INVBRIEF

Property investment market

Winter 2012/13

Economic overview

- UK exits recession, (at least for now), with GDP growth of 0.9% in Q3 2012
- UK growth forecasts downgraded again
- Inflation increases (2.7% in December)
- UK's AAA rating at threat

Property overview

- Downward trend in All Property total returns eases slightly in Q3 2012
- All Property capital values contract for the fourth consecutive quarter
- Central London remains an oasis of growth
- Evidence of lenders adopting a stricter stance in relation to problem loans
- 1.7% – our estimate of total return in 2012

GERALDEVE

0.9%

(Q3 2012 GDP)

UK exits recession but near term growth is likely to fall

" Coalition's fiscal austerity measures to be extended into 2017-18. "

ECONOMY

Q3 signals end of double dip

Output increased by 0.9% over the course of the third quarter according to the final estimate of GDP by the Office for National Statistics (ONS). Whilst signalling the end of the "double dip" recession and being the strongest quarterly growth since 2007, Q3 output was undoubtedly boosted by a number of special factors such as the Queen's Diamond Jubilee which weakened the performance of the previous quarter, and the Olympic and Paralympic games, the tickets sales for which, accrued to Q3 regardless of their actual date of purchase.

Whilst it is not possible to determine exactly the impact that these events have had upon quarterly output, estimates by the Bank of England and ONS have indicated that respectively, they may account for approximately 0.5 and 0.2 percentage points of the 0.9% increase that occurred over the third quarter.

Disaggregation of the GDP data under the output approach reveals that growth in output was driven by the service and production sectors which grew by 1.2% and 0.7% in Q3. Output of the construction sector continued its downward trend for the third consecutive quarter, falling by a further -2.5%.

… but outlook remains bleak

Despite growth in Q3, most commentators are anticipating fourth quarter GDP growth to fall or even become negative, as the Olympic effect falls out. Already survey evidence is pointing to a Q4 contraction.

Indeed, given the still considerable economic headwinds that the UK currently faces, it is difficult to see exactly from where any support for growth can emanate.

Having trended downwards from its September 2011 peak of 5.2%, CPI inflation fell to 2.2% in September 2012. Increases in university tuition fees and rising energy costs, however, have since resulted in an uptick in inflation to 2.7% in each of the last three months of the year. With average earnings growth at just 2.0% real incomes will once again suffer, hurting consumer expenditure.

Any rebalancing of the economy towards net trade also looks increasingly unlikely, with the Eurozone entering recession in Q3 and the US only having narrowly avoided the so-called 'fiscal-cliff'.

Continuing loose monetary policy…

To paraphrase Sir Mervyn King, Governor of the Bank of England, the economy is likely to continue to 'zig zag', resulting in a slow and protracted recovery. The Bank of England's November Inflation Report was notably more pessimistic than the previous August edition, with the MPC stating they now believe that the economy is more likely than not to remain below its pre-crisis levels for the next two years.

The November Inflation report saw the Bank of England downgrading its forecast of GDP growth whilst simultaneously upgrading their inflation forecast. Inflation is now expected to remain higher than expected over the near term before falling over the second half of 2013.

Interestingly, the Bank of England has suggested that the elevated level of inflation of recent years may, in part, be attributable to lower levels of productivity. Any future increase in demand may, therefore, serve to increase productivity, implying that the normal positive relationship between increased demand and inflation may not be as pronounced as usual.

Whilst this could leave the door open for further QE, some MPC members have hinted that they believe any additional asset purchases could have a marginally diminishing effect. The MPC is also likely to wait for further evidence of the impact of its Funding for Lending Scheme before making any further pledges, although there is some evidence to suggest that it has already resulted in some easing of credit conditions. In any case, and as noted by the MPC, the transfer to the Treasury in October of coupon payments amounting to £35bn on existing asset purchases is akin to additional QE.

Whilst we anticipate monetary policy to remain loose for the foreseeable future, time will tell as to whether the appointment of Mark Carney, former head of the Canadian Central Bank as the new Governor of the Bank of England will signal a radically different approach.

… and further fiscal tightening

It was against a backdrop of downgraded growth expectations, lower tax revenues and deteriorating public finances that the Chancellor made his Autumn Statement to Parliament on 5th December.

Still, the Chancellor surprised many, including the shadow Chancellor Ed Balls in proclaiming that the annual budget deficit for 2012-13 would fall rather than rise. However, this was only achieved by way of some creative accounting including the recognition

of £3.5bn as proceeds from the sale of 4G licences, prior to their actual sale.

As widely expected, he was forced to announce his failure to meet his key supplementary fiscal target to bring down net debt as a percentage of GDP by the 2015/16 fiscal year.

With the Office for Budget Responsibility (OBR), the Government's fiscal watchdog, downgrading their GDP forecast for each year to 2016 whilst upwardly revising the expected deficit for each financial year to 2016/17, public sector net debt as a percentage of GDP is now expected to peak in 2015/16 at 79.9%.

The failure to meet the 2015/16 debt reduction target has already led to some rating agencies questioning whether UK can retain its much prized AAA sovereign debt rating.

Of further concern is that the lower than anticipated levels of growth means that the UK is now faced with an additional year of austerity which will now continue until 2017-18.

The Statement, which like the March budget, was fiscally neutral, included a number of pro-growth measures such as the announcement of £5bn in new capital spending, a 1p cut in corporation tax from April 2014 and an increase in the investment allowances of firms. However, on balance, the OBR anticipates that the economic impact of the Autumn Statement's new policy measures will provide only a marginal boost to growth of 0.1% in 2013 and 2014.

A new normal?

Indeed, it is the weakness of the Bank of England's and OBR's forecast of the recovery over an extended period of time that is most telling and suggestive perhaps of a new era in which lower than pre-crisis levels of growth is the new normal.

In the short term, there are increasing concerns over a triple dip scenario and in some quarters, growing voices calling for the Chancellor to reassess the scale of his fiscal consolidation programme. For now, Osborne remains steadfast in his commitment to austerity. Presently, he has the support of the OBR who still believe that the Coalition will meet its principal fiscal target of eliminating the structural debt over a rolling five year horizon.

Some economists are suggesting, however, that the OBR's downgraded GDP forecast, particularly over the medium term is still too optimistic. It is unlikely, therefore, that we have seen the last of the downward revisions to the UK's growth outlook.

Fig 1. Profile of UK GDP by sector (Q1 2008 = 100)
Source: ONS

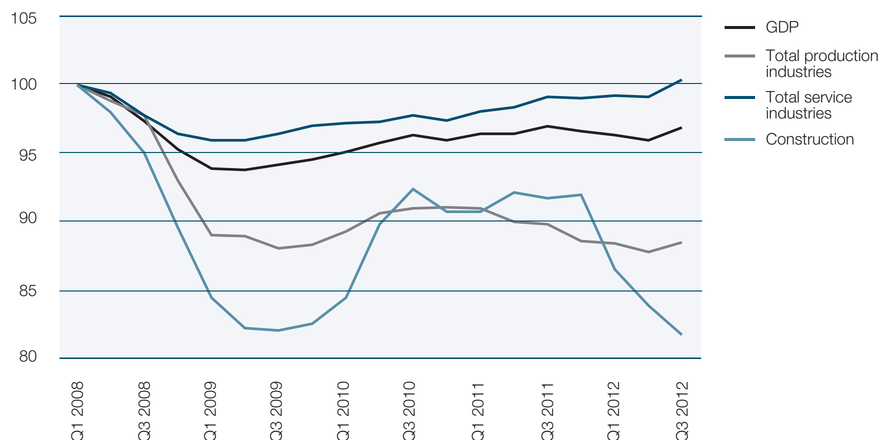


Fig 2. 2012-16 forecast of UK GDP % growth as at March 2012 & October 2012
Source: OBR

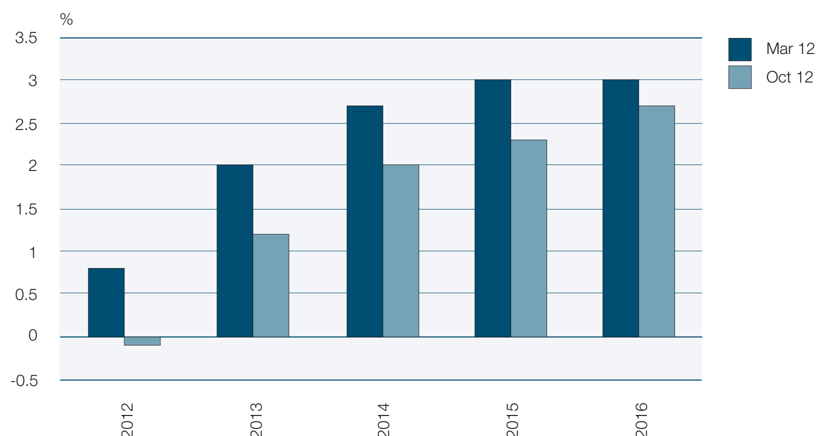
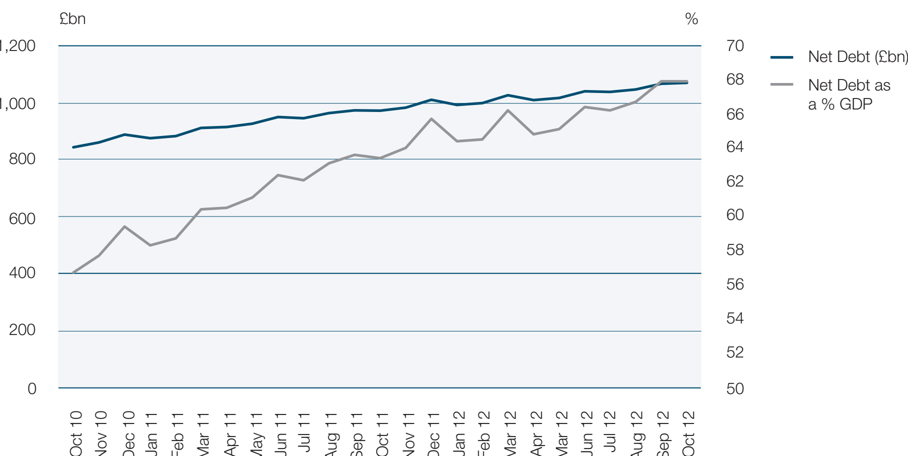


Fig 3. Net debt £bn and net debt as a % of GDP (excluding financial interventions)
Source: ONS



0.7% (Q3 2012)

Total return of UK commercial property (IPD Quarterly Digest)

" Rental value growth remained flat for the fourth consecutive quarter at the All Property level. "

COMMERCIAL

The downward trend in UK commercial property total return eased slightly over the course of the third quarter, with total returns for the three months to September standing at 0.7%, according to the IPD Quarterly Digest.

Total return, however, remained almost entirely income based, with quarterly income return rising by 10 basis points to 1.5%. Capital value growth remained negative for the fourth consecutive quarter at -0.8% owing to a negative yield impact of -0.7%. Rental value growth was flat in Q3, continuing the trend that has occurred at the All Property level since September 2011.

At the sector level, the total return of office properties of 0.8% remained marginally ahead of the industrial and retail sectors, both of which returned 0.6%.

The retail sector saw the most significant change in quarterly total return, having recorded -0.1% over the course of the previous quarter. This was driven by an improved performance in capital value growth, which although remained negative at -0.8% in Q3, declined at a slower rate than previously, (-1.6% in Q2). This, in turn, was attributable to a diminishing negative yield impact, reflecting the extent to which investor sentiment continues to impact upon real estate performance. Nonetheless, this was the fourth consecutive quarter of falling values in the retail sector, over the course of which values have fallen by a total of -3.6%.

Industrial properties saw the largest fall in capital values in Q3 at -1.1%, considerably ahead of the -0.5% fall in values that occurred in the office sector. However, both industrial and offices have now seen three consecutive quarters of falling capital values, with values having fallen by 2.8% and 1.1% respectively over this period. As with the retail sector, these falls in capital values were largely attributable to yields edging further upwards, resulting in a negative yield impact of -0.8% in industrials and -0.7% in offices.

Office values, however, continued to be supported by positive rental growth which remained at 0.3% over the course of three months to September. By contrast, rental levels in the retail and industrial sectors fell by a further -0.2% and -0.3%, continuing the downward trend which has seen their rental levels fall steadily since the second half of 2008. In fact, their rent levels are now respectively 8.1% and 7.5% below their pre-crisis peak.

Sectors & regions

Reflecting the divergence in the recovery between different regions of the UK, the total returns of the office sectors were amongst the best and worst performing of all the IPD key markets. Whilst the total returns of the West End/Midtown and City markets outperformed most other sectors, standing at 2% and 1.3%, offices in the south east and rest of the UK were alone in posting negative returns of -0.1% and -0.9%.

The returns of the central London office market were driven by continued capital value growth, most notably in the West End where values rose by 0.9% over the quarter, this being the highest quarterly growth of all the IPD key markets. Values also rose in the City office market, albeit marginally, by 0.1%. Office values in all regions outside of London continued to fall with values of offices in the south east and rest of the UK falling by a further -1.8% and -2.6% over the course of Q3 2012.

Whilst values in the West End/Midtown and City markets were supported by yield compression (resulting in a positive yield impact of 0.1% and 0.2% respectively), the outperformance of the combined West End and Midtown markets was driven by rental growth which saw rents increase by 0.8% in Q3, double that of the 0.4% recorded by the City office market.

Rising yields continued to act as a drag on office values outside of London, as did rental growth, which either fell or remained flat in most regions, an exception being the South East which saw rental growth turn positive at 0.3%.

Of the retail sub sectors, South East standard retail posted the highest total return of 1.6%, considerably higher than the returns of standard retail in the rest of the UK whose quarterly return was 0.2%.

South East standard retail was the only retail sector to post positive capital growth (0.3%) owing to both a positive yield impact of 0.1% and rental growth of 0.2%.

Total returns of shopping centres and retail warehouses became positive in Q3 at 0.7% and 0.3% respectively. However, both sectors saw further negative capital growth resulting in values falling by -0.8% and -1.2%. The drivers behind their fall in their values were different, being largely attributable to falling rental values in the shopping centre sector of -0.4% and a negative yield impact for retail warehouses of -1.1%.

The total returns of the industrial sector in Q3, matched those of the previous quarter with South East industrial properties posting a return of 0.7% and those in the rest of the UK, 0.4%. The outperformance of south eastern industrial properties was driven by a lower rate of capital value falls (-0.9% vs. -1.4%) which in turn was attributable to a lower negative yield impact and rental value decline.

Outlook

It is perhaps too early to suggest that the easing in the downward trend in the All Property total return, represents a bottoming out. Arguably the short term outlook for property as a whole is likely to remain somewhat subdued.

The publication of the latest IPD Monthly Digest revealed that total return at the All Property level weakened in November falling to 0.1% from 0.3% in October.

Capital values fell across each of three main sectors, with values dropping by a further -1.2%, -0.8% and -0.4% in the retail, industrial and office sectors over the course of October and November.

The strongest performing sectors remain the the Central London office and retail markets, outside of which, capital values continue to fall and rental growth prospects remain muted.

In the following section, we provide our estimate of total return and rental value growth for the full calendar year and our forecast for 2013 and beyond.

Figure 4. All property quarterly investment performance: Q2 2010 - Q3 2012

Source: IPD Quarterly Digest

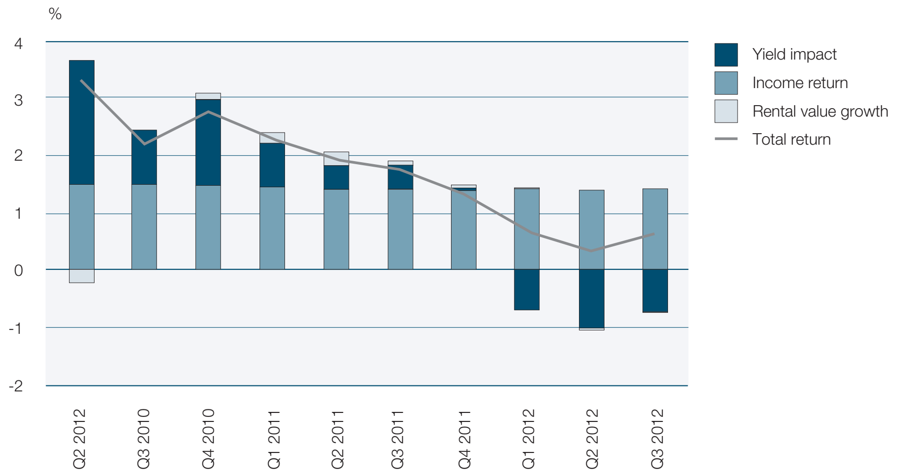
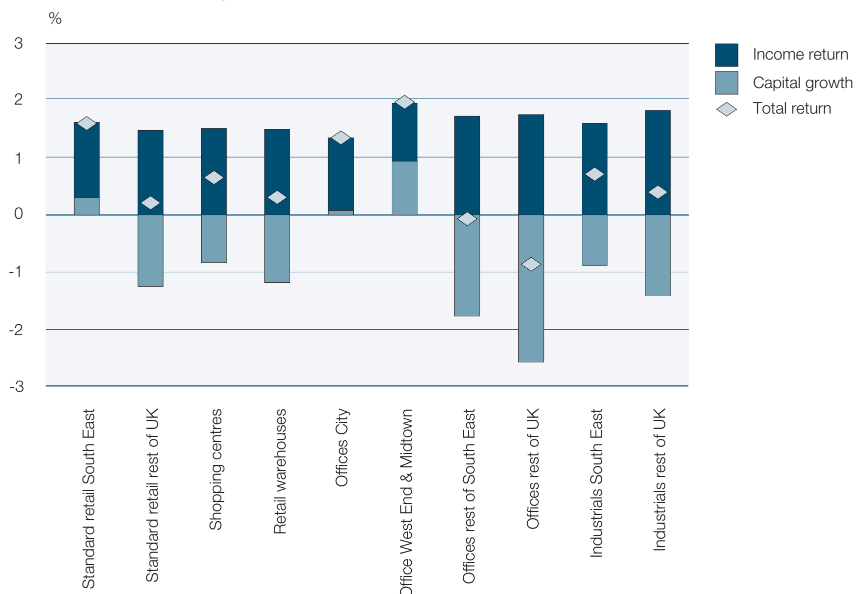


Fig 5. Quarterly investment performance by sector & region: Q3 2012

Source: IPD Quarterly Digest



1.7%

Total return estimate for property in 2012 (Gerald Eve Research)

“ Central London offices are anticipated to continue to outperform over forecast horizon. ”

“ Away from Central London, rental incentives are likely to increase. ”

OUR FORECASTS

As previously outlined, the outlook for the economy continues to remain subdued. Indeed, since the last issue of Invbrief, the IMF, Bank of England and OBR have all made downgrades to their GDP growth forecasts. With the economy flat-lining in 2012 and with no real indication of an economic rebound on the immediate horizon, the outlook for the property market remains rather muted.

The potential for a further re-escalation of the Eurozone crisis continues to provide an ominous backdrop, weighing heavily upon both business and consumer sentiment. Consequently, we do not foresee business expansion under these conditions. Retailers also remain under considerable pressure; the bottom line is that incentives are likely to increase in order to attract occupiers.

On the investment front, whilst domestic lending remains highly constrained, London continues to attract overseas buyers. However, outside of central London there does not appear to be much prospect for rental growth. Essentially it is fair to say that there are two markets namely London, and then, everything else.

Given the ongoing uncertainty surrounding the recovery, we have revised our 2012 estimate of rental growth and total return and forecasts for 2013-16 downwards. Furthermore, the downside scenario to our forecasts continues to exert a greater impact than any potential upside.

Rental growth

We estimate that All Property rental growth will be marginally negative in 2012.

Reflecting the continued below trend growth in economic activity, we forecast aggregate rental growth will be in the region of -0.5% in 2013. The only positive news is that within this figure the office sectors are anticipated to deliver positive growth, with West End offices, seeing rental growth of some 2.8%, almost double that of the City of London. We anticipate that shopping centres will provide the worst performance, with negative rental growth exceeding 2%. Across all sectors, we do not expect rental growth to be positive until 2014, averaging 0.8%.

Over the five-year period 2012-2016, the bottom line figure for All Property results in an annual average rental growth of 0.8%, compared with an average figure of -2.6% over the three years to 2011 and an average of -0.9% over the five years to 2011. Over the period 2012-2016 the City and West End London office markets are expected to produce average annual figures of 3.1% and 2.2% respectively, with shopping centres producing the lowest annual average over the period, being in the region of -0.1%. Going forward we have concern regarding retail rental growth outside of the premier shopping centres. Undoubtedly, the sector is in a poor state overall.

Table 1. Rental growth forecast (%pa)

Sector	2012 estimate	2013	2014	Average 2012-16
Standard shops	-0.7	-1.4	0.4	0.2
	(-1.2)	(-0.4)	(1.1)	(0.7)
Shopping centres	-1.7	-2.2	0.2	-0.1
	(-2.1)	(-0.7)	(1.0)	(0.5)
Retail warehouses	-0.1	-0.4	1.0	0.7
	0.0	(0.8)	(1.8)	(1.6)
West End offices	3.1	2.8	2.9	3.1
	(3.8)	(3.3)	(4.0)	(3.9)
City offices	2.2	1.5	1.8	2.2
	(2.1)	(2.2)	(3.5)	(2.9)
Offices (all)	1.3	0.9	1.5	1.7
	(1.0)	(1.2)	(2.5)	(2.2)
Industrials	-0.6	-0.7	0.0	0.3
	(-0.9)	(-0.3)	(0.5)	(0.5)
All Property	-0.1	-0.5	0.8	0.8
	(-0.4)	(0.2)	(1.4)	(1.2)

Figures in brackets represent IPF Consensus Forecasts

Table 2. Total return forecast (%pa)

Sector	2012 estimate	2013	2014	Average 2012-16
Standard shops	1.5	2.4	5.2	4.5
	(1.0)	(3.9)	(6.8)	(5.3)
Shopping centres	-1.6	3.5	6.4	4.7
	(-1.3)	(4.6)	(7.6)	(5.5)
Retail warehouses	0.9	3.5	6.2	4.8
	(1.3)	(5.9)	(8.1)	(6.4)
West End offices	8.6	4.7	6.1	5.7
	(7.6)	(6.4)	(7.4)	(6.9)
City offices	5.1	5.3	6.2	5.5
	(5.1)	(6.0)	(7.8)	(6.8)
Offices (all)	4.1	4.7	6.4	5.5
	(3.7)	(5.5)	(7.7)	(6.6)
Industrials	3.1	3.6	6.4	5.3
	(2.9)	(5.8)	(7.8)	(7.0)
All Property	1.7	3.7	6.0	5.0
	(2.0)	(5.1)	(7.6)	(6.2)

Figures in brackets represent IPF Consensus Forecasts

In spite of the relatively low levels of development activity that has taken place across the UK since the onset of the downturn, and the consequent impact that this will continue to have upon the supply of space, in our view the underlying fundamental driver of rental growth, the letting markets, will continue to remain weak, other than for the central London office market. Under such conditions no doubt landlords will continue to offer considerable incentives, thereby resulting in effective rents being considerably lower than reported headline figures. Consequently, net effective rental growth will likely be lower, and considerably so in certain markets, than the average figures reported in the forecast Table.

Total return

We estimate that total return at the All Property level will be 1.7% in 2012, this reflecting negative capital returns of some -4%. The West End and City office markets are anticipated to outperform with total returns in the order of 8.6% and 5.1% respectively. By contrast, shopping centres are expected to be the only sector to post a negative total return, of some -1.6%.

Going forward, in 2013 total returns will pick-up a little, reflecting a mild improvement in the economy and yield compression, but still displaying negative capital growth. At the All Property level total returns are anticipated to be 3.7%, with the London office markets again delivering the highest returns, being 4.7% and 5.3% for the West End and the City respectively. Underlying the total return figures for 2013, most sectors will once again experience negative capital growth. 2014 will again show some improvement, with total returns at the All Property level being 6%. Underlying the total return figures we anticipate that the retail sectors and industrials will exhibit negative capital returns over the next three years.

Over the five-year period 2012-2016 annual average returns at the All Property level are forecasted be in the region of 5%. We expect West End and City offices to produce the highest average annual total returns over the five-year period 2012-2016, with annual capital growth, sustained by global capital flows. Average annual returns for the West End and City offices are expected to be similar, being 5.7% (3.4%) and 5.5% (0.3%) respectively. The corresponding figure for the industrial sector is 5.3% (-1.2%), outperforming the retail segments over the period (figures in brackets are the corresponding averages over the five years to 2011). Across the board our forecasts are lower than the corresponding consensus averages.

Fig 6. Annual rental growth forecast
Source: Gerald Eve Research, IPD

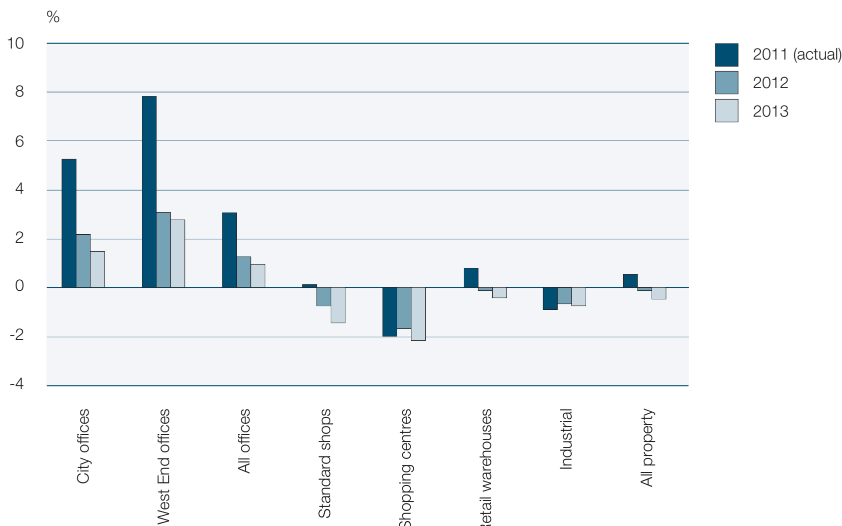
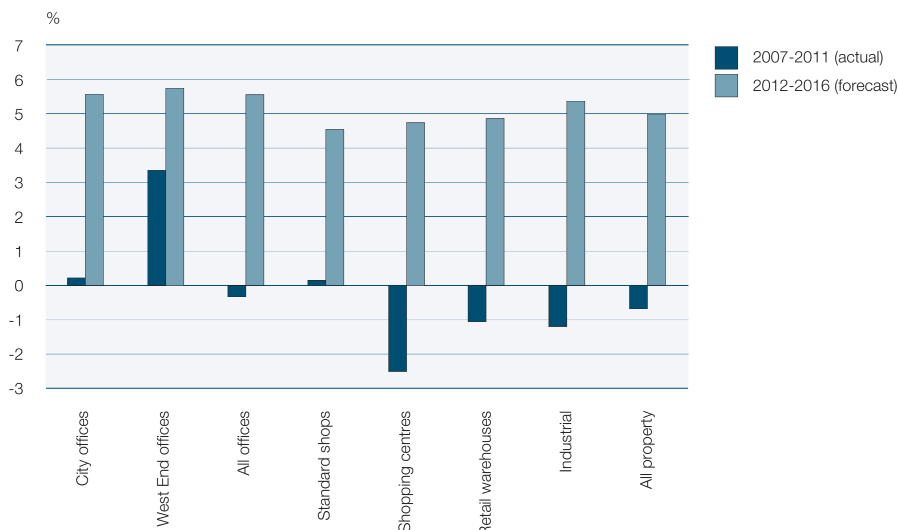


Fig 7. Historic and forecast 5 yr annualised total return
Source: Gerald Eve Research, IPD



GERALDEVE

5.2%

Prime yields for City offices

“ Strong demand persists for limited high quality office stock in Central London ”

INVESTMENT

Central London offices

The West End market continued to show its robust occupier and investment features in the second half of 2012 with consistent depth of demand being shown for a variety of assets. Annual investment transactions recorded by the close of 2012 are anticipated to be at comparable levels to the peak of 2006 at around £6bn.

Stock remains very restricted and with demand outstripping supply the pressure upon pricing remains upwards. The trend of investors seeking quality assets and security in prime locations is not new, whilst the conversion of offices-to-residential has continued to be prevalent in all lot sizes where income is short dated. Interest in this area has come from private investors to the large property companies.

The yield gap between prime offices (at 4.0%) and secondary continues to demonstrate the perceived stability at the prime end of the market. Fringe markets have remained attractive, however, with sales such as 100 Avenue Road, NW3 for £33.5m to Essential Land LLP, attracting interest from core central London investors looking for value.

The majority of overseas investors remain interested in the core with new entrants including purchasers from Thailand and Sweden joining competition from the US, China, Japan and the Middle East. These continue to compete with UK and continental Europe experienced investors across a variety of assets and development opportunities. In short, interest is deep from all parts of the world.

The occupational trend has also remained positive. Prime rents continue on an upwards curve across all sub-markets. Anticipated pre-lets from Lane Clark & Peacock at Great Portland Estates’ and Scottish Widows Investment Partnership’s Wigmore Street development; Coca Cola at Royal London Asset Management’s Wimpole Street and Google’s potential purchase at Kings Cross are all examples of significant removals from the supply pipeline. British Land has also pre-let space in Portman Square to Saudi Aramco and in Victoria, positive news has come with John Lewis, Intuit and Debenhams committing to significant acquisitions.

The outlook for 2013 is, therefore, positive for landlords with the balance tipping in their favour. There is a strong case to be made for further rental growth although this is likely to be tinged with on-going economic uncertainty. With the availability rate at sub-5% in the West End and limited supply coming through, 2013 could be a year for tenants to concentrate on the benefits of lease renewals and re-gears, such as Warner Bros in Theobald’s Road, if they wish to remain in locations of strong demand.

Total transaction volume in the City during Q3 was lower than Q2, although still well ahead of the same period last year. The market is still being dominated by equity-rich overseas investors with the pool of investors widening as the relative stability and liquidity of the Central London market proves ever more attractive.

The total level of transactions has fallen as the availability of genuine prime assets, of a certain lot size, has diminished. That said there are still plenty of opportunities for investors looking for large, prime buildings. However, traditionally, these investors have sought well-located, single-let, freehold assets but as supply diminishes, new entrants are having to consider moving further up the risk curve and compromising on one or more of these factors.

Total investment turnover has been driven largely by these £100m plus deals with the largest transaction of Q3 being the Brookfield deal on the £520m Hammerson portfolio followed by Hines’ acquisition of Broadgate West for c300m. Peterborough Court was sold to Qinvest for £281m reflecting a NIY of 6.2%.

Q4 has already seen a number of notable transactions too with the purchase of 1 Great Winchester Street for £245m by Korea Life reflecting a NIY of 5.5%, KWAP’s purchase of 10 Gresham Street for £200m reflecting a NIY of 5.25%, and the £165m purchase of 10 Queen Street Place by Lembaga Tabung Haji in a JV with Gatehouse Bank reflecting a NIY of 5.0%. In total, there were over nine deals of £100m plus in the last four months.

At the other end of the market, things are not quite as buoyant. There are still good levels of transactions, but secondary assets are not trading as quickly as they once did, and values are being put under pressure. Vendors expectations are still ahead of those of purchasers, and some assets are struggling to attract serious levels of interest at the asking prices. The market is thinner at the more ‘traditional’ end at present, and this trend looks set to continue into the new year as funds look outside of central London for their primary returns, and levels of available debt remain low.

Regional offices

The outlook for regional offices has not changed significantly since the summer. During the second half of 2012 investor interest for prime regional office stock has maintained the reasonable levels of demand that were seen in Q1 and Q2. Institutional and overseas investors continue to focus on low risk assets with the inherent appeal of higher returns when compared to central London stock. Notable transactions are Union Investment's purchase of G1, George Street Glasgow for circa £60m which reflects circa 6.25% NIY and Credit Suisse's purchase of Princes Exchange, Leeds for £36.6m which reflects 6.8% NIY. Whilst not exhaustive these confirm the trend that the best assets in the top five locations will continue to attract the keenest returns. Given the continued crisis in the Eurozone, the UK is still seen as a safe haven and there are few signs that interest from overseas investors is waning. Even given sluggish rental growth prospects this should maintain yields and pricing throughout 2013.

However, the market has started to slacken for all but the very best prime out of town stock, owing perhaps to restrained liquidity combined with low risk appetites. Speculative development remains almost exclusively focused upon the Thames Valley, in towns where rental growth and a shortfall of Grade A stock is predicted.

While prime stock has continued to perform well over the last six months, secondary and tertiary yields continued to drift out. This is due to the continued supply of this stock to the market as the banks continue to progress in working out their non-performing loan books. This combined with the continued dearth of readily available debt and the prevailing risk adverse attitude amongst many investors maintains pressure on yields. Transactions have continued but at highly discounted levels. By contrast, prime yields in the sector remain at 6.0% for the top five centres and are expected to stay at this level for the foreseeable future.

Fig 8. Transaction value by property type

Source: Property Data

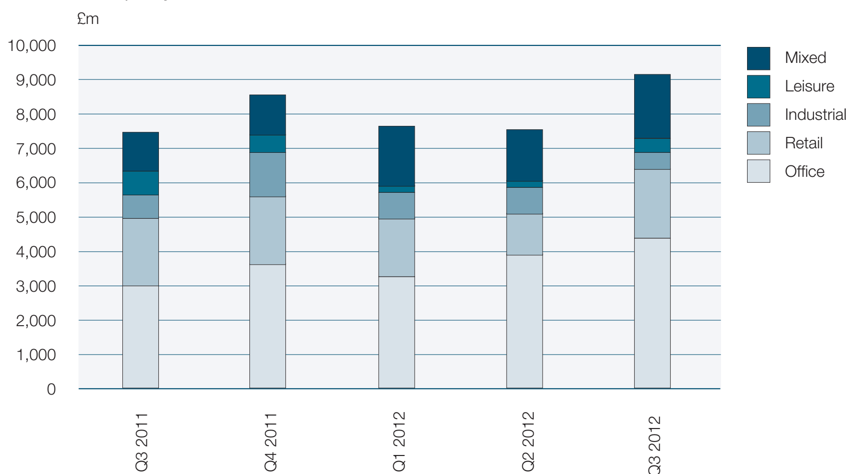
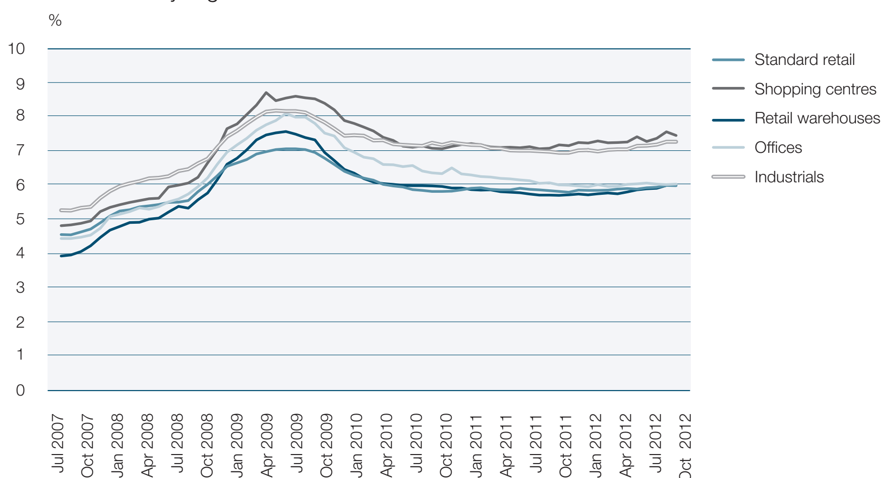


Fig 9. Initial Yields – UK sectors

Source: IPD Monthly Digest



“ Surveyor expectations suggest a modest improvement in the housing market... but that comes with a warning about downside risk. ”

“ Increasing regulatory burden could constrain future levels of commercial real estate lending. ”

Leisure

In the last edition of InvBrief we reported on the proposed CVA at Travelodge which has subsequently been approved and executed. Whilst the full impact of the CVA is under review, the challenge for Travelodge should it wish to continue its expansion is to entice investors for new development opportunities and for existing hotel investments to transact. We note below that in London and the South East this is beginning to happen, but the provincial investment market remains closed.

Two of the most notable Travelodge transactions in the last quarter include the Balham and Egham Travelodges which were purchased by CBRE Global Investors and BP Pension Fund at yields reflecting 6.0% and 5.75%, respectively. The Egham transaction forms part of a joint development including a Waitrose which is reflected in the yield. Outside London and the South East, Travelodge has not been able to complete such transactions. By contrast, the forward funding of the Premier Inn at Fleet, Woking and Dudley are reported to have exchanged at yields ranging from 6.0% to 6.3% which reflects their provincial locations.

In the pub sector as like for like sales continue to grow, ranging between 2.0% to 5.0%, churning of estates has dominated the last quarter as operators seek to concentrate on their key markets. Spirit, Orchid, Punch, Enterprise Inns, Admiral Taverns continue to sell and Regional Brewers (Fullers, Shepherd Neame and St Austell) together with Marstons, Greene King, Stonegate and Youngs continue to acquire and invest. The highest multiple reported in 2012 was Shepherd Neame at circa 15x EBITDA.

In the Leisure Park sector there has been significant market activity with four separate leisure park transactions reported in the last quarter with yields ranging from 6.25% to 6.75%, including The Gate at Newcastle, Printworks at Manchester, Southwater Square at Telford and Parkway at Bury St Edmunds.

RESIDENTIAL

According to the Land Registry house price index for England and Wales, the average house price rose by 1.4% over the course of the 10 months to October 2012.

London saw the strongest growth in house prices at 6.5%. Outside of London, house prices appreciated in the South East (1.9%), Wales (1.5%), West Midlands (1.5%), South West (1.0%) and East Midlands (0.1%).

House price falls were confined to the northern regions with prices falling by -3.7% and -2.6% in the North West and North East respectively.

Nonetheless, prices still remain considerably below their peak December 2007 level in all regions of England and Wales. The sole exception being London where average house prices thanks largely to the performance of the prime Central London markets are now 4.3% above their pre-crisis peak.

Away from London, house prices remain in excess of 10% below their peak levels in seven of the remaining nine regions of the UK, with the percentage fall in prices generally becoming greater the further the distance away from London.

Nevertheless, as recently as October, survey indicators seemed to suggest a small improvement in outlook aided by improved lending conditions which in turn, are partly attributable to the Bank of England’s Funding for Lending Scheme.

The Q3 2012 Bank of England Credit Condition Survey reported the highest increase in the availability of secured lending since the survey began in 2007. Encouragingly, there was a significant increase in the availability of loans with a LTV ratio in excess of 75% which should provide some support to the mainstream property market.

Buoyed by the improved lending environment, the RICS October UK housing market survey saw surveyor expectations at three and twelve month horizons turning less negative for prices and generally more positive for sales.

RICS have recently published their central forecast for annual house price growth for 2013 which predicts growth of 2% at the national level. However, they acknowledge that it is not difficult to imagine a more negative outturn given the downside risks which remain.

The central London market is anticipated to see house price growth over the course of 2013 but estimates do vary and are geographically influenced at the micro level. The rest of London and the south east should also see an increase in house prices whilst the remainder of the UK will either follow a broadly flat trend or one in which there are further modest house price falls.

FINANCE

According to the UK Commercial Property Lending Market survey published by De Montford University, the aggregate value of outstanding debt secured by UK commercial property fell by 4.3% to £204.1bn over the course of the six months to June 2012.

Of the 65 organisations contributing to the survey, 37 undertook new loan origination during the first half of 2012, totalling £11.3m, although almost 50% of this amount was attributable to just four firms. In addition, loans totalling a further £1.9m were extended.

The value of new loan origination equates to 41% of the value originated over the course of 2011 and represents a decrease on the value of loans that were originated during the first 6 months of last year.

As at mid-year 2012, the proportion of outstanding debt with a loan to value ratio of 71% or more had fallen to 46%, down from 50% as at the end of 2011, suggesting a slight improvement in the level of outstanding debt that remains potentially unrefinanceable on current terms. This rebalancing of the aggregate loan book reflects the slow reduction in high LTV legacy debt and the lower LTV ratios to which new lending has been subject post the 2007/2008 financial crisis.

The value of loans in breach of their financial covenant remained largely unchanged standing at £22.0m in mid-2012. However, there is evidence to suggest a weakening in borrower's cashflows, with the proportion of loans in breach owing to either interest or principal being wholly or partly unpaid, increasing over the first six months of the year.

The value of loans in default totalled £19.8m, remaining broadly similar to that seen as at the end of 2011. Just over half of the organisations surveyed reported that they had taken action to accelerate repayments.

The report suggests that faced with the continued subdued nature of the recovery of the UK economy and the lack of a final resolution to the Eurozone crisis, some organisations are taking an increasingly stricter stance in relation to problem loans.

Increasing regulatory pressures resulting in greater capital adequacy requirements are also serving to increase the cost of holding debt. This has the potential to not only incentivise further the removal of distressed debt from loan books but may also constrain future lending levels.

Fig 10. Change in average house prices since peak by region
Source: Land Registry

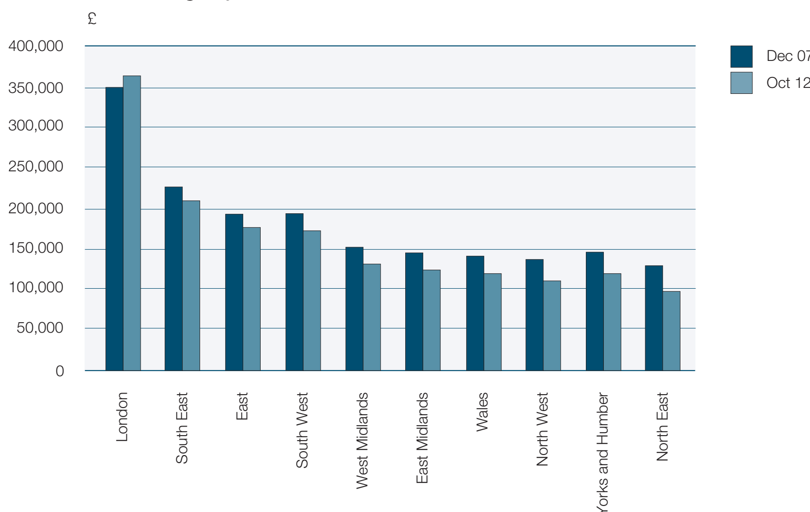
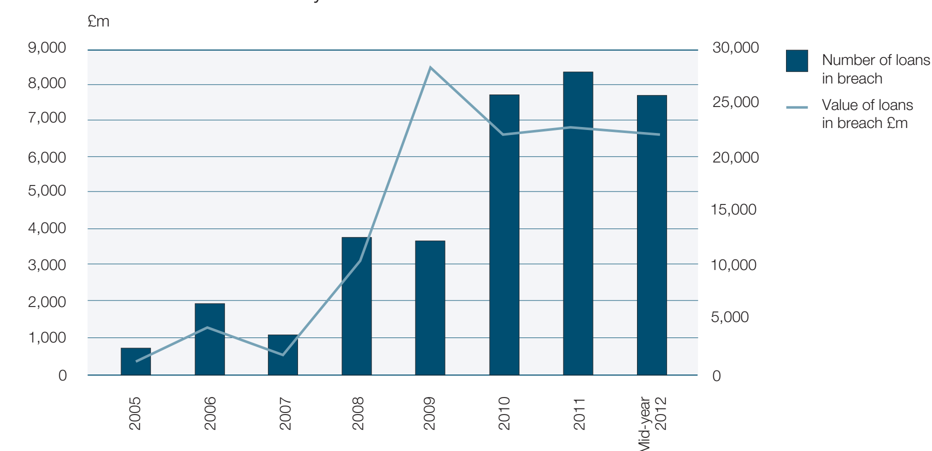


Fig 11. Quarterly amount of total secured gross lending to individuals & housing associations (seasonally adjusted)
Source: Bank of England

Fig 12. Number and value of loans in breach: 2005-2012 mid year
Source: De Montford University



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