

Q2 2018

**CAP RATE
REPORT**



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Q2 2018 Overview

Cap rates in the net lease market are trending up and although only a 17-bp jump, it's the largest jump since the fourth quarter of 2016. Adding fuel to this upward trend was the uptick in the number of double-net (NN) lease deals that traded. The pharmacy and automotive sectors posted the largest quarter-over-quarter changes.

Sectors	Q1 2018					Q2 2018					Avg Cap Rates (bps)	Lease Years (Rem)
	Avg Cap Rate	Low	High	Avg Lease Years	Sample Size	Avg Cap Rate	Low	High	Avg Lease Years	Sample Size		
Automotive	6.28%	4.79%	8.61%	8.9	31	6.93%	4.62%	11.70%	9.5	31	65.0	0.6
Bank	5.69%	4.25%	8.00%	8.9	18	6.03%	4.00%	8.60%	8.8	21	34.4	(0.0)
Big-Box	7.15%	6.35%	8.47%	8.0	8	7.17%	5.49%	9.10%	8.9	22	2.1	0.9
Casual Dining	6.06%	4.72%	8.24%	13.3	33	6.46%	4.50%	8.86%	10.8	39	39.7	(2.5)
C-Store	5.58%	4.57%	8.00%	14.1	21	5.66%	4.00%	8.50%	11.3	26	8.3	(2.8)
Dollar Store	6.81%	4.40%	9.49%	12.1	69	6.75%	5.25%	18.86%	10.5	58	-6.4	(1.6)
Educational	7.29%	5.41%	8.50%	9.3	6	7.19%	6.56%	7.90%	12.5	3	-9.5	3.2
Medical	6.66%	5.60%	7.68%	9.3	8	6.32%	5.50%	11.66%	11.8	12	-34.1	2.6
Pharmacy	5.90%	4.35%	12.40%	11.7	38	6.63%	5.00%	15.81%	10.5	30	73.0	(1.3)
QSR	5.50%	3.69%	8.68%	13.8	125	5.67%	3.82%	8.32%	13.8	109	16.8	0.0
Other Retail ¹	6.48%	4.60%	9.55%	12.0	41	6.50%	4.93%	10.00%	12.0	31	1.9	(0.0)
Average	6.31%			11.0		6.48%			11.0		17.4	(0.1)
Total Sample Size					398					382		

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

How did this 17-bp jump play out when examined by specific markets? Here is an alphabetic breakdown of performance by sector:

The **automotive sector** had the second largest increase in cap rates (65-bps, compared to the **pharmacy sector's** 73-bp change. See Markets in Depth). A changing tenant mix with a higher percentage of auto service centers, compared to auto parts retailers, was the prime driver of the increase.

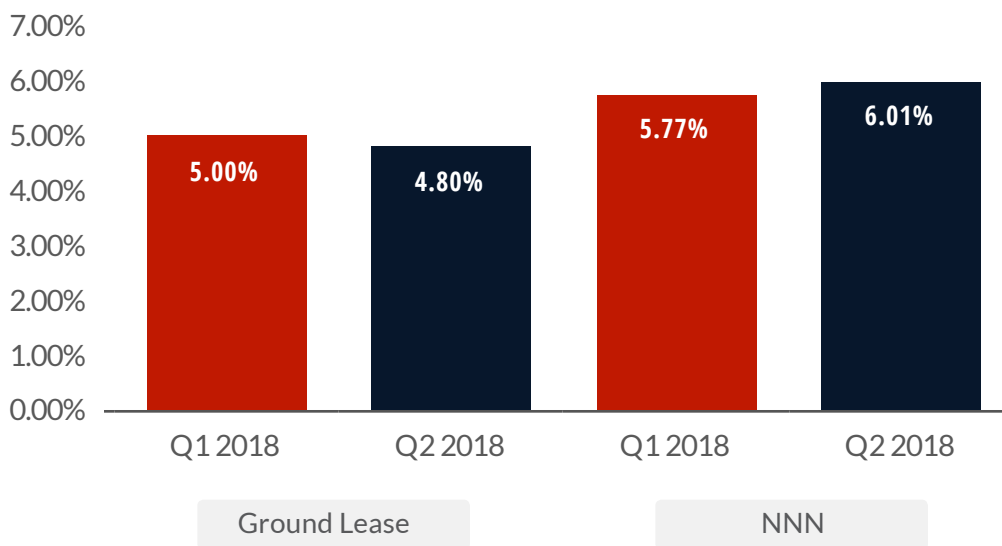
A couple of factors contributed to the 34.4-bp hike in **banking sector** cap rates. While lease years remaining were steady quarter over quarter, the decreasing number of properties in premium locations coupled with the rising number of banks scaling back on branch locations drove the average higher.

The **casual dining sector** saw remaining lease years decline by an average 2.5 years, which translated into a 40-bp increase in cap rates for the sector.

The **medical sector** experienced a 34-bp cap rate compression, newer properties traded hands with more lease years remaining, which drove the average cap rates lower.

Average cap rates for **quick-service restaurants (QSR)** ground leases and triple net leases moved in opposite directions. These opposing forces kept the quarter-to-quarter change in cap rates (16.8-bp) minimal.

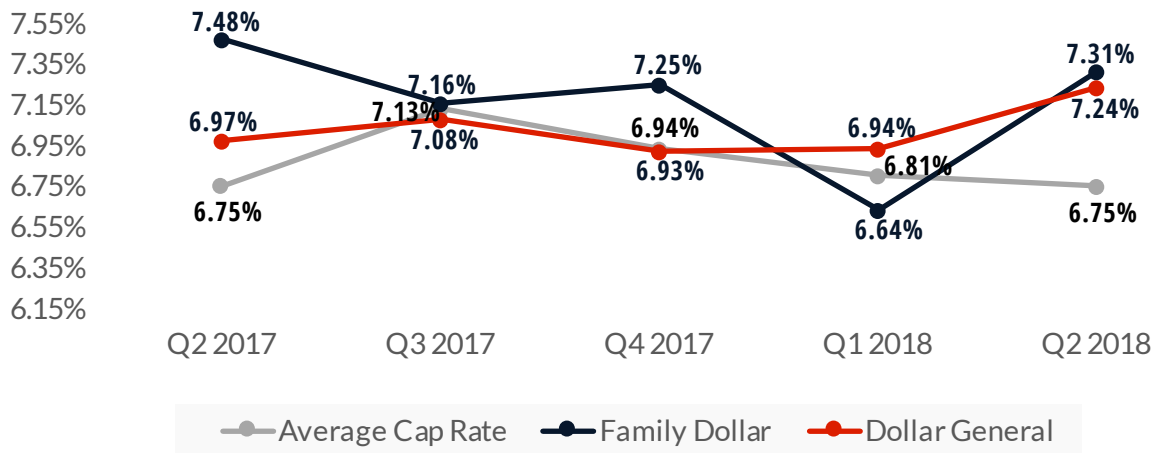
Average Cap Rates for QSR by Lease Type



Markets in Depth: Dollar Stores

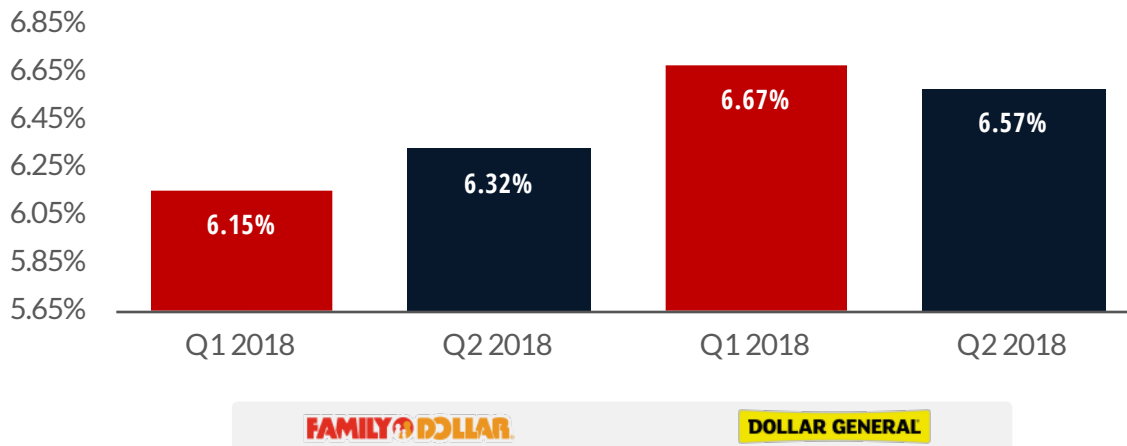
The dollar-store sector witnessed just a small decline--only six bps--while the average number of lease years remaining decreased 1.6 years. Fewer properties traded in premium markets, and more NN leases were signed compared to the first quarter. These factors typically push the sector average higher, and cause a large skew in our data. A skew of 4.44 is large enough to conclude the mean does not accurately describe the data and the use of the median is a more appropriate measure of the sector.

National Average Cap Rates by Dollar Store



While the overall trends for Dollar General and Family Dollar, the two largest tenants in the dollar store sector, show a tick up in the cap rates, the 10+ years remaining category give a clearer picture of the true changes in the sector. With Family Dollar slightly up and Dollar General slightly down, the sector average is nearly unchanged from the first quarter.

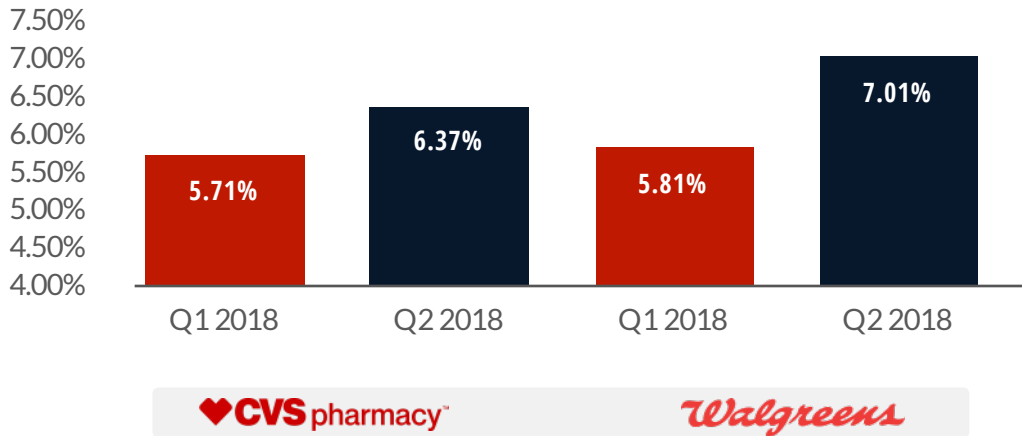
National Average Cap Rates by Dollar Store 10+ Years Remaining



Markets in Depth: Pharmacy

As a whole, the pharmacy sector experienced a 73-bp increase in cap rates in the second quarter, as reported above, the largest of any sector. This change is explained in part by a slight decrease in the number of average lease years remaining. The shift toward more NN leases accounts for a large portion of this cap rate swing.

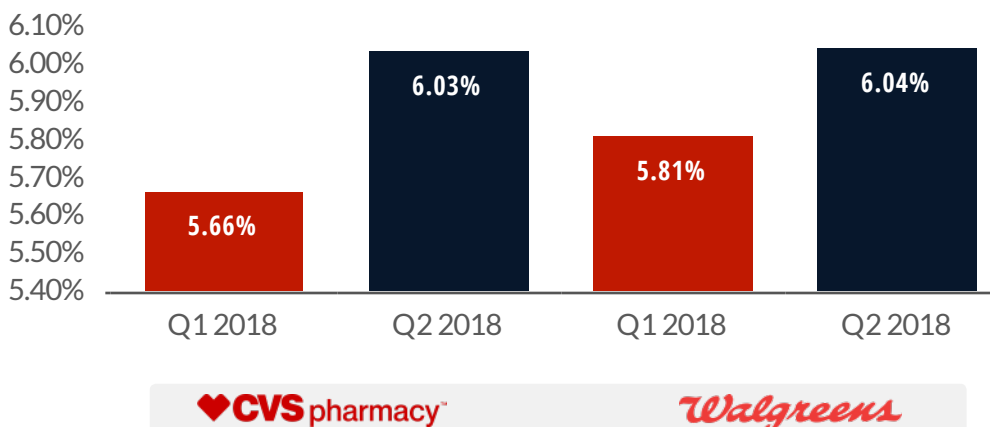
National Average Cap Rates by Pharmacy



CVS and Walgreens both had large cap-rate changes (66 and 120-bps respectively) from quarter to quarter. Much like the overall sector trend, at the tenant level, the upward movement appears to be due to older stores trading with more NN leases.

That change is much less pronounced when looking at properties that had at least 10 lease years remaining at the time of sale. This filters out some of the older NN properties and gives us a better look at any real changes occurring in the pharmacy sector.

National Average Cap Rates by Pharmacy 10+ Years Remaining



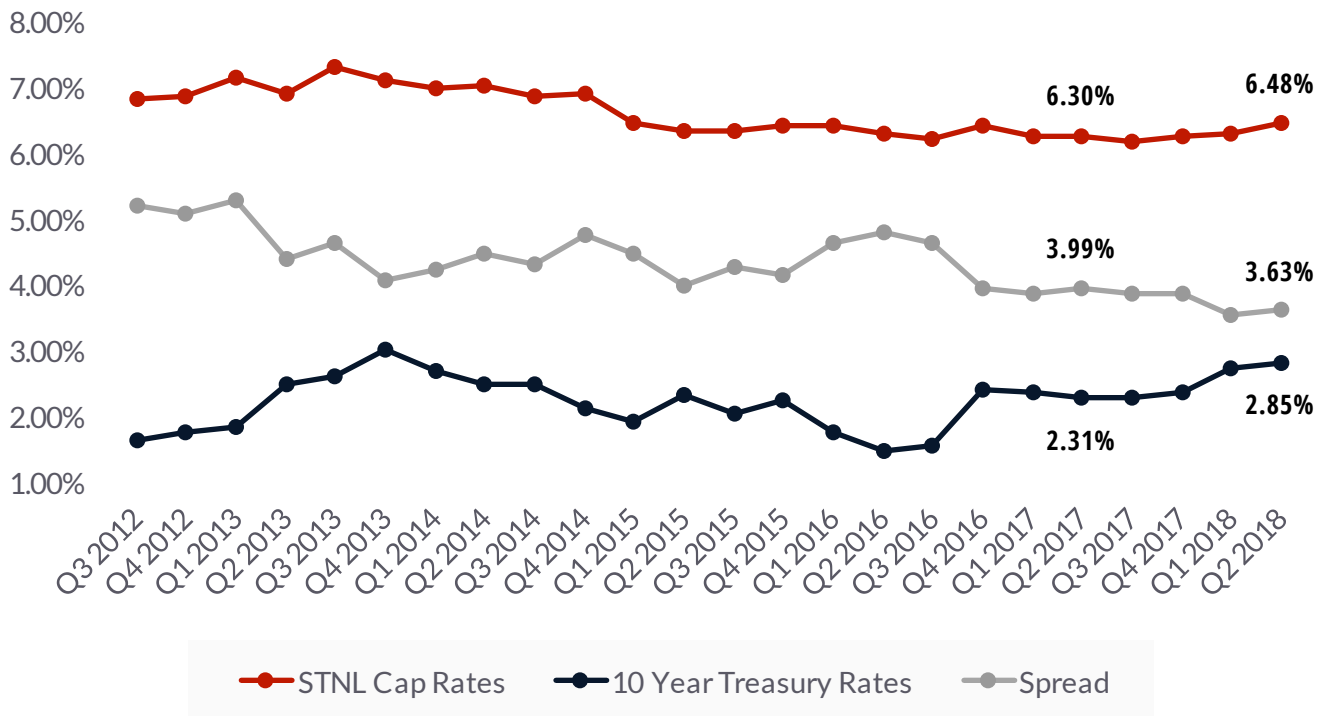
Brand-By-Brand: Average Cap Rate Changes

- **7-Eleven:** The cap rate compression of nearly 43-bps is the result of the high percentage of properties in premium markets closing during Q2.
- **Burger King:** The decrease in the number of premium-market sales and the slight decrease in number of lease years remaining led to an average cap rate that was 47.2-bps higher than Q1.
- **Dunkin' Donuts:** Q2 saw fewer sales in high-demand markets than Q1, resulting in a 30.8-bp expansion.
- **Hardee's:** The increase in ground leases was the main driver in the 22.3-bp compression of Hardee's cap rate from Q1 to Q2.
- **Sonic:** The average number of years remaining on the leases fell, leading to the 76.5-bp expansion.
- **Raising Cane's:** In Q1, Raising Cane's had ground leases and properties in California trade, keeping the cap rate very low. The increase from quarter to quarter (28.7-bps) is due to the cap rate moving back to its average.
- **Starbucks:** With nearly half of the Q1 sales occurring in California, the 30.2-bp increase is the mirror opposite of the 29-bp compression from Q4 2017 to the first quarter of this year.
- **Taco Bell:** The net effect of an increase in ground lease sales and decrease in the number of premium-market sales led to the 25.2-bp cap rate expansion.
- **Wendy's:** Newer stores trading during Q2 drove the 38.8-bp compression.

Tenants	Q1 2018 Avg Cap Rates	Q2 2018 Avg Cap Rates	Change in Avg Cap Rates (bps)
7-Eleven	5.20%	4.77%	-42.8
Arby's	5.79%	5.80%	0.9
Bojangles'	5.74%	5.65%	-9.0
Burger King	5.66%	6.13%	47.2
CVS	5.66%	6.03%	37.1
Del Taco	4.78%	4.73%	-5.0
Dollar General	6.67%	6.57%	-9.9
Dunkin' Donuts	5.30%	5.61%	30.8
Family Dollar	6.17%	6.32%	15.1
Hardee's	5.90%	5.68%	-22.3
KFC	5.35%	5.30%	-5.1
O'Reilly Auto Parts	5.68%	5.68%	0.5
Raising Cane's	5.14%	5.43%	28.7
Safeway	5.32%	5.45%	13.0
Sonic	5.55%	6.32%	76.5
Starbucks	4.44%	4.74%	30.2
Taco Bell	4.88%	5.13%	25.2
Walgreens	5.81%	6.04%	23.0
Wawa	4.63%	4.70%	6.8
Wendy's	5.77%	5.38%	-38.8

**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 Single Tenant Net Lease (STNL) average cap rate has increased slightly for three straight quarters. During Q2, the 10 year treasury rates varied between 2.73% and 3.11% before closing at 2.85%. The spread between cap rates and the 10 year treasury rates have remained under four percent for seven straight quarters.



Conclusion:

The second quarter was devoid of the drama that defined much of the net lease market in Q1--especially as it concerned the pharmacy sector. The big news for the quarter then becomes one of overall performance and the nearly 18-month record changes in cap rates. In short, for the foreseeable future, we expect cap rates to continue to rise.



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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