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Investment Grade Companies Predicted to Sell More Real Estate

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Glen D. Kunofsky, executive managing director investments, Marcus & Millichap/Image credit: © Matt Greenslade

NEW YORK CITY—In the last few years corporate debt has been very cheap. "With investment grade credit rating, you could call up Goldman and Barclay's and raise very cheap corporate debt and bonds with limitless amounts of debt out there," says Glen. D Kunofsky, executive managing director investments, Marcus & Millichap, and founder and chairman of NNN Pro Group. "Now, with the tax change, companies can only write off a certain amount of corporate debt."

In 2018 some of the larger investment grade-rated companies are going to be more open to selling their real estate because rent is still 100% deductible. It doesn't affect their leverage ratios on EBITA. Also with the tax bill, with the corporate tax rate going down, a company can sell property and only pay a 20% pass-through rate, explains Kunofsky.

These two driving factors are starting to affect the market, Kunofsky tells GlobeSt.com in a preview of some of the issues he'll address at the RealShare Net Lease Conference on April 4-5, at the Park Lane Hotel.

Kunofsky focuses on sale leasebacks and structuring net leases for private equity companies and tenants using real estate as an alternative financing mechanism. His track record includes closing on 3,500 properties with an aggregate value of approximately $5.5 billion, including over $225 million in each of the past six years.

In the private capital market, with 1031 exchanges, he has observed pressure to sell other types of property such as apartment buildings and shopping centers and move into net lease. An aging population owning these other types of assets is seeing markets cap out on price. Many of these investors are trying to sell those assets to get out of the day-to-day management and move into net lease, says Kunofsky.

People often think of the 1031 market as being on a smaller scale, ranging from $1 million to $5 million. Kunofsky's New York-based group represents 1031 investors that are large family offices. One of the capital market shifts he has seen includes the family office with large, unleveraged buildings which the owners are selling from $50 million to $150 million, then going into larger net lease deals.

"I think that is going to continue into 2018, where you have large private investors more successfully competing with institutions," says Kunofsky.

Over the past year, he has also observed noticeable shifts away from big box retail, although many aspects inside retail remain very well regarded. "Big box retail, especially general merchandise cap rates, the flow of deals has slowed just because both bank financing and general demands on the institutional side for big box retail has shifted," says Kunofsky.

The grocery anchor center traditionally traded at the highest premium and was viewed as untouchable, never to fall. But Amazon's buying Whole Foods has shifted the market.

"People are taking pause. How big is Amazon going to be in that space—both on a retail basis in terms of having Whole Foods expand that footprint, and also on the home delivery side of owning Whole Foods? Are they really going to push through the Amazon delivery system groceries even harder?" asks Kunofsky.

He points out the Amazon effect has grown from a lending and a capital markets standpoint. Buyer perception now involves decisions made, based not only on Amazon but also how these businesses will be affected by technology.

In addition, offices have suffered due to the trend for many years of millennials and companies reducing traditional office space. People are working from home and in different ways, so the demand for net lease office and the demand for companies that truly need big office space has also softened, Kunofsky says.

However, he points out in urban areas, corporate office building headquarters are still in high demand in net lease, especially investment grade offices. Cap rates are still very good and offices are trading at a high premium.

At the Net Lease RealShare conference, on the panel "Capital Markets Update & the 'Real Deals' of 2017: Lessons Learned and Implications for What's Next," he'll discuss more of these capital markets trends. The panel will address what's happening in the private and institutional markets, and what the cost of capital and debt is going to look like for the rest of the year.