Q&A: In More Evolved Market, Still Some Plays
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By Dees Stribling

The privately held Lutz Real Estate Investments, based in Farmington Hills, Mich., has been in commercial real estate investment and development for decades, completing about $2 billion in deals all together spanning the spectrum of property types. CPNetLease net lease expert Dees Stribling spoke with managing principal Adam M. Lutz, who is also a principal with the Michigan and Florida offices of iCap Realty Advisors, and Tony T. Landa, vice president of Lutz, about the latest in the net lease market.

CPNetLease: What’s next for the net lease market?

Lutz: It's a mature market now, but there are still some interesting new developments. The market's evolved so that now there are really two net lease plays. Primarily it’s still about investors who in essence want a bond--those who looks at the term and the investment grade and the tenancy and whether there’s escalation in the leases. That part of the market is very mature, especially with the way that the Internet can communicate information to all investors and brokers around the country, which is an efficient process. The other market is a short-term play consisting of properties most of whose lease terms have burned off, those with maybe five years left. With those properties, rents are certain for a few more years, but after that there's an unknown factor. Landa: Developers and other investors are now taking a hard look at these kinds of short-term net lease deals. The strategy is to take the certain income of the property for a few years, and then afterwards redevelop the property if renewal isn't possible. This part of the market has become exciting lately. These properties offer an opportunity for developers and other investors to roll up their sleeves and take the time to figure out what to do--and maybe how to do much better with the property--if the tenant decides not to renew.

CPNetLease: If these are riskier kinds of net lease deals, do they generally trade at higher cap rates?

Lutz: Yes. Cap rates are usually higher because there's more risk involved. But an astute buyer of these types of net leases can make some cash-on-cash returns and save money in escrow for that potential rollover. Landa: It's a growing part of the market because there are a lot of lease terms that are now closer to being burned off. Some of the original net lease deals are now coming toward their end, and are being sold off. Lutz: We purchased a property in St. Petersburg, Fla., that fit that description. It was an office building leased to an A-rated tenant, and when we bought it there were about 22 months left on the lease. The tenant planned to move to a much larger facility, and because of that we were able to buy at a favorable cap rate basis, and are getting good cash-on-cash returns. We're using the extra money to re-tenant the property, which we think will work out because there's upside to rent in that particular market, which is growing.

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