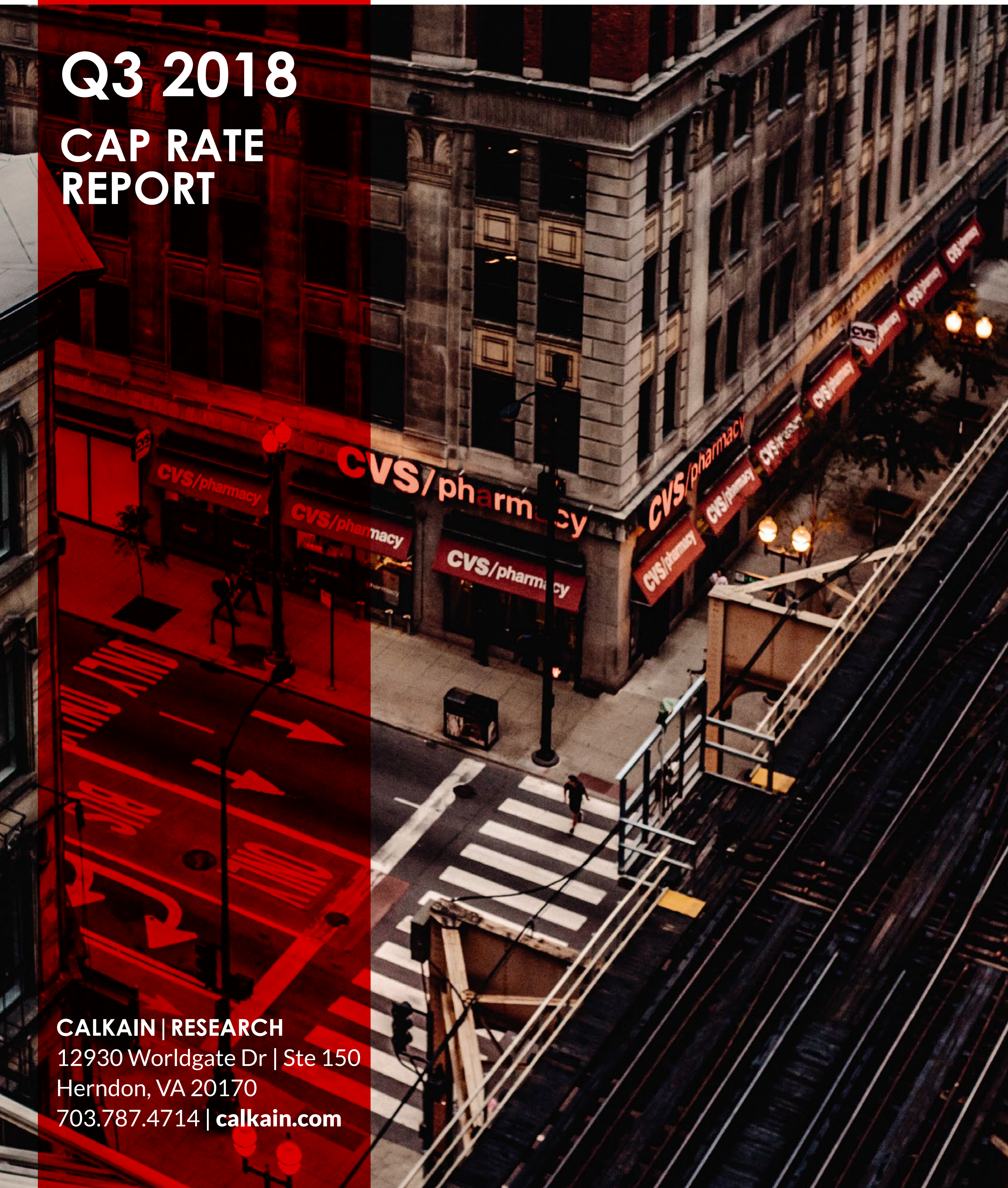
CALKAIN | RESEARCH
AMERICA'S NET LEASE COMPANY®

Q3 2018

CAP RATE REPORT



CALKAIN | RESEARCH
12930 Worldgate Dr | Ste 150
Herndon, VA 20170
703.787.4714 | **calkain.com**

Q3 2018 Overview

Cap Rates Continue Upward Trajectory

The upward trend of cap rates we have been tracking through the year continued in the third quarter, with an eight basis-point (bps) gain, and it shows no sign of abating. If anything, as investors begin to turn their focus to Q4 and 2019, we see interest-rate growth outpacing that of cap rates in the short run until an acceleration in cap-rate increases over the next few months. Still, the expectation is one of moderate growth.

Some question has arisen about such concerns as the coming midterm elections, inflation and the possibility of a mid-2019 correction. Most experts agree, these are non-issues for the coming year and will have little to no effect on the cap rate trajectory. The two sectors at either end of the cap-rate change spectrum this quarter are dollar stores, up 45.1 bps, and pharmacies, which posted a -29.3 shift.

Despite these concerns, the net lease market is on track for continued strong performance. There is an equilibrium between buyers and sellers, even as more new investors enter the field. Buyers do what they always do: they push on pricing, and there is enough inventory out there for selectivity in their choices but without a dangerous overstock.

A note here about the interplay of internet sales and brick-and mortar. The winners here are those, such as Amazon and Warby Parker, that recognize the importance of existing in both realms, and we see more online names opting for physical locations as a part of their strategy. It is a wise decision. Some 90% of retail sales still occur in brick-and-mortar locations, a fact that bodes well for all retail, especially the triple-net (NNN) space.

Sectors	Q2 2018					Q3 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	6.93%	4.62%	11.70%	9.5	31	6.83%	4.50%	12.84%	9.8	55	-9.2	0.2
Bank	6.03%	4.00%	8.60%	8.8	21	5.89%	4.07%	8.80%	7.9	33	-14.5	(1.0)
Big-Box	7.17%	5.49%	9.10%	8.9	22	7.18%	3.81%	11.48%	9.3	25	0.2	0.4
Casual Dining	6.46%	4.50%	8.86%	10.8	39	6.34%	4.00%	9.77%	11.8	58	-12.1	0.9
C-Store	5.66%	4.00%	8.50%	11.3	26	5.63%	4.40%	13.51%	9.1	34	-3.8	(2.3)
Dollar Store	6.75%	5.25%	18.86%	10.5	58	7.20%	5.21%	9.93%	10.8	75	45.1	0.3
Educational	7.19%	6.56%	7.90%	12.5	3	7.31%	6.30%	8.63%	8.3	9	11.9	(4.2)
Medical	6.32%	5.50%	11.66%	11.8	12	6.59%	4.93%	9.29%	9.9	10	26.5	(1.9)
Pharmacy	6.63%	5.00%	15.81%	10.5	30	6.34%	5.05%	9.00%	12.3	35	-29.3	1.8
QSR	5.67%	3.82%	8.32%	13.8	109	5.88%	3.50%	9.47%	12.4	151	20.8	(1.4)
Other Retail [1]	6.50%	4.93%	10.00%	12.0	31	6.85%	4.75%	11.85%	9.9	45	35.0	(2.1)
Average	**6.48%**			**11.0**		**6.55%**			**10.1**		**6.4**	**(0.8)**
Total Sample Size					**382**					**530**		

[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

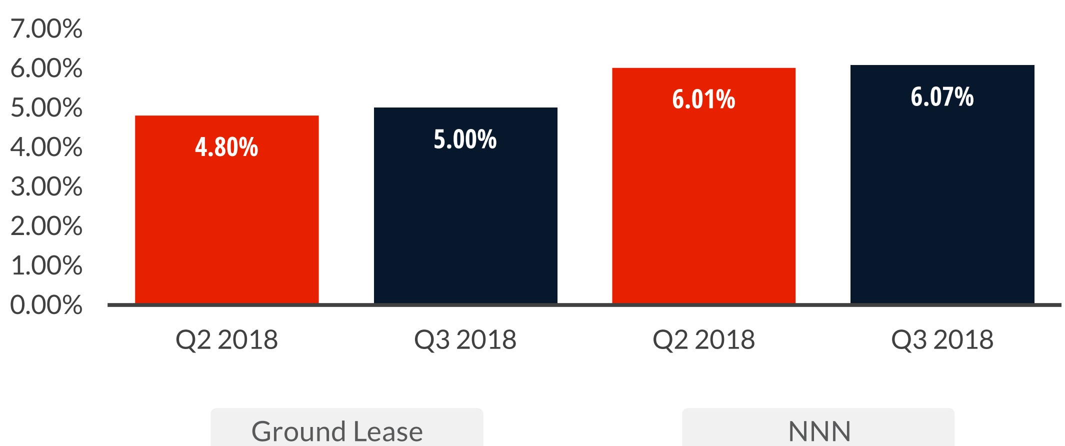
How did specific sectors perform in Q3 compared to Q2? Lower cap rates were the theme for the **Casual Dining** sector (down 12.1 bps to 6.34%) driven by an increase in lease years and more ground leases.

Convenience Stores saw a compression of 3.8 bps and the average number of years remaining dipped by 2.3 years. Normal with a fall in the number of years remaining we expect the average cap rate to rise but an increase in the number of CA sales, which typically trade at low cap rates, and changing the mix of tenants led to cap rates compressing slightly.

Medical is another sector where lease years remaining dropped an average of -1.9 years. The sector posted slightly higher cap rates (26.5 bps over Q2).

Quick-Service Restaurants (QSRs) are enjoying an influx of new investors, attracted both by price point and a model that many consider Amazon-proof. In all, the sector showed a moderate movement quarter over quarter, in terms of both lease years (-1.4) and cap rates (up 20.8 bps). Ground leases saw a moderate increase in average cap rates.

Average Cap Rates for QSR by Lease Type

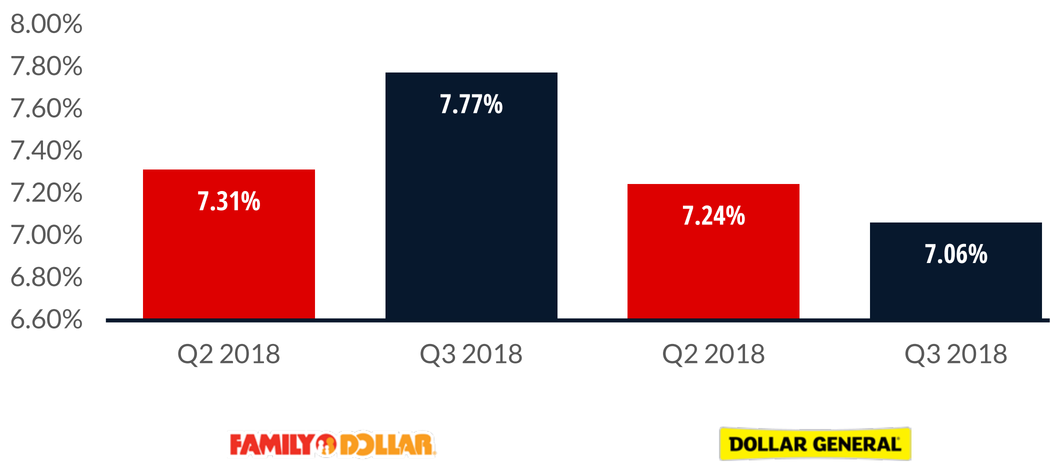


Markets in Depth: Dollar Stores

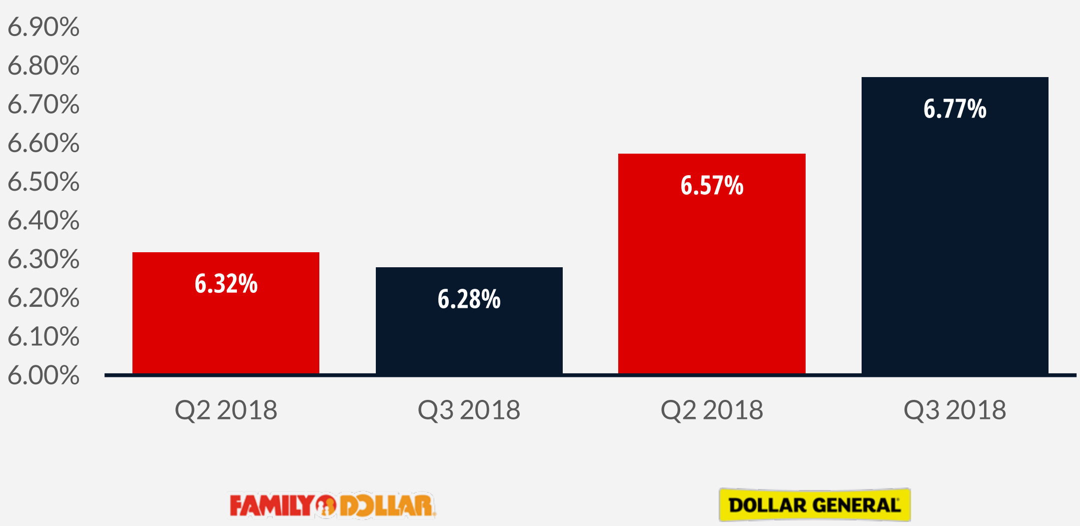
An oversupply of dollar stores has not yet resulted in a buyer's market, but investors are becoming more selective, especially in secondary and tertiary locales, resulting in upward cap rate pressure--by 46 bps in the case of Family Dollar. Bucking the trend is Dollar General, which posted lower cap rates, down 18 bps. (These are the two biggest names in the category.)

Looking at those stores with 10 or more years remaining, the picture changes with Family Dollar down by 4 bps and Dollar General is up 20 bps, larger than a previous quarter over quarter changes.

National Average Cap Rates by Dollar Store



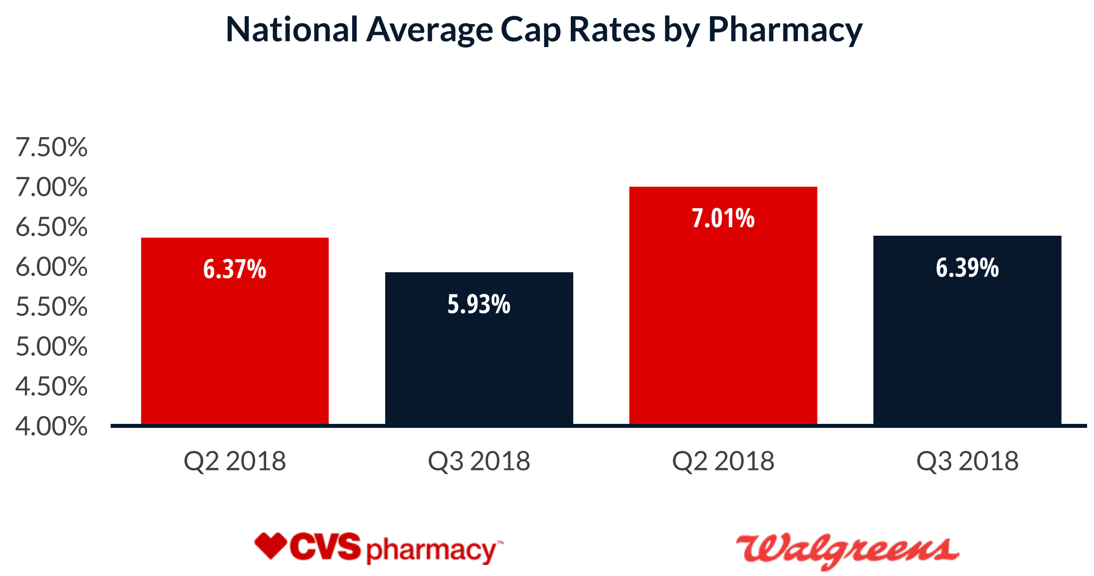
National Average Cap Rates by Dollar Store 10+ Years Remaining

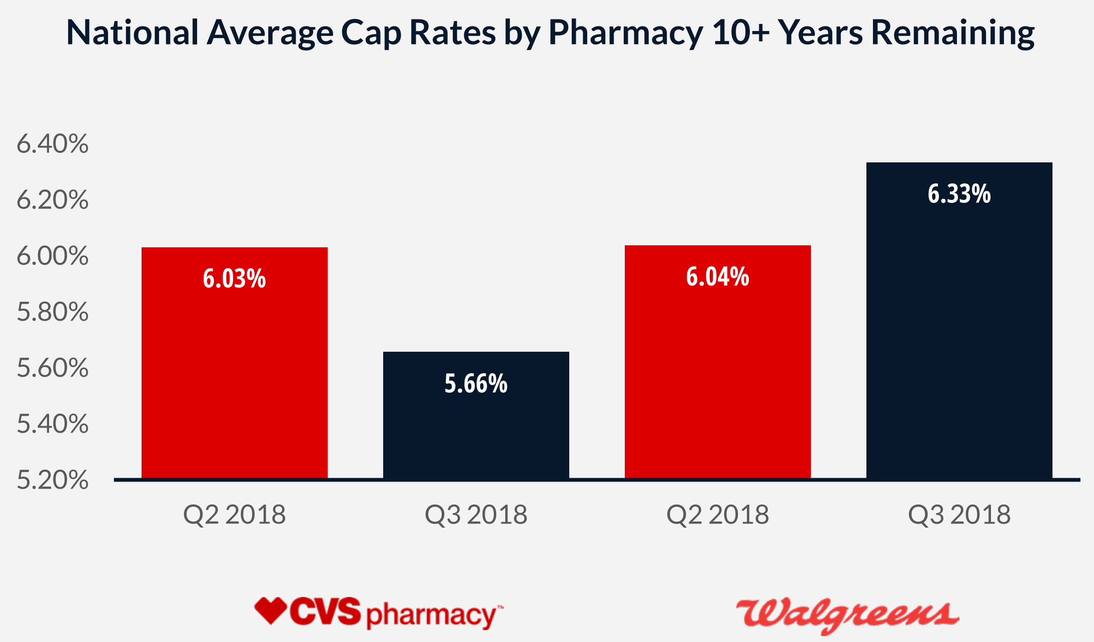


Markets in Depth: Pharmacy

Looking at the overall picture, cap rates in the Pharmacy sector dropped by 29.3 bps while assets had on average 1.6 more lease years remaining. Most notably, there were quarter-over-quarter changes to specific brands that were larger than the sector overall, namely Walgreens, which fell by 62 bps, and CVS by 44 bps.

For assets where more than 10 years remaining on the lease, CVS was down 37 bps, while Walgreens rose 29 bps, countering its overall trend.





Brand-By-Brand: Average Cap Rate Changes

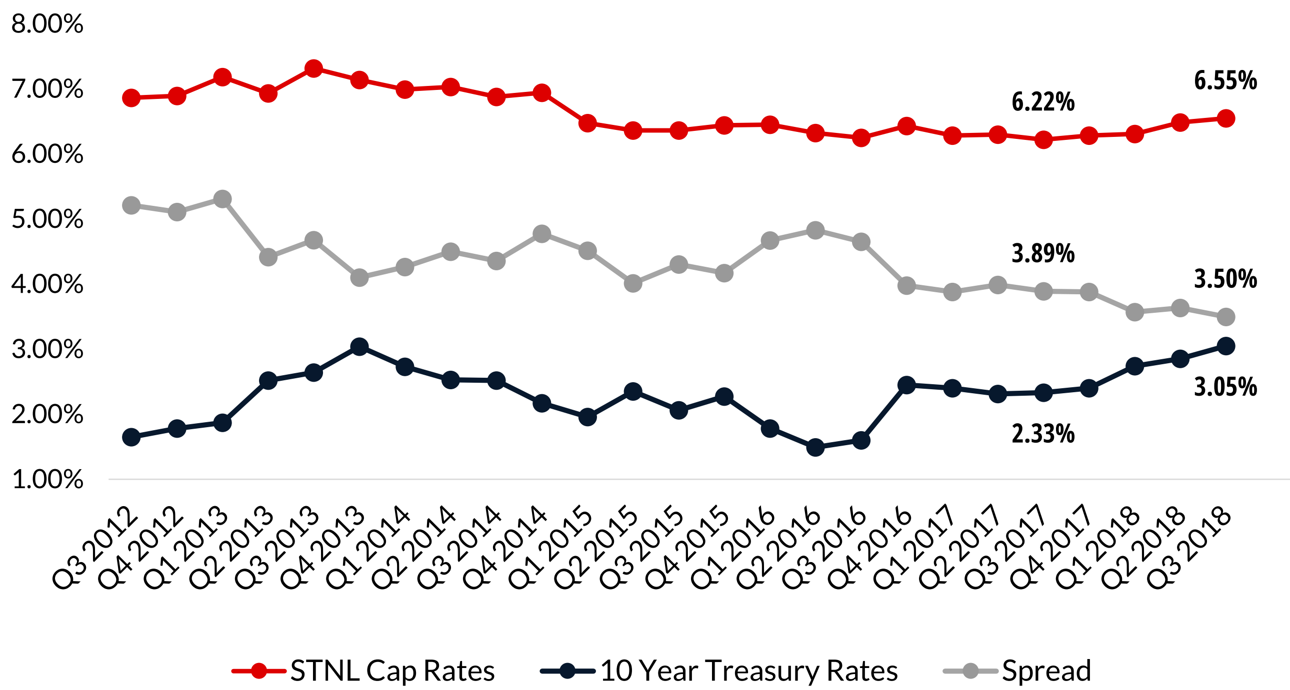
- **7-Eleven:** With more California trades in Q2, cap rates rose 53.7 bps.
- **Applebee's:** Cap rates rose 37.9 bps due to the average number of lease years slipping quarter-over-quarter.
- **Burger King:** A compression of 35 bps was the result of more years remaining and more California deals.
- **Jiffy Lube:** There were only CA & FL comps in Q2 while no Jiffy Lubes closed in premium markets during Q3.
- **KFC:** There were more premium-market sales in Q2 than Q3, causing cap rates to rise 26.6 bps.
- **McDonald's:** The increase in west coast sales caused a compression in average cap rate.
- **Sonic:** The 27.8-bp compression of cap rates was caused by deallocation plus an increase in the number of average lease years remaining.
- **Starbucks:** Most of the Q3 comps are in CA and below a 4% cap, creating the appearance of cap rate compression. We expect to see a rebound in average cap rate when we get a normal distribution of deals across the country.
- **Taco Bell:** The chain experienced a large change in a number of years remaining, which was partially offset by fewer GLs in Q3. We typically expect to see a larger change in cap rate when the number of average lease years remaining changes by almost 4.5 years.

Tenants	Q2 2018 Avg Cap Rates	Q3 2018 Avg Cap Rates	Change in Avg Cap Rates (bps)
7-Eleven	4.77%	5.31%	53.7
Advance Auto Parts	6.88%	6.37%	-51.3
Applebee's	6.63%	7.01%	37.9
Arby's	5.80%	5.72%	-7.8
AutoZone	4.87%	5.54%	66.5
Bojangles'	5.65%	6.15%	49.7
Burger King	6.13%	5.78%	-35.0
CVS	6.03%	5.66%	-37.5
Denny's	6.38%	6.05%	-32.7
Dollar General	6.57%	6.73%	15.5
Family Dollar	6.32%	6.28%	-4.0
Hardee's	5.68%	5.81%	13.0
Jack in the Box	5.10%	5.67%	56.7

Tenants	Q2 2018 Avg Cap Rates	Q3 2018 Avg Cap Rates	Change in Avg Cap Rates (bps)
Jiffy Lube	5.42%	7.69%	226.8
KFC	5.30%	5.56%	26.6
McDonald's	4.60%	4.22%	-38.3
O'Reilly Auto Parts	5.68%	5.58%	-10.5
Raising Cane's	5.43%	6.18%	75.0
Sonic	6.32%	6.04%	-27.8
Starbucks	4.74%	4.01%	-73.7
Taco Bell	5.13%	5.37%	24.7
Tractor Supply Co.	6.49%	6.45%	-4.5
Walgreens	6.04%	6.33%	29.6
Wawa	4.70%	4.61%	-9.3
Wendy's	5.38%	5.39%	0.8

**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 cap rate has increased for four straight quarters now, while the 10 year treasury rate have increased over the last six, finishing the quarter over 3% for the first time since Q4 of 2013. We do expect the rise in T-bills to level off in the short term.

Spreads have remained below 400 bps for more than two years. Currently, we are at the smallest spread we have ever recorded. One more Fed rate hike is expected before we close out the year, putting more upward pressure on cap rates.

Conclusion:

Building on cap rate performance year-to-date, the major trend for the coming months will be an accelerated but still remain a moderate rise, driven by the interest rate environment. Concerns beyond those that are market-specific, appear to be non-issues.

In all, the investor reaction to the dynamics of the current marketplace, from the rise in cap rates, interest rates, and the T-bill to the interplay of web-based sales and brick-and-mortar, is cautious optimism.

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.

CALKAIN | RESEARCH
12930 Worldgate Dr | Suite 150
Herndon, VA 20170
703.787.4714 | **calkain.com**

Interested in Calkain's Research Services?
Contact us at **research@calkain.com**