Owners of Single-Tenant Properties Rush To List Sites for Sale As Interest Rates Rise

But Buyers Are Taking a Breather To See Where Pricing Settles

By Mark Heschmeyer and Candace Carlisle

Rising inflation is causing an influx of single-tenant commercial properties to hit the market after the number of sales shrank in the third quarter, a marked change from the first half of the year.

The dynamic raises uncertainty whether sellers can get offers that match their pricing expectations, according to brokers and investors specializing in net-lease properties. Buyers, in the meantime, may now be more willing to wait and see which way the economy goes.

Under net-lease arrangements, tenants are responsible for many building expenses. Escalating rents written into these deals have traditionally provided landlords protection against inflation and increasing costs. The spike of properties hitting the market indicates that protection could be seen as weakening.

The average sale price per square foot is now way off its second-quarter 2022 peak, according to CoStar data. In addition, the number of buyers willing to make an offer and the number of sellers willing to accept lower offers are shrinking, according to investors.

The backdrop to the rising number of listed net-lease properties and declining sales volume and prices is the Federal Reserve's move to boost bank borrowing costs in an attempt to tame inflation. The Fed's latest action came Sept. 21 when it increased rates by 0.75%, bringing total hikes to 2.25% this year with the potential for two more rate bumps coming before 2023.

The rise in interest rates over the past six months has been a shock to commercial real estate and has shifted net-lease investing from a seller's market to a buyer's market, Aaron Baum, co-founder and chief acquisitions officer at Detroit-area-based One Family Property, told CoStar News in an interview.

One Family has acquired more than $120 million of net-lease properties in the past two years and has set a goal of acquiring up to $200 million per year going forward.

"Markets do not like uncertainty. They want stability and they want predictability," Baum said. "And that's missing from this economy. People are a little bit concerned or worried about the next 36 months. If they were a seller [in the past], they would definitely be more of a seller now rather than waiting for the market to get better."

Peaking for Sellers

That is particularly true for individual net-lease property owners, Baum said. If those individuals are looking to retire in the next five years, maybe even 10 years, they are looking at now being the peak of the seller's cycle.

B+E, a New York-based investment brokerage firm specializing in net-lease real estate, sees the same dynamic.

"The feeling is that these increases will be the tipping point for the peak pricing and record-level [rates of return] we've been seeing in the market," B+E noted in a report last month. "We already see the effects of this as lenders are requiring borrowers to bring more capital to the table: deals that used to require 75% loan to value, are now around 55% to 60% loan to value."

The first half of the year posted strong net-lease sales with $10.2 billion in activity in the first quarter and $11.1 billion in the second quarter, according to CoStar data. That number fell to $6 billion in the third quarter.

"Volume is slowing primarily due to the rapid rise in interest rates and the price discovery that is going on," Randy Blankstein, president of net-lease brokerage The Boulder Group, told CoStar News in an email. "Aggressive amounts of net-lease owners have brought properties to market the past few weeks as many are deciding to sell versus refinance at these interest-rate levels."

CoStar data shows 11,637 single-tenant properties for sale from one to 90 days, indicating they came on the market in the third quarter.

By comparison, there were about 9,700 such properties in the second quarter.

The average sale price per square foot of net-lease properties sold in the third quarter fell to about $227. That is down 18% from the second quarter, when pricing peaked at about $278 per square foot.

Acquisition Criteria Affected

The rising rates and relatively high inflation has affected the acquisition criteria of investors for net-lease properties, according to Blankstein.

“Investor demand for properties with rent growth or the ability to increase rents in the near term are in the greatest demand,” he said. “Accordingly, demand for properties with limited or no rental escalations are limited to properties with above market yields or strong underlying real estate.”

There are, though, sellers willing to test what prices they can achieve in the current market.

Convenience store giant 7-Eleven is looking to sell 73 locations in 22 states, most of them in New York, New Jersey and Pennsylvania. Many of the properties were acquired two years ago in a $21 billion megadeal that added 3,800 Speedway gas station-convenience stores to its portfolio.

NRC Realty & Capital Advisors is marketing the sites, the majority of which “7-Eleven determined didn’t meet its current business plan,” Evan Gladstone, the real estate and financial advisory services firm’s executive managing director, told CoStar News. “They are being sold without the 7-Eleven franchise with a current gas brand.”

Baum of One Family is also among the firms boosting for-sale listings. The firm has about a dozen properties on the market, many of them acquired in a 29-property portfolio purchase just seven months ago.

“We take advantage of opportunities where they seem to fit,” Baum said. “If we bought something for $1 and we think we can sell for $1.50, to people who call and say, ‘We want to buy your property,’ we say, ‘Everything is for sale, give me a price.’”

Buyer Interest Remains

Even though sales transactions and volume slowed in the third quarter, that doesn’t mean there are no buyers out there, according to Baum and Gladstone.

NRC’s Gladstone said he expects “spirited bidding” on the 7-Eleven properties based on more than 1,400 responses the firm has received so far with a deadline less than a month away.

However, not all sellers can expect multiple buyers competing for their properties. If there were five buyers before, there may be only one offer now, Baum said. And sellers may turn that offer down if it doesn’t hit their goal.

Baum added there are still buckets of capital out there to get deals done going into the traditional high time during the year for net-lease investing.

“Brokers will tell you that 40% to 50% of volume is done in the fourth quarter, and I think you’ll still see a lot of buyer transactions before year-end,” he said.

Despite the rising cost of capital in the market, there are a lot of players needing to deploy cash by the end of the year, according to B+E. Sellers in the first and second quarters who were looking to exchange their investments through tax-advantaged sales have 180 days to find a replacement property.

And some funds also haven’t fully spent the capital they raised for spending in 2022, indicating there could be an uptick in sales, B+E said.