New Zealand Research Report

May 2021

OUTPERFORMING EXPECTATIONS

A review of commercial office, retail and industrial market conditions one year on from the end of New Zealand's national lockdown finds that most sectors have performed more strongly than expected.

The effect of lockdowns, both locally and internationally, however, has varied across market sectors. This, along with some continued ongoing uncertainty, has resulted in property markets experiencing a flight to quality in both the occupier and investment sectors.

Economy proves resilient and prospects are improving

The New Zealand economy has responded to the unprecedented amount of stimulus from the Government and the Reserve Bank, with increased Government spending and lower interest rates supporting a recovery in demand.

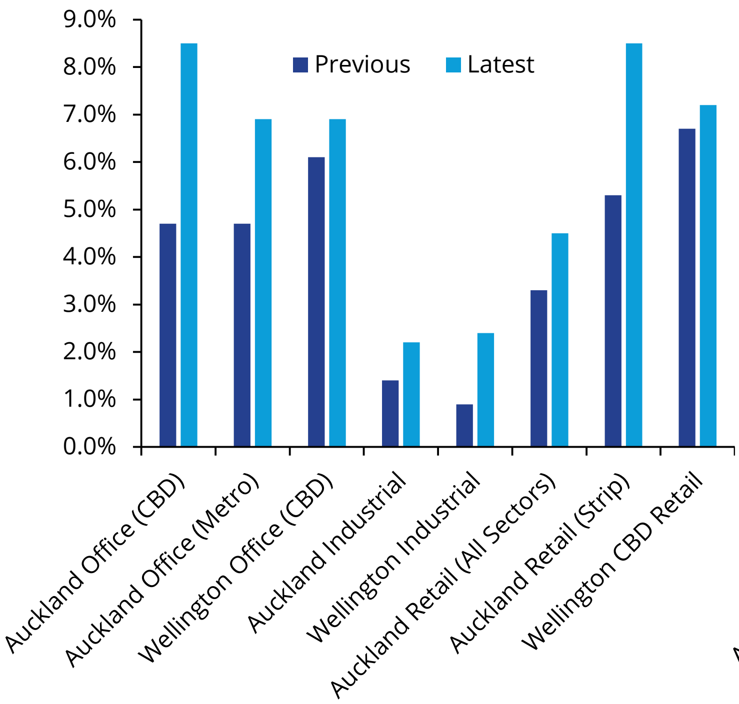
The 'V-shaped' economic recovery currently remains on course. Business and consumer confidence are recovering, with a reduction in uncertainty over the past year leading businesses to feel more positive about hiring and investment.

Given the strength of the economic recovery, further reductions in interest rates are becoming increasingly unlikely. Rates will, however, remain accommodative for some time given that increases are likely to be slow and that the movement is from historically low levels.

Vacancy rates lift

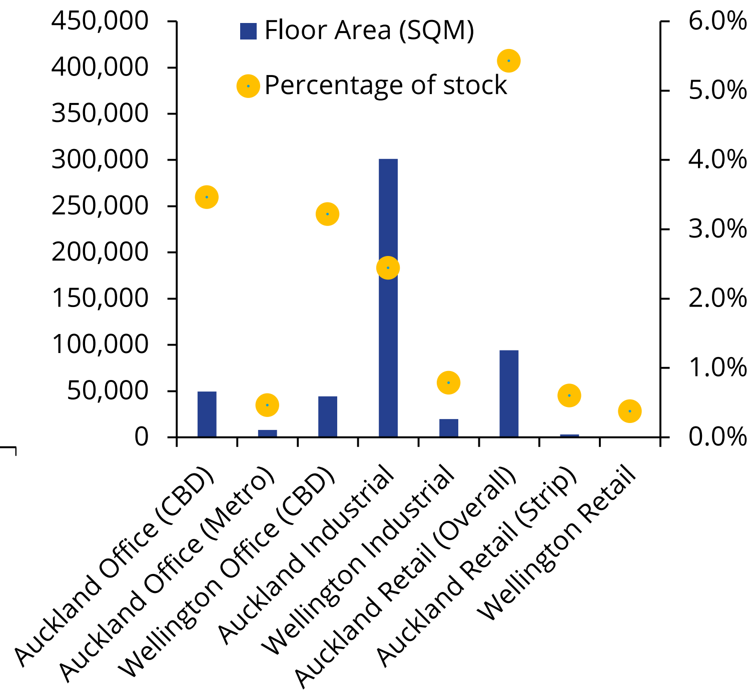
Vacancy rates have lifted across all markets over the course of 2020. The economic impact of COVID-19 and the influences which it has had on workplace practices and shopping habits has been a factor. Another significant influence, however, has been the introduction of new supply reflecting heightened development activity apparent over recent years driven by tight market conditions.

Vacancy Rates



Source: Colliers Research

12 Month Change in Total Stock



Source: Colliers Research
All survey data December except. Auckland Metro office (March) and Auckland Industrial (Feb)
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Investor sentiment improving but caution still evident

The positive outlook for the economy, prospects of ongoing low interest rates and a growing belief that the worst of the disruption caused by COVID-19 is now behind us has seen investor sentiment improving over recent months. Demand though is heavily weighted towards safe haven investments both in regard to location and asset class. The "golden triangle" centres of Auckland, Hamilton and Tauranga remain favoured locations in the North Island, with Christchurch and Dunedin favoured in the South Island. Preferred investment assets are those which offer strong defensive fundamentals with the industrial, large format retail and flagship offices remaining particularly sought after.

Industrial sector displays resilience

The industrial sector has proved resilient in the face of the COVID-19 pandemic, well-illustrated by vacancy rates which have remained at low levels. In Auckland, industrial vacancy rates sit at just 2.2% while in Wellington the rate is only slightly higher at 2.4%.

Tenant demand within the industrial sector is being strongly underpinned by growth within a number of occupier sectors. E-commerce is experiencing significant expansion fuelling demand for logistics warehousing and last mile facilities. Construction is another sector growing substantially as it responds to the housing shortage with further impetus to be added as the government rolls out its multi-billion-dollar infrastructure programme.

The increase in competition for a limited number of assets has resulted in further yield compression, and in turn, an increase in capital values and total returns. Prime industrial assets in the Auckland market are currently transacting at yields of between 3.8% and 4.5%. In Wellington, yields have also tracked down with prime properties commanding yields of between 4.25% and 6%.

Large Format Retail also in favour

As with the industrial sector, large format retail premises have attracted high levels of investor interest given that they share many of the strong defensive fundamentals.

Tenant demand has been strong reflected in vacancy rates of just 1% across Auckland. Demand for bulk retail space has been strongly underpinned by a surge in consumer spending following the national lockdown. New Zealand's total core retail spending lifted by 5.3% between the December 2019 and December 2020 quarters, reaching $22.6 billion. This was the highest quarterly figure on record, according to Statistics New Zealand. Growth was greatest within large format stores - DIY/hardware stores, recreational goods outlets, electrical and electronic goods retailers and supermarkets - with national retail spending lifting 8.1% over the year.

As with the industrial sector heightened competition has driven yield compression forcing up capital values. Prime assets are regularly commanding yields of between 4% and 5% across multiple locations while sales of premium assets have seen initial yields of sub-4%. The latest figures released by global data provider MSCI show the strongest performing asset classes over 2020, generating total returns of 16.7% over the year to December 2020.

Retail sector remains under pressure

While large format retail property has continued to experience high levels of both tenant and investor demand, other sub-sectors of the retail market face a more challenging environment.

COVID-19 has brought the fragilities in the retail sector front and centre, hastening the inevitabilities for some retailers faced with low consumer spending and changing shopping habits with online retailers increasing competitive pressures.

The strip retail sector has seen the greatest increase in vacancy rates. Across Auckland the vacancy rate closed 2020 at 8.5% up from 5.3% a year earlier with suburban markets the major contributor with 8.9% of stock vacant. In Wellington, the figure increased from 3.8% to 7.8% over the course of 2020.

Vacancy within shopping centres and regional centres have increased over 2020 although the movement in vacancy rates has not been as marked as those within the strip centre. The performance of centres varies upon location and tenant mix.

Investor demand for retail assets is dependant on a large number of factors. Properties located within secondary catchments with low occupancy rates or tenanted by businesses which are most adversely impacted by increasing competition from online retailers are seeing little purchaser interest. Yields for retail assets, outside of the large format sector, have therefore softened over the last year. This repricing has led to an increase in interest, from some experienced investors, for assets that are well positioned to prosper over the longer term as the economy rebounds.

Auckland office sector witnesses a flight to quality

Vacancy rates across both CBD and metropolitan office markets have lifted from historically low levels over the last 18 months, reflecting a combination of increases in new supply, the economic impact of COVID-19 and changing work habits. This has presented tenants with a greater number of occupational options than have been available for a number of years.

Tenant uptake has been concentrated within prime buildings and locations. Within the Auckland CBD, demand has migrated north, to the CBD core and waterfront precincts, accelerating a trend apparent for decades. Within the Auckland fringe office market, premium locations within Newmarket, Parnell and Ponsonby have attracted the greatest proportion of tenant inquiry. Elsewhere in the city, landlords are finding it more challenging to attract tenants and are offering more rental incentives.

Cognisant of the dynamics in play, investors are shaping their investment strategy accordingly. As a result, there is a clear divergence in demand between locations and quality of stock. Well located premises benefitting from high levels of occupancy providing long average weighted lease terms continue to generate high levels of buyer inquiry. This is in sharp contrast to properties which do not benefit from the same fundamentals.

Wellington office market underpinned by government occupation

The approximate 35% of government occupied office space in Wellington and a positive private sector has supported market conditions in Wellington. Although the overall Wellington CBD office vacancy rate increased to 6.9% in December 2020, the movement over June 2020 was limited, up only 45 basis points and remains well below the 20-year average of 9.2%.

Conditions at the prime end of the market remain particularly tight with vacancy at just 1%. This has strongly incentivised ongoing development with Precinct Properties, Newcrest and Willis Bond progressing significant schemes.
The purchase of 20 Customhouse Quay by Stride in late 2020, for a 4.5% yield, clearly illustrates the investment demand that there is for prime Wellington located assets. The sale has re-rated prime yields in Wellington CBD's office sector.

**5 – Year Average, Source: CoreLogic, Colliers Research*
Note: Investing in commercial property differs in many respects from the residential sector. Investors new to the sector should ensure that full due diligence and expert advice is sought prior to purchase.

New Zealand Economic Indicators Table

	Dec-20 (vs. previous quarter)	Sep-20 (vs. previous quarter)	Q-o-Q Change	Dec-20 Vs Dec-19	Dec-19 vs. Dec-18	Y-o-Y Change	March Quarter 2021F	March Quarter 2022F	March Quarter 2023F
GDP	-1.0%	13.9%	-14.8%	-0.9%	1.7%	-2.6%	1.2%	2.5%	3.4%
Current Account (% of GDP)	NA	NA	NA	-0.1%	-3.3%	3.2%	-0.4%	-2.7%	-3.8%
Retail Sales (ex-auto)	1.4%	24.7%	-23.3%	8.6%	3.9%	4.8%	3.6%	9.1%	4.2%
CPI Inflation	0.5%	0.7%	-0.2%	1.4%	1.9%	-0.4%	1.5%	1.3%	1.8%
Net Migration Change (000's)	2	3	-1	39	73	-34	8	9	15

	Dec-20	Sep-20	Q-o-Q Change	Average Year To Dec-20	Average Year To Dec-19	Y-o-Y Change	March Quarter 2021	March Quarter 2022F	March Quarter 2023F
Unemployment Rate	4.9%	5.3%	-0.4%	4.6%	4.1%	0.8%	4.7%	4.1%	3.8%

	Feb-21	Jan-21	M-o-M Change	Feb-20 (yr rate)	Y-o-Y Change	10 Year Average	March Quarter 2021F	March Quarter 2022F	March Quarter 2023F
Tourist Numbers Growth	-98.1%	98.1%	-2.8%	-52.1%	-46.0%	-30.8%	-48.8%	-0.9%	10.0%

	Mar-21	Feb-21	M-o-M Change	Mar-20	Y-o-Y Change	10 -Year Average	March 2021F	March 2022F	March 2023F
Official Cash Rate	0.25%	0.25%	0 bps	0.3%	0 bps	1.99%	0.25%	0.25%	0.25%
90 Day Bank Bill Rate	0.33%	0.30%	5 bps	0.7%	-38 bps	2.2%	0.4%	0.4%	0.4%
10 Year Government Bond	1.8%	1.5%	30 bps	1.1%	68 bps	2.9%	0.6%	1.3%	1.8%
Floating Mortgage Rate	4.4%	4.4%	0 bps	4.5%	-12 bps	5.7%	4.4%	4.4%	4.4%
3 Year Fixed Housing Rate	3.3%	3.3%	0 bps	4.4%	-103 bps	5.5%	NA	NA	NA
Consumer Confidence	111	113	-2%	106	4%	119	NA	NA	NA
NZD vs:									
US	0.72	0.72	-1%	0.60	19%	0.74	0.72	0.69	0.67
UK	0.52	0.52	0%	0.49	7%	0.51	0.52	0.50	0.47
Australia	0.93	0.93	0%	0.97	-4%	0.90	0.93	0.90	0.88
Japan	76	76	0%	65	17%	76	76	71	71
Euro	0.60	0.60	0%	0.55	9%	0.61	0.60	0.61	0.63

Source: NZIER, Colliers Research

Recent Commercial, Industrial and Vacant Land Transactions

16 College Hill, Auckland Central

Auckland Region | $10,200,000

8B Target Road, Totara Vale

Auckland Region | $5,800,000 | 5.0%

23 Ross Reid Place, East Tamaki

Auckland Region| $4,550,000 | 3.5%

90 Gill Street, New Plymouth

Taranaki Region | $1,305,000 | 4.6%

17 & 17A Kirkwood Avenue, Upper Riccarton

Canterbury Region | $1,600,000

33 Sale Street, Auckland Central

Auckland Region | $8,325,000 | 4.6%

46 Karewa Place, Hamilton

Waikato Region | $8,500,000

15J Mercari Way, Albany

Auckland Region | $2,350,000

45 Heuheu Street, Taupo

Taupo Region | $1,250,000

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