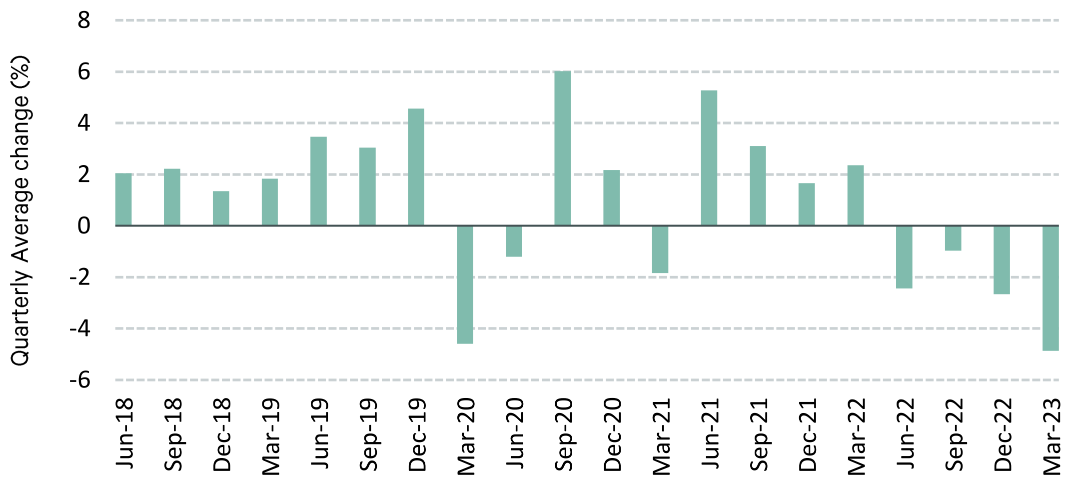
CBRE

Wellington Property Market Overview

INSIGHTS

- In Q1 2023, an increase in outgoings across all sectors had a material dampening impact on net rents.
- Low levels of transactional activity continue to hamper calls on pricing but CBRE's assessment of market trends resulted in yield increases of 45-97 basis points since the late 2021 market peak across the various sectors.
- The market witnessed the removal of several office buildings due to strengthening and refurbishment works. These were partly offset by the completion of new built and refurbished buildings.
- During H2 2022, CBD office vacancy was largely stable at 7.5%. Premium grade remained very tight with less than 1,000 sqm vacant, but Grade A vacancy has increased due to relocations into new supply creating backfill as well as some occupiers rationalising their space requirements.
- Industrial vacancy is 2.4% overall, but with material variation between precincts and grades. There is no Prime vacancy. Good rates of gross rental growth continued into Q1, although as for other sectors, increasing Opex has resulted in lower net rents.

Average Office, Retail, Industrial Capital Values – q-o-q % change



Market indicators

Market Sector	Stock (sqm)*	Vacancy (%)*	Gross Face Rent ($/sqm/yr)	Incentives (%)	Yield Range (%)
Prime CBD Office	426,239	2.3	600 – 875	4 – 6	5.75 – 7.60
Secondary CBD Office	890,945	9.9	225 – 650	5 – 14	7.40 - 10.45
Prime Industrial	456,849	0.0	190 – 235	1 – 2	6.00 - 6.25
Secondary Industrial	1,716,795	3.1	120 – 170	3 – 4	6.50 - 7.55
Prime CBD Retail	-	-	2,200 - 2,500	7 – 9	6.66 – 7.06
Secondary CBD Retail	-	-	900 – 1,600	8 - 10	7.35 – 8.00

* Stock and Vacancy figures are as of December 2022. Gross Face Rent, Incentives and Yield Range figures are as of March 2023.

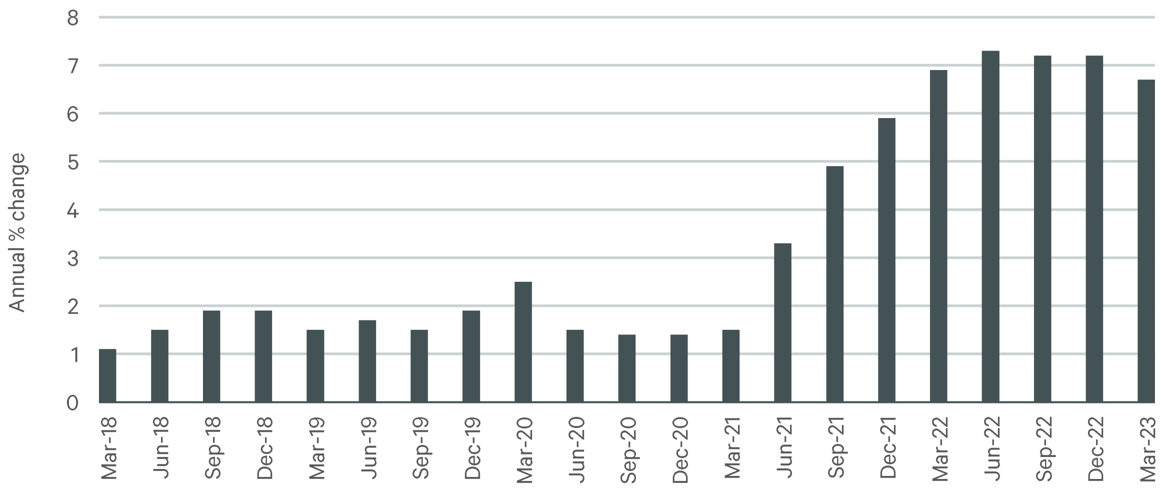
Economy

The economic environment became hazier during the first months of 2023. So far, inflationary pressures seem to be entrenched in the New Zealand economy, at least according to RBNZ, and its effects on the wider economy continue to be prevalent. This led the RBNZ to continue with its hawkish position despite the risk of forcing the local economy into a recessionary environment by trying to suppress aggregate demand. However, in its last session in late May, the RBNZ's Monetary Policy Committee increased the OCR only by another 25 basis points (from 5.25% to 5.50%), catching the market off guard, most of whom had pencilled a 50 basis points increase, especially after the presentation of the Budget 2023, which proved to be more spendy than expected. Even though the RBNZ now expects the OCR to stay (and peak) at 5.50% in the next 12 months, most economists still expect the OCR to peak around 5.75-6.00% during the same period due to the potential stickiness of non-tradable inflation.

During Q1 2023, annual inflation dropped to 6.7%, lower than during Q4 and Q3 2022 (7.2% on both quarters). However, non-tradeable inflation reached 6.8% in Q1, the highest level on record. Domestically generated non-tradeable inflation is an important measure because this is the inflation component that the RBNZ can directly influence through monetary policy.

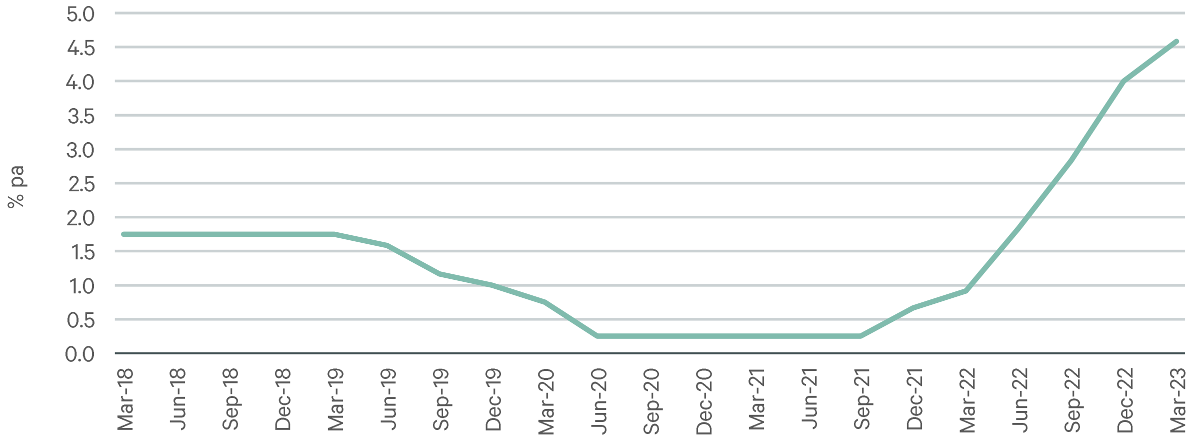
Both the market and the RBNZ are still expecting that CPI will be back within the 3% target ceiling by H2 2024, but a wide range of opinion remains on how quickly inflation will fall in the next few quarters, especially given the expansionary fiscal impulse presented in the latest governmental budget and migration pressures. Longer term rates have also been volatile but should provide some relief to fixed mortgage interest rates and property cap rates before the OCR starts moderating, although the rate of decline in 2023 is likely to be modest.

Consumer Price Index



Source: : Statistics New Zealand

Official Cash Rate (OCR) (quarterly average)



Source: Reserve Bank of New Zealand

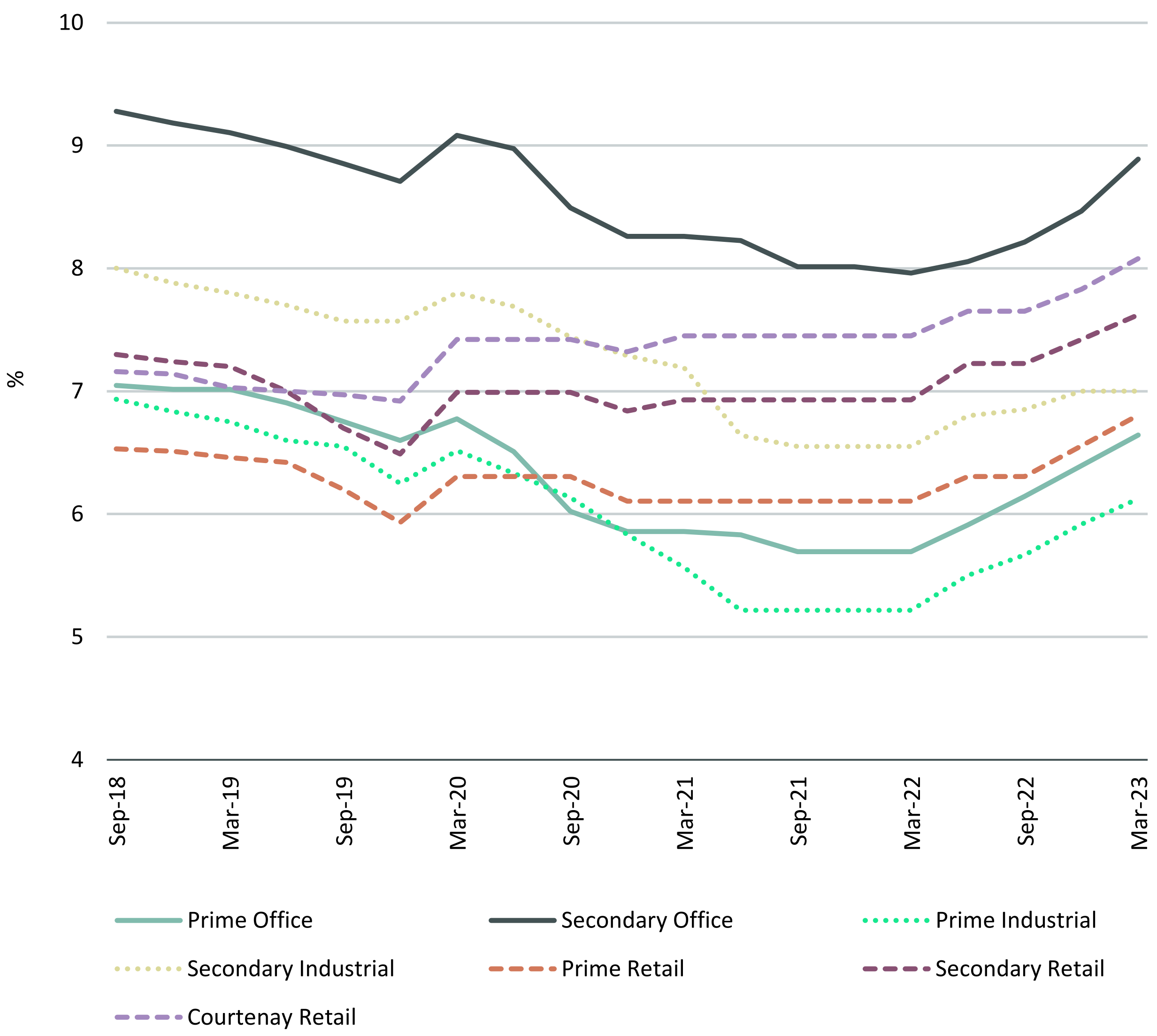
Investment market

During Q1 2023, yields continued their softening trend across almost all market sectors, with Secondary industrial the exception. The hike of the OCR by 300 basis points during the last eight months came through with greater force into the commercial real estate market in CBRE's assessments of indicative yields. Although investment market activity is starting to rebound with a greater volume of deals concluding and/or underway with clearer market price indicators, our quarterly yield assessments continue to primarily rely on CBRE's market interactions and available bidding statistics and aim to find the middle ground between the diverging expectations of potential vendors and purchasers.

On the investment side, funding influence and bank support remain key, pushing the pendulum in favour of those with portfolio funding capacity. In the current environment, investors are tending toward value-add opportunities, which can still offer a positive carry. With liquidity concentrated on these, they remain relatively resilient from a buyer demand perspective.

Despite low vacancy rates and rental growth dynamics, given their small margins relative to interest rates, Prime assets in both the office and industrial sectors registered the greatest changes in the last year with yields in Q1 2023 easing at similar rates (of 20-25 bps) as in Q4 last year. Retail is also seeing similar rates of easing, with Secondary office the most negatively impacted at 40-45bps increases during the quarter notwithstanding already high absolute yield levels.

Wellington Indicative Yields by Sector



CBD Office Vacancy

Wellington CBD office vacancy was largely stable during H2 2022, moving from 7.4% to 7.5%. The amount of total CBD vacant office area decreased from 99,200 sqm to 98,459 sqm in H2 2022, and the slight increase in the vacancy percentage was due to stock losses which had a denominator effect on the vacancy rate calculations. There also appears to be a spike in sub lease vacancy reappearing although not all this space is physically vacant,

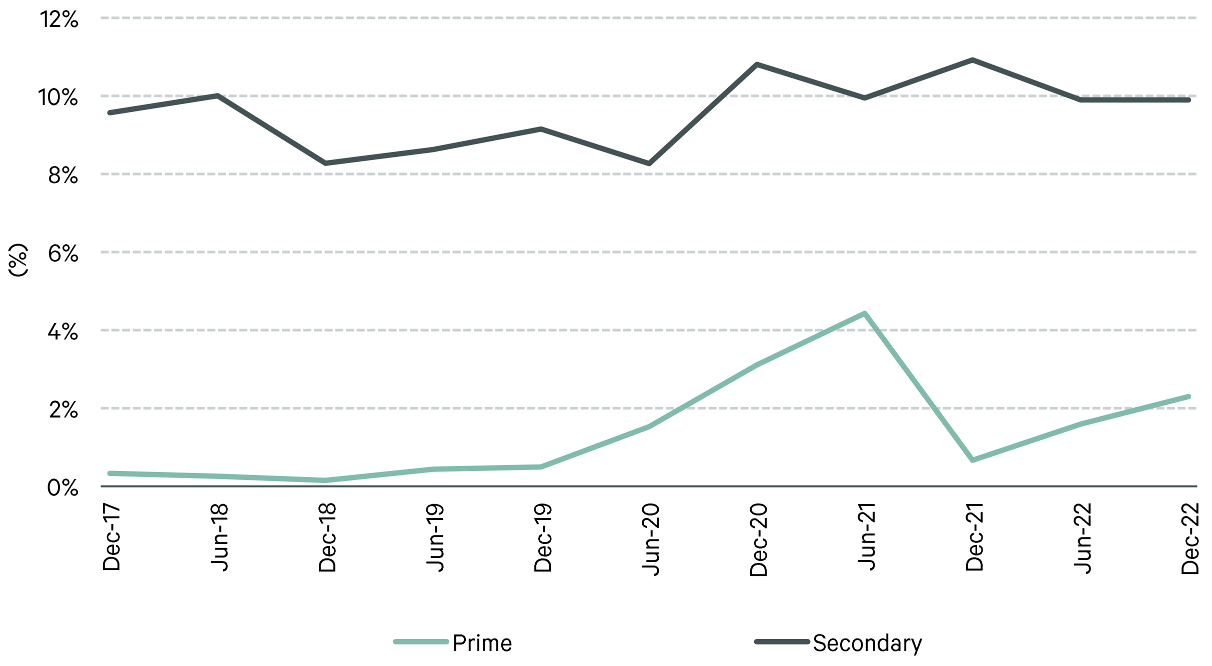
During H2, several buildings were taken out of the market including 33 Bowen Street from Grade B and 109 Featherston Street from Grade D in the Core CBD, one Grade B building (Environment House) in Thorndon, and one Grade D building (13-27 Manners Street) in Te Aro. These removals reduced the CBD office stock by circa 45,191 sqm. This reduction was partially offset by the introduction of circa 15,874 sqm of stock due to the completion of two new buildings (Site 9 and 40 Bowen Street) and one building that came back after being redeveloped (360 Lambton Quay).

While Secondary (Grade B to D) vacancy remained stable at 9.9% in H2 2022, Prime (Premium and Grade A) vacancy increased from 1.6% to 2.3% (a 3,498 sqm increase). Premium grade displayed a small increase in vacant space during this period, due to a financial services company leaving 420 sqm in the Deloitte Centre, which caused the Premium vacancy rate to increase from 0.7% to 1.2% during H2 2022. Also, Grade A vacancy increased from 1.8% to 2.6% in this period, mainly due to backfill vacancy implications (such as EY relocating from the Majestic Centre to 40 Bowen Street, providing 2,050 sqm more vacant space) and occupiers reducing their space footprint.

CBD Office Vacancy Change by Grade

		PREMIUM	GRADE A	GRADE B	GRADE C	GRADE D	TOTAL
Vacancy at December 2022	%	1.2%	2.6%	5.1%	12.6%	17.7%	7.5%
	sqm	954	8,995	21,577	37,265	29,668	98,459
Vacancy at June 2022	%	0.7%	1.8%	4.3%	10.9%	22.3%	7.4%
	sqm	534	5,917	19,667	32,469	40,613	99,200

Wellington CBD Office Vacancy



CBD Office Rents

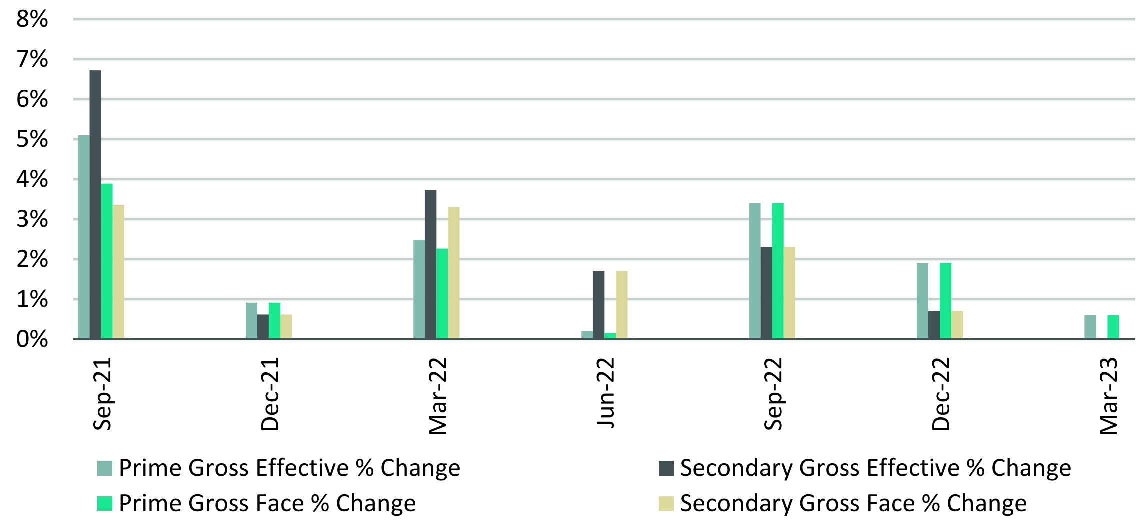
In Q1 2023, CBD Prime office rents experienced higher growth rates than Secondary. Rental growth for both Prime and Secondary office markets during this period was lower than during Q4 2022.

Also, during Q1 outgoings witnessed an increase across all CBD office submarkets due to insurance and property rate hikes, producing a decrease in net rents compared to Q4 2022. With Opex accounting for a larger share of their gross rents, the lowest-quality CBD office buildings were the ones most impacted by this.

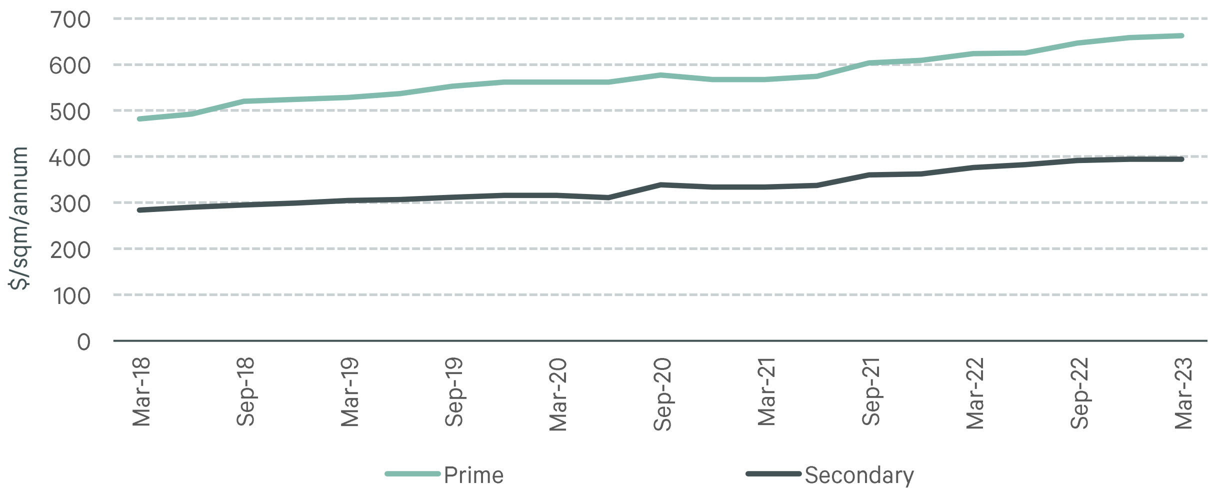
Both CBD Prime gross effective and Prime gross face rents rose by 0.6% during Q1 2023 compared to Q4 2022, averaging $662 and $703 per sqm respectively. Moreover, since CBD Secondary gross effective and Secondary gross face rents did not register growth during the same period, they continued to average $394 and $443 per sqm, respectively.

Based on CBRE's assessment, during Q1 2023 indicative market incentives remained stable for both Prime and Secondary space, accounting for 4.0% and 8.6% respectively of face rents.

Wellington Office Rents – Quarterly Change



Wellington Gross Effective Office Rents



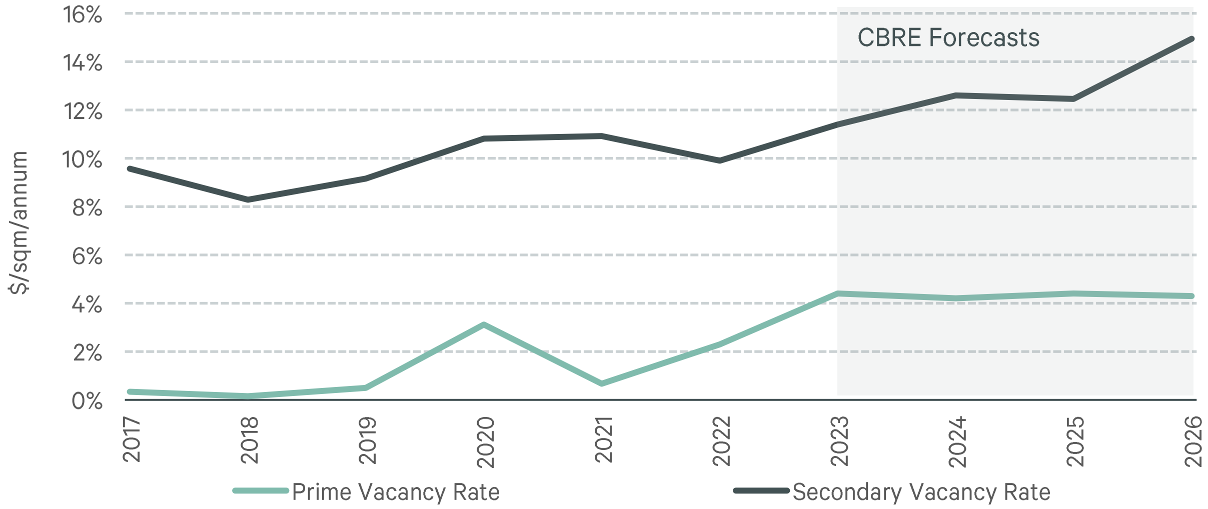
CBD Office Market Outlook

Diminishing economic growth is forecast to flow through to lower market demand in 2023 and 2024 although actual absorption is forecast to be volatile year to year. Supply additions, and the take up of pre-committed space in these, will have a material bearing on the expected annual fluctuations in absorption. CBRE expects moderately positive demand over the next four years at an annual average of just over 7,000 sqm in our base scenario forecasts.

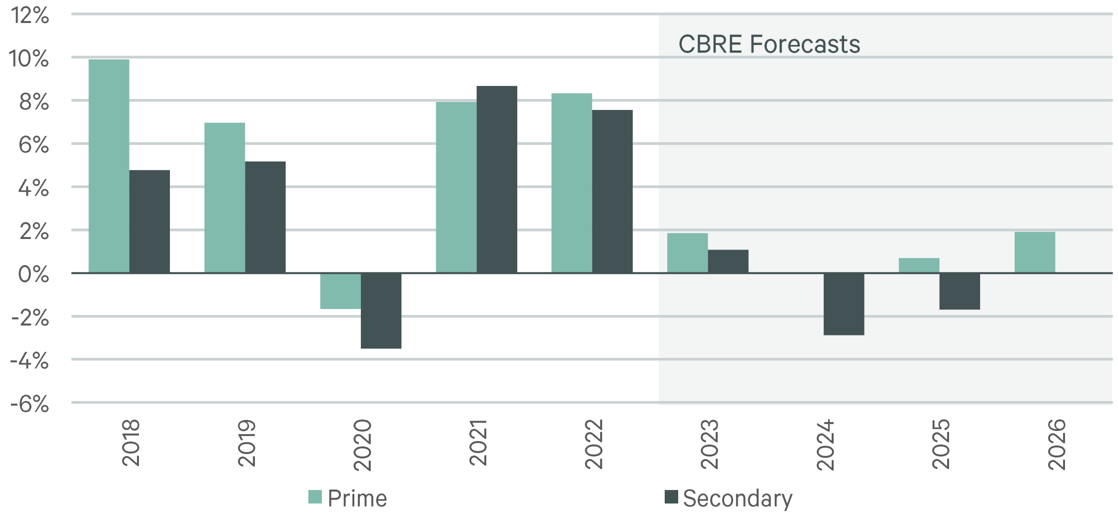
In terms of stock, three new buildings are expected to be completed: Victoria Quarter (Stage 1), 44 Bowen Street (part of the Bowen Campus Stage Two project) and One Whitmore. The last two (both over 10,000 sqm) have a 100% pre-commitment level, although with backfill vacancy implications. Examples include NZTA moving out of Chews Lane to 44 Bowen Street and BNZ moving out of three existing buildings to One Whitmore. Also, three buildings are expected to finish their refurbishment work during 2023: 126 Lambton Quay, Bowen House, and Asteron Centre. Asteron Centre's previous tenants are expected to come back in 2023. However, at the time of our latest vacancy survey circa 12,000 sqm of space remained available for lease, mainly because some major tenants (like IRD) will occupy less space than before.

We expect vacancy to increase in 2023 given the significant net supply pipeline. In our base forecast scenario vacancy will increase by 56,000 sqm. While the bulk of the vacancy increases will fall in Secondary grade, occupier relocations from existing Prime buildings into new build Prime will also create an overhang of Prime backfill vacancy in addition to a measure of speculative, yet to be committed, new supply. In a broader context however, the circa 4% vacancy expected for the Prime submarket remains modest.

CBD Office Actual and Forecast Vacancy



CBD Office Actual and Forecast Annual Gross Effective Rental Change

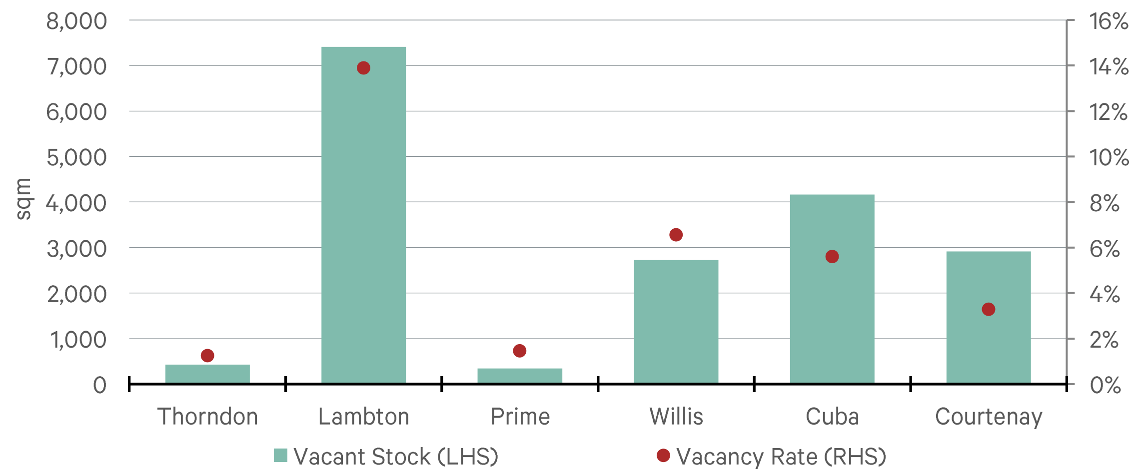


Retail Vacancy

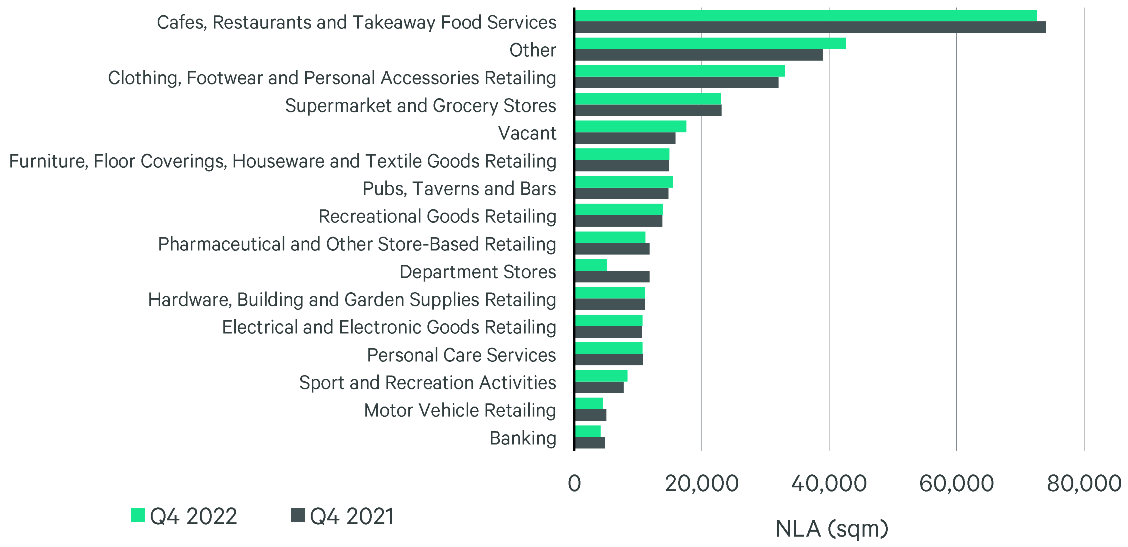
During 2022 Wellington CBD retail vacancy was relatively resilient. The vacancy rate increased from 5.2% to 5.7% compared to December 2021. David Jones has left the market resulting in a decrease of total department store space, but all their legacy retail space has now been leased to several brands. Also, the market gained some new shops associated with office building completions, for example, five new shops at 360 Lambton Quay & 8 Willis Street and three new shops on the ground floor of Site 9.

The biggest change in the category composition of the CBD retail market was the reduction in department store space. Space occupied by cafes, restaurants and takeaways also reduced slightly but this category remains by far the largest occupier. On the other hand, clothing, footwear and accessories retailers saw their collective footprint increase during the year.

Wellington Retail Vacancy by Precinct - Q4 2022



Wellington Retail Occupancy by Industry

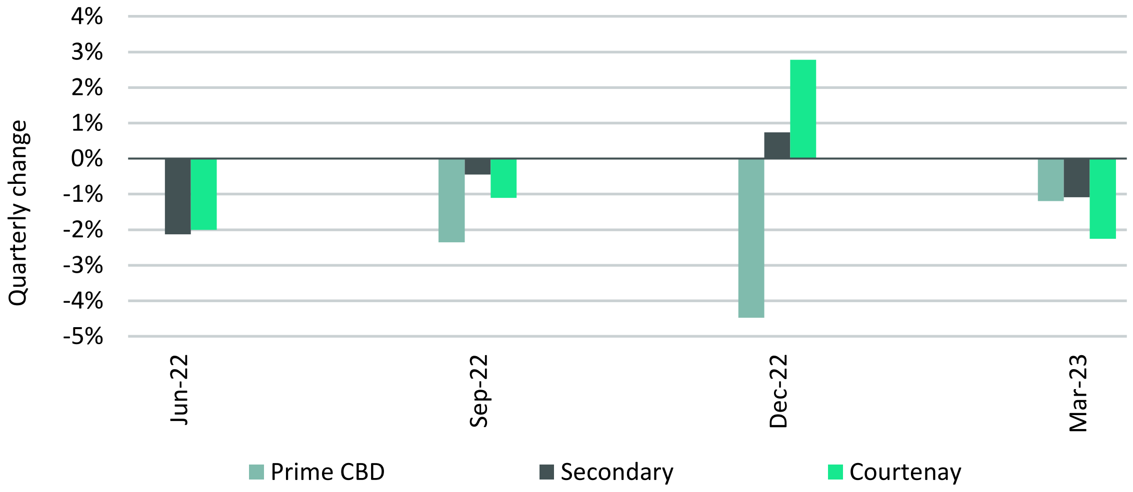


Retail Rents

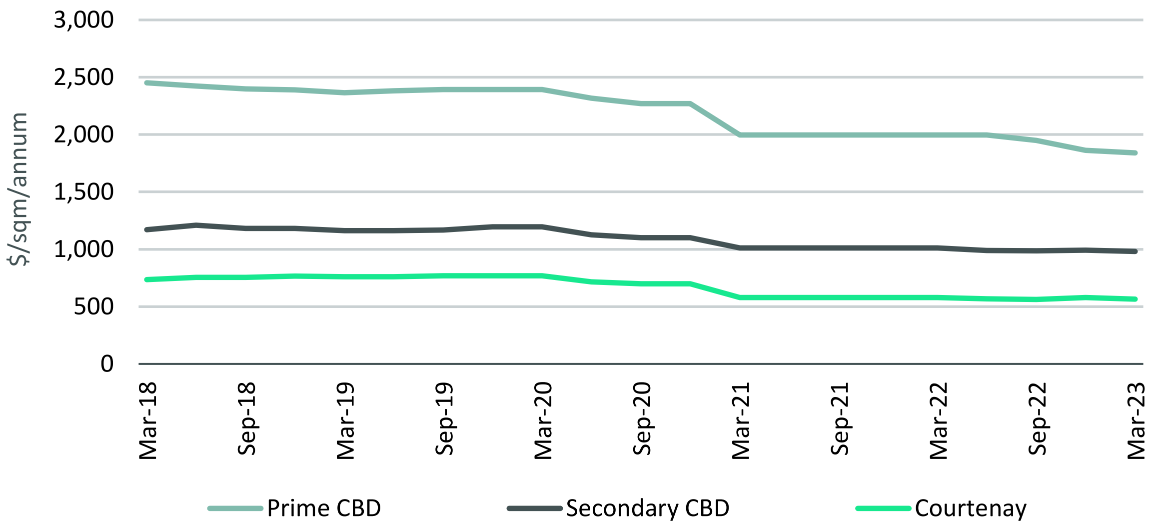
Gross rents remained unchanged in all CBD retail locations during Q1 2023. The retail market continues to be stable, especially in the Prime CBD (Lambton Quay) and in the Secondary CBD (Willis Street and Cuba Street) markets that continue to benefit from improving demand for retail space and increasing foot traffic levels. However, some areas of the CBD, such as Courtenay Place, remain subdued and challenging from a retail leasing perspective.

According to CBRE's assessment, all retail submarkets experienced a drop in net effective rents in Q1 due to a universal hike in Opex.

Wellington Retail Rents – Quarterly Change



Wellington Net Effective Retail Rents



Industrial Vacancy

Overall vacancy remained at 2.4% during the twelve months to December 2022, representing only a 222 sqm increase in vacant space. Grade A vacancy remained unchanged at zero, showing continuous demand for high-quality industrial space in Wellington. The increase in vacancy in Grade B industrial buildings (2,588 sqm) during 2022 was offset by the decrease in vacant stock in the Grade C submarket (-2,366 sqm).

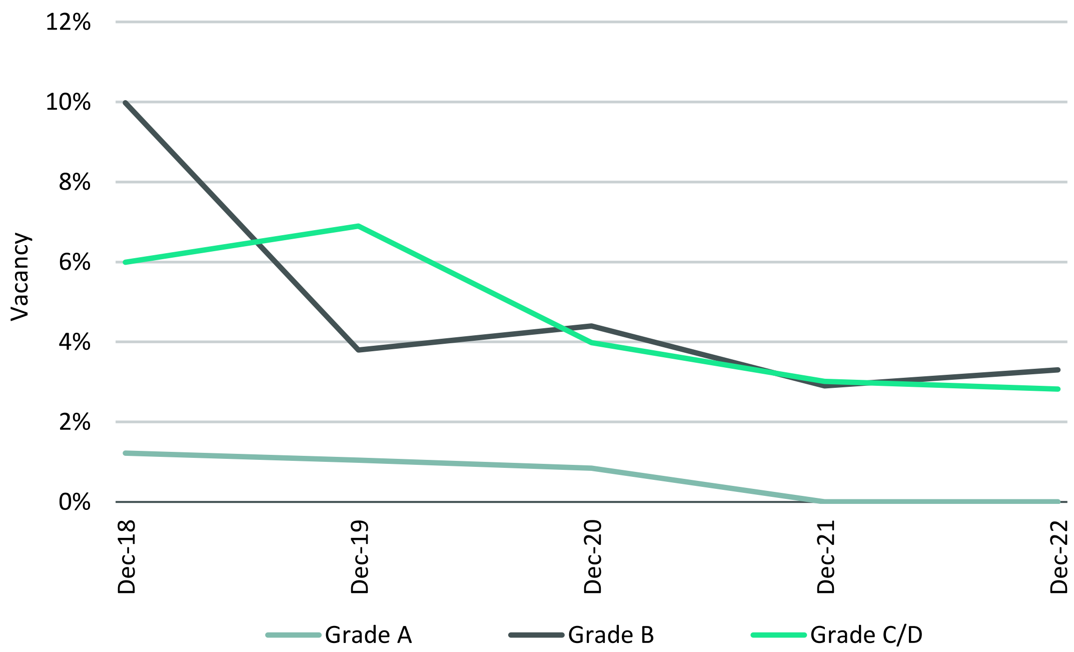
Circa 27,750 sqm were added to the market as new stock. Also, 11,350 sqm were withdrawn from the market, out of which 1,940 sqm were from a vacant Grade C building in Naenae.

Seaview experienced the largest change in vacancy, decreasing from 2.2% to 1.1%, largely due to 20 Bell South Road, a 5,970 sqm building that is now owner occupied. Also, Upper Hutt experienced the largest vacant space increase (7,330 sqm), mainly due to 42 Lane Street, a 2,270 sqm building that became vacant due to a civil engineering company leaving this property.

Wellington Industrial Vacancy Change by Grade

		GRADE A	GRADE B	GRADE C/D	TOTAL
Vacancy at December 2022	%	0.0%	3.3%	2.8%	2.4%
	sqm	0	18,796	32,585	51,381
Vacancy at December 2021	%	0.0%	2.9%	3.0%	2.4%
	sqm	0	16,208	34,951	51,159

Wellington Industrial Vacancy

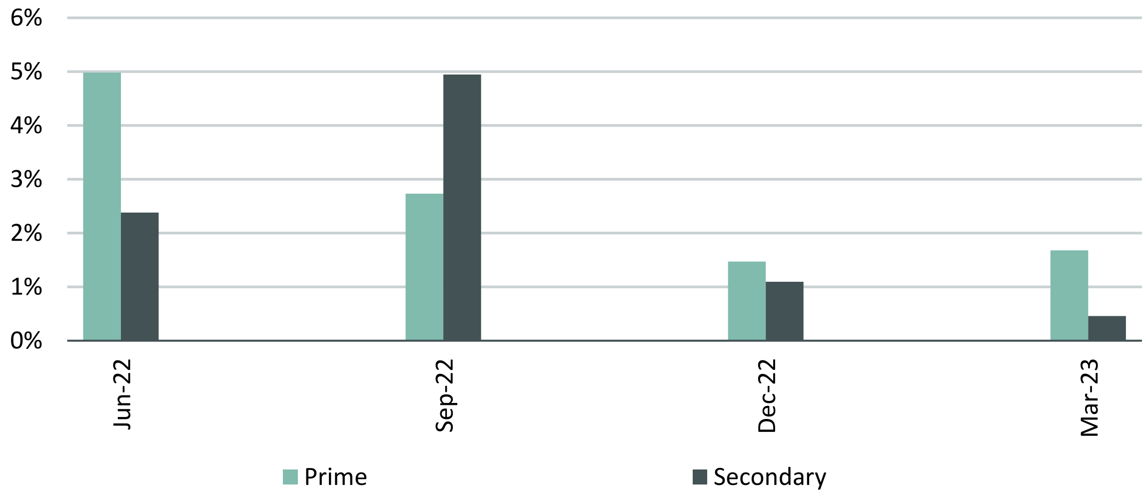


Industrial Rents

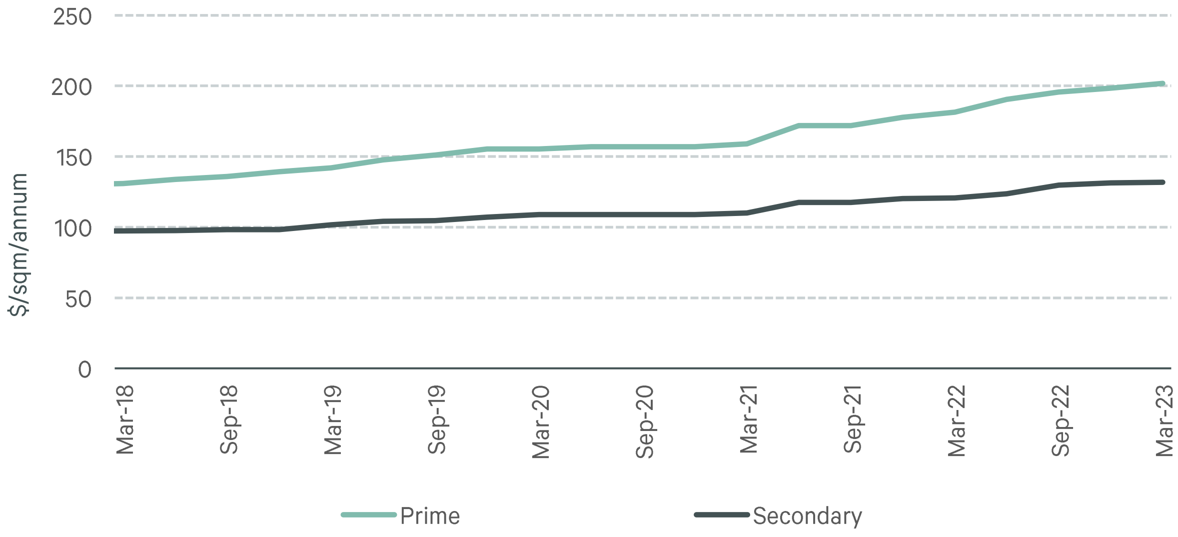
In Q1 2023 the rental growth trend registered in previous quarters continued for both the Prime and Secondary submarkets. Industrial Prime gross effective rents reached $202 per sqm, up by 1.7% compared to the previous quarter. Also, during the same period Industrial Secondary gross effective rents reached $132 per sqm, up by 0.5% compared to Q4 2022. However, an increase in Opex during Q1 triggered a drop in net effective rents in all industrial submarkets.

Based on CBRE's assessment, indicative market incentives remained unchanged in Q1 2023. The Wellington Industrial market has been characterised by consistent incentives during the past three years with Prime incentives at 1.9% of face rents and Secondary at 4.2% of face rents.

Industrial Gross Effective Rents Quarterly Change



Wellington Industrial Gross Effective Rents



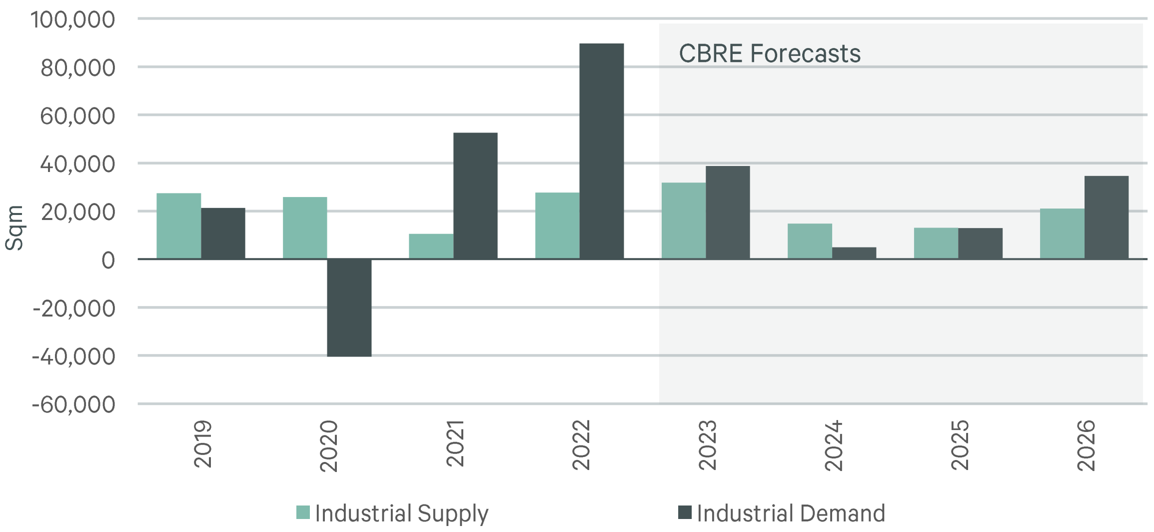
Industrial Market Outlook

Weaker economic conditions could translate into lower demand for industrial space in the next two years. However, compared to previous cycles, we feel that the bottom of the current cycle will remain relatively resilient.

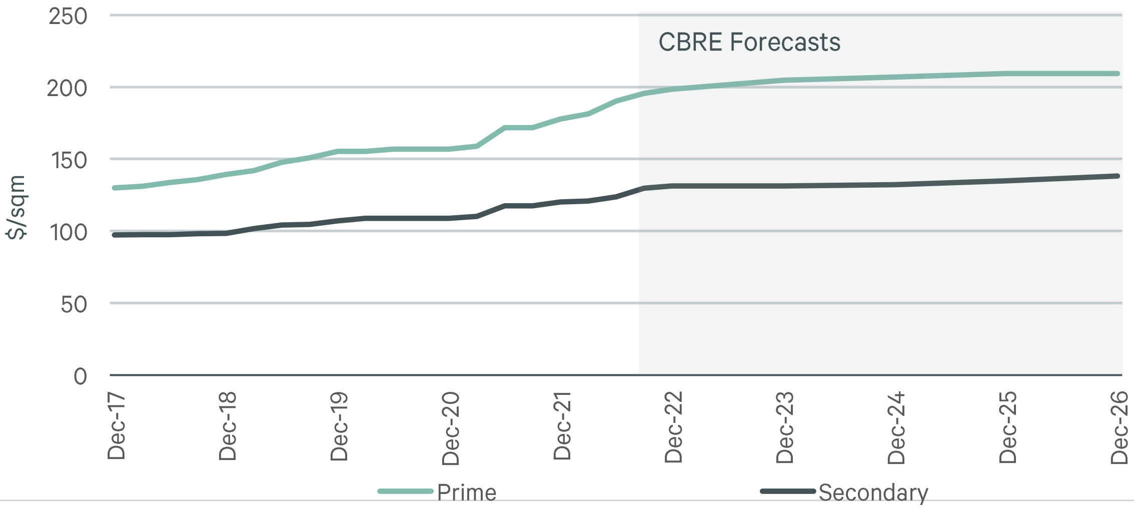
The supply pipeline remains strong into 2023, with small unit developments dominating. The biggest of these is the Works Elsdon in Porirua totalling some 11,000 sqm across 87 units. CBRE expects new industrial supply to increase over the next four years at an annual average of just over 20,000 sqm in our base scenario forecasts.

The strong rent growth momentum experienced in 2021 continued into 2022. However, this year we expect growth rates to ease. Positive momentum should carry into the first half of 2023, but the growth rate is forecast to weaken over the calendar year. It's likely that Prime will outperform Secondary.

Wellington Industrial Supply and Demand Forecasts



Wellington Industrial Gross Effective Rents Outlook



Definitions

Office building grades

Premium: Top quality landmark space which is generally the pacesetter in establishing rents and includes the following general attributes: prestige lobby; high architectural merit; prominent location; prestigious occupiers; the latest or recent generation of building services; ample natural lighting; good views and outlook; quality access to and from an attractive street environment; large size - +20,000 sqm. **Grade A**: High-quality modern space including many but not all Premium features. **Grade B**: Good quality modern space with some but not all Grade A features and to a lower standard. **Grade C**: Average quality air-conditioned space. **Grade D**: Older style poor quality space. **Prime**: Combination of Premium and Grade A. **Secondary**: Combination of Grade B and C.

Industrial building grades

Prime: Industrial space used for general warehousing or logistics with stud heights of 9 metres or more, largely column free. Lettable area will exceed 1,500 sqm. The property will be of a high specification and well maintained. The grade encompasses properties from the current generation of design build premises to buildings built over the previous cycle. **Secondary**: Industrial space generally built prior to the mid 1990s, inferior to Prime space in terms of building quality and specifications being lower stud (generally between 6 and 9 metres) and in some cases lacking Capex and having deferred maintenance issues although still providing functional industrial accommodation. Lettable area will exceed 500 sqm.

Rents and yields

CBRE uses the "basket of buildings" methodology to determine market yields and rents. For each property sector covered, a group of representative buildings are nominated and a panel containing senior members of appropriate departments within CBRE convenes to assess the market level of yields and rents for these buildings. Based on this, CBRE's indicative average rental and yield figures reflect our view of the market after considering available appropriate evidence. Yields represent initial yields based on market rents. Rents are net effective. The industrial rents presented are a combined warehouse and office figure.

Contacts

Zoltan Moricz
Executive Director, Head of Research New Zealand
zoltan.moricz@cbre.co.nz

Matthew St Amand
Managing Director, Wellington
t: +64 27 562 2244
e: matt.stamand@cbre.co.nz

Graeme Lundie
National Director, Property Management
t: +64 21 586343
e: graeme.lundie@cbre.co.nz

Duncan Watts
Director, Valuation & Advisory Services
t: +64 27 414 0174
e: duncan.watts@cbre.co.nz

Jorge Chang Urrea
Research Manager
jorge.changurrea@cbre.com

Matt Hince
Director, Office Leasing
t: +64 21 333 005
e: matt.hince@cbre.co.nz

Martin Veale
Senior Director, Valuation & Advisory Services
t: +64 27 448 6825
e: martin.veale@cbre.com

CBRE