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PRESS RELEASE

U.K. Occupiers Sought Greater Flexibility in Shorter Leases and Break Clauses in Face of Brexit and Economic Uncertainties

London – November 8, 2018 – U.K. occupiers negotiated shorter leases or more flexible long-term tenancy commitments in face of Brexit uncertainties and sluggish economic growth, according to the annual UK Lease Events Review compiled by MSCI Inc. (NYSE: MSCI), a leading provider of research-based indexes and analytics.

MSCI's research, sponsored by BNP Paribas Real Estate and the British Property Federation, showed that new leases with a duration of less than five years accounted for 42.1% of new tenancy agreements signed to the end of December 2017. That compared with a 39.4% share for the same period a year earlier.

The shift to shorter new leases reversed the trend since 2011, in which occupiers increasingly signed medium-term leases. MSCI's latest findings highlighted that the proportion of new signed leases with a duration of five to nine years declined to 36.9% from 39.1% a year earlier. This came as exports and business investment slowed against a backdrop of uncertainty over the outcome of the U.K.'s negotiations to leave the European Union. The average lease term was unchanged by the shift at 7.1 years, the study showed.

Will Robson, Executive Director, MSCI, said: "Many businesses seemed to be looking for flexibility when they leased space, so they are best placed to adapt to the fast-moving environment. For instance, risks such as rising inflation and prospects of higher interest rates as the Bank of England 'normalized' monetary policy meant that some occupiers may have wanted room to maneuver and adapt to business conditions."

When MSCI reviewed the new leases data by weighting it according to the size of contracted rent, this revealed that large tenants were increasingly signing short or very long leases. This was particularly the case in the retail and office sectors, where average lease lengths declined by 12 and 15 months respectively. Occupiers with large estates of rented space typically favor longer leases because it allows them to capitalize the cost of installing themselves in new premises.

The weighted data show that leases of one to four years accounted for 22.2% of new tenancies in the first half, up from 16.9% a year earlier. Meanwhile, leases of 20 years or more represented a 17.9% share, or a 3.9 percentage point increase from a year earlier. The proportions for all other new lease term brackets declined.

MSCI's analysis of 2017 data found that 28.1% of leases of more than 21 years had "break" clauses in their rental agreements that allow the tenant to vacate the property they are occupying. There has been a steady rise from a 15.5% proportion for these long-term leases in 2009, highlighting how occupiers increasingly built in flexibility when they signed very long-term rental commitments.

Break clauses were included in 38.5% of leases as of the end of the first half, MSCI observed, noting the increase from a 22.7% proportion in 2007, or shortly before the escalation of the Global Financial Crisis. While these clauses were exercised in about one in five leases in 2017, there were significantly higher levels of break clause exercise in London's West End and the City of London office markets as well as in the industrial sector.

Andy Martin, UK Chief Executive, BNP Paribas Real Estate, said: "In a world that it is ever more difficult to predict, the ability to align property horizons to operational horizons becomes paramount, and macro drivers including demographics, technology, and globalisation have resulted in many companies seeking flexibility. It is therefore not surprising to see the proportion of leases shorter than five years increase, a reversal on 2017, while leases between five and nine years have declined. For larger tenants, stability is increasingly important and the longest leases again increased in 2018, highlighting that the leasing market is becoming ever more polarised."

At lease expiry, just 32% of tenants chose to renew their leases and in 61% of these cases their rents rose. MSCI also found that for 65% of new leases rents were either the same or higher than before. The levels of rent free incentives granted to tenants by landlords remained stable from the previous year, MSCI found. Higher rents were most prevalent in the industrial sector and the Central London office markets, while only 28% of new leases in the retail sector registered higher rents, its study showed.

The steady decline in tenant default rates seen since 2012 continued and fell to 2.3% of all tenancies in 2017, or the lowest level since 2007.

Ian Fletcher, Director of Real Estate Policy, British Property Federation, said: ""The commercial lettings market is proving resilient in the face of domestic and Brexit turbulence. A lot of short lets negotiated in the aftermath of the recession are coming up for renewal and providing rental growth for the time-being. Occupiers, however, remain cautious and this is reflected in use of short leases and high incidence of break clauses. This survey is relatively positive on tenant defaults, but doesn't pick up the spate of retail CVAs in the retail sector this year. The breakdown of the various parts of the retail sector provides glimpses of the significant structural changes affecting retail, and landlords adapting to those."

MSCI compiled the study from a sample of 89,000 existing leases in the IPD UK Annual and Quarterly Property Universe as well as more than 9,300 new leases.

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