NET LEASE REPORT September 2017

QSR SECTOR

The Quick Service Restaurant (QSR) sector has proven to be extremely robust. Amazon has caused disruptions in many industries, but the QSR sector appears to be, at least for now, immune to the so called "Amazon Effect." Food delivery is by no means a "disruptive" new thing, and most fast food is eaten out thereby limiting Amazon's ability to turn this sector of the retail industry upside down.

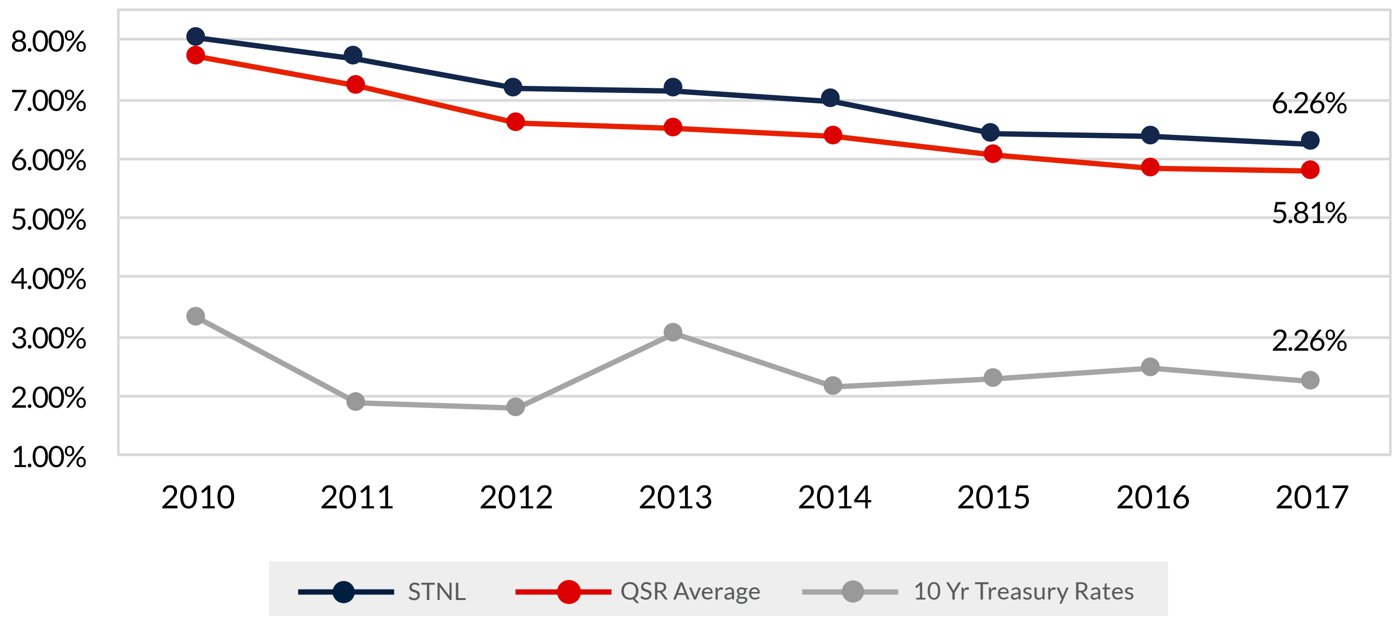
The largest challenges to the industry are changing government regulations and shifting customer preferences. These and other issues have plagued some QSR chains, forcing some out of the competitive food space.

While many fear the largest threat to QSRs may be rising labor costs, there is little reason to worry. McDonald's and Panera Bread, for instance, have rolled out self-service kiosks partially in an effort to reduce labor costsand more QSRs are expected to do the same in the near future.

These Quick Service Restaurants fit in well with the current trend of consumers demanding products quicker and quicker, however increasingly health conscious customers pose a challenge for QSRs in the future. QSRs also compete for customers in the convenience sector. QSRs will choose locations that are easily seen from roadways and offer convenient access. These qualities are attractive for any retail tenant heightening the competition to obtain these locations.

These factors lead to a generally safe net lease investment, and a premium to the single tenant net lease (STNL) average can be seen over the last few years. This premium has averaged approximately 50 bps. The QSR and overall net lease averages have been dropping, but rising interest rates are expected to push cap rates up across the board.

STNL Cap Rates vs. QSR Sector Average vs. 10 Year Treasury Rates Cap Rates

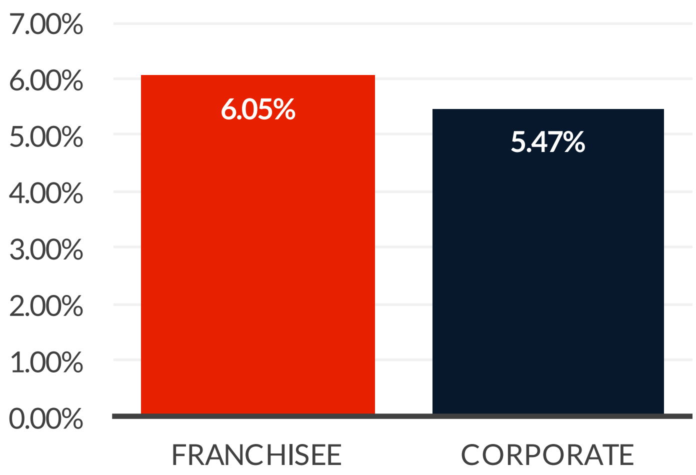


Franchisee vs Corporate

There has been and continues to be a large variance in cap rates between corporate-backed and franchisee-backed net leases. The differences in cap rates are due to various financial strengths of the guarantors. Many corporate QSRs are publicly traded companies, allowing investors access to financial records and enabling more informed decisions.

Franchisees are much more varied. Included under this category are franchisees who own one location and operating companies who run many QSRs from multiple brands. The financial record of these franchisees may not be as obvious. Even with financial information on a franchisee, investors will still pay a premium for the security that comes with a guarantee from a multi-billion dollar corporation.

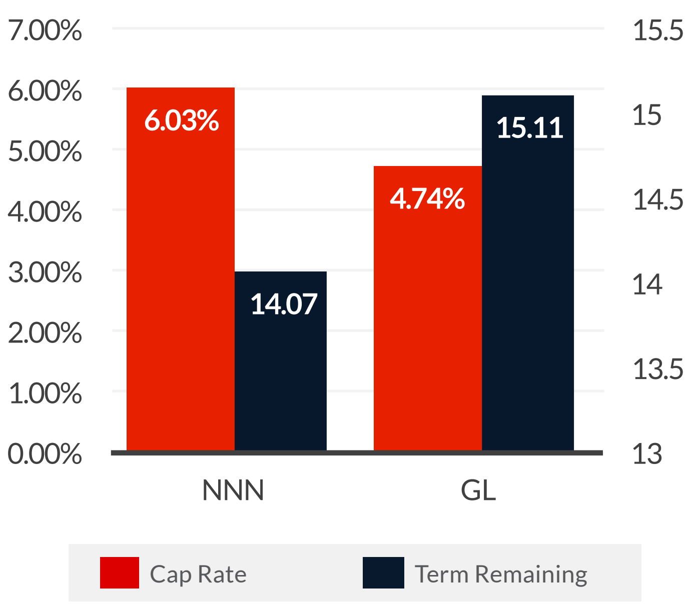
Average Cap Rate
From the Past 12 Months



Lease Type

Most QSRs are subject to either a triple net lease or a ground lease. A triple net lease means the tenant is responsible for the taxes, insurance and maintenance costs. This leaves the investor with a passive source of income. A ground lease is even more hands off - the investor owns only the ground. The tenant must construct any improvements (buildings) at their own expense. Due to the substantial construction costs a tenant must bear, ground leases tend to have a longer term and start at a lower rent. This equates to new ground leases trading at lower cap rates but also lower prices due to the lower rents paid.

Average Cap Rate and Term Remaining by Lease Type From the Past 12 Months

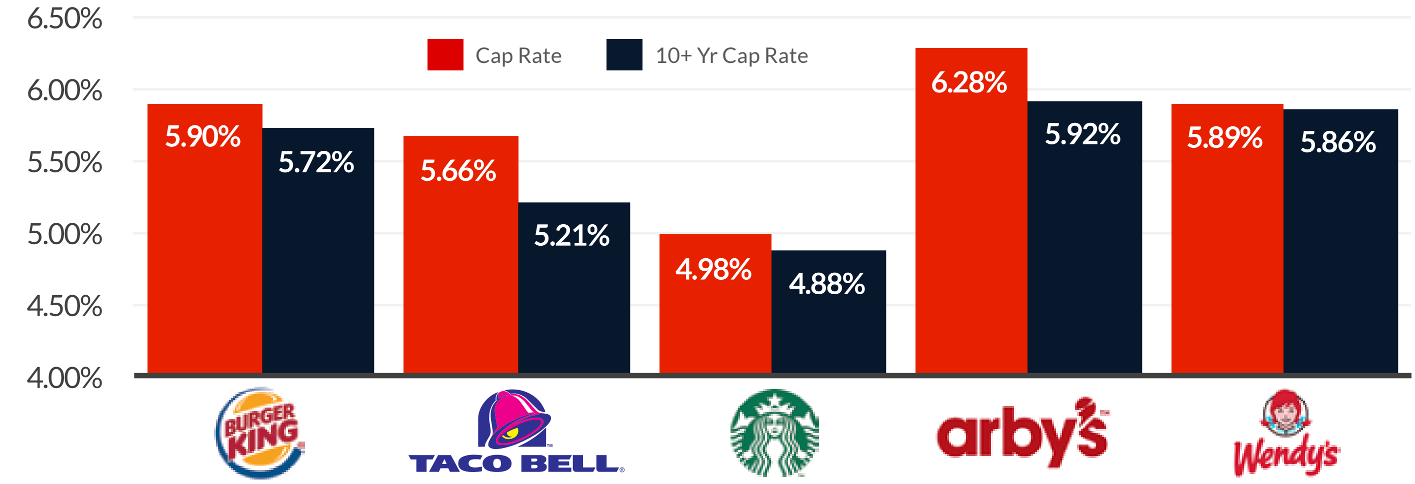


Most Common Tenants

Below is a chart of the 5 most traded QSR tenants from the last 12 months. The effect of the number of years remaining on the cap rate is visible by the gap between the average cap rate and the average cap rate for properties with at least 10 lease years remaining.

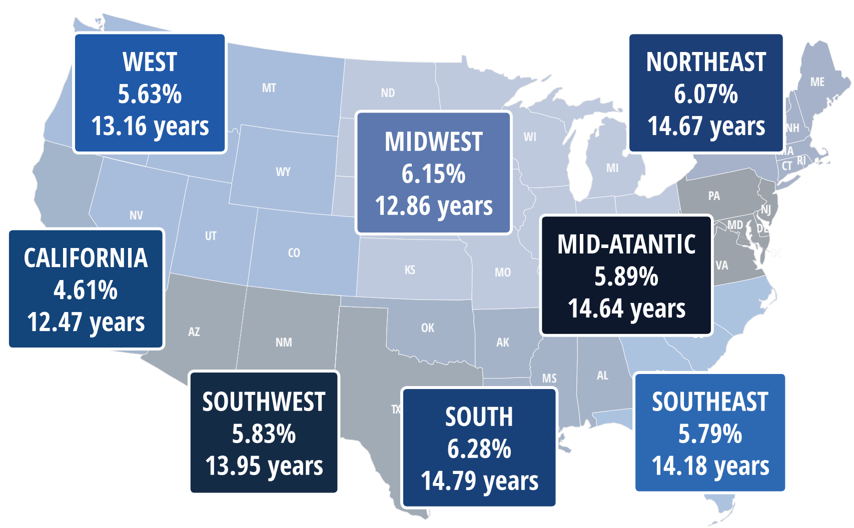
- **Burger King** was the most traded QSR during the last 12 months. Our dataset captured over 100 sales of this tenant alone.
- **Taco Bell** had the largest difference between average cap rates and cap rates for properties with 10 or more years remaining. The sub-10 years remaining sales carried very high cap rates pulling the aggregate average up.
- **Starbucks** trades at very low cap rates, driven by a very strong corporate guarantee and prime locations.

Average Cap Rate for the Most Common Tenants From the Past 12 Months



Average Regional Cap Rates

This map shows the geographical breakdown of cap rates. California has the lowest cap rate (4.61%) of all the regions and the fewest number of years remaining on their leases (12.5). A lower number of lease years remaining is typically associated with a higher cap rate, however, the high demand for properties in California more than offsets that fact.



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DISCLOSURES: As part of our market research, we collect sales price, cap rate, and lease years remaining for all publicly advertised and sold STNL properties. a) We are not able to capture 100% of the off-market transactions that occur; however the nature of off-market typically limits their value as true market comps. b) Sources include public records, sales announcements, Calkain sales, and appraiser obtained sales amongst others. c) Our collection process, while thorough, is not all encompassing and there may be biases in the data as it relates to geography, tenancy, or brokers involved in the transaction. d) Public records often lag behind when transactions actually close, months in some cases. Consequently the data supplied here for any given quarter is likely to miss a material amount of transactions that actually closed in it.