# Spotlight on…

# Residential auctions


## Summary

- The residential auction market contains a higher than average proportion of cash and equity-rich buyers
- Auctions have accounted for a higher proportion of all transactions during the downturn as they are not as exposed to the constrained mortgage lending
- Out of the 18% of auction buyers who are owner-occupiers, one-third are buying for the first time
- This summer has seen a turnaround in sentiment in the auction room with a higher proportion of lots selling and a new influx of buyers who believe that prices have bottomed out
- Frustration with low levels of available stock in other markets is increasingly attracting bidders to the auction room
- July saw a dramatic increase in developer (not housebuilder) activity. This was attracted by small, fundable plots on offer and looking for opportunistic sites rather than larger bespoke ones with dated planning permission
- Auctions remain dominated by investment buyers both those seeking to enlarge existing portfolios and start new ones. Most are willing to buy vacant rather than tenanted property to let themselves
- The crossover between investment and development is increasing as developers build and improve in order to let, while investors build and improve to enhance yields
- Auctions are expected to continue to be an important source of sales, to take increasing market share in a low-supply market and to provide lead indicators of sentiment in the wider market


## Overview

The continued improvement in market sentiment has been evidenced by an increase in the sales rate at auctions in London. Cash buyers with increasing levels of confidence in property investment, coupled with low savings rates, are fuelling demand. This is leading to both higher sales success rates and prices.

Auctions are now becoming a more popular means of property disposal. The sale of residential property by auction is a significant portion of the market, 20,000 transactions (or 3% of the whole market) in 2008. A further 10,000 were offered but did not sell prior to or in the auction room, though it is possible that they sold post auction increasing the share of the market further. It is a specialised market, generally adopted by those who have to sell within a finite period or wanting a definite sale-completion date, who are taking advantage of a quick and effective means of disposal. It is also used by organisations needing to demonstrate public marketing and a fair sale in the disposal of any assets.

In a low turnover market, such as that experienced during 2008, auctions have become relatively more important both in dealing with higher numbers of repossessions (although not as high as was expected by some) and enabling vendors to achieve a definite sale by a finite date. Consequently, auction traffic has risen while overall market transactions have fallen dramatically. Lot numbers rose by 2% between 2007 and 2008/9 compared to a fall of 58% in the number of sales across the residential market as a whole over the same period.

Buyers at auction are significantly different to most residential property buyers, comprising a far higher proportion of investors, speculators and developers. A high proportion of cash buyers, makes auction turnover less reliant on mortgage borrowing and less affected by constrained lending criteria. The rates of sale and prices achieved at auction can therefore be a useful advance indicator in providing a guide to underlying market sentiment and purchaser activity in the rest of the market.

Our analysis of buyer types in the auction room reveals the level of interest being experienced from different groups. At present, the market is dominated by longer-term investors with cash. These longer-term investors account for roughly 50% of the market, the vast majority of whom are adding to their existing residential rental portfolio.

## Auctions lead

In the late summer and early autumn of last year (2008), success rates (that is properties sold as a proportion of lots offered) fell as low as 58% in UK auction houses. This was amid some of the sharpest falls in UK house prices on record. It is of some interest to property-watchers therefore that over the last two quarters the success rate has risen to levels of 71% and 72% respectively. The extent of price-falls can be fully and immediately realised in the auction room, leading to higher turnover than in the general market where reluctant vendors can suppress sales levels for longer.

In the second quarter of this year, the national levels of stock available to purchase at auction rose, possibly the result of some of these vendors no longer remaining reluctant. This rise in auction stock took place against a trend of diminishing and low stock-levels in the rest of the market, thereby making auctions more important in contributing to turnover.

Even though demand is limited by a lack of mortgage funding at present, prices are being bid upwards on the back of very thin turnover. It is hardly surprising, therefore, that auctions have returned to popularity this year, having experienced a period of relative inactivity in 2008. Lots are being bid upwards and success rates are consequently high again.

It was a common perception that increased repossession levels in 2009 would cause auction houses to be flooded with stock. This has not occurred and partly reflects that fact that low interest-rates have reduced the level of repossessions against what was expected. Also, lenders have been dealing with repossessions in a much more diverse manner than has historically been the case, not invariably resorting to auction disposals.

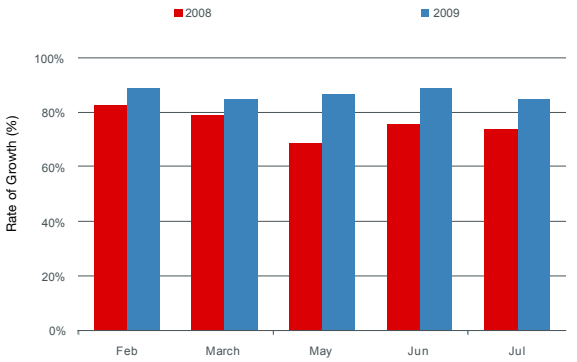
Our analysis of what auction buyers were looking for in August 2009 reveals that standard types of property are in high demand, especially smaller houses and apartments (the latter particularly popular with investors). This suggests that auctions may be a particularly attractive outlet at present for this type of property – repossessed or otherwise.

## Cash is king

In the residential market as a whole, approximately 40% of all transactions are outright cash purchases, rising to 67% in the auction room. Of the remainder, leverage is low, with the majority of buyer mortgages being under 60% loan to value. Those with the biggest cash reserves are developers and 'professional' investors with large portfolios, 80% and 70% of whom, respectively, were using 100% cash to fund their purchases. The credit crunch has pushed these buyers towards smaller lots and plots, which they can fund with capital as opposed to commercial borrowing. Purchasing power is greatly enhanced by those able to pay with cash. Even first-time buyers, who constituted a surprising 6% of those buying in the auction, are still primarily cash-funded. Half used 100% cash funding and the other half utilising no more than a 60% mortgage.

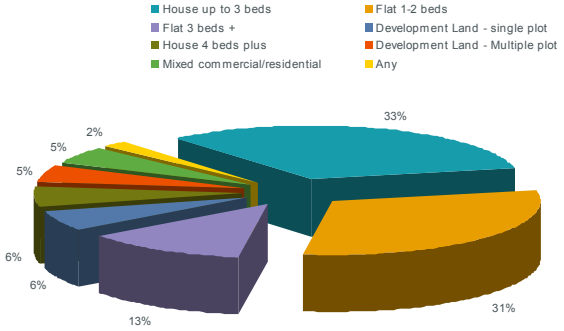
The dominance of the cash buyer, combined with a sense that prices will not fall much lower, if at all, has boosted sales success rates. In July 2009, Savills' own residential auction, for example, achieved an 85% sales success rate. Our analysis of auction buyers helps to reveal why auction sales are at the leading edge of recovery. The combination of improved buyer sentiment along with restricted stock levels in the broader market has resulted in much more competitive bidding in the auction rooms.
Although most auction buyers are coming to the auction room looking for value, a significant number are attracted by a ready source of suitable property not matched by many high-street agents. Linked to this are the speed of sale and certainty of purchase, again unmatched

**Graph 1. Signs of an improving market – Properties sold as proportion of lots offered**




*Source: Savills Research*

**Graph 2. Types of Property that auction-buyers are seeking**




*Source: Savills Research*

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by more conventional means of sale. The pressure of stock scarcity appears to be attracting people hitherto unfamiliar with auctions. More than half (51%) had never bought at auction before. There was a significant divide between those with greater experience who were looking for medium- and long-term holds and those buying at auction for the first time.

A surprisingly high proportion of these are first-time investment buyers. This suggests that auctions may be attracting braver individuals frustrated in other markets by a lack of stock. Half of the respondents to the survey felt that market conditions have now become conducive to buying and many are frustrated by the lack of stock and competition for it in more conventional markets.

## Investors bidding

Investment buyers adding to existing rental portfolios made up 29% of our July 2009 auction survey responses. New investment buyers accounted for 20%. Between them, investors dominate the auction room, most are not buying tenanted stock. Most of the lots on offer are vacant possessions, which will need to be let by the investor. Investors are therefore competing against other types of buyer, including owner-occupiers who constitute 18% of buyers. Among these, first-time buyers are a minority group at 6%.

Longer-term investors have been encouraged to re-enter the market by a perception that they are able to buy at, or close to, the bottom of the market. They also see UK residential property as a more attractive investment than either holding cash or acquiring overseas investment property, at present.

## Developer revival

Aside from improving cash-buyer sentiment, auctions are also revealing possible changes in developer activity. Developers, both part-time and professional, constitute 32% of buyers. High costs and a lack of development finance for larger projects means that developers are chiefly confined to smaller, more easily fundable plots, development schemes and refurbishments such as those often offered at auction. The numbers of developer bidders has increased suddenly. One-third of those buying at auction in July 2009 were property dealers and developers, compared to only 12% in June 2009.

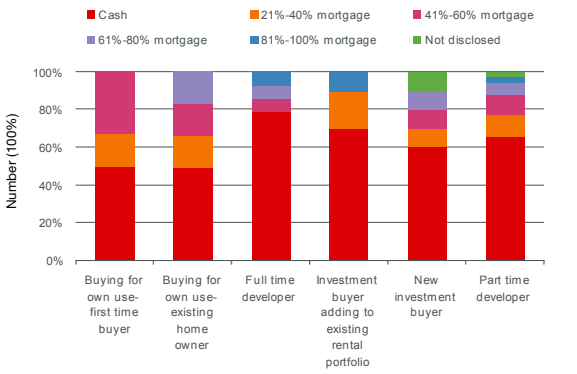
The interest from developers was evident despite the fact that the majority of lots were neither plots nor billed as development sites, and of the eight that were offered, only one sold. This suggests that developers are being more opportunistic in selecting properties that might usually be bought by other types of purchaser. They might also possibly be finding that designs and planning permissions agreed in the boom times are inappropriate for the changed market post-crash.

The number of developers looking for small-scale projects is increasing. It would seem that developers are being opportunistic and looking for more unusual propositions in a market where anecdotal evidence suggests that 'oven ready' lots are selling like hot cakes prior to auction. (At the same time, large-scale, capital intensive and difficult-to-fund sites are still sticking on the market.) There is a distinct shift from 'buying, doing up and selling' as seen in the rising market to 'buying, doing up and renting' with the plan to sell in a few years time when capital values have significantly increased. Thus the roles of investors and developers are somewhat merging, with developers showing investor behavior in some cases and investors showing developer behaviour in order to enhance yields.

## Polarised turnaround times

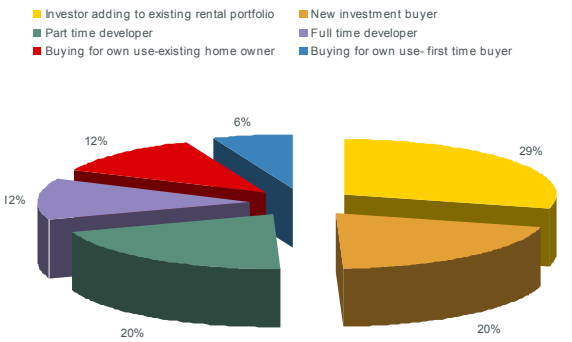
There was a significant divide between those with greater experience of auctions who were looking for medium- and long-term holds and those buying at auction for

**Graph 3. Source of funds**



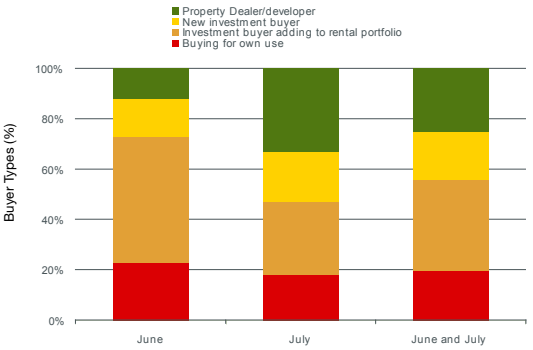

*Source: Savills Research*

**Graph 4. Types of Buyer in the July 2009 Savills Auction**




*Source: Savills Research*

**Graph 5. Buyer Types (June and July 2009)**




*Source: Savills Research*

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the first time, with a higher proportion of short-term 'flippers' amongst them. Most auction buyers, especially experienced ones, are looking for medium-term and long-term holds. A significant, but usually inexperienced, minority (22%) aim to 'flip' in under 6 months (dealers, 'FTBs' and first-time investors).

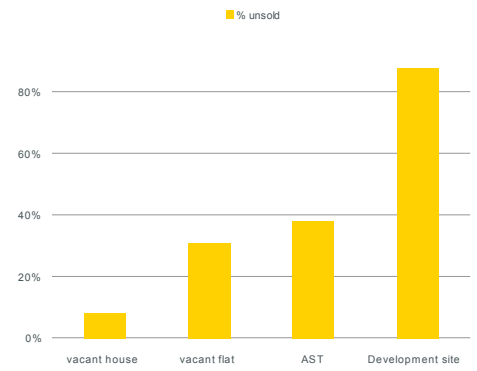
## Outlook

We see that the future of auction activity is likely to be higher than in the rest of the market, given that it usually involves higher-than-normal proportions of cash, or equity-reliant buyers. It is exactly this type of buyer that we expect to dominate the residential market until mortgage availability improves in the medium term.

Auction buyers are a highly discretionary group, most are driven by opportunity rather than need. This means that auction activity will remain a strong indicator of market sentiment. A sustained recovery in auction activity is therefore likely to be closely linked to the strength of the recovery in the UK housing market but with an important lead-lag effect.

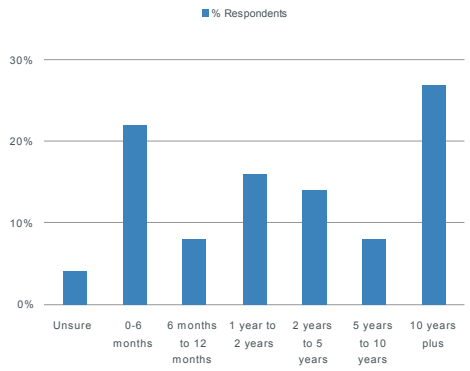
Restrictions on the availability of mortgage finance, particularly within the buy-to-let and refurbishment/ redevelopment sectors is likely to mean that cash buyers and those with limited mortgage requirements will continue to drive demand. The investment objectives of those buyers, combined with continued uncertainty over the strength of any recovery in the market as a whole, is likely to mean that such buyers remain conscious of the need to secure best value over the course of the next 24 months. We expect that they will continue bid relatively cautiously on properties where the cost of refurbishment is a major variable. In the short term at least, it is unlikely that interest-rates rises will be a significant driver in bringing additional distressed or repossessed stock to the auction rooms. If this is the case, then there is little prospect of further significant downward pressure on auction prices. ■

**Graph 6. Unsold lots in the August Savills Auction**




*Source: Savills Research*

**Graph 7. Time over which purchasers intend to keep the property**




*Source: Savills Research*

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