

L N L CAPITAL



From Mailbox Money to Mainstream

The Institutionalization of Net Lease

Setting the Stage

In a globally integrated world, constantly shifting economic and political conditions - from trade tensions to geopolitical conflicts - continue to fuel rapid volatility across capital markets.

Though not entirely immune to these forces, U.S. commercial real estate (CRE) offers a compelling refuge. Long-term, strategic investment in CRE - in both private credit and equity - provides tangible, income-generating opportunities without compromising return potential.

Real assets are increasingly appealing to investors in both private equity and private credit net lease strategies, offering safety of principal and a proven inflation hedge against competing fixed-income instruments.

CRE's essential role in modern asset allocation is rapidly expanding, driven by structural market shifts, including the financial demands of an aging population, stock market volatility, and frequent policy changes from the current administration. These macro uncertainties are driving incremental institutional and private capital toward tangible assets.

The asset class's growing relevance stems from its potential for consistent income generation, appreciation, and its inherent ability to hedge inflation. In an environment where stability and predictability are at a premium, select market segments are standing out. ***One of the most notable is net lease.***

"There is a huge difference between the business that grows and requires lots of capital to do so and the business that grows and doesn't require capital." ¹

- Warren Buffett

A League of its Own: Why Net Lease Stands Out

Most commercial property types are named for their use (e.g., industrial, retail, office, multifamily, self-storage). Net lease, however, refers not to the building, but to the contractual rental agreement between landlord and tenant.

While a net lease requires the tenant to pay rent like any other commercial agreement, the similarity ends there. The critical distinction is the expense transfer. A net lease mandates that the tenant assumes all or a substantial portion of the property's operating and management expenses, typically including:

- **Property Taxes.** All taxes and assessments associated with the property.
- **Insurance.** A commercial policy that covers the building's physical structure and general liability.
- **Maintenance.** All building operating costs, including utilities and repairs.

Beyond operating costs, the tenant is also responsible for all major capital expenditures (CapEx) - including the roof, structure, and critical systems like HVAC and plumbing, despite not owning the property. This transfer of CapEx (and risk) allows the property owner to enjoy more streamlined, passive income.

Net lease structures - know your N's:

- **Single Net.** A "N" lease is the lowest level of expense-pass-through from landlord to tenant. The tenant pays base rent plus one additional major property expense (e.g., property taxes).
- **Double Net.** A "NN" lease finds itself as the middle child, in between the N and NNN leases with the tenant paying base rent plus two of the three primary operating expense categories.
- **Triple Net.** A "NNN" lease is the most common net lease agreement. Tenants are responsible for base rent plus payment of all three primary property operating expenses - highlighted above - hence the term "triple."² Note: Due to the prevalence of NNN agreements in the industry, this report uses the terms "NNN" and "net lease" interchangeably.
- **Absolute Net.** Like the NNN lease, though includes an additional clause requiring the tenant to rebuild the property in the event of structural damage.

NNN properties are typically stand-alone, single-tenant commercial buildings (though a net lease structure can apply to almost any property type). NNN lease terms are famously among the longest in commercial real estate, usually ranging from 10 to 20 years and often including lease extensions at the tenant's option. Rent escalates annually or every few years, either at a fixed rate (typically 1% - 3%) or indexed to inflation (e.g., CPI), allowing the owner to hedge against rising costs.³

Net lease real estate is often regarded as a fixed-income substitute due to its long-term, highly predictable cash flows. However, the potential for rising rental income from contractual escalations and the appreciation of the

underlying real estate make it an ill-suited comparison to traditional bonds.

At first glance, estimated NNN returns may appear lower than competing real estate returns because they prioritize stability and long-term income over cyclical appreciation. For example, value-add investors often desire properties with shorter lease terms and more frequent tenant turnover, expecting a higher Internal Rates of Return (IRR) compared to the net lease model. Still, the value-add model requires CapEx (NNN does not) and assumes periodic vacancy, which can add variability to forecasted returns.⁴

In the NNN model, rental payments represent a contractual, long-term obligation, which effectively minimizes vacancy risk and eliminates tenant improvement costs for the owner, resulting in certainty of cash flow. Consequently, NNN portfolios often feature some of the highest occupancy rates and operating margins in the entire commercial real estate sector.

NNN: A Simple Lease Turned into a Trillion-Dollar Market

The net lease model can trace its roots back to sale-leaseback (SLB) transactions, where a property owner sells a building to an investor and immediately leases it back typically under a long-term NNN contract. SLBs are particularly prevalent in mission-critical industrial and warehouse space. Given the accelerating trends of e-commerce, U.S. manufacturing reshoring, and the post-COVID demand for last-mile real estate, we anticipate the industrial sector's relevance to only increase over time.⁵

The SLB structure is intentionally designed to mutually align the long-term interests of both the tenant and the landlord. Since the tenant's ability to pay rent and assume all operating expenses over the entire lease term is paramount, diligent credit underwriting at the

outset becomes a critical factor, often determining the property's long-term value.

Why would a tenant agree to pay the property's expenses? For the seller (now the tenant), maintaining full control over costs and ensuring timely payments for critical items on their mission-critical location(s) represents sound business practice. A change in property title does not change their operational DNA. Under NNN agreements, tenants often prefer managing and controlling essential costs themselves, gaining cost certainty over the complexity and potential mismanagement of relying on an outside party.

"Take a simple idea and take it seriously." ⁶

-Charlie Munger

Triple Net Takes Flight

The net lease segment's relevance has steadily grown as it provides investors with reliable rental cash flows insulated from rising property operating costs like taxes and insurance. This defensive profile is particularly attractive during times of elevated inflation and economic instability, as long-term leases with contractual rent escalations help safeguard returns.

The net lease market's continuous growth is fueled by an increasing prevalence of sale-leaseback transactions, which allows corporate property owners to unlock capital from their real estate. This financing structure creates a continuous and expanding supply of high-quality net lease properties for the investment market.

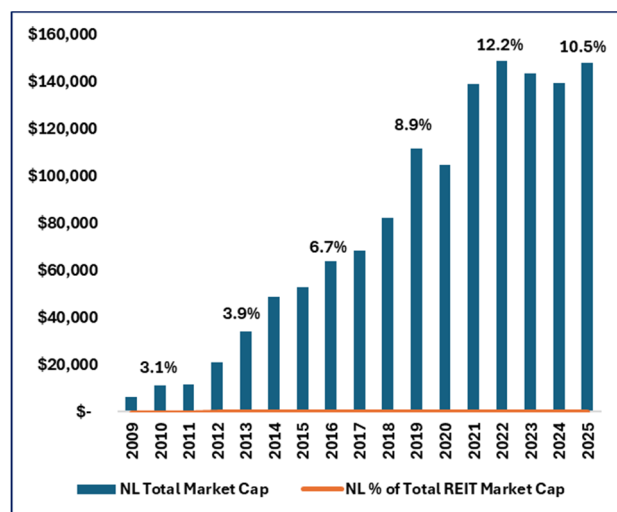
In turn, both large publicly traded REITs and major private equity firms have aggressively assembled substantial net lease portfolios.

Key players leveraging these compelling benefits include:

Publicly Traded NL REITs	Private Equity NL Owners
Realty Income	Blackstone
W.P. Carey	Apollo Global Management
NNN REIT, Inc.	Blue Owl Capital

Serving as a key proxy for the broader net lease market, the sector's acceptance by institutional investors is evident in publicly traded REIT market capitalization. As of Q3 2025, net lease REITs represented 11% of the overall equity REIT market cap, up significantly from about 3% following the Global Financial Crisis (GFC). We expect net lease's rising relevance to continue driving capital deployment across both public and private markets (see Exhibit 1 below.)

Exhibit 1. Rising Trend in Net Lease REIT Market Cap



Source: National Association of Real Estate Investment Trusts

"You've got to be willing to make a change. The great money-making periods of life are when you are in sync with the dominant forces of your time."

-Stanley Druckenmiller

Welcome to Net Lease 2.0

Net lease, once a niche slice of the commercial real estate pie, has evolved into a well-established industry segment. NNN was traditionally viewed by retirees as a fixed-income substitute, known for providing tax-efficient passive "mailbox money" to supplement retirement. However, its other attractive benefits remained largely unknown and untapped.

Historically, single-tenant, stand-alone retail properties dominated the space due to their lower price points, fungibility (ease of re-tenanting), and wide-reaching addressable market. The current estimated U.S. market opportunity for potential SLB activity is immense, sourced from company-owned real estate held inefficiently, in our view, on corporate balance sheets. As of Q2 2025, the Federal Reserve reported \$15 trillion of non-financial corporate business real estate.⁸ While not all of this will transact via SLBs, it highlights the sheer size of the opportunity set.

Over time, investor appreciation for net lease's stable, long-term cash flows drove acceptance and expanded the market beyond retail. Today, NL includes sectors such as industrial, healthcare, gaming, lodging, and self-storage.⁹ This evolution represents a positive adaptation, allowing the net lease structure to reinvent itself across virtually all commercial real estate.

Recognizing this expanding appeal, both institutional and individual investors are increasingly embracing the sector for diversification, returns uncorrelated to capital markets, and stability of cash flows. Several of the primary investment groups capitalizing on these well-known benefits include (among others):

The Institutional Capital Market

- **Pension Funds.** As conservative investors with defined benefit obligations, Pension Funds prioritize safety of principal; they favor NNN's long, credit-backed lease terms and its stable, current income to meet future employee liabilities.
- **Insurance Companies.** Like pension funds, insurers must match significant long-term liabilities with reliable assets. NNN investments help supply the demand for stable, tax-efficient investment income required to fund future claims and adhere to regulatory requirements.
- **University Endowments.** Endowments rely on permanent capital to support their core missions. Stable and predictable NNN cash flows are essential for reliably funding core functions (e.g., scholarships, faculty salaries, and facilities maintenance).
- **Sovereign Wealth Funds.** The U.S. commercial real estate market provides compelling advantages for foreign investors, particularly for its transactional transparency, political & currency stability, and legal protections. For these international investors, global diversification across stable, NNN assets remains a vital strategy.

For **Family Office & High Net Worth (HNW)** individuals, net lease investments represent an attractive source of passive, tax-efficient current income. Several key NNN characteristics drive this appeal:

- **Long Time Horizons.** Safeguarding generational wealth requires durable strategies. With time horizons often counted in decades, NNN's long-duration leases make ideal core holdings for stable, multi-generational income.
- **Tax Efficiency.** The IRS permits commercial real estate investors to depreciate buildings over several decades; this non-cash deduction minimizes taxes on rental income, thereby enhancing after-tax returns.
- **Illiquidity.** Family offices, focusing on generational wealth, value predictable cash flows across market cycles; they often prefer direct real estate investment, recognizing that long-duration assets do not require daily liquidity like publicly traded securities.
- **Premium Spreads.** Private net lease investments can yield premium spreads over comparable liquid, fixed-income instruments; this premium compensates the investor for the illiquidity and operational risk inherent in tangible assets.
- **Uncorrelated Returns.** NNN investments can generate returns that are uncorrelated to stock and bond markets, providing diversification benefits that can stabilize the overall portfolio.

Ray Dalio defines the "Holy Grail of Investing" as constructing a portfolio of at least 15 uncorrelated assets, which can reduce risk by 80% while maintaining expected returns.¹⁰

Net lease's inherently passive income makes it a favorite among investors looking for supplemental retirement income; this makes net lease an increasingly critical asset class for institutional investors managing pension and retirement assets for the growing, aging U.S. population.

To illustrate investment trends, consider the asset allocation decisions of Tiger 21, a prominent U.S.-based HNW networking group. As of Q2 2025, Tiger 21's survey showed:¹¹

- **Private Equity**, ranked #1 (28% of total assets)
- **Real Estate**, ranked #2 (26%)
- **Public Stocks**, ranked #3 (23%)

*"Do you know the only thing that gives me pleasure? It's to see my dividends coming in."*¹²

-John D. Rockefeller

The Thirst for Yield Is Unquenchable ...

The aftermath of the GFC created a yield desert. Historically, low interest rates amplified the demand for current investment income, paving the way for higher-yielding, income-oriented Alternative Assets ("Alts") to gain prominence.

While the COVID-19 pandemic spurred the Federal Reserve to aggressively raise interest rates to combat inflation (which remains above the 2% target),¹³ the core problem persists. Despite the hikes, current investment yields remain below long-term historical averages, prompting investors to continue seeking out quality income sources.

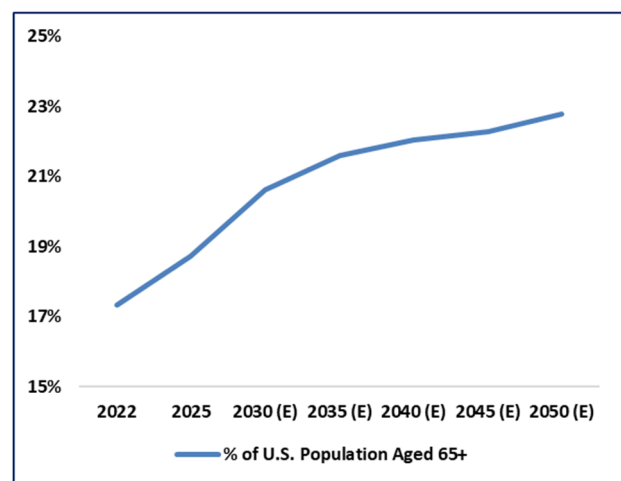
... Driven By the Silver Tsunami

Worldwide populations are rapidly aging, led by a massive demographic wave known as the "Silver Tsunami" - a global phenomenon of older adults entering their retirement years. In the U.S., the 65+ year-old cohort is forecast to be the fastest-growing segment for the next several years. The retirement of the Baby Boomer generation is fundamentally reshaping the age structure of the U.S. population. The most

striking milestone: older adults are projected to outnumber children for the first time by 2040.¹⁴

In the U.S. alone, there are currently 63 million Americans aged 65 or older, representing 19% of the total population. This concentration is projected to accelerate to 21% by 2030, 22% by 2040, and 23% by 2050 (see Exhibit 2 below.)

Exhibit 2. Percentage of the U.S. Population Aged 65+



Source: U.S. Census Bureau, Population Division, November 2023

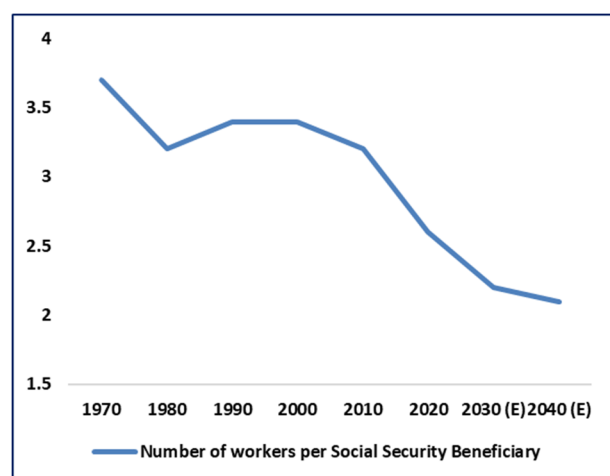
Retirement Awaits. Fact or Fiction?

The current U.S. Social Security system relies on contributions from employed workers to fund benefits for today's retirees. However, criticism of this system centers on its long-term solvency, fueled by the concern that trust funds may be depleted, forcing a reduction in future benefits. Demographic trends point to a looming financial shortfall.

The imbalance is clear: the 65+ population growth rate is forecast to significantly outpace that of the prime working age (25 - 54 years old) by 2050; over this period, the older cohort is expected to grow by 30%, compared to just 6% for the working-age group.¹⁵ This creates an imbalance in the ratio of the current workforce to

Social Security beneficiaries. For the period 1974 – 2008, there were about 3.3 workers for every beneficiary. As of 2023, the ratio declined to approximately 2.7 workers for every beneficiary.¹⁶ We believe the market opportunity and income reliability of net lease investments can play a meaningful role in helping to fill this substantial income gap (see Exhibit 3 below.)

Exhibit 3. Number of U.S. Workers Per Social Security Beneficiary



Source: Social Security Administration, The OASDI Trustees Report, June 2024

The Flip Side: Potential Risks

Despite the “hands-off” reputation of NNN properties, an active mindset is essential. The concentration risk inherent in these investments requires scrutiny of these key risk factors, but not limited to:

- **Tenant Credit.** For single-tenant properties, 100% of rental income is dependent on a single company's financial health. Any material decline in the tenant's rent coverage ratio can transform a predictable income stream into a fragile one.
- **Tenant Bankruptcy.** During Chapter 11 bankruptcy protection, the tenant's lease is either assumed or rejected. The tenant's

priority is to shed unprofitable locations, which is why a site's “mission critical” status remains paramount.

- **Lease Renewals.** Unlike multi-tenant properties where partial vacancies are routine, single-tenant non-renewals result in zero income and the assumption of all property operating costs and exposure to tenant improvements and CapEx.
- **Illiquidity.** Real estate is inherently illiquid, which may limit the ability to quickly shift course in response to changing market conditions.
- **Interest Rate Fluctuations.** Rising or elevated interest rates may directly influence borrowing costs for potential buyers, negatively impacting property valuation and / or ability to refinance existing debt at favorable terms.

Bottom Line

Traditionally, net lease was characterized as the investment version of The Tortoise and the Hare, prized for its slow and steady returns. Today, however, increased investor education has led to a much deeper understanding and appreciation of net lease's robust investment and portfolio benefits. Net lease's appeal may lag cyclical properties that can raise rents quicker during economic expansions. However, embedded rent escalators provide a valuable buffer to sustain cash flows when economic conditions reverse. As such, net lease is an “all-weather vehicle,” cycle-tested over time.

The structural shift created by the Baby Boomer generation - millions retiring simultaneously and increasing demand for stable income - is transforming the market. With the net lease industry's estimated global total addressable market exceeding \$15 trillion, there is ample runway for investors to participate in this dynamic and expanding space.

Finally, recent discussions in the Administration regarding efforts to allow 401(k) participants to access alternative investments - including direct investment in net lease real estate - could be a meaningful catalyst for investors of all sizes.¹⁷ This change may open a space historically only reserved for large institutions. We anticipate significant industry dialogue and commentary around this potential shift in the months ahead.

LNL aims to create an asset management platform that originates both short and long-term fixed income investments for insurance and pension fund balance sheets. While the investment horizon for the loan may be shorter than the lease term, insurance and pension funds balance sheet can absorb the duration risk if structured properly.

LNL Capital

LNL Capital specializes in net lease equity and debt strategies, with the goal of providing investors with stable, predictable returns over long-term horizons.

LNL Capital maintains that the ideal investor is one with patient, long-duration capital that aligns with the NNN asset class. These investors typically target core returns of 6%-10%, where the preservation of principal remains paramount. While NNN leases have long served as a proxy for corporate bonds, investors historically demanded an “illiquidity premium” for the real estate component.

Today, sophisticated allocators increasingly recognize that NNN can generate favorable risk-adjusted returns compared to corporate bonds, a profile underpinned by the residual value of the hard assets and legal protections of lease affirmation in bankruptcy.

For example, institutional investors like insurance companies and pension funds, are inherently suited for NNN investments, given their traditional focus on asset-liability matching to satisfy predictable, long-term payout obligations. Specifically for insurance companies, structured mortgage and mezzanine loans on NNN assets can provide favorable capital treatment, optimizing balance sheet efficiency.

Endnotes

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