NEW ZEALAND RESEARCH REPORT

May 2020

More market considerations arising from COVID-19

After five weeks of lockdown in Alert Level 4, we are now in 'Alert Level 3 – restrict' for at least two weeks from 11:59pm on the 27th of April. Following on from our last monthly report in April, we provide more market considerations arising from COVID-19 over the past few weeks and potential implications for the property sector ahead.

Economic, Financial and Government considerations

- We are now out of 'Alert Level 4 – lockdown' and are in 'Alert Level 3 – restrict'. Prime Minister Ardern and Minister Andrew Little have indicated that approximately 75% of the economy is 'up and running' under Alert Level 3.
- Economic conditions are slowly becoming more apparent, but there is still some way to go before we have a clearer picture on the full effects. Economists are sharing their views on how activity is resuming and where 'green shoots' between Alert levels could emerge.
- The government has provided a range of support mechanisms and continues to review and provide further measures. These are being updated at the Beehive website.
- The government is now actively considering measures under which parties to a commercial lease would be expected to consider rent concessions in whole or in part for a period where the response to COVID-19 has had a material impact on a business.
- RBNZ remains committed to supporting the market and financial market liquidity. Along with a sizeable Quantitative Easing programme, LVRs have been removed for 12 months. The next Monetary Policy Statement, OCR decision and Financial Stability report are out in May which will provide further guidance on where we have been and are heading. More QE could follow in the next couple of weeks?
- Westpac economists indicate we could see a negative official cash rate later this year. This won't necessarily lead to lower overall lending costs.
- Support for a Trans-Tasman bubble continues to grow to assist with our domestic-led recovery.
- Rider Levett Bucknall released their construction market and escalation forecast update recently, providing the case for price rises and falls.

Office market considerations

- Rising unemployment rate forecasts will likely lead to an impact on office sector space occupancy and absorption rates, but to what extent remains unclear. The current record low vacancy rates in many office markets nationally are seen as a key insulator, and will likely assist with future market strength.
- Further, moderate supply pipelines in comparison to previous downturns will assist the sector's demand and supply balance over the medium term.

More market considerations arising from COVID-19 (cont…)

- Some variances between occupier groups are emerging. Government, IT and health sectors are clear beneficiaries from the recent changes. There is also resilience in insurance, legal and accounting sectors. Travel, retail, hospitality and other associated occupiers are feeling the greatest challenges.
- The debate on the future of the office market and the demand profile continues to be a main point of interest. Central to this is the 'working from home' experience and what it could mean for the future. An international Colliers survey across 23 countries and 4,000 participants shows some interesting results. Please get in touch for more information. We will be conducting a New Zealand survey shortly for a comparison.

Industrial market considerations

- Industrial continues to be regarded by many as more resilient than other sectors under current market conditions.
- Growth in logistics, which was already increasing the demand for space, is an important driver of confidence.
- An extremely low vacancy rate, limited access to land for development activity and a modest supply pipeline are also important positive fundamentals.
- Businesses involved with servicing rural and agribusiness sectors are also benefiting and adding to the sector's demand.
- The expectations for construction activity vary by sector, but public works and infrastructure activity through 'shovel-ready' projects should boost sector activity. The ability for private sector activity to rise will be on a case-by case basis, with many discussions surrounding speed of consent and funding ability.

Retail market considerations

- Restricted people and transport movements along with limited access to all retail goods and services under the lockdown have impacted spending, providing a clear indication of the sector's struggles.
- There remains a wide variation between retailers paying rent and those that are not. May 1 provides another important insight into the interpretation between retailers and landlords on what is considered 'fair and reasonable'. The government may step in, as noted on the front page of this report.
- Under Alert level 3 with more services and products available through contactless payments and click and collect, there will be a rise in spending activity. Supporting local will be a key step forward for many retailers, but more support is likely to be required.
- The necessity for retailers to establish an online presence is expediting some retailers' plans to venture into a more omni-retail world in the future. The ratio between the two is yet to be clarified.
- There are a number of retail stores and shopping centres undergoing reconfiguration to get operational under Alert Level 3. New concepts and methods of retailing are likely to be created from this, with a key focus on food and beverage common areas and the future of experience based retailing activities.
- Indications of house price changes and increases in unemployment rate forecasts suggest that consumer spending attitudes will likely change in the short-term. This could lead to a change in focus towards necessity and value-based products, while discretionary and aspirational retailing may moderate.
- Some tenants are approaching landlords looking into a total turnover based rent with flexible lease term that either party can terminate to boost cash flows and de-risk the opportunity.
- There is unlikely to be a significant expansion of existing retail networks over the next 6-12 months. Many retailers will be focussing on what the current trading impact is on their current store network.

Investment market considerations

- Funding for existing clients rather than new clients continues to be a major focus from banks. The most favourable opportunities remain with assets that have an A++ tenant covenant.
- Investors with retail, accommodation and hospitality tenants are in regular contact with their banks to address any concerns, increase transparency and instigate solutions as required.
- Liquidity, and the cost of capital, continue to be key areas of focus for funders. Anecdotally, the cost of debt could start edging up despite a lower OCR if liquidity and risk margins on top of base rates are stretched.
- From a sales perspective, conditional contracts are in progress, but there has not been enough unconditional sales activity in the past couple of weeks to set new price and yield benchmarks.
- The pipeline of buyers looking for prime quality assets as well as those on a more opportunistic front are starting to emerge. This could add to some pent-up demand for some asset types.
- There is an expectation that there will be a number of campaigns that will start in Alert Level 2, including a number of 'sale and leaseback' and 'off-market' campaigns. This will potentially provide some more deal flow for Q22020 and Q32020 enabling better price guidance.

New Zealand Key Economic Indicators – May 2020

	Dec-19	Dec-19	Sep-19	Q-o-Q Change	Dec-18	Y-o-Y Change	2021F*	2022F*	2023F*
GDP Growth	1.8%	0.6%	0.7%	-0.1%	3.3%	-1.5%	-12.5%	1.6%	4.5%
Current Account (% of GDP)	-3.0%	NA	NA	NA	-3.8%	0.9%	-8.6%	-5.6%	-4.5%
Retail Sales (ex-auto)	4.2%	1.1%	1.8%	-0.7%	4.4%	-0.3%	1.8%	3.6%	4.5%
Unemployment Rate	4.1%	4.0%	4.1%	-0.1%	4.3%	-0.2%	6.6%	7.8%	7.9%
	Mar-19 (yr rate)	Mar-20 (qtr rate)	Dec-19 (qtr rate)	Q-o-Q Change	Mar-18 (yr rate)	Y-o-Y Change	2021F*	2022F*	2023F*
CPI Inflation	2.5%	0.8%	0.5%	0.3%	1.5%	1.1%	1.3%	1.2%	0.9%
Net Migration Gain (000's)	42	9	10	-1	48	-6	28	20	17
	Feb-20	Jan-20	M-o-M	Feb-19	Y-o-Y	10 Year	2021F	2022F	2023F
Tourist Numbers Growth	-9.7%	-9.7%	-7.7%	5.3%	-15.0%	3.5%	4.5%	4.0%	4.7%
	Mar-20 (yr rate)	Feb-20 (yr rate)	M-o-M Change	Mar-19 (yr rate)	Y-o-Y Change	10 Year Average	2021F*	2022F*	2023F*
Official Cash Rate	0.25%	1.00%	-75 bps	1.8%	-150 bps	2.21%	0.25%	0.50%	0.50%
90 Day Bank Bill Rate	0.7%	1.2%	-47 bps	1.9%	-117 bps	2.4%	0.4%	0.5%	0.6%
10 Year Government Bond	1.1%	1.3%	-20 bps	2.0%	-94 bps	3.2%	1.8%	2.2%	2.3%
Floating Mortgage Rate	0.0%	0.0%	0 bps	5.9%	-585 bps	0.0%	4.4%	4.5%	4.6%
3 Year Fixed Housing Rate	4.4%	4.5%	-18 bps	5.0%	-64 bps	0.0%	NA	NA	NA
Consumer Confidence	106	122	-13%	122	-13%	120	NA	NA	NA
NZD vs US	0.60	0.64	-5%	0.68	-11%	0.74	0.65	0.65	0.65
NZD vs UK	0.49	0.49	-1%	0.52	-6%	0.51	0.47	0.46	0.45
NZD vs Australia	0.97	0.96	1%	0.97	1%	0.88	0.90	0.87	0.85
NZD vs Japan	65	70	-8%	76	-14%	75	65	68	71
NZD vs Euro	0.55	0.59	-7%	0.60	-10%	0.61	0.55	0.63	0.65

Source: NZIER, Colliers International Research
*March year forecast

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