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PHARMACY SECTOR

NET LEASE REPORT January 2018

PHARMACY SECTOR

The pharmacy sector has consistently been attractive to investors as it offers a steady income stream that tracks closely with the Single Tenant Net Lease (STNL) average. By nature of its product line, namely medicine, customers will continue to visit to fill and refill prescriptions. Although we saw some trepidation with investors through the merger talks, activity has picked up and we're now witnessing a struggling Rite Aid, an expanding Walgreens, and CVS in the midst of acquiring Aetna.

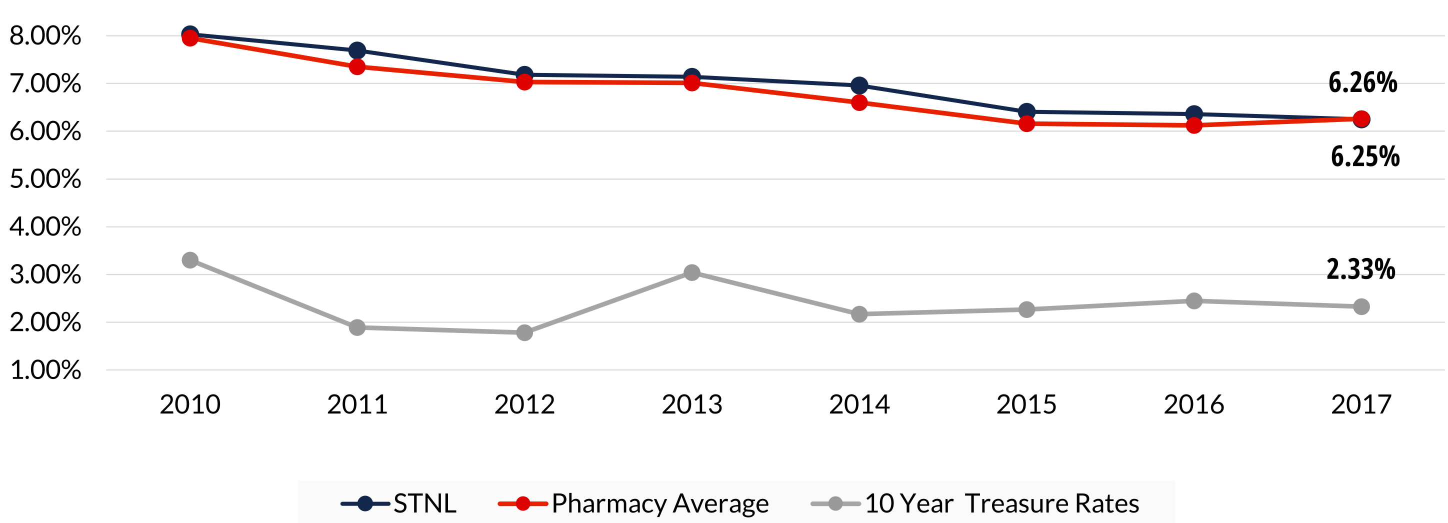
The Walgreens/Rite Aid merger discussion has been ongoing since October of 2015. In June of 2017, the Federal Trade Commission approval for the merger looked bleak, and instead, Rite Aid agreed to sell some of their locations to Walgreens. In September of 2017, the new deal was approved. Walgreens bought 1,932 stores for $4.375 billion.

CVS has recently announced plans to acquire the insurer Aetna. They hope to expand the role of their pharmacy locations and become "health hubs" for the communities they serve. CVS will have a greater reach into their patients' health.

CVS, Walgreens, and Rite Aid have many aspects that make them very attractive assets for net lease investors. The two largest players in the sector, CVS and Walgreens, have great credit, BBB+ and BBB respectively, both investment grade. Rite Aid has lower credit, B, but can be acquired for a discount. All three tenants sign long leases, commonly 20-25 years. These long term commitments provide security for investors, but will have flat rent during the primary term (except for Rite Aid). The pharmacies offer a mix of NN and NNN leases, sometimes leaving investors with some landlord responsibilities, such as roof and structure. The locations pharmacies tend choose have many attractive aspects, including being in highly visible, corner locations that hold a high value for any retail tenant. As the US population ages, the entire healthcare industry will see increased demand. Pharmacies are well positioned for the future.

The pharmacy sector has averaged about 20 bps below the STNL over the last few years. In 2017, this trend was shaken up with the rising Rite Aid cap rates pulling up the sector average to be right in line with the STNL average.

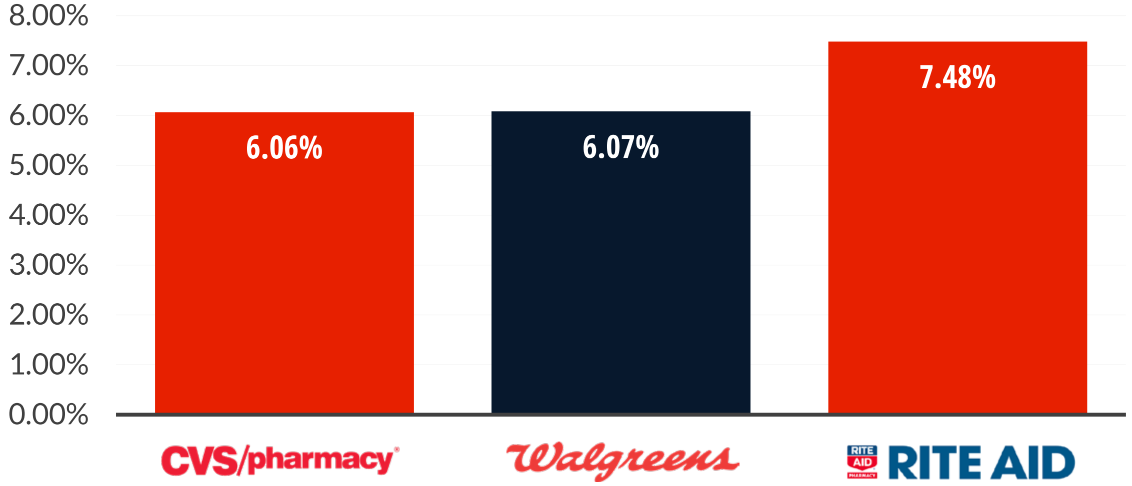
STNL Cap Rates vs. Pharmacy Sector Average vs. 10 Year Treasury Rates



Cap Rate by Tenant

The tenant has a large effect on cap rates. Rite Aid has traded at a significant discount to the two largest tenants in the pharmacy sector. This discount is due to numerous things including a non-investment grade guarantee behind the leases, and a merger that turned into a sale of 1,932 locations to Walgreens. CVS and Walgreens had nearly identical cap rates to match their nearly identical credit ratings (BBB and BBB+ respectively).

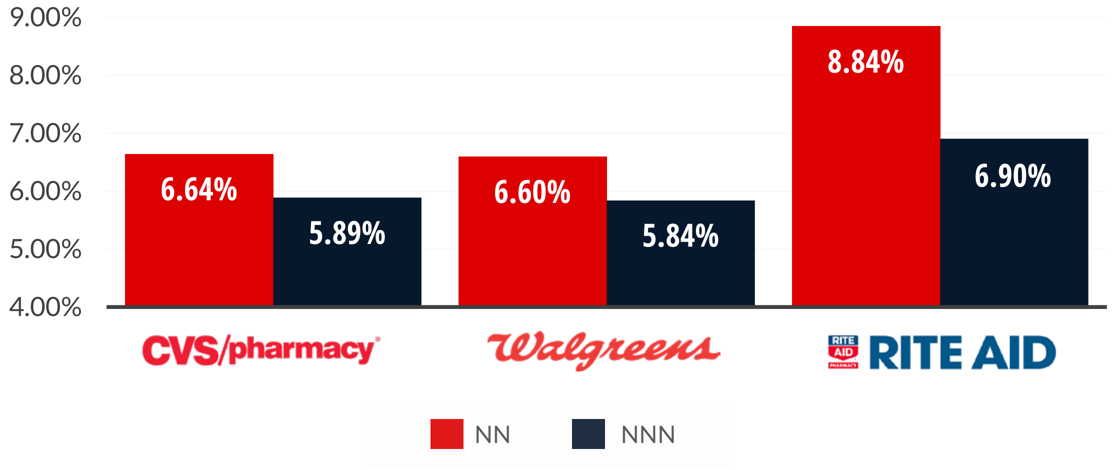
Cap Rate by Tenant From the Past 12 Months



Cap Rate by Lease Type

Double and triple net leases are the most common leases for net leased pharmacy properties. Double net leases leave the investor with some form of landlord responsibility, such as roof and structure. Triple nets will trade at lower cap rates but make the property a management-free investment for the owner. The average cap rates for double and triple net leases are very similar for CVS and Walgreens while Rite Aid had significantly higher cap rates on both types of leases.

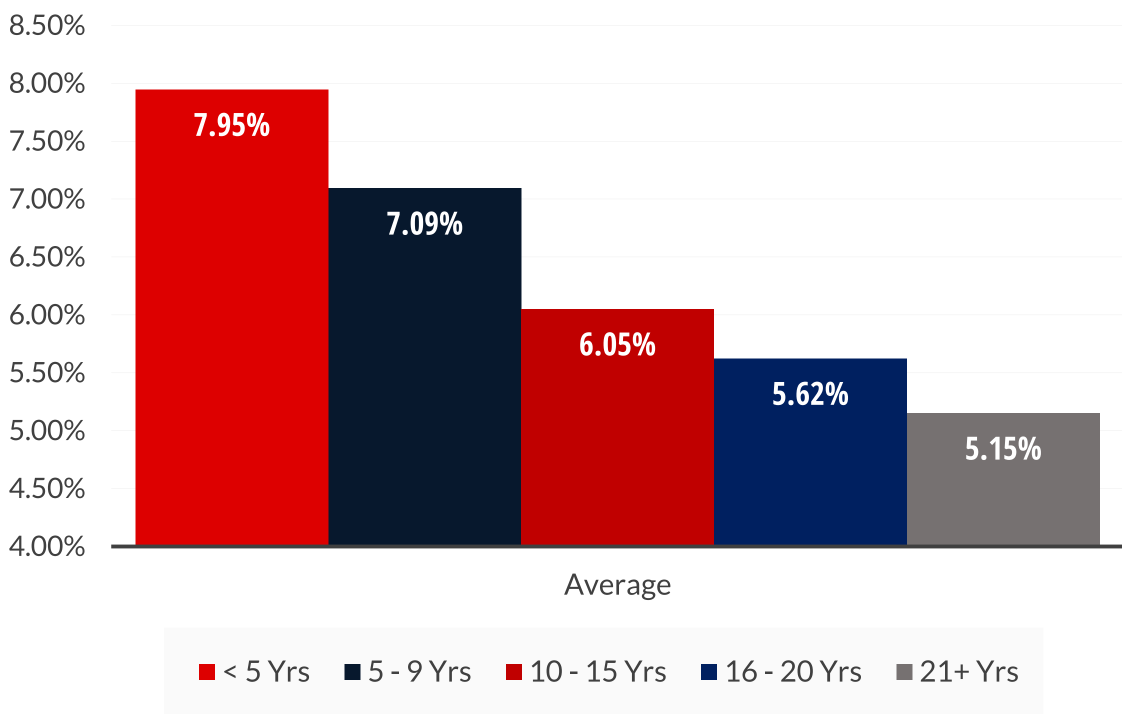
Cap Rate by Lease Type From the Past 12 Months



Average Pharmacy Cap Rate by Term Remaining

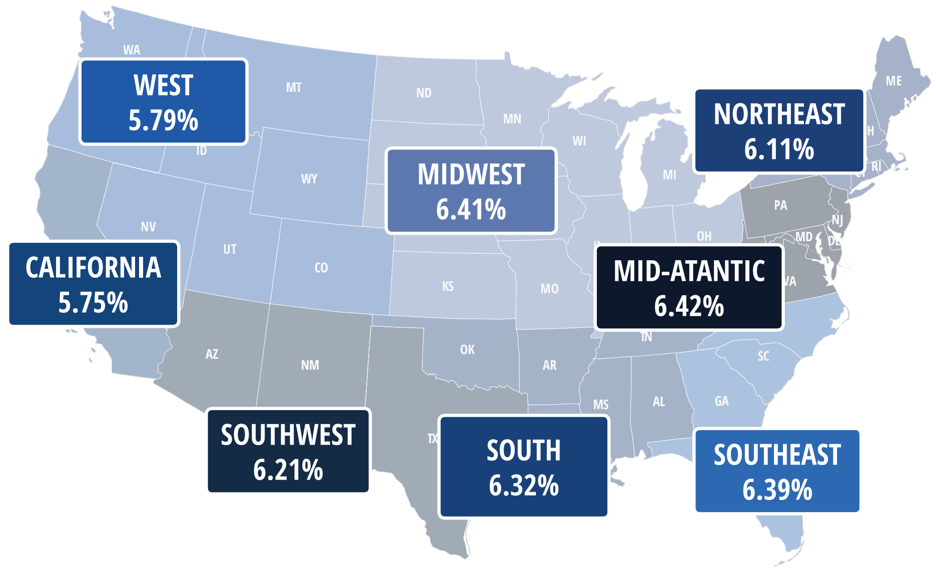
The number of years remaining on a lease can have a major impact on the cap rate of a property. Investors will pay a premium to own a property that has a large number of years left on the lease.

Average Pharmacy Cap Rate by Term Remaining From the Past 12 Months



Average Pharmacy Cap Rate by Region

California and the West Coast have the lowest average cap rates in the last 12 months. These regions have been experiencing a high demand for net lease properties that has kept cap rates low. This high demand has pushed cap rates in the western part of the country to below 6%.



CALKAIN RESEARCH
12930 Worldgate Drive | Suite 150
Herndon, VA 20170
703.787.4714

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.