NATIONAL REPORT

NET-LEASE RETAIL

IPA INSTITUTIONAL PROPERTY ADVISORS

2022

Resilient Retailers Set to Overcome Potential Hurdles; Rising Interest Rates Could Put Pressure on Yields

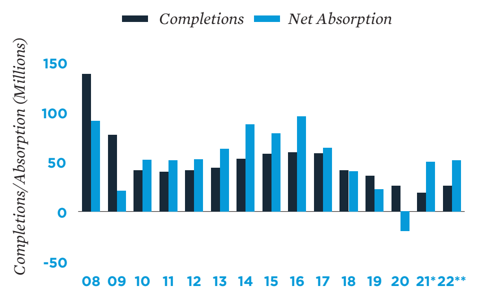
Net-leased sector faces mix of tailwinds and headwinds. Reopened stores and robust consumption bode well for single-tenant retailers this year, although some challenges remain. A shortage of supplies coming in at higher prices may erode consumer demand as 2022 progresses and the possibility of future virus variants could reintroduce some pandemic shopping behavior. The impact would vary by retailer. Auto parts vendors are benefiting from a widespread shift to longer vehicle ownership, a structural trend that was exacerbated by pandemic-driven shortages of new cars. Fast food restaurants have generally recovered in-house dining but could leverage drive-thru options again if needed. Chains such as Wendy's and Jack-in-the-Box are resuming new store openings this year. These and other fast casual dining restaurants nevertheless face a persistent labor shortage, including Denny's, which lacks the workforce necessary to sustain its staple 24/7 level of service in many locations. Overall though, the single-tenant, net-leased sector is poised to report improving property fundamentals this year. Construction remains restrained, while more companies are resuming expansion plans, backfilling spaces and supporting accelerating asking rent growth.

Investors double down on proven concepts. Sales velocity for single-tenant assets is climbing more readily than multi-tenant properties. Investors are maintaining focus on tenants that demonstrated resilience during lockdowns, including auto part stores, necessity retailers and fast casual restaurants. Inflation concerns put an emphasis on businesses that can leverage scale to provide better value for customers. Planet Fitness is one example, excelling where smaller gyms have failed due in part to lower membership rates. Risk-averse institutions and REITs are targeting assets with high credit grade tenants and long lease terms, utilizing their lower borrowing costs to close trades at compressed cap rates. The national single-tenant average is now pushing below 6 percent. Competition from larger investors is pushing private buyers in the $3 million and under tranche to consider buildings occupied by noncredit tenants who weathered the downturn. The higher yields associated with these properties could become more appealing as interest rates rise this year. Contracting margins in the face of a rapid interest rate climb could lead to price adjustments on some listings.

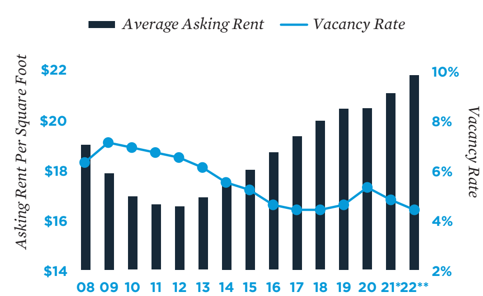
Health Retail Evolution Carries Investment Implications

Drug stores pursue primary care ambitions. Healthcare providers have been entering the retail sector with increasing frequency for years, with the rise of urgent health care centers. The pandemic has similarly forced drug stores such as CVS and Walgreens to deploy more clinical service offerings. So far that has predominantly taken the form of supplying COVID-19 tests and vaccinations, but both of these major brands are committing to multi-year plans to transition many of their stores away from the traditional pharmacist model to include primary care sites. This capital investment comes with plans to close stores, creating competition among investors for the contracting pool of assets occupied by these historically stable tenants. There is also some risk that post-pandemic, customers will transition back to earlier healthcare habits. That may be the perspective of Rite Aid, which is focusing on expanding its traditional pharmacist business.

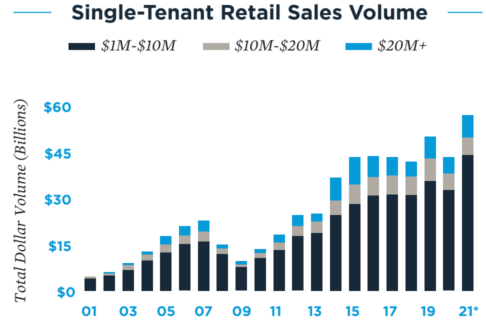
Single-Tenant Supply and Demand



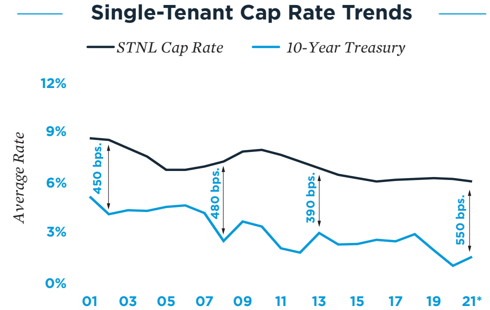
Single-Tenant Vacancy & Rent Trends



Single-Tenant Retail Sales Volume



Single-Tenant Cap Rate Trends



* Estimate

** Forecast

Sources: Marcus & Millichap Research Services; Federal Reserve; Real Capital Analytics; Moody's Analytics

Brand	Locations*
Auto Parts	
Advance Auto Parts	6,286
AutoZone	6,785
Caliber Collision	1,411
O'Reilly Auto Parts	5,762
Convenience Stores	
7-Eleven	9,519
Circle K	11,197
Wawa	934
Dollar Stores	
Dollar General	17,915
Dollar Tree/Family Dollar	15,966
Fast Casual Restaurants	
Applebee's	3,439
Bloomin' Brands	1,170
Chili's	1,650
Darden Restaurants	1,852
Red Lobster	672
Fitness Centers	
LA Fitness	709
Planet Fitness	2,193
Grocery & General Retail	
Kroger	2,726
Aldi	2,097
Safeway	2,278
Sherwin-Williams	4,824
Verizon Wireless	6,480
Walmart	10,566
Pharmacies	
CVS	9,955
Walgreens	8,973
Quick Service Restaurants	
Burger King	15,481
Chick-fil-A	2,598
McDonald's	14,888
Starbucks	16,826
Wendy's	6,891
Yum! Brands	18,366

Closed STNL Cap Rate Range by Brand

** Number of locations in the United States and Canada*

Cap rates shown above are representative of transactions that closed in the trailing 12 months ended 2Q 2021.

Actual yields will vary by locations, tenant, lease terms and other considerations.

Locations sourced from CreditNtell for public companies and company websites for private companies.

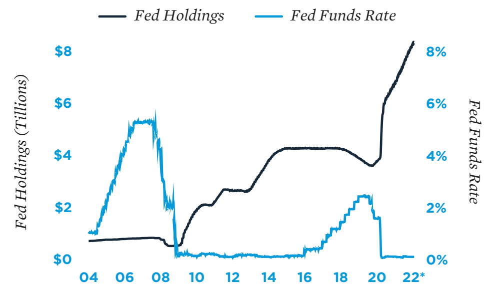
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Moody's Analytics; RealPage, Inc.; U.S. Census Bureau

Fed Takes Action to Temper Inflation; Wide Range of Retail Performance Spurs Lender Considerations

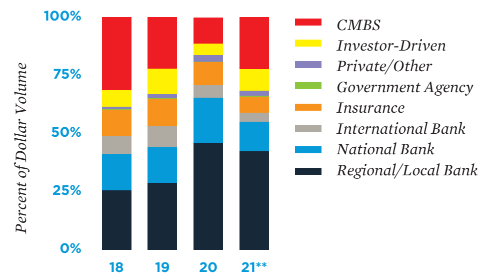
Fed redirects policies to curb inflation. The Federal Reserve's main focus this year will be combating inflation without derailing economic growth. The Federal Open Market Committee (FOMC) anticipated rising prices following global production shutdowns and port closures in 2020 and adjusted policies to permit a period of above-target inflation. Prices climbed more quickly last year than expected, however, prompting an end to the Fed's accommodative monetary policy. Entering 2022, the central bank had already begun unwinding the quantitative easing measures put in place during the health crisis. These bond-buying programs are set to conclude in March, at which point the federal funds rate will almost certainly be raised off the zero lower bound by at least 25 basis points. Multiple rate hikes are expected to follow within the year. The central bank may also begin reducing its balance sheet, in an additional measure of quantitative tightening. These plans are subject to change, especially if the FOMC overestimates the current strength of the economy and growth stalls. The uncertain nature of the health crisis may also lead to unforeseen hurdles that prompt changes in Fed policy.

No one-size-fits-all approach to retail lending. While most retailers have generally reopened, foregone rental income and lingering health/logistical disruptions keep lenders and investors cautious. The retail sector can never be painted with a broad brush, but that is especially true today, with property performance varying widely depending on a range of asset-specific features. Where an asset is located as well as the strength of its tenants are important factors lenders are considering. Properties located closer to residential rather than commercial hubs are looked at more favorably, as are assets occupied by tenants that proved their resiliency during the height of pandemic lockdowns. Single-tenant properties net leased to high credit grade tenants such as national drug store chains as well as grocery-anchored shopping centers are garnering more attention. Properties in commercial districts or secondary/tertiary neighborhoods will bear more consideration. A borrower's ability to demonstrate minimally interrupted rent collections is a distinguishing factor. Local and regional banks continue to be the most active lenders, followed by CMBS sources, which are more active now following a steep drawback in 2020. Bridge lending is available for transactions with shorter terms.

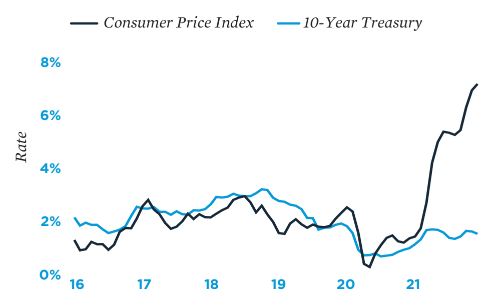
Accommodative Monetary Policy



Retail Lender Composition



Inflation Could Pressure Interest Rates



* Through January 26

** Estimate

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Price: $250

Sources: IPA Research Services; CreditNtell; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; Real Capital Analytics; U. S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; U.S. Census Bureau.