Acuitus Commercial Property Auctions
2021 Review and 2022 Outlook

acuitus

Real Estate Auctioneering & Investment

To analyse long-term trends across commercial property auctions, Acuitus uses quarterly data which goes back to 1985.

The data for this 2021 analysis has been provided by The Essential Information Group and is a subset of the results of commercial property auction sales.

As this is true market data, the analysis will reflect the number and characteristics of the assets available on the market at that time.

All individual transactions highlighted throughout the document and in the sales cross-section on p9-11 were conducted at Acuitus auctions.

Acuitus Research
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During 2021, the volume of UK commercial property sales at auction was £780.6m. This was the highest level of activity since 2017 and 43% higher than 2020.

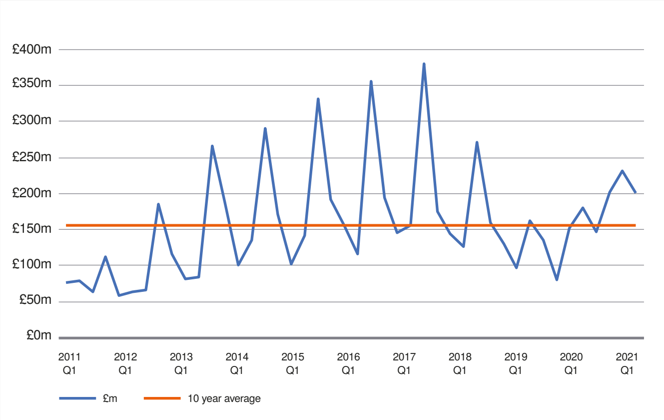
Residential bolsters commercial confidence

Our previous analysis has shown that there is a correlation between the confidence in the housing market and the demand by investors for commercial property. There are, of course, other factors at play here but the “feel-good” factor in housing does positively impact the commercial property market at a later stage.

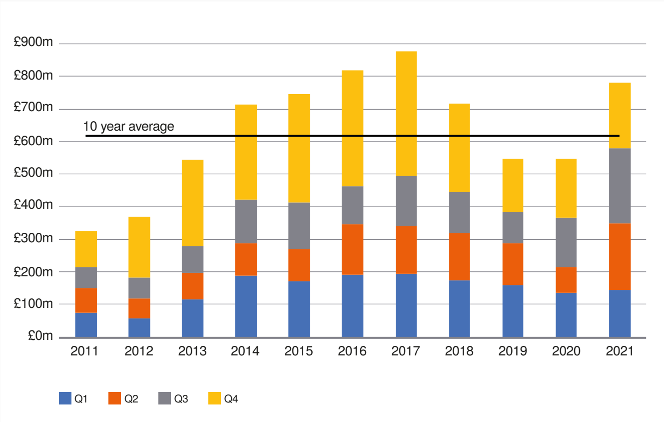
In 2021, UK house prices grew at the fastest pace for 15 years, reaching a record high as low interest rates, comparatively low levels of supply and pent-up pandemic demand boosted transactional activity. According to data from the Nationwide Building Society Average house prices rose by 10.4% in December which helped make the calendar year performance the strongest since 2006.

This has bolstered the confidence of developers and investors who have been targetting mixed-use schemes and opportunities for residential conversion of redundant commercial space such as offices and under-utilised retail upper floors.

Quarterly commercial property auction volumes 2011-2021



Annual value of commercial auction transactions



173-175 Friar Street and 27-32 Market Place, Reading: sold for £2.65m

- Major freehold town centre development opportunity
- Planning permission granted for 182-bed hotel, together with bar/restaurant /gym, E-Use Class units and eight residential units
- Currently comprises approximately 49,483 sq ft on a site area of 0.40 acres

The scope of buying in the auction room broadened during 2021 as investors targeted a wider range of asset types and developed strategies that responded to a changed world.

Retail resurgent

Retail properties which have an existing or potential residential dimension were particularly sought after during 2021.

As we noted in our H1 2021 report, a growing number of sellers have capitalised on the high demand from investors for retail investments. This trend continued to the year-end. Assets in demand were typically those whose pricing reflected re-based rents and often had some scope for capital growth through active asset management.

Sellers have included international investment and asset managers as well as corporate occupiers wishing to utilise capital more productively in their core businesses through sale-and-lease-backs. These sellers have exited their positions in an orderly, efficient and timely way using a programme of sales to achieve best prices unconditionally.

In line with this, single shops with upper parts or parades in suburban locations with a significant percentage of local occupiers were very popular. Geographically, this pattern of buying was most pronounced across Greater London, the South East and regional locations where economic activity is above the national average GDP.

By the year-end, retail property transactions in the auction room had reached £560m which represented 72% of all sales by value. This was slightly above the long-run average of 69% but exceptional given the current sentiment around retailing and the trading problems caused by the pandemic.

Royal Arcade, Castle Street, Norwich: sold for £3.375m

- Historic covered shopping arcade in pedestrianised city centre
- 20 retail units totalling over 30,000 sq ft
- Asset management opportunities

Shopping centres: good or bad?

Whilst shopping centres generated more headlines than any other retail sub-sector – largely because of dramatic pricing adjustments – they are attracting a growing number of investors seeing the opportunities that these large urban footprints can provide.

From a buyer's perspective there are undoubtedly substantial inherent risks. These are complex and management-intensive assets but investors have a better understanding of what resources they will need to commit to managing a centre where costs exceed income – and also what upside an alternative use could generate.

If a centre is to continue its useful life then reducing outgoings and rebuilding the tenant base invariably are the main priorities to address but there are big cash returns available if this can be achieved. A large negative operating income can quickly become significantly positive if empty rates and service charge short-fall can be slashed. Entrepreneurs can often see a way through this minefield – especially if a local authority is committed to the centre's place in the economic landscape.

The High Street: we need to talk

There's not much that hasn't been said about UK High Streets in the past few years. It's systemic problems prior to the advent of Covid-19 have been dwarfed by the subsequent dislocation of retail and the resultant mountain of back-rent which is owed to landlords.

This needs to be addressed – not least as the moratorium on evictions finishes at the end of March. Having said this, what is interesting is that for the vast number of sale properties landlords and tenants have resolved any outstanding issues.

From a more positive perspective, we now have a clearer feel where rents are and if anything good came out of the pandemic it is that there is a more positive dialogue between landlords and occupiers – and also more creative thinking about how to move forward.

Out of this can come a rebuilding of performing investment stock which can enable retail assets to be seen as viable diversifier from equities and bonds.

Two legacies of the pandemic are the popularity of healthcare-backed assets and the uncertainty around offices.

Healthcare in focus

The healthcare sector is also increasingly prominent on the radar of investors. Not surprisingly in the context of the past two years, the essential nature of the sector and what it provides in terms of investment attributes have come to the fore. It is seen as a defensive stock which offers diversification benefits. Assets have medium to long-term income flow with leases often RPI-linked and minimal asset management input required from the investor. Popular assets in this sector include pharmacies, dental surgeries, healthcare centres and assisted living accommodation.

Portfolio of pharmacies: sold for £4.832m

- Sale and leasebacks of ongoing pharmacy businesses that are unaffected by the sale
- 15-year leases
- Five-yearly RPI-linked rent reviews subject to a minimum and maximum increase at each review

Offices uncertainty

Office investments accounted for 6.5% of auction sales during the year. Given the uncertainty surrounding the future shape of the office sector and the rise of the working from home phenomenon, owners have been reluctant to put their properties on the market until the picture is clearer.

A significant amount of regional in-town office stock has already been re-positioned as residential which has absorbed surplus space but there is still demand for redundant offices for conversion to residential.

Investors are wary and looking closely at likely future demand for existing office space and how this needs to be adapted to appeal to staff returning to work full or part-time and also the costs of implementing stringent energy-efficiency measures along the road to net-zero carbon status. These obligations may lead to a rise in sales as owners pass on assets to investors who have deeper pockets and greater asset management skills to meet the requirements.

Sales rates remained high throughout 2021 and averaged 90% – above the long run trend and ahead of the 84% 2020 sale rate.

More buyers, more being bought

Multi-channel live-streamed and online-only auctions have undoubtedly put the auctions process within the reach of a greater number and larger geographical spread of buyers. The pre-registration required for online sales has also given deeper insight into the patterns of buyer demand and has helped inform ongoing marketing strategies. This extra information has allowed sellers to fine-tune their sales strategies up to and including the auction day and this has resulted in higher sale rates.

Sales of properties in London boomed with more than 200 properties selling for a total realisation of over £180m. The final quarter of 2021 was especially strong in this respect with properties in the capital accounting for 29% of sales by value against the long-run average of 19%.

The average lot size of London assets in the auction room was £900,000 – 50% higher than the rest of the UK which was just under £600,000.

The unsatisfied demand by property companies and developers for larger asset management opportunities has led them to buy through auction. Lots selling above £1m reached a four-year high in 2021, with some 220 transacting during the year – more than 30% up year-on-year.

The well-documented – almost exponential – investor demand for industrial and logistics assets saw almost anything that came into the auction room find a host of willing buyers. However, the supply of investable stock has been low as owners have preferred to retain their assets. As a consequence, industrial/logistics assets accounted for only 8% of property sold during the year.

85-87 Clarence Street, Kingston Upon Thames: sold for £2.05m

- Retail investment
- Ground and first floors let to Pret a Manger (Europe) until 2028
- Floor area: 3,310 sq ft

The Average All Property net yield stands at 8.51% – 65 basis points up from 7.86% at the end of 2020.

Mind the yield gap

The yield gap between prime and secondary assets which are selling at auction stood at 3.56% as at Q4 2021. The lower quartile net yield representing the private investor prime yield remained firm at 5.98% (2020: 5.90%). The upper quartile yield representing secondary property also remained firm closing 2021 at 9.54% (2020: 10.09%).

On a regional level, the yield gap between Greater London and the rest of the UK widened by over 100 basis points and currently stands at 4.39%. The Greater London Average All Property net yield hardened to 5.16% as at Q4 2021 from 5.47% at the end of 2020. The Rest of UK Average All Property net yield weakened to 9.55% from 8.83% year-on-year.

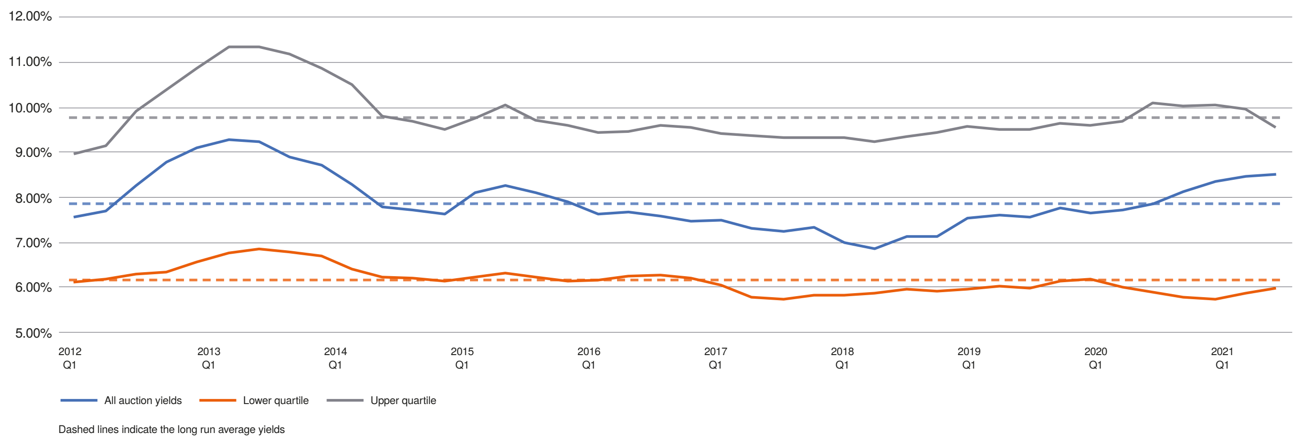
A significant number of leases are now under five years in length. Investors are therefore needing to take an increasingly more proactive approach to investment and appear to be more comfortable with the shorter leases.

The Q4 2021 Average All Property yield for properties with less than five years to expiry hardened over the 12 months by 151 basis point to stand at 7.95%

Leases longer than 10 years came in by 42 basis points with a current Average All Property yield of 7.04%

NB: Net yields calculated on a 12-month rolling average basis.

Commercial property auction net initial yields



For the commercial property auction sector, 2021 finished strongly with a clear sense of where prices and demand are at the moment for most assets.

Outlook

The volume of auction transactions in 2021 provided a more liquid market and gave a much clearer sense of market pricing and demand factors.

There was ready demand for prime properties with good secure income or where a positive asset management outcome could be measured with more certainty. The secondary market – where long-term outcomes are more uncertain – saw many owners reluctant to sell without more clarity.

As we head into 2022 we do not see a decline in demand notwithstanding continuing political uncertainty, supply chain and labour issues and inflation. Investors will still need to find an outlet for their funds and property is a valid diversifier as it offers less volatility than equities and a better return than bonds.

The tangibility of property is no less important. The difference today is that investment funds on a global scale are vast and the internet has put commercial property assets in reach of a huge pool of investors who have skills in property ownership and understanding value creation.

From a more macro perspective, interest rates and inflation are on everyone's minds.

Although interest rates are rising the impact on borrowing costs for new borrowers should be negligible and could be countered by the banks' new flexibility around margin cover. The outlook for inflation is less clear with some commentators believing it is here to stay while others claim it is a transitory phenomenon which will be rectified as the year progresses.

Property is seen by some as a hedge against inflation although a more important influencer of capital growth is GDP and the disposable incomes of consumers. We need to wait and see how these scenarios play out and, for the present, we expect property yields to remain broadly unchanged

Investors are learning to live with uncertainty and develop strategies accordingly. Therefore, with other things being equal, we expect the investor base to grow and consequently the number of buyers.

On the asset supply side, far greater number of properties came on the market in 2021 and with sale rates over 90% we are a long way from there being any over-supply.

In our H1 2021 review we commented: "Assets which provide for the day-to-day needs of a local population such as supermarkets, convenience stores and pharmacies have been popular this year and will continue to be in demand going forward. The continued rise in the popularity of the healthcare sector is notable".

Given everything that is happening in both the economy and the wider world, we believe this emphasis on 'essential' asset types will be a continuing theme throughout 2022 and auctions will benefit from investors continuing to reorientate their holdings to meet changing conditions.

A cross-section of 2021 Acuitus auction sales

82-84 St Ann's Road, Harrow: sold for £3.225m

- High Street investment/development opportunity
- Approximately 13,685 sq ft with the upper floors comprising 9,133 sq ft
- Residential development potential on upper floors

32 High Street and 11-15 Woodbine Place, Wanstead: sold for £1.525m

- Unbroken parade comprising five shops on prominent corner location
- Average unexpired lease term of almost eight years
- Future redevelopment potential

Hillsborough Exchange shopping centre, Sheffield: sold for in excess of £3m

- Substantial centre comprising 91,933 sq ft with site area of c.2.8 acres
- Around 90% of floorspace let to national tenants
- Asset management opportunities

St Elli Shopping Centre, Llanelli: sold for £2m+

- 90,425 sq ft centre comprising producing annual income of c.£725,000
- Site area of 7.74 acres
- Asset management opportunities

Wellgate Shopping Centre, Dundee: sold for £1.4m

- 539,240 sq ft centre with 583 space multi-storey car park
- Tenants include B&M, Savers, Superdrug, Home Bargains, Iceland, JD Gyms, Poundland and Burger King
- Asset management opportunities

Esso petrol filling station, Willesden, NW10: sold for £4.575m

- Let to Euro Garages until 2050 (no breaks)
- 2.5% pa compounded five-yearly rental increases
- Includes Spar convenience store, Subway and Starbucks On The Go

Old Bank House medical centre, Uxbridge: sold for £1.69m

- Let to Central and North West London NHS Foundation Trust on lease expiring March 2026 (no breaks)
- Comprises 5,412 sq ft with on-site parking
- Potential change of use opportunities

Knowsley Village medical centre, Liverpool: sold for £1.001m

- Let to Aston Healthcare
- Newly re-geared lease with 15 years unexpired (no breaks)
- Majority of rental and occupational costs reimbursed by the NHS

Portfolio of dental surgeries: sold for £3.106m

- Locations including Wareham, New Milton and Bournemouth
- All let on new 15-year leases
- Sold for prices ranging from £204,000 to £614,000 at yields starting below 5%

19 Cavendish Road, Clapham SW12: sold for £1.62m

- Freehold assisted living charity let investment let to charity on lease expiring 2037
- Five-yearly RPI-linked rent reviews collared at 2% and capped at 4%
- Current income of £82,222 rising to minimum of £90,779 in November 2022

Units A&B, Elms Industrial Estate, Bedford: sold for £3.2m

- Let on a FRI lease expiring in September 2034 (no breaks)
- Modest passing rent equating to £4.48 per sq ft with fixed rental uplift to £5.73 per sq ft in March 2022
- Low capital value of £67 per sq ft

ICS House, Maldon, Essex: sold for £5.3m

- Office and two warehouses buildings totalling 74,792 sq ft on a site of 1.67 acres
- Majority let until 2035
- Potential residential conversion opportunity

The Oliver Conquest public house, Leman Street E1: sold for £1.95m

- Let on new lease until 2031 (no breaks)
- Current annual rent of £90,000 rising to £165,000
- Lease outside the Landlord and Tenant Act 1954 with landlord's option to break

Rainton Meadows Arena, Houghton Le Spring: sold for £1.725m

- Regional entertainment venue let until 2034 (subject to option)
- Comprises 27,155 sq ft of leisure facilities on site of 5.30 acres
- Low site coverage of around 12%

9-10 High Ousegate, York: sold for £1.42m

- Let to Lakeland at current rent of £105,000 pa
- Close to Coppergate shopping centre and multi-storey car park
- Future development potential for upper floors

9 White Lion Street, Norwich: sold for £1.305m

- Let to Specsavers Optical Superstores on a 10 year-lease until 2029
- Rent re-based in 2019 to £126,250 pa
- Excellent trading location

Former public house, Dagenham: sold for £2.485m

- Former pub with car park on 0.57-acres site
- Current annual income of £126,306 pa with residential redevelopment potential
- Opposite a majority new residential development

10 Church Street, Weybridge: sold £2.8m

- Two shops with separately accessed pilates studio and offices above plus large site to the rear with parking
- Current income of £183,300 pa
- Development and change of use opportunity on upper parts and rear site

Sainsbury's Local, South Croydon sold for £805,000

- Convenience store let on a new 15-year lease with a 10-year tenant break and five-yearly CPI-linked rent reviews
- Parking for seven cars
- Sale reflected yield of 5.3%

541 Holloway Road, London N19: sold for £2.21m

- Comprises 7,072 sq ft with current income of £117,500 pa
- Includes six flats let on separate leases
- Potential future development potential

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