NET LEASE REPORT December 2018

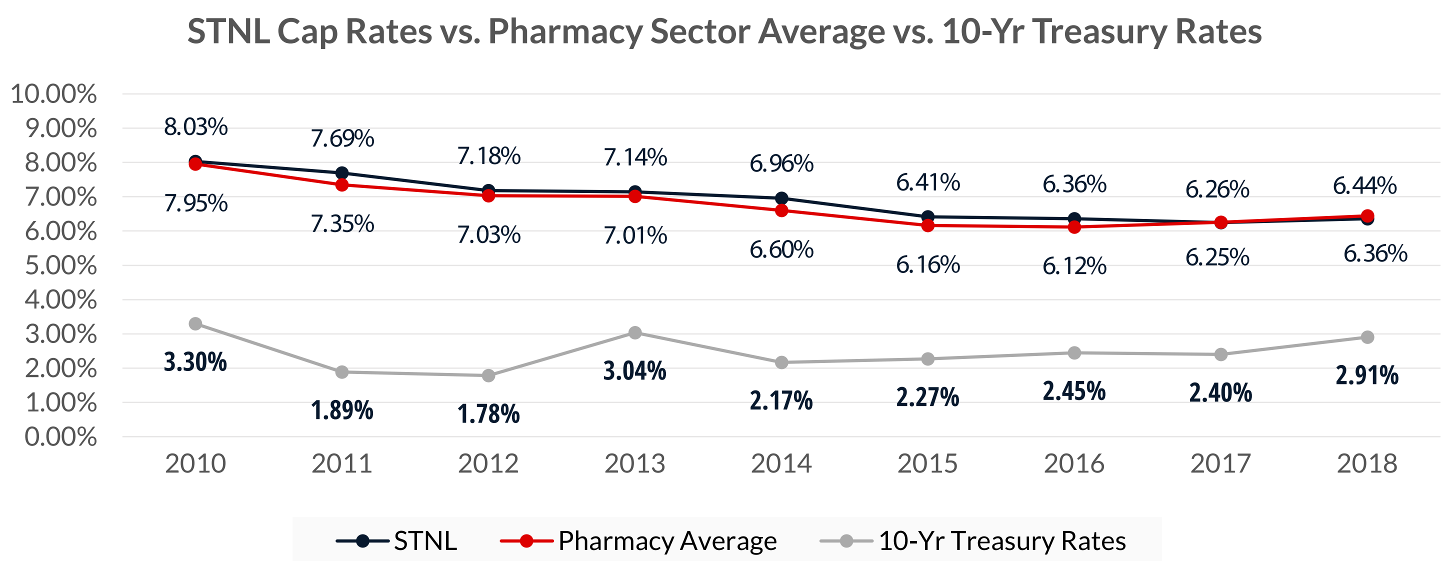
PHARMACY SECTOR

The pharmacy sector has remained attractive to net lease investors because it offers assets with long term leases, backed by financially strong companies, in an industry that people will rely on for years to come. The three largest pharmacy tenants typically sign leases for 20 – 25 years. CVS and Walgreens leases usually don't have any rental increases during the primary term but offer the tenant multiple chances to extend the lease, up to an additional 50 years. Rite Aid has some locations with rental increases written into the lease offering investors a chance to acquire an asset that will provide a hedge against inflation. Across the sector, pharmacies have a mix of double and triple net leases, offering investors multiple options on the risk/reward spectrum.

Credit Ratings	S&P	Moody's
CVS pharmacy	BBB	Baa2
Walgreens	BBB	Baa2
RITE AID	B	B3

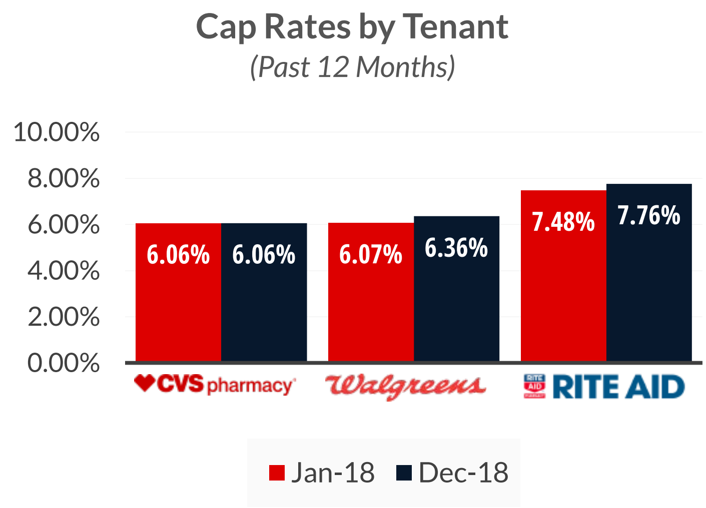
The two largest tenants in the pharmacy sector, CVS and Walgreens, have identical credit and tend to trade at similar cap rates. Rite Aid currently has many concerns about their balance sheet, as a result their properties have traded a higher average cap rate than their industry peers. While they have taken steps to reduce their debt, including the sale of 1,932 stores to Walgreens for $4.16 Billion, Rite Aid is still under financial pressure. The transfer of these stores was completed in March of 2018. This infusion of capital will be beneficial not only to their operations but to their creditors.

The pharmacy industry is well positioned for the future. Advances in medicine have greatly extended the average life expectancy in the US and this changing demographic will drive the need for pharmacies for the foreseeable future.



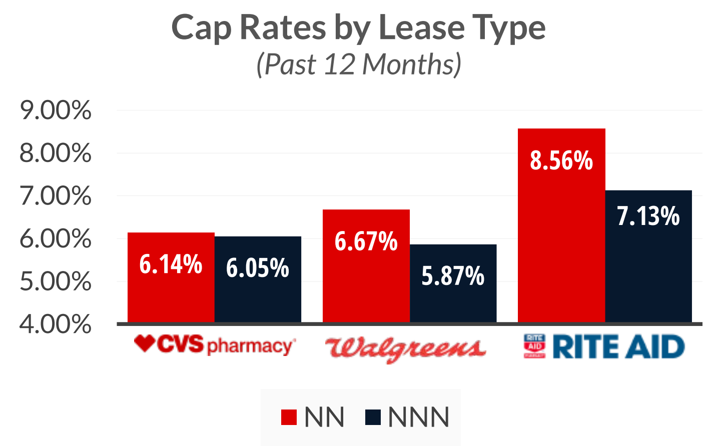
Cap Rates by Tenant

The tenancy of pharmacy locations had a large effect on the average cap rate over the last 12 months. Rite Aid has continued to sell at a significantly higher cap rate than their more stable and financially stronger competitors. CVS has remained strong, not moving since the last time we examined the Pharmacy sector in detail in January of 2018. Walgreens has seen their cap rate rise slightly over the course of 2018 due to the average term remaining falling and several former Rite Aids selling during or after their transition to the Walgreens brand. The average term remaining for Walgreens fell by almost a full year, putting upward pressure on cap rates. In addition to fewer lease years remaining, properties transitioning from Rite Aid have traded at an average cap rate of 6.44% putting further expansionary pressure on cap rates.



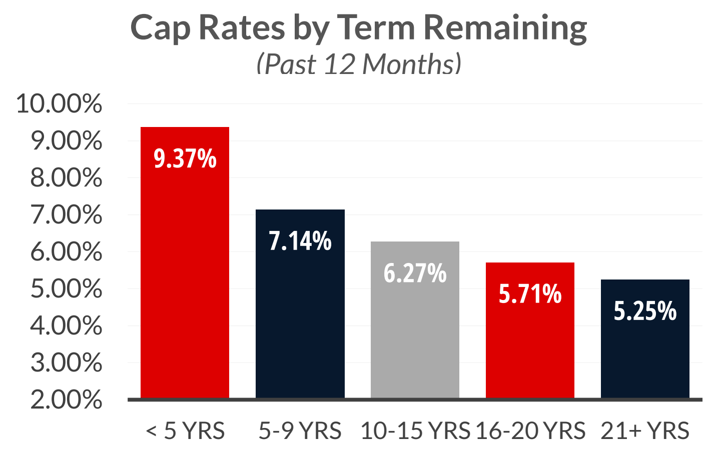
Cap Rates by Lease Type

Pharmacies tend to operate on double or triple net leases. Double net leases leave the investors with some landlord responsibilities, typically roof and structure, while triple net leases relieve the investor of any cost. Properties with differing lease structures tend to trade at different cap rates to compensate investors for the difference in risk, double net leased properties will have a slightly higher rent to sale ratio than their triple net counterparts.



Cap Rates by Term Remaining

Net lease investors tend to seek out longer leases tas the longer terms postpone the vacancy risk and ensures a stable cash flow for years, even decades to come. That premium investors have been willing to pay for long term security is evident in the low cap rates of properties with a high number of years remaining. The pharmacy tenants tend to sign leases longer than most other net lease sectors, 20-25 years vs. 10-20 years.



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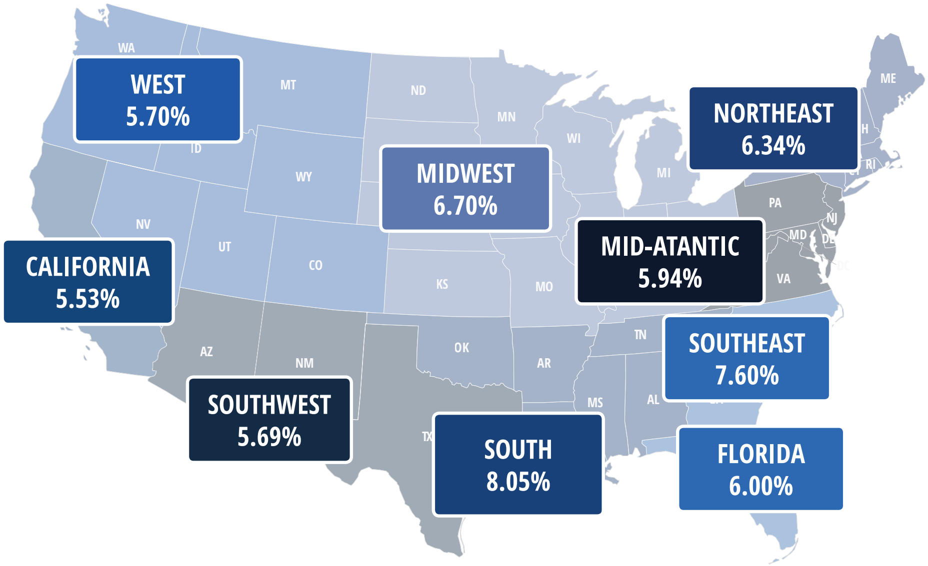
PHARMACY SECTOR

Cap Rates by Region

California and the West Coast continue to have low average cap rates across all sectors. The high demand for assets in those areas has kept cap rates compressed. The Southwest and Mid-Atlantic have also had cap rates below 6% due to the high number of average lease years remaining of sales in those areas. We can also see large split between Florida and the Southeast. Both regions had few years relative to the rest of the nation but high levels of demand for Florida properties (similar to California and the West Coast) have kept cap rates on the low end of the spectrum.

Cap Rates by Region
(Past 12 Months)



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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.