Morgan Stanley
INVESTMENT MANAGEMENT

Why the Real Estate Matters in Net Lease Investing

MORGAN STANLEY REAL ESTATE INVESTING | August 2025

Elevated market volatility and a slowing economy favor net lease investments that are characterized by durable, long-term cashflows with fixed escalations in sectors and assets that are generally less sensitive to the cyclical economy. However, given heightened credit risk with some tenants who may struggle to absorb higher input costs from tariffs, it is critical that investors truly understand the residual value of the underlying real estate in addition to the credit of the tenant in assessing the attractiveness of a net lease investment.

Net lease investing has grown increasingly popular for its stability and inherent low-risk approach to real estate investing. In a world awash with uncertainty, net lease investments provide a predictable income return that is fixed and durable, with inherently lower volatility given the long-term nature of the lease. Relative to other types of real estate, net lease is particularly attractive today as it is much less exposed to risks associated with both slowing economic growth (exposure to rent volatility) and rising inflation (as the investor is not responsible for increases in wages, capital expenditures or insurance costs). Net lease investing also provides investors with unique tax advantages and inflation protection plus the appreciation potential of hard asset ownership.

MSREI adopts a targeted approach to net lease investing, focusing on properties leased to credit-worthy tenants in the strongest real estate sectors and markets which benefit from long-term structural megatrends that power through cyclical ups and downs. One such megatrend, extremely topical today, is the onshoring of manufacturing throughout the US. This trend is likely to accelerate given the onset of tariffs and should lead to more sale leaseback and build to suit activity in key manufacturing clusters in Midwest and Southeast markets that have established manufacturing ecosystems.

In a typical sale leaseback transaction, the investor acquires mission critical real estate directly owned by a business, and then leases the real estate back to the business under a long-term lease agreement. The investor receives a series of fixed and often contractually escalating rental payments in which

AUTHOR

TONY CHARLES
Global Head of Research & Strategy, Morgan Stanley Real Estate Investing

the new tenant is responsible for capital expenditures and operating expenses of the real estate. Thus, the sale leaseback structure is both a credit investment and a real estate investment. The income stream is downside protected with predictable characteristics of private credit, and the real estate ownership provides appreciation potential and tax advantages to the investor.

In our view, mission critical net lease real estate provides more security than equivalent private credit for investors. Since the tenant may not be able to operate their business without its truly essential real estate, the net lease structure is functionally senior to traditional corporate debt. “Four wall economics”, such as the share of total corporate revenue generated at the site and the ratio of annual revenue generated by the facility versus annual rent, are critical metrics in assessing the mission criticality to the tenant. More nuanced evaluations include the number of like-kind facilities operated by the business, and the amount of capital invested into the site by the tenant over time. Beyond the assset itself, market-level considerations including demand/supply balance, nearby demographics and access to required labor pools become critical elements in evaluating the attractiveness of the real estate. To illustrate the importance of the underlying real estate and market dynamics, in a major metro such as Dallas, renewals as a share of leasing are significantly higher (+30-50 percentage points)[1] in a premier submarket such as South Dallas, compared with secondary locations such as East Dallas, suggesting higher tenant stickiness in better locations.

Net lease investing demands rigor in both credit and real estate underwriting. Today, the value of the underlying real estate is even more important than in other market environments given the elevated credit risk associated with tenants in sectors that will be adversely affected by tariffs. Higher input costs could negatively impact tenant coverage ratios if operators are unable to pass through the costs to their end-customers. High quality, well-located real estate will have a greater likelihood of being released or sold to a third party.

In conclusion, net lease investments may provide a compelling risk-adjusted return for investors in today’s more volatile environment, particularly given the wider cap rates that have resulted from the general re-pricing of real estate over the past two years. However, to be successful, investors need to balance tenant credit quality with the underlying quality of the real estate. Return outperformance is ultimately underpinned by renewal probability, which is directly shaped by the mission criticality of the underlying real estate assets.

[1] Source: Costar as of May 2025

IMPORTANT DISCLAIMERS

The document has been prepared solely for information purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision. The information contained herein refers to research but does not constitute an equity research report and is not from Morgan Stanley Equity Research.

Unless otherwise indicated, the views expressed are those of the research and strategy team of Morgan Stanley Real Assets and may differ from those of Morgan Stanley Equity Research and other Morgan Stanley affiliates (including others within Morgan Stanley Real Assets). These views may also differ from investment strategies implemented by Morgan Stanley Real Assets now or in the future. The information (including facts, opinions, estimates or projections) contained herein is based on financial, economic, market and other conditions prevailing as of the date hereof. As such, it remains subject to change at any time. By providing such information, Morgan Stanley Real Assets assumes no obligation to provide any update or supplement to such information following the date hereof. Although reasonable care has been taken to ensure that the information (including facts, opinions, estimates or projections) contained herein is accurate, complete and fair, no warranty, express or implied, is made as to the accuracy, completeness or fairness of such information. Certain economic and market information contained herein may have been obtained from third parties' sources. While Morgan Stanley Real Assets believes that such sources are reliable, neither Morgan Stanley Real Assets nor any other Morgan Stanley affiliate has independently verified such information or assumes any responsibility or liability for the accuracy, completeness or fairness of such information or any omission of information.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. There are important differences in how the strategy is carried out in each of the investment vehicles. Your financial professional will be happy to discuss with you the vehicle most appropriate for you given your investment objectives, risk tolerance and investment time horizon.

The information contained herein is highly confidential. By accepting this document, you agree that this document (including any data, analysis, conclusions, or other information contained herein and all oral information, if any, provided by Morgan Stanley Real Assets in connection herewith) may not be photocopied, reproduced or otherwise shared or distributed to any other persons, in whole or in part, without the prior consent of Morgan Stanley Real Assets. Notwithstanding the foregoing, this document and information may be provided to (a) your legal, tax, financial and other advisors who agree to maintain this document in confidence and (b) a government official to the extent necessary to comply with a judicial or governmental order.

Except as otherwise indicated herein, the views and opinions expressed herein are those of Morgan Stanley Real Assets, are based on matters as they exist as of the date of preparation and not as of any future date and will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date hereof.

Historical information is not indicative of future results, and the historical information in this Presentation should not be viewed as an indicator of any future performance that may be achieved as a result of implementing an investment strategy substantially identical or similar to that described in this Presentation.

Certain information contained in this Presentation constitutes "forward looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance may differ materially from those reflected or contemplated in such forward looking statements. Prospective investors should pay close attention to the assumptions underlying the analyses and forecasts contained in this Presentation. The analyses and forecasts contained in this Presentation are based on assumptions believed to be reasonable in light of the information presently available. Such assumptions (and the resulting analyses and forecasts) may require modification as additional information becomes available and as economic and market developments warrant. Any such modification could be either favorable or adverse. Nothing contained in this Presentation may be relied upon as a guarantee, promise, assurance or a representation as to the future.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

Real estate investments are subject to special risks, including interest rate and property value fluctuations, as well as risks related to general and economic conditions.

Morgan Stanley, its affiliates and Morgan Stanley Financial Advisors do not provide tax, accounting or legal advice. Individuals should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving legal matters.

Morgan Stanley is not responsible for the information contained on any third party website or your use or inability to use such site, nor do we guarantee its accuracy or completeness. The terms, conditions, and privacy policy on any third party website may be different from those applicable to your use of any Morgan Stanley website. The opinions expressed by the author of an article written by a third party are solely his/her own and do not necessarily reflect those of Morgan Stanley. The information and data provided by any third-party website of publication is as of the date of the material when it was written and is subject to change without notice.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

EMEA:

This communication was issued and approved in the United Kingdom by Morgan Stanley Investment Management Limited, 25 Cabot Square, Canary Wharf, London E14 4QA, authorized and regulated by the Financial Conduct Authority, for distribution to Professional Clients only and must not be relied upon or acted upon by Retail Clients (each as defined in the UK Financial Conduct Authority's rules).

Financial intermediaries are required to satisfy themselves that the information in this document is suitable for any person to whom they provide this document in view of that person's circumstances and purpose. Morgan Stanley Investment Management shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If such a person considers an investment, she/he should always ensure that she/he has satisfied herself/himself that she/he has been properly advised by that financial intermediary about the suitability of an investment.

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM and Eaton Vance materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at 24-26 City Quay, Dublin 2, DO2 NY19, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In Switzerland, MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Outside the US and EU, Eaton Vance materials are issued by Eaton Vance Management (International) Limited ("EVMI") 125 Old Broad Street, London, EC2N 1AR, UK, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority. **Italy**: MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. The **Netherlands**: MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 11096HA, Netherlands. **France**: MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain**: MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain.

MIDDLE EAST

Dubai: MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). In addition, real estate investments are subject to a variety of risks, including those related to, among other things, the economic climate, both nationally and locally, the financial condition of tenants and environmental regulations. Saudi Arabia. This document is not and does not purport to be any of the following: (a) a marketing communication, (b) a securities advertisement, (c) a financial promotion. Material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, recipients or viewers of this document should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision. This document may not be distributed in the Kingdom of Saudi Arabia except to such persons as are permitted under the Rules of Offering Securities and Continuing Obligations and the Securities Business Regulations issued by the Capital Market Authority. The disclosure of this presentation is restricted to sophisticated investors.

The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers should conduct their own due diligence on the accuracy of the information in this presentation. If you do not understand the contents of this document, you should consult an authorized financial adviser.

Hong Kong: This material is disseminated by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this material have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this material shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore**: This material is disseminated by Morgan Stanley Investment Management Company and should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia**: This material is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. Calvert Research and Management, ARBN 635 157 434 is regulated by the U.S. Securities and Exchange Commission under U.S. laws which differ from Australian laws. Calvert Research and Management is exempt from the requirement to hold an Australian financial services licence in accordance with class order 03/1100 in respect of the provision of financial services to wholesale clients in Australia.

morganstanley.com/im