

## Net-Leased Assets Sought After by Exchange Buyers

Many sectors of the single-tenant market are reevaluating expansion plans after the robust pace of growth subsequent the last recession. The merger between Family Dollar and Dollar Tree will require divesting 340 stores, according to the Federal Trade Commission, most of which are expected to be Family Dollar locations. Dollar General, on the other hand, will expand by more than 700 locations this year and a similar amount in 2016. The discounters are not the only major single-tenant operators adjusting their portfolios. Walgreens, the nation's largest pharmacy company, will close 200 stores in a cost-cutting move to shore up financials. Rite Aid, meanwhile, appears to be on the brink of expansion again after the Eckerd merger is no longer weighing on the bottom line. Taken together, the openings and closings of single-tenant users are a reflection of a market that is searching for equilibrium after rapid growth in recent years. As pad sites on large projects are developed, the pace of growth from single-tenant retailers will be more disciplined in the coming year, but expansion will persist overall.

The potential rise in interest rates is the most pressing subject for single-tenant, net-leased investors in the market in 2015. Plenty of capital remains in the market and listings featuring new construction are capturing overwhelming attention from investors. In fact, the temporary absence of one of the largest single-tenant REITs in the market has done little to slow deal flow in the net-leased sector. Buyers are targeting assets as long-term capital preservation and income-producing investments. A seven-year freeze on the federal funds rate has shifted buyers' expectations for yield, and cap rates have sunk to an all-time low across multiple single-tenant sectors. Poor economic growth in this year's opening period, meanwhile, will push back action by the Fed until September, keeping interest rates low and delaying a rise in cap rates in the near term.

## Net-Leased Retail Market Overview



**Auto-Part Retailers:** Average cap rates tightened 50 basis points year over year. New AutoZone stores begin at cap rates in the mid-5 percent range, while Advanced Auto Parts trade close to 6 percent and Pep Boys 50 basis points higher.



**Casual-Dining Establishments:** Average cap rates dipped 40 basis points year over year to the low-5 to low-6 percent range as buyer interest intensified.



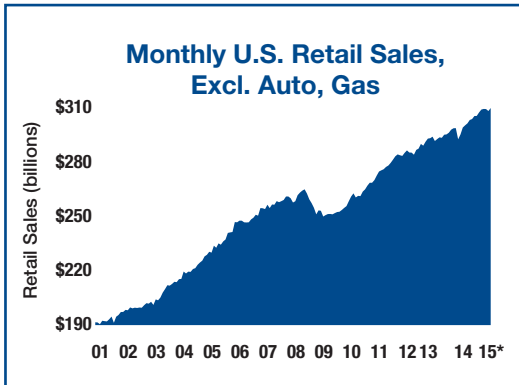
**Dollar Stores:** Cap rates for discounters compressed 60 basis points in the most recent 12-month period. Family Dollar and Dollar General with new leases average in the low-6 percent range, while Dollar Tree first-year returns are 75 basis points higher.



**Drugstores:** Average cap rates on new construction for Walgreens and CVS are in the low- to mid-5 percent area, while Rite Aid trades at first-year returns from 6 percent to 6.5 percent.

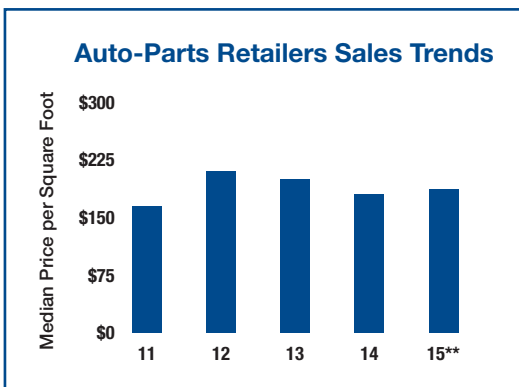


**Quick-Service Restaurants:** Average cap rates begin between 4 and 5 percent for assets with full-term leases, unchanged from the prior annual period. McDonald's ground leases typically trade at first-year returns close to 4 percent.



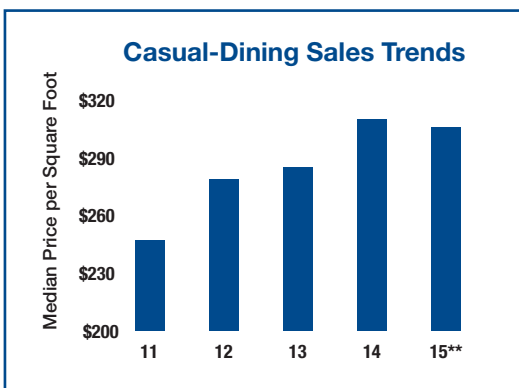
## Economy

- An exceptionally cold and snowy opening quarter of 2015 slowed year-over-year retail sales growth to just 2.4 percent, the softest pace since the end of 2009. Nonetheless, the opening months of the second quarter recorded healthy gains, indicating the setback is temporary.
- Since the recessionary trough, retail sales have climbed by 31 percent nationally, lifting the average retail sales 17 percent above the previous high watermark. Retail sales per household are up nearly 25 percent since the recent low.
- Retail trade payrolls expanded by nearly 310,000 spots during the past 12 months, representing a 2.0 percent increase. Total nonfarm payrolls increased 2.3 percent in that time.
- **Outlook:** Although the first quarter disappointed in terms of economic growth and retail sales, the remaining three quarters should reverse the trend, similar to 2014. Retail sales should expand in the mid-3 percent range in 2015, while retail trade employers will hire more than 300,000 new workers.



## Auto-Part Retailers

- Vehicle sales have remained strong to open this year, though the pace of transactions slipped in the early months of 2015. In the past 12 months, 16.5 million new cars were purchased, keeping sales near the post-recession high.
- The number of auto-parts retailers that changed hands during the most recent 12-month period doubled as investors raced to place capital prior to an interest rate hike. The median price remained relatively stable during that time at \$187 per square foot.
- Average cap rates tightened 50 basis points year over year. New AutoZone stores begin at cap rates in the mid-5 percent range, while Advanced Auto Parts trade close to 6 percent and Pep Boys 50 basis points higher.
- **Outlook:** Higher returns and a large inventory of available properties will keep auto-parts retailers prime targets for single-tenant investors in the coming months as exchange capital moves from the coasts into Middle America.



## Casual-Dining Establishments

- Many national casual-dining establishments are struggling to participate in the economic recovery as guests turn toward local chains and fast-casual concepts in the wake of tighter budgets.
- Over the past year, transaction velocity accelerated 8 percent in the restaurant segment. Investors paid a median price of \$306 per square foot during the period, 10 percent above the prior year's median.
- Average cap rates dipped 40 basis points year over year to the low-5 to low-6 percent range as buyer interest intensified.
- **Outlook:** In an effort to raise capital, some large national chains will participate in sale/leasebacks over the next few months. As these deals come to market, pricing clarity will emerge for the national chains.

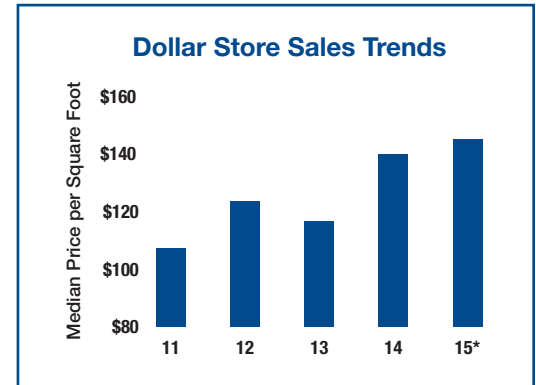
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

\* Through first quarter

\*\* Trailing 12 months through first quarter

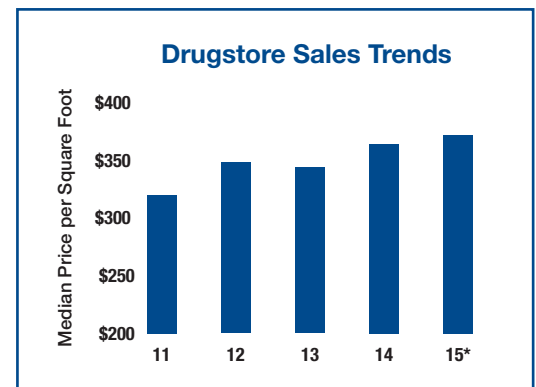
## Dollar Stores

- After a failed attempt to merge with Family Dollar, Dollar General will accelerate expansion plans to 700 stores this year. The FTC, meanwhile, is forcing the newly combined Dollar Tree and Family Dollar to divest 340 stores.
- The number of discount stores that changed hands in the past year ticked up modestly, though some uncertainty regarding the recent megamerger may have sidelined some investors. Buyers paid a median of \$145 per square foot over the past year, up 12 percent from the prior period.
- Cap rates for discounters compressed 60 basis points in the most recent 12-month period. Family Dollar and Dollar General with new leases average in the low-6 percent range, while Dollar Tree first-year returns are 75 basis points higher.
- **Outlook:** Now that the Family Dollar/Dollar Tree merger has been finalized, uncertainty surrounding discounters has abated and investors will be active in this segment again this year.



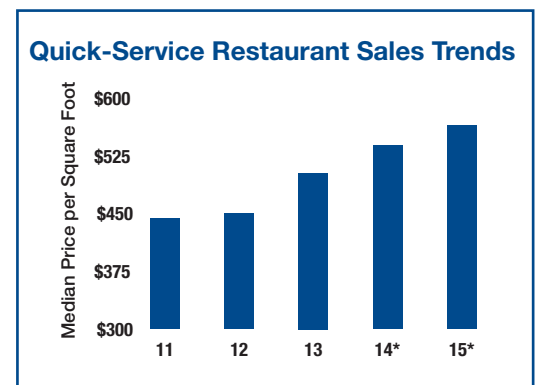
## Drugstores

- Drugstores are rebalancing their portfolios after years of aggressive expansion in the nation. Walgreens and CVS are following disciplined growth strategies, while Rite Aid is finally in a position to begin looking for new sites.
- In the most recent 12-month period, transaction velocity surged 24 percent at drugstores remain in high demand. The median sales price jumped 6 percent to \$372 per square foot.
- Average cap rates on new construction for Walgreens and CVS are in the low- to mid-5 percent area, while Rite Aid trades at first-year returns from 6 percent to 6.5 percent.
- **Outlook:** Some shuttering locations and modest growth expectations will limit the number of available drugstores on the market this year. As a result, little pressure is anticipated on cap rates for the next few quarters.



## Quick-Service Restaurants

- Elevated competition among fast-food restaurants will persist this year as long-term stalwarts adjust to changing consumers' palates. McDonald's and Burger King will grapple for market share with each other and emerging fast-casual concepts that are luring away customers.
- The number of fast-food restaurants that changed hands during the last year increased 5 percent. Median sales price, meanwhile, surged 11 percent during that time as buyers bid-up properties.
- Average cap rates begin between 4 and 5 percent for assets with full-term leases, unchanged from the prior annual period. McDonald's ground leases typically trade at first-year returns close to 4 percent.
- **Outlook:** Although some concerns about oversaturation will persist, investors will remain interested in fast-food listings. The passive nature of the investment class and properties with corporate-backed leases are among the most secure real estate offerings available.



Sources: Marcus & Millichap Research Services;  
CoStar Group, Inc.  
\* Trailing 12 months through first quarter

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## NET LEASED PROPERTIES GROUP

Visit [www.marcusmillichap.com](http://www.marcusmillichap.com)  
or call:

**Bill Rose**

Vice President, National Director  
National Retail Group, Net-Leased Properties Group  
Tel: (858) 373-3100  
[bill.rose@marcusmillichap.com](mailto:bill.rose@marcusmillichap.com)

# Marcus & Millichap

Prepared and edited by  
**Stephen Hovland**  
Senior Analyst  
Research Services

For information on national  
retail trends, contact  
**John Chang**  
First Vice President, Research Services  
Tel: (602) 687-6700  
[john.chang@marcusmillichap.com](mailto:john.chang@marcusmillichap.com)

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## Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- The Fed recently indicated that it may raise its short-term lending benchmark as early as June, though September is the most likely target as the central bank awaits further tightening in the labor market and stronger wage growth. Against the prospect of an inevitable rise in interest rates, investors remain highly motivated to purchase retail assets and debt providers continue to compete for market share while also maintaining underwriting discipline.
- Loan-to-value ratios generally range from 60 percent to 75 percent, depending on asset age, quality, location and tenant credit rating. Debt-service ratios range from 1.25x to 1.35x and debt yields of 8 to 9 percent. Lending rates remain low for performing assets in primary markets. All-in rates for five-year retail loans typically start in the mid- to high-3 percent range, while seven- and 10-year loans price between 3.7 percent and 4.4 percent. Loans up to 20 years range from 4.8 percent to 5.85 percent.
- CMBS lenders participated in slightly more than 50 percent of loans in the tertiary markets, and national banks funded 25 percent. Banks, both national and regional/local, have increased their market share in all markets.

## Recent Sales Highlights

Property Name	City, State	Sales Price	Price per Sq. Ft.	Cap Rate
Wal-Mart Neighborhood Market	Ashland, VA	\$11,564,000	\$281	5.2%
Walgreens	Merrimack, NH	\$7,363,636	\$541	5.5%
Wells Fargo	Fairfax, VA	\$7,000,000	\$226	5.5%
Rite Aid	East Northport, NY	\$6,900,000	\$633	6.7%
Giant Eagle	Ligonier, PA	\$5,649,600	\$150	7.8%
Walgreens	Glenolden, PA	\$5,125,000	\$369	7.4%
Rite Aid	Portsmouth, VA	\$5,116,830	\$370	7.0%
Walgreens	York, SC	\$4,937,000	\$334	5.6%
Rite Aid	Morehead City, NC	\$4,714,690	\$341	6.8%
Sheetz	Chambersburg, PA	\$4,000,000	\$800	5.5%
Wendy's	Manasquan, NJ	\$3,616,296	\$521	6.4%
CVS	Lakesite, TN	\$3,549,827	\$297	6.3%
CVS	Rocky Mount, NC	\$3,050,000	\$301	7.7%
Rite Aid	Wilson, NC	\$3,000,000	\$230	9.7%
Rite Aid	Winterville, NC	\$2,673,000	\$265	8.0%
Taco Bell	Dayton, NV	\$2,550,000	\$1,020	7.8%
Family Dollar	Elizabeth, NJ	\$2,325,000	\$176	7.0%
Taco Bell	Bristol, TN	\$2,200,000	\$843	5.4%
IHOP	Westerville, OH	\$2,100,000	\$285	5.5%
Panera Bread	Mount Vernon, OH	\$2,020,000	\$532	5.9%
Starbucks	Laramie, WY	\$1,880,000	\$979	5.6%