

National Net Lease Market

WITH CORPORATIONS STILL LOOKING TO SALE-LEASEBACK AS A WAY TO RAISE CAPITAL AND IMPROVE THEIR BALANCE SHEETS BY REMOVING REAL ESTATE FROM THEM, THE NATIONAL NET LEASE MARKET CONTINUES TO DO WELL IN THE CURRENT DOWN CYCLE. One participant estimated that the sale-leaseback market is probably up 10.0% to 12.0% this year; however, he goes on to state “the market is still not as robust as some had hoped.” One reason may be that some indecisive corporations have waited too long to take advantage of sale-leaseback transactions and in the interim their credit ratings have fallen to levels that are enticing few investors. Nevertheless, the market remains strong and its

future looks bright.

Several large net lease transactions have occurred recently. In one, W.P. Carey & Co. purchased two mixed-use office, manufacturing, and distribution facilities from Special Devices Incorporated for \$37.7 million. In another, Griffin Capital purchased a 175,000-square-foot office building in the Chicago suburb of Plainfield from Chicago Bridge & Iron Company for \$20.7 million. Finally, Uno Restaurant Corporation sold and leased back 12 restaurant locations from U.S. Realty Advisors for \$25.0 million.

One indication that this market has remained steady appears in our key indicators. While there have been only

minor fluctuations in most of them for the national net lease market over the past year, the changes have been less subtle in markets such as national CBD office, national regional mall, national power center, and all hotel markets. As a result, some major investment companies are waking up to the opportunities that this market presents, thereby creating a more competitive environment. For example, GE Capital Real Estate entered the arena this year. Others are likely to follow suit.

Two major players in the national net lease market have recently announced merger plans – Commercial Net Lease Realty, Inc. and Captec Net Lease Realty, Inc. The joining of these two firms will surely create a powerhouse with a commanding presence in the retail sector of this market. The deal is expected to close in the fourth quarter of 2001.

The net lease market for retail properties continues to soften, but according to a participant this fact reflects problems in the industry more so than any other factor. Since the market is saturated with drug stores and consumer confidence in the retail sector is waning, lenders and industry leaders are now focusing more on industrial and office properties. “Retail remains a buyers’ market, while office and industrial are sellers’ markets,” affirms a participant. Still, one bright spot for the retail market appears to be in the 1031 exchange market. In fact, many 1031 exchange buyers prefer retail investments because they require less hands-on management. Regardless of property preferences, most investors agree that overall the net lease market will continue to do well for the remainder of the year. ♦

Table 22

NATIONAL NET LEASE MARKET			
Third Quarter 2001			
KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)^a			
RANGE	9.00%–20.00%	9.00%–20.00%	9.00%–12.00%
AVERAGE	11.84%	11.80%	11.00%
CHANGE (Basis Points)	—	+4	+84
Overall Cap Rate (OAR)^a			
RANGE	8.00%–11.00%	8.00%–11.00%	8.00%–11.00%
AVERAGE	9.41%	9.40%	9.45%
CHANGE (Basis Points)	—	+1	–4
Residual Cap Rate			
RANGE	8.00%–10.00%	8.00%–10.00%	8.00%–10.00%
AVERAGE	9.41%	9.42%	9.50%
CHANGE (Basis Points)	—	–1	–9
Market Rent Change Rate^b			
RANGE	2.00%–3.00%	2.00%–3.00%	2.00%–3.00%
AVERAGE	2.50%	2.50%	2.67%
CHANGE (Basis Points)	—	0	–17
Expense Change Rate^b			
RANGE	2.00%–3.00%	2.00%–3.00%	2.00%–3.00%
AVERAGE	2.70%	2.75%	2.67%
CHANGE (Basis Points)	—	–5	+3
Average Marketing Time (in months)			
RANGE	4.00–7.50	4.00–7.50	4.00–6.00
AVERAGE	5.70	6.00	5.00
% CHANGE	—	–5.00	+14.00
a. Rate on unleveraged, all-cash transactions b. Initial rate of change			

NATIONAL NET LEASE MARKET – INVESTOR SURVEY RESPONSES *
Third Quarter 2001

PREFERRED PROPERTY TYPE	CHANGE RATES			PREFERRED CREDIT RATING	RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	UNDERLYING VACANCY & CREDIT LOSS	RESERVE	MARKETING TIME
	Market Rent	Expenses	Cap Rate		Selling Expenses	Free & Clear					
PRIVATE INVESTMENT FIRM Primary valuation method is DCF analysis; also uses direct capitalization; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve.	Office, retail, R&D, industrial, banks, restaurants	Varies flat, fixed, or CPI	0.0%	Below & above investment grade	(1)	(1)	Depends on lease term	8.50% to 10.50%	0.00%	None	Typically holds properties
PRIVATE FUND MANAGER Primary valuation method is direct capitalization; also uses DCF analysis.	Any	(2)	(2)	BB and above	(2)	(2)	9.00% to 12.00%	9.50% to 11.00%	0.00%	None	(2)
PRIVATE INVESTMENT FIRM Primary valuation method is sales comparison approach; also uses DCF analysis.	Office, industrial	2.0%	3.0%	BBB to AAA		2.60%	11.60%	9.40%	0.00%	None	6
REIT Primary valuation method is DCF analysis; also uses direct capitalization and sales comparison; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve.	Office, industrial, big-box retail	3.0%	3.0%	BB to AAA		2.00%	10.50% to 11.00%	9.00% to 10.00%	0.00%	\$0.15	4
INVESTORS AND BROKERS Primary valuation method is direct capitalization; also uses sales comparison approach.	Drug stores, retail	(2)	(2)	BBB to A+		(2)	(2)	9.00%	0.00%	None	(2)
INVESTMENT ADVISOR Primary valuation method is DCF analysis; also uses direct capitalization; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve.	Office, industrial, retail	2.0%	2.0%	BB to AAA		(2)	10.00% to 12.00%	8.00% to 10.00%	0.00%	\$0.10 to \$0.20 (NN leases only)	6
REIT/PRIVATE FUND Primary valuation method is direct capitalization; also uses DCF analysis; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve.	Retail, warehouse, industrial, office, restaurant	(2)	(2)	BB to A		3.00%	12.00% to 20.00%	(2)	0.00%	None	(2)
REAL ESTATE SERVICE FIRM Primary valuation method is DCF; also uses direct capitalization; prepares valuations subject to financing.	Drug stores	3.0%	3.0%	BBB		2.0% to 3.0%	10.00% to 11.00%	8.00% to 9.00%	5.0%	\$0.10 to \$0.15	4 to 6

(1) Does not consider any residual value
(2) Did not disclose

*Representative sample; due to space constraints, not all responses are included.