cPad

MARKET FLASH

Commercial Property Auction Data

JAN 2012

"UNSETTLED" 2011 COMES TO A CLOSE

An unsettled market was how one investor described 2011 as sentiment and market activity fluctuated constantly. October had been a positive month in the commercial property auction room but December saw the amount invested down by 45%.

This reduction was not due to a fall in overall sale rates but in most part from the increase in the number of smaller lots and by sellers putting off decisions until the New Year with hopes for a clearer financial and economic situation.

Prices for secondary investments will remain well below boom levels, and a new pricing benchmark will become evident to reflect today's economic and financial conditions.

However, as we move into 2012, potential market mispricing now may hold opportunities for investors who have equity and asset management skills.

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

cPad

cPad is a joint initiative between Acuitus and IPD utilising selected 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.

KEY STATS

Change since October 2011

▼ **45%** Sales Volume

▼ **52%** of sales were retail properties

▲ **67%** Sales Rate

▲ **9.1%** average initial yield

AUCTION COMMENTARY

In the room: unsettled market characterises 2011

Private investor activity in the final weeks of 2011 was muted from both a buying and selling perspective. This was a consequence largely of the bad economic news from the US, Eurozone and UK. By the time the "festive season" arrived investors were ready to take a break and wait to see what 2012 would bring.

In the final round of 2011 auctions, retail investments represented a smaller than normal proportion (just over 50%) of the total properties sold with an increasing percentage of office and leisure investments.

At 27%, there was a large percentage of properties located in the London region which also showed a significantly higher sale rate.

Some investors asked "why sell now when prices are so low?" but this ignores several factors such as the opportunity cost of equity locked away in the investment and the management time and skill that will have to be applied over a long period of time until the property markets normalise.

In many cases it is the lenders who want their money back and the decision to sell is not solely the owner's. The lenders recognise that in most cases it will require some exceedingly good fortune and/or asset management skill for matters to improve in the medium-term and the property markets may take a lot longer to normalise before loans can be repaid fully.

Market mispricing – or an "unjustified depression" about the state of the market – may now be offering opportunities for the intelligent buyer. Investors generally may fall into a state of depression that extends the recession beyond its rational end. This gives those investors who have the requisite knowledge the greatest opportunity to invest in mispriced assets.

The next 2-3 years could be one of those rare opportunities to start again. To let properties at rents that make sense to the occupiers and yet allow the investor a decent return on their money without the pressure of having to push the rents ever higher to service the loan.

A new generation of investors may be rising slowly from the ashes of the last boom. This generation of new investors are so far proving to be more financially savvy, more plentiful, more international, and have a better grasp of what makes property tick.

Commentary: Acuitus

Data source: EIG

COMMERCIAL AUCTION SALES SUMMARY

		Dec 2011	Oct 2011
Volume (£ million)	▼	39.7	71.7
Properties Sold	▼	84	135
Average Lot Size (£)	▼	472,786	531,030
Sales Rate	▲	66.7%	66.1%

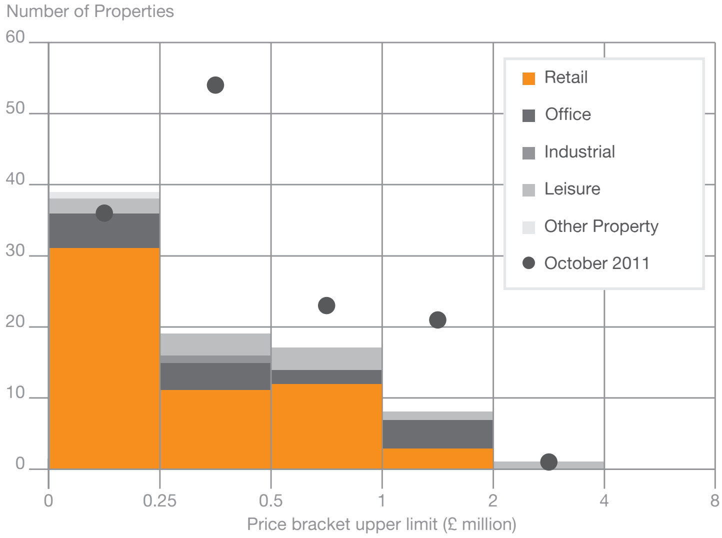
COMMERCIAL AUCTION SALES, £ MILLION

Sector		Dec 2011	Oct 2011
Retail	▼	21.0	55.5
Office	▲	9.8	7.5
Industrial	▼	0.4	1.6
Leisure and Other	▲	8.5	7.0
Region		**Dec 2011**	**Oct 2011**
London	▼	10.7	17.9
Rest of UK	▼	29.0	53.8

COMMERCIAL AUCTION SALES RATE, %

Sector		Dec 2011	Oct 2011
Retail	▲	67%	66%
Office	▲	74%	57%
Industrial	▼	33%	86%
Leisure and Other	▼	62%	75%
Region		**Dec 2011**	**Oct 2011**
London	▲	82%	59%
Rest of UK	▼	64%	68%

COMMERCIAL AUCTION SALES BY PRICE BAND



In the market: two tiers prevail

The current downturn in prices which started after the summer accelerated in the latter part of the year with the average cPad yield weakening by 70 basis points to stand at the end of the year at 9.1%; definite evidence of a double dip.

There is now arguably the most significant two-tier market in a generation with at one end private investors seeking the safe haven of real estate when it is available but at the other end shying away from the rest. Prices are as high as they have ever been for absolutely secure long-term income but even so, still offering attractive returns compared with gilts. For the rest, prices have had to fall to attract investor interest and that is only from investors who have demonstrable property asset management skill and a following from those with equity to make up for the paucity of available debt.

Yields for properties with less than five years to expiry have risen dramatically to 12.6% which is a reflection of the over-rentedness particularly in the retail sector where the rents will have to be lower to attract tenants when the leases expire. Indeed the average retail yield has weakened by 110 basis points since October and now stands at 9.3%.

Whilst there were proportionally a greater number of smaller lots sold there was no discernable pattern in yields between sub-£1m and £1m+ lots.

Investor demand is good for properties that are let to financially strong tenants on long leases (at least 10 years unexpired) and where, if there is an element of over-rentedness, it is not too severe. Some of the leisure investments have exhibited these characteristics and this property sector recorded some yield hardening.

Commentary: Acuitus

Data source: EIG

YIELD SUMMARY

All Commercial Property Totals		Dec 2011	Oct 2011
Average Initial Yield	▲	9.1%	8.4%
Lower Yield Quartile	▲	6.8%	6.7%
Upper Yield Quartile	–	9.6%	9.6%
Yield by Unexpired Lease Term			
0-5 years	▲	12.6%	8.7%
6-15 years	▲	8.9%	8.3%
16 years +	▲	8.8%	8.6%
Yield by Value Band			
£0 - £250,000	▼	9.0%	9.5%
£250,000 - £500,000	▲	9.3%	8.5%
£500,000 - £1 million	▲	8.7%	8.0%
£1 million +	▲	9.7%	7.1%

YIELD SUMMARY BY SECTOR

All Commercial Property Totals		Dec 2011	Oct 2011
Retail	▲	9.3%	8.2%
Office	▼	10.5%	10.6%
Industrial	▼	9.7%	10.6%
Leisure and Other	▼	6.7%	8.8%

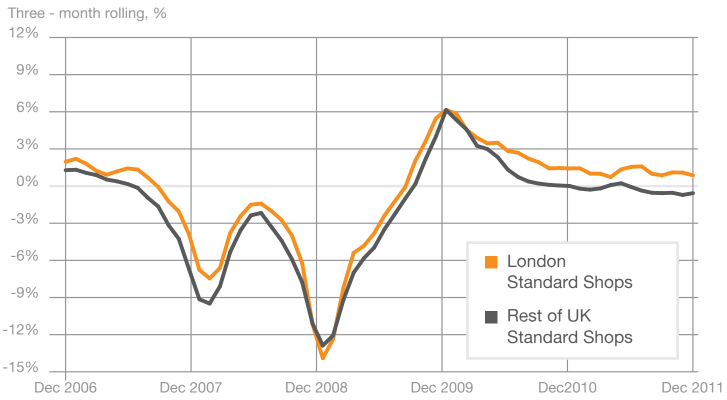
YIELD SUMMARY BY REGION

All Commercial Property Totals		Dec 2011	Oct 2011
London	▲	9.1%	6.9%
Rest of UK	▲	9.1%	8.7%

SUMMARY BY YIELD BAND

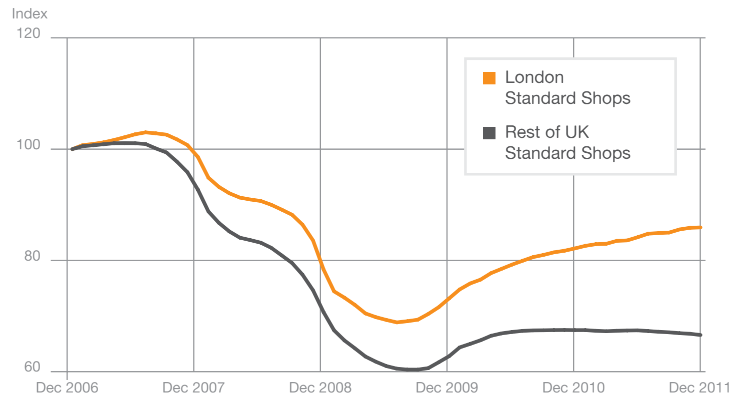
STANDARD SHOPS
THREE-MONTH ROLLING CAPITAL VALUE CHANGE, %

Source: IPD UK Monthly



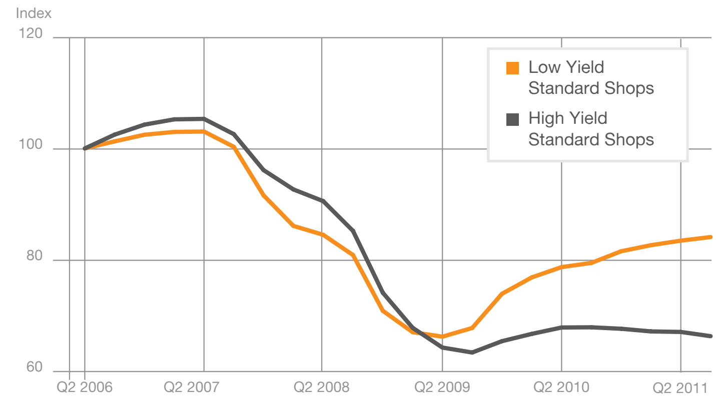
STANDARD SHOPS
CAPITAL VALUE INDICES BY REGION, MONTHLY

Source: IPD UK Monthly



STANDARD SHOPS
CAPITAL VALUE INDICES BY YIELD, QUARTERLY

Source: IPD UK Quarterly



IPD PROPERTY MARKET COMMENTARY

The IPD Monthly Index produced its first month of retail capital value falls in 27 months at 0.1% m/m in November 2011. The majority of those months only saw very minor gains but the end to those tiny uplifts has investors looking down rather than up, in terms of price expectations.

Looking specifically at standard shops, the divide in capital value change between London and the rest of the country remained in place in November. London saw prices rise by 1.1% over the previous three months, whereas prices fell by 0.7% outside London over the same period. The rate of growth in London has remained more or less constant in the second half of 2011.

However, the regions have seen the rate of decline creep up since May 2011, when prices last increased by 0.2% over the previous three months and hinted towards an extended recovery. Institutional investors subsequently backed away from regional retail properties in the light of disappointing economic data, particularly weak employment data and a lack of consumer confidence. London's resilience is due to a combination of location strength and tenant strength. Investors have been chasing assets that offer low risk rather than superior income return, despite the increasing attraction of the latter.

The differing fortunes of low and high-yielding assets in IPD's Quarterly Universe add weight to this observation. Low-yielding assets, generally of high quality and an adequate proxy for prime, continued to see further price rises in Q3 2011 at 0.8% q/q, or 5.8% y/y, whereas high-yielding assets saw prices fall by 1.1% q/q, or 2.8% y/y. High income returns may well be the key to outperformance in a market with little yield movement but it is the quality of the income and length of lease that has drawn the greatest interest from the large investors.

Over 2011, the auction market has proven itself adaptable to the changes in the economic climate and a good barometer for the wider commercial property market. The last cPad report mentioned that pressure will be on investors to assess if the defensive characteristics of prime property and property in London are enough to justify further price increases. EIG data has shown that yields have risen consistently since February 2011 and, although part of this is due the increased availability of poorer secondary property, has been a leading indicator to subsequent price falls in the secondary market.

The auction data has shown that prime yields are also moving out and with price falls now filtering into the institutional market, it seems commercial property is in dire need of some good economic news for the start of 2012.

KEY MARKET DATA

Economic Score Card Average

The economic score card average rose to 2.4 in November 2011, up from 2.0 in September. This score still represents an impaired market, particularly for retailers. The advancement in the overall score was thanks to improvements in equity prices and house prices. Equity prices have since seen further improvements up to mid-December but remain volatile whilst uncertainty surrounding the resolution of the European debt crisis, and in particular the UK's role in that process, persists. House prices are now largely flat over the last quarter, but the outlook is for continued soft pricing, according to Nationwide, due to subdued demand.

ECONOMIC SCORE CARD AVERAGE

	2007				2008				2009				2010				2011				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Oct	Nov
Economic Score Card Average	6.5	6.8	6.6	5.9	5.7	3.1	1.1	1.5	2.6	4.4	5.8	5.8	5.9	5.4	4.9	4.3	4.4	4.5	2.0	2.0	2.4
Inflation (CPI y/y)	4	6	7	7	6	2	1	4	5	7	5	5	3	4	4	2	1	1	1	1	1
FTSE All Share (q/q)	7	7	6	7	4	5	1	1	5	7	7	7	7	5	7	7	7	7	2	5	5
Nationwide House Price Index (q/q)	7	7	5	4	3	1	1	1	4	7	7	5	6	7	3	2	6	7	4	3	5
Consumer Confidence	7	7	7	7	6	1	1	1	1	2	6	6	7	5	3	2	1	3	1	1	1
Unemployment Expectations	7	7	7	7	7	5	2	1	1	1	3	4	5	4	3	3	2	4	4	2	3
Retail Trade Confidence	7	7	7	5	7	4	1	1	1	4	7	7	7	6	7	7	7	5	1	1	1
Expected Retail Trade	7	7	7	4	7	4	1	1	1	2	6	7	7	7	7	7	7	5	1	1	1

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

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ECONOMIC SCORE CARD VARIABLES

Economic Score Card Variables	Score	Nov 2011	10-yr avg.	Analysis
Economic Score Card Average	2.4	2.4	5.7	The ESC average improved from 2.0 in Q3 2011 to 2.4 in November, thanks to improvements to the scores of the FTSE All Share and the Nationwide House Price Index. However, a score of 2.4 is still indicative of impaired market function.
Inflation (CPI y/y)*	1	4.8%	2.2%	Inflation fell to 4.8% year-on-year in November, the second fall in as many months. Downward pressure was provided by food and petrol, although heating bills increased further.
FTSE All Share (q/q)	5	-7.0%	0.0%	The end of November saw equity prices rebound slightly after heavy falls earlier in the month, during political negotiations surrounding the euro debt crisis. Overall, shares ended the month 7% down on the prior three months and so far we have seen further improvements in December.
Nationwide House Price Index (q/q)	5	-0.1%	1.8%	UK house prices increased 0.4% in November, according to Nationwide. Prices are largely unchanged over the last three months. Demand for homes remain weak and transaction volumes are around half that seen in the boom period.
Consumer Confidence	1	-24	-8	Consumer confidence remains very weak at -24, down from -22 at the end of Q3 2011. High inflation, particularly rising energy bills and high food costs are eroding disposable income.
Unemployment Expectations**	3	48	30	The unemployment expectations survey revealed that a lack of job security is still prevalent in UK households. November saw the survey return a score of 48, high above the long-term average of 30.
Retail Trade Confidence	1	-26	1	Retail trade confidence fell off a cliff in Q3 2011. So far in Q4, confidence remains at recession-like levels but the falls have somewhat subsided with October seeing a score of -24 and November seeing -26.
Expected Retail Trade	1	-30	11	Expected retail trade confidence appears to be as bleak as confidence surrounding current trading conditions. By way of example, HMV has announced that tough future trading may put it in breach of bank covenants in January.

*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.

Source: IPD, ONS, EcoWin, Nationwide

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. For further details, email IPD using the contact details found at the back of this report.

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