

## INTRODUCTION & METHODOLOGY

There has been much debate over recent years about the suitability of current lease terms and practices for occupiers. However, little headway has been made in reconciling the needs of occupiers and investors.

During the 2001 BCO conference in Berlin, at a session entitled *'Giving the occupier what they want'* these issues were debated, and unsurprisingly came across the usual stumbling blocks. In particular, there appeared to be little appetite from UK investors for changing the lease practices and structures that make office properties such an attractive investment product.

However, the BCO session did highlight an interesting anomaly that has stimulated this research. In Germany office lease terms and conditions appeared to be more tenant friendly than in the UK, *and yet Germany still had active property investment markets and lower yields than in the UK.*

This report addresses some of the issues that this question raises. In particular, the BCO asked Property Market Analysis to study six key continental European countries – France, Germany, Holland, Italy, Spain, and Sweden – and the US, to:

- identify leasing practices across key international markets,
- to see if, and how, they offer flexibility to occupiers,
- to provide a ranking of lease flexibility by country, including the UK,
- and to see how this flexibility is reflected in investor attitudes and pricing.

As well as reviewing previous research, this project has involved qualitative surveys of over 30 local market experts, including both investors and consultants. This has enabled us to not only clarify local lease practices, but to identify those terms that created problems for occupiers and/or investors. These experts' opinions were checked and analysed in the light of practices outlined in various consultant and academic publications, enabling conclusions to be drawn. Further research could involve a larger survey to check these findings, and further analysis of investment and pricing implications.

## EXECUTIVE SUMMARY

- The key factor in lease flexibility is the ability to match property holdings to rapidly changing business conditions. Minimum lease lengths are therefore the chief concern.
- Control of costs is a secondary issue. This largely reflects that only in the UK are rents reviewed during the standard lease period, and so *without giving the occupier the opportunity to vote with their feet by moving.*
- France has the most flexible leasing structure, with an ability to break every 3 years, but to remain in occupation for 18 years. Italy is a close second, with an initial lease of 6 years that can be renewed for another 6 years with





# OFFICE LEASES: CAN THE UK BE MORE FLEXIBLE? EXECUTIVE SUMMARY

no market review, while indexation is below price inflation.

- The next most flexible leases are in Spain and Sweden, with leases of 5 years with options to renew. Indexation is standard, as are rent reviews at year 5 to market, up *and* down.
- Most other countries have leases of 5 or 10 years, and where 10 years is the standard this reflects a recent outward shift from 5 due to tight market conditions. Again indexation is standard.
- The UK has the least flexible international leasing structure. The standard 15 years in key markets in the UK is 50% longer than all other markets; breaks are not standard. In contrast to all other countries rents will be reviewed upwards every 5 years providing significant cost uncertainty for occupiers, though there is no indexation.
- Flexible leases do not necessarily equate with a rapid turnover of tenants. In European markets where data is available, turnover rates are lower (moves every 12 to 15 years in Paris and Madrid) than in the City of London (moves every 7 years). This suggests that greater flexibility could be offered in the UK without a significant impact on length of occupation. However, shorter leases may necessitate a closer and more symbiotic relationship between occupiers and investors/owners, as is the case in Europe.
- The varying degree of flexibility of lease terms internationally is not reflected in yields and values; most countries have similar yields to the UK with the exception of the US, where net yields of 9.5% are reportedly standard.
- Yields at a country level are set by domestic investors appraisal of risk, return, and value, and the domestic weight of money. As the property risk premium, and the risk attached to other asset classes, the importance of capital vs income growth, and the risk of breaks/renewals being taken varies markedly by country, so international comparisons suggest that mis-pricing may exist.

While this research suggests that mis-pricing is evident, further work needs to be done to suggest what fair pricing may be and how prices may change over time. Equally, research into what the impact would be on the UK investment market and UK values of offering more flexible leases also needs to be fully appraised. These steps are to come.

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