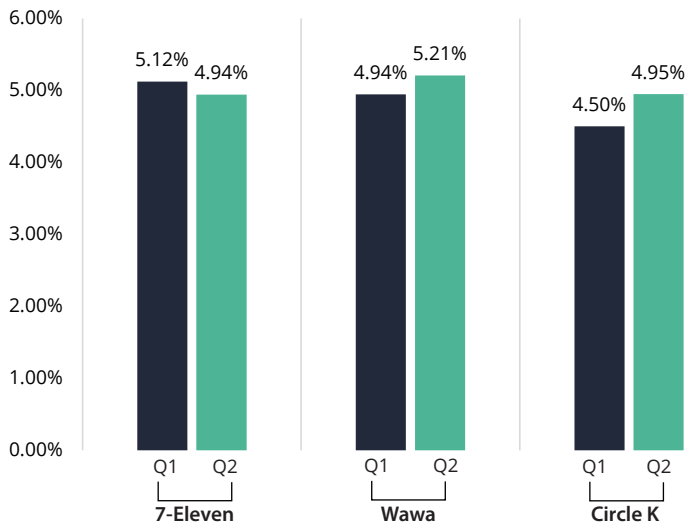
QSR Cap Rates by Term Remaining



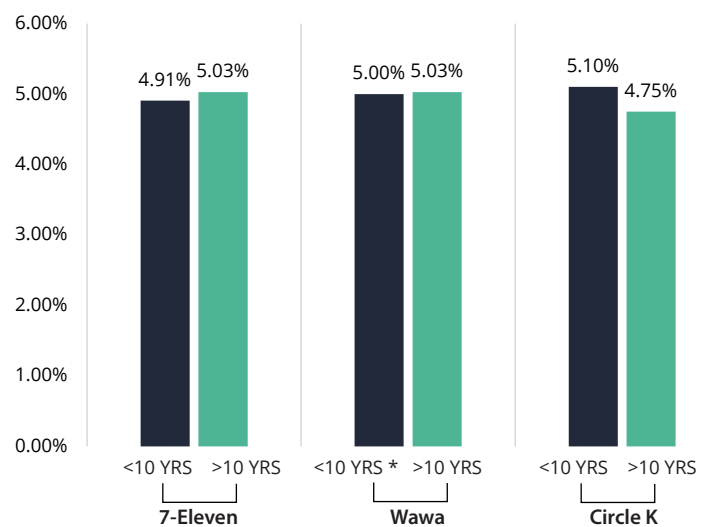
Markets in depth: C-Store

C-store assets saw a drop in transactional volume compared to Q1 2024, with 23 observed trades in Q2 2024. Cap rates also dropped by 23 basis points, while average sale prices slightly decreased to \$2,167,888. Average remaining term length increased to 14.4 years in Q2 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

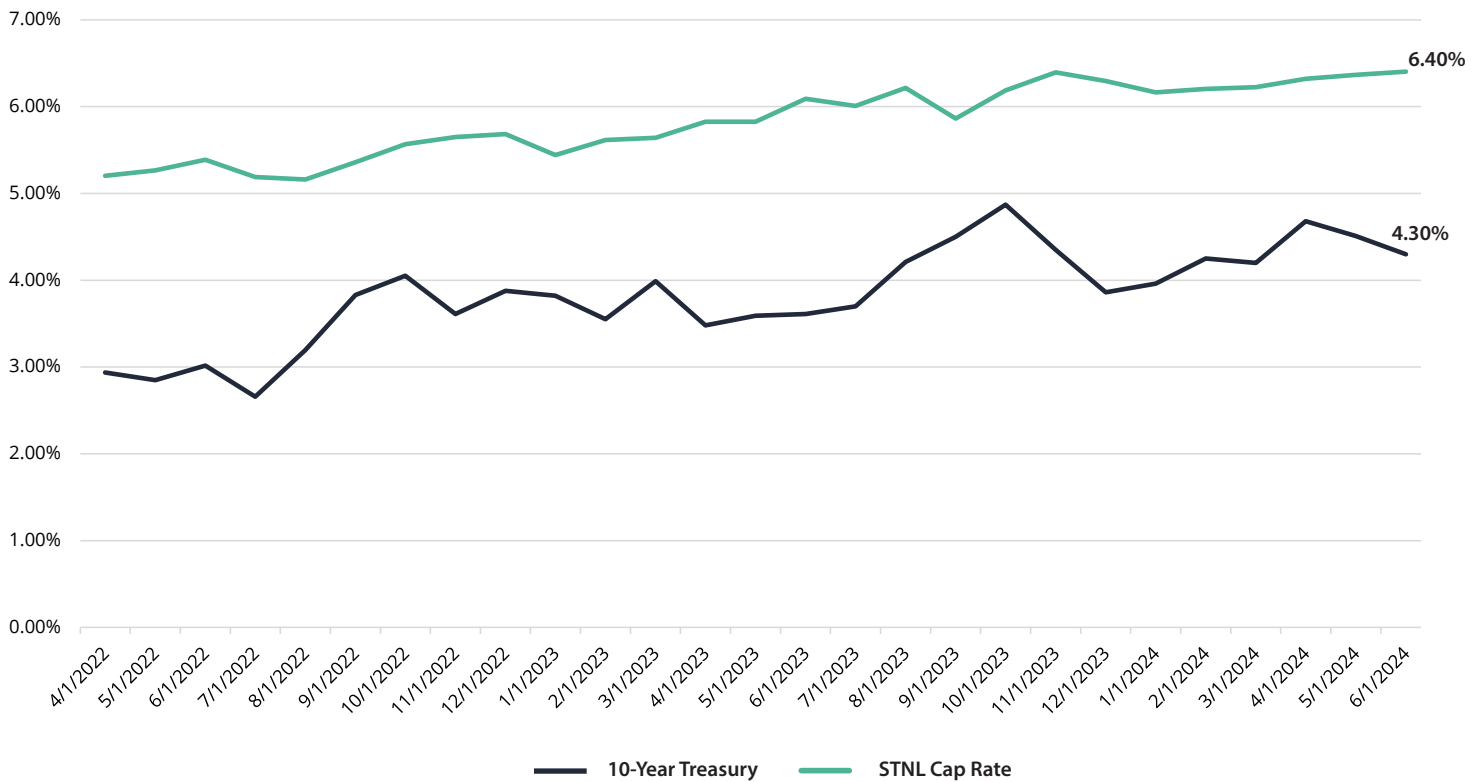


Brand by brand: Average cap rate changes

Tenants	Q1 2024 Average Cap Rates	Q2 2024 Average Cap Rates	Change (bps)
Dollar General	6.84%	7.04%	20.95
Starbucks	5.45%	5.53%	7.56
7-Eleven	5.12%	4.94%	-18.23
Family Dollar	7.76%	8.24%	47.63
Walgreens	6.70%	6.59%	-10.84
DutchBros	5.00%	5.29%	28.70
Chipotle	5.01%	5.07%	5.47
Take 5 Oil Change	5.88%	6.10%	21.70
Taco Bell	5.79%	5.46%	-32.15

*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 are made, 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. Still, it is not immune to these larger issues, and understanding tenant industries continues to be crucial for investors aiming to capitalize on the opportunity at hand.

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