

NET-LEASED (NNN) PROPERTIES

The Real Estate Investment with the Features of a Corporate Bond

By Jonathan S. Horn

Why are so many investors, foreign and domestic, placing their money in NNN properties?

Net-leased real estate provides a unique investment opportunity to individuals or institutions interested in owning real estate without the hassles of management and leasing typically found in conventional real estate investments. Net-leased projects are most commonly single-tenant, credit-driven investments on long-term leases which require minimal or no landlord responsibility.

As a result, investors are not bound to their geographic markets, whereas they would most likely be with a traditional real estate investment, not just closely watched “backyard” opportunities.

A net-leased (NNN) property is effectively a long-term bond of a corporation in the form of a lease document encompassed by real estate. The investment appears to be a bond-type investment due to the “coupon-clipper” type of returns, 7%-15%. However, they also provide the added benefits of tax reduction and property appreciation found in conventional real estate.

The net-leased investment can be categorized three ways:

1. **Retail** refers to big-box users (i.e. discount variety stores, department stores, or home improvement stores) as well as small-box users (i.e. restaurants or drug stores).
2. **Industrial** includes facilities used for either distribution, manufacturing, or research and development.
3. **Office** refers to any single user such as an oil company or pharmaceutical firm occupying a facility as the sole tenant.

Pricing on net-leased projects is based primarily on the tenant’s credit, the terms of the lease, and the location. Although each of these variables has an important role in the pricing of net-leased projects, it is the combination of all three that will determine a true purchase price.

Tenant’s Credit

- Many net-leased projects are based solely on a tenant’s credit.
- Tenants considered investment grade by a recognized rating agency usually trade at a premium (i.e. Walmart, Walgreens, General Motors).
- Tenants with junk bond (non-investment grade) ratings or minimal net worth typically trade for a higher return (i.e. UA Theaters, Dairy Mart convenience stores, Taco Cabana restaurants).

Lease

- Length of a lease is another primary factor in determining the sales price on a net-leased investment. Primary terms of 15 or more years are preferred; 10 years is sufficient in 1031 tax-deferred exchanges and similar cases

- “Absolute” triple-net leases, where the tenant is responsible for roof, structure, and parking, trade at a premium.
- “Double-net (NN)” leases, where the landlord is responsible for roof and structure, trade at a higher yield and usually include a reserve taken for any potential repairs.
- Leases with “bumps”- rental increases or upside trade at a premium, with the exception of flat leases with investment grade credit.

Location

- NNN leases are credit-driven, causing location to be the least important factor.
- Investors often pay an added premium for the residual benefit of

specifying a certain geographic location.

The combination of credit, lease and location can lead to paying a higher premium (i.e. Walmart: 20 year absolute NNN, flat) or receiving a higher yield (i.e. CSK Auto: 15 year NN).

The market for net-leased real estate investments is strong. The availability of attractive financing combined with minimal landlord responsibilities create highly desirable opportunities, especially for investors desiring a property for an IRS Section 1031 tax-deferred exchange.

Whether a risk-averse individual or institution is in need of a smart depreciation vehicle or a relatively safe “coupon-clipper,” net-leased properties provide great investments in both credit and real estate markets.

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