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IPD/Acuitus Commercial Property Auction Data (cPad) Auctions report Q3

Published September 2013



Market edges back towards normality

Welcome to the latest Commercial Property Auction Data (cPad) Market Flash which analyses £82.5m of commercial property assets that sold at auction in July 2013.

The 30% increase in sales volumes in comparison to the corresponding period in 2012 is a vivid illustration of the new momentum in the auction room.

Encouraged by fresh levels of investor demand in the auction room, a growing number of property owners now believe the time is right to put their assets up for sale.

The conditions for selling are now the most conducive we have seen for many months. There is now a market where the expectations of buyers and sellers are being met.

However, like the economy as a whole, recovery is fragile and investors have to proceed with the utmost care and caution.

The majority of commercial property assets offered for sale at auction still require experienced investors who have both equity and asset management expertise.

We hope you find this cPad Market Flash useful and would be pleased to discuss any of the points that it raises.

Key Stats

▲ **30%**
increase in activity
year-on-year

▼ **72%**
of sales were retail
properties

▼ **79%**
sale rate for office
properties

▼ **9.9%**
average property yield

cPad

cPad is a joint initiative between Acuitus and IPD utilising auction sales data from EIG to provide a unique perspective on the commercial property market for private investors and private property companies. The aim is to create a valuable snapshot of today's market and help investors shape their future investment strategy.



In the auction room

Retail resurgent as volumes increase

This year has seen continued strengthening of demand in the auction room. Assets totalling over £82.5m were sold at auction in July which represented a 30% increase in volume against the corresponding period in 2012.

Retail property has been resurgent in the room recently. It accounted for 72% of properties sold in July which was a significant change from July 2012 when it accounted for just over half.

A greater understanding of the issues facing the High Street and the rebasing of rents is enabling investors to see a way forward for retail assets. They are taking a more pragmatic approach to pricing especially where there are other management angles such as residential accommodation on upper floors.

Although retail is dominating auction sales, investor demand is still very selective and focused primarily on assets which are let on longer leases and located in areas where trading remains solid.

Such has been the doom-laden press about the High Street there is possibly now too much negative sentiment towards the retail sector as a whole. The problems on the High Street have been well-documented and are very real, but investors are in danger of blinding themselves to what are real opportunities during the next 12 months.

Office investments accounted for 17% of sales in July which continues the rekindled interest in this sector that first became evident around nine months ago. As long as pricing reflects the investment risks attached to short leases, voids and capital expenditure the property-savvy investors are prepared to buy offices.

Commercial property auction sales summary			
Sector		July 2013	May 2013
Volume (£ million)	▲	82.5	80.4
Properties sold	▲	167	148
Average lot size (£)	▼	494,198	542,929
Sales rate	▼	73.6%	76.0%

Re-cycling these assets from reluctant and indebted owners to those who have the skill and the equity to invest in them is an important function of the auction market.

There is a growing consensus amongst sellers and buyers on pricing which has allowed more trades to take place. However pricing for non-prime assets is sensitive to market sentiment and the strength of the asset. Great care is still required not to over-price these assets in the auction room.

Of the office properties offered for sale in the July auctions, 79% sold. This was slightly down on the 83% achieved in May but up on the corresponding period last year (69%). Whilst the current success rate is broadly in line with expectations of a normally functioning market, sellers must still tread carefully when bringing these assets to market as there is still a great deal of investor uncertainty.

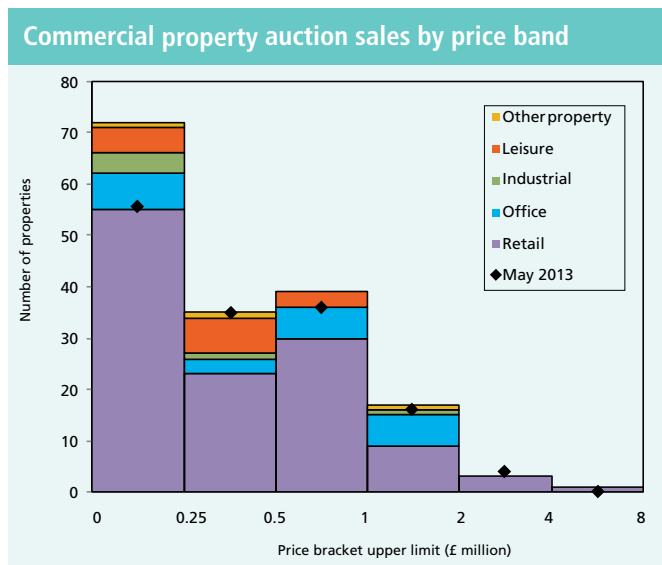
Demand for London investments remains unabated but auctions are also acting as an important market place for assets across the UK, which accounted for 81% of the total sold.

The average sale price has fallen by 10% to just below £500,000. This is driven mostly by the type of properties offered rather than a fall in prices or buyer preference. As a consequence there can be short-term volatility but it is worth noting that it is towards the bottom end of the range. The largest lot sold was over £4m.

Commercial property auction sales, £million			
Sector		July 2013	May 2013
Retail	▼	59.3	59.6
Office	▼	14.0	14.4
Industrial	▼	2.1	0.9
Leisure and other	▲	7.2	5.4
Region		July 2013	May 2013
London	▲	15.8	8.6
Rest of UK	▼	66.7	71.8



Commercial property auction sales rate, %			
Sector		July 2013	May 2013
Retail	▼	72%	76%
Office	▼	79%	83%
Industrial	▲	100%	67%
Leisure and other	▲	75%	72%
Region		July 2013	May 2013
London	▼	85%	93%
Rest of UK	▼	72%	74%



In the market

Yield gaps reflect investor caution and regional divide

The average yield has weakened 40 basis points (bp) since May 2013 and stands at 9.9%. However it remains within the 12-month range of 9.5% - 10.0% and any fluctuation is more likely to be due to the type of properties offered during each auction round. With retail dominating and investor confidence being hit by the woes of the High Street, it is unlikely that average yields will fall significantly until there is occupational stability, rental growth off re-based rents and/or a change of use. The average retail yield is 9.6%.

The average office yield is 10.8% but this needs to be interpreted with care as again, stock selection is more significant than underlying market trends. It should also be noted that most investors price on a 'per square foot' basis rather than initial yield especially if the level of vacant space is high.

The gap between prime and secondary is 490bp with the prime yield standing at 7.1% and the secondary at 12%. The prime yield has hardened 20bp since May whilst the secondary yield has weakened by 70bp. However, these figures lie within the 12-month range.

With improved liquidity and robustness being seen in the auction market there has been an increase in the supply of

the more secondary stock which is characterised by short leases, over-rents and requirements for capital expenditure.

Lenders with non-performing loans who are not prepared to take the risks and see asset prices fall further are forcing sales through. This has seen a greater number of higher yielding assets come to market either consensually or through administrators and receivers. Yields of 20% plus are not uncommon and accepted by valuers, but 'price per sq ft' is a more meaningful measure. This end of the market is the preserve of the property-savvy investor who has equity to invest.

At the prime end of the spectrum there has been a strong demand for investments that are rack-rented on 10 year-plus leases without tenant breaks. Neither the locations nor the buildings need to be 'prime' but clearly if they are, demand from high net-worth investors who are prepared to buy at yields of 5% is stronger. Apart from offering a better initial yield than gilts and building society bonds there is potential for growth and additionally the funding market for these type of investments has seen a significant freeing-up over the last 3-6 months.

As expected there is a large yield gap between an exuberant London market and the rest of the UK with a 300bp point average yield gap.



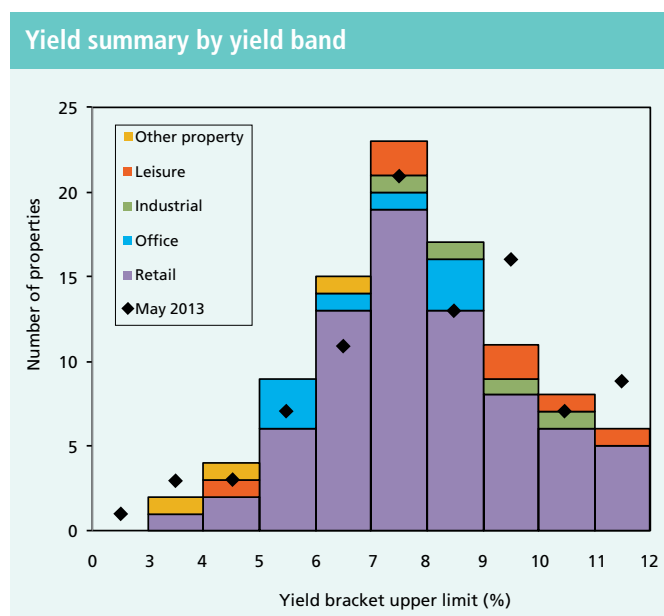
The average yield difference between the smaller (<£250,000) and larger (>£1m) investments shows little variation. This demonstrates that in the auction market investment criteria are more important in determining investor's pricing than lot size.

Yield summary			
All commercial property totals		July 2013	May 2013
Average initial yield	▲	9.9%	9.5%
Lower yield quartile	▼	7.1%	7.3%
Upper yield quartile	▲	12.0%	11.3%
Yield by unexpired lease term			
0-5 years	▲	13.0%	9.8%
6-15 years	▲	8.9%	8.5%
16 years +	▲	8.1%	7.4%

Yield summary			
Yield by value band		July 2013	May 2013
£0 - £250,000	▲	10.7%	9.7%
£250,000 - £500,000	▼	9.7%	10.3%
£500,000 - £1 million	▲	8.8%	8.7%
£1 million +	▲	10.1%	8.5%

Yield summary by sector			
Sector		July 2013	May 2013
Retail	▲	9.6%	9.0%
Office	▼	10.8%	13.1%
Industrial	▼	10.2%	15.5%
Leisure and other	▲	12.2%	8.5%

Yield summary by region			
Sector		July 2013	May 2013
London	▼	7.3%	8.2%
Rest of UK	▲	10.3%	9.7%





UK retail market analysis

Regions begin to show signs of a recovery

According to the latest figures from the IPD UK Monthly Index, national standard retail values fell by 0.1% during the month of July 2013. This was the first time values have fallen since April earlier this year. On the high street, the divergence between the Capital and the rest of the country remains very much in force across the British retail sector as London values increased by 0.2% whilst the rest of the UK saw declines of 0.3%. Although there remains a deviating trend between the two regions, capital values have risen at a slower pace in London and values across the rest of the UK have declined at a slower pace. This may indicate that we could finally be seeing a slight convergence in pricing for the two regions.

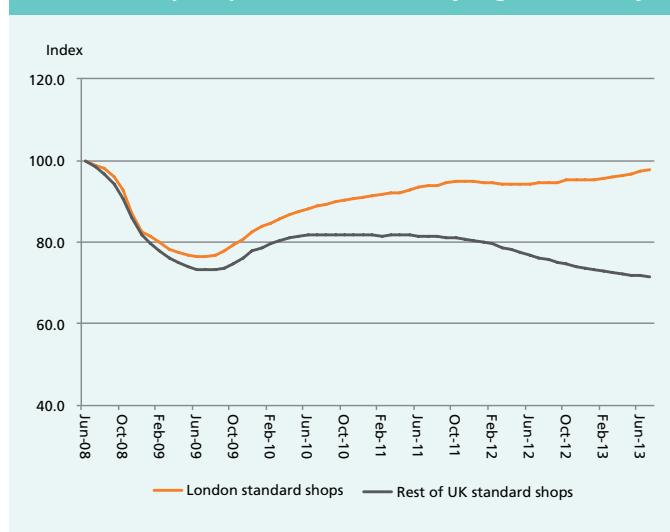
On a 12-month basis, however, a price differential between the two regions continues to exist. Since July 2012, London saw capital values in the standard retail unit's segment increase by 3.3% whilst prices in the rest of the UK continued to decline and stood 6.3% lower in July compared to 12 months prior – however this fall in value has decelerated in recent months.

On a rolling 3-month basis, standard retail in London saw capital values rise by 1.4% and saw those outside the city decline by 1.0%.

With the continued erosion of the traditional retail outlet trading where internet sales have continued to take an increasing market share, the divide between capital value changes across the UK remains in place.

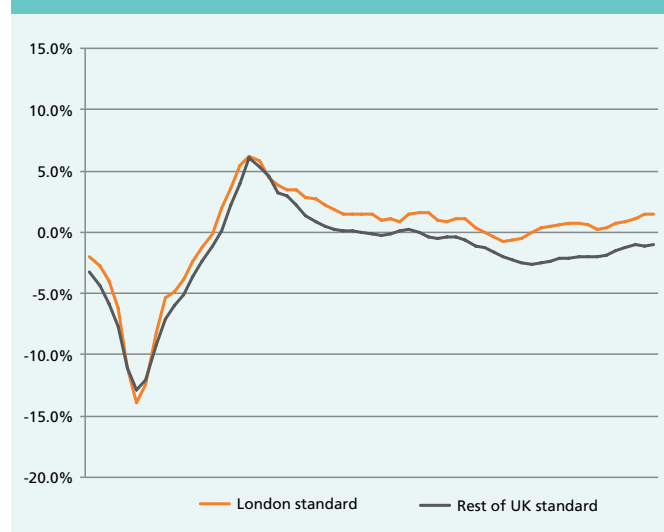
IPD's standard retail unit sample can be split by yield performance in order to determine trends for prime (low yield) and secondary (high yield) assets. The trend observed, by asset quality mimicked that of location quality. In the second quarter of 2013, prime retail assets saw capital values rise by 1.4%. However, secondary asset values fell by 1.6%. Much of this decline could be attributed to yield expansion. A weakening investor sentiment and re-pricing, to account for slightly weaker rental growth, has meant that investors are continuing to re-examine potential cash flows and default risks.

Standard shops capital value indices by region, monthly



Source: IPD UK Monthly Property Index

Standard shops three-month rolling capital value change, %

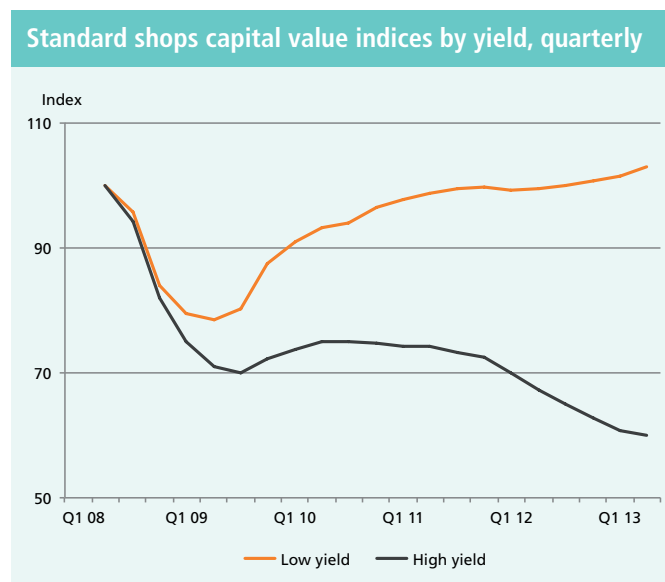


Source: IPD UK Monthly Property Index



A compelling case could still be made for investing in the market; high yields continue to drag on secondary asset's capital values, however, this decline is occurring at a slower rate, which, combined with improvements in consumer, and retailer confidence provides investors with more encouraging signs.

Lease event risk has increasingly become a large focus for investors, in terms of managing income as well as in terms of valuations. Based on the activity in the auction rooms, any asset with a short lease term has been valued with a high yield against the rest. The spread between short- and long-let property yields is larger, however on a positive note, lease event risks are now being correctly priced into valuations.



Source: IPD UK Quarterly Property Index

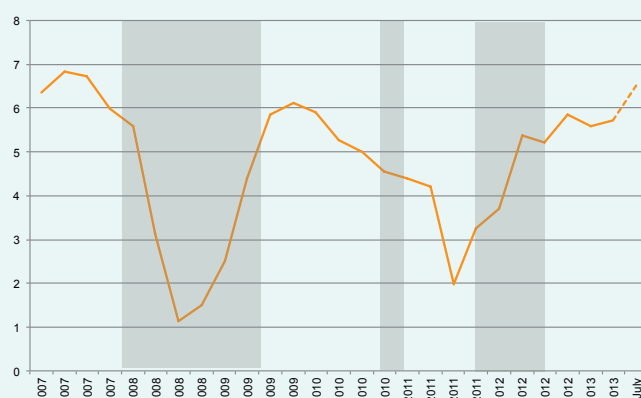


Economic Score Card

Economic Score Card Average

The Economic Score Card average remained steady at Q2 2013, at 5.7, but then rose to 6.5 in July 2013. This represents the largest average score recorded since Q3 2007. Retailer confidence surrounding current and future trading conditions coupled with consumer confidence were the main reasons behind the recent rise. Although the retail sector continues to remain one of the UK's weakest markets, optimism can be found from recent GDP figures where, although output remains 3.0% below the peak of activity in early 2008 before the recession, the balanced growth across all regions means that the UK is showing resilience in the face of slowing global trade.

Economic Score Card average



Source: IPD, ONS, EcoWin, Nationwide

	2008				2009				2010				2011				2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	July	
Economic Score Card Average	5.6	3.1	1.1	1.5	2.5	4.4	5.9	6.1	5.9	5.3	5.0	4.5	4.4	4.2	2.0	3.2	3.7	5.4	5.2	5.9	5.6	5.7	6.5	
Inflation (CPI y/y)	6	2	1	4	5	7	5	5	3	4	4	2	1	1	1	1	3	6	7	5	5	5	5	
FTSE All-Share (q/q)	4	5	1	1	5	7	7	7	7	5	7	7	7	7	2	7	7	7	7	7	7	7	7	
Nationwide House Price Index (q/q)	2	1	1	1	3	7	7	7	6	6	4	4	6	5	4	5	4	4	5	5	5	5	6	
Consumer confidence	6	1	1	1	1	2	6	6	7	5	3	2	1	3	1	1	1	1	2	3	2	3	7	
Unemployment expectations	7	5	2	1	1	1	3	4	5	4	3	3	2	4	4	2	4	5	6	7	7	7	7	
Retail trade confidence	7	4	1	1	1	4	7	7	7	6	7	7	7	5	1	4	3	7	4	7	6	6	7	
Expected retail trade	7	4	1	1	1	2	6	7	7	7	7	7	7	5	1	3	4	7	5	7	7	7	7	

Source: IPD, ONS, EcoWin, Nationwide

Score card key

7	6	5	4	3	2	1
Fully functioning market		Partially functioning market		Impaired market function		Severely impaired function



Economic Score Card Variables	Score	July 2013	10-yr average	Analysis
Economic Score Card Average	6.5	6.5	5.7	The Economic Score Card Average rose to 6.5 in July 2013, a figure well above the 10-year average. This has been largely due to positive scores across the entire score board where an optimistic outlook now seems to be seeping back into the economy, most notably with consumer and retail trade confidence.
Inflation (CPI y/y)*	5	2.8%	2.2%	Inflation fell by 10 bps from June 2013 to 2.8% in July. Although the inflation rate remains above the Bank of England's target of 2%, recent figures suggest a downward trend in inflation and may see it fall back to the 2% target at some point next year. The fall came after the cost of clothing and leisure and cultural activities decreased. This decrease was partially offset by rising petrol diesel prices. However, CPI still remains close to market expectations and will continue to do so, dependant on oil price developments.
FTSE All Share (q/q)	7	4.2%	0.0%	Diversified growth across the UK is beginning a more broad-based recovery. The equity market continues to gather momentum fuelling optimism that the FTSE All-Share is beginning to recover.
Nationwide House Price Index (q/q)	6	1.6%	1.8%	Although the latest figures do not suggest a return to a housing boom, with prices still 10% lower than the record highs of 2007. The pick-up in the economy, as well modest rises in employment has led to a more confident outlook amongst buyers which is slowly now being reflected in the housing Index. The access to debt for investors is no longer as restricted, allowing for potential investors to secure assets easier, albeit, still remaining risk aware.
Consumer confidence	7	-7	-8	Although consumer confidence remains in the negative, confidence is now at -7 in July 2013 compared to -14 in April 2013. Consumers are continuing to see a squeeze on their spending power, however confidence reached its highest level in almost four years in July. The steady flow of economic good news over the past few months may see this optimistic trend continue.
Unemployment expectations**	7	19	30	During the second quarter of the year, UK unemployment fell by 4000 to 2.51 million in the three months to June. However, worrying signs about the underlying job market still remain, although the economy is creating jobs, the workforce is growing, which means that the rise in unemployment is almost matched by the increase of the workforce and those that are employed are seeing falls in the real value of their pay.
Retail trade confidence	7	13	1	Retail trade confidence rose to 13 in July 2013, from -2 in March 2013. Confidence within the retail sector has begun to pick up as the economy begins to gain momentum. However, the retail industry still continues to be stretched. Poor income growth is limiting consumers ability to spend making retail trade confidence limited until recovery gains pace.
Expected retail trade	7	33	11	Expected retail trade jumped to 33 in July 2013 the highest figure recorded since the recession. With recent macroeconomic data better than predicted, expected trade could see momentum gather.

* Scoring is based upon deviation (either above or below) from the Bank of England's target CPI rate of 2%

** Scoring is inverted. e.g. high value equals low score.

Sources: IPD, ONS, EcoWin, Nationwide

Economic Score Card Variables

The Economic Score Card is an economic indicator tailored to monitor the health of consumers and retailers. For each component, a score of seven is awarded if the data point is greater than its 10-year average. For every third of a standard deviation the data point is below the average, the score is reduced by one. Each score contributes to the overall average, which is weighted using the same methodology as the European Commission's Economic Sentiment Indicator (ESI) methodology. For further details, email IPD using the contact details on the back page.



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