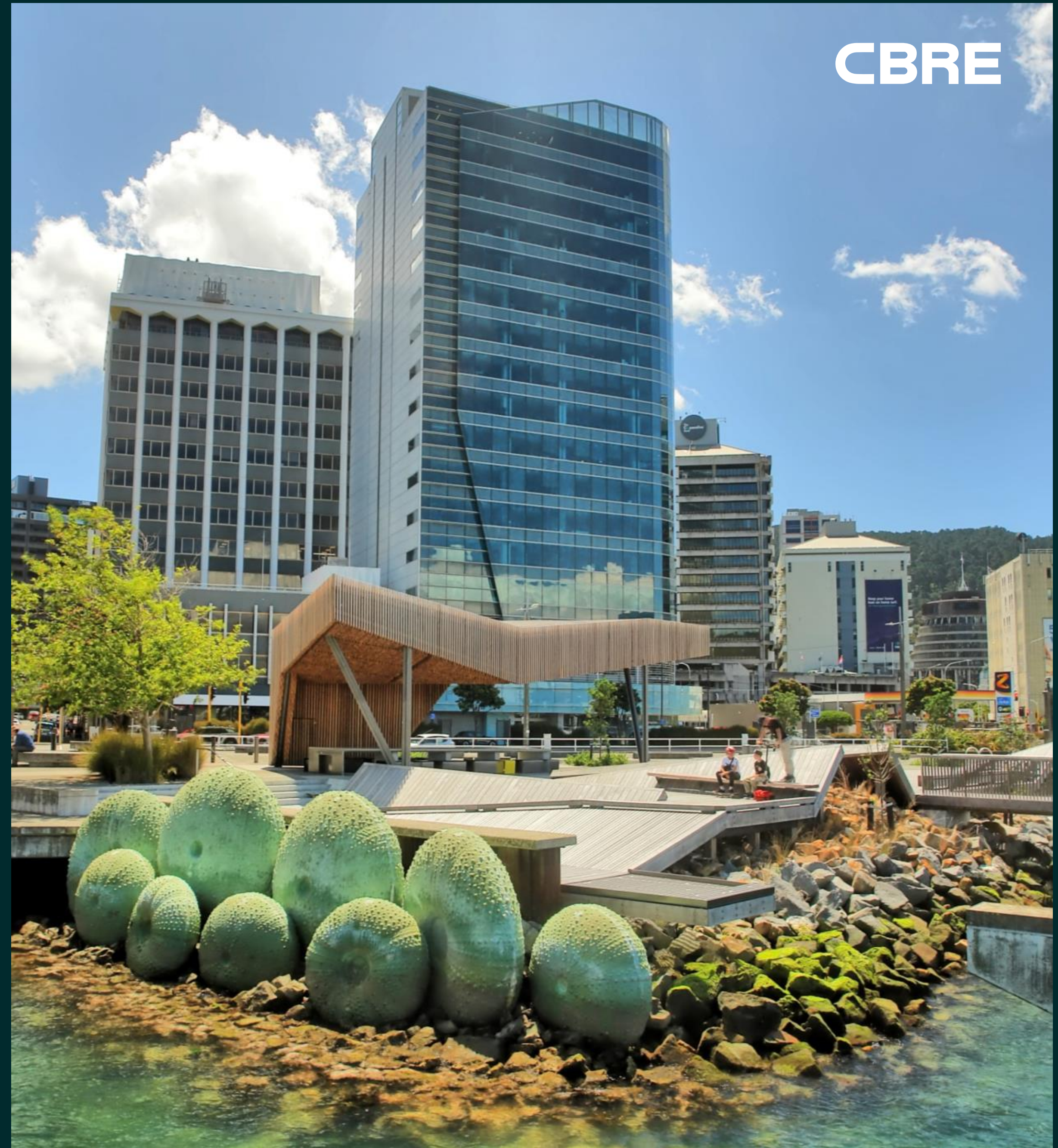
Intelligent Investment

2024

New Zealand Market Outlook

REPORT

CBRE RESEARCH
March 2024



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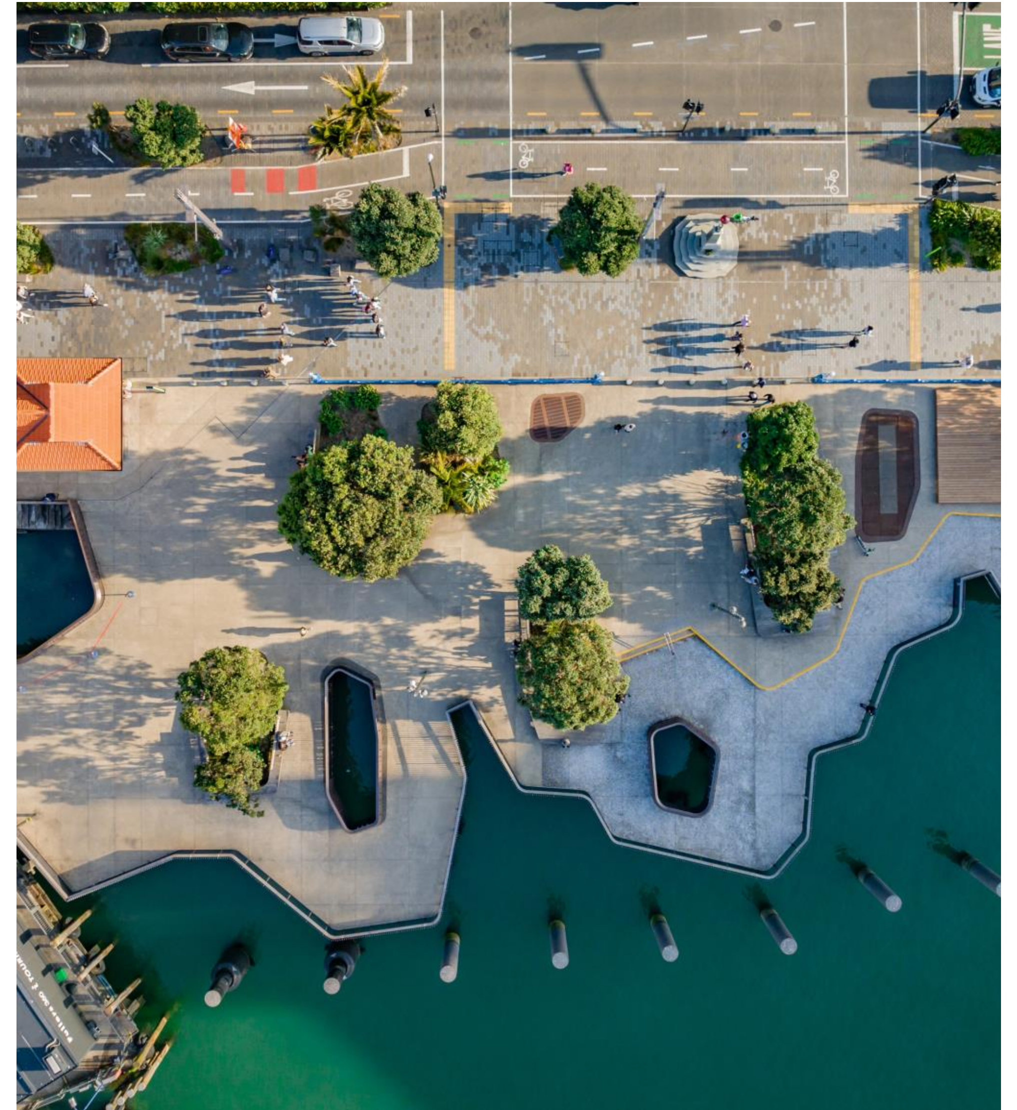

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> Total returns are forecast at 3.5% in 2024.
>
> By 2025 both rents and yields will contribute positively to capital growth and total returns approach 14% in 2026.

Zoltan Moricz

Head of New Zealand Research

We are close to the top of the current yield cycle, although we expect selling pressure on some vendors to intensify in the coming months. Average Prime yields are forecast to fall from their cyclical peak of 6.80% in mid-2024 to 6.40% in December 2025. Based on interest rate forecasts, this also implies yield to 2-year swap rate margins expanding from 175 bps to 280 bps.

Investor allocations to real estate will increase, with the current market seen as a good time to buy for those in a position to do so. Investors see the market as having had a reasonable price adjustment with more motivated sellers. This provides a window of buying opportunity over the next six to nine months. Investor sentiment remains the most robust towards industrial but is improving for the retail and hotel sectors. Residential built-to-sell and student accommodation are also gaining more attention, complementing the already strong interest in built-to-rent.

Expansionary demand remains a feature of the occupier market but to a lesser degree than in the past two years. Office occupiers are pursuing real estate strategies in support of new workplace requirements. This will continue to manifest in a general flight to quality trend, although, in 2024, cost conscious occupiers will be more focused on restructuring leases and optimising current premises to be fit for purpose in the hybrid working era. Amenity requirements are also evolving, with our office occupier survey indicating that proximity to public transport access is becoming organisations' most important building/location level amenity.

Occupier demand for more sustainable buildings is increasingly manifesting in greater willingness to pay a rent premium to support the more significant upfront cost of provision. As we move into 2025 and beyond, Green Star and Nabers credentials will become an increasingly important differentiator of asset level occupancy and rental performance.

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01

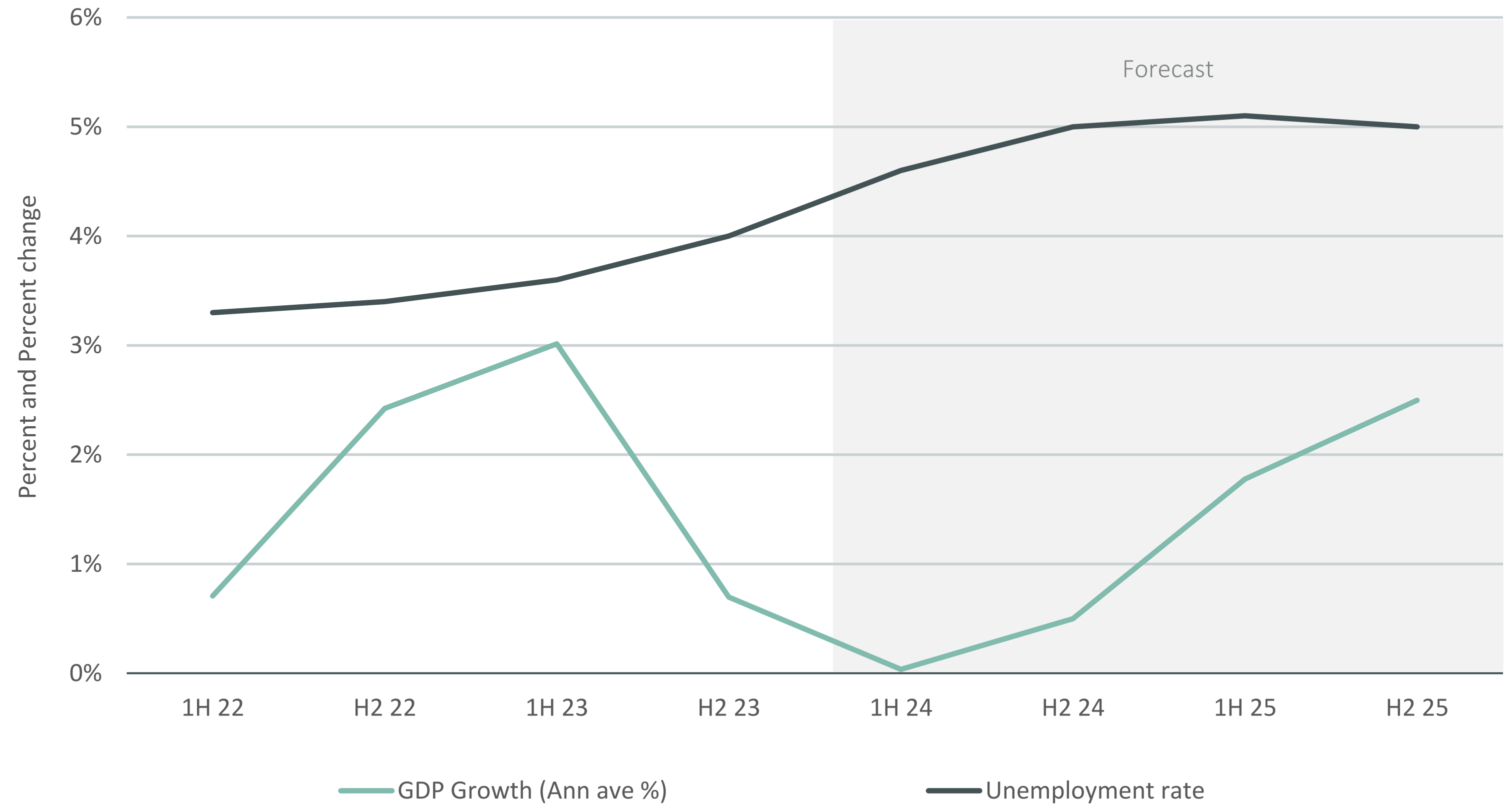
Economic Outlook

GDP growth bottoming out in first half of 2024

The New Zealand economy lost steam during 2023 after exposure to the consequences of a restrictive monetary policy, high cost of living, low economic confidence, and external shocks. Restrictive monetary conditions will continue to hinder interest rate-sensitive pockets of the economy in 2024, and residential investment, business investment, and household spending are expected to underperform.

While monetary conditions are a considerable headwind to growth, the tailwinds from net migration and increasing tourism provide some positive offset. The new National-led government's growth influence through improving business confidence and looser housing-related policy is likely to act as a slightly stronger economic tailwind than otherwise, although it is also be winding back some of the fiscal stimulus from the previous government.

Figure 1: New Zealand GDP Growth And Employment



Source: Stats NZ, Economist forecasts, CBRE Research

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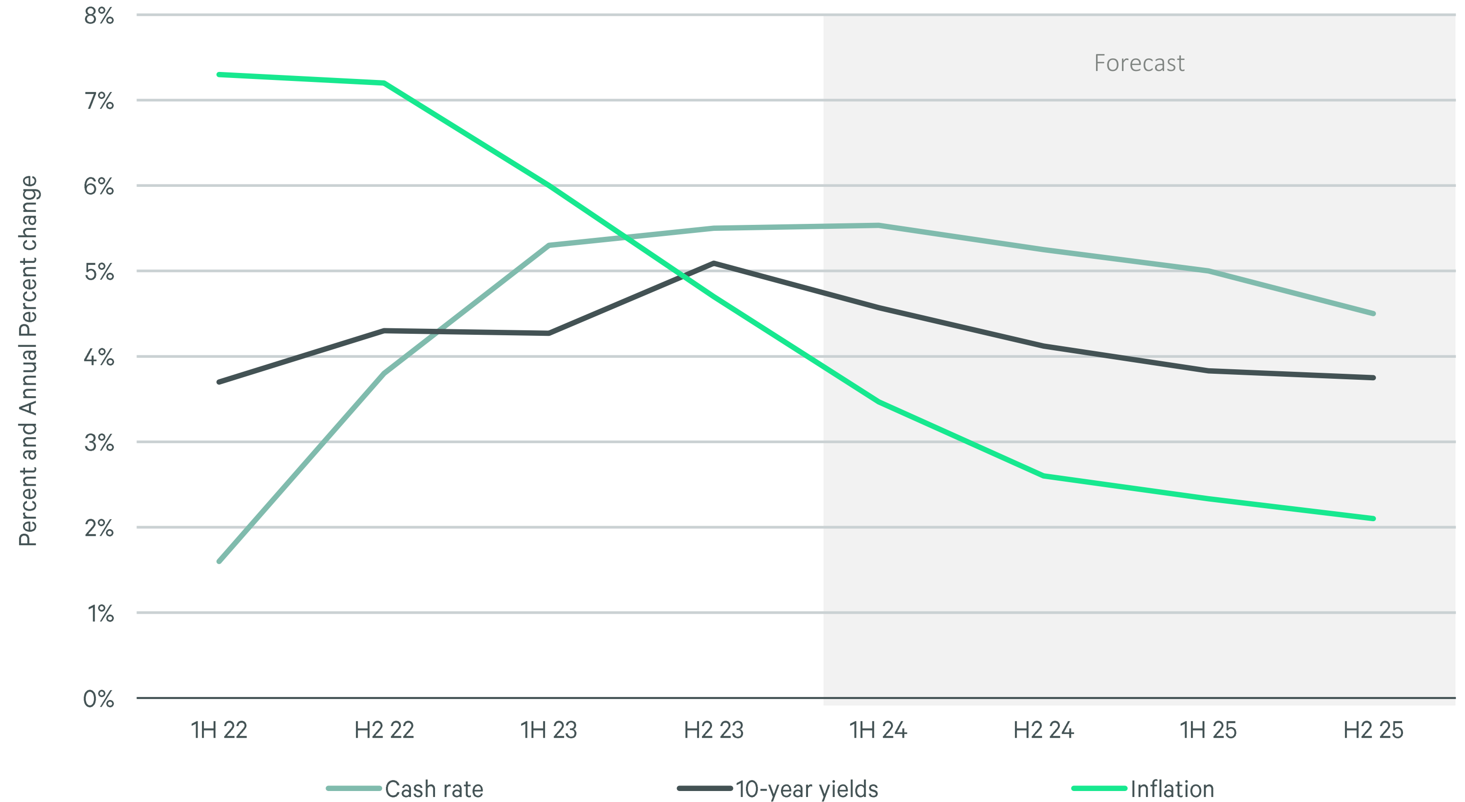
Market starting to see beyond the peak of the interest rate cycle

Current market consensus points to a cut in the cash rate in late 2024 or early 2025. Long-term interest rates started to retreat after a spike early in the year. This decline was more apparent after the RBNZ's less hawkish wording in its last meeting, in which it slightly reduced the probability of another hike this year, even though it continued to signal to the market that a cut will materialise by early 2025.

In its latest statement, the RBNZ mentioned that high population growth due to high levels of net immigration is a key variable that will continue to pour glue over domestic-generated inflation, making it potentially stickier in the short term, although New Zealand's CPI will likely be back within the RBNZ's target range by late-2024.

We expect that the OCR, wholesale rates, and bond rates will all fall 100-125 bps by mid to late 2025.

Figure 2: New Zealand Interest Rates And Inflation



Source: Stats NZ, Economist forecasts, CBRE Research

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Recent population growth tracking above Stats NZ's high growth scenario

2023 saw two annual records for immigration into New Zealand by non-New Zealand citizens.

- The country witnessed 254,400 migrant arrivals in the year to December 2023, the highest ever for a 12-month period.
- The overall net population gain from migration was 139,000, an increase of around 2.5% of the country's population in the past year.

Between 2018 and 2020, population growth was tracking above Statistics New Zealand's high growth scenario. Even with the impact of Covid on migration, growth currently tracks above the medium growth projection scenario.

If future population growth only tracks at Statistics New Zealand's medium projected growth rate, which is well below recent trends, we will see an extra 210,000 people by 2028. If growth eventuates at their high growth scenario (still below last year's growth), population will lift by about 520,000 people during the five-year period from 2024 to 2028.

Figure 3: Net Migration (rolling year ended)

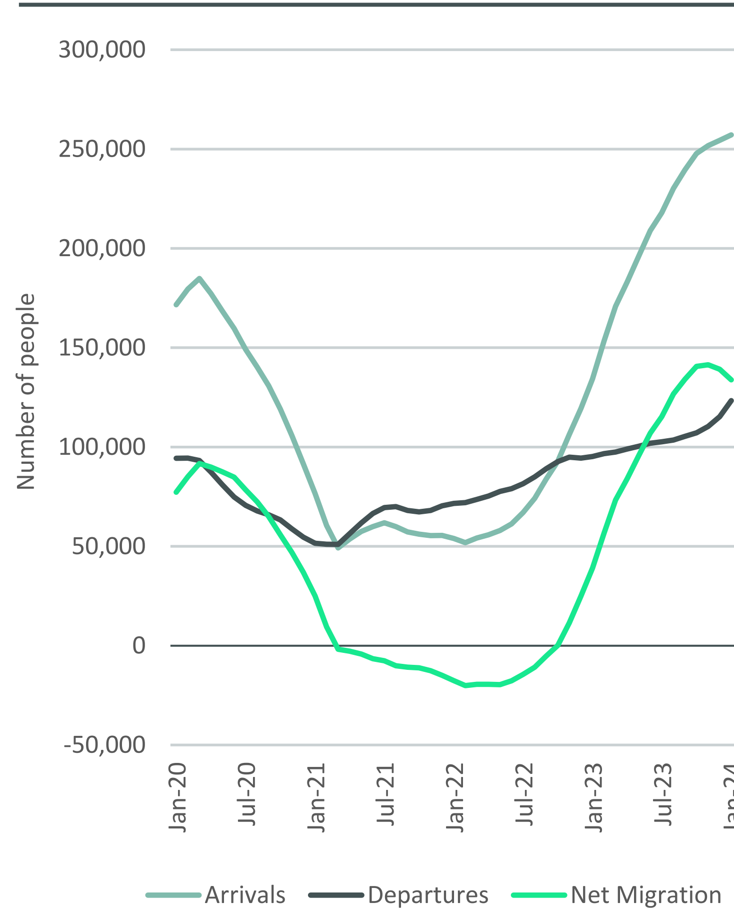

Figure 4: Population Projections to 2018-2028 vs Actual to 2021

Source: Stats NZ, CBRE Research

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02

Emerging Themes

APAC investors keen to increase allocations to real estate

CBRE's 2024 APAC Investor Intentions Survey indicates a general desire towards greater real estate allocations. More than half of Australian and Korean respondents said they would look to increase their allocation to real estate. While the predominant sentiment amongst Singaporean, Japanese, and Hong Kong SAR investors is allocations remaining stable in 2024, investors domiciled in these markets still show a greater desire to increase rather than decrease real estate allocations.

The reasons for increasing allocations are not surprising. They predominantly revolve around the current market being seen as a good time to buy for those in a position to do so. Investors see the market as having had a reasonable price adjustment with more motivated sellers, which provides a window of buying opportunity.

While our survey results don't explicitly indicate an appetite for investment in New Zealand, they indicate an opportunity to capture an increased volume of cross-border capital.

Figure 5: Real Estate Allocation In 2024 By Investor Origin

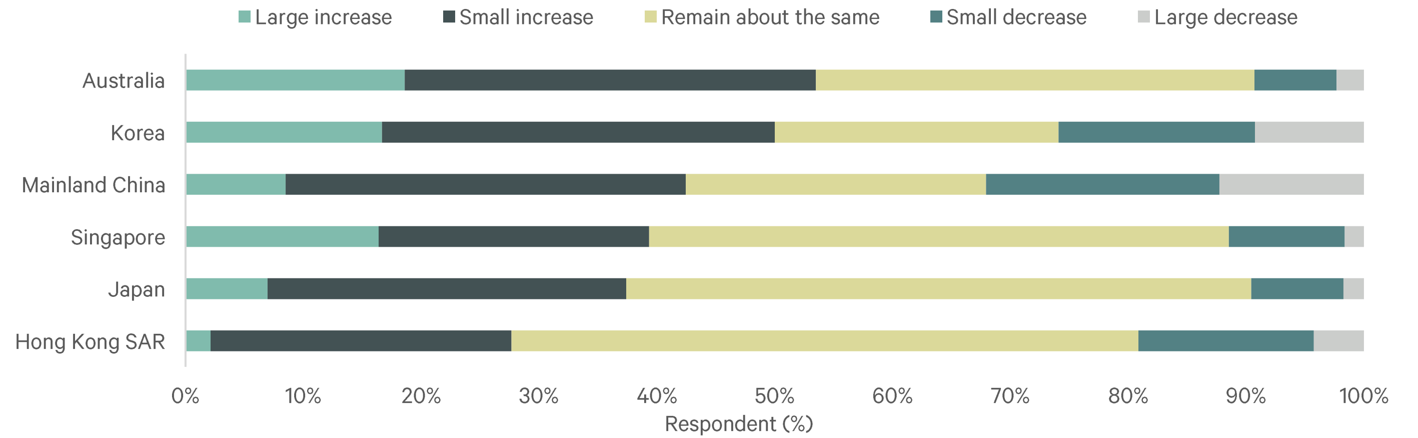
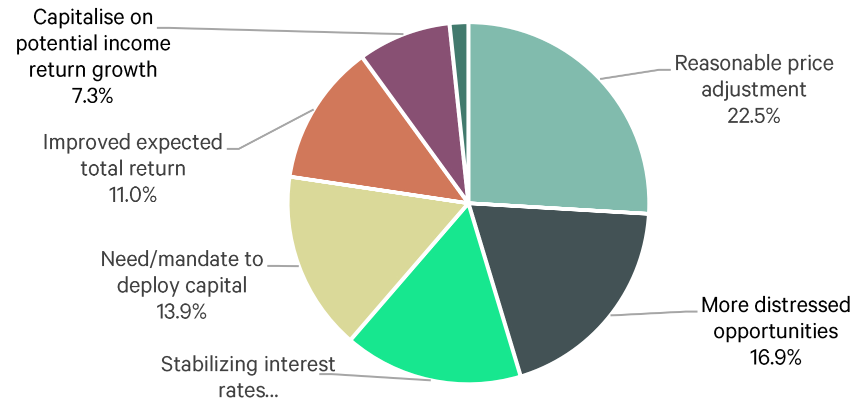


Figure 6: Reason For Increasing Real Estate Allocation In 2024



Source: CBRE Research, Asia Pacific Investor Intentions Survey

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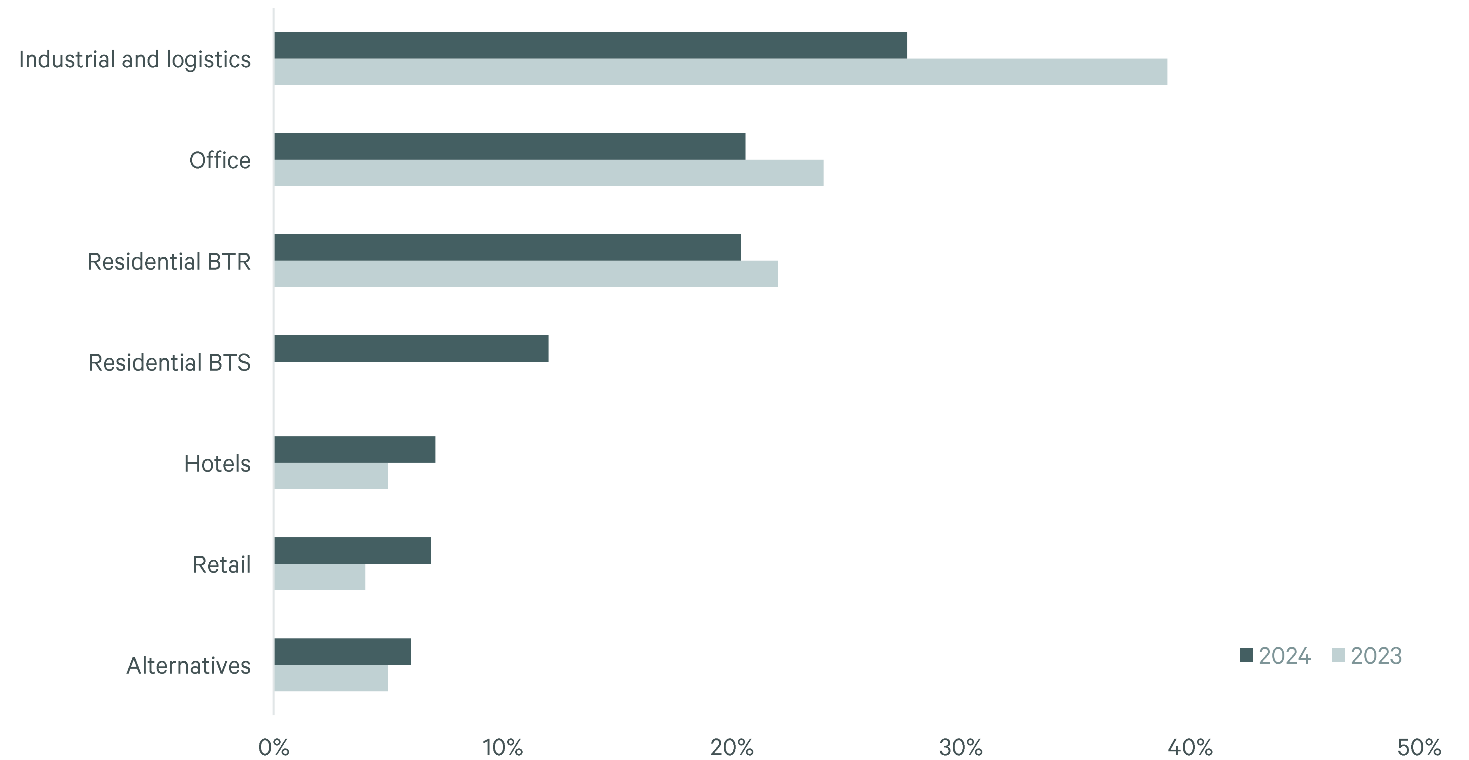
Sectoral investment preferences are shifting

Investors continue to favour logistics most, followed by office. However, interest in both asset classes faded from the previous year.

Despite economic and monetary headwinds, the living sector with an emerging built-to-sell component remains resilient, with ongoing structural change continuing to underpin demand, although the market size remains relatively small. Australia has become a significant market of focus for global capital seeking build-to-rent development and investment opportunities, although currently, it's unclear to what extent New Zealand can leverage this in the short term.

While the retail and hotel sectors are not primary investment targets, investor sentiment towards them is improving.

Figure 7: Which Mainstream Property Sector Are You Primarily Targeting For Investment In 2024?



Source: CBRE Research, Asia Pacific Investor Intentions Survey

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Debt markets remain challenging but lending appetite is improving

CBRE New Zealand's latest lender survey of 20 onshore and offshore bank and non-bank lenders shows a slight improvement in lending appetite. This improvement is mainly for investment loans, with a net result of 45% (those expecting appetite to be up minus those expecting appetite to be down). For construction loans, the net result is 21%, up from 12% in 2022.

While banks have advised they have a greater appetite for lending, anecdotally, they remain conservative when considering new transactions and are primarily focused on servicing existing clients. Opportunistic non-banks will increase lending, albeit cautiously and with expectations of higher returns.

The decrease in construction lending is demand driven. Due to challenging market conditions, fewer projects have commenced, especially in the residential space.

Construction lending will continue to be driven by a flight to quality. Until residential presales levels and construction costs normalise, construction lending will diminish.

Figure 8: Appetite For New Non-construction Loans Is Likely To Move

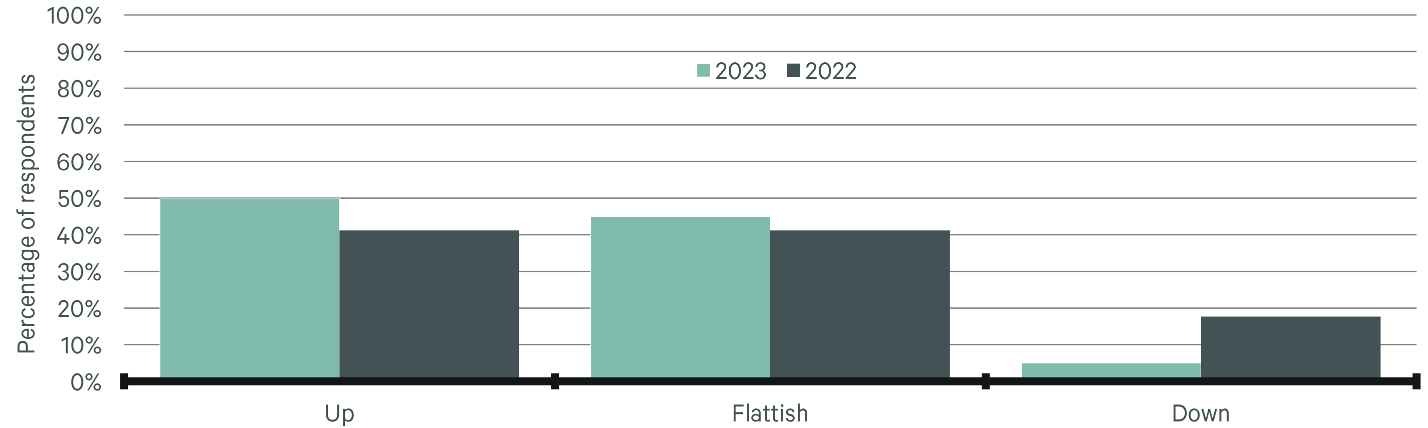
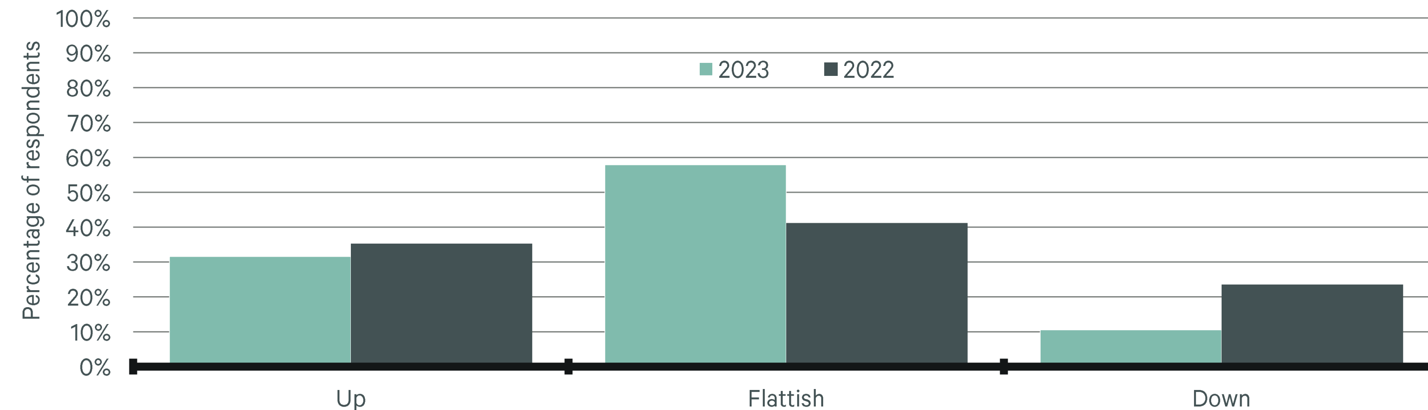


Figure 9: Appetite For New Construction Loans Is Likely To Move



Source: CBRE Research, New Zealand Lenders' Survey

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Occupier demand for more sustainable buildings is driving increased occupancy and rental premiums

Occupier demand for more sustainable buildings is increasingly manifesting in a greater willingness to pay a rent premium to support the greater upfront cost of provision.

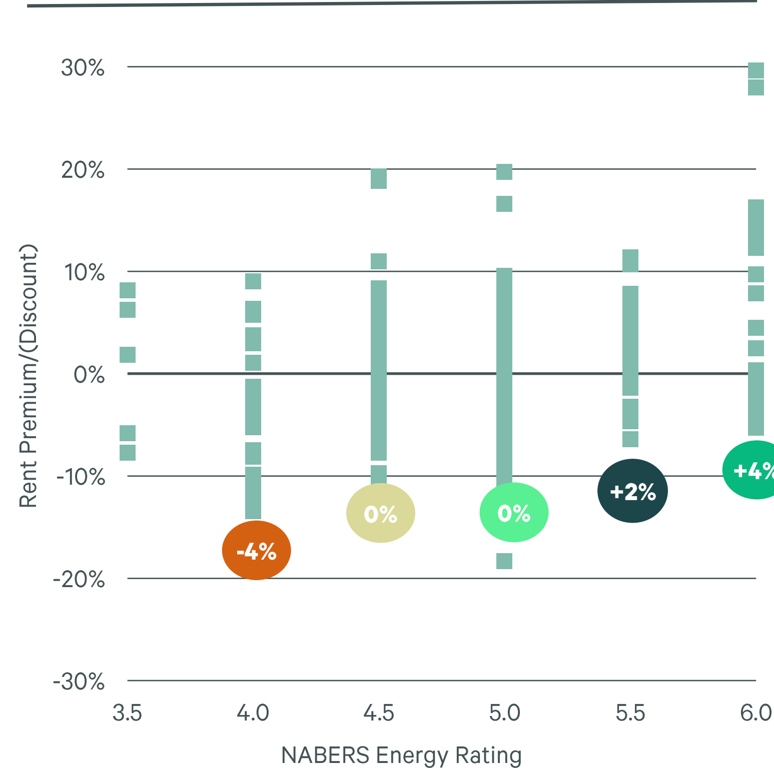
Our Australian colleagues compared office building rents based on their NABERS ratings. They determined the premium/(discount) by comparing peer buildings within the same market sectors. The data suggests discounts for the lowest rated and premiums for the highest rated buildings ranging from;

2%-4%

Similarly, the analysis of Green Star rated office buildings found that the average occupancy rate improved by 2% for each notch of ratings, 4 Star vs 5 Star vs 6 Star.

Results from our most recent New Zealand industrial occupier survey also indicate that 36% of occupiers are prepared to pay a rental premium of 5% or more for a building that meets their environmental sustainability goals.

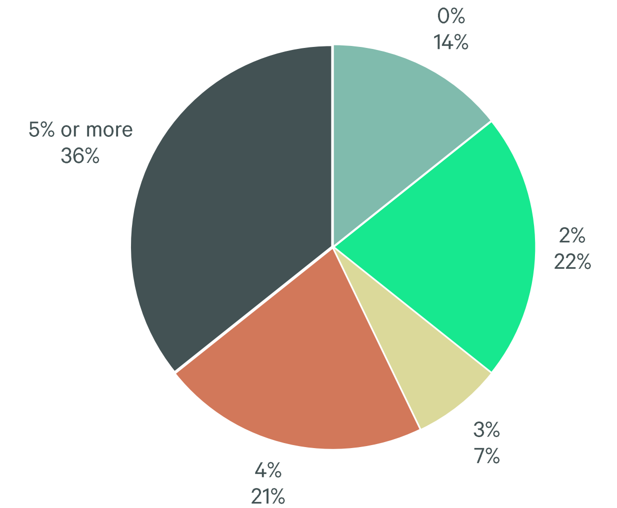
Figure 10: Office Rent Premium/(Discount) To Same City Peers And NABERS Energy Rating (Australian Main Cities)



Source: Company reports, CBRE Research

Figure 11: New Zealand Industrial Occupiers' Willingness To Accept Cost Increases For More Sustainable Buildings

What is the level of 'direct' cost increase that you are willing to accept in order to achieve greater environmental sustainability performance?



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New Zealand is taking a balanced approach in adopting hybrid working

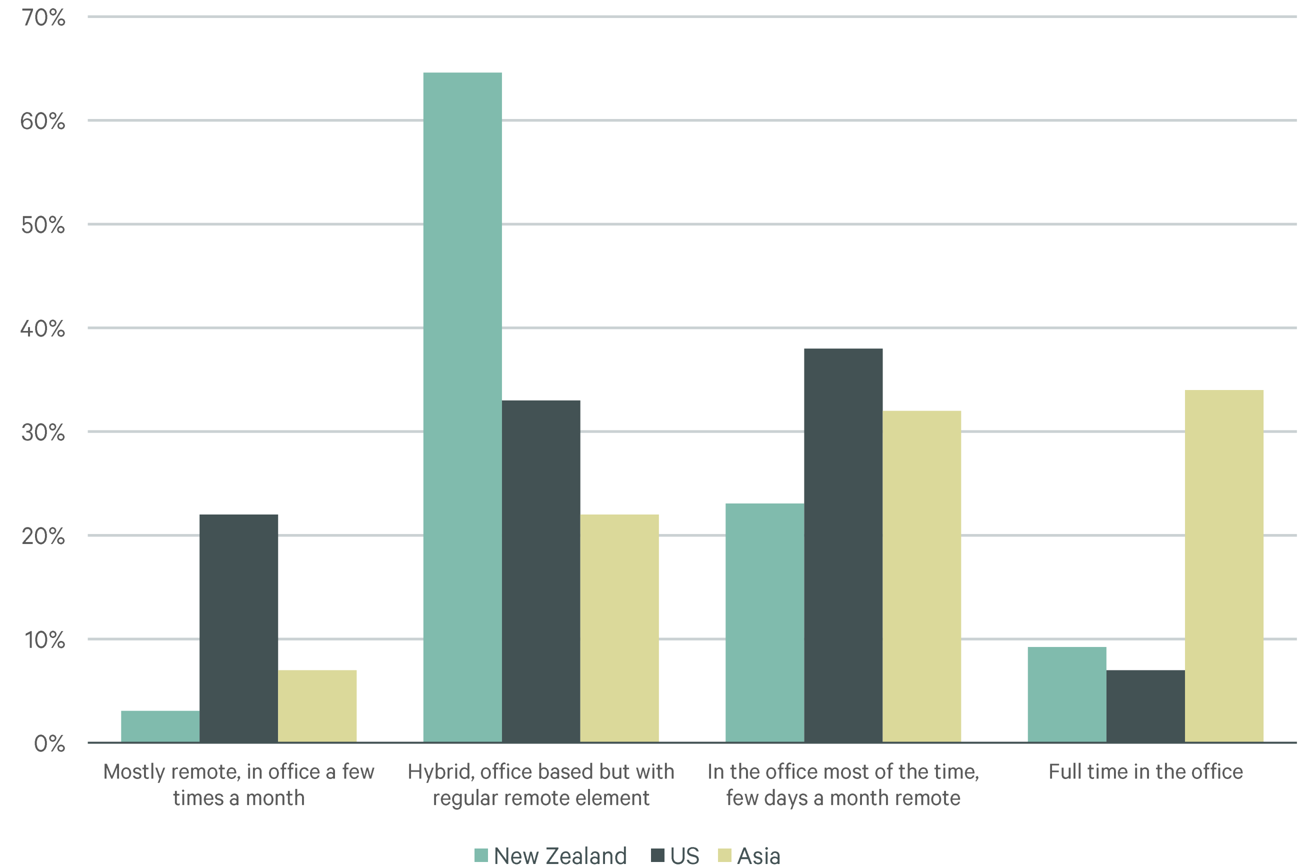
A hybrid working model is more widely adopted in New Zealand than in the US or Asia, which show a greater prevalence of either remote or office-based modes.

Among New Zealand office occupiers, 94% of organisations have adopted hybrid working. Half of the participants have their employees in the office three days on average during a typical work week, and 15% two days a week. Only 3% of organisations adopted a predominantly remote working model, while 9% are fully office based.

Corresponding with the predominantly hybrid workplace model New Zealand occupiers have adopted, most operate at 40% to 80% utilisation rates across a typical work week. 17% of organisations have above 80% utilisation, with only 1.5% below 20%.

Moving from the devolved model of the immediate Covid period, a more top-down organisational approach on hybrid working and office attendance is evolving. The net result will be a reduction in remote working, with 21% of organisations looking to decrease the extent of hybrid working during the next two to three years.

Figure 12: Office Attendance And Adopted Workplace Models



Source: CBRE Research, New Zealand Office Occupier Survey

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Office occupiers are pursuing real estate strategies in support of new workplace requirements

Location and building specific requirements for amenities are also evolving. Eighty-three percent of respondents in CBRE's New Zealand office occupier survey indicate that location close to public transport is the most important building/location level amenity for their organisations.

Overall averages though can hide significant disparities for some variables. For instance, public transport/active commute facilities are vital in Wellington and Auckland but much less important in Christchurch.

What is important in addition to public transport proximity are building amenities that support active commuting modes (end of trip facilities) and a pleasant work environment supported by good levels of natural light and a high quality workspace/fit out.

Occupiers are responding to the increasing importance of higher building amenities by seeking better-quality office space. 42% of survey respondents are pursuing or planning relocation to better quality premises. Many who are not looking to relocate are taking the opportunity to restructure existing leases.

Figure 13: Which Real Estate Strategies Are Currently Being Pursued Or Planned By Your Organisation?

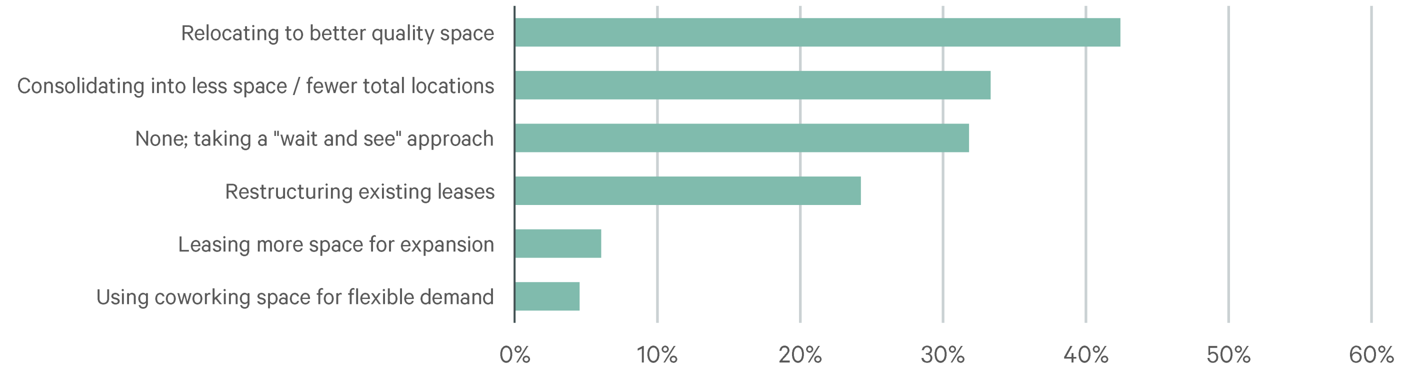
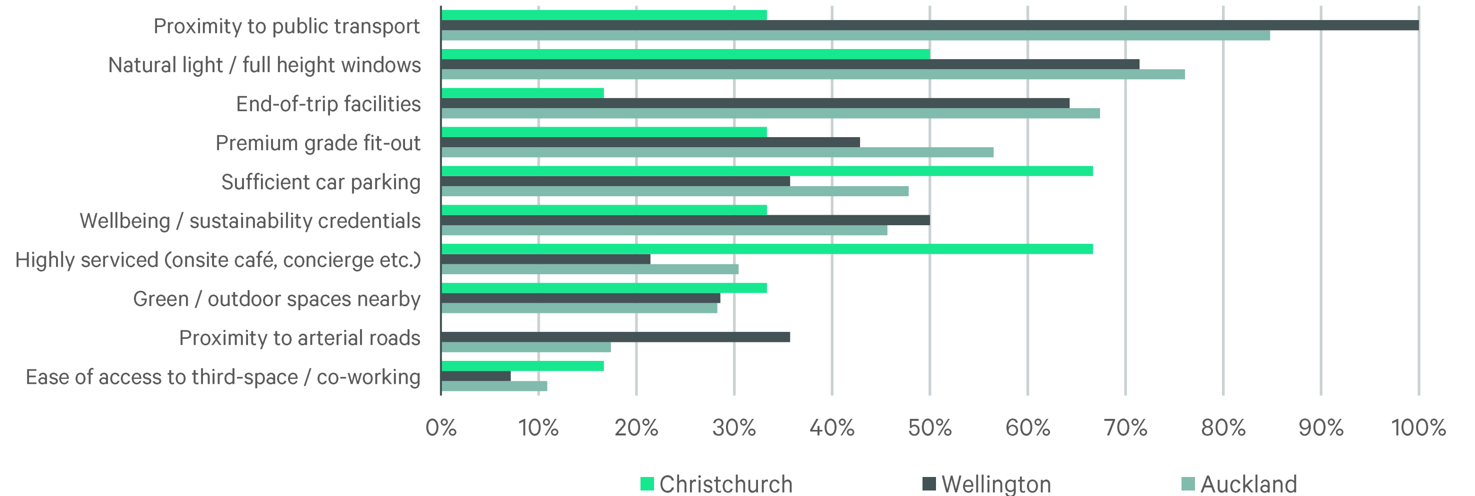


Figure 14: Which Building Amenities Are Most Important To Your Organisation/Employees?



Source: CBRE Research, New Zealand Office Occupier Survey

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New Zealand is well placed on the global e-commerce drivers index

New Zealand scores within the top 10 markets globally on the seven factors that CBRE identified as being the key drivers in the future growth and adoption of e-commerce. Globally, a positive relationship exists between high e-commerce preparedness, high logistics demand, and low vacancy. While cyclical factors will overlay shorter term vacancy fluctuations, this structural driver will underpin long term industrial space demand growth and help suppress vacancy.

The 7 key e-commerce drivers

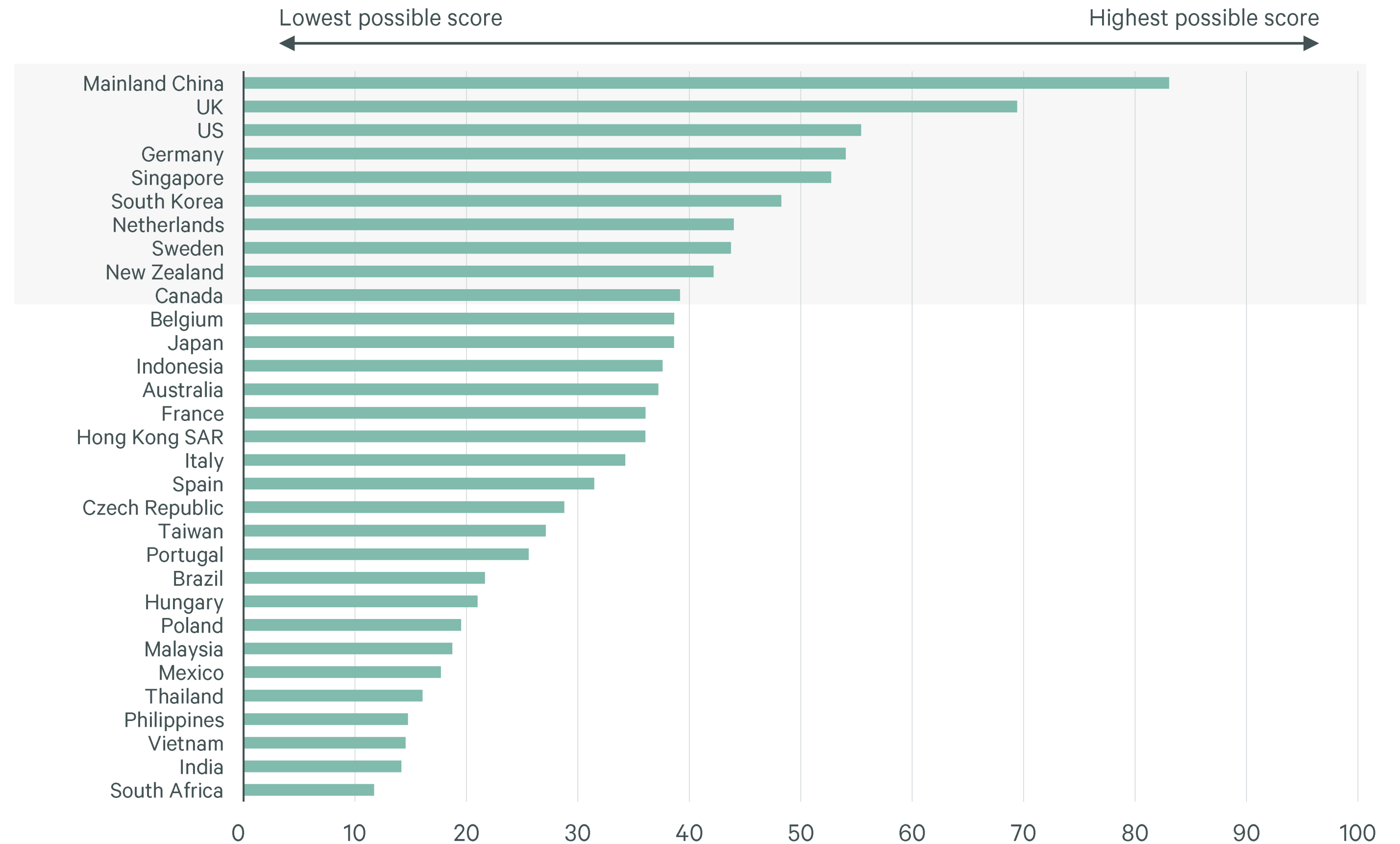
Demographics
- % of urban population

Usage
- Digital skills of population
- Mobile internet ratio
- Dominant e-commerce player

Cultural
- Credit and debit card use/ digital wallets

Infrastructure
- Fixed broadband subscriptions

Figure 15: CBRE Global E-commerce Drivers Index



Source: CBRE Research. We used a cross-sectional regression model to identify the variables that best explained cross-country differences in e-commerce penetration. We then calculated the dependent variable for each country and created an index by rebasing each value to the median of e-commerce penetration of all countries at a future date. Our model has been enhanced with new data series that better reflect the use of digital payments, particularly in APAC markets, and with additional markets, hence differences in the index compared to the previous version.

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Expansionary occupier demand is translating into higher appetite for space; especially in the retail sector

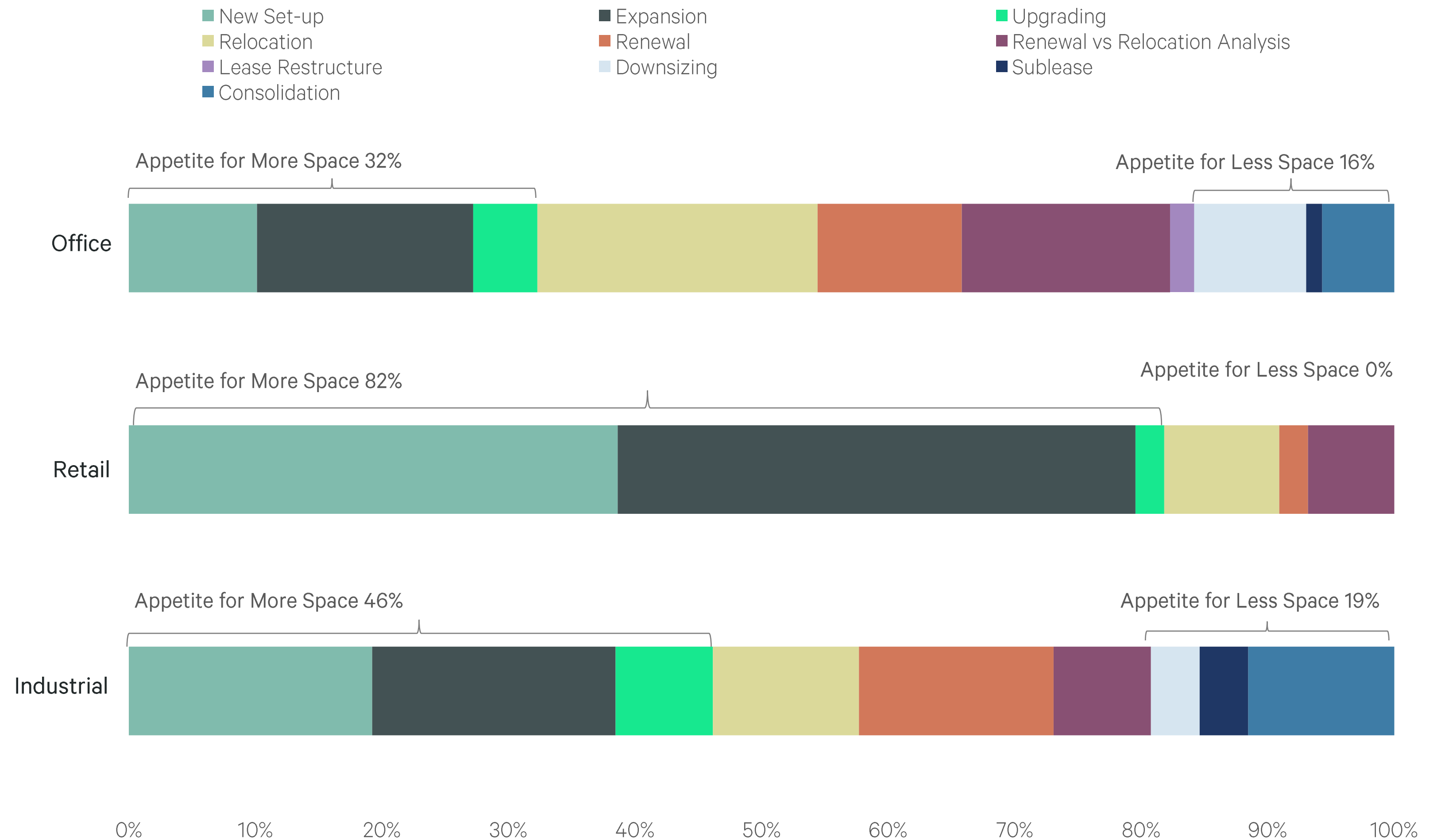
Notwithstanding increasing e-commerce penetration, CBRE's Asia Pacific leasing sentiment index indicates high retail expansionary occupier demand. Despite retaining a cautious approach to CapEx and store network planning, retailers are poised to expand in 2024. However, large scale expansion will remain limited as retailers prioritise consolidating resources and focusing on the most profitable locations.

Expansionary demand will be highly focused on prime retail space. Amid the emphasis on securing high quality space, retailers will perform more rigorous due diligence, a trend that will lengthen the time required to conclude lease negotiations.

Growth in industrial leasing activity is expected to be more modest than in recent years due to the more conservative business outlook among logistics occupiers.

Expansion in the office market has lagged the other sectors in the post-Covid environment, and this trend is expected to prevail, although the net result of our survey shows a greater appetite for more space than for less space in 2024. We expect this to also manifest in the flight to quality trend favouring Prime absorption.

Figure 16: Nature Of Occupier Leasing Enquiries To CBRE Leasing Brokers Across Asia Pacific



Source: CBRE Research, Asia Pacific Leasing Market Sentiment Index

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03

Market Outlook

New supply volumes are differentiated across the sectors and cities

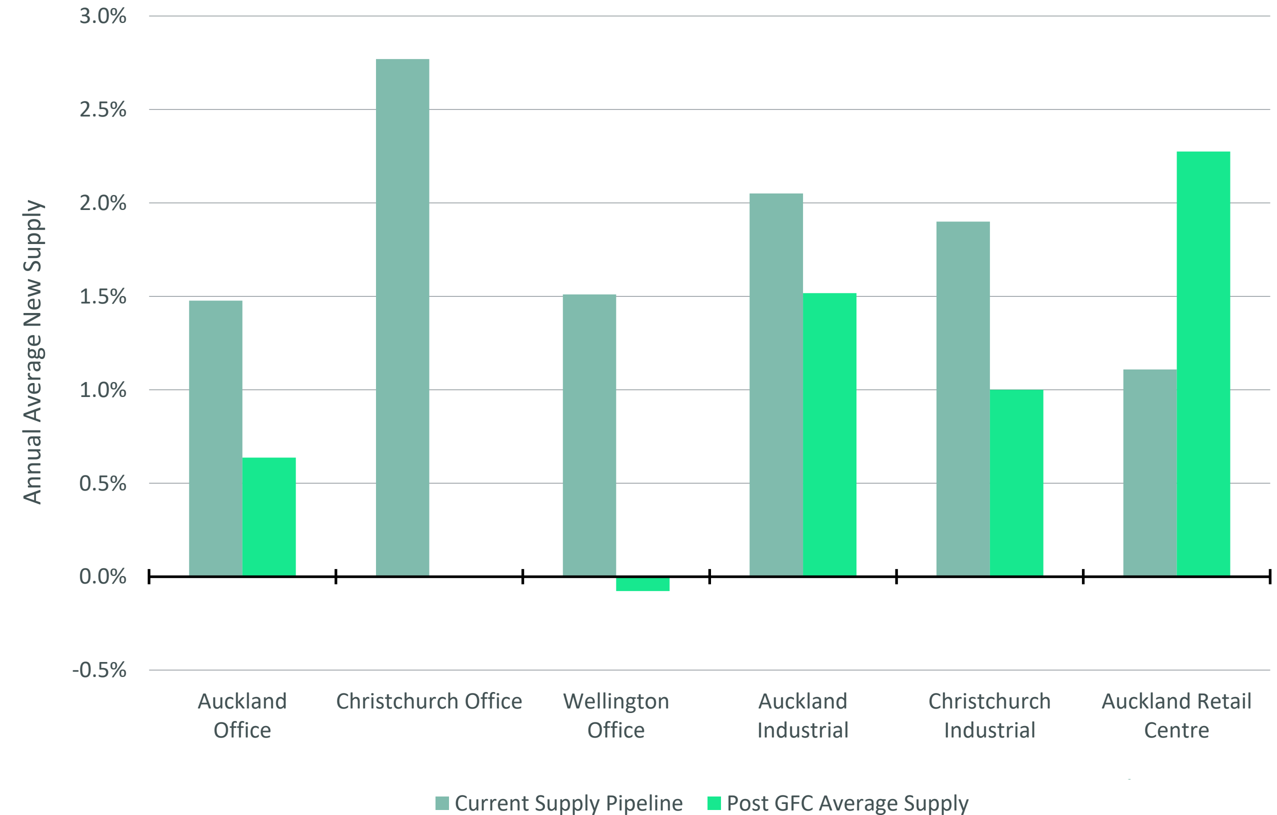
Figure 17 contrasts the new supply pipelines of the various markets to each other as well as to their historic trends.

This shows the retail centre sector's favourable outlook, with a limited amount of new supply coming on to pose a competitive threat to existing assets and unbalance the market. Expected new supply will increase existing stock by only 1.1% pa, well below the historic norm of 2.3% supply growth per annum and also below the expected supply pipeline in the industrial and office sectors.

More active development pipelines characterise the office and industrial markets. Supply in these will be somewhat above historic averages, with Christchurch standing out due to its 2.8% pa stock growth being the highest and Wellington, where the active supply environment contrasts with the net loss of office space between 2010 and 2022 due mainly to the impacts of the earthquakes.

However, a broad-brush approach to supply and demand hides some significant detail variations in all these markets, such as the concentration of Christchurch supply in one project, and the strong occupier commitment that new buildings, albeit often at the expense of existing buildings, tend to achieve in the three cities' office markets.

Figure 17: New Supply as a % of Existing Stock



Source: CBRE Research

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Distinct occupancy trends are emerging

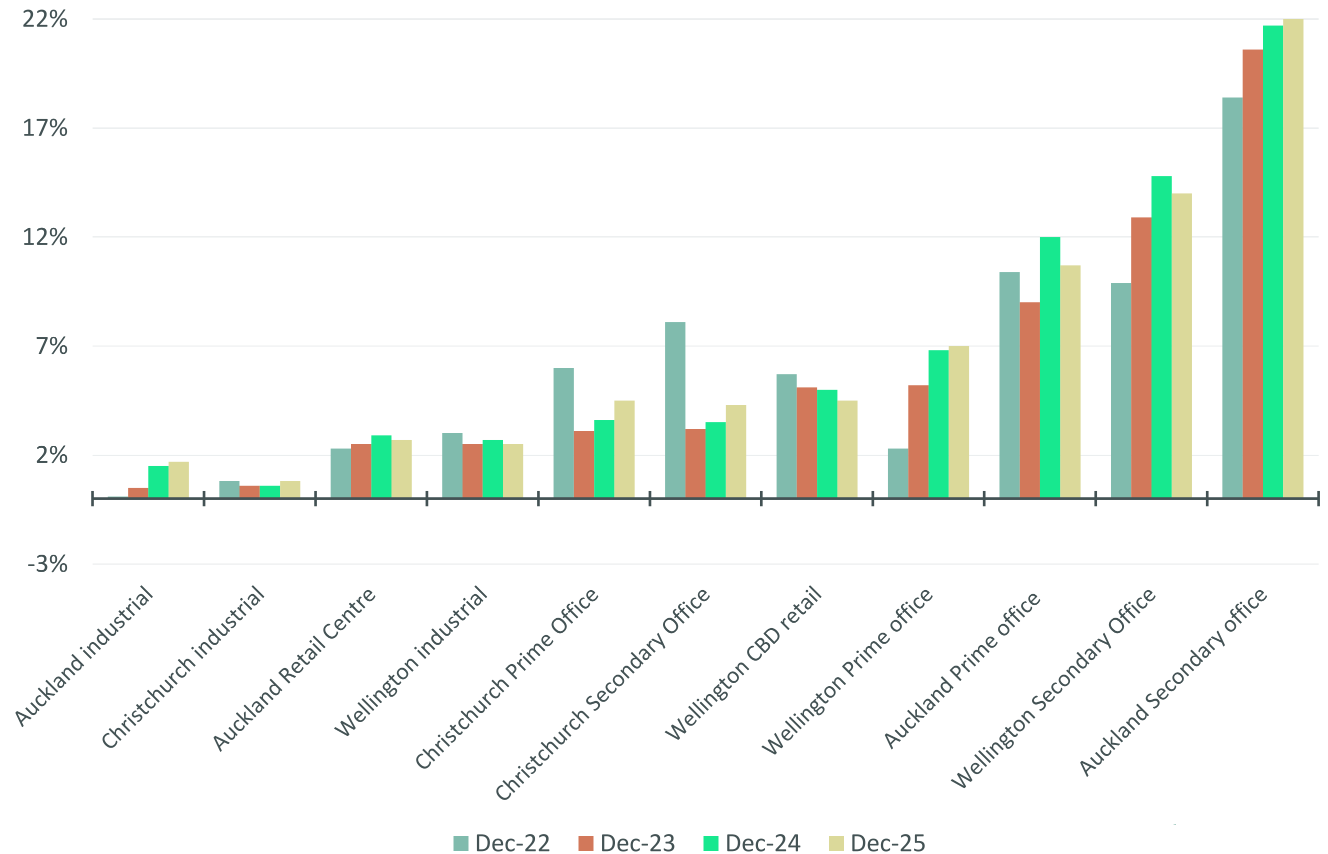
Industrial vacancy in our two major markets is some of the lowest globally. Still, in Auckland, with a cyclical moderation of demand coupled with a strong supply pipeline, it has started trending up in the past year, although the market remains tight at only 0.5%. By contrast, Christchurch has been more resilient; its overall vacancy rate dropped in the past year, with Prime vacancy of only 0.1%.

Christchurch's office market has also outperformed. Largely unaffected by Covid related market disruptions, its vacancy has been downward for the past few years. Prime and Secondary vacancy both sit at circa 3%Auckland's office market is bifurcated. Prime vacancy has been on a downward trend in the past year, reaching 9.0% in December, but Secondary continues to suffer from weak demand.

Wellington's office market was exposed to its biggest supply phase of the past twenty years in 2023. While occupier commitment has been strong, it has been at the expense of rising vacancies in existing buildings. Prime and Secondary vacancy both increased in the past year. Given the very tight market of the past few years, however, Prime vacancy remains comparatively low at only 5.2%.Auckland retail centre vacancy dropped in the past year for four of the five centre typologies we monitor. Vacancy is concentrated in a handful of centres, mainly subregional centres, which are under significant competitive pressure in their catchments.

The softer economic backdrop, coupled with expected supply, will result in a general upward vacancy trend in 2024, but we forecast occupancy to improve during 2025 in sectors less affected by new supply.

Figure 18: Vacancy Rates



Source: CBRE Research

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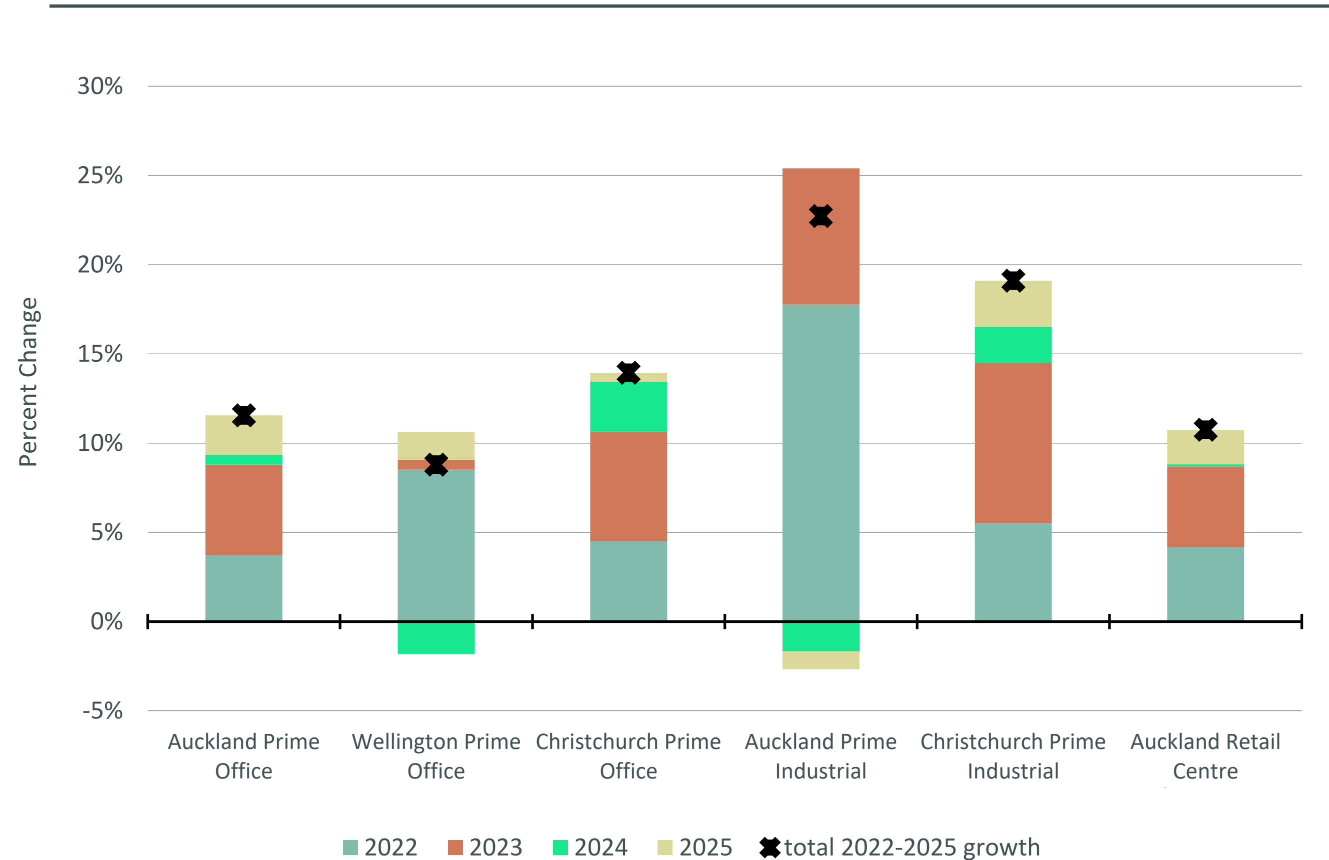
Cyclical moderation in rent growth this year with momentum strengthening in 2025

All Prime market sectors have been characterised by healthy rent growth over the past two years, ranging from 8.7% for retail centers to 25.4% for industrial.

The evolving supply and demand environment in 2024 places rents on a more divergent path. While face rents are forecast to remain positive, a more competitive leasing market is expected to result in higher incentives and lower net effective rents in the Auckland industrial market. We forecast that the Prime office sector in Auckland and Christchurch will continue to post modest net effective rent growth, but the emerging occupancy pressure in Wellington will translate into increasing incentives this year.

In most markets, the improving economic and demand backdrop in 2025 is reflected in strengthening rent growth, although the Christchurch office supply pipeline may mean increased competition between landlords in the leasing market, which could slow rent growth.

Figure 19: Net Effective Rent Growth



Source: CBRE Research

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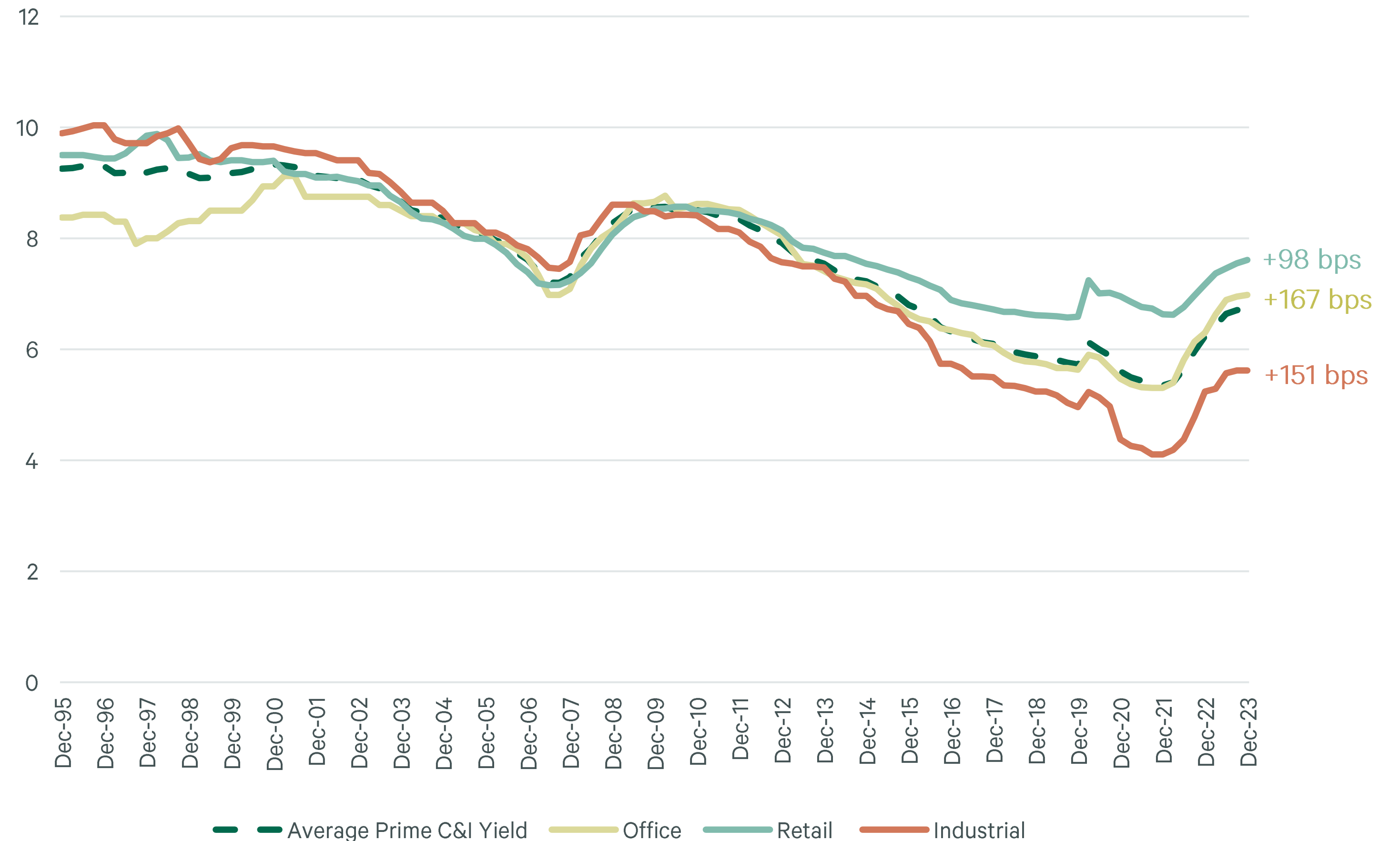
Cap rate increases starting to plateau

CBRE's assessment of market yield movements shows a c100-170 bps increase since the interest rate hiking cycle began at the end of 2021.

In our Q4 2023 yield assessment, more than half of the markets we monitor showed little to no change, indicating the narrowing of the divide between vendor and purchaser price expectations. This result entrenched the slowing cap rate expansion trend that started in Q3 when we made the most minor changes since the yield easing cycle commenced in early 2022.

We are close to the top of the current yield cycle, altough we expect selling pressure on some vendors to intensify in coming months.

Figure 20: New Zealand Office, Retail Centre and Industrial Sector Prime Property Yields



Source: CBRE Research

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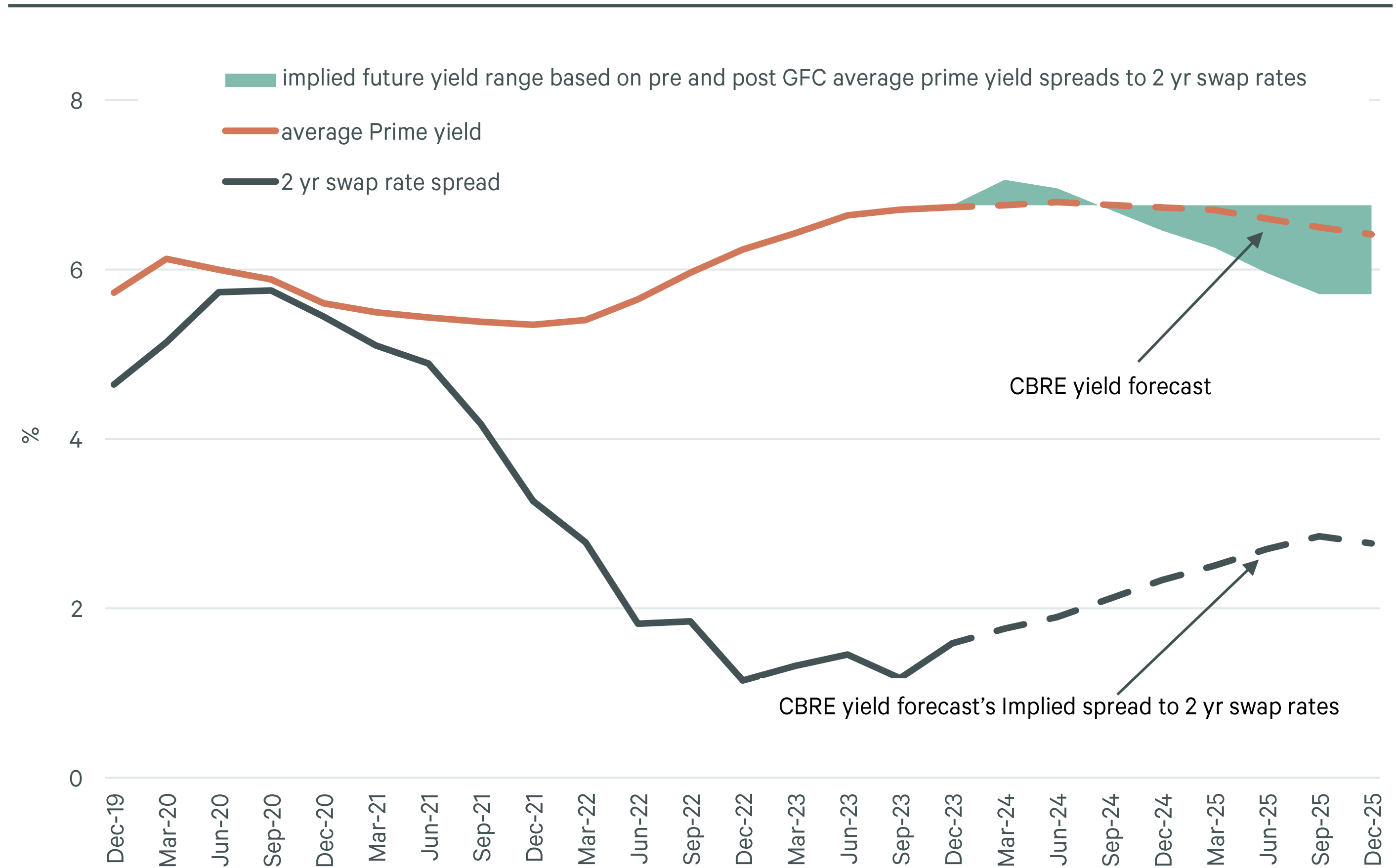
Interest rate falls will provide a platform for both margin rebuild and cap rate compression

During the past two years, interest rate rises have not translated to a one-for-one yield increase. Instead, margins compressed back towards pre-GFC norms. So, how will the outlook for interest over the next two years translate to property yields? Will falling interest rates translate to falling yields, or will this be a chance for the market to rebuild yield to interest rate margins closer to post-GFC norms, implying limited yield movement?

We forecast yields remaining close to current levels until late 2024 and then declining moderately once economic conditions turn more positive and interest rate falls are entrenched. This scenario leads to average (across office, industrial, and retail centres) Prime yields falling from their cyclical peak of 6.80% in mid-2024 to 6.40% in December 2025. It also implies yield to 2-year swap rate margins expanding from their current 175 bps to c280 bps, higher than the pre-GFC average but materially below post-GFC.

Figure 23: New Zealand Prime Property Yields and Margin Forecasts



Source: CBRE Research

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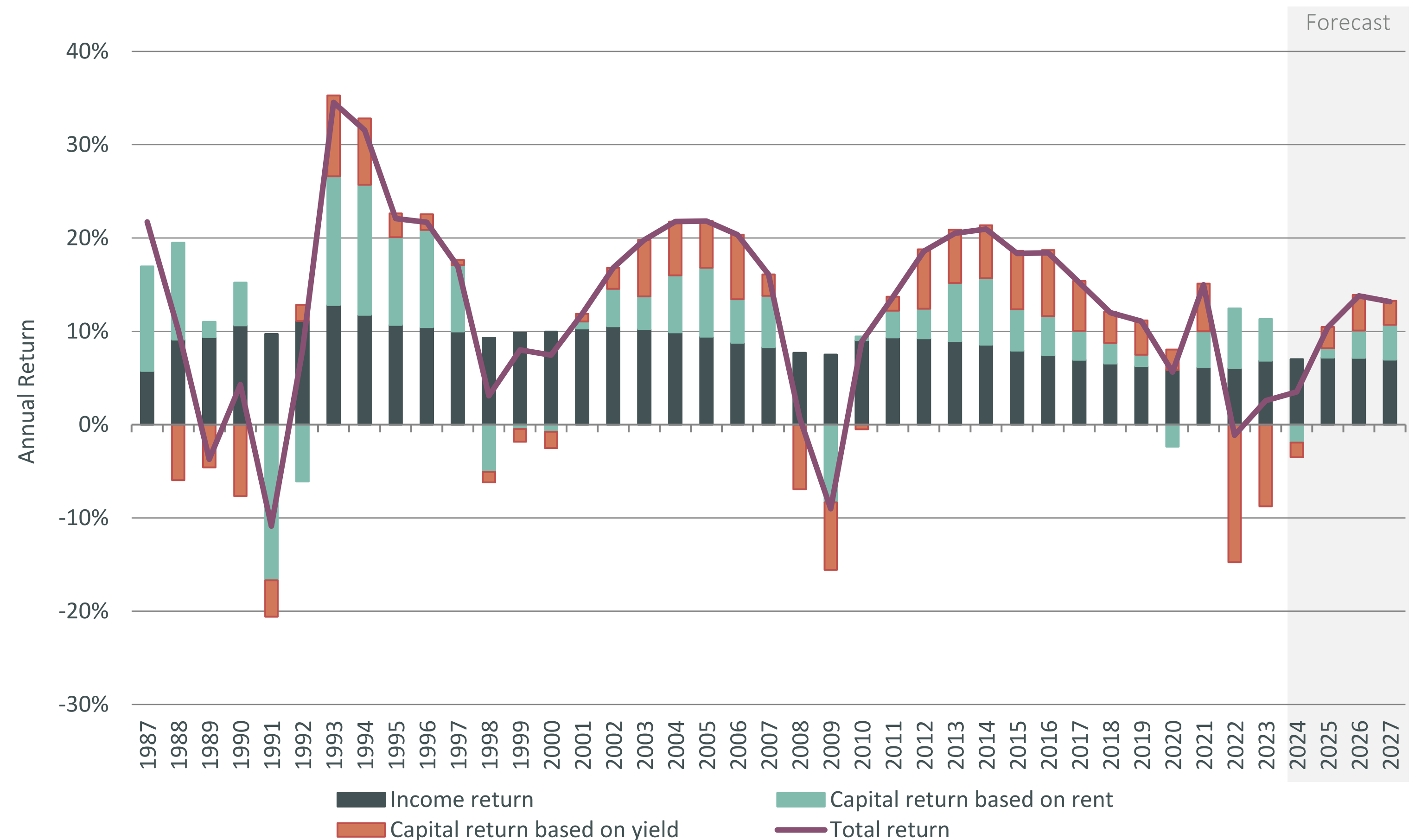
Total returns forecast at 3.5% in 2024 before increasing to c14%pa by 2026/27

As the rate of yield driven capital return losses moderated, helped by favourable rent growth, total returns improved last year.

The lack of rent growth in 2024 and some further cap rate expansion results in negative capital returns and relatively modest total returns, but by 2025, both rents and yields will contribute positively to capital returns, and in 2026/2027, total returns are forecast to reach double digits.

Figure 24: Overall Average New Zealand Commercial and Industrial Investment Returns – CBRE Base Scenario Forecasts



Source: CBRE Research

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05

Market Performance in the Australasian Context

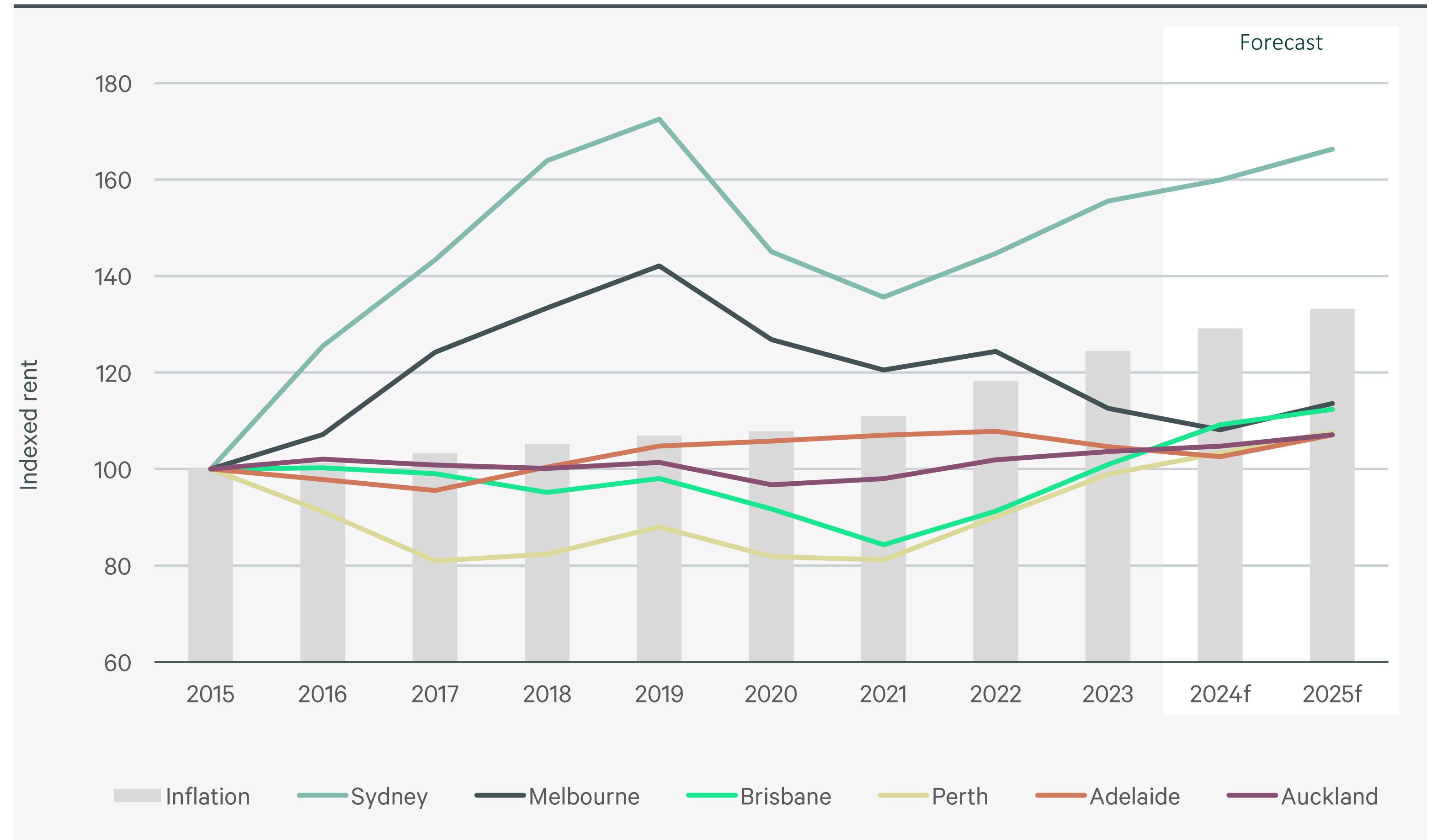
Net effective rent growth for CBD Prime Office continued to recover in Sydney, Brisbane and Perth in 2023. Leasing conditions and rent growth remained challenging in Melbourne, albeit there were sizeable differences between pockets of the CBD.

In 2024, we expect Brisbane to have the highest net effective rent growth, followed by Perth and Sydney. All markets are likely to see some face rent growth albeit movements in incentives should drive relative performance.

Looking at expected rent performance over a decade, it has lagged inflation in almost all markets except Sydney. Curtailing future supply (and hence lower incentives) are needed to regain growth above inflation rates.

While Auckland's office rent growth lagged the more dynamic Australian markets, its performance is forecast to be on par over the next two years.

Figure 25: Australia and New Zealand Office Net Effective Rent Growth



Source: CBRE Research

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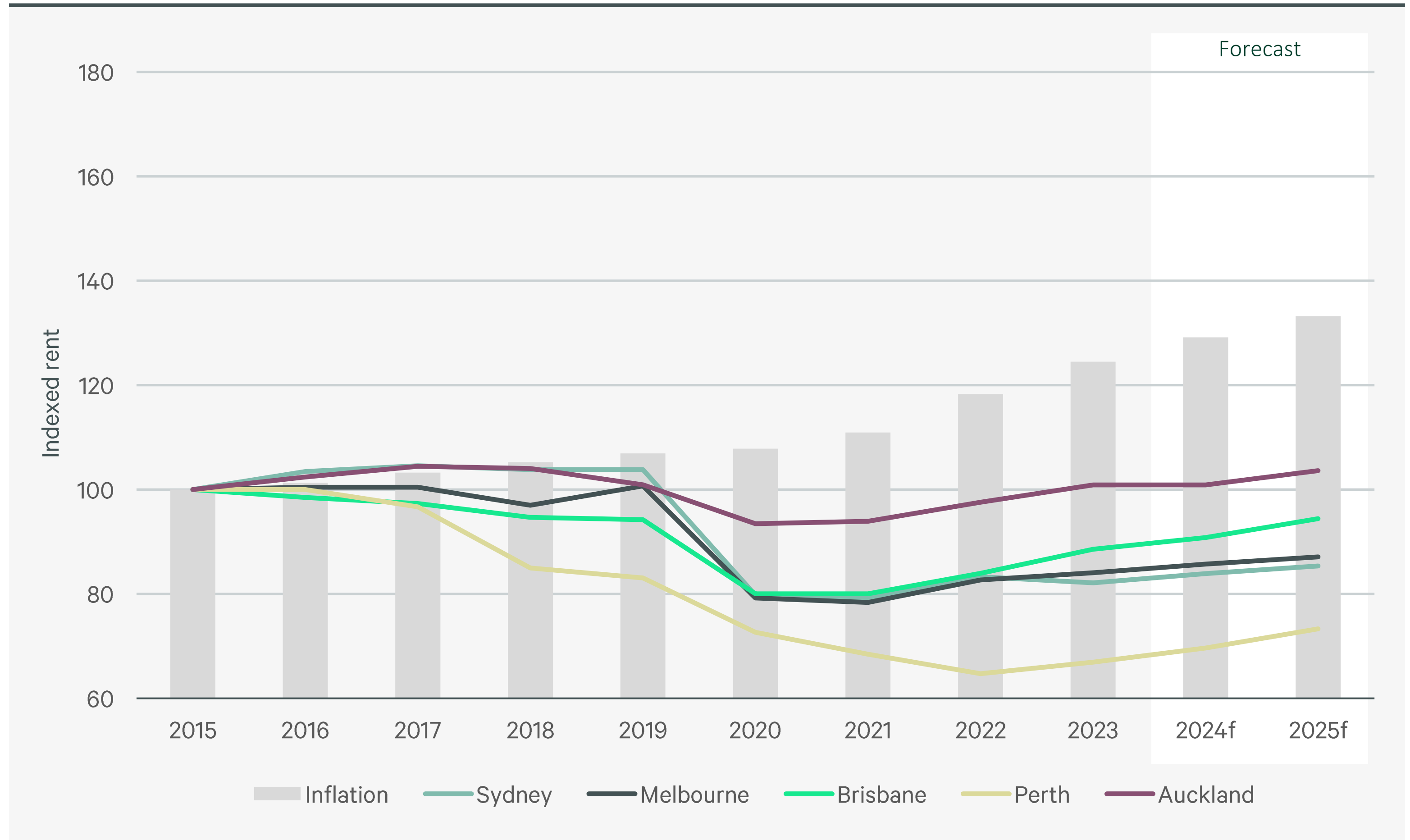
Rents for shopping centres are forecast by CBRE to grow at low-single rates through 2024, continuing the recovery experienced in 2023. Rents are still likely to be ~5%-20% below 2019 levels in Australia, providing scope for upside surprise if vacancy rates decline significantly.

Shopping centre rents in Auckland were more resilient than in Australian cities during the Covid lockdowns and, assisted by CPI based rent review mechanism and good turnover growth in catchment dominant centres, have shown a healthy rebound in the past two years. The inflationary impetus will diminish in 2024 and, with retail sales under pressure in a challenging economic environment, stable rents are forecast in the coming year.

Figure 26: Australia and New Zealand Regional Shopping Centre Net Effective Rent Growth



Source: CBRE Research

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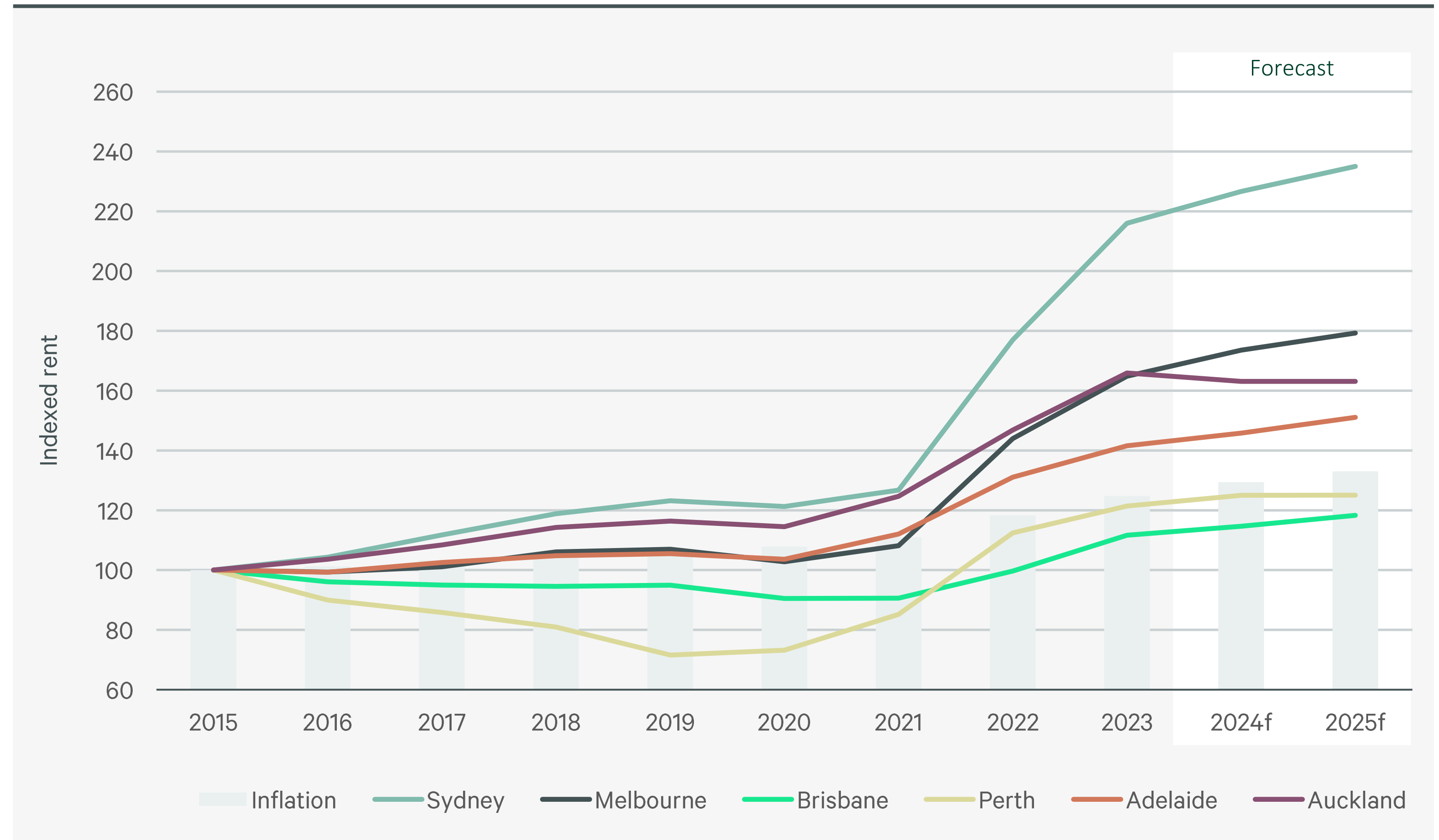
We are witnessing a steady increase in the vacancy rate across all major Australasian cities as demand normalises and supply (to an extent) is being added to the market. Despite the rise in space availability, we expect vacancies to remain modest in all cities.

Over the medium to long term, the supply of serviced industrial zoned land will remain constrained, and this will continue to contribute to a limited development supply pipeline. Coupled with this, demand will be driven by growth in exports/imports, significantly rising population and expanding e-commerce sector.

In Auckland, a cyclical slowdown is likely as we believe that landlords will be willing and able to offer more competitive rents through higher incentives in a more competitive leasing market during H2 2024. This will have a negative impact on net effective rents although we still expect face rents to increase.

Figure 27: Australia and New Zealand Industrial Net Effective Rent Growth



Source: CBRE Research

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Cap rates – Industrial & Office

For Super Prime Industrial and Prime Office, we expect c200bps of cap rate expansion through this down-cycle.

In Industrial, cap rates have already increased by 150-175bps and we foreshadow another 25-75bps increase. In Sydney and Melbourne, Super Prime Industrial could see mid-high 5% cap rates. However, strong rent growth is likely to see valuations remain stable/slightly higher.

In Prime Office, cap rates have already expanded by an average of 100-150bps and we see up to 75bps of expansion through 2024. This could see Sydney CBD Prime Office at low 6% and Perth at mid-high 7%. We feel that cap rates are closer to their cyclical peaks in New Zealand, with Australian capital cities further to go to before reaching market equilibrium.

Figure 28: Indicative Cap Rates For Prime Assets In Select Locations

Industrial - Super Prime				
	Peak	**Q4 2023**	**Change**	**2024 outlook**
Sydney	3.68%	5.30%	162	+25-50 bps
Melbourne	3.94%	5.50%	156	+25-50 bps
Brisbane	4.25%	5.80%	155	+25-50 bps
Auckland	4.11%	5.62%	151	+0-25 bps
Perth	4.35%	6.00%	165	+50-75 bps
Adelaide	4.27%	6.00%	173	+50-75 bps
Christchurch	5.14%	6.17%	103	+0-15 bps

Office - CBD Prime				
	Peak	**Q4 2023**	**Change**	**2024 outlook**
Sydney	4.50%	5.90%	140	+25-50 bps
Melbourne	4.65%	6.00%	135	+50-75 bps
Brisbane	5.31%	6.30%	99	+25-50 bps
Auckland	5.31%	6.98%	167	+0-25 bps
Perth	6.26%	7.20%	94	+25-50 bps
Adelaide	5.99%	7.40%	141	+25-50 bps
Canberra	5.30%	6.60%	130	+25-50 bps

Source: CBRE Research

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Cap rates – Shopping & Hotel

For Shopping Centres and hotels, we expect less volatility in cap rates during the current cycle.

Retail had already experienced cap rate adjustment in the lead-up to 2020 and rents have rebased lower as well. We foreshadow c75-100bps of cap rate expansion through-cycle for Retail, including another 25-50bps in 2024.

Figure 29: Indicative Cap Rates For Prime Assets In Select Locations

Retail Shopping Centres				
	Peak	Q4 2023	Change	2024 outlook
Sydney	5.00%	5.53%	53 bps	+25-50 bps
Melbourne	5.35%	5.80%	45 bps	+25-50 bps
Brisbane	5.25%	6.00%	75 bps	+25-50 bps
Auckland	5.91%	6.97%	106 bps	+0-25 bps

Hotels				
	Peak	Q4 2023	Change	2024 outlook
Sydney	4.75%	5.25%	+50bps	+25-50bps
Melbourne	5.0%	5.5%	+50bps	+25-50 bps
Brisbane	5.5%	6.0%	+50bps	+25-50bps
Auckland	6.25%	7.0%	+75 bps	+0-25 bps

Source: CBRE Research

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