CALKAIN | RESEARCH
AMERICA'S NET LEASE COMPANY®

Q3 2019

CAP RATE REPORT

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Q3 2019 OVERVIEW

ACTIVITY SHAKES THE SUMMER DOLDRUMS

When Calkain released its second-quarter Cap Rate Report, we were deep in the summer doldrums, and activity—and cap rate movement—reflected the quiet. Summer's gone now and, despite a slight tapping of the brakes—with thoughts of presidential elections and trade wars dancing in our heads—the investment market has shaken its lethargy.

Market-wide, there's been more transactional activity, with a total of 544 deals posted for the quarter. But the average cap rate has risen since the middle of the year, with a 15.9-basis-point (bp) jump, from 6.41 percent to a current 6.57 percent. Much of this movement goes to the sectors with the fewer deals, particularly the Banking sector (27 transactions), which moved from 5.84 percent to 6.43. Conversely, one of the two largest sectors (Quick Service Restaurants, or QSR, with 150 deals), showed a relatively minor movement of 0.4 bps. Additionally, one interesting aspect was the types of deals completed quarter to quarter. Between Q2 and Q3 2019, we can see similar number of transactions for NN and NNN deals, but it appears that the number of Ground Leases quarter to quarter dropped off a decent amount, which could have something to do with the increasing cap rate for Q3.

Activity in the final weeks of any year are always a challenge to predict, amid the push to close and the speculation around who will make it to the finish line. There's also generally a lag time between interest rate movement and cap rate changes. Given that interest rates slipped again in Q3, it will make November and December months to watch.

Sectors	Q2 2019					Q3 2019					Change Avg Cap Rates (bps)	Change in Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Years	Sample Size	Avg Cap Rate	Low	High	Avg Lease Years	Sample Size		
Automotive	6.32%	5.00%	9.28%	11.3	48	6.56%	4.60%	10.48%	10.9	68	24.0	(0.4)
Bank	5.84%	2.76%	8.75%	9.2	27	6.43%	4.90%	8.53%	5.7	23	58.6	(3.5)
Big-Box	7.42%	4.27%	11.70%	10.2	28	7.23%	5.10%	9.50%	8.7	26	-19.3	(1.5)
Casual Dining	6.50%	4.46%	9.60%	11.6	72	6.54%	4.62%	10.45%	11.6	63	4.1	0.0
C-Store	5.97%	4.00%	12.31%	15.2	30	5.77%	4.00%	14.30%	14.9	25	-20.0	(0.3)
Dollar Store	7.08%	5.25%	10.00%	11.5	55	7.19%	5.85%	10.57%	11.2	92	10.6	(0.3)
Educational	6.97%	6.29%	7.70%	11.9	10	7.16%	5.40%	8.50%	7.8	10	19.0	(4.1)
Medical	6.61%	4.76%	10.80%	12.3	15	6.50%	4.43%	8.50%	9.6	10	-11.1	(2.7)
Pharmacy	6.21%	1.87%	8.25%	14.3	54	6.73%	4.25%	13.00%	10.9	41	52.2	(3.4)
QSR	5.57%	3.10%	10.79%	14.0	85	5.57%	2.94%	9.58%	14.3	150	0.4	0.3
Other Retail	6.03%	4.00%	9.50%	11.6	40	6.59%	4.50%	11.65%	9.3	36	55.9	(2.3)
Average	**6.41%**			**12.1**		**6.57%**			**10.5**		**15.9**	**(1.6)**
Total Sample Size					**464**					**544**		

[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.*

SECTORS IN BRIEF

The number of sales in the **Big Box** sector remained relatively flat quarter to quarter (from 28 to 26 deals) while the average lease term left dropping from 10.2 to 8.7. Counter-intuitively, despite this drop, cap rates also slipped, by 19.3 bps, to 7.23 percent.

Automotive, on the other hand, remained closer to the norm, with a dip in term remaining (from 11.3 to 10.9 years) and a cap rate hike of 24.0 bps, to 6.56 percent. The number of transactions also jumped by 20 deals, owing in large part to an increase in sales in premium markets such as California and Florida.

The average years remaining also decreased in the **Pharmacy** sector, by 3.4 years, which pushed cap rates to 6.73 percent, a 52.2-bp jump over Q3. Additionally, investors may be growing cold on pharmacies overall as their leases can feature non-rent increases over an extremely long term length.

Banks experienced the largest adjustment of the quarter. This cap rate increase most likely stems from the fact that most of this quarter's sales represented smaller, regional banks while Q2 was mostly corporate bank branches.

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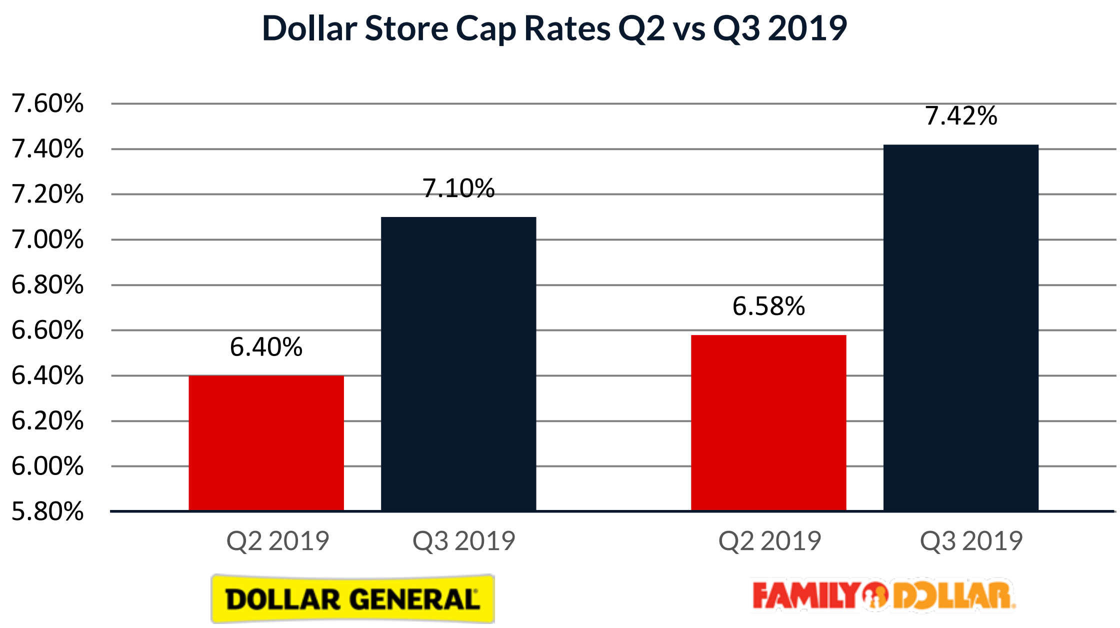
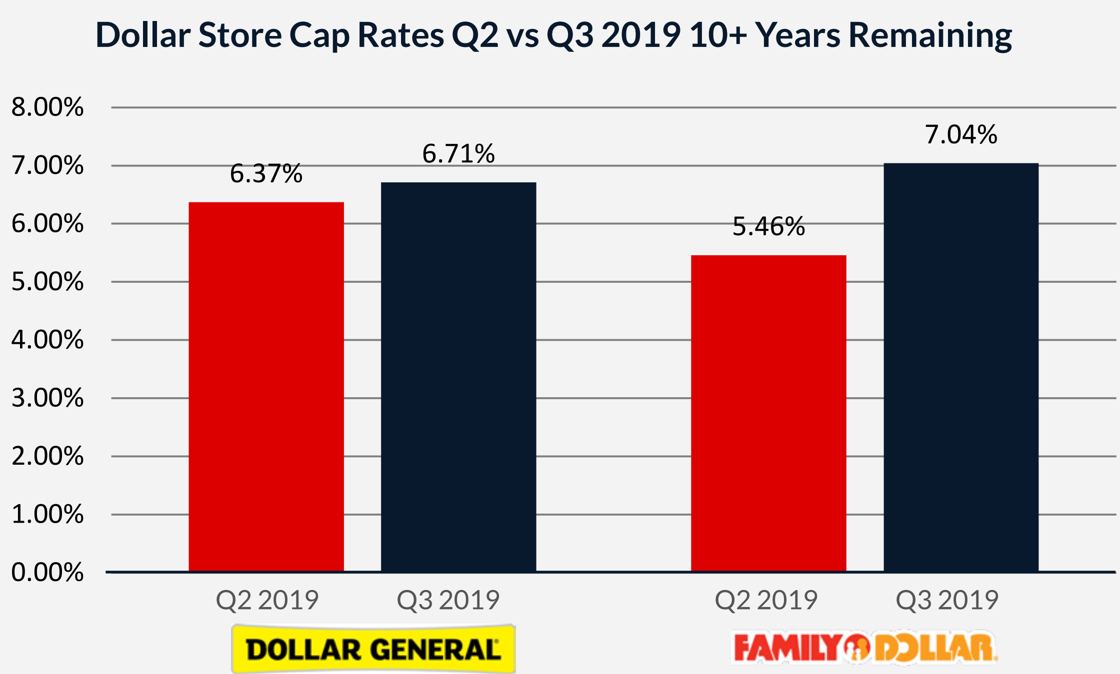
MARKETS IN DEPTH: DOLLAR STORES

The sector is experiencing growth in the number of stores on the market, with the obvious effect of lowering values. Simultaneously, the number of years left on the average lease has also decreased, by only four months, nevertheless putting further upward pressure on cap rates, which rose by an average 10.6 bps—to 7.19 percent. As the chart shows, Family Dollar saw the biggest cap-rate jump –to 7.42 percent.



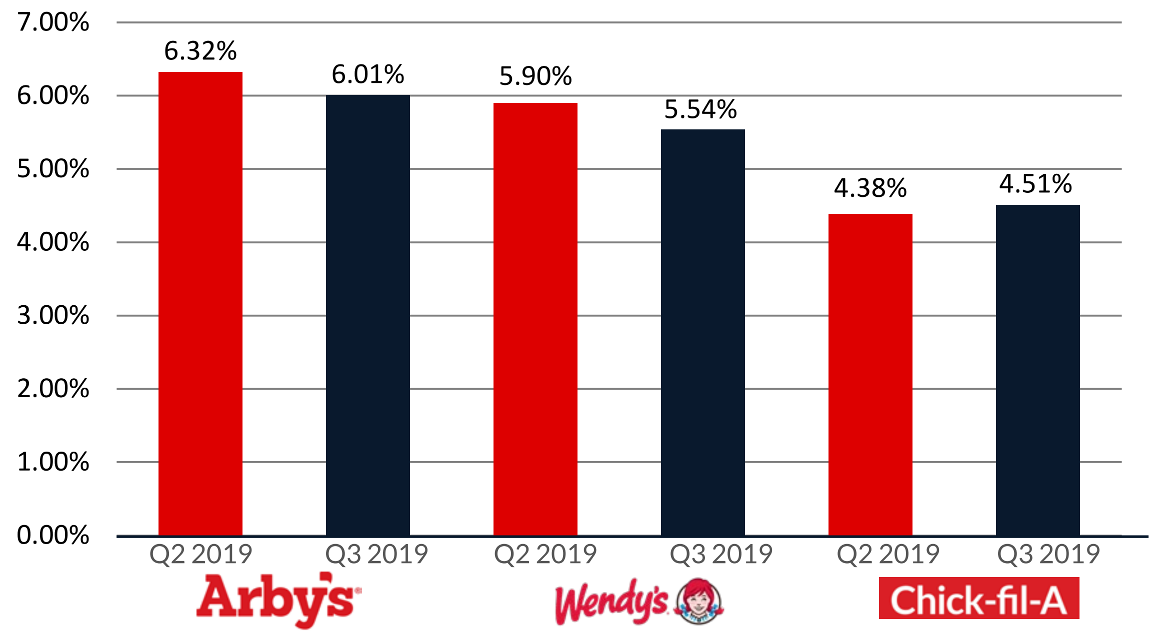


MARKETS IN DEPTH: QSR

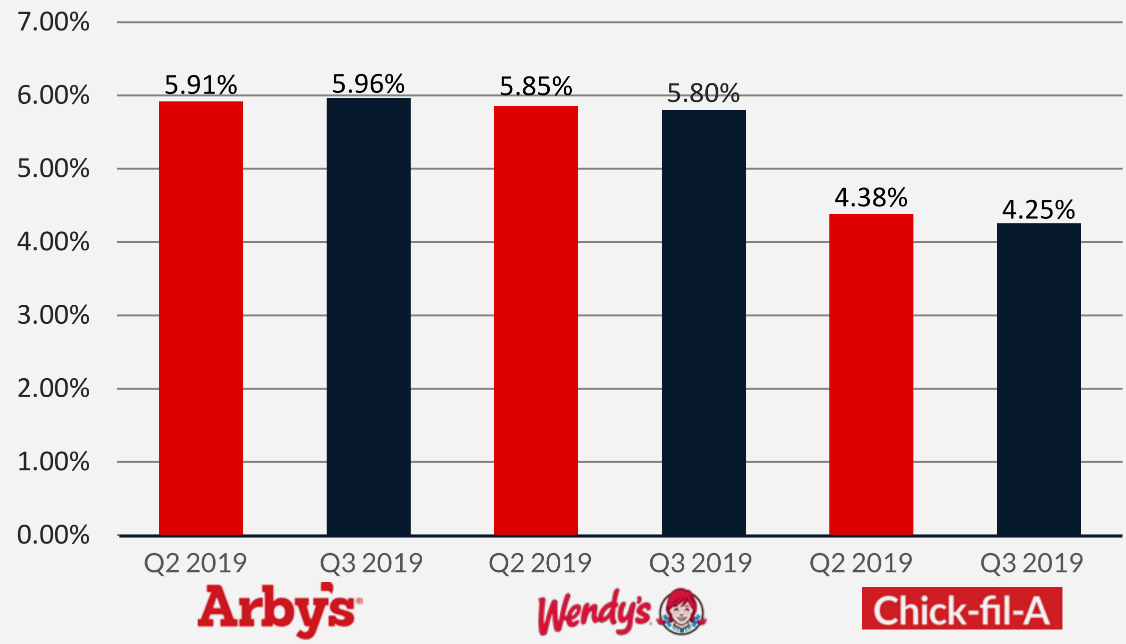
While the number of properties sold nearly doubled quarter to quarter (from 85 to 150) the average cap rate moved just a 0.4 bps—to 5.57 percent QSR sector. Remaining lease terms were also relatively flat, extending just four months, to 14.3 years.

That said, the sector is a virtual sure-bet. People need to eat, and the growing availability of more plant-based options unlocks a new source of clientele. Tenants are also paying above-market rent, all of which amounts to increased value for owners. California and Florida saw the most transactional activity.

QSR Cap Rates Q2 vs Q3 2019



QSR Cap Rates Q2 vs Q3 2019 10+ Years Remaining



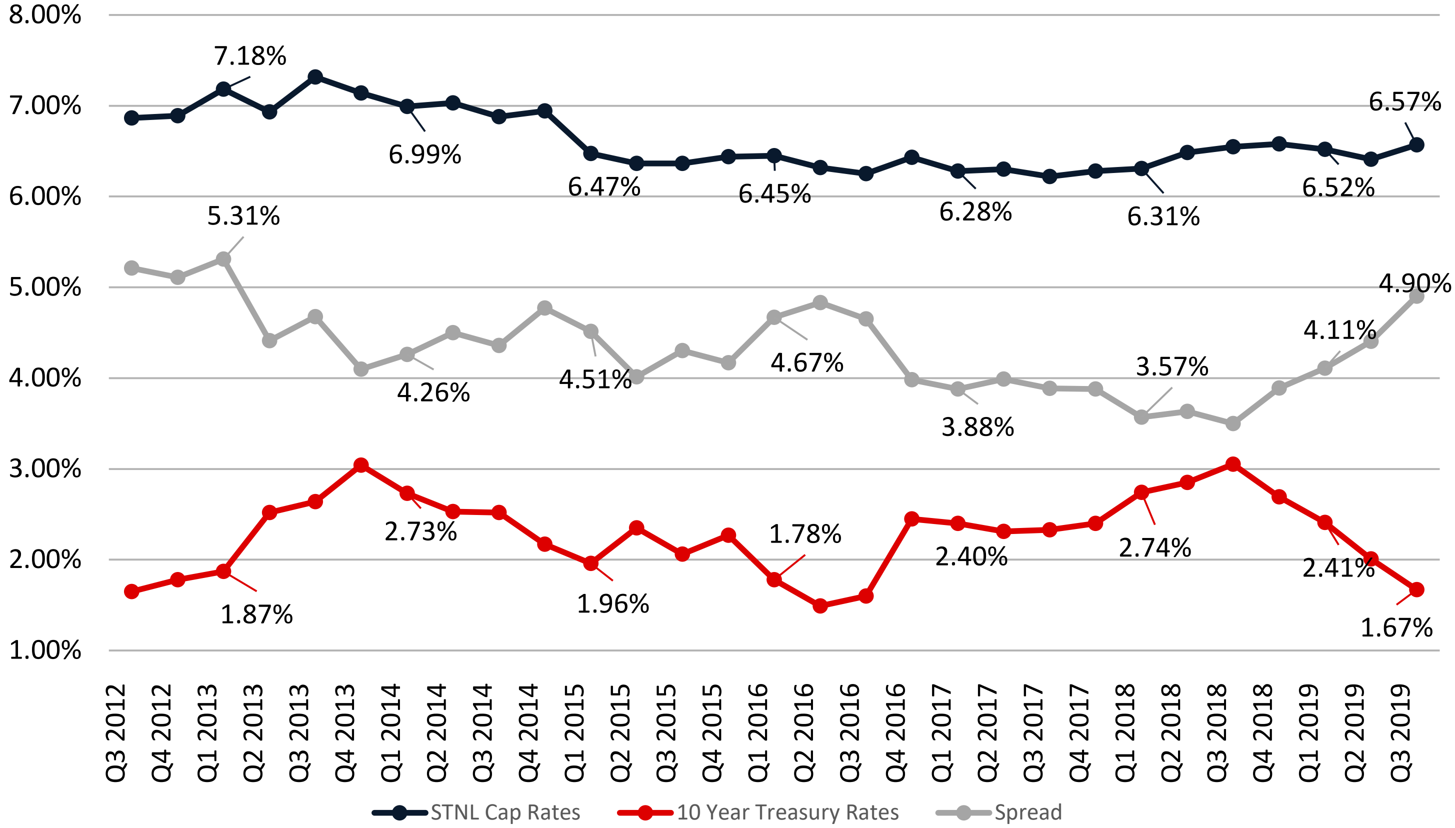
BRAND-BY-BRAND: AVERAGE CAP RATE CHANGES

- **7-Eleven** The convenience store brand saw an increase in the average number of lease years remaining, with its 5.07 percent cap rate going toward the single-tenant net lease (STNL) average.
- **Arby's** There were upticks in both average lease years remaining (from 15.75 to 16.5) and average cap rate (5.91 to 5.96 percent), but these obviously amounted to little more than quarter-to-quarter flatness.
- **Burger King** The average cap rate increased by 22 bps to 5.87 percent. This was the result of the lease term going down by more than two years.
- **Dollar General** More properties were added to the market from last quarter's eight to 23 in Q3, driving cap rates up (by 33 bps) and values down.
- **Taco Bell** A cap rate increase of 90 bps—the largest single shift among all brands tracked--brought the rate back to 5.26 percent, closer to the STNL average
- **Walgreens** The time left on lease terms plummeted quarter to quarter by more than six years, with the obvious result of bringing the average cap rate up by 57 bps, to 6.97 percent.
- **Wendy's** Premium-market sales went from two to six, quarter to quarter, compressing cap rates by 5.0 bps.

Tenants	Q2 2019 Avg Cap Rates	Q3 2019 Avg Cap Rates	Change in Avg Cap Rates (bps)
7-Eleven	4.99%	5.07%	8.0
Arby's	5.91%	5.96%	5.0
Burger King	5.65%	5.87%	22.0
Chili's	5.39%	5.73%	34.0
CVS	5.41%	5.70%	29.0
Dollar General	6.37%	6.70%	33.0
Pizza Hut	6.38%	6.97%	59.0
Ruby Tuesday	4.36%	5.26%	90.0
Taco Bell	6.40%	6.97%	57.0
Walgreens	5.85%	5.80%	-5.0
Wawa	4.75%	4.68%	-7.0
Wendy's	6.02%	5.85%	-17.0

**All calculations are based upon available comps for each specific quarter with 10+ lease term remaining. The total number of sale comps for respective tenants in each quarter also varies significantly.*

STNL CAP RATES VS. 10 YEAR TREASURY RATES



The third quarter was the fourth in a row to experience a decrease in the 10-Year Treasury. It also saw the highest spread since Q2 of 2016--4.83% vs 4.90%.

CONCLUSION

With the summer doldrums over, transactional activity has grown overall—from 464 to 544 deals, a clear mark of investor confidence, despite global news—such as trade wars and the fast-approaching presidential election. As expressed above, the cap rate average has also increased. It will be interesting to see how both of these market drivers will play out as we approach year end.

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. e) In order to accurately capture the middle of the data, any sector with a skew larger than +/- 2 will be replaced with the median value in our overview chart.

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