rapid

Residential Auction Property Investment Data

February 2012

allsop

Essential Information Group

What is RAPID?

RAPID stands for Residential Auction Property Investment Data.

It is a joint venture between Allsop, a leading property consultancy and the UK's largest property auction house, and the Essential Information Group (EiG), the leading provider of property auction results and information in the UK.

What does RAPID do?

RAPID analyses the data recorded in relation to residential auction disposals. This data is drawn from 225,000 lots which in total have raised £21.48bn.

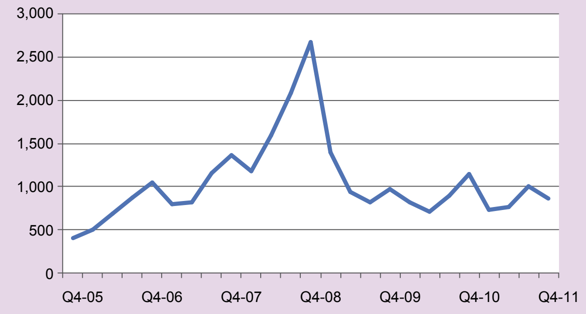
What does RAPID not do?

RAPID is not a residential index. Its function is data collection, interpretation and analysis. It does not track the performance of the same sample data. By definition, auctions will see different properties offered at each sale. Consequently, RAPID should be regarded as presenting data and interpreting trends rather than as an industry index.

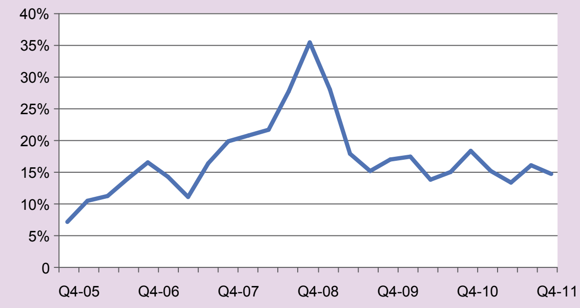
In this on line report, we examine the level of distressed stock in the residential auction market since the start of first signs of recession. We interpret these against the background of activity in the banking sector and endeavour to predict patterns of sale and demand in the year ahead. We look at the performance of assured shorthold and ground rent investments and examine how this may change in the context of movements in capital and rental markets. The analysis draws on statistical data from within four geographical areas of the UK.

Distressed* lots offered

DISTRESSED LOTS OFFERED



DISTRESSED LOTS OFFERED AS A % OF ALL RESIDENTIAL LOTS OFFERED

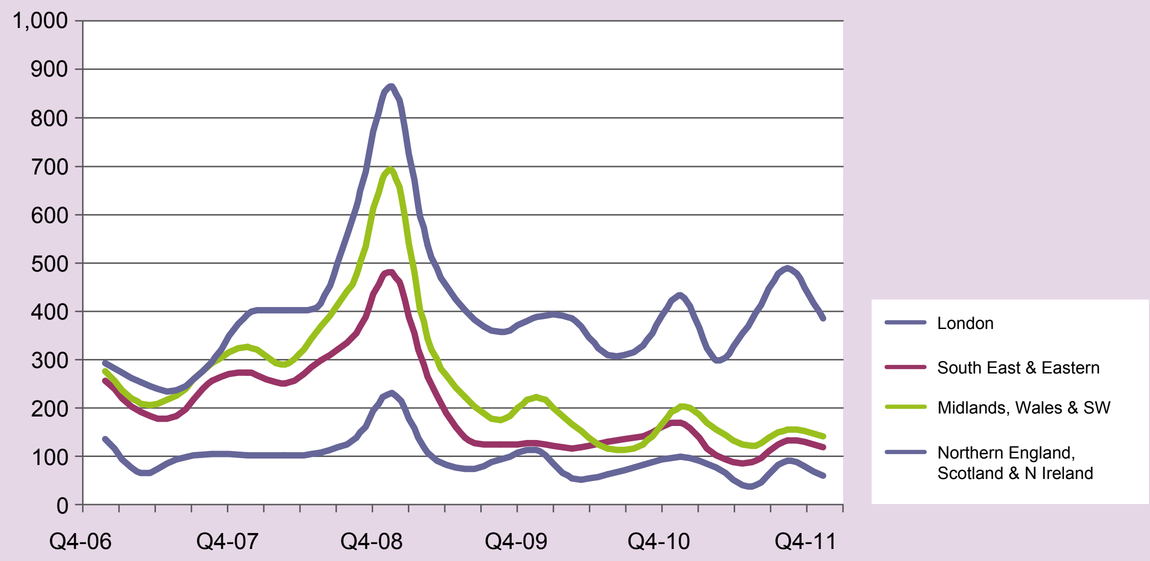


- The number of distressed lots offered at auction peaked in Q4 '08 at 2700 representing over a third of all lots offered at that time. Less than a year later those figures had dropped to 800 lots and 15%. They have maintained relative stability at those levels since.
- Q4 '08 saw significant disposals of repossessed residential property. (Allsop held a four day 1000 lot sale of repossessions in December that year, its largest sale by volume ever held). This was immediately prior to the partial nationalisation of banks such as Northern Rock, RBS, Lloyds TSB and HBOS. From this point, political considerations influenced recovery strategies and lenders' policies moved from forced sale to forbearance. With base rate at 0.5% many borrowers, particularly those on low fixed rate and tracker mortgages, have been spared hardship.
- Following government intervention, repossession gave way to the use of fixed charge receivers. In these cases, ownership remains unchanged while the receiver exercises a power of sale, sometimes with the borrower's consent.
- Receivership sales have included former buy to let (BTL) investments no longer sustainable due to rental shortfalls or persistent voids.
- In H2 '11 distressed sales levels at auction fell slightly. We suspect that this may have been due to an increased reluctance on the part of banks to sell in higher volumes while the economic uncertainty caused by instability in the Eurozone persists.
- Reports last year of escalating credit card debt being used to meet mortgage commitments and utility bills indicate an unsustainable reprieve. As fears of a double-dip recession grow, following GDP growth figures of -0.2% in Q2 '11 and a rise in unemployment, market confidence is unlikely to improve in 2012. Consequently, the level of distressed sales is unlikely to fall.
- The Council of Mortgage Lenders (CML) has forecast that repossessions will rise from 37,000 in 2011 to 45,000 in 2012.
- Many loans were refinanced in 2008 and 2009 when it was expected that the recession would last only two or three years. As these new loans mature, further refinancing may be difficult. Lenders requiring an orderly exit may force borrowers to sell and some stock will inevitably find its way to auction.
- Much of the consensual and forced sales since 2008 have comprised the 'low hanging fruit', namely the readily saleable stock with appeal to wider markets. As loan books distil to the less attractive problem properties, auction will offer an efficient route to market.
- Different banks have been moving at very different paces in dealing with distressed assets. Those that have been slower in getting to grips with non-performing loans will need to accelerate sales. This will force increased volumes into the auction room.
- Transactional activity in the loan book market is however on the increase. As debt parcels are sold to privately owned buyers, with less political sensitivity and a more immediate focus on revenue, a new breed of auction seller will emerge. Non-performing mortgages within the book will have to be addressed in order to meet projections dictated by price paid.
- Some loan book buyers will inevitably favour the private treaty route although a persisting environment of mortgage drought will impact upon speed of sale and price achieved. The best of both worlds option of 'private treaty to auction' will become more popular. If a sale through an estate agent is not achieved in, say, three to six months, the property will be offered by auction. The less attractive domestic mortgage security of unmodernised houses and flats will be put straight to auction to establish best price from cash bidders.
- We see the levels of distressed sales rising in 2012 with unmodernised single vacant units and BTL stock predominating.
- Cash buyers will continue to dominate the market. Auctions rooms have always been populated by savvy buyers and this year will be no exception. Every recession brings opportunities and it will be the larger sales offering higher volumes of realistically priced stock that will attract the money.

* Distressed sales include repossessions, receivership, liquidator and administrator sales

Distressed lots sold by region

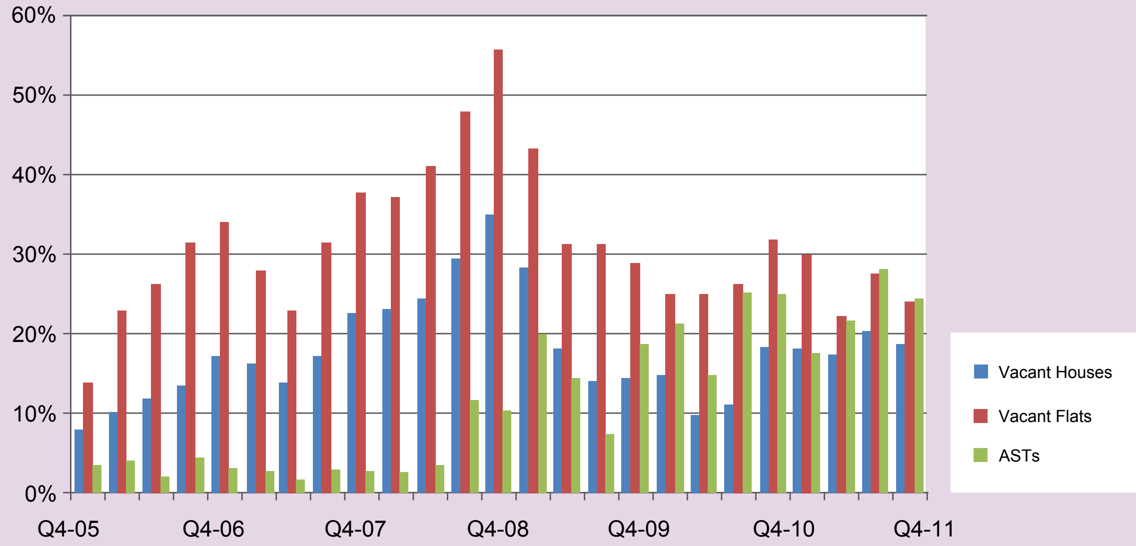
DISTRESSED LOTS SOLD IN THE FOUR RAPID REGIONS



- Distressed sales have been least prevalent in London and the South East over the last five years. The highest volumes have consistently been in the north of England, Scotland and Northern Ireland. This is likely to be due to the higher levels of unemployment in the more depressed areas outside of the South East. Furthermore, in London and the Home Counties capital values have seen some recovery since 2008 and in hindsight, forbearance is seen to have been justified. Earlier forced sales in these areas would have crystallised greater losses. Where values have continued to fall, early disposals have served to cut losses.

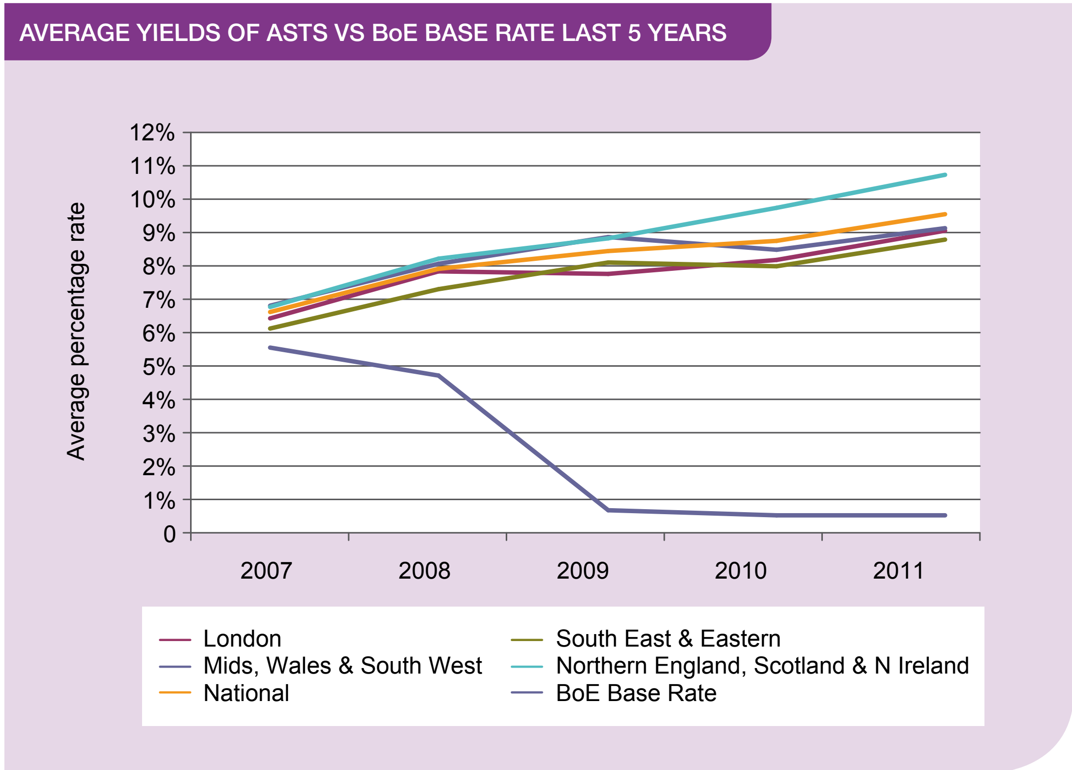
Distressed lots sold by type

DISTRESSED LOTS OFFERED AS A PERCENTAGE OF ALL LOTS OFFERED



- In Q4 '08, when distressed sales peaked, vacant units, specifically flats, predominated. As levels declined towards Q4 '11, AST investments sales grew. The latest figures show that ASTs represent almost a quarter of all distressed lots offered under the hammer (3% in Q2 '08). Most of these will have been offered by fixed charge receivers. We attribute this increased proportion to the fact that these sales are less politically sensitive than those of private homes.

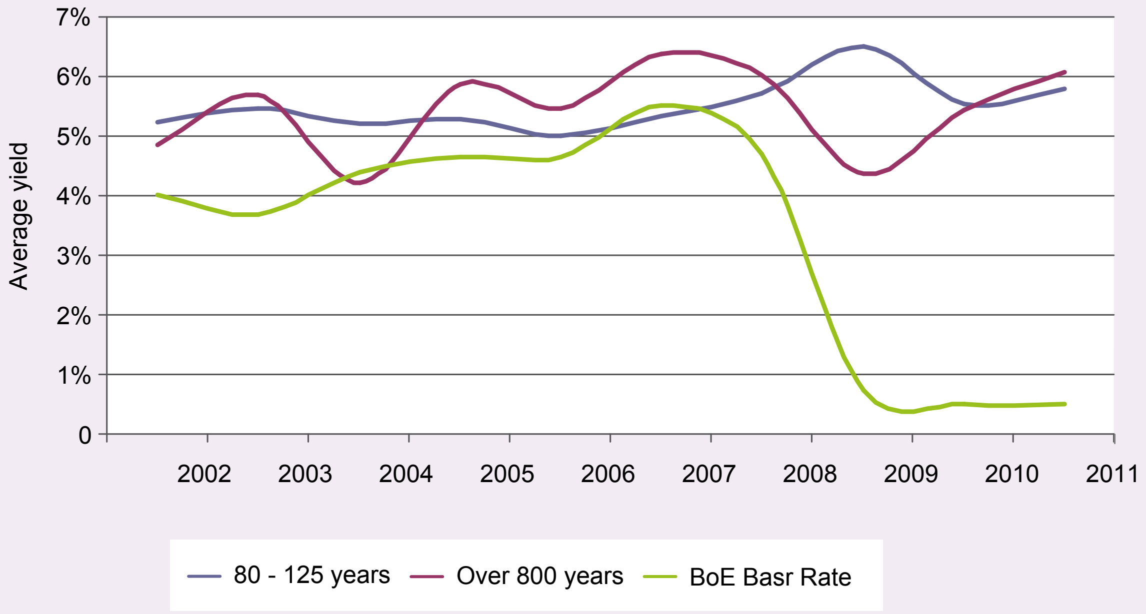
Average AST yields - last 5 years



- Since Q3 '07 assured shorthold tenancy (AST) yields in all areas at auction have increased from within a band of 6%/6.9% to 8.9/10.8% in Q2 '11. London and the South East showed the lowest returns.
- Many parts of the UK, notably those with higher levels of employment and typically London and the South East, have seen rental growth. This has been the result of tighter lending policies and, in particular, their effect upon the first time buyer market. Many new entrants have been unable to find the equity required by lenders, often up to 25% of value. Unable to get a foot on the housing ladder, many have rented, thus increasing competition for available stock and driving rental growth.
- The divergence of the range demonstrates a growing divide between the South East and the rest of the country. Buyers have favoured the perceived relative security of London and the Home Counties but have required higher returns as compensation for investment in the regions. In those areas where unemployment levels are high and/or rising, rents are obviously at greater risk.
- The steady rise in average AST yields at auction over this period may also indicate lower confidence in capital values in certain parts of the country. Investors seeking to preserve total returns (rental streams and capital appreciation combined) may have adjusted their price expectations accordingly.
- In 2012 we expect to see more cash and low geared investors attracted to the BTL market by the relatively high returns available. Alternative methods of saving and investment, such as deposit accounts or pensions, offer derisory rewards. This trend will increase competition.

Ground rent yields

AVERAGE GROUND RENT INVESTMENT YIELDS VS BoE BASE RATE



- The graph shows a rise in average yields for long dated ground rents from 4.4% (22.7 YP) in 2009 to 6.1% (16.4 YP) in 2011. Conversely, ground rents having 80 to 125 years unexpired have shown an average yield drop from 6.5% (15.4 YP) to 5.8% (17.2 YP) over the same period. We attribute the rise in the average value of mid dated ground rents to the exceptional security offered by these investments in an otherwise volatile climate.

Conclusion

Confidence in UK residential property will centre on London, the South East and those regional conurbations experiencing lower unemployment and stronger tenant demand. Stability of prices and investment yields will follow in these locations. It is likely that the divide between these areas and the rest of the UK will widen. This polarisation will be influenced by uncertainty in European markets as investors seek to minimise risk and turn to quality.

Supply in the auction rooms will be driven by sellers seeking predictable returns within an immediate timescale. The establishment of best price will be a key attraction for lenders. Loan book buyers keen to tackle non-performing loans will emerge as a new contributor.

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Essential Information Group

Essential Information Group is the only source of nationwide comprehensive property auction information, past, present and future, covering the activities of every UK property auction house.

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Source: Essential Information Group Ltd, Land Registry. Data sample has been taken from: 549 residential auctioneers across the UK, and from information compiled from a data set of around 248,000 individual auction lots for general analysis, 11,000 for AST analysis and 4,800 for RgR analysis.