PROPERTY INCOME RISK & PERFORMANCE

FOCUS ON RETAIL AS OF JUNE 2017

NATIONAL MARKET **USA**

As of Q2 2017, just over half of U.S. commercial leases tracked by MSCI were set to expire within five years. The underlying contracts were concentrated heavily by property type (nearly 60% were tied to office assets) and geographically (more than half the value was weighted to California and the Northeast corridor from Boston to Washington, DC). The timing of expiration schedules and the level of open market rents matter, especially in these areas of concentrated investments. In this report, we examine the structure of U.S. retail leases, which account for one-fifth of institutional investment in U.S. real estate. The analysis covers the four primary dimensions of income risk – concentration, lease length, market conditions and tenant credit – as captured by IRIS, MSCI's flagship product for property income risk.

SECTOR FOCUS **RETAIL**

The retail sector has faced headwinds in recent years with changes in consumer spending patterns and structural challenges, including the growth of online sales, obsolescent physical formats and an evolving landscape of major retailers. Despite the negative headlines, retail remains a sizable and important part of the investment landscape, accounting for nearly 22 cents of every dollar in contracted rent. An analysis of MSCI's IRIS database shows that at a high level, U.S. retail leases appeared well positioned at mid-year, with potential gains on lease renewals averaging over 16%, a level far ahead of suburban offices or industrial properties. Nevertheless, at a more granular level it is clear that the risks are not evenly distributed across metropolitan markets and tenant types.

USA: NATIONAL OVERVIEW AS OF JUNE 2017

THE FOUR MAJOR COMPONENTS OF REAL ESTATE INCOME RISK*

		CONCENTRATION CONTRACTED RENT *% of national market*	TERM REMAINING LEASE TERM *years (weighted)*	MARKET % GAIN / LOSS TO LEASES *market vs contract rent*	CREDIT TENANT RISK LOW MED HIGH
	ALL PROPERTY	**100.0%**	**5.1**	**14.3%**	
BY EXPIRATION	2017	**6.0%**	—	**11.5%**	
	2018	**10.6%**	—	**9.8%**	
	2019	**10.6%**	—	**6.8%**	
	2020	**11.1%**	—	**10.6%**	
	2021	**12.5%**	—	**11.1%**	
	2022 and beyond	**49.1%**	—	**9.4%**	
BY LOCATION	LA/OC/Riverside	**12.9%**	**4.7**	**17.4%**	
	SF Bay Area	**12.8%**	**4.7**	**26.9%**	
	NY/NNJ/LI	**10.8%**	**6.1**	**21.3%**	
	Chicago	**9.6%**	**6.1**	**10.9%**	
	Boston	**8.0%**	**6.0**	**16.3%**	
	Washington DC	**6.9%**	**5.3**	**-1.6%**	
	Seattle	**4.4%**	**5.0**	**18.4%**	
	South Florida	**4.2%**	**4.4**	**13.3%**	
	Atlanta	**3.3%**	**6.0**	**5.3%**	
	Houston	**3.3%**	**4.7**	**11.6%**	
BY SECTOR	CBD Office	**40.4%**	**5.6**	**17.7%**	
	Retail	**21.8%**	**5.8**	**16.4%**	
	Industrial	**20.2%**	**4.2**	**7.0%**	
	Suburban Office	**17.6%**	**4.2**	**12.1%**	
BY TENANT INDUSTRY	Banks/insurance (OFF)	**11.0%**	**4.6**	**17.0%**	
	IT/R&D/consulting (OFF)	**6.5%**	**5.0**	**13.6%**	
	Legal services (OFF)	**5.9%**	**6.7**	**12.8%**	
	Manufacturers (IND)	**4.5%**	**4.4**	**9.8%**	
	Mfg ex-pharma/med (OFF)	**3.9%**	**4.7**	**28.0%**	
	Software & media (OFF)	**3.8%**	**4.4**	**16.8%**	
	Clothing/fashion (RET)	**3.7%**	**4.8**	**10.5%**	
	Wholesale traders (IND)	**3.5%**	**3.9**	**8.9%**	
	Retailers (OFF)	**3.5%**	**6.5**	**13.5%**	
	Transport/logistics (IND)	**2.9%**	**3.8**	**8.2%**	

Source: MSCI (IRIS)

**based on the current status and expiration schedules of actual lease contracts held by institutional owners. This is not a forecast.*

PROPERTY INCOME RISK & PERFORMANCE

MSCI FOCUS ON RETAIL AS OF JUNE 2017

MSCI

CONCENTRATION RISK

		ALL SECTORS CONTRACTED RENT *% of national market*	RETAIL CONTRACTED RENT *% of property sector*
	USA	100.0%	100.0%
BY EXPIRATION	2017	6.0%	5.3%
	2018	10.6%	9.8%
	2019	10.6%	10.4%
	2020	11.1%	12.1%
	2021	12.5%	10.7%
	2022 and beyond	49.1%	51.7%
BY LOCATION	LA/OC/Riverside	12.9%	12.9%
	SF Bay Area	12.8%	10.8%
	South Florida	4.2%	8.9%
	Chicago	9.6%	8.7%
	NY/NNJ/LI	10.8%	7.5%
	Washington DC	6.9%	7.1%
	Denver	2.6%	4.6%
	Boston	8.0%	3.7%
BY TENANT INDUSTRY	Clothing/fashion (RET)	—	16.9%
	Groceries (RET)	—	11.7%
	Full-service dining (RET)	—	7.0%
	Furniture/home (RET)	—	6.9%
	Misc merchandise (RET)	—	4.8%
	Fast-food dining (RET)	—	4.7%
	Sports/toy/hobbies (RET)	—	4.4%
	Financial storefronts (RET)	—	4.2%
	Pharmacy/optical (RET)	—	3.3%
	Bulk merchants (RET)	—	3.2%

KEY POINTS

● As of Q2 2017, expiring U.S. leases were slightly more front-loaded overall than the retail sector. About 51% of all U.S. commercial leases were set to expire before 2022 versus 48% of U.S. retail leases in the same period.

● Institutional retail portfolios also differed geographically from property investments overall. Major outliers at Q2 2017 included New York and Boston, where investors were less weighted to retail than to other property types, and South Florida, where the opposite was true.

● The highest tenant industry exposure was clothing/fashion, which accounted for 17% of contracted retail rents, followed by groceries at 12% of contracted rents.

TERM RISK

		ALL SECTORS REMAINING LEASE TERM *years (weighted)*	RETAIL REMAINING LEASE TERM *years (weighted)*
	USA	5.1	5.8
BY LOCATION	LA/OC/Riverside	4.7	5.9
	SF Bay Area	4.7	6.4
	South Florida	4.4	5.3
	Chicago	6.1	7.2
	NY/NNJ/LI	6.1	5.0
	Washington DC	5.3	5.0
	Denver	4.9	4.4
	Boston	6.0	8.8
BY TENANT INDUSTRY	Clothing/fashion (RET)	—	4.8
	Groceries (RET)	—	10.1
	Full-service dining (RET)	—	5.4
	Furniture/home (RET)	—	5.9
	Misc merchandise (RET)	—	4.7
	Fast-food dining (RET)	—	5.3
	Sports/toy/hobbies (RET)	—	4.5
	Financial storefronts (RET)	—	5.2
	Pharmacy/optical (RET)	—	7.5
	Bulk merchants (RET)	—	4.4

KEY POINTS

● As of Q2 2017, about 5.8 years remained on the average U.S. retail lease, compared to 5.1 years for all U.S. leases.

● In major metropolitan areas of California, Boston and Florida, retail leases were notably longer than the local averages at mid-year. This contrasted with New York, Denver and Washington DC where retail leases were set to expire ahead of the all-sector average.

● A typical grocery tenant at Q2 2017 remained a decade away from renewal, well beyond other tenant types like fast-food and apparel.

**based on the current status and expiration schedules of actual lease contracts held by institutional owners. This is not a forecast.*

PROPERTY INCOME RISK & PERFORMANCE

MSCI FOCUS ON RETAIL AS OF JUNE 2017

MSCI

MARKET RISK

		ALL SECTORS % GAIN / LOSS TO LEASES *contract rent vs market rate*	RETAIL % GAIN / LOSS TO LEASES *contract rent vs market rate*
	USA	**14.3%**	**16.4%**
BY EXPIRATION	2017	**11.5%**	**8.8%**
	2018	**9.8%**	**6.7%**
	2019	**6.8%**	**5.2%**
	2020	**10.6%**	**12.3%**
	2021	**11.1%**	**14.3%**
	2022 and beyond	**9.4%**	**11.3%**
BY LOCATION	LA/OC/Riverside	**17.4%**	**28.4%**
	SF Bay Area	**26.9%**	**7.6%**
	South Florida	**13.3%**	**11.5%**
	Chicago	**10.9%**	**23.9%**
	NY/NNJ/LI	**21.3%**	**23.9%**
	Washington DC	**-1.6%**	**1.7%**
	Denver	**24.3%**	**32.1%**
	Boston	**16.3%**	**22.3%**
BY TENANT INDUSTRY	Clothing/fashion (RET)	—	**10.5%**
	Groceries (RET)	—	**38.1%**
	Full-service dining (RET)	—	**-5.3%**
	Furniture/home (RET)	—	**18.2%**
	Misc merchandise (RET)	—	**8.8%**
	Fast-food dining (RET)	—	**-19.1%**
	Sports/toy/hobbies (RET)	—	**28.7%**
	Financial storefronts (RET)	—	**-14.4%**
	Pharmacy/optical (RET)	—	**-7.1%**
	Bulk merchants (RET)	—	**24.7%**

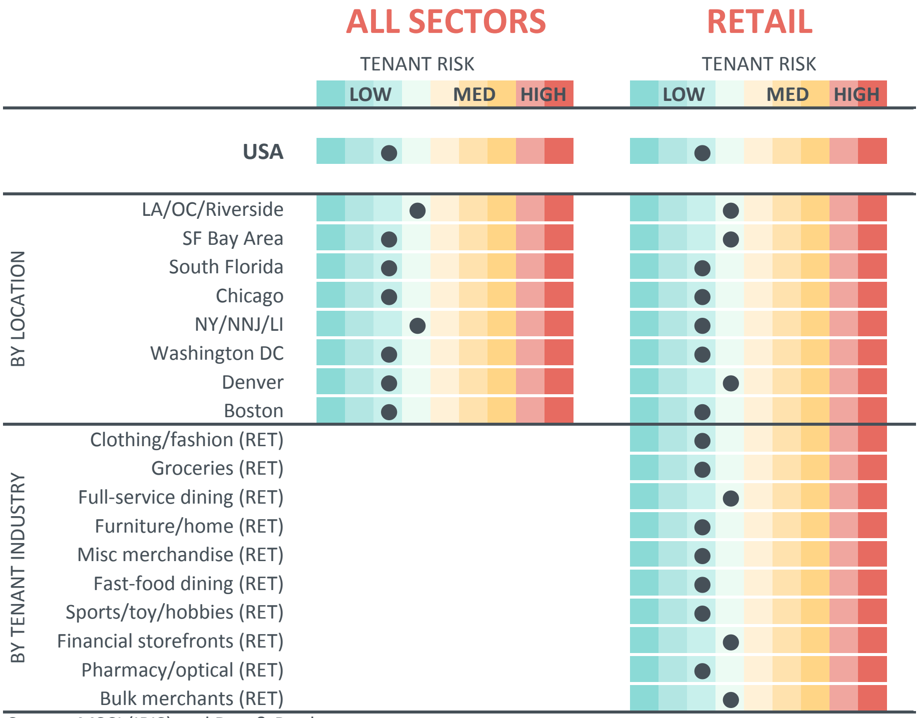
KEY POINTS

- If expiring leases were renewed at market rents, the average U.S. lease contract would rise by 14% compared to nearly 16% for retail properties.

- Potential retail gains are not evenly distributed across metropolitan markets with the SF Bay Area, South Florida and Washington DC lagging the aggregate retail measure. in the former two, potential retail gains also lag the all sector comparison.

- Across tenant types, reversionary potential also varies considerably. Grocery leases are positioned for average mark-ups of 38% but fast-food dining and financial storefront leases are facing potential negative reversion of 19% and 14%, respectively.

CREDIT RISK



KEY POINTS

- Credit risks at the tenant level can be weighted and rolled up to identify discernible differences when aggregated across time, geography or tenant industry.

- Among U.S. retail tenant types, lower-than-average credit risks could be identified in consumer staples such as groceries, pharmacy/optical and homewares. Risks were slightly higher among tenants with more elastic demand such as full-service dining.

- From a credit standpoint, the amount of high risk income for retail (0.3%) is below office (0.5%), and the average tenant risk score is below industrial (3.4 and 3.5, respectively).

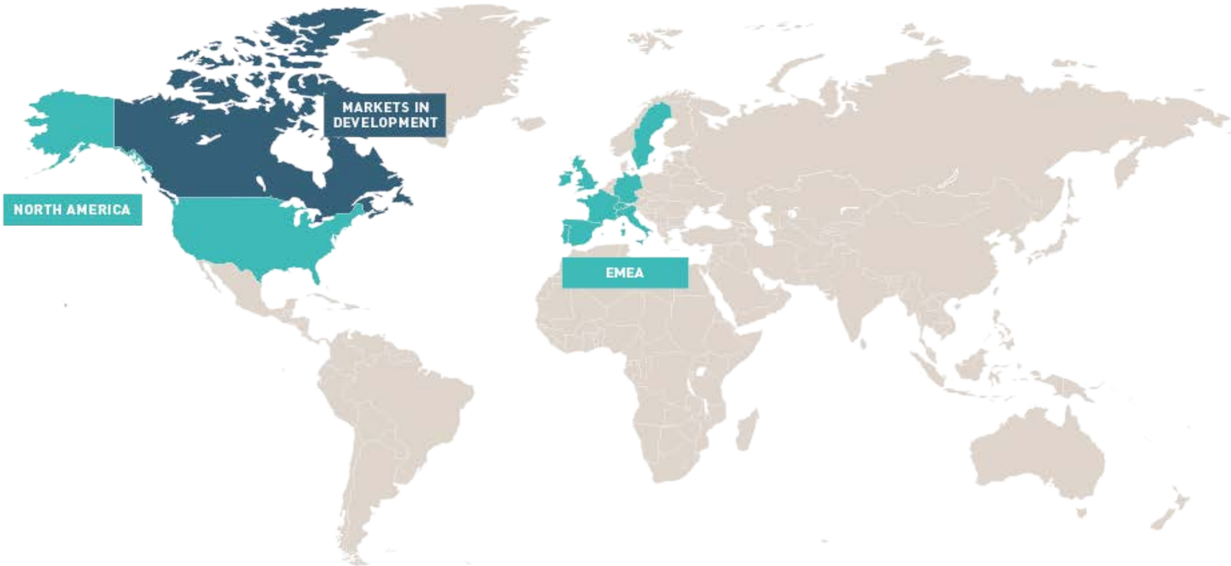
Source: MSCI (IRIS) and Dun & Bradstreet

**based on the current status and expiration schedules of actual lease contracts held by institutional owners. This is not a forecast.*

The MSCI Rental Information Service (IRIS) provides real estate investors with analytical tools to help them measure and manage forward looking income risk factors that impact value across their portfolio.

KEY BENEFITS

- Reduced performance volatility through active management of opportunities and risks to changes in value.
- Optimized duration of income through more informed leasing strategies in business plans for individual assets within your portfolio.
- Improved communications with current investors, prospective investors, and consultants.



MARKETS COVERED		
FRANCE	PORTUGAL	UK
GERMANY	SPAIN	USA
IRELAND	SWEDEN	
ITALY	SWITZERLAND	

MARKETS IN DEVELOPMENT
CANADA