



April 18, 2011

Written by Randyl Drummer (rdrummer@costar.com)

---

## CoStar Q&A: Daniel Herrold of Stan Johnson Co. On Prospects for Net Lease Business

*Brokerage Specializing In Single-Tenant, Net-Lease Transactions Saw 140% Growth Last Year, Planning To Open Offices in Additional Markets in 2011-12*

After 23 years of doing net lease brokerage business largely out of its Tulsa, OK, headquarters, Stan Johnson Co. embarked on an expansion plan to open regional offices in 2008, a time when many commercial real estate companies were downsizing.

The firm, one of the country's leading real estate brokerage and advisory firms specializing in net-lease investment sales, tapped Daniel Herrold to lead the effort and he opened the first regional office in Houston. That office grew its transaction volume and added several brokerage professionals to its roster in 2010. Last year, the company -- which also has a capital markets group based in Oklahoma City -- opened offices in Chicago in March and Los Angeles in October, and the firm expects to recruit additional brokers this year.

Herrold, who serves as the company's executive managing director of business development, has been with Stan Johnson Co. since 2003. Before being promoted to regional director, he helped close nearly 200 single-tenant transactions valued at more than \$1.6 billion.

Stan Johnson's growth parallels a rise in the number of net lease activity across the country. According a first-quarter 2011 PricewaterhouseCoopers investor survey, the improving economy, a rise in motivated sellers eager to profit from lower overall capitalization rates, and greater loan availability are firing up interest in net lease sales.

Investors expect a rise in sale-leaseback deals as companies look to raise cash for growth. One investor told PwC that he expects sales volume will rise 30% or more in 2011 over last year. Moreover, many investors are looking beyond opportunities in core office, industrial and retail net leases to properties with credit tenants in tow in secondary and tertiary markets, and single-tenant medical facilities with leases guaranteed by hospital systems.

Herrold is noting many of those trends in his own company's business. CoStar Group connected with Daniel recently to discuss the current state of the net lease market.

CoStar Group: Let's start with the big picture. How is the overall net lease market performing?

Daniel Herrold: There's definitely a strong uptick in activity. There's always demand for net lease product, whether the economy is down or strong. When investors are more risk averse, they're going to make safe bets. When the market is frothy and people are making money in all investment types, you see a new emergence of wealth that comes into real estate for the first time. Those new investors lean toward net lease assets because they're relatively easy to understand.

The triple-net market was one of the first sectors to benefit as investors eased back into the real estate market in search of higher yield, correct?

Correct. As investors started to explore putting money back into real estate to seek greater returns in 2010, they were looking for high-quality, stable assets. The safest bet. Net lease is kind of like the bond of the real estate market. It's easily predictable and provides a steady return over a fixed period of time.

And you can underwrite the credit. Single-tenant, net lease assets are considered a safe real estate haven.

A lot of factors led to investors getting back into the net lease business. Investors put their money in safe investments in 2008 and 2009 when real estate tanked -- money markets, CDs, strong corporate bonds. Last year, we saw some positive signs in the economy and a lot of investors started to get tired of tired of those 1% to 5% returns in the money markets and bonds. They started to move off the sidelines back into real estate.

The other driver was the financing market started to loosen up. We saw conduit lenders come back into play. Life insurance companies and some of the larger banks started to get active. As general transaction volume increased over the course of the year, investors started looking at passive real estate vehicles for 1031 exchanges. Toward the end of 2010 and even more so this year, we saw a lot more 1031 investors than ever before. That market was deathly quiet in 2009 and early 2010.

How is Stan Johnson Co. doing now that this market is heating up?

We saw 140% growth in sales in 2010 over 2009. It was a tremendous year -- the second-best in the history of our firm over 25 years. We first saw the growth start to trigger during second quarter of 2010.

You've been in expansion mode for some time. What's the current headcount at the company? What markets are you targeting for offices and personnel?

We launched a growth plan in January 2010. At that point, we had our Tulsa headquarters, an office in Houston and a small office in Oklahoma City. Our broker count was around 20. We're now at 33. Last year we opened offices in Chicago and Los Angeles, and we're looking at opening offices in three additional locations, San Francisco, Atlanta and New York, by 2012.

REITs have been major players in the net lease field. Will that continue if investors can find higher yields in other real estate assets? What's your view of the private net lease investors versus the REITs in that space?

Non-traded REITs, especially, raised more money in 2010 than I've ever seen in eight years in the business. The re-emergence of the institutional players has been one of the largest drivers of the basic demand in our business. Cole Capital, a private REIT based in Phoenix, is a great example. Cole Capital deployed \$2.5 billion, of which close to \$2 billion alone was in net lease product they acquired in 2010.

Private investors have two alternatives. They can either buy a single-tenant asset like a Walgreens on their own behalf, or they can buy into a REIT with its diversified strategy and portfolio. As less-sophisticated investors first get into real estate, they may want to go that route versus owning assets individually. They find companies like Cole Capital appealing because the properties it buys are household names that they understand -- recognizable tenant names like Best Buy and Walgreens and Home Depot and Lowe's. The companies that own those properties will continue to thrive as the economy rebounds and the REITs will continue to be successful in their fundraising.

What's the profile of the typical deal Stan Johnson has been transacting over the last two or three quarters? Has there been a shift in the types of buyers or sellers?

Larger transactions are occurring and the product types have shifted dramatically. The two drivers are financing and the emergence of institutional players, which are buying larger deals. In 2009, our average deal size at Stan Johnson was \$3.5 million, which entails more deals for retail product. In 2010, the average transaction size was more in the \$7 million range, a 100%-plus increase. We did over 30 deals last year greater than \$10 million, and those larger deals involve office, industrial and medical buildings. I believe 50% of our transaction volume last year was in those three areas.

Are the deals somewhat riskier than the retail deals?

They are, but the institutions and the buyers are willing and able to mitigate the risk. They're looking for either an asset that's in a core market like Dallas, Chicago or Los Angeles, or they're looking for a headquarters or some other mission-critical property. If a medical office building is on the campus of a major hospital system, there's not as much impact if a particular tenant moves out.

Private and public REITs have a mandate to invest all the capital they've raised. They gravitate to these larger deals and in most cases they're acquiring them all-cash and financing at a later point. We're seeing a lot of larger deals take place in our industry.

Is the company doing a lot of sale-leaseback transactions?

Probably 10% to 15% of our business on an annual basis is in the sale-leaseback space. But as we grow, we want to build-out specialized teams and capitalize on those opportunities -- to focus on corporate users and private equity groups that are buying companies and later monetizing the real estate. It's probably the largest piece of net lease transaction volume. For example, corporations doing a sale-leaseback of a headquarters or a portfolio of distribution facilities. Many of those types of transactions are typically very quiet and under the radar.

Also, very few brokers specialize only on the sale-leaseback space, but it's an area that we think is a great area to jump into. A lot of sale-leaseback buyers are back in the market again , and we're at a good point in the financing cycle where those deals can get done.