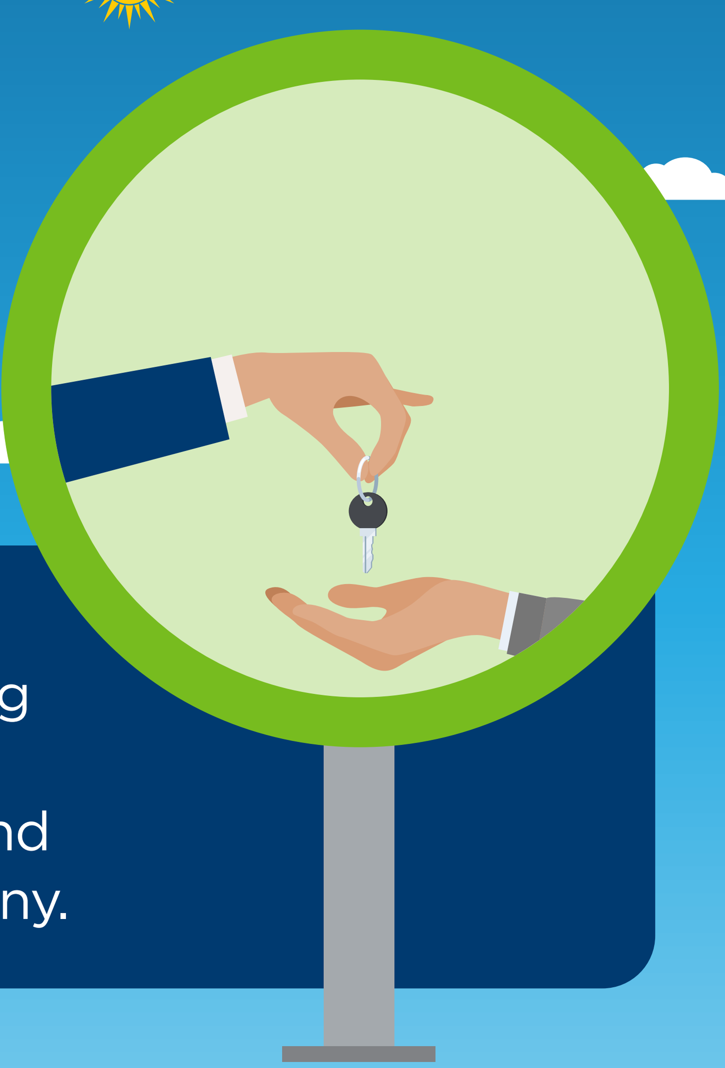
WHAT IS A NET LEASED INVESTMENT?



A net leased investment is typically a freestanding retail office or industrial building that is leased and occupied by one company.

Typically, the tenant has committed to a long term lease of 10 or more years with increasing rent over the lease term. The tenant is responsible for paying rent plus some or all of the operating expenses, therefore, the annual base rent paid is equal to the actual net return for the property owner.

Let's compare net leased investments to other forms of real estate ownership

Not only are apartment buildings management intensive, but apartment leases are typically only for one year at a time, meaning the building's financial performance suffers the ups and downs of the market, has a typically high turnover, potential loss of income, and significant lease-up costs.

Land has the most risk since it is speculative in nature and in some cases, there is little or no income generated.

Alternatively, net leased real estate is considered to be the lowest risk property type since it usually involves a long term lease with a creditworthy national or regional tenant & they are strategically located, with predictable long term income and the opportunity for appreciation.

Historically, net leased investments have the highest occupancy rates through market ups and downs. This is why net leased investments are one of the most passive forms of real estate ownership and require little or no management, vacancy, or lease-up costs.

Let's examine where net leased investments come from

1 DEVELOPERS

The tenant agrees to have the developer build a location for them for a certain return, however, the developer rarely holds these properties long term

2 SALES LEASEBACKS

Tenants seek out locations & develop their own stores or acquire other businesses with real estate ownership included. Rather than keeping the property, the tenant sells and then leases it back from the buyer which frees up capital for the tenant's core business but still allows the tenant possession of the property

3 SECONDARY MARKET

An existing owner simply decides to sell the property to another investor

So, how are net leased investments valued?

Net leased properties are valued using their capitalization rate, which is the unleveraged net annual return on the investment

Net leased investment cap rates reflect the value of a stream of economic benefits discounted for time & risk.

Some of the major considerations when evaluating cap rates are:

1. Creditworthiness of the tenant
2. Length of the lease
3. Type of lease
4. Type and frequency of rent increases
5. Strength of the location
6. Expense & downtime by re-tenanting
7. Age & the condition of the building

Generally, the more positive the factors, the lower the cap rate or the higher the value of the property related to the income stream.

A typical net leased investor will also consider a property outside of their immediate area. For example, due to intense competition for assets in California, a net leased property inside the state may trade at a 50 to 100 basis point premium on the cap rate compared to a similar property with the same tenant and lease term elsewhere in the U.S.

Net leased investing allows out of state investors to reach out of their immediate geographic area and put money in properties they wouldn't otherwise be able to if the property required a more management intensive strategy.

LYONSTAHL
INVESTMENT REAL ESTATE