

Ramping Up

Stan Johnson Continues to Expand as Net Lease Investors Increase Activity

Twenty-six years after founding his eponymous net lease brokerage company, Stan Johnson sat down with *CPE* editor-in-chief Suzann Silverman to discuss the state of the sector; Stan Johnson Co.'s expansion plans, which have continued despite the challenges presented by the economy; and his anticipation for the market's recovery. Closing more than \$1 billion in transactions a year, the company first expanded its offices outside of Tulsa, Okla., in 2008, opening an office in Houston. It has since opened two more offices, with plans for more.

Q. You reported having one of your best years last year. What drove your success?

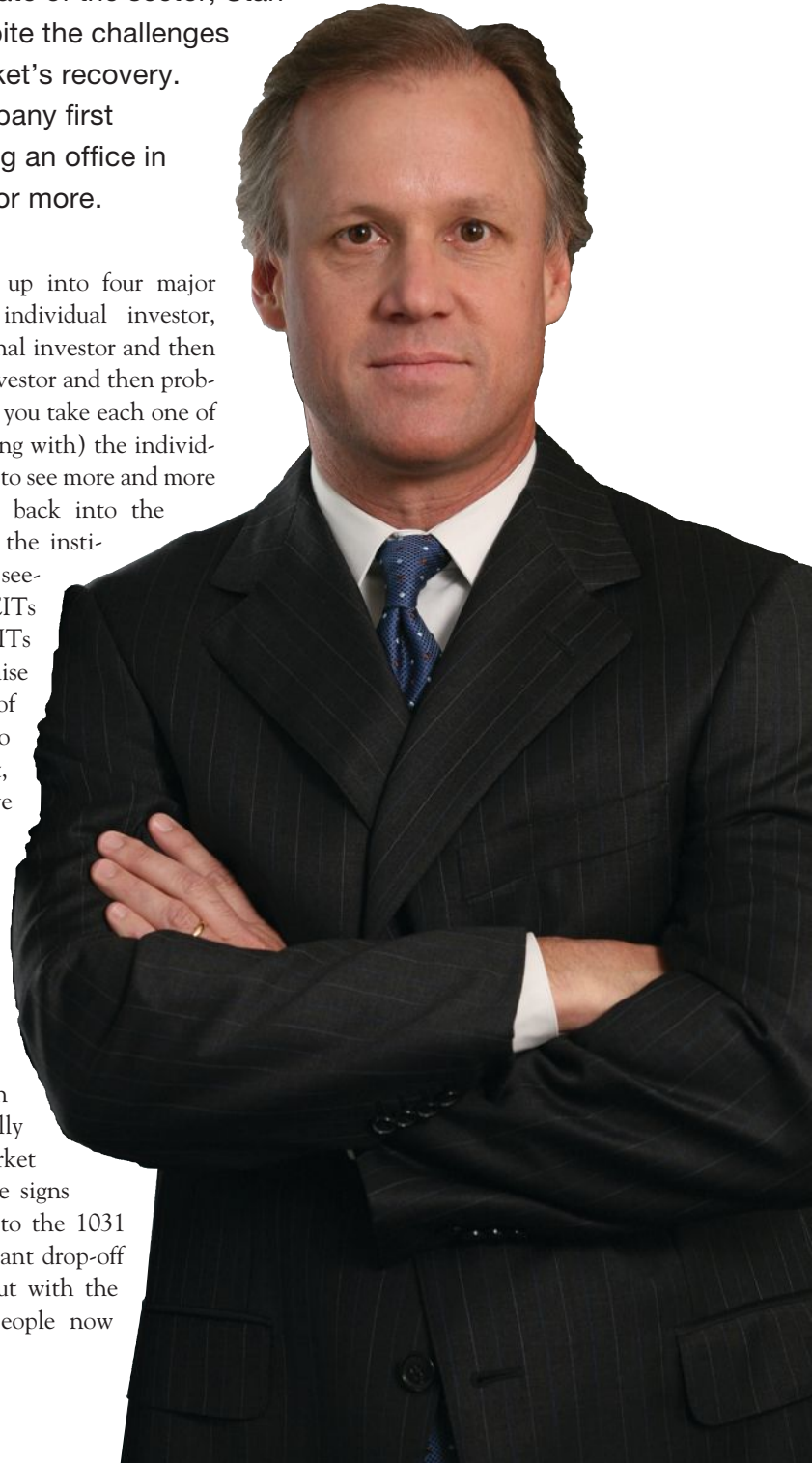
A. The money sitting on the sidelines finally got tired of earning 1 to 2 percent and decided to come back into the market, and with skepticism still in the market, net leases are a safe place to go. ... That probably is the biggest thing—they've been on the sidelines so long. So we ended up seeing a lot of the high-net-worth individuals who had been waiting come back into the market. The bank financing was available for those guys. And then ... all the private equity guys have had monster years in terms of raising money. We'll see all of the private REITs continue to have record years in terms of raising money. In conjunction with that, you just have more and more people who have confidence in the economy, which bleeds over to the real estate industry.

Q. Have you seen any change in the types of investors interested in net-leased properties?

A. It's really a lot of the people very familiar with net leases who have been on the sidelines who are finding their way back into the market.

Q. What classes of investor do you see being particularly active this year?

A. We break it up into four major classes: the individual investor, the institutional investor and then you'd have the foreign investor and then probably the 1031 investor. If you take each one of those individually, (starting with) the individual investor, we continue to see more and more of those people coming back into the market. With respect to the institutional investor, you are seeing all of the private REITs and even the public REITs having the ability to raise capital. So there's a lot of equity flowing back into the institutional market, and where it could have been a couple of the largest private REITs a year ago, you're now seeing some of the other REITs who are continuing to get capitalized and who have money to get into the market. And then with respect to the foreign investors it's never really been a big part of the market but ... we're seeing some signs of life. ... With respect to the 1031 market, we had a significant drop-off a couple of years ago, but with the cap rate compression, people now



[Visionary]

have been able to be sellers, which is starting to create some more 1031s. Not near the velocity that we saw in '07, but we're starting to see a pickup in the 1031 market as well—just primarily due to the cap rate compression.

Q. Regarding deal characteristics, what stood out for you most in the recent market?

A. I think the theme would be “Things in the Fairway.” And great location, great credit, good economic structure, things that had financing available. I think that has been really what's been driving the market over the last 12 to 18 months. But we're seeing that financing is starting to come back and starting to pick up. You will see things that are moving toward the side of the fairway. We're not seeing things that are really outside the fairway that are driving this market, where in '07 pretty much anything was trading ... as net lease or could be characterized as net lease.

Q. What types of changes did you make to your strategy in the recent difficult market?

A. That probably goes back to late '08, when we really made a decision to take a regional approach to our growth. We had always envisioned that we would do everything out of Tulsa, but with the growth initiatives that we had and with the goals that we had set, we really weren't going to be able to accomplish a lot of what we set out to do in the time frame we wanted to. So we had to look at other alternatives.

The timing maybe wouldn't be perceived as great (for expansion), but in hindsight it was probably one of the better times to expand because the one thing that is a particularly scarce commodity is good people. In a difficult market like we experienced in '08, there's more talent available, broker talent available, and so we took an opportunity to start to look at how we could hire more people that had experience.

We've historically homegrown everyone. A lot of people that came to work with us really were not in the real estate area; they were more business professionals that we had

to basically retool into the real estate market and then into the net lease space. So we just took an opportunity with real estate talent out there to be able to go out and go to regional areas—and really the choice of regional cities had a lot to do with probably three things: One, it had to do with the broker talent that was in the market. No. 2 is really assessing the clients that were underserved that we were not even touching in those markets. And then three, the transactional volume that was out there. We basically looked at the country and tried to identify markets where we felt like we would be able to go out and have a high probability of success.

Q. Have you maintained the pace of that strategy in the face of the tough economy?

A. Actually, we've ramped up and we've staffed more in the recruiting area, with the idea being that you have a window of opportunity. We feel like over the next couple of years we've got an opportunity to make a big push and get in some of these markets that we want to get into.

Q. You opened the Houston office, then Chicago, then L.A. more recently. How many new markets are you planning to enter, and have you set a pace for entering new markets versus adding people in the existing markets?

A. We are looking to build those (existing) offices out. And at the same time we are going to be very opportunistic and be recruiting in (the new) markets. We're going to be looking in the Southeast and the Northeast, as well as the Northwest, San Francisco. ... We have initiatives (both to) increase broker productivity and also to increase the broker count.



Q. How are you increasing broker productivity?

A. That really comes down to ... being very intentional on a daily basis about how you build the platform, from your marketing initiatives to your training initiatives to your research. ... We act as one team and so we're able to disseminate and share information as one team, which creates a lot of synergy among that group. So we're looking for synergistic opportunities among our brokers. ... We set out the year with very specific goals on platform improvements that we're going to have throughout the year, and then we survey our broker group and they grade out our platform in probably 30 different areas. The cumulative grade has a lot to do with compensation for the support services of the company. We get a lot of feedback from the brokers that is evaluated. ... They're constantly looking for ways to improve the services they provide.



“It’s just another cycle, where the economy recovers, financing comes back and the market continues to expand as more financing becomes available.”

Q. Where do you see the greatest opportunities opening up?

A. A lot of it has to do with the economy, with the financing that’s available. As we see the economy continue to improve, it’s going to create more opportunities for the supply side of the business with developers. I think that there is some cautious optimism in the development community that there are going to be new build-to-suit opportunities and expansion with some of the existing clients. I think that from a developer’s standpoint there is opportunity on the horizon if the economy continues to improve.

Opportunity from an investor’s standpoint has a lot to do with the financing that’s available. Right now, there are deals that are not financeable, whether it’s credit or whether it’s real estate or it could be the lease terms. ... There can be mispricing in the market because of that. A deal could not even be saleable because there is not financing available

for it, or it can be too large a transaction and there are very few buyers, if any, and (because) those people (need) financing (it) isn’t saleable at any cap rate. As financing comes back, if you’re on the leading edge of what is the next thing to be financed, there might be an opportunity to buy something at a very favorable cap rate and bring the financing into the market and capitalize on that. So staying very tuned in to what new credits or type of deals are able to be financed—the investor would be well-advised to stay close to the lenders in that regard.

Q. Do you see anything new that’s emerging or do you see this as really just the cyclical market, just another cycle?

A. I think it’s just another cycle. I mean, this market has been around since the ’60s, and it’s gone through high interest rates and low interest rates, but historically there had been financing available. ... We saw a pretty major disruption in the market in ’07 that probably hadn’t been seen—certainly not in my career, but it could have happened in years past. But I think that it’s just another cycle, where the economy recovers, financing comes back and the market continues to expand as more financing becomes available, and the faster the economy recovers, the faster the financial markets recover, the faster the velocity of transaction volumes.

Q. What do you think will or will not be OK for net lease investors to consider this year?

A. Certainly, as there’s more competition in the market, people are going to have to compromise something. They basically have three choices: They can either compromise on the credit, the quality of the credit that they’re buying, or they can compromise on the quality of location or they can compromise on the terms of the lease, whether that be lease term, cap rate, the pricing or the structure of the lease. I think there is just a lot of money out there, and it started out with everything in the fairway, and you’re starting to see compromises being made.

Q. Net-leased property carries many advantages for investors, but what have been the greatest challenges regarding this property in the recent market?

A. It probably boils down to two things: One would be credit—net lease transactions typically have a 10- to 20-year lease term, and a lot of things can happen to a credit over that period of time. We’ve seen Circuit City (stores) and others like that which were at one time perceived to be an investment-grade credit close up shop. Net leases do carry some credit risk over the lease term. The other big risk is really renewal risk. Because a lot of net leases started out above market on rents, they have substantial tenant improvements on them, and things change, the uses change. Particularly in the retail area, the concepts change. People go from wanting big boxes to smaller boxes or vice versa. You saw the Wal-Marts go from the large formats to the supercenters and now you’re seeing them go back to some of the smaller-type boxes. ... When renewals come up, a lot of uses have changed and you can be up above market on the rents, you could have improvements that you haven’t amortized, so there’s rollover risk to manage.

Q. And what about this year? Are there any aspects of the business this year that are of particular concern to you?

A. We kind of know where we stand with a lot of the national credits because they’ve gone through their most difficult time, and with the large banks having put a lot of pressure on them. Now, it could be that some of the smaller credits are still dealing with their banks and the question of where they stand with the smaller banks, which maybe do not (apply) the same kind of pressure the big banks have. So I’d say that there might be a little bit more fleshing out on some of the smaller credits. ... With a recovering economy, you start to assume that everyone’s going to find their way through it. But there could be some collateral damage as a result of the better economy, where (if) banks can’t take the write-off, they might put more pressure on some of the tenants that were struggling. **CPE**