COMMERCIAL PROPERTY AUCTION DATA (CPAD) REPORT SUMMER 2018

Prepared by MSCI in association with Acuitus

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INTRODUCTION

Welcome to the MSCI /Acuitus cPad report reviewing activity in the commercial real estate auction market. The report is underpinned by analysis of the long running Commercial Property Auction Data (cPad) series, which provides transaction-based market prices. In combination with an analysis of performance trends in the wider IPD/MSCI UK investment universe, the report provides a review of activity in the first quarter of 2018 and indications for activity for the remainder of the year.

The uncertain economic and political environment associated with the ongoing Brexit negotiations was inevitably going to impact on private investor activity; over £175m of assets were sold, 10% down on the same period last year. Nonetheless, over the 12 months to the end of March the value of sales stood 4% ahead of the previous 12 months. At 77% the sale rate was marginally down on the long run average.

Restructuring of institutional and property company portfolios delivered a number of London investment opportunities for private investors. As a result, 19% of assets sold were London based, double the proportion seen at the latter end of 2017 and ahead of the long run average. As predicted in the Winter report, pricing has stabilised, with the cPad All Property Rolling Average Yield (RAY) moving out marginally to 8.15%. The gap between prime and secondary yields has also remained stable, aided in part by strong demand for short lease length assets but only when they have demonstrable re-positioning value on the one hand, and long income assets on the other. Private investor demand will remain sensitive to political disruption, but the latest auction results underline strong private investor demand for selective assets which offer a strong investment case.

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

KEY STATS

▲ **6%**

Increase in the value of assets sold in the 12 months to May 2018 compared with the previous 12 months

▲ **9%**

Increase in the average lot size compared with the February / March auction round

▲ **30%**

London assets sold during the May auction period

▼ **8.10%**

Rolling Average Yield down 10bp on same period in 2017

cPad is a joint initiative between Acuitus and MSCI 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 MARKET*

Over £857m of institutional grade commercial real estate assets were sold in the auction room in the 12 months to the end of May 2018, 6% ahead of the previous 12 months. Sales during May itself were in line with the same period in 2017, both by value and number. Reflecting the upturn in activity, the sale rate rose to 78.2%, improving on a sub 77% rate in February / March, but still marginally below the long run average.

INCREASE IN LARGER LOT SIZES SOLD IN ROOM

The average lot size sold rose by 9% on the February/March auction round, this driven in particular by higher value office properties coming forward for sale. These assets found strong demand with a close to 94% sale rate for the sector overall.

INCREASE IN LONDON ASSET SALES

The upturn in the lot size was also a reflection of an increase in the proportion of London assets sold during the May auction round, representing over 30% of all sales on a value basis. At almost twice the long run average this upturn is notable, following on from the uptick seen at the start of 2018. Institutional investors pursuing the ongoing restructuring of portfolios has driven the growth in sales of London assets as well as a focus by investors on safer markets.

While a degree of uncertainty hangs over the capital in the coming Brexit crunch period, it is likely this activity will continue. The sale rate of 89.3% for London assets in the May auctions underlines the demand from private investors keen to secure assets in the capital.

COMMERCIAL PROPERTY AUCTION SALES SUMMARY

SECTOR		MAY 2018	MAR 2018
VOLUME (£ MILLION)	▼	144.2	175.1
PROPERTIES SOLD	▼	255	337
AVERAGE LOT SIZE (£)	▲	565,312	519,443
SALES RATE	▲	78.2%	76.9%

* The "In the market" section of the report has been prepared by Acuitus.

PRIVATE INVESTORS SELECTIVE IN RETAIL INVESTMENT

Despite a steady train of bleak corporate retailer news during the spring, the sector still represented 63.2% of sales by value in May, achieving a sale rate of 76.9%. While the sale rate is below the long run average, the depth of private investor demand for high street assets is notable given the backdrop. With the benefit of re-based rents and an understanding of local markets, investors are seeking long term incomes from such assets, albeit with greater scrutiny of purchases.

We expect this to continue. The rising prominence and track record of independent retailers, combined with new occupiers in the entertainment and leisure sectors such as gyms, will over time present new high street opportunities, providing pricing is assessed with care.

STOCK SHORTAGES UNDERPIN PRICING

Since the nature of the stock moving through the auction room varies between auction rounds, the cPad series provides a Rolling Average Yield (RAY) rather than a spot yield. This smooths variation caused by the sample size and the differences in the basket of properties sold between auctions. The RAY is a moving average of the current and four preceding auction rounds in a 12-month period.

The average all-property RAY stood at 8.10% at the end of the current auction round, 10 bp down on the same point last year. Perhaps to be expected, it was only the retail sector that saw a yield upturn in May, although only by 3 bp to 8.19%.

COMMERCIAL PROPERTY AUCTION SALES (£ MILLION)

SECTOR		MAY 2018	MAR 2018
RETAIL	▼	91.1	129.9
OFFICE	▼	11.0	17.4
INDUSTRIAL	▼	1.7	7.1
LEISURE	▲	15.0	12.2
OTHER	▲	25.3	8.4

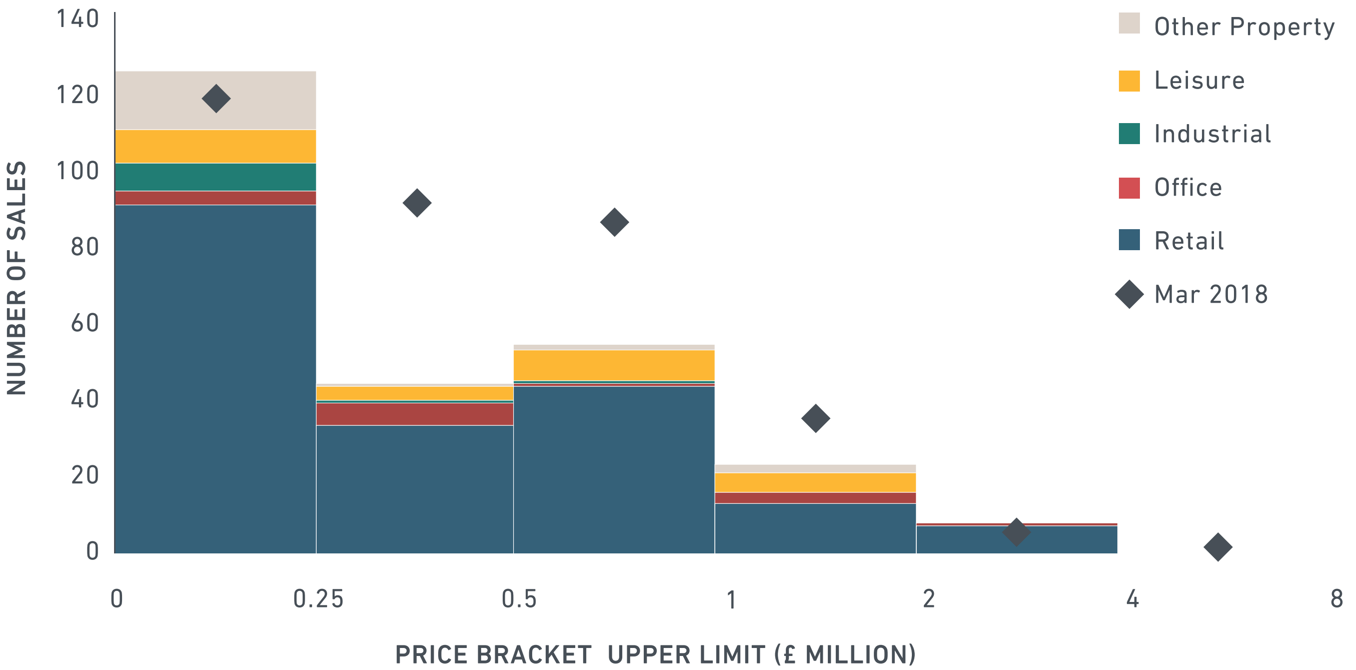
REGION		MAY 2018	MAR 2018
LONDON	▲	43.5	32.6
REST OF UK	▼	100.7	142.4

COMMERCIAL PROPERTY AUCTION SALE RATE (%)

SECTOR		MAY 2018	MAR 2018
RETAIL	▼	77%	79%
OFFICE	▲	94%	78%
INDUSTRIAL	▲	82%	69%
LEISURE	▲	74%	67%
OTHER	▲	79%	68%

REGION		MAY 2018	MAR 2018
LONDON	▲	89%	69%
REST OF UK	▼	77%	78%

COMMERCIAL PROPERTY AUCTION SALES BY PRICE BAND



Source: cPad

All other sectors saw yields move inwards, with a particular shift for the office sector RAY which has dropped 208 bp over the last 12 months. This is driven in part by the increase in London sales during this period. However, the yield profile of assets in the capital sold in May suggests that there is continuing strong interest in residential redevelopment.

DIVERGENCE BETWEEN PRIME AND SECONDARY YIELDS REMAINS

The difference between prime and secondary commercial property values has changed little over the last 12 months. The Lower Quartile RAY, which reflects the higher quality segment of the market, moved out by just 3 bp to 6.07%. The Upper Quartile segment of the market, saw a rise of 6 bp to 9.59% over the same period. Overall, the difference between the prime and secondary RAY increased by just 10 bp, despite the headwinds of market uncertainty.

Differing private investor buying strategies is evident in the pricing of both long (11-15 years) and short (0-5 years) lease length income. Over the last 12 months the demand for long term income has been evident on a 120 bp inward yield movement for assets with 11+ years income. Meanwhile there remains strong demand for properties on short leases that have a “good story”, with a 15 bp inward movement for those with less than 5 years of income remaining. Higher value assets (£1m+) have seen a greater price strengthening than those of lower value.

STOCK SHORTAGES DURING UNCERTAIN PERIOD

Private investors continue to focus on quality income producing assets and those with proven opportunity value. This has been met by institutional disposals and private investors seeking to restructure portfolios. The strong take-up of London assets underlines the latent demand for exposure to the capital which has traditionally been difficult for private investors to source. We expect more institutional investors to take advantage of this demand potential over the coming auction periods to divest.

Structural change in the retail sector will persist for some time. Given growing Brexit uncertainty, this structural impact is likely to be compounded by wider economic challenges over the coming months. However, realistically priced retail assets in locations with a story continue to attract buyers. As local authorities and larger investors seek to tackle the consequences of retail disruption, town centre improvement schemes and investment will present opportunities despite the backdrop.

The current environment presents challenges for all asset classes, illustrated by recent volatility on the currency and financial markets. Historically, such periods have attracted increased real estate demand, in particular for long income investments. The latest cPad results underline both the robust appetite for the right assets and the opportunity for sellers into the latter half of 2018.

At the Acuitus May auction, a 15,220 sq ft Aldi store near Sheffield sold for £3.275m at a yield of 5.21%

SPOT YIELD SUMMARY

ALL PROPERTY		MAY 2018	MAR 2018
AVERAGE INITIAL YIELD	–	8.0%	8.0%
LOWER YIELD QUARTILE	▼	6.0%	6.1%
UPPER YIELD QUARTILE	▲	9.5%	9.3%

YIELD BY UNEXPIRED LEASE TERM		MAY 2018	MAR 2018
0-5 YEARS	▲	8.9%	8.8%
6-15 YEARS	▼	7.9%	8.0%
16+ YEARS	▲	6.6%	6.1%

YIELD BY VALUE BAND		MAY 2018	MAR 2018
£0 - £250,000	▼	8.7%	9.1%
£250,000 - £500,000	▲	8.5%	8.4%
£500,000 - £1 MILLION	▲	7.4%	7.2%
£1 MILLION+	▼	6.6%	7.0%

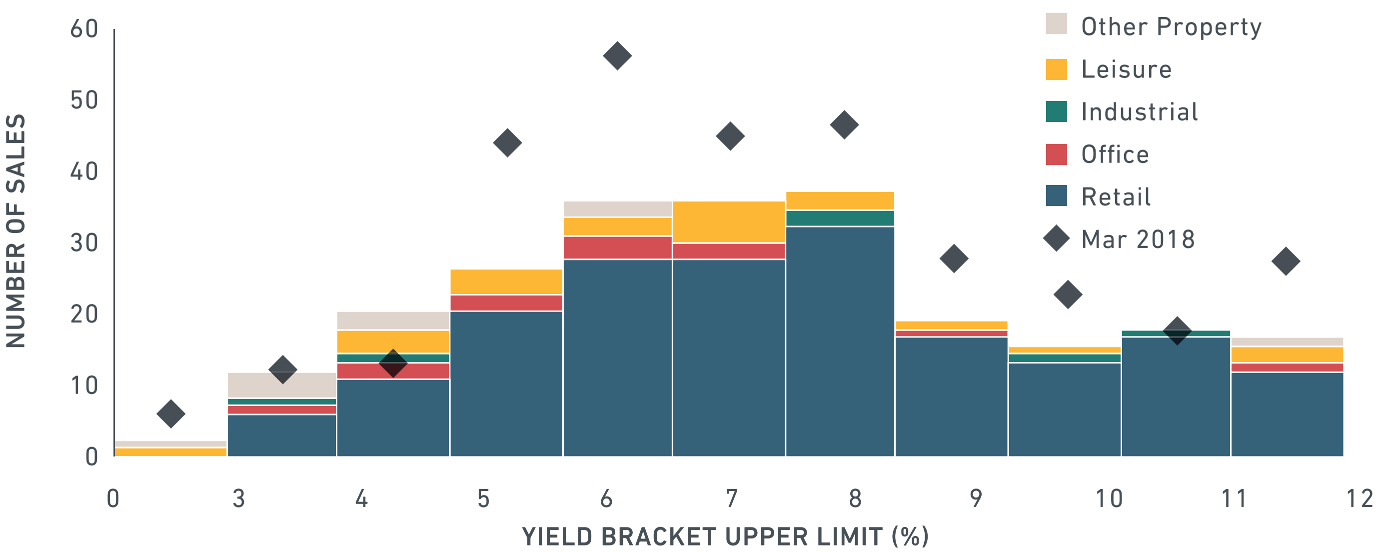
SPOT YIELD SUMMARY BY SECTOR

SECTOR		MAY 2018	MAR 2018
RETAIL	▲	8.3%	8.1%
OFFICE	▼	7.0%	8.7%
INDUSTRIAL	▼	7.7%	8.8%
LEISURE	▲	7.5%	7.4%
OTHER	▲	6.1%	4.8%

SPOT YIELD SUMMARY BY REGION

REGION		MAY 2018	MAR 2018
LONDON	▲	6.4%	6.0%
REST OF UK	▼	8.2%	8.3%

SPOT YIELD SUMMARY BY YIELD BAND



Source: cPad

UK RETAIL MARKET ANALYSIS*

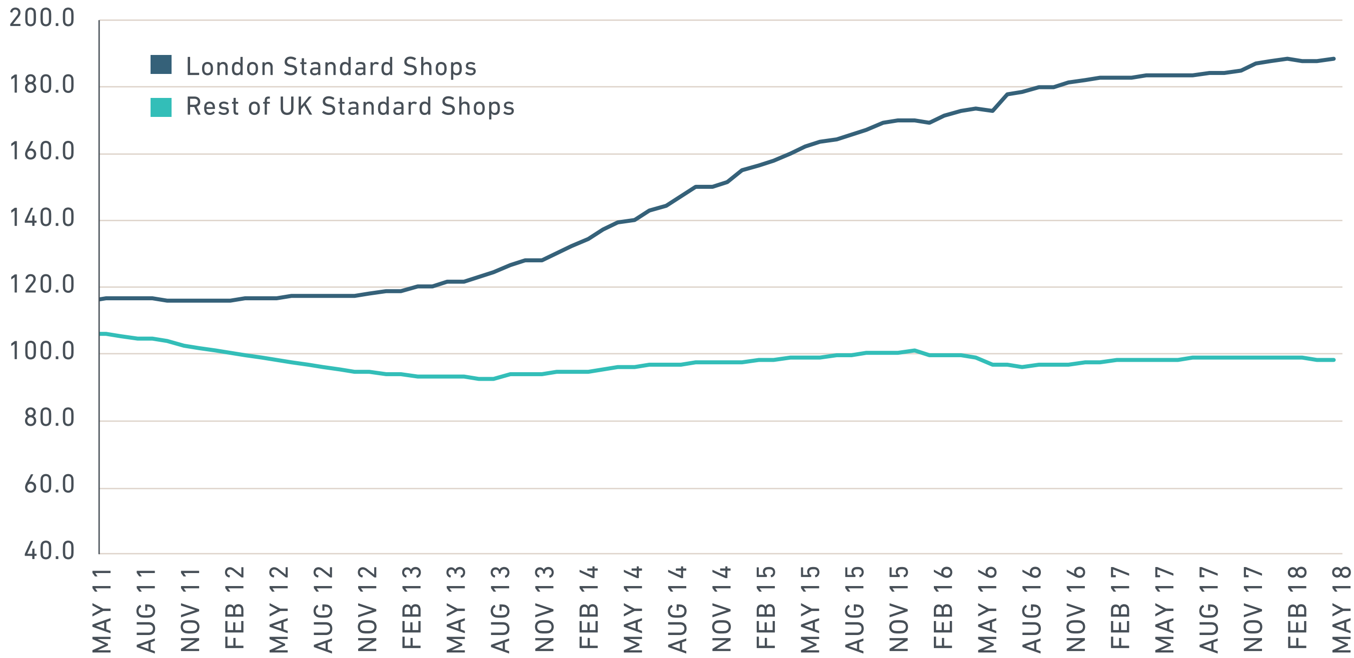
The U.K. commercial property market saw values grow on average by 5.3% in the year to June 2018, according to the IPD UK Monthly Property Index. Capital values have risen in each of the past 21 months, as confidence has returned to the market. Of the major sectors (retail, office and industrials) all bar retail recorded increases, but industrial sheds and distribution warehouses saw the majority of the price rises, as investors chased yield as well as rental value growth opportunities.

The annual income return to U.K. commercial property closed the year at 5.4%, almost in line with 2017 (5.5%), near record lows. This was the lowest income return seen since 2007, maintaining the trend that started in December 2009, when income return peaked at 7.3%.

The average net initial yield across the U.K. commercial property market stood at 5.0% in June 2018, marginally down from 5.3% in June 2017, with the initial yield for standard shops – the focus of the CPAD report – closing at 5.2%. Yields in this market have compressed from highs of 7.1% (initial yield) and 8.4% (equivalent yield) at the bottom of the market in 2009, highlighting the recovery in values for this type of property, albeit mostly driven by strong Central London performance.

Standard shops in the Rest of the UK, excluding the South East and London, recorded a total return of 4.1% in the year to June 2018, driven by a sector-leading income return of 6.0%. However, capital values here fell by an average of -1.9%, whiles investor sentiment toward the sector remained positive, reflected in a yield impact of 0.7%. The rental market was however slightly more challenged, with average asset rental values decreasing by -1.9% over the year. Driven by a challenging environment and a reduction of confidence among occupiers in this part of the market.

STANDARD SHOPS CAPITAL VALUE INDICES BY REGION (MONTHLY)



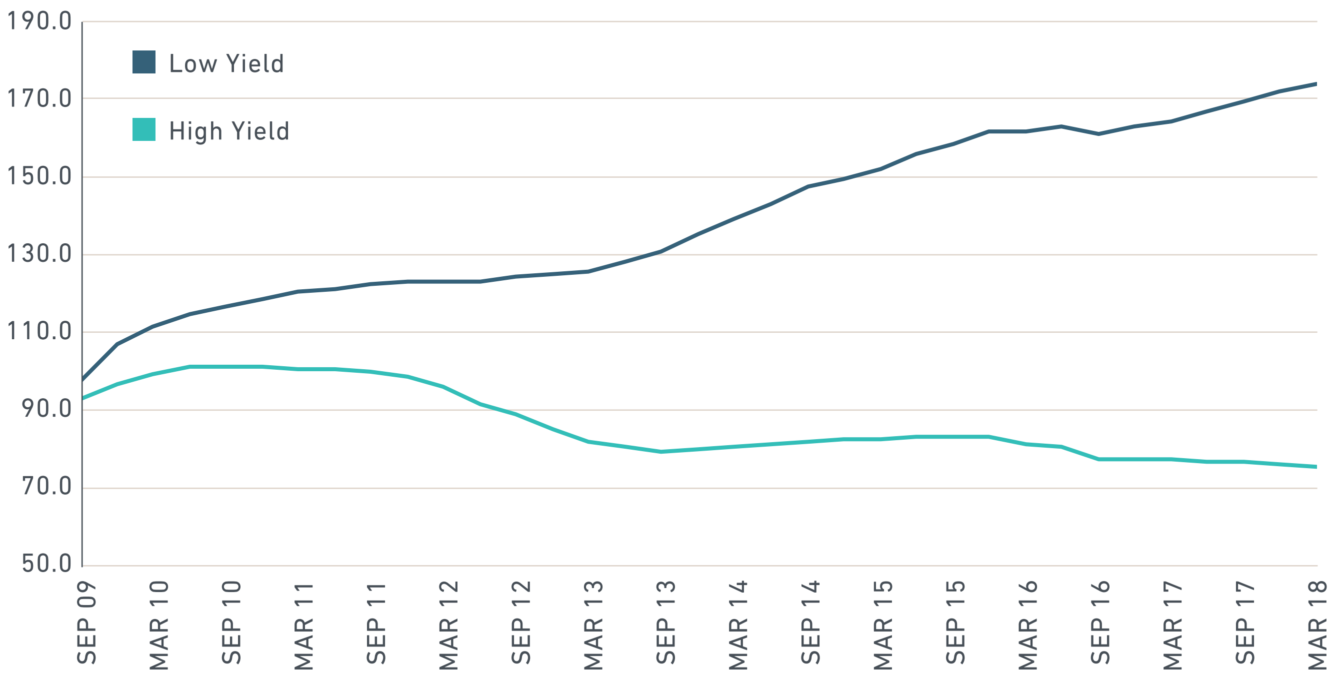
Source: ***IPD*** **UK Monthly Property Index**

* The "UK Retail Market Analysis" section of the report has been prepared by MSCI.

STANDARD SHOPS THREE-MONTH ROLLING CAPITAL VALUE CHANGE (%)

Source: *IPD* UK Monthly Property Index

STANDARD SHOPS CAPITAL VALUE INDICES BY YIELD (QUARTERLY)



Source: *IPD* UK Quarterly Property Index

ECONOMIC SCORE CARD*

ECONOMIC SCORE CARD AVERAGE

All leading economic indicators continued to prove resilient in the second quarter of the year, with economic growth remaining positive, although slowing, and unemployment levels continuing to fall. However, risks remain for the U.K. economy, with the growing threat of a global trade war, and no further clarity of its future relationship with the EU, which it is due to leave in the less than 9 months' time.

Consumer confidence is decreasing as households begin to hold onto their cash – given the macro-economic headwinds. While food stores benefited heavily from the good weather and World Cup in June, internet sales held up and continued to grow in other sectors, clothing and footwear in particular. High Street retailers continue to be challenged with an increasing number having to restructure their businesses.

As of June 2018, annual inflation stood at 2.3%, above its 10-year average and the Bank of England target rate of 2.0%.

The Economic Score Card fell to 6.6 in June 2018, down from 6.7 in March 2018. Still over 100 basis points above the 10-year average of 5.6%, underlining a general confidence in the wider U.K. economy.

	2007		2008				2009				2010				2011				2012				2013				2014				2015				2016				2017				2018	
ECONOMIC SCORE CARD AVERAGE	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	6.5	6.2	5.7	4.0	1.6	1.7	2.4	4.4	5.9	6.5	6.6	5.5	5.7	5.3	5.1	5.3	2.3	4.3	4.7	5.4	5.6	6.6	6.4	6.4	7.0	6.9	6.3	6.6	6.2	6.1	6.2	5.9	6.2	6.5	5.2	5.9	6.6	6.8	7	6.5	6.4	6.7	6.7	6.6
Inflation (CPI y/y)	5	6	7	4	1	6	7	5	3	7	5	6	6	4	3	3	1	3	5	7	6	7	7	7	7	6	4	5	3	1	1	1	1	3	1	1	4	5	7	7	6	6	7	7
FTSE All-Share (q/q)	5	6	2	5	1	1	2	7	7	7	7	1	7	7	6	6	1	7	7	4	7	7	7	5	7	7	5	6	5	6	7	5	7	7	1	7	7	7	7	6	6	6	5	7
Nationwide House Price Index (q/q)	7	6	3	1	1	1	3	7	7	7	7	7	4	4	7	6	5	6	5	5	6	6	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	6	7	7	7	6
Consumer confidence	7	7	7	4	3	1	2	4	7	7	7	6	5	4	3	5	3	2	3	3	4	5	4	5	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7
Unemployment expectations	7	7	7	6	3	1	1	2	4	4	6	5	4	4	3	5	4	4	4	5	6	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7
Retail trade confidence	7	6	7	4	1	1	1	4	7	7	7	6	7	7	7	6	1	4	4	7	5	7	6	7	7	7	7	7	7	7	7	7	7	7	6	6	7	7	7	7	5	7	7	7
Expected retail trade	7	5	7	4	1	1	1	2	6	7	7	7	7	7	7	6	1	4	5	7	5	7	7	7	7	7	7	7	7	7	7	7	7	7	7	6	7	7	7	7	5	6	7	7

Source: *IPD*, ONS, EcoWin, Nationwide

SCORE CARD KEY

7	6	5	4	3	2	1

Fully functioning market

Partially functioning market

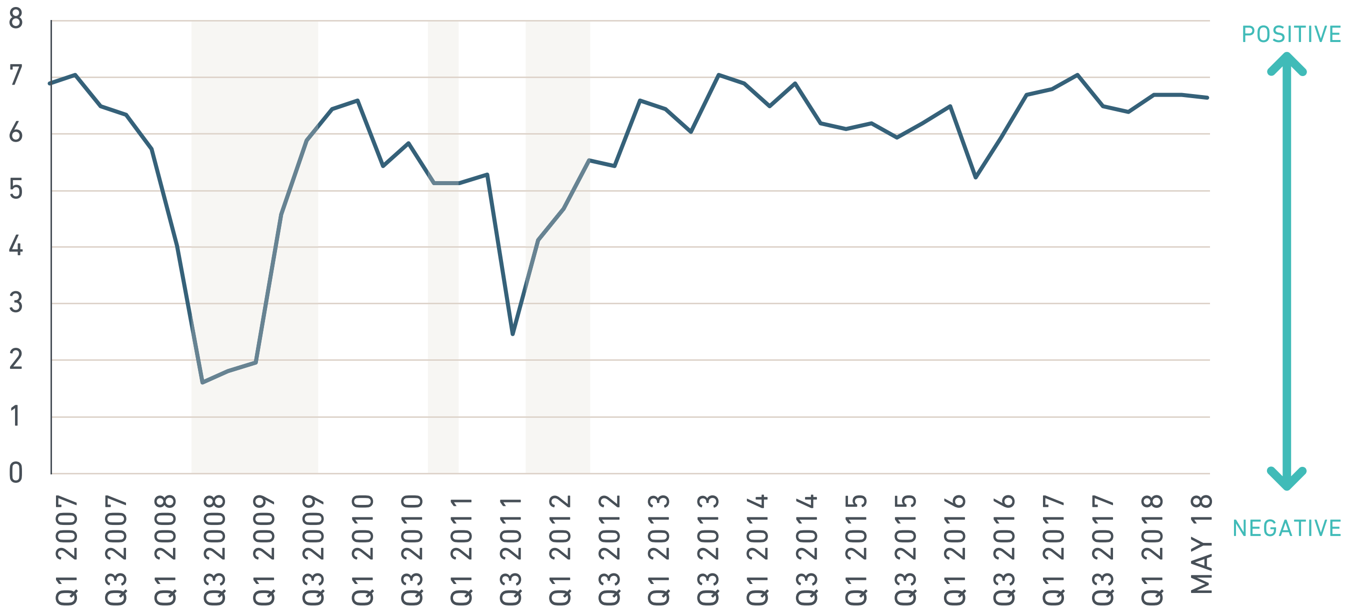
Impaired market function

Severely impaired function

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 ESI methodology.

* The "Economic Score Card" section of the report has been prepared by MSCI.

ECONOMIC SCORE CARD AVERAGE



Source: *IPD*, ONS, EcoWin, Nationwide

In May at the Acuitus auction, the Willow Tree public house in Torquay sold for £1.54m at a yield of 5.09%. It is let on a lease expiring in 2036 and produces current income of £83,250pax

ECONOMIC SCORE CARD VARIABLES	SCORE	MAY 2018	10-YR AVG.	ANALYSIS
ECONOMIC SCORE CARD AVERAGE	6.6	6.6	6.0	The Economic Score Card Average fell slightly in the second quarter of 2018, to stand at 6.6 at the end of June. While equity performance was improved, the Brexit negotiations continued to falter, there was growing threat of a global trade war and a number of high street retailers showed signs of balance sheet weakness. Unemployment continued to fall, wages started to grow beyond inflation and the economy grew steadily, if at a slightly slower rate than previously. The Score Card is still 100 basis points above its long-term average of 5.6, suggesting that the U.K. economy remains close to full capacity.
INFLATION (CPI Y/Y)*	7	2.40%	2.37	According to the Office for National Statistics (ONS), the rate of inflation rose to 2.3% in the year to June 2018, but although it has been increasing since the end of 2015, the rate of growth has now levelled off. Downward pressure on inflation was driven by clothing and games, toys and hobbies. In 2018, the majority of categories have seen fallen back. The recent increase in interest rates seems to have had the desired effect, stemming the rise in inflation. That said, the annual rate of inflation remains above the Bank of England's target rate of 2.0%.
FTSE ALL SHARE (Q/Q)	7	6.0%	3.02%	U.K. and global equity values grew in the second quarter of 2018. The FTSE 100 was one of the best performing major stocks market – gaining around 9.2%. Investors had concerns over rising interest rates, which never materialized, a potential trade war has been tempered and global geo-political tensions have reduced. The wider UK economic picture has been mixed, GDP has continued growing, albeit at a slowing rate, wages have started to increase, while more high street retailers are struggling. International investors however remain generally negative towards the UK.

ECONOMIC SCORE CARD VARIABLES	SCORE	MAY 2018	10-YR AVG.	ANALYSIS
NATIONWIDE HOUSE PRICE INDEX (Q/Q)	6	0.00%	0.55%	U.K. house price growth steadied in June 2018, with the annual growth rate of 2.0% significantly down on the previous 12 months (3.1%). The East Midlands proved to be the strongest performing region, with house prices increasing on average by 4.4%, London was the only region to record a decline. However, conditions for growth still persist: a shortage of supply combined with low long-term interest rates, increasing employment levels and wage growth. Still, rising household costs and affordability concerns have created headwinds in some markets.
CONSUMER CONFIDENCE	7	-3.0	-9.52	U.K. consumer confidence decreased in June 2018, moving downwards from -7 recorded in March to -9, with the number of pessimists continuing to outweigh the number of optimists. A number of headwinds persist with concerns over domestic political uncertainty, global geo-political issues and our future relationship with the EU – consumers are imposing a general household austerity due to overall negative outlooks for the wider economy.
UNEMPLOYMENT EXPECTATIONS**	7	17.4	27.84	U.K. employment levels have continued to improve through mid-2018, with the June month-end unemployment rate of 4.2% at its lowest level since 1975, and down from 4.6% a year previous – with an estimated 32.39 million people in employment. This was however still above the lowest rate ever recorded, 3.4% at the end of 1973. Both men and women aged from 16-64 have recorded their highest levels of employment since records began. The increase in women in employment has also coincided with changes to the State Pension age.

ECONOMIC SCORE CARD VARIABLES	SCORE	MAY 2018	10-YR AVG.	ANALYSIS
RETAIL TRADE CONFIDENCE	7	0.2	0.07	U.K. retail sales grew in the 3 months to June 2018, with official volumes increasing by 2.1%, however month-on-month figures to June fell by -0.7%. The good weather and World Cup can be seen as some of the contributing positive factors, food stores benefiting from this in particular, recording their strongest three-month on three-month growth since May 2001. Overall internet sales held stable at 18% of total, however the percentage of clothing and footwear sold through internet vendors was at its highest ever level 17.5%.
EXPECTED RETAIL TRADE	7	23.6	10.15	Many analysts forecast a decrease in consumer confidence in the second quarter of 2018, given the wider macro-economic hurdles with the challenges associated with BREXIT and global trade. While there has been a return of wage growth and inflation steadying off – even if it remains above the Bank of England target rate of 2% - continuing employment growth and a low interest rate environment. This contrasts sharply with the challenge facing a number of high street retailers - changing retail habits through growth of the internet, increasing commercial rents and rates and a globally competitive market place has led to more having to restructure their businesses.

* Scoring is based upon deviation (either above or below) from the Bank of England's target CPI rate of 2%
** Scoring is inverted. (High value equals low score)

Sources: IPD, ONS, EcoWin, Nationwide

MSCI

ABOUT MSCI

For more than 40 years, MSCI´s research-based indexes and analytics have helped the world´s leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

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Since it was founded in 2010, Acuitus has sold more than £1bn of commercial property assets at auction and delivered a new, innovative and hugely successful approach to the auction process.

The firm has transformed auctioneering from a simple means of buying and selling property into a sophisticated platform for enabling investment strategies.

It collaborates with MSCI to produce the commercial property auction sector's leading research studies.

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ABOUT EIG

EIG is recognised as the Industry Standard for auction information and currently includes details on over 800,000 lots. With 35,000 lots coming to auction each year, it is used by investors and developers to identify buying opportunities

In addition the fully searchable historic database spanning 26 years is a valuable resource for valuation comparables.

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